

LD 1in Year 3

*A comprehensive look at the impact
of spending limits on all levels
of government in Maine.*

A report by the
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Introduction

This report is the Maine Municipal Association's "Year 3" analysis of the spending limitation system enacted by the State in January 2005. The system, commonly referred to as LD 1 (PL 2005, Chapter 2) was adopted following strong voter approval of MMA's Question 1A citizen-initiative in 2004 that required the state to pay 55 percent of the cost of K-12 education as a way to reduce the burden on Maine property taxpayers.

The MMA Year 3 analysis is for budgets that began in calendar year 2007; this is fiscal year 2008 for communities whose budget year is not a calendar year. This is the third year of LD 1, but only the second year in which all local governmental units came under the limits. In 2005, municipalities and counties that operated on a budget year that began before July 1, 2005, were not subject to the LD 1 spending limits – state government, schools and municipalities/counties operating on a July/June fiscal year were.

For municipal compliance, the analysis relied on data from both a survey conducted by MMA and from data provided by the Maine State Planning Office (SPO). Other data in the report analyzing state, county and school compliance were provided by SPO, the Maine Department of Education, and the Legislature's non-partisan Office of Fiscal and Program Review. The data are contained in the Appendices.

NEW IN YEAR 3 REPORT

This Year 3 report will add a new focus of analysis. The LD 1 “growth factor” that each municipality calculates (a percentage) is often confusingly portrayed as the LD 1 “growth limit.” The growth factor really should not be viewed in that fashion. The only true LD 1 limit is the maximum property tax commitment allowed. The maximum property tax commitment allowed is calculated by applying the LD 1 growth factor to last year’s property tax limit.

LD 1 is a “limit-to-limit” system which means that the starting point for this year’s limit is last year’s limit – not last year’s taxes or spending.¹ So, if a municipality was below its LD 1 limit in 2006, it carries this reserve over to 2007.

An example might help illustrate the “reserve spending capacity” effect of the LD 1 limit-to-limit system. The municipal government “baseline” or starting point for 2007 is the LD 1 limit for 2006 (expressed in dollar terms). There were 253 municipalities for which we have data from both 2006 and 2007. The total property tax commitment of these 253 municipalities for municipal operations in 2006 was \$373 million. The corresponding 2006 LD 1 limit was \$391 million dollars. Accordingly, these 253 municipalities were \$18 million below their collective LD 1 limit in 2006. This \$18 million is the “reserved spending capacity” that is carried forward to Year 3.

Again, for Year 3 (2007), the baseline is last year’s limit of \$391 million which is \$18 million more than last year’s actual spending. If this “reserve capacity” is spent, it obviously counts against the overall municipal LD 1 limit. However, the expenditure of this “reserve spending capacity” disappears when calculating spending relative to the LD 1 “growth factor.” That is, these municipalities could spend \$18 million just to catch-up to the baseline and it is against this baseline that the growth factor is applied.

However, this \$18 million does become visible in two other calculations. It appears when expressing the LD 1 budget limits. It also appears when calculating an actual spending-to-spending analysis which calculates the rate of growth in property taxes.

Therefore, this report is transitioning away from reporting data in percentage terms and instead refocusing on limits in terms of total dollars. This will help tease-out the “reserve capacity” spending. It should be noted that the existence of the “reserve capacity” is the cumulative impact of municipalities consistently staying below the LD 1 limit. This report is also introducing spending-to-spending data so that actual growth in taxes is more visible.

A spending limit could be structured in one of two ways: the baseline for the current year could be either: (i) last year’s actual spending or (ii) last year’s spending limit. Many feel that that using the previous year’s limit as the starting point is the more prudent approach. There are two reasons for this. First, if actual appropriations are the starting point, the law would create an incentive for governments to appropriate more than they actually need so that they do not “lose” any of their allowance. Second, when there are down-turns in the economy and appropriations decline, the decline gets built into the system and the governmental service delivery system has trouble recovering. This is the infamous “ratchet down” effect that has plagued other spending limit systems.

Executive Summary

Maine municipalities, on the whole, continued to adhere to the spending limits contained in LD 1. Using the data provided by the 253 municipalities who participated in the MMA and SPO surveys, we project that all Maine municipalities collectively had a property tax commitment that was \$22.3 million below the Year 3 LD 1 limit of \$611 million. The aggregate growth above the baseline that was allowed pursuant to LD 1 for these municipalities was 4.85%; the actual growth above the LD 1 baseline for these 253 municipalities is a mere 0.8%.

For this first time, MMA does not have complete data for school units. The Department of Education is our source for the school data; and 29 schools did not provide DOE with their data this year (see Appendix C). The schools, which have a different type of spending limitation system from the other levels of government, appear to have again exceeded their aggregate LD 1 limit. County data appears to have some reliability issues; but based upon the data we have, counties stayed within their limits again this year. Lastly, State Government is also within the LD 1 limit.

Specifically

- Municipalities were \$22.3 million below this year's LD 1 limit.
- Municipalities were only 0.8% above their Year 3 baseline.
- 57% of Maine municipal governments stayed at or below their LD1 limits.
- State government spending was \$65 million below its LD1 limit.
- Counties were \$1.1 million below their aggregate limit.
- Schools continue to exceed the LD 1 limit as defined by Essential Programs and Services, the state's funding model for school budgets. School budgets that exceed 100 percent of EPS are deemed to be non-compliant with the LD 1 spending limits. Collectively, the 261 out of 280 school units for which we have data exceeded EPS in 2007 by 8.8 percent, or nearly \$137 million. In all, 82 percent of the reporting K-12 school administrative units were over their EPS benchmarks in FY 2007.

Caution ahead

- Since municipalities tapped their reserve capacity, actual increases in property taxes for municipal operations were 5.5%.
- Municipalities reduced their reserve capacity from \$25.6 million last year to \$22.3 million this year.
- Municipalities that exceeded their LD 1 limits in 2006 did so by an average of 5 percent; those who exceeded their limits in 2007 did so by an average of 10.5 percent.
- State exemptions to the LD 1 limit for education aid will end shortly and the state would exceed LD 1 if there were no exemption.
- Actual State spending grew faster this year (3.79%) than its LD 1 growth factor (3.08%).
- The LD 1 limits apply to less than 40 percent of total state revenue.
- School spending continues to exceed LD 1 and the gap between school spending and LD 1 continues to grow.
- Actual increase in county property taxes was 5.8%.
- County governments, and schools, should have more technical help from the state to effectively implement LD 1.
- Reserve capacity spending may become an issue.

Third Year Impacts

When enacted by the Legislature on January 20, 2005, the primary goal of LD 1, “*An Act to Increase the State Share of Education Costs, Reduce Property Taxes and Reduce Government Spending at All Levels*” (PL 2005, Chapter 2), was to incrementally reduce Maine’s tax burden to the middle one-third of all states by 2015.

First Year Impact

In February of 2006, the Maine Chamber of Commerce and the Maine Municipal Association co-authored a “First Year” report analyzing the impact of the LD 1 spending limitation system. While LD 1 only applied to a limited number of governments that yearⁱⁱ, the First Year report concluded that, “LD 1 had been a step in the right direction for reducing Maine’s overall tax burden”ⁱⁱⁱ.

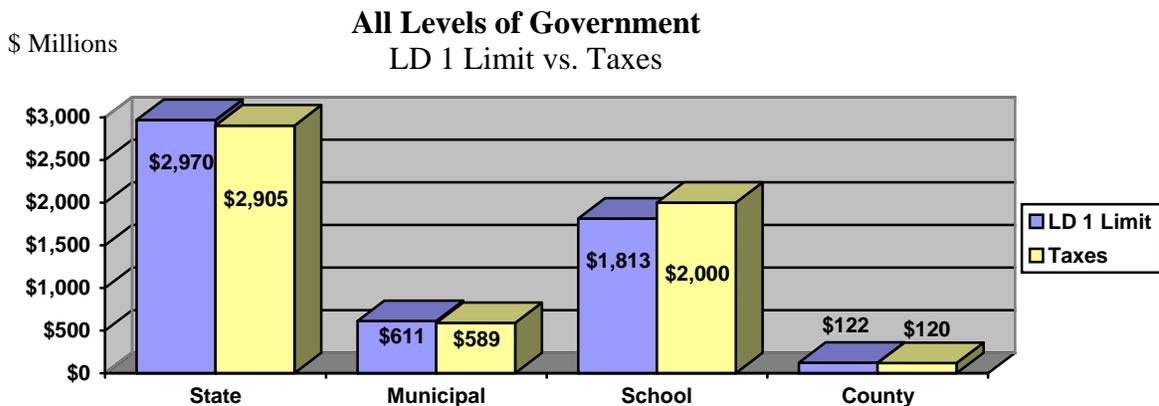
Second Year Impact

MMA’s “Year 2” analysis showed that the state, municipalities and counties were able to provide government services within the LD 1 limits, while schools collectively exceeded the limits for the second year in a row.

Third Year Impact

MMA’s “Year 3” analysis has the same general findings as previous reports: municipalities, counties and the state remain within their LD 1 limits while the schools do not. See Chart 1 below.

Chart 1:



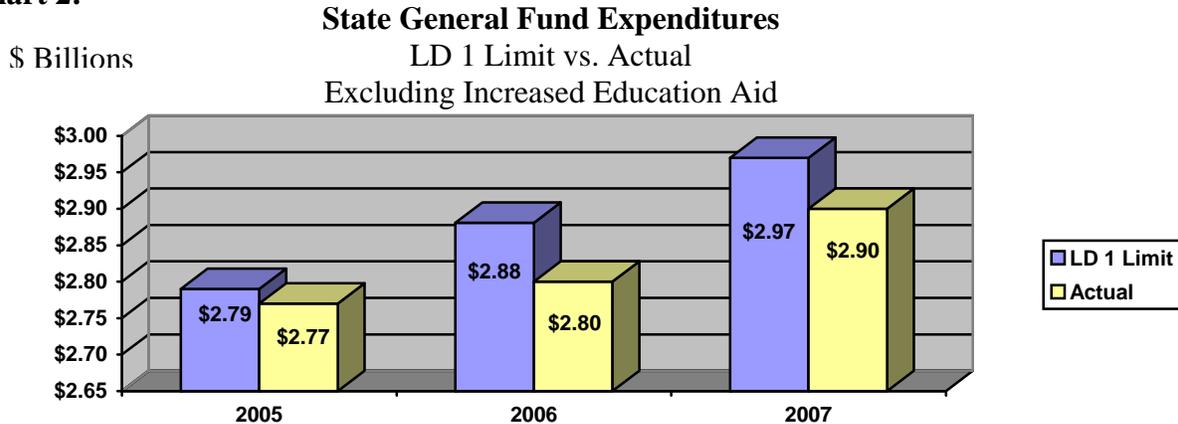
The best measure of LD 1’s success is the limitation system’s ability to keep tax increases at a rate that is below the increase in Maine’s personal income. In other words, in order to reduce Maine’s overall tax burden, personal income in Maine must increase at a rate that is higher than the growth in tax-supported government spending. Between 1995 and 2005, *average nominal growth* in total personal income was 5.03%, while the *average real growth* in total personal income was 2.47%.^{iv}

In 2007, growth in aggregate municipal property tax spending was 5.5%; for counties it was 5.3%; due to the lack of data, year-to-year comparisons are not possible for the schools.

State Limit

As illustrated in *Chart 2* the state has adopted a General Fund budget that is within the LD 1 limit for the third year in a row.

Chart 2:



What Spending is Limited?

The LD 1 spending limit for the state focuses on a portion of the state's General Fund expenditures. The General Fund primarily consists of sales and income tax revenue. According to the Office of Fiscal and Program Review (OFPR), sales and income tax revenue funded 87% of all General Fund expenditures^v in FY 2008 (July 1, 2007 to June 30, 2008). As crafted by the Legislature, the LD 1 limit system includes a temporary exemption that excludes any additional school aid appropriated above the FY 2005 base school aid expenditure. This exemption expires once the state has achieved the 55% requirement, which was scheduled to occur in FY 2009^{vi}.

For FY 2008, total school aid equals \$977.9 million. This is an increase of \$243.4 million above the FY 2005 level of \$734.5 million. It is this Question 1A increase in aid which is exempted from the LD 1 limit. (It is interesting to note that the accurate OFPR figure of \$243 million is much less than the politically-calculated "\$1 Billion" increase in education aid that is often alleged in the press.)

What is the State's Growth Factor?

The spending limit on the State is calculated by adjusting the State's previous LD 1 limit by the State's annual growth factor. The State's annual growth factor is calculated by adding the ten-year average annual change in real personal income growth in Maine (2.47% in FY 08), plus population growth (0.61%). Therefore the Year 3 growth factor applied to the state's baseline was 3.08%^{vii}.

Amount Under Limit

Actual General Fund spending in FY 2008 for LD 1 purposes was \$2.904 billion^{viii}. The corresponding LD 1 limit for General Fund expenditures was \$2.969 billion. State spending was accordingly \$65 million less than the FY 2008 limit.

However, the State did increase its spending. Actual year-to-year growth in the State's LD 1-related spending was \$106.1 million. This is equal to an actual growth rate of 3.79%. While the LD 1 "growth factor" of 3.08% is not the spending limit, it is useful to compare the two. As is the case with municipalities, the state was able to increase spending by more than the "growth factor" due to reserves it had built-up over the previous two years.

Table 1 below presents the State's LD 1 limits and actual spending for the first three years of LD 1.

Table 1:

LD 1 Limit vs. Actual Spending			
	LD 1 Limit	Actual Spending	Under LD 1 Limit
FY 06	\$2,794,180,033	\$2,770,299,268	\$23,880,765
FY 07	\$2,881,079,032	\$2,798,797,109	\$82,281,923
FY 08	\$2,969,816,266	\$2,904,866,157	\$64,950,109
Increase: FY 07 to FY08	3.08%	3.79%	
Increase: FY 06 to FY08	6.29%	4.86%	

Incomplete Data

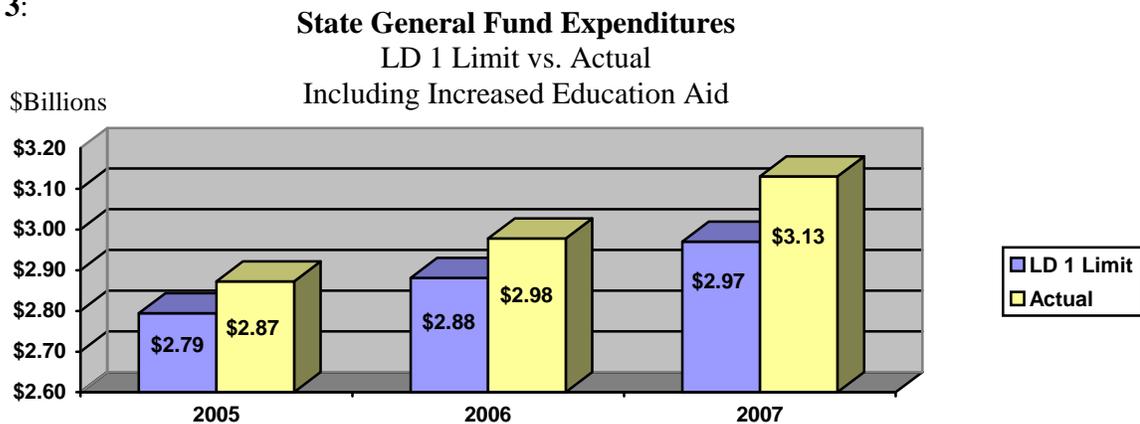
Please keep in mind that MMA's analyses are based upon State budgets as they exist in January each year – prior to any supplemental spending increases or reductions. Last year, the State passed a supplemental budget that increased spending. This year, it is anticipated that the state will be passing a supplemental budget that will likely decrease expenditures due to a reported budget gap of \$95 million. So, for example, the FY 2007 expenditure amount listed in this Year 3 report (\$2.79 billion) is higher than the amount reported in our Year 2 report for FY 2007 (\$2.77 billion) due to a supplemental budget passing in the Spring of 2007 following the publication of our Year 2 report.

State Limit Without Education Exemption

As indicated above, the state's LD 1 limit excludes the growth in education aid (GPA) that was directed by the passage of Question 1A by the voters in June 2004. This exemption expires once the state satisfies the Question 1A obligation on the state to fund 55% of the costs of K-12 education; which the Legislature has defined as the total Essential Programs and Services allocation.

There has been interest in seeing how the state would fare under an LD 1 analysis assuming there was no exemption for GPA growth. In each of the 3 years that LD 1 has been in effect, the state would have exceeded its LD 1 limit had increases to GPA not been exempted. This is a different conclusion than we have reached in past years because our data from past years was incomplete. That is, it did not include the supplemental budget spending as discussed above. Below is a chart of actual expenditures (including increases in GPA) vs. LD 1 limits.

Chart 3:



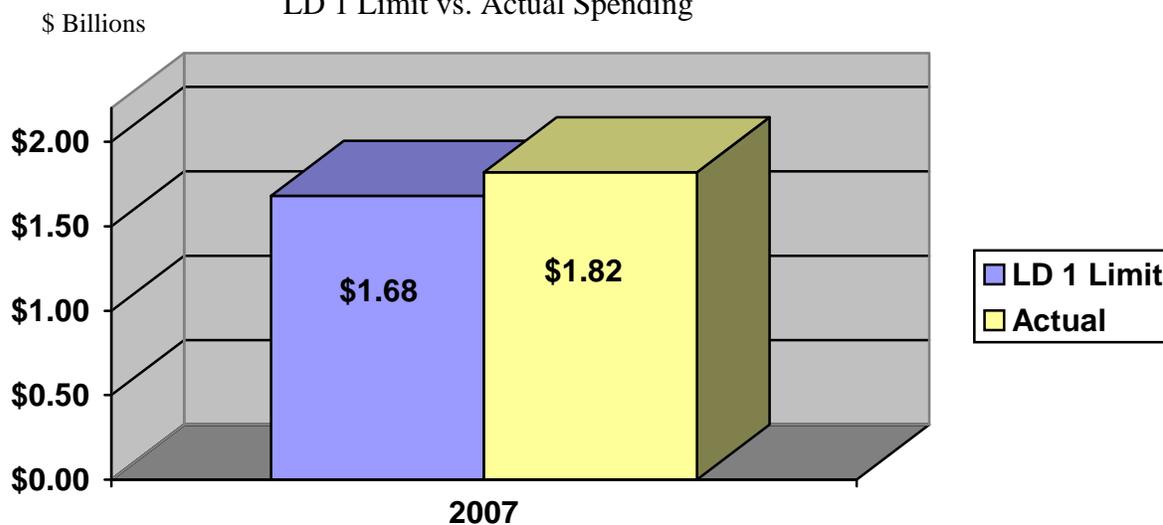
MMA supported the exclusion of increased education aid from the State's LD 1 limit for policy reasons explained in previous LD 1 reports.

K-12 School Limit

Schools have a mixed record on staying within the LD 1 limit. Unfortunately, the data set available to us for this Year 3 report is incomplete. For the prior two reports, we had complete data. The missing data is the amount of property taxes being raised by the school unit in 29 school units.^{ix} Accordingly, this report will only analyze the data from 261 units.

In the aggregate, these 261 units exceeded the LD 1/EPS limit by \$137,914,173.

Chart 4: **Schools**
LD 1 Limit vs. Actual Spending



What is the School Limit?

The LD 1 limitation system for schools is based upon the Essential Program and Services (EPS) funding model. The EPS funding model calculates how many dollars should be invested in each student and school unit in order to adequately educate to Learning Results proficiencies. That EPS figure is used to determine if actual total state and local school spending is under or over the limit. Any school administrative unit that appropriates more state, “local required”, and “additional local”^x dollars (excluding local-only debt service) than the calculated EPS funding number is deemed to have exceeded the LD 1 limit.

As illustrated in *Table 2*, the Department of Education calculated that \$1.8 billion was necessary to adequately fund K-12 education in FY 08. However, for the school units for which we have data, the actual total state and local education spending, excluding local-only debt, was \$1,817,099,753 billion. This is \$138 million (8.2 %) over the calculated limit. In the previous year, FY 07, the schools collectively exceeded the LD 1 limit by 7.5%^{xi}.

Table 2: **LD 1 Growth Limit Impact on K-12 Education Spending**

	Total K-12 EPS Model	Total K-12 Actual Spending	\$ Over EPS Limit	% Over EPS Limit
FY 06	\$1,722,788,902	\$1,797,028,309	\$74,239,407	4.3%
FY 07	\$1,762,583,400	\$1,895,270,194	\$132,686,794	7.5%
FY 08 *	\$1,679,185,580	\$1,817,099,753	\$137,914,173	8.2%

Note: Data for FY 06 and 07 includes all school units; for FY 08 the data only includes 261 units.

Over and Under

Applying the LD 1 benchmarking system that is described in the statutes, 215 of Maine’s 261 K-12 school administrative units for which we have data exceeded the FY 08 EPS benchmark. In the aggregate, the 215 school units that exceeded the limit did so by \$147 million. By comparison, 46 units were below the EPS amount. Collectively these units were under the LD 1 limit by \$9 million.

The unit-by-unit impact analysis conducted by the Maine Department of Education is found in Appendix C.

Table 3:

School Units Over/Under the 2007 LD 1 Limits

	# of School Units	% of School Units	% Over/(Under) The LD 1 Limit	\$ Aggregate LD 1 Limit	\$ Over/(Under) LD 1 Limit
Under Limit	46	18%	(3.5%)	\$269,495,399	(\$9,306,199)
Over Limit	215	82%	10.4%	\$1,409,690,181	\$147,220,372

Local Education Spending on Property Taxes

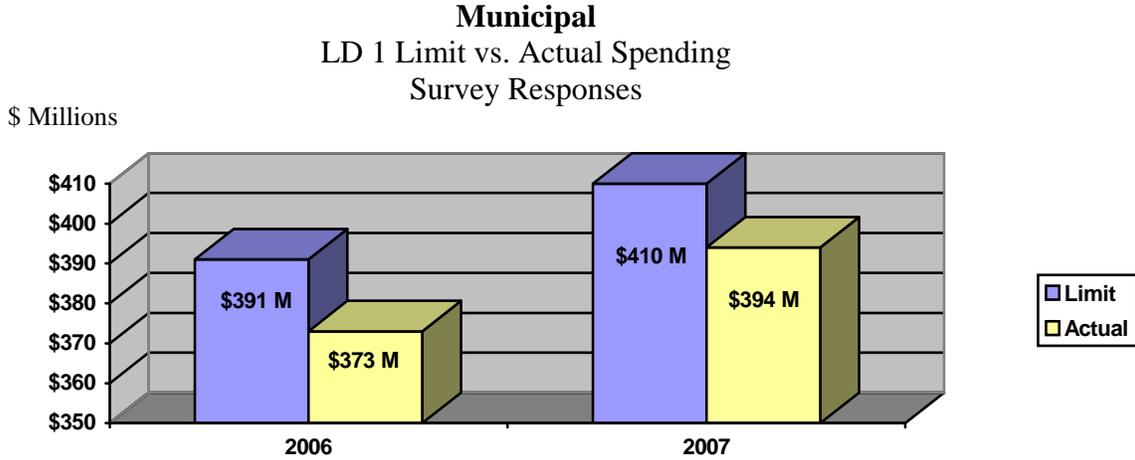
The LD 1 analysis looks at education spending in total. It does not break-out the relative impact school spending has on local property taxes vs. state revenues. Since the primary motivation behind Question 1A was property tax relief, this report does provide data on the impact of school spending on property taxes.

The data found in Appendix C, which are used to calculate the statewide impact described above, exclude from the local appropriation “local only” school debt. In previous reports we used this data to identify the impact of school spending on the property tax. This analysis requires the total amount of property taxes collected for educational purposes, a representative sample can not be used. Unfortunately, because we don’t have complete data, we can not provide this analysis for FY 2008.

Municipal Limit

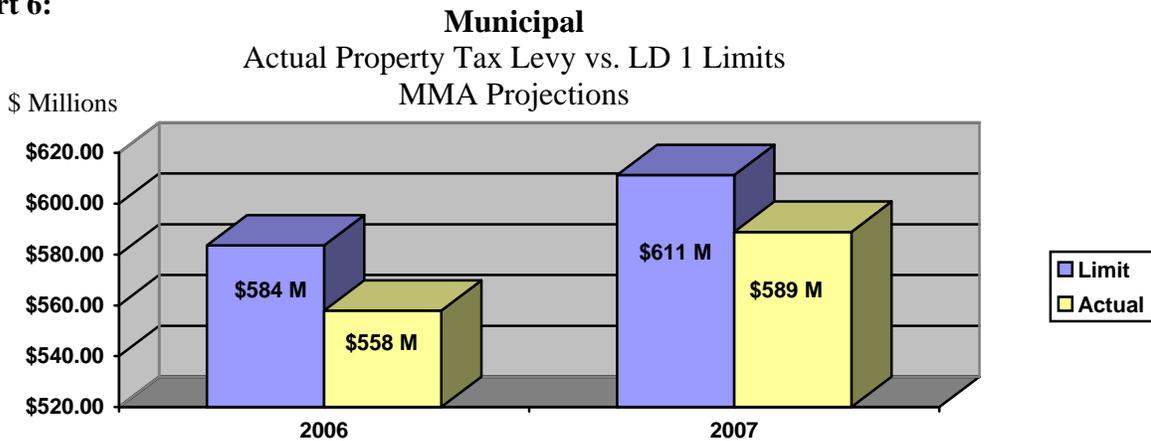
Municipalities continue to stay within LD 1 limits in the aggregate. MMA analyzed LD 1 survey responses from 253 municipalities. A summary of the responses is in Appendices B and D. These 253 municipalities were collectively under their limit by \$16 million in 2007 (Chart 5).

Chart 5:



Based upon survey responses received, MMA projected the aggregate LD 1 compliance for all Maine municipalities. In the aggregate, Maine’s municipalities were collectively below the LD 1 limit in 2007 by \$22.3 million.

Chart 6:



What Spending is Limited

The LD 1 spending limit system as applied to municipalities creates a threshold for the number of property tax dollars used to fund municipal services. To calculate the municipal limit a community must first determine its “core municipal commitment”; that is, the amount of property tax dollars used to fund municipal services in the base year. Core municipal commitment is calculated by subtracting county assessments, school appropriations or assessments, tax increment financing (TIF) payments and the overlay from the total property tax commitment. What remains are the property tax dollars used to fund municipal programs for the base year. The municipal spending limit is then calculated by adjusting the core municipal commitment by the growth factor^{xii}. In 2007, MMA advised its members to use an alternative calculation method that looks at appropriations rather than the tax commitment. Both methods yield the same result and either method is acceptable under the law. Please see Appendix E for a description of the new, preferred method.

What is the Growth Factor

The growth factor is calculated by adding the municipality's property growth factor to the state-calculated income growth factor. The property growth factor, which is unique to each community, calculates the growth in new development (i.e., property that has never been taxed before, such as new builds, lots and additions, etc.) as a percent of the total taxable value of the community. The income growth factor, as is the case with the state limit, is the annual average real growth in Maine's total personal income, which is annually calculated by the State Planning Office.

As explained in the "What's New" section of this report, it is important to keep in mind that the LD 1 Growth Factor does not completely define a municipality's growth limit. Thus, a municipality's actual rate of property tax increases may exceed the LD 1 Growth Factor. Because LD 1 is a "limit-to-limit" system, if a municipality is below its growth limit in one year it carries forward a "reserve spending capacity" into the next year.

Aggregate Limits and Spending

MMA projections, based upon survey results from 253 municipalities, show that in 2007, municipalities raised \$588.9 million in property tax revenue to help fund municipal services. After adjusting downward for any "net new state funding", LD 1 would have allowed these municipalities to raise \$611.3 million and still stay within their aggregate limit. Municipalities were accordingly \$22.3 million below their LD 1 limit in 2007.

However, when one looks at LD 1-related actual property tax growth for municipal services, the rate of increase was 5.5%. This exceeds the growth in total personal income in Maine during FY 2007 (4.75%)^{xiii} and will impede lowering Maine's tax burden.

Table 4: LD 1 Limit vs. Actual
MMA Projection

	Projected LD 1 Limit	Projected Actual Spending	Under LD 1 Limit
FY 07	\$583,572,203	\$557,951,405	\$25,620,798
FY 08	\$611,258,021	\$588,887,228	\$22,370,793

% Increase		
FY 07 to FY08	4.7%	5.5%

Over/Under the Limit

Of the 253 municipal LD 1 survey responses analyzed, 57% (144) were below their limits. A corresponding 43% (109) exceeded their LD 1 spending limit. (See Appendix D for a municipality-by-municipality analysis.) Based on this survey data, communities that exceeded the growth limit did so by an average of 10.5%. Communities that adopted budgets that were under their LD 1 limit did so by an average of nearly 7.3%.

Table 5:**Municipalities Above and Below the 2007 LD 1 Limits**

	Number of Municipalities	% of Municipalities	% Over/(Under) The LD 1 Limit	Aggregate LD 1 Limit	Over/(Under) LD 1 Limit
Under Limit	144	57%	(7.3)%	\$330 million	(\$24.2 million)
Over Limit	109	43%	10.5%	\$80 million	\$8.4 million

This 57%-43% split between towns under the limit and those over the limit may be somewhat misleading though. The 144 communities that were under their limits controlled much more than 57% of the property taxes in the survey group. The municipalities that were under their limits controlled 78% (\$306 million) of that levy; those that were over controlled 22% (\$88 million) of the survey group's aggregate levy.

For the most part, the municipalities filling out the surveys indicated a need to exceed the LD 1 spending limit for one of four reasons: 1) capital investments ; 2) contract increases; 3) general voter desire; 4) general municipal budget. (Appendix F provides a list of the reasons councils and town meeting participants decided to exceed the limit.)

Lastly, voters overwhelmingly agreed in a general sense with the budgets proposed by local elected officials – whether the budget was over or under the LD 1 limit.

Table 6:**Municipal Legislative Body
Responses to Budgets as Proposed**

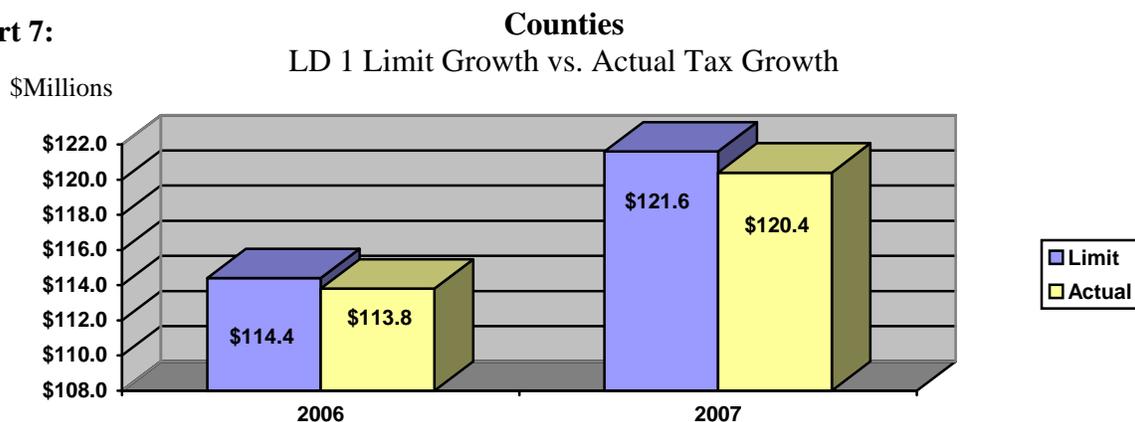
	# of Responses	% of Total
Proposed and Adopted Budget Within LD 1 Limit	66	60%
Proposed and Adopted Budget Over LD 1 Limit	39	35%
Proposed Budget Over LD 1 - Adopted Budget Within LD 1	4	4%
Proposed Budget Within LD 1 - Adopted Budget Over LD 1	1	1%
Total	110	100%

Only 5% of finally adopted budgets had a different LD 1 status than the proposed budgets.

County Limit

As indicated in the introduction, in its first year of implementation the LD 1 limits did not impact any level of government that operated under a calendar year budget cycle. Of Maine's 16 counties, 15 adopt calendar year budgets. Only Sagadahoc County has a July to June fiscal year. Accordingly, 2007 is only the second year that LD 1 has had an impact on the counties. Counties were again under their LD 1 limit in the aggregate (See Chart 7).

Chart 7:



What is Limited and How is Limit Calculated

The LD 1 spending limit levied on Counties applies only to the property taxes used to fund county operations. The process used to calculate the limit is nearly identical to the municipal limit described above, the major difference being that the growth factor calculation treats all the municipalities within the county as one large municipality.

Lincoln and Sagadahoc counties were provided a special two-year exemption by the Legislature for the costs associated with a new regional jail facility, including construction costs, debt service, operation and maintenance. The special exemption no longer applies; therefore, the FY 08 limit for those two counties is equal to their assessments from last year (including the assessments for the jail) multiplied by their respective growth factors. For this reason, we will no longer calculate the LD 1 impact on counties both with and without the jail exemption as we have in previous reports.

In the aggregate, the 2007 statewide county tax commitment was \$120.4 million. With the regional jail facility cost exemption, LD 1 allowed counties to raise up to \$121.6 million in property taxes for county services and still stay within their aggregate limit. Accordingly, the Counties remain under their limit, but they too have eaten into their reserve account. As illustrated in *Table 7*, the aggregate county LD 1 growth limit was 6.3%; actual property-tax assessments for county spending grew by 5.8%. See Appendix G for county-by-county data.

Table 7:

2007 LD 1 Impact on Aggregate County Spending

	LD 1 Limit		Assessment	
2005	\$105,127,431		\$105,127,431	
2006	\$114,357,101	8.8%	\$113,810,784	8.3%
2007	\$121,569,974	6.3%	\$120,436,115	5.8%

Over/Under the Limit

Of the 16 counties, 14 were below their limits; a corresponding 3 exceeded their LD 1 spending limit. Counties that exceeded the growth limit did so by an average of 11.5%. County budgets that were under their LD 1 limit were under by an average of 3.2%.

Table 8:

Counties Above and Below the 2007 LD 1 Limits

	# of Counties	% of Counties	% Over/(Under) LD 1 Limit
Under Limit	13	81%	(3.2%)
Over Limit	3	19%	11.5%