CITIZENS LEAGUE REPORT

No. 88

Reply to the Minneapolis Board of Estimate and Taxation Re: Borrowing Policy

June 1958

approved by Bd of Directors 6/4/58 (88)

Citizens League
601 Syndicate Building
Minneapolis 2, Minnesota

June 16, 1958

SUBJECT: REPLY TO BOARD OF ESTIMATE'S QUESTIONS ON BORROWING POLICY

Following is the Citizens League's reply to four questions on city borrowing policy submitted by the Board of Estimate and Taxation. The League's Board of Directors on June 4 officially approved the statement, subject to final ratification by its Taxation and Finance Committee. The Taxation and Finance Committee formally ratified the statement at its June 13 meeting.

Question I. How much property tax money should the City of Minneapolis plan to spend annually for bonded debt service during the next five to ten years?

Since its establishment in 1952 the Citizens League has taken the general position that under the present structure and administration of the property tax, the tax is at a level in Minneapolis which tends to place business enterprise in the City at a competitive disadvantage, with a resultant discouraging effect on business-created employment as well as earnings. During this time the property tax for City purposes has increased from 107.855 mills to 125.98 mills. Moreover, the tax for State, County and district purposes has risen from 36.687 to 45.53 mills.

Many of the operating fund millage increases accounting for the overall rise in the City millage were supported by the League as necessary because of pressing needs for such governmental services as schools, parks, and general current expenses and the lack of an immediate alternative revenue source. However, attached to this support was the strong emphasis that these were unusual needs, and that to meet continually growing service needs of the City without further aggravating the property tax burden, and indeed to reduce the property tax, the City must find a major non-property tax source of revenue.

As early as 1954, after a thorough survey of the City's taxation problem, the League recommended adoption of an earnings tax as the single best non-property tax source capable of relieving the property tax and meeting service and capital improve-

ment needs. The League also backed a wheelage tax, utilities taxes and service charges.

The League sought to have an earnings tax approved by the Legislature in 1955 and also, after approval by CLIC's finance task force, by the Legislature in 1957. It also worked for a wheelage tax statute in the 1957 session.

In view of these conditions, the League believes that the average property tax rate for bonded debt service during the next five to ten years should not exceed the current rate of 18.20 mills. In fact, we prefer to see it reduced, if anything, by the use of a new non-property tax revenue source.

Question II. How much bonded indebtedness should the City of Minneapolis carry?

Question III. What policy should the Board of Estimate and Taxation follow with respect to the maturity of bonds issued?

Question IV. What is the maximum amount of net debt bonds which should be issued annually during the next five to ten years?

Basic to any policy of issuing bonds for capital improvements are a sound organization and procedure for orderly planning of the City's capital needs. Within the restrictions of the policy outlined below, we believe the decision as to whether the City should expand or contract its borrowing for capital purposes will depend on the size and urgency of capital improvement needs as determined in a foresighted planning process.

We believe that, aside from borrowing for emergencies, the City has two types of projects for which it should issue bonds. The first are projects to replace worn out or obsolescent existing plant. Examples are school buildings, fire stations and streets. The second are capital improvements needed because of growth, additional services and readjustment. Examples are new school buildings, storm sewers and improved streets to meet heavier traffic needs.

The first, or "replacement" type project, ideally should be financed out of current revenues, since it is in the nature of maintenance and rehabilitation, can be anticipated with reasonable accuracy and requires a reasonably constant level of

expenditure. Lacking current revenue resources for this purpose, however, the City must use bond moneys or else see its existing plant run down, with resultant higher costs of later replacement and lower standards of service in the meantime.

The City should first allocate annually from its debt service revenue enough money to provide for the necessary level of these annual "replacement" projects. This might amount to $3,000,000 to $5,000,000, but should be determined as accurately as possible by responsible City agencies on the basis of careful study and planning. (1)

Since these expenditures would ideally be financed out of current revenue resources, the bonds issued for these projects should have relatively short maturities, perhaps within the 10 year maturity program followed by the Board of Estimate and Taxation in recent years.

After allocating from debt service revenues enough funds to take care of the short term bonds issued for annual plant "replacement" needs, the City should consider the remaining debt service revenues available for financing the second type project -- new capital improvements. The maturities of bonds for these purposes need not necessarily be kept short but should not exceed the useful life of the improvements. Whether longer or shorter maturities should be used will depend on the urgency and size of the need, since long maturities will be required in order to issue more bonds in the early years. The greater the number of bonds issued in the early years, of course, the fewer bonds will be available for later issue until the bonds issued in the early years are retired.

****

(1) The City Comptroller's annual financial report for the period ending December 31, 1957 shows City fixed assets other than land totaling about $90,000,000. These are original cost figures, but probably the depreciation factor is offset to a great extent by the inflationary factor. However, these figures do not include the estimated value of city streets. In 1951, before street valuations were taken out of the report, they were valued at about $100,000,000. All things considered, the City's replaceable capital plant is probably worth at least $200,000,000, on a conservative basis. Assuming an average 50 year life, the City would need to allocate at least $4,000,000 a year to meet the normal wearing out and obsolescence of this plant. A minor portion of this might be covered from non-property tax sources, such as State Highway Aids.

In summary, we believe that:

(1) The property tax levy for debt purposes should not exceed the present 18.20 mills, and preferably should be lower.

(2) Responsible city officials should first determine the amount of money needed annually to provide for regular replacement of depreciated and obsolescent existing plant.

(3) These needs should have first claim on annual bond allocations (except where emergency needs arise), and bonds for their financing should have relatively short maturities.

(4) Responsible City officials should then determine, by careful study and planning, capital needs arising from growth, added services and readjustment. Bond issues for these purposes should be limited by these factors:

(a) Debt service charges for these bonds from property tax sources should not, when added to debt service charges for "replacement" bonds, exceed 18.20 mills.

(b) Maturities should not exceed the life of the improvements financed.

(c) A reasonable margin of legal borrowing power should be kept available for unforeseen contingencies.

(d) Bonds should not be issued for these purposes in such amounts as to make it impossible to issue sufficient bonds in the future to take care of the "replacement" needs within the 18.2 mill property tax levy for debt service.

If these policies are pursued, the fact that the net debt is increased or decreased in a particular year is not of major significance.

The specific effects of the policies in terms of an immediate expansion of outstanding debt will depend on the City's determination of the level of "replacement" bonds. The higher this annual level, the greater the limitation on a possible "crash" program to provide funds for the new capital improvements.

The extent of this limitation may be illustrated by these facts:

(a) 18.2 mills produce approximately $6,950,000 of tax revenue at the present time.

Rev. 6/4/58

(b) About $900,000 of this tax revenue must be used to pay interest on the debt now outstanding, leaving $6,050,000 available on the average for annual capital expenditures.

(c) The City's existing bond program contemplates average new bond issues of $7,000,000 per year.

(d) If the existing program is maintained indefinitely, or if a program involving greater average annual bond issues is adopted, it would be impossible in the long run to maintain a maximum debt levy of 18.2 mills.

We recognize that holding to the policies we have outlined may force the deferment of new capital projects, which in the long run could retard the community's economic expansion. But we also feel that adding to the City's already high property tax rate under present circumstances and neglecting plant replacement in the long run will do even more damage to the City's economy. If deferment of new capital improvement is forced, under these policies, we would suggest that the way to avoid it is to develop non-property tax sources.

Rev. 6/4/58