CITY OF LOVELAND
MEMORANDUM

TO: Mayor and City Council

FROM: Tom Carroll, City Manager Tom

RE: Tax Increase Options – Memorandum No. 11

DATE: February 6, 2012

This memorandum provides Council and the Finance Committee with several options for replacing lost tax revenues through income tax alternatives. The Finance Committee wanted to review several options which would replace lost revenue and avoid severe City service cuts.

Background
Looming fiscal problems for the City's General Fund (and more recently, Fire and EMS-related funds) have been detailed in the Citizen's Budget Guide, the 2012 Budget and 2011 City Manager Memorandum No. 127. The City faces a $950,000 to $1.1 million loss of general government revenue between 2011 and 2015. The City has already reduced its operating expenditures more than $930,000 to address the City's revenue problems and reduce the cost of government in general, and more than $500,000 of these savings benefit the General Fund.

At the request of Council in October, staff drafted a memorandum—2011 City Manager Memorandum No. 127 also referred to as the Budget White Paper—which showed the effects of absorbing state-inflicted revenue losses through budget cuts alone. In this report, staff accounted for cuts already made and showed the City would face a structural deficit of $402,000 in 2013 and $750,000 in 2014. These deficits will grow annually, and it is expected that the State of Ohio will further cut revenues in 2014-2015 by completely eliminating the Local Government Fund.

Since the close of the 2011 fiscal year and the publication of Memo 127, the City's General Fund cash position has improved by $191,000 because of improved income tax collections and some expenditures not actually being made to the level contemplated in the 2011 forecast. There are a few 2011 expenditures which have been encumbered but not paid for, and these expenditures will reduce this $190,100 figure to an estimated $130,000 improvement. Overall, this improved situation is very good news. The improved cash position means some of the cuts contemplated in 2013 and 2014 may be pushed into the future, but the fundamental structural deficit remains.

Revised Fiscal Plans
Staff has updated the assumptions made in Memo 127 to account for the improved position at the end of the year in 2011. This includes starting with an additional $130,000 in 2013 (carrying forward the balance we began 2012 with into the next fiscal year) and a new income tax base of $3,290,000. All other assumptions remain unchanged.

This means that the necessary expenditure reductions will be $182,000 in 2013 (instead of $402,000) and $530,000 in 2014 (instead of $750,000).

Accordingly, staff is proposing the next two years of cuts would be modified from the White Paper and look as follows:

Table 1: Revised Budget Cuts, 2013-2014

2013 Budget Reductions		
Eliminate fire memorial landscape services ($500), eliminate Veteran's Memorial services ($3,500), eliminate the Fourth of July celebration ($9,000), eliminate Beautification support ($7,500), eliminate flower watering expenses ($8,350 reduction in Parks salary), eliminate employee administration relations ($10,000) and reduce continuous training budget from 2012 levels ($2,500)	$41,350	2013
Reduce the General Fund's contribution to the annual Road Rehabilitation Program	$25,000	2013
Eliminate the Assistant City Manager position	$116,000	2013
2013 Subtotal	**$182,350**	**2013**
2014 Budget Reductions (in addition to those made in 2013 which are continued)		
Eliminate one full-time police officer	$95,000	2014
Eliminate the General Fund subsidy to the Street Maintenance Fund, laying off one maintenance worker position and reducing street maintenance and snow removal	$61,000	2014
Reduce the General Fund's contribution to the annual Road Rehabilitation Program	$115,000	2014
Reduce by 50% all part-time police officer hours (the equivalent of one and one-half full-time positions)	$100,000	2014
2014 Subtotal	**$371,000**	**2014**
2013-2014 Cumulative Base Budget Cuts	**$553,350**	

Thus, this plan eliminates the equivalent of 2.5 police officers, one street worker and the Assistant City Manager, a reduction in force equal to an additional 10% cut in the City's workforce. This is less impactful than the full 15% contemplated in the Budget White Paper, but it is important to remember that the City has already reduced staffing by 10%. The road rehabilitation program will be reduced by half instead of by two thirds. Also, this approach still depletes General Fund balances (other than the emergency reserve) in 2013 and 2014. The fundamental problem of a structural deficit has not been solved by the above cuts. While staff has yet to prepare a 2015 forecast, the elimination of the Management Analyst and the remaining part-time police officer hours will be necessary in 2015, getting the City to the same place as contemplated in Memo 127, but doing so one year later.

Policy Options

This memorandum will detail and discuss four different income tax increase options, based on the discussions at the Finance Committee meeting on January 26th. Property tax options are not contemplated.

1. Raise the City's income tax rate from 1% to 1.1%, and keep the credit at 1%. Thus, every resident and employee in the City with earned income would pay an additional 0.10% income tax rate.

2. Reduce the City's income tax credit from the full 1% to 0.5%. This would affect 51.23% of City of Loveland resident taxpayers, specifically those Loveland residents who have earned income and pay another municipality income tax where they work.

3. Raise the City's income tax rate from 1% to 1.25% and maintain a full credit of 1.25%. This would capture additional revenue from all employees working in the City and any of those who work in a City with an income tax rate less than 1.25%.

4. Raise the City's income tax rate from 1% to 1.25%, and keep the credit at 1%. Thus, every resident and employee in the City with earned income would pay an additional 0.25% income tax rate.

These options will be analyzed from several perspectives. First, how much additional annual revenue will each option generate for the General Fund and who would pay it? Second, what are the implications for various Loveland taxpayers using the mean, median and standardized income levels? Third, how would each tax option change the City's relative tax rate and tax burden compared to other communities in Southwest Ohio?

Revenue Impact

These four income tax options are first analyzed from the perspective of how much revenue each would generate to the City's General Fund, from lowest revenue generating to highest.

Table 2: Revenue Impact on Four Income Tax Options

Option	Description	Forecasted Annual Revenue	% of Total Additional Annual Revenue Coming From Loveland Residents	Percentage of City of Loveland Tax Accounts[1] Which Would Pay the City of Loveland More Tax
1	1.10% (1.00% credit)	$455,381	59.98%	100.00%
2	1.00% (0.50% credit)	$696,684	100.00%	51.23%
3	1.25% (1.25% credit)	$857,309	46.86%	62.97%
4	1.25% (1.00% credit)	$1,138,452	59.98%	100.00%

Because these options are all related to the income tax rate or credit, it is important to note that those residents who do not have earned income would not pay additional taxes. For instance, those residents who are living on Social Security, public or private pensions, and/or 401 (k) income would not have to pay additional taxes. Similarly, those residents who are unemployed and do not have an earned income would also not have to pay additional tax.

So, when the table above discusses "Tax Accounts" the words are chosen very carefully and with a very precise meaning. "Tax Accounts" does not refer to the percentage of Loveland households which would be affected because of course the total number of households includes retirees, the unemployed and those who are working. Instead, the term "Tax Accounts" includes those a) who are residents of the City of Loveland, b) who are working and therefore have to file a tax return with the City. These individuals might work in Loveland, a township, or another income tax levying municipality, but they are all City of Loveland residents active in the work force.

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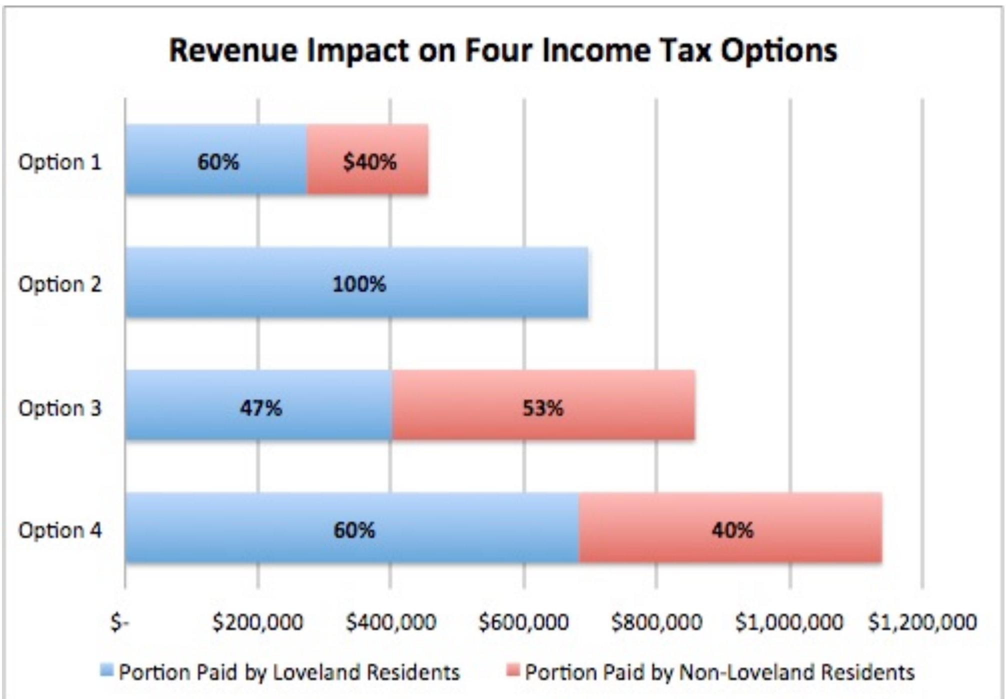
[1] Loveland residents comprise 5,669 tax accounts. Of these accounts, people who work in and live in the City limits total 27.7% of all accounts and 72.3% are commuters who live inside the City of Loveland limits but commute elsewhere for work. Of our residents, 19.90% in the work force commute to a township, and therefore pay no earnings tax where they work and thus pay the City earnings tax because they are not eligible for a credit. Thus, a higher percentage of our Loveland residents in the workforce (more than one out of four) work inside the City limits, and fewer than one out of every five commute to a job in a township.

One can see that for option 2, all the additional revenue comes from Loveland residents only, and it is 51% of Loveland taxpayers, specifically those who work in a municipality other than Loveland who today enjoy a full credit. These residents who might work in Cincinnati, Blue Ash or Sharonville would still have to pay those communities whatever the percentage of earned income tax they are required to pay where they work, but would then also have to pay the City of Loveland one-half of one percent (0.5%) of their income. So, a Loveland resident who works in Cincinnati would see her tax rate go from 2.1% today to 2.6%, a resident who works in Blue Ash would see their total municipal tax burden go from 1.25% to 1.75%, etc. The additional tax burden under Option 2 entirely falls to Loveland residents who commute to another municipality, so 100% of the additional tax burden falls to this segment of the community.



Two of the options—option 1 and 4—affect 100% of those with earned income. This is consistent with a very common sentiment expressed by participants in the budget focus groups last year: everybody should shoulder some of the additional tax burden. This is accomplished in these two options by increasing the rate and holding constant the credit at 1%.

Option 3 places the smallest percentage of the new burden on Loveland taxpayers. It has the advantage of continuing to offer a full credit, an important consideration for potential homebuyers who wish to reside in our community but whose job requires them to commute to Cincinnati or some other community with a higher rate. There are some resident commuters who today enjoy the full 1% credit who will continue to pay their work community 1% (e.g. Mason or Montgomery) but will pay the City of Loveland 0.25%. For those who work in communities with a 1.25% income tax rate or higher (e.g. Cincinnati = 2.1%, Sharonville = 1.5%, Blue Ash = 1.25%) they would not have a tax increase because they already pay 1.25% or more to their work community. So, option 3 creates two groups of commuters: those who pay only to the municipality where they work and those who pay some or all of their income tax burden to the City of Loveland.

One final consideration for Option 3 is that as other communities around the Cincinnati metropolitan area raise their income tax rates, the amount of revenue the City will generate from Option 3 will decline. If a city with a 1% tax rate today which had Loveland residents working in it raised their tax rate to 1.25%, the commuter would pay that community 1.25% and would enjoy the full credit from Loveland. Thus, the revenue should be viewed as a ceiling which would decrease as other communities follow suit and raise their tax rates to address state-inflicted revenue losses.

Taxpayer Implications
According to 2010 Census, the median household income in the City of Loveland is $68,000 and the mean household income is $74,000. Both the median and mean are detailed below. In addition, to simplify matters, staff is showing what a person earning $100,000 per year would pay under these four policy options.

Table 3: Additional Tax From City Resident Working Within City of Loveland

Option	Description	$68,000	$74,000	$100,000
1	1.10% (1.00% credit)	$ 68	$ 74	$ 100
2	1.00% (0.50% credit)	$ 0	$ 0	$ 0
3	1.25% (1.25% credit)	$ 170	$ 185	$ 250
4	1.25% (1.00% credit)	$ 170	$ 185	$ 250

It should be noted that Table 3 shows the potential annual cost to a Loveland resident who is working inside the City of Loveland or who is working in a township and therefore not paying a municipal income tax. Again, this excludes retirees and the unemployed.

Table 4 below shows the potential annual cost to a Loveland resident who is working outside the City of Loveland and is working in another municipality with a tax rate between 0% and 1% in income tax rate today. Again, this excludes retirees and the unemployed.

Table 4: Additional Tax From City Resident Commuting to Another Municipality

Option	Description	$68,000	$74,000	$100,000
1	1.10% with 1% credit	$68	$ 74	$ 100
2	1% with 0.05% credit	$340	$ 370	$ 500
3	1.25% with 1.25% credit	170	$ 185	$ 250
4	1.25% with 1% credit	0 to $170	$0 to $185	$0 to $250

Commuting Loveland residents will have varying impacts under option 4 based on what the income tax rate is where they work. A commuter who works at Bethesda North will pay the City of Montgomery 1% of their income and 0.25% to the City of Loveland, provided the City of Montgomery continues to have a 1% tax rate. A commuter who works at Western and Southern in downtown Cincinnati will pay the City of Cincinnati 2.1% of their income and nothing additional to the City of Loveland.

One can see clearly that all options impact different types of residents very differently depending on where the resident works and what the tax rate is where they work.

Benchmarks
The City of Loveland is well-known for its performance measurement and benchmarking. To further inform the pros and cons of these options, staff has benchmarked the City's tax rate today and under all four options against the tax rates of other Southwest Ohio jurisdictions. The comparative data is from the Southwest Ohio Tax Administrators Association (SWOTAA) and was collected in November of 2011. A statewide comparison has not been made for lack of easily available data, but is commonly found when analyzed that Southwest Ohio generally has lower municipal income tax rate than other parts of Ohio. Thus, we are benchmarking against a relatively low tax rate region.

Attached to this memorandum are two whisker diagrams showing comparative tax information. The first is a simple comparison of municipal tax rates for the 92 jurisdictions which report to SWOTAA. Today, Loveland's 1% is clearly within a block of communities with the comparatively low, one-percent tax rate. The whisker diagram also shows where the City of Loveland would be if it increased its tax rate from 1% to 1.1% or 1.25% relative to these peer communities. Option 2, which adjusts only the credit, is not shown on this whisker diagram because the tax rate would stay the same as it is today, 1%.

Generally speaking, it is difficult to make "apples-to-apples" comparisons of municipal tax rates because two key variables differ from community to community: the income tax rate and the income tax credit. Some cities, like Loveland, have a 1% tax rate with a full credit. Other cities, like Milford, have a 1% tax rate but no credit. Thus, there are two similarly situated communities and both have a relatively low income tax rate, but the fact that Milford offers no income tax credit means the economic burden on a Milford commuter is in most instances higher than it is for the equivalent Loveland commuter. And of course there are communities like Wyoming which has a lower tax rate of 0.8% but offers no credit or Springboro which has a 1.5% income tax rate and provide a partial credit of 1% for taxes paid elsewhere. Because different communities in the region differ on either or both of these variables, coming up with one economic burden measure is difficult.

To attempt to better describe relative tax burden for both of these variables, staff has generated a new metric which is referred to here as the Tax Base Overview (or T-BO, pronounced *Tebow*). This metric combines the municipal income tax rate and the income tax rate less the credit (Tax rate + (Tax Rate-Credit)). This provides one measure for each community to show the combined economic burden stemming from variations in tax rate and the tax credit. The higher the T-BO, the higher the overall tax burden is in that community from the combination of tax rate and tax credit.

The T-BO graphic shows that Loveland's economic burden is low today—only Georgetown, Ohio has a lower score on the T-BO metric and peers with the same T-BO score presently are in the lowest 20th percentile of SWOTAA peers. Any of the income tax/credit variations considered would leave the City of Loveland below the 50th percentile compared to SWOTAA peers on the T-BO. It is also important to realize that many of these communities in this whisker diagram will be addressing their tax rate or tax credit in the coming months, so other T-BO scores for our peers will likely increase and the City's relative position may well revert back to a similar position as to where it is today.

Process
Any increase in the municipal income tax rate above 1% must be placed before the voters for their consideration. City Council can change the income tax credit by ordinance. It should be expected

that any ordinance reducing the credit would be subject to a referendum; therefore, any additional tax measure should be viewed as subject to approval or rejection by the citizens of Loveland.

The Budget White Paper detailed how the City would respond if the reductions in revenue were to be absorbed solely through budget cuts, and this memorandum updated the response with the latest financial data. This memorandum details another policy choice—raising taxes to replace state-inflicted revenue losses—and contemplates placing the choice before the electorate.

Preliminary Staff Recommendation
Staff recommends that City Council place before the voters in November an increase in the tax rate from 1% to 1.25% and extend the full credit to 1.25% if the voters approve the additional tax. This is option 3.

Principles Behind Staff's Preliminary Recommendation
The following overarching principles were used by staff in the formulation of the preliminary policy recommendation:

1. Retired residents and those who are unemployed will not have any additional burden because residents who do not have earned income do not have to pay municipal income tax. This policy option therefore does not cost anything for those on a fixed income or who have endured a job loss.
2. The revenue generated from it will be sufficient to meet the expected losses, known and anticipated, but not substantially more than is needed to maintain today's service levels. The City of Loveland has not altered its income tax rate of 1% since 1967 when an income tax was first established, and the revenue raising proposal should reset a structural balance to the City's Budget.
3. The number one suggestion from all five focus groups in 2011 was that the City should increase its income tax rate. Staff's recommendation follows this resident feedback.
4. The City's income tax rate is amongst the lowest in the region, and even if increased to 1.25%, will be below most other tax rates in our region at the present time.
5. Raising the City's income tax rate and keeping a full credit will place the City at a lower overall T-BO than most other communities in Southwest Ohio.
6. The majority of the additional revenue will not be paid by Loveland residents under option 3, but instead will be paid by non-residents who work here.
7. Residents have been asked for their input on what services they wish for the City to cut to close the budget gap. Many of these suggestions have been implemented already, and this proposal recognizes the logical conclusion from these focus groups: cut costs and then consider a tax increase to preserve quality services. This recommendation is therefore responsive to the citizen feedback the City received in 2011.

Surplus Options
Both options 3 and 4 would provide revenue in excess of the projected deficits in 2013 and 2014, with option 3 generating a very modest surplus which is expected to be eroded by future state revenue sharing reductions in the next State Budget. These surpluses could be used in a variety of ways, but I think it is important that the City communicate to the voters that if an additional tax

generated a surplus that the City will spend it or reserve it for specific purposes. If a surplus were to be generated, staff would propose the following priorities:

1. **No changes to staffing or operating service levels would be made**. The only exception to this would be if the Loveland City School District and the City reached a shared service agreement on providing a school resource officer at the Loveland High School. Other than a potential second SRO, the City would not undertake any additional hiring, even to replace positions which have been eliminated through outsourcing, reorganization and attrition.

2. **Stabilize the Fire and EMS funds**. As Council knows, the property tax funds which support Fire and EMS will need an additional levy in 2014 irrespective of the fiscal position of the General Fund (unless the policy decision is made to rethink the City's fire and EMS service model and service levels). Still, any surplus which an additional income tax generated could be used to push a property tax levy for Fire and EMS into the future.

3. **Invest more in Loveland's roadways.** As presented by the City Engineer, the City's investment in our streets is below an asset management level. The City should be investing $750,000 per year in our roadways and we have been spending about half of that total for many years. The City could increase its spending on roadways to meet or come closer to the City Engineer's recommendation.

4. **If Council wishes to draw down on working capital in the Water Funds, the City could set aside some or all of the surplus generated from Options 3 or 4 into another fund to provide an additional security**, as is discussed in City Manager Memorandum No. 12. Council fully understands and appreciates that the various revenue requirements the City has come from our residents. While we know that the law requires the City to separate water revenue, property tax collections and income tax dollars, the resident is less concerned with such distinctions. Wherever the dollar is spent, it is under any circumstance a compulsory payment to the City of Loveland from their checkbook. The City is properly looking at all of the services our residents receive and how they are funded, and if one policy decision is made which allows less payment in another area from the resident, it is worth considering if that is a good option.

Recommendation
Staff recommends City Council await feedback from the Finance Committee. Staff recommends that Council decide by April either to place a tax issue on the ballot or direct staff by way of a motion to implement the service cuts detailed in this memorandum.

XC: Finance Committee

Attachments: Comparative Income Tax Rates
Tax Burden Overview (T-BO)