A Good News/Bad News Financial Outlook : Understanding the long term impact of the 2% tax levy cap

(The following is based on the supervisor's 2015 Tentative Budget and does not reflect changes made by the Town Board when it adopted a Preliminary Budget on November 14th.)

Previously, Part I of this two-part series on the town budget explored how the town's increasing reliance on the town's rainy day funds, aka fund balance, aka reserves, has had the positive effect of reducing some taxes and limiting the increase in other taxes.

Part II explores how the increasing reliance on the rainy day funds has affected the 2% tax levy cap and what this means for future budgets, tax rates and fund balances. As discussed in Part I, it's a classic case of what happens when the financial can is kicked down the road.

To understand the long term problem, one has to first understand the differences between the allowed tax levy, the actual tax levy and the tax rate and how each is calculated and applied.

The ALLOWED TAX LEVY is calculated only for compliance with the 2% tax levy cap and is the **total** amount of money the town is allowed to raise in taxes from all 27 separate town funds (budgets) after all other sources of revenue, such as the mortgage tax, sales tax, recreation fees, etc., are taken into account. *The allowed tax levy number does not determine the tax rate or what your tax bill will be*.

The ACTUAL TAX LEVY is the **total** amount the town actually levies when the individual tax levies from all 27 funds are combined. This number can be lower than the allowed limit. If it's higher, the town has exceeded its allowed levy. When the tax levy cap was enacted into law in 2011, town boards had the option of overriding the cap without incurring any penalties. However, beginning in 2015, if the town overrides the cap, taxpayers will not be eligible for a state check reimbursing them for any increase in their town taxes.

The TAX RATE is what a property owner pays per $1,000 of assessed value. The tax rate is the number that determines what a homeowner's tax bill will be. With the exception of the General, Highway and Library funds that are combined into one calculation known as the "Town" tax, each of the remaining 24 funds has its own tax rate that is arrived at by dividing the fund's own tax levy by the fund's total assessed value. *There is no cap on the increase in the tax rate.*

The TAX CAP. The cap is set each year by the state and is either a maximum 2% increase over the prior year's actual tax levy or the rate of inflation, whichever is lower. For 2015, the cap is 1.6%, which, for Yorktown, means 1.6% of the 2014 actual tax levy.

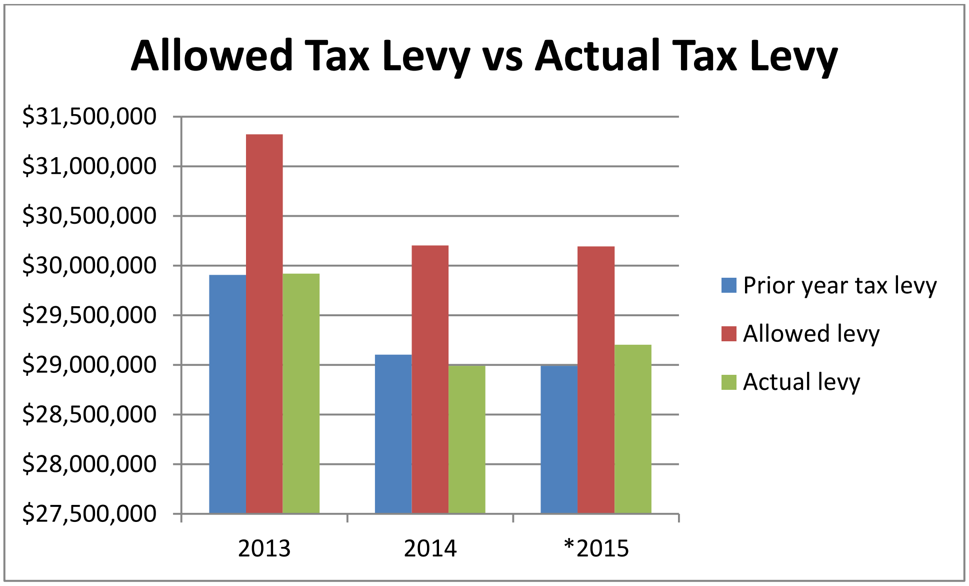
Putting all the pieces together — and what it means for future taxes
As detailed in Part I and illustrated in the accompanying charts, beginning with the 2013 budget, the town adopted a two prong strategy designed to keep taxes as low as possible. (Whether the town realized at the time what the consequences of the strategy would be for future budgets is not known.)

In 2013 and 2014, the town:

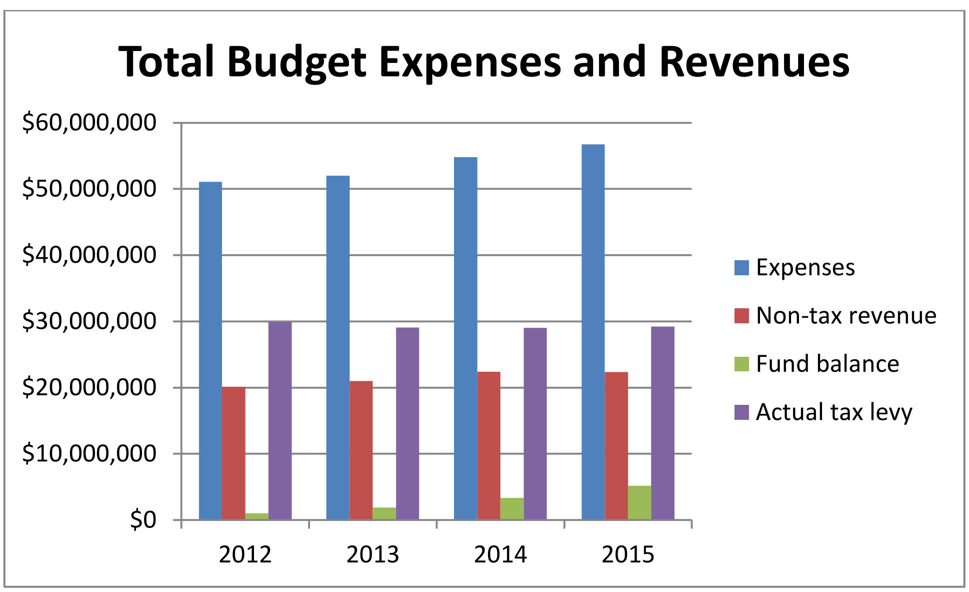
- used $5.3 million from fund balance
- set tax rates for the major budget funds that, when combined into the total actual tax levy, generated less in tax revenue than the allowed tax levy. Or put differently, tax rates could have been higher and still stayed well within the overall tax levy cap.

In the 2015 budget, the consequences of the 2013-2014 strategy has become all too apparent.

- The town has become dependent on using fund balance as the only option for staying within the allowed tax levy. The supervisor's 2015 Tentative Budget proposes using $5.2 million in fund balance, up from $3.4 million in 2014 and $1.9 million in 2013.
- The town's allowed tax levy for 2015 is actually **less** than it was in 2012, despite the fact that over the three year period total expenses have increased $5.7 million and non-tax revenue has grown by only $2.2 million.



We're spending more but taxing less. We're on an unsustainable path that can only get worse, not better.



Where does the town go from here? Should the town continue the politically popular strategy of keeping tax rates as low as possible for as long as possible, or should it begin to take steps to get back on a fiscally sound and responsible path?

There are three possible options.

Option A
Business as usual. Continue keeping increases in the tax rate as low as possible by using increasing amounts of fund balance and levying less in taxes than the allowed tax levy limit. The problem with this option, however, is that, over time, the various reserve accounts will run out of money leaving higher tax levies and higher tax rates as the only way to balance the budget. But higher tax levies will likely exceed the tax cap, which in turn, will jeopardize the state credit checks.

Option B
Bite the bullet, explain the problem to taxpayers and gradually begin to lessen the use of fund balance and raise taxes up to, or close to, the allowable tax levy limit. This will have the positive effect of increasing the allowable tax levy for the following year which, in turn, should lessen the future need to rely on fund balance. In the meantime, the town could begin using a portion of the reserves in the Water and Yorktown Sewer funds to finance long delayed major capital improvement projects. Paying cash for some of the projects instead of borrowing and paying interest would have the added benefit of holding down future debt service costs.

Option C
Go cold turkey and drastically reduce the use of fund balance to its earlier levels. This option, however, would mean exceeding the tax cap and jeopardize the state credit checks.

As taxpayers, we've all appreciated the fact that over the past two years, our total town tax bill has either gone down a few dollars, or increased modestly. But that was yesterday when the town kicked the financial can down the road. Today, it's time to start facing reality and deal with the consequences of those past actions.

Before the December budget hearing, taxpayers need an open, informative and honest discussion about budgets, the use of fund balance, the tax levy and increases in tax rates.