

**CITY OF LOVELAND
MEMORANDUM**

TO: Mayor and Council

FROM: Tom Carroll, City Manager 

RE: Financial Matters Update - Memorandum 19

DATE: February 24, 2012

This memorandum provides an update for Council regarding two issues that are currently before the Finance Committee, (1) a recommended tax increase, and (2) a recommendation to finance the second water tower at the Commerce Park.

Background

On December 13, 2011 City Council referred the Budget White Paper to the Finance Committee for review. Staff has provided Council and the Finance Committee four potential tax increase options.

On January 24, 2012 City Council referred the matter of financing a second water tower at the Commerce Park to the Finance Committee. Staff has provided three potential funding mechanisms and two financing methods.

Tax Increase Policy Options

The Finance Committee discussed four policy options regarding tax increases:

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.

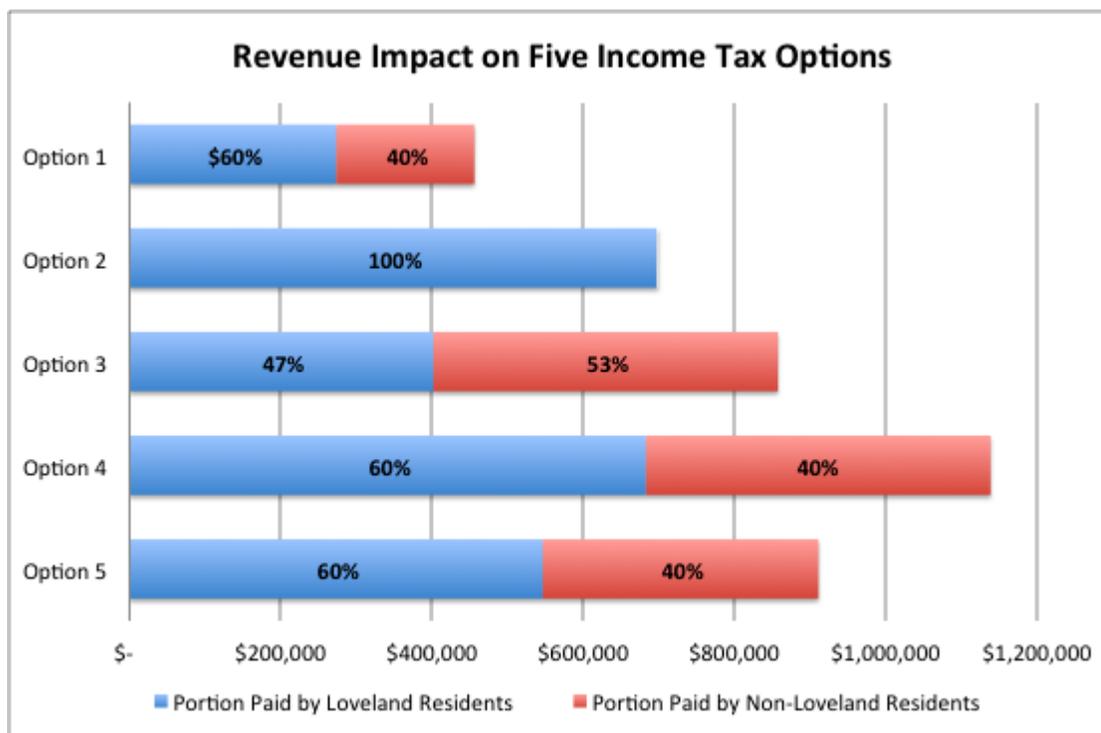
After determining that their goal for the City is to generate \$900,000 in revenue to have a balanced budget and increase funding for roads, the Finance Committee's recommendation, with a vote of 5-2, was for a 1.20% income tax rate and a 1% credit. The two dissenting votes felt that this option would not generate enough revenue or preferred Option 3. Staff has conducted an analysis of what this new option, Option 5, would have on revenues, and how many residents will contribute.

Tax Increase Analysis

A 1.20% income tax rate is forecasted to generate \$910,762 in annual revenue. One-hundred percent of working Loveland residents would contribute, and 40% of the revenue will come from non-Loveland residents. Retirees and unemployed residents will not be affected because they have no earned income to be taxed at the municipal level. A further breakdown of the data is illustrated below.

Tables 1 and 2: Revenue Impact on Five 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%
5	1.20% (1.00% credit)	\$910,762	59.98%	100.00%



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.

Tax Increase Fiscal Impact

If Council recommends a 1.20% income tax rate with a 1.00% credit, this will generate approximately \$910,000 in annual revenue. \$910,000 in revenue will also mean that the planned budget cuts in 2013, 2014 and 2015 outlined in Memorandum 11 will not need to occur. The Finance Committee was particularly adamant that no further reductions to personnel can be tolerated for the City of Loveland. They did not recommend that Council generate any less revenue than was needed to maintain services and personnel.

Option 5 would generate revenue sufficient to increase funding for the streets program annually. The Finance Committee pointed out that the 4-inch water line replacements have been assisting the Road Rehabilitation program simply because the Water Fund can pay for the resurfacing of streets that are often torn up with the water line replacements. After a few years, this will no longer be an option and the roads will be significantly underfunded.

The fiscal impact on Loveland residents with Option 5, a 1.20% income tax rate and a 1.00% credit can be seen in tables 3 and 4 below. The Finance Committee recommended Option 5, which affects 100% of Loveland residents in the workforce.

Table 3: Additional Tax From City Residents 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
5	1.20% (1.00% credit)	\$ 136	\$ 148	\$ 200

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

Option	Description	\$68,000	\$74,000	\$100,000
1	1.10% (1.00% credit)	\$68	\$ 74	\$ 100
2	1.00% (0.50% credit)	\$0 to \$340	\$0 to \$ 370	\$0 to \$ 500
3	1.25% (1.25% credit)	\$0 to \$170	\$0 to \$ 185	\$0 to \$ 250
4	1.25% (1.00% credit)	\$170	\$185	\$250
5	1.20% (1.00% credit)	\$ 136	\$ 148	\$ 200

Tax Increase Legislative Process

Because an increase in income tax above 1.00% must be approved by a vote of the people, Council may, by way of motion, direct staff to prepare draft legislation for a 1.20% income tax rate and a 1.00% credit.

Water Tower Financing Policy Options

The Finance Committee discussed two mechanisms to finance the water tower.

1. Interest only payments for years 1-7 with principal and interest payments for years 8-20.
2. Strict amortization payments for 20 years.

Water Tower Financing Analysis

The Finance Committee was ambivalent on the two financing mechanisms and requested more information from staff before making a recommendation to Council. Many members of the Committee were not thrilled with an interest-only loan, which could increase the total cost of the

loan. They were equally concerned with a 15% water rate increase on residents at a time when they were recommending an income tax increase.

Further analysis will be conducted where Bond Counsel will be asked to model a third financing model that is not interest only, but still achieves the goal of back loading the principle payments. This will enable staff to compare the total interest cost for the three financing options.

The Finance Committee also requested that staff analyze the Water Fund's debt payment schedule. The Committee stated that if the interest-only financing method helped the fund to maintain level debt payments, the additional cost in interest may be palatable.

Staff will continue this analysis and present the results at the next City Council meeting on March 13, 2012, which will include a recommendation from the Finance Committee, who will be meeting on March 12, 2012 to discuss the matter.

Recommendations

A public hearing is not required to place a tax issue before the electorate, but Council may desire to provide such an opportunity to our residents. Staff recommends that Council set a public hearing for the purpose of hearing public comments on a tax increase for March. Council can, by way of a motion, direct staff to draft legislation that would put a 1.20% income tax rate before the voters in November while keeping the credit at 1.00%. It is staff's recommendation that any action take place by April to ensure adequate time is available to education residents as to why this is necessary.

Regarding the water tower financing, no action is necessary at this time. Staff will present income tax analysis and water tower financing analysis at the next Finance Committee meeting on Monday, March 12, 2012. After this meeting, staff will have recommended actions for Council. If it is Council's desire, by way of motion, they can direct staff to contract an outside engineer to study the validity of a second water tower.