

Governor's Tax Reform Proposal

Governor Baldacci released his long-awaited tax reform package on Thursday this week. The Governor immediately emphasized that he considers the plan described in a 14-page concept draft to be a "fiscal reform" – rather than a "tax reform" – package. That package appears to have been developed with the considerable influence of the industrial and business lobby and Evan Richert, the former director of the State Planning Office under the administration of Angus King.

The Governor's proposal is specifically and expressly designed to be placed on the ballot on November 4, 2003 as a "competing measure" against the citizen-initiated *School Finance and Tax Reform Act of 2003*. The *School Finance Act* was initially drafted by a group of municipal officials working within MMA and is now being advanced by a wider group, the *Citizens for Local Property Tax Relief State-wide*. The initiated measure received a record 100,000 signatures in a single day of petitioning last November and is widely acknowledged, by critics and proponents alike, to have brought the tax reform debate center stage.

Apparently, the specific competing measure proposed by the Governor will not be available until next week as an actual bill. Until then, a clear financial analysis of the Governor's fiscal reform plan will be largely guesswork because the conceptual proposal is fuzzy on the math.

The Governor's plan comes in three phases and is designed to be rolled out over an extended period of time. The press packet released on Thursday focuses most specifically on Phase I. Phase II and Phase III, whenever they

kick in, are described in their entirety as follows:

"Phase II builds on the efforts of Phase I to reduce tax burden and increase competitiveness by attacking the issue of sprawl which is driving costs across all levels of government, by assembling a comprehensive relief package to strengthen Maine's service center communities, by actively seeking energy efficiencies and by implementing key recommendation from the Blaine House Conference on Natural Resource-Based Industries (including working waterfront proposals) and the Creative Economy....Once efficiencies are in place, Phase III will consider further re-balancing of the system to achieve the other principles of reform such as stability, fairness, tax mix and exportability."

Phase I. The more immediate elements of the Governor's tax reform plan are as follows:

Repeal the Homestead Exemption. The Homestead property tax exemption would be repealed and most of those \$35 million in state "savings" would be converted into an expansion of the Circuit Breaker property tax and rent rebate program. Instead of an upfront exemption, the property tax and rent relief would be delivered as a check in the mail from Augusta to income qualified applicants.

Personal Property Tax Repeal. The personal property tax on business machinery and equipment would be repealed in a going-forward manner, effectively eliminating approximately 10% of the municipal tax base state-wide after the repeal is fully phased in. That tax base, however, is concentrated in approximately 50 industrial and

service center municipalities, where the property tax burden would be shifted from the industrial to the residential and small business sectors. From some perspective, the proposal is seductive because in the first year the burden shift is subtle, but the negative property tax impacts increase significantly over time. Although the written proposal is silent on the subject, the apparent intention is to reimburse municipalities for 50% of the lost tax revenue as required by the Constitution whenever the Legislature enacts a new property tax exemption. Ultimately, 15 years out and after netting-out the presumed municipal reimbursement, the proposal represents the elimination of about \$80 million in municipal revenue in today's currency. With the phased-in repeal of the personal property tax, the state will gradually reduce its exposure to the 100% Business Equipment Tax Reimbursement Program and replace it with a 50% municipal reimbursement obligation. That marginal differential in reimbursement obligations, which is practically nonexistent over the next two biennia, is apparently the major funding source for the "fiscal reform" package.

Small Counties. Touted as the "Sinclair Act II", in reference to what the Governor referred to as the "highly successful" law that created Maine's School Administrative Districts (SADs), the proposal provides for the creation of a new level of government that would be multi-municipal districts consisting of at least 5 merged municipalities, 2 merged school administrative units, with a minimum population of 20,000 people. These "Municipal

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GOVERNOR'S (cont'd)

Service Districts” or small counties would be required to enact a charter and form a representative, rather than direct, form of government. To “incentivize” the multi-municipal mergers, the law would create a 5-year window of opportunity to sign-up. Towns that agree to the merger would be provided four incentives: (1) technical assistance grants to facilitate the merger; (2) state takeover of portions of the county assessments; (3) a 10% bonus in General Purpose Aid to Education for a 5-year period; and (4) state takeover of 50% of the municipal debt.

The expected outcome of this new-governance vision is described in the Governor’s proposal as follows: “Over time, an estimated 60-80 municipal service districts in Maine, each with an elected council and a single school board, would be created. Most would be town or small-city sized in terms of population, but with much more clout. They would control larger tax bases and larger land areas, with many more options for local economic development, while maintaining local identities. For example, a mid-sized municipal service district might have a population of 25,000, a tax base of \$1 to \$2 billion, and a jurisdiction of 300-500 square miles. It would have much greater opportunities for economies of scale, efficient growth, and reduced costs.”

Local Option Sales Tax. The Governor’s proposal would allow Maine’s “service center” communities and the new “Municipal Service Dis-

tricts” to impose a local option sales tax to fund regional infrastructure projects, such as civic centers or regional auditoriums. Based on the narrative description, the local option proposal is essentially the same as developed by Evan Richert in 2001 and promoted, albeit unsuccessfully, by the administration of Governor King.

Essential Programs and Services.

The Governor’s plan urges the adoption of the Essential Programs and Services (EPS) school funding model, but it doesn’t specify at what percentage of state funding. EPS, by itself, doesn’t specify what share of the statewide school budget will be picked up by the Legislature, but the Governor’s proposal appears to be supporting the 5-year phase-in of increased state funding for EPS so that in 2008 the state share will be at 50%, where it will remain. That proposal would override and overturn the legislative intention to provide at least 55% of the costs of K-12 education, which has been in Maine law since 1985 and never fulfilled. Perhaps the Governor’s intention as to the enforceable state share of education will become clearer when the competing measure is printed as a bill. If not, it would appear that the Governor is supporting the phased-in approach where EPS would come out of the gate in an 84% “percentage reduction” format, whereby the state pledges to pay 49% of 85% of the EPS allocation. “Percentage-reduction” methodology is where we are right now with the GPA system, and it is also the system Congress uses to avoid paying 40% of the costs of special education, even though 40% special education funding is Congress’s stated intention.

The narrative description in the press packet documents issued by the Governor’s Office address the point as follows: “My proposal gets us to 55% education funding over 5 years in 2 ways: 1) It builds on the Essential Programs and Services method of school funding currently before the Education Committee. We need the Legislature to pass the Governor’s bill (sic) this session; 2) And, it provides significant State funds to municipalities that form Municipal Service Districts and direct (sic) savings to property tax re-

lief and education.” It certainly remains to be seen how we get to 53% of education funding through a five-year phase-in of “percentage reduction” EPS, combined with municipal districting incentive funds that are provided by capitalizing on a tax revenue loss to municipalities.

Converted Income Tax Relief.

Current law ensures that the four income tax brackets are indexed annually for inflation so that a person who gets a cost-of-living pay raise won’t get pushed into a new rate bracket. The Governor’s proposal would exchange at least some of the benefits that are provided across all income levels through the bracket indexing process for a reduction in the highest marginal income tax rate from 8.5% to 7.5% over time. The stated purpose of this conversion of income tax benefit from bracket relief to the highest marginal rate is because the highest income tax rate is considered by the business and finance community as a major disincentive to investing in new businesses and growing existing businesses.

Money Bills

Legislative proposals that have fiscal impacts on the state treasury and are poised to be finally enacted by the Legislature are sent to “special tables” where they sit until the budget bills are finally adopted and an analysis is made of how much free-floating state revenue still exists to fund the individual bills. Even in the best of times, competition for funding among the bills on these special tables is fierce.

The following is a sampling of some of those bills on the “Special Appropriations Table” and “Special Highway Table” that have municipal impacts. Final passage of these bills is never assured until their funding is finally secured.

LD 48 – *An Act to Reduce Jail Overcrowding.* (Sponsored by Rep. Watson of Bath)

This bill requires that a person whose probation is revoked must be re-sentenced to that person’s original

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Legislative Bulletin

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Editorial Staff: Geoffrey Herman, Kate Dufour, Jeff Austin, and Laura Veilleux of the State & Federal Relations staff.

Essential Programs & Services and Tax Reform

The Department of Education distributed two spreadsheets on Wednesday this week to the members of the Education and Taxation Committees, who were convened in a joint work session. In different ways the spreadsheets describe the implementation of the Essential Programs and Services (EPS) school funding model for each school administrative unit in Maine. Anyone interested in obtaining a copy of those spreadsheets should feel free to contact MMA's Laura Veilleux at 1-800-452-8786.

The 10-mill Cap Spreadsheet. The most informative spreadsheet of the two describes the impact of fully implementing the EPS school funding model and establishing a 10-mill property tax cap for education. This represents an element of the tax reform plan under consideration by the Taxation Committee. According to the Department's most recent fiscal analysis of the proposal, establishing a 10-mill property tax cap for education, with the state paying the difference according to the EPS model, would move the state share of education funding from 43% of the total to 51%, 4 percentage points shy of the Legislature's 20-year old, unfulfilled statutory intention.

The first column of that spreadsheet identifies for the first time the "total EPS allocation" for each school administrative unit the state. The total EPS allocation represents what the EPS benchmarking formula calculates as the total amount of combined state and local funding each school administrative unit should have to provide an adequate education to meet the "Learning Results" standard. The total EPS allocation includes all funding for operations, program costs (special ed., transportation, etc.) and debt service. The only costs not reflected in the EPS calculation are the so-called "adjustments", which are special subsidies for out-of-district special education placements, wards of the state, geographic

isolation, etc.

The spreadsheet also describes the maximum local contribution to that total EPS allocation that would be required according to the 10-mill cap proposal. If the municipality supporting the school system is able to raise the EPS allocation with a tax effort of less than 10 mills, it would get no subsidy from the state. Otherwise, the maximum amount the municipality would have to raise to meet its education obligation would be 10 mills, and the state would provide the difference up to the total EPS allocation. The voters would be free to raise more than the total EPS allocation, but the state would not participate in over-EPS spending.

And the spreadsheet identifies the state share for education that would be provided under this new system for each school unit, which is simply the difference between the local revenue raised under the 10 mill cap and the total EPS calculation. Radically simple in its design, the mill cap proposal would effectively replace the current school funding distribution calculation, which is based on a school unit's "fiscal capacity" (85% valuation, 15% income) and is the focus of perennial storms of political controversy.

For comparison purposes, the spreadsheet finally describes the amount of revenue raised locally for education in FY 03 and each municipality's mill rate effort, measured in "full value". As provided to the Committee, the spreadsheet information enables a rough assessment of the financial impact of the 10-mill cap proposal for any municipality in the state.

EPS and "Percentage Reduction" Methodologies. The second spreadsheet is an attempt to show the first-year impacts of implementing the EPS system in a phased-in manner over the next five years, without any tax reform and with only a modest increase in

state funding for education. This information provides a good idea of what the Department of Education and Governor Baldacci, apparently, will be recommending if no tax reform or major education funding reform is embraced by the Legislature. In order to accomplish this phased-in approach, EPS would only be funded at an 84% "transition percentage", and the state would only participate at a 49% share of that "transition percentage". In essence, EPS would be implemented but the model would be manipulated to fit a status-quo level of legislative appropriation. This phased-in proposal looks very similar to the current "foundation allocation" system, where the state share is manufactured to fit the level of appropriation, rather than the other way around.

Although there is a growing interest in adopting the EPS funding model along with a mill rate cap system to establish the maximum local share requirements, no coherent proposals have been identified to actually fund the state's proper share of school funding. The spirit is willing, but the flesh is weak.

DOT Stalls on Info Request

This session, two bills were submitted to address an existing Department of Transportation (DOT) funding practice that requires Maine's larger communities to contribute up to 15% of the cost of state principal arterial, minor arterial and major collector road construction projects. That policy has been operating for years without the guidance of a statute, rule or any written policy statement whatsoever. LD 832 would have required the state to fund the entire cost of improvements to state arterial and major collector roads, unless the local legislative body voted to financially participate in the project. LD 1392 would have brought an "equity" to the process by reducing the rate of contribution required by Maine's urban communities and recu-

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Floor Work on Municipal Issues Winds Down

As the June 18th statutory adjournment date approaches, the Legislature continues to process bills of municipal interest. This week, the Legislature took action on bills proposing to amend the foreclosure process, implement the Governor's Pine Tree Zones economic development proposal, establish a \$0.20 per gallon fee on the retail sale of paint to fund household hazardous waste collection programs, direct the Department of Environmental Protection (DEP) to develop a mechanism for the safe disposal of arsenic-treated wood and limit municipal authority over the adoption of ordinances regulating the operation of ATVs. Two other initiatives, a bill proposing to prohibit retroactive municipal ordinances adopted through the citizen initiative process and a bill to allow the self-governance of water districts, remain solidly tabled in the Senate.

Foreclosure. Both the House and the Senate have now voted to support the "ought not to pass" recommendation on LD 937, *An Act To Require the Net Proceeds from the Sale of a Foreclosed Property To Be Returned to the Former Owner*. A 5-member minority of the Taxation Committee was pushing for an amended version of the bill that would have required municipalities to specially manage the funds resulting from the sale of tax-acquired property and reimburse the former owner certain residual proceeds, as banks would be required to do.

Arsenic-treated Wood Disposal Process. An amended version of LD 1309, *An Act to Protect Public Health by Reducing Human Exposure to Arsenic*, received initial support from the House and Senate this week, and it is currently being held in the Senate. The most municipally relevant section of the bill directs Maine DEP to develop a plan to safely dispose of arsenic-treated wood. As directed by the bill, the plan must include recommendations for: 1) separating and segregating arsenic-treated wood at solid waste

handling facilities, 2) restricting the combustion of arsenic-treated wood at incineration facilities, biomass boilers and other boilers; and 3) restricting the disposal of arsenic-treated wood at unlined landfills. The proposed plan must be submitted to the Legislature by January 1, 2005.

Pine Tree Zones. Both the members of the House and Senate supported an amended version of LD 1385, *An Act to Establish the Pine Tree Development Zones Program*. This bill would create the Pine Tree Development Zones program. The program would be administered by the Department of Economic and Community Development (DECD). Up to 8 Pine Tree Development Zones would be created statewide, four in already-determined locations (Aroostook County, Androscoggin Valley region, Penobscot Valley region, and the Washington County-downeast region) and four in other locations that meet certain criteria. For each Pine Tree Development Zone, the legislative body or bodies of a municipality or a group of municipalities would have to vote to designate the zone within their respective jurisdictions. If adopted by the municipality or multi-municipal groups, certain qualified businesses in the manufacturing, technology and financial services sectors would be entitled to a cluster of tax breaks if they establish themselves within the designated zones. The tax breaks would run for a 10-year period for qualifying businesses, and no tax benefits created by the bill could be provided the qualifying businesses after December 31, 2018. Those tax breaks would be: (1) a sales tax exemption for the construction materials to build the facilities; (2) a sales tax exemption for any tangible personal property purchased for use directly and primarily for that business; (3) a 100% premium tax credit (for the first 5-year period) and a 50% premium tax credit (for the second 5-year period) for qualifying insurance

companies; (4) a 100% income tax exemption for the first 5-year period and a 50% income tax exemption for the second 5-year period; (5) a reimbursement to the qualifying business for 80% of the employee withholding (income) tax the business would otherwise have to remit to the state; and (6) whatever property tax benefits the municipality with taxing jurisdiction may provide through the Tax Increment Financing (TIF) program. With respect to TIFs, the bill provides that the standard TIF limitations regarding the maximum allowable value created within a TIF district and the maximum allowable land area designated as a TIF district do not apply to TIF programs created within Pine Tree zones. DECD is further directed to submit rules to the Legislature by January 15, 2004 for the implementation of the Pine Tree Development Zones program. Since estimates show that over the next four years (2004-2007) the program's income and sales tax incentives will cost the state \$2.2 million, the bill has been placed on the Special Appropriations Table for funding before it can be finally enacted by the Legislature.

ATVs. As reported last week, an amendment to LD 1482, *An Act To Revise Certain Provision's Of Maine's Fish and Wildlife Laws*, would have prohibited municipalities from enacting ordinances that affect the "operation" of All Terrain Vehicles (ATVs). The proposal was not part of the original bill and MMA was surprised to discover it in the unanimous "committee report" on LD 1482. Due to the significant municipal feedback, a compromise was reached whereby municipalities will continue to have authority to regulate ATVs with respect to town-owned property, right of ways and easements. Otherwise, the operation of ATVs on private property many not be regulated by municipalities according to the bill. The Governor has just created by Executive Order a 13-member group to study ATV regulation, which does not include a municipal representative. Hopefully, municipalities will get an audience before that task force so that the remaining concerns with ATV activity on the lo-

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FLOOR WORK (cont'd)

cal level and the impact of deeply restricting municipal regulatory authority over that activity will get a fair hearing.

Paint Fees. The House and Senate provided preliminary support for an initiative imposing a \$0.20 per gallon fee on paint and \$0.20 per container fee on pesticides sold in Maine. Ninety percent of the revenue generated by the fees imposed in LD 1549, *An Act To Fund Municipal Collection of Household Hazardous Waste* will be dedicated to the Maine Solid Waste Management Fund and used as the state's cost-share to municipalities for the operation of household hazardous waste collection and recycling programs. Up to 5% of the collected revenue will be used by the Department of Environmental Protection or State Planning Office to conduct education and outreach programs, and up to 5% will be used by the Department of Agriculture to support the pesticide use minimization goal established in statute.

Tabled Bill. Two bills supported by MMA's Legislative Policy Committee (LPC) remain tabled in the Senate. Since its May 13th debut, LD 1359, *An Act to Establish the Locally Governed Water Districts* has been on the Senate's table. The bill would create a 4-year pilot program authorizing water districts to be self-governed rather than regulated by the Public Utilities Commission, upon receiving approval from the municipal officers in the municipalities where the water district is located. Proponents of LD 1359 have offered an amendment that limits the number of participating water districts in the program to 8; structures the program so that the Portland Water District is not obligated to participate, and maintains PUC oversight of rate increases for those communities served by an "interconnection agreement".

LD 389, *An Act to Amend the Laws Governing Municipal Citizen Initiatives and Referenda* is also tabled in the Senate. The amended version of the bill supported by the members of the House would prohibit citizen petitions on the municipal level that would initiate ordinance or bylaw changes that

have retroactive impacts if the municipality uses a permitting process that includes at least one advertised public hearing. The prohibition created by this initiative would not apply to any final approval regarding the disposal of sludge or septage. LD 389 has received initial support from the House.

Fee Bills. Perhaps fueled by the Governor's no tax increase pledge, proposals seeking to increase existing fees or adopt new fees have been popular this session. The Legislature has enacted the hunting and fishing licenses fee increases in the Governors Part I budget and has provided initial support for a proposed fee on gallons of paint and containers of pesticides. However, the interest in enacting other fee increases seems to be waning as two bills seeking fee increases are meeting resistance in Legislature.

On Wednesday this week, a bill that received unanimous support at the Committee level was defeated in the House by a margin of 82-63. The bill was LD 1186, *An Act To Revise the Reimbursement by the County Jail Prisoner Support and Community Corrections Fund and To Provide Additional Support to County Jails*. As amended, the bill would change the formula used to provide state financial assistance to counties for the provision of county jail and community corrections services by reimbursing each county a percentage of the total actual costs. Also, in order to increase the state's share of funding county jail and community corrections, a 10% surcharge would be assessed on every fine, forfeiture and penalty imposed by any Maine court, except that the proposed surcharge would not be applied to fines on overweight commercial vehicles.

Members of the House in opposition to the fine increases focused their debate on two arguments. First, the

opponents believe that fine increases are inappropriate because the courts, under their own authority, have recently increased all court fines, and the proposed surcharge would be piling-on to that recent increase. Second, some members of the House believe the fee increases are unfair because most of the increased fine revenue is generated by persons paying fines for traffic offenses that do not typically require jail sentences.

The Senate disagreed with the "ought not to pass" recommendation from the House and on Thursday requested that the House join in a "committee of conference" to try to resolve the conflict.

Following House passage of an amended version of LD 1545, *An Act To Amend the Animal Welfare Laws*, the Senate narrowly rejected the bill, putting its fate in limbo. The primary thrust of the bill was the doubling of fees for licensing dogs. Almost all of that increased revenue was directed to the state's Animal Welfare program, with municipalities receiving just a \$2 increase for each license for a non-neutered dog. The Senate's rejection of the bill is primarily due to objections to the stiff fee increase. Accordingly, the House is proposing an amendment that reduces the fees somewhat.

The table below outlines the dog licensing fees under current law, the bill rejected in the Senate, and the new House amendment.

Under the amendment, the fees will only jump to \$6.00 and \$11.00 instead of doubling to \$8.00 and \$15.00. However, municipalities will not be receiving the \$2 originally provided with respect to licensing the non-neutered dogs. In short, municipal animal welfare programs will get nothing more for local enforcement from the proposed increases to the general fee structure.

LD 1545	Current Law		Rejected Bill		New Amendment	
	Spay/ Neuter	M-F	Spay/ Neuter	M-F	Spay/ Neuter	M-F
State Animal Welfare	\$1.00	\$6.50	\$5.00	\$12.00	\$3.00	\$9.00
Municipality	\$2.00	\$0.00	\$2.00	\$2.00	\$2.00	\$0.00
Clerk Fee	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00
Total	\$4.00	\$7.50	\$8.00	\$15.00	\$6.00	\$11.00

DOT (cont'd)

operating the lost revenue by requiring all communities with state arterial and major collector roads to contribute to the cost of improvements to those roads.

Although both bills provided the Legislature with the opportunity to articulate a position on the existing DOT practice, the Committee instead killed both bills and decided to extend the practice of delegating revenue-raising authority to DOT. Specifically, the Committee asked the Department to work with the Service Center Coalition and the Maine Municipal Association to develop and implement, as soon as possible, a practice requiring a local match of up to 7.5% on improvements made to sections of state arterial and major collector roads with posted speed limits of 35 miles per hour.

Since May 2nd, MMA has made repeated requests to DOT for a copy of the Committee letter and, more importantly, a list of the communities impacted by the new funding proposal. Unfortunately, DOT has yet to respond to that request. For that reason, MMA is undertaking its own effort to identify the impacted communities. In order to collect the most accurate information we need your help. If there are any state arterial or major collector roads with posted speed limits of 35 mph or less in your community, please contact Kate Dufour (kdufour@memun.org or 1-800-452-8786). Also, please contact Kate if you are interested in receiving updates on the progress of DOT's new

funding initiative so that you can be included on our state road funding "interested parties" list. Thank you for your assistance.

MONEY BILLS (cont'd)

place of imprisonment, which would often be a state correctional facility rather than a county jail. The bill also includes a \$2 million fiscal note to fund the increased FY 04-05 biennium cost that will be borne by state correctional facilities if the bill is finally enacted.

LD 1577 – *An Act To Amend and Improve the Education Laws*. (Sponsored by Sen. Douglass of Androscoggin County)

This bill makes a number of changes to the laws governing public education, including: (1) incorporating what appears to be updated federally-mandated language regarding homeless students; (2) clarifying the prorated tuition cost charges for students attending a school who also receive some of their education from applied technology centers; (3) adding "emotional disability" to the list of defining disabilities of "exceptional students"; (4) amending the section that governs state grants to schools for their "gifted and talented" programs from a required 2:1 state-local match to whatever the Department of Education requires; (5) mandating each school administrative unit to fully implement its plan for phasing-in its "gifted and talented"

program in FY 05; (6) providing any school administrative unit with an opportunity to appeal the mandated FY 05 implementation of the gifted and talented program to the Commissioner of Education on the basis of "undue burden"; and (7) defining "undue burden" with respect to a school system's appeal that it should be allowed to extend its lease for temporary, "non-administrative" space (i.e., portable classrooms) beyond the 5-year maximum limit. The bill identifies the mandated full implementation of gifted and talented programs as "insignificant".

On the Special Highway Table:

LD 1414 – *An Act To Amend the Laws Regarding Storage of Sand and Salt and To Provide Funding for State and Municipal Storage Facilities*. (Sponsored by Rep. Usher of Westbrook)

This bill provides the Department of Transportation (DOT) with certain exemptions from being found in violation of best management practices governing sand and salt storage facilities if DOT abides by certain reporting requirements to the Legislature with regard to the availability and the use of state funding to DOT for the construction of sand-salt facilities. The bill also appropriates \$3 million over the FY 04 – 05 biennium to support the construction of both state and municipal sand-salt sheds. Out of that \$3 million appropriation, \$600,000 would be available each year of the biennium for municipal sand-salt facilities.