General Fund Levy

Attestation Engagement—Review

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I. *Introduction and Scope*

Property taxes are likely considered one of the most unpopular among citizens. The often cited reason is how they continue even after a given transaction. For instance, sales taxes occur at the point of sale. Income taxes are commonly withheld through payroll on a paycheck. With property, however, despite being fully owned taxes on it persist into perpetuity—albeit proportional to the assessed value of the underlying personal property or real estate. In light of this reality, there is quite the continuing political push from voters seeking reductions in their property taxes. People are more willing it seems to pay a consumption-based, voluntary system of taxes (i.e. sales) than one on the necessities of life like work, shelter, and vehicles. Groceries are frequently taxed at a lower state sales tax level for food stamp eligible items, per Revised Missouri Statute (RSMo) 114.014, but full local sales taxes apply.

Consequently, when taxes are adopted annually for County government by the Commission and before September 20th (RSMo 137.055), its property taxes and revenues come under much scrutiny. While most property taxes actually derive from one's local school district or even city, the bill itself is sent out by the County Collector. The County Assessor determines the assessed value as well. Hence, there is an overwhelming association of all property taxes with the County. Indeed there can be numerous other entities on an individual's property tax bill breaking out the various distributions—such as your community college, public library, and the State of Missouri. The County services portion can in fact be as low as roughly 5% or less of the overall property tax. Nevertheless, the return address and letterhead on property tax statements make their appearance entirely County-related. Further, taxpayers remit their payments on the County's website or in person at the Courthouse or Annex. This is because the Collector collects property taxes for all the other jurisdictions.

Due to this rather insurmountable perception, it is a popular position for Commissioners to look at cutting the County's relatively low property tax levies—particularly its General Fund levy. Currently, the County only has two separate levies for its General Fund (100) along with its Road & Bridge Fund (220). Those rates are 0.0532% and 0.0766% per $100 of assessed valuation, respectively. The Commission does name Board members for the outside agencies of Senior Services, Mental Health and Developmental Disabilities (DDRB). Their present respective levies, also approved by the Commission, are 0.0470%, 0.0942%, and 0.1130%. Summed together, the County's overall rate is effectively 0.3840%. Still, the County generates most of its revenues from a sales tax of 0.75% and 0.125% for Law Enforcement. An assortment of fees collected from different departments additionally supplement total County revenues.

Although the County has so far largely seen a negligible impact from the COVID-19 pandemic on its sales and property tax revenues, the potential implications from reducing its General Fund property tax remain significant. Therefore, this audit will explore what that specific toll would be on the County's budget picture. The ultimate goal is to provide the existing and future Commissions with an idea of what would be required in order to enact such a tax cut. It is essentially a timely and relevant fiscal note on the legislative theory before levies are set.

In accordance with Generally Accepted Auditing Standards (GAGAS), the audit is a type of Attestation Engagement called a Review. Reviews call for the auditor to reach conclusions based on sufficient and appropriate evidence. No opinions or recommendations are delivered, meaning there are no corresponding responses from management of the auditee. This sort of audit was chosen over alternatives on account of an ongoing citizen-petitioned performance audit by the State Auditor's Office plus the annual financial statement audit done by an external firm.

II. Background and Audit Plan

To give proper context, this section describes the statutory background behind the County's sales and property taxes. We will also aim to better detail the formulaic process involved with setting property tax levies, as similarly governed by Missouri law. To begin, RSMo 137.065 caps the General and Road & Bridge property tax at 0.35%, and that can only be increased by a vote of the people. Then, Missouri Constitution Article X, Section 22(a), referred to colloquially as the Hancock Amendment, mandates that a County must annually adjust its levy to receive no more revenue than it did in the previous year—after accounting for changes in the assessed valuation base and inflation. In other words, counties must "rollback" their levies if assessed values broadly increase—so as to prevent a government windfall of money.

The other side of the property tax equation is, oddly enough, sales taxes. This is because when the Commission put the original sales tax question on the ballot in November, 1979, its specific language, pursuant to RSMO 67.505, said:

"Shall the County of Clay impose a County-wide sales tax of ½ of 1% and reduce its total general fund property tax levy annually by 50% of the total amount of sales tax revenue collected in the same year?"

Later in November of 1987, the Commission put another ¼ of 1% sales tax on the ballot, which likewise passed, but it had no similar link to property tax reduction. That is how the County arrived at its cumulative 0.75% sales tax rate for general operations.

During succeeding years, the ballot language has been interpreted by the State—who certifies the County's levy decisions every September— in RSMo 137.073 and elsewhere to mean that the "sales tax reduction" applies to the maximum property tax rate at its inception (0.35%). Any voluntary levy reductions taken by a Commission figure in to that cap by reducing it even more. Otherwise, the general property tax levy would have already been zeroed out by now. Yet, with our General Fund rate at a mere 0.0532%, it is clear that sales tax reductions have brought it closer and closer to nothing anyway.

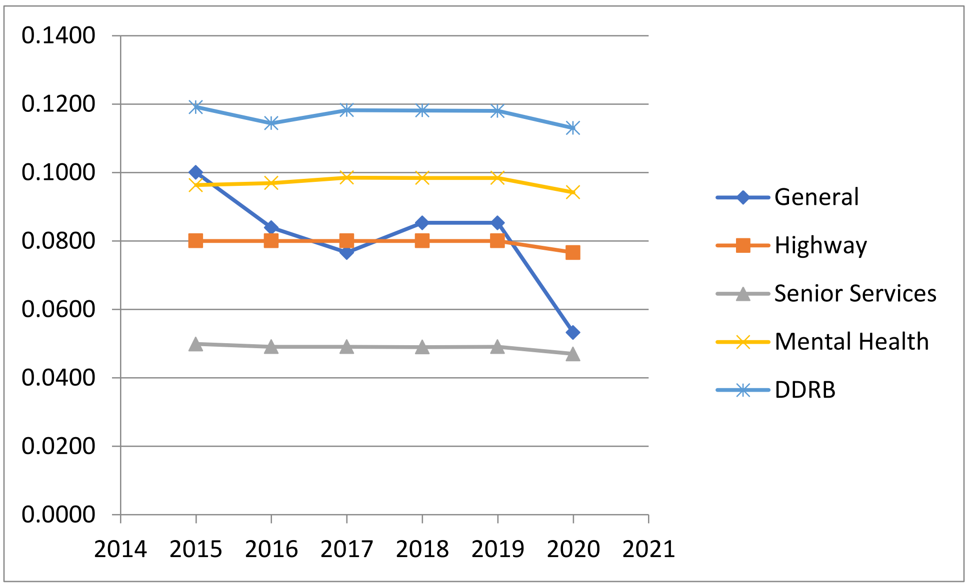
As for the Road & Bridge property levy of 0.0766%, our earlier audit of the Highway Department covered the perils of lowering that rate any further. Legal settlements from 2012 with incorporated Road Districts demand that the County true up its rate to 0.14% for them per RSMo 67.548 and supplement that with some sales tax dollars (50% of revenues from $7 million to $9 million). As a result, this audit will not analyze the possibility of any extra cuts to that levy. There is a Parks levy option as well, but it is at 0.00% as having not been utilized. Nor we will address the social services levies from Senior Services, Mental Health, and DDRB.

Turning to the Audit Plan in brief, this Review will thus first spell out the recent trends over the last five years with respect to sales tax and General Fund property levy revenues; included in that discussion will be the assessed valuation status for the County amid these economic times. Next, we intend to focus in on especially the General Fund's financial condition. We will iterate its own trends in the same timeframe, the last five years of 2015-2019 and YTD 2020. Attention will be paid to the budgetary appropriation diversion of sales tax revenues for general operations to other special revenue funds like Highway, Parks, and Law Enforcement (on top of the Law Enforcement Sales Tax). This pattern has had a tremendous ramification on the balance of the General Fund. Finally, a sundry of scenarios will be tested to discern the effect of any more rate cuts to the General Fund levy on the General Fund.

III. <u>Audit</u>

- **Trends of property tax levies and assessed valuations**

Going back to 2015, or the last full five years, we initially notice that all County-controlled property taxes have basically decreased on the whole. There was a slight bump up in 2018 and 2019, but that has since declined for 2020 below that starting 2015 threshold. The following graph and accompanying chart depict these facts:



Property Tax	2015	2016	2017	2018	2019	2020	Change	%
General	0.1000	0.0839	0.0766	0.0853	0.0853	0.0532	-0.0468	-46.8%
Highway	0.0800	0.0800	0.0800	0.0800	0.0800	0.0766	-0.0034	-4.3%
Senior Services	0.0499	0.0491	0.0491	0.0490	0.0491	0.0470	-0.0029	-5.8%
Mental Health	0.0963	0.0969	0.0985	0.0984	0.0984	0.0942	-0.0021	-2.2%
DDRB	0.1191	0.1144	0.1182	0.1181	0.1180	0.1130	-0.0061	-5.1%
Total	0.4453	0.4243	0.4224	0.4308	0.4308	0.3840	-0.0613	-13.8%

The General Fund levy certainly stands out for its cut nearly in half amid this time period. The others appear to have remained stable. Glancing at the movement of assessed valuations Countywide in the same interval, we could plausibly see the cause for rollbacks in these rates as attributable to increases in property values.

General Levy Revenue	2015	2016	2017	2018	2019	Change	%
100-405-502	$ 3,725,438.11	$ 3,404,937.34	$ 3,413,158.06	$ 3,741,463.22	$ 3,525,549.84	$ (199,888.27)	-5.4%
Assessed Valuation	$ 3,554,815,341.00	$3,753,556,008.00	$ 3,875,575,121.00	$ 4,041,196,664.00	$ 4,198,115,963.00	$ 643,300,622.00	18.1%

When juxtaposed with the General Levy's income, however, we realize how the sales tax reduction has accomplished a unique and perhaps detrimental effect on the General Fund—regardless of improving property values. Stated simply, the General Fund lost net cash from its own property levy while the economy grew (through 2019). For an explanatory note on the preceding chart, it is worth pointing out that the assessed valuation (AV) from the immediately prior year is what calculates the majority of property tax collections in January of the current year. This is owing to how most taxpayers pay their property taxes near the end of the year when the bills get to them. Those deposits are then settled and reconciled in January of the new year. Considering year-to-date, the 2020 tax year certified AV for 2019 is $4,540,729,864. YTD collections on that AV with the 0.0532% rate are only $2,497,853.32 in the General Fund revenue account line, much lower than 2019. The 2020 AV for 2021 collections as of this writing is $4,666,510,144.

Moving on to sales tax revenues trends, those too have logically increased over the past five years. The General Fund's portion has jumped as well, at least until its 2020 YTD ratio. Once again, the following chart highlights this progression:

Sales Tax Revenues	2015	2016	2017	2018	2019	2020 (YTD)
Total	$ 25,220,022.04	$ 25,919,705.33	$ 26,536,997.17	$ 27,652,898.76	$ 28,787,042.12	$ 18,355,475.07
General	$ 11,054,105.93	$ 11,558,928.70	$ 12,544,095.75	$ 13,373,920.88	$ 14,378,444.49	$ 7,922,302.24
%	43.8%	44.6%	47.3%	48.4%	49.9%	43.2%

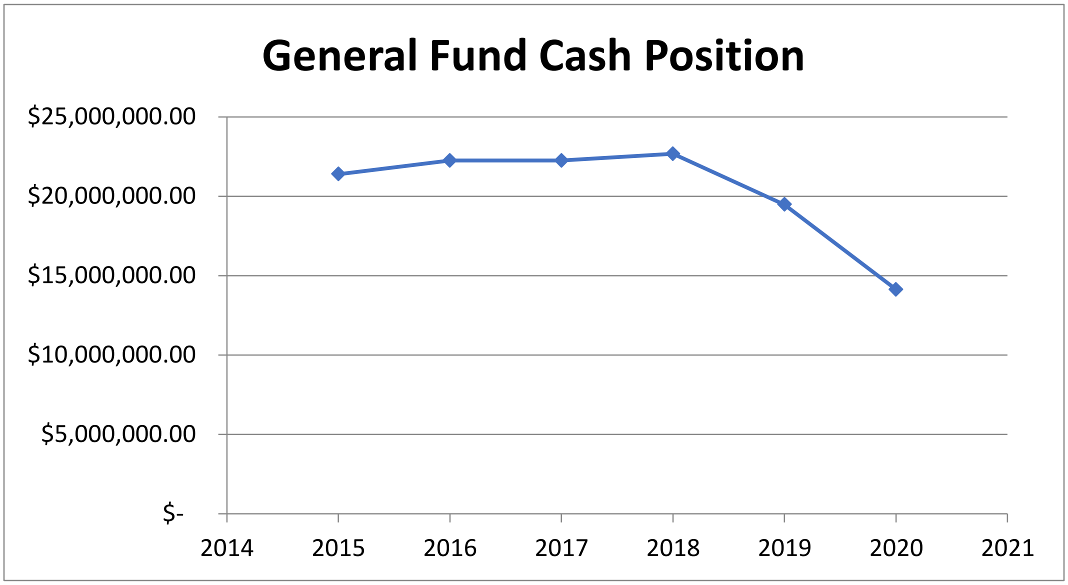
<u>Conclusion</u>: The sales tax reduction on the General Fund property tax levy has led to a marginal decrease in General Fund property tax revenues, irrespective of increasing AV numbers. Sales tax proceeds for the General Fund have largely offset that, but that might not hold true for 2020.

- **General Fund financial condition**

The most reasonable answer as to why sales tax proceeds for the General Fund are all of the sudden reverting back to its lower ratio not witnessed since 2015 lies with the Commission's budgetary sales tax allocation to other funds. What happens is, with every monthly 0.75% sales tax proceeds, these non-General funds get a set monthly amount. The balance then goes to the General Fund of whatever is left. As the below chart reveals, such allocations made a big spike—with the change for Parks greater than the rest—in the most recent 2020 budget approved by a majority of the Commission:

Sales Tax	2015	2016	2017	2018	2019	2020	Change	%
Highway (220)	$ 1,825,428.00	$ 1,950,000.00	$ 1,950,000.00	$ 1,950,000.00	$ 1,950,000.00	$ 1,950,000.00	$ 124,572.00	6.8%
Parks (240)	$ 913,799.00	$ 914,000.00	$ 914,000.00	$ 914,000.00	$ 914,000.00	$ 2,414,000.00	$ 1,500,201.00	164.2%
Law Enforcement (279)	$ 8,354,696.00	$ 8,354,686.00	$ 8,355,000.00	$ 8,354,686.00	$ 8,354,686.00	$ 8,354,686.00	$ (10.00)	0.0%
Emergency Communications (282)	$ 250,000.00	$ 250,000.00	$ 250,000.00	$ 250,000.00	$ 250,000.00	$ 125,000.00	$ (125,000.00)	-50.0%
Law Enforcement Capital Reserve (289)	$ 300,000.00	$ 300,000.00	$ 300,000.00	$ 45,000.00	$ 45,000.00	$ 45,000.00	$ (255,000.00)	-85.0%
Total	$ 11,643,923.00	$ 11,768,686.00	$ 11,769,000.00	$ 11,513,686.00	$ 11,513,686.00	$ 12,888,686.00	$ 1,244,763.00	

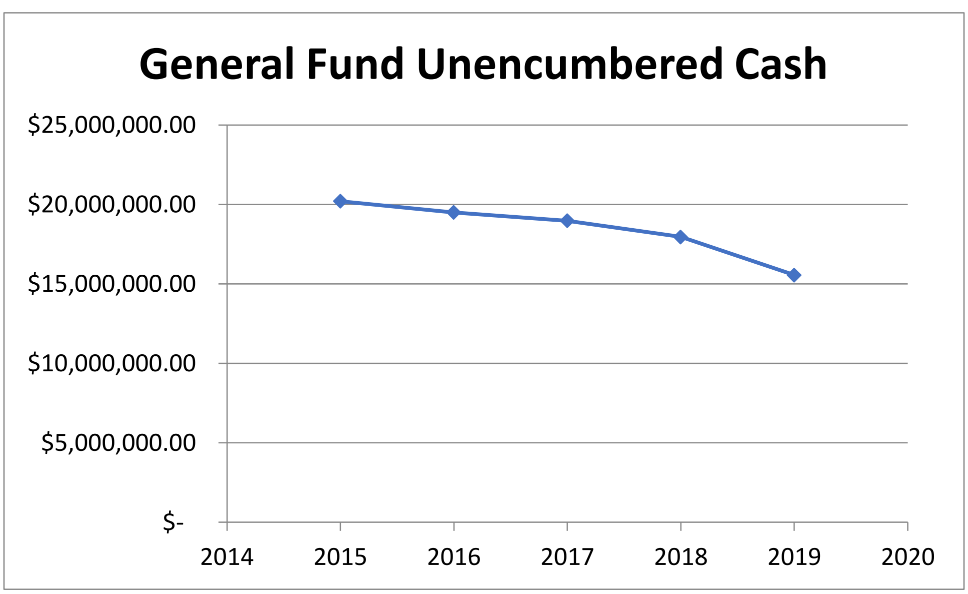
In turn, the lowering of both property and sales tax revenues for the General Fund has contributed to its relative decline in fiscal position. The data presented here display that observation:



End of July Cash	2015	2016	2017	2018	2019	2020
General	$21,389,227.72	$ 22,245,362.26	$ 22,249,422.26	$ 22,669,975.88	$ 19,471,411.14	$14,123,540.50

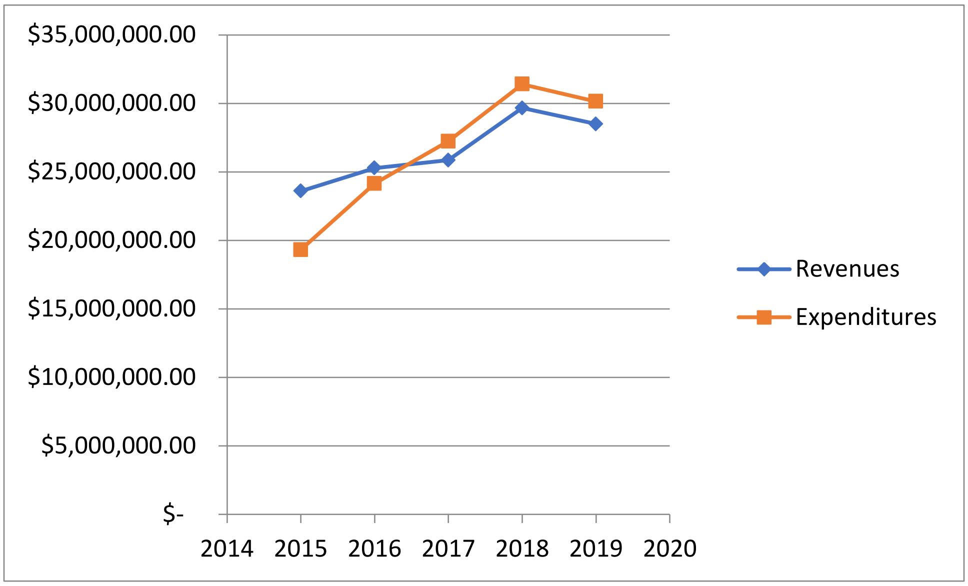
Bear in mind that these statistics are through the end of July in each year, so as to provide a similar comparison.

Revenues are only half of the equation, though. When contemplating the growth of General Fund expenditures, it is apparent that they only compound the cash problem. If we apply a lens on unencumbered cash—that is, that actual cash available after taking into consideration encumbered reserves for contracts and planned purchases—the story is worse:

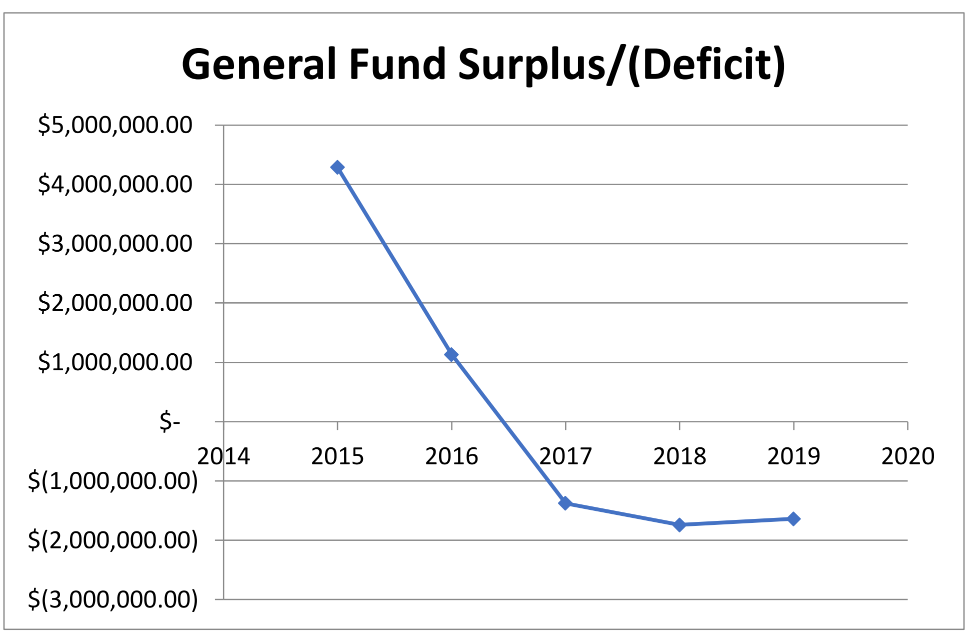


General Fund	2019	2018	2017	2016	2015
Unencumbered Cash	$15,560,194.48	$ 17,954,064.85	$ 18,971,949.86	$ 19,501,509.31	$ 20,203,243.99

As our prior audit on Budget Trends showed, too, the County has failed to spend less than it brings in lately. This is pointedly true for the General Fund. The next graphs and charts help visualize this situation for the General Fund:



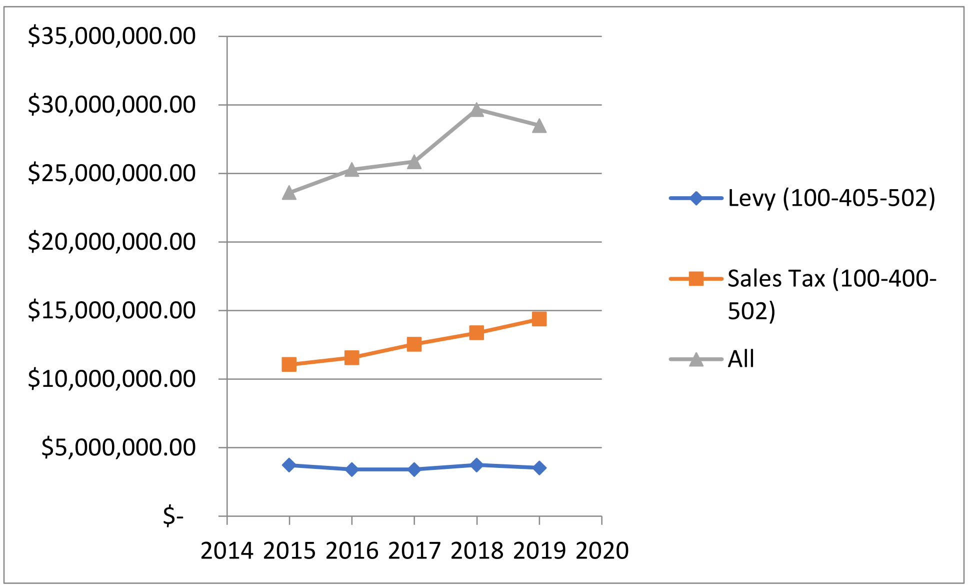
General Fund	2015	2016	2017	2018	2019
Revenues	$ 23,594,934.10	$ 25,283,771.72	$ 25,856,872.76	$ 29,664,072.93	$ 28,492,860.76
Expenditures	$ 19,307,805.97	$ 24,152,730.90	$ 27,234,073.53	$ 31,403,936.99	$ 30,132,009.02
Surplus/(Deficit)	$ 4,287,128.13	$ 1,131,040.82	$ (1,377,200.77)	$ (1,739,864.06)	$ (1,639,148.26)



Conclusion: The annual budgetary allocation of County sales tax to non-General funds diminishes the ability to replace declining General Fund property tax revenues. Greater General Fund expenditures than revenues only accelerate its depleting cash position.

- **Plausible scenarios for General Fund property levy cut**

With the aforementioned perspective, we in conclusion assess any possible options for cutting the General Fund property tax levy. Returning to the General Fund revenue side, this graph and chart in a nutshell portray what is at stake with such a hypothetical cut:



General Fund Revenues	2015	2016	2017	2018	2019
Levy (100-405-502)	$ 3,725,438.11	$ 3,404,937.34	$ 3,413,158.06	$ 3,741,463.22	$ 3,525,549.84
Sales Tax (100-400-502)	$ 11,054,105.93	$ 11,558,928.70	$ 12,544,095.75	$ 13,373,920.88	$ 14,378,444.49
All	$ 23,594,934.10	$ 25,283,771.72	$ 25,856,872.76	$ 29,664,072.93	$ 28,492,860.76
%	15.8%	13.5%	13.2%	12.6%	12.4%

Removing the comparatively small property tax revenue component from the General Fund would nonetheless ultimately force some hard decisions for the Commission in order to achieve an entire balanced budget for all funds.

Expressed more precisely, we have estimated the incremental effect in 2021 of reducing the existing 0.0532% General Fund levy by say one hundredth of a percentage point to 0.0432%. Assuming the 2020 AV of $4,666,510,144, each 0.01% cut would result in a $**476,067.62** loss to the General Fund. Additional possibilities are outlined below:

	2021 Budget Year Possible Rate Change Consequences						
	2021 Budget at 2019 Tax Rate	.0001 Reduction	Change	1/2 Reduction	Change	100% Reduction	Change
Assessed Valuation	4,666,510,144	4,666,510,144		4,666,510,144		4,666,510,144	
General Levy	0.000532	0.000432	-0.0001	0.000266	-0.0003	0	-0.0005
Estimate	2,492,000.00	2,015,932.38	(476,067.62)	1,241,291.70	(1,250,708.30)	-	(2,492,000.00)

Conclusion: For the Commission to feasibly and responsibly cut the General Fund property levy any further, it would need to concurrently reduce General Fund expenditures as well as sales tax allocations to other non-General funds. The General Fund is already hemorrhaging cash and just a percentage point levy cut creates about a half million dollar need on top of that circumstance.

IV. Overall Rating for this Audit

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