2012 Report to

The City of Kansas City, Missouri

CITIZENS' COMMISSION ON MUNICIPAL REVENUE

Report to the Mayor, City Council, and City Manager with recommendations for optimal revenue structure

TABLE OF CONTENTS

6. Utility Tax

7. Business License Fee

8. Other Taxes and Fees

10. Comparison of Revenue Structure and Tax Burden

APPENDICES

1.0 Executive Summary

1.1 About the Commission

The Citizens' Commission on Municipal Revenue (CCMR) was established by Mayor Sly James on July 27, 2011. CCMR members are Kansas City Missouri residents and consist of representatives from diverse geographic, racial, and ethnic backgrounds recruited from among the business, civic, neighborhood, and non-profit communities. A list of those members and brief description of their backgrounds appears in Appendix A.

The mission of the CCMR is to analyze the City's current revenue structure[1], consider the fairness and level of each major source, explore additional opportunities for improvements, and provide the Mayor and City Council with innovative recommendations to improve the City's long-term financial position. CCMR was not tasked with review of spending issues. However, CCMR did review expenses and financial need in the context of designing an optimal revenue structure that will ensure growth, fund basic services, and enable the City to fund dynamic projects. The full text of the Commission's Charter Statement can be found in Appendix B.

1.2 Current Challenges

Independent analyses of Kansas City's revenue structure confirm it to be generally sound.[2] The City relies upon a variety of sources and no single one provides more than a quarter of total revenues. This diversity is a major factor for reliability—revenues are mostly stable, protected from extreme fluctuation, and prior to the recent recession, overall growth was generally strong. Major taxes are efficient to administer, costing about one cent per dollar collected. Property taxes are relatively low, and a majority of other revenues are partially paid by non-residents using City services, easing the overall burden on Kansas City's taxpayers.

But the current structure poses some disadvantages. Several of the taxes are regressive—falling more heavily on low income families. The business license fee and land only

[1] This study reviews General Municipal Revenues which do not include enterprise functions.
[2] "Kansas City Missouri Long-Term Financial Plan", The PFM Group, December 17, 2008 and "Comparative Tax Analysis", Kansas City Auditor's Office, October 2000.

assessments are either inefficient, inequitable, or stagnant. The earnings tax and sales tax rates could negatively influence individual and business location and shopping decisions.

These realities have been in place for some time. But in the last ten years, the following factors have converged to compel this revenue review:

1. Citizens have passed six taxes with sunset provisions and dedications, increasing volatility and uncertainty, while diminishing City Council flexibility to address changing needs. In 2012 dedicated revenues comprise over 60% of total sources.

2. During the recent recession, the City, like other governmental entities felt the impact on its revenue base. Total taxes in 2009, 2010, and again in 2011 remain below collections of 2008, primarily due to significant declines in sales and use taxes. Assuming even a nominal growth rate, this translates into about $120 million fewer resources over the last three years. Although it appears a recovery may be on the horizon, the starting point for collections is lower and the number of years to recoup prior losses uncertain.

3. Missouri voters approved Proposition A which requires earnings tax renewals every five years. Although Kansas City residents overwhelmingly approved a five-year extension through December 2016, the City's long-term financial health is vulnerable to renewal requirements of this critical source of operating funds.

4. Redirections—taxes dedicated to economic development projects—have nearly tripled in the last 10 years and in the 2012 budget they represent over $40 million, or nearly 5% of general municipal revenues.

5. The State of Missouri's "low tax/low service" badge comes at a price.[3] Many services traditionally funded at higher levels by most states, such as health care and transportation, are shifted to the City.

6. The City did not fully leverage opportunities prior to the recession to build adequate reserves, address debt levels, or maintain and improve the City's infrastructure.

[3] See www.mobudget.org/facts_glance.html for comparison of Missouri's per capita revenue and expenditures to national averages.

1.3 REVENUE POLICY

As a first step to address these challenges, CCMR worked closely with Finance Department staff to develop a Revenue Policy that complements the Investment, Debt and Reserves policies currently used by the City Council and management in conjunction with the City's budgeting and financial planning efforts. CCMR reviewed model revenue policies from eight peer cities (Denver, Fort Worth, Memphis, Minneapolis, Oklahoma City, Omaha, St. Louis, Tulsa) and model policies as recommended by three professional organizations (Government Finance Officers Association, National Advisory Council on State and Local Budgeting, International City Management Association).

The policy requires the City to consider seven fundamental characteristics when assessing its revenue structure or when evaluating any tax. CCMR had considerable discussion regarding the relative importance of the seven characteristics and considered each in its review of revenue streams. Of primary significance to CCMR are: dependability of revenue sources, followed closely by equity and diversity. Other important considerations include potential for growth, renewal periods, dedication and ease of administration.

1.4 CCMR RECOMMENDED REVENUE STRATEGIES

The following is a summary of all recommendations. Supporting details and other options considered by CCMR are provided in the body of this report.

Global.1 City Council adoption of the Revenue Policy

The full text appears in Appendix C of this report. The City shall consider, at minimum, seven fundamental characteristics when weighing any changes to its revenue structure or when evaluating the continued levy of any tax. Dependability shall be the City's primary review consideration followed closely by equity and diversity. Other characteristics including potential for growth, renewal periods, dedication and ease of administration shall be considered secondary.

(1) **Dependability.** The City shall include taxes and fees in its revenue structure that produce a consistent level of revenue from period to period.

(2) **Equity.** The City shall consider the fair distribution of tax burden on businesses and residents when considering new, renewing and continuing

revenue sources. Horizontal and vertical equity should be considered when evaluating the distribution of taxes.

3) **Diversity.** The City shall strive to maintain a diversified mix of taxes and fees to protect it from short-term fluctuations in any of its various revenue sources. The City should also support economic policies designed to attract businesses that grow and increase the diversity of its tax base.

(4) **Growth.** The City shall seek to include revenue streams in its mix of taxes and fees that grow over time at a rate that exceeds the rate of inflation.

(5) **Renewals.** In order to reduce volatility, the City shall strive to limit both the dollar amount and number of taxes and fees subject to renewal periods of five years or less. Any newly authorized revenue stream with a sunset ideally shall not be used to fund recurring service delivery costs.

(6) **Dedicated/Non Dedicated Revenue.** Whenever possible, the City shall not dedicate a revenue stream to a specific use or program. Dedication or earmarking of revenue streams does not allow the City to respond to changing economic conditions or service expectations and is dispositive to the City's general credit.

(7) **Ease of Administration.** The City revenue mix should facilitate taxpayer compliance and be applied uniformly. Efficiency in administering taxes and fees should also be considered including source and cost of collection.

Global.2 Further research regarding tax relief options

CCMR considered ways to structure tax relief to low-income individuals, including wage brackets for the earnings tax and credits against the earnings tax for City property taxes paid. Because such relief for low-income taxpayers would also benefit taxpayers across all earnings levels, CCMR was concerned that the revenue loss would be prohibitive. Since equity is the second highest consideration in the proposed revenue policy, CCMR recommends continued discussion and research for methods to mitigate the impact of existing and future taxes on low-income residents.

Global.3 Rigorous testing of sunset provisions

For all future tax and revenue initiatives, the application of sunset provisions should be rigorously tested. If a tax is specifically dedicated to a function with an end date, then such dedication may have a sunset date. In most cases, taxes with a sunset should not be used to fund recurring or operating costs, unless a financial plan adopted by City Council and annually updated by staff clearly shows the elimination of these revenues and all related expenses upon the sunset date.

Global.4 Ensure sunset dates match the life of activity or project

The selection of a sunset date for a sunset provision should be long enough to match the expected life of the activity or project, and made in consideration of all other scheduled renewals, the civic resources to fund campaigns, financial impact on the City budget, and voter fatigue. Renewal periods for taxes and fees should be no less than 10 years.

Global.5 Reinstate a multi-year revenue and expenditure forecast

A forecast should be done in the context of a multi-year strategic plan that clearly identifies priorities for expenditures, investments, and revenue requirements. Proposed changes to the revenue structure, especially plans to increase existing rates, should be incorporated as part of the strategic plan—not considered in isolation, but in relation to all stated priorities.

Global.6 Require future bond initiatives to have new revenue source

Because current debt levels are high compared to peer cities, the impact on the City's credit rating from issuing additional and significant levels of debt must be of primary concern. Credit rating agencies cite explicit voter authorization of new revenue to cover new debt as essential to protecting the City's rating, and ultimately its cost to borrow.

Global.7 Diligent evaluation of tax redirections

Redirections are justified by a "but for" test: the development and resulting tax revenue would not have materialized "but for" the use of tax incentives. But at an estimated $40 million in 2012, the City must remain diligent in evaluation of projects that could result in substitution effects, driving tax revenue away from non-TIF areas, and thereby resulting in lower aggregate revenues. The City should continue to track and publicly report project results against original benchmarks.

Global.8 Incorporate a regional strategy to fund services

The City provides and bears the cost of many entertainment and leisure opportunities for the metro area. The City should leverage opportunities to import revenues from nonresidents who use these amenities, and explore options to fund them on a regional basis to generate broader financial support for, and metro commitment to, those amenities.

Earnings.1 Retain The Earnings Tax

CCMR considered methods of eliminating or reducing the earnings tax. CCMR found those options unacceptable because it would eliminate a tax that is vital to the General Fund budget, and is paid in large part by nonresidents. A complete elimination of the earnings tax would hamper the City's ability to fund basic services; and full replacement would require large increases in sales and/or property taxes. Furthermore, since half of the earnings tax is now paid by nonresidents, the burden of funding services that benefit all metro area Missouri and Kansas residents, whether they work in the City or visit the multiple cultural and entertainment offerings in the City, would shift disproportionately onto Kansas City residents.

Earnings.2 Pursue Legal and Legislative Relief of Proposition A at State

To protect the City's largest single source of revenue, CCMR recommends aggressive pursuit of both legal and legislative relief at the State level regarding Proposition A. This renewal requirement is cited by credit rating agencies as a significant concern, placing a major funding source for general operations at jeopardy. At a minimum, the State has the power to extend the election cycle to something longer than five years. CCMR recommends renewal periods of no less than 20 years.

Earnings.3 Forego Dedication of Earnings Tax

Although there are some discussions to dedicate the earnings tax to capital improvements, CCMR recommends the tax remain undedicated for the following reasons:

- 78% of the citizens voted to continue the earnings tax in its current form. The potential loss of basic services appears more compelling than cuts to capital maintenance.
- Dedications to capital projects often lead to a "divide by six" situation—ensuring each district receives a share, but ultimately giving citizens more reason to oppose the tax, and perhaps not address the highest priority needs.
- Dedication of revenues ties policymakers' hands so they are unable to respond to changing needs without endangering taxpayer trust.

Sales.1 Support State Legislation to Implement Streamlined Sales Tax Agreement

Legislation to ensure equitable collection of sales tax is currently under consideration in Missouri and has received bipartisan support and the endorsement of the business community. Although the State cannot collect sales taxes on remote sales, a use tax is still due. There are 24 states that participate in Streamlined Sales Tax, including all of Missouri's surrounding states with the exception of Illinois. Most cities in states who have implemented this have realized some increase in use tax collections. The Streamlined Sales Tax Agreement would institute a mechanism designed to make the current sales and use tax easier to compute and close a collections gap, and also sets the stage for if and when the Federal government approves taxation of internet sales.

Sales.2 Do Not Renew Fire Protection Sales Tax; Replace with Capital Improvement Sales Tax Effective January 1, 2017

CCMR recommends against renewal of the 1/4 cent sales tax for Fire Protection. This tax has a sunset and currently funds operating expenses in violation of the proposed Revenue Policy. Additionally, infrastructure is a high priority, so the City should ask voters to approve a 1/4 cent capital improvement sales tax effective January 1, 2017, upon expiration of the Fire Protection Sales Tax. The revenues would then be used to partially address the considerable infrastructure backlog in the Mayor's $1 billion plan. Given low interest rates, local capacity for construction projects, and the pressing need to begin now, CCMR recommends the Finance Department continue to evaluate the use of alternative financing structures such as capital appreciation bonds and capitalized interest secured by a capital improvement sales tax. Such a structure could fund about $150 million or 15% of the total $1 billion plan. CCMR acknowledges this recommendation related to the Fire Protection Sales Tax requires the City to plan for a $16 million operating budget gap for Fire operations.

Sales.3 Expand the Sales Tax Base to Cover More Consumer Services

CCMR recommends that a review of existing sales tax exemptions, and opportunities to expand the base, be added to the City's legislative agenda as a high priority. Recommendations to eliminate consumer services exemptions should consider the impact on low income households and on the competitive position of the City.

Sales.4 Renew General Sales Tax for Capital Improvements

CCMR recommends renewal of the capital improvement sales tax in 2018, with a longer renewal period (15-20 years) and ordinance language broad enough to allow more flexibility to respond to changing needs.

Sales.5 Use Economic Development, Transportation, & Capital Improvement Sales Tax Authorizations for Projects Focused on Population and Employment Growth

CCMR reviewed the statutory uses of an Economic Development Sales Tax. The City has authority to levy up to 1/2 cent for purposes that include installation of infrastructure for industrial or business parks; improvement of water and wastewater treatment capacity; extension of streets; and public facilities directly related to economic development and job creation. At this time, CCMR has no recommendation regarding this tax but believe any future use of the Economic Development, and/or Transportation, and/or Capital Improvement sales tax authorities must be invested in projects that ultimately lead to population and employment growth and retention.

Property.1 Implement Plan To Leverage State Property Tax Credit

Because the State of Missouri Property Tax Credit Claim has no cost to the City, but is an important way to bring tax relief to lower income Kansas City citizens, the City should implement an annual procedure to reach low to moderate income senior citizens and disabled taxpayers to encourage them to file for the State of Missouri property tax credit.

Property.2 Repeal Motor Vehicle License Fee and Land Only Assessments, Replace with 1/2 Cent Sales Tax for Parks and Storm Water

CCMR recommends that the Mayor and City Council place before voters this August a 1/2 cent sales tax for Parks and Storm Water, 60% allocated to parks and 40% for storm water. The estimated annual amount the tax would generate is approximately $32 million. Voters would be asked in the same ballot issue to repeal the following property taxes and fees:

1. Motor Vehicle License Fee which provides approximately $3.5 million for Community Centers and park maintenance, and expires in August.
2. Boulevard Tax which is currently $1.00 per foot and generates $600,000.
3. Parkway Maintenance Tax levied on land-only and generates $6.6 million a year.
4. Trafficway Maintenance levied on land-only, and generates $3.3 million for Public Works. To replace this funding for Public Works, the General Fund transfer to the Parks Department would be reduced by the same amount.

The total of the repealed taxes would be $14 million. The net effect for the programs would be as follows: $5.2 million net annual increase for Parks to maintain existing properties and programs; $12.8 million annual increase for storm water improvements, which would be used to partially offset future wastewater rate increases.

Because the motor vehicle license fee expires this year, it is the recommendation of CCMR that this proposal be placed on the August 2012 ballot.

Property.3 Renew the Temporary Health Levy Contingent Upon Supreme Court Decision on Affordable Health Care Act

If the Patient Protection and Affordable Care Act is upheld by the Supreme Court (i.e., retains subsides targeted at low income individuals to purchase health insurance policies), CCMR recommends that voters be asked to renew the Temporary Health Levy in 2014 for no more than four more years. If the Affordable Health Care Act is overturned, CCMR recommends that the City Council determine how much, how long, or if the temporary levy should be extended in light of other priorities of the City.

Property.4 Address Capital Infrastructure Backlog with Property Tax

CCMR supports the Mayor's vision to tackle the sizeable deferred maintenance and infrastructure backlog without further delay and considers this investment a key component for attracting and retaining population. To that end, CCMR supports property tax levy increases to pay for the Mayor's $1 billion infrastructure program, mitigated with a 1/4 cent sales tax that can spread some of the burden to non-residents (see recommendation 4.5.2). CCMR considered one scenario that funds the Mayor's plan with the new 1/4 cent sales tax and average increases to the property tax levy of about 10 cents per year beginning in 2014, resulting in a cumulative property tax impact on the average taxpayer of $200 over the ten year period. CCMR acknowledges that this is just one of many scenarios that should be considered in order to optimally structure a financial investment of this magnitude.

Utility.1 Retain Emergency Rate for Commercial Customers

Retain the 4% emergency rate levied on commercial customers but do not restore the emergency tax on residential users. Research the origins of the terminology "emergency" and consider removal of this designation.

Other.1 Bring Closure to Business License Fee Reform

CCMR believes that it is important to address the Business License Fees. The business license taxes have been the subject of several studies or reports, all of which recommended that they either be eliminated or made more equitable. To that end, CCMR will continue its work on this issue for several more weeks, working with the business community and other stakeholders, focused solely on business license reform, with plans to issue an addendum report mid-summer that will attempt to bring closure to a 15+ year conversation.

Other.2 Expand Convention & Tourism Tax Base to Include Non-Profit Entities

CCMR supports the position of the Convention and Visitors' Bureau and recommends the City pursue a change in the enabling legislation for convention and tourism taxes, removing the current exemption for non-profit entities. Most cities do not offer this exemption, and the Bureau does not feel it would limit the City's ability to attract non-profit conventions.

Other.3 Evaluate Sin & Sugar Taxes to Fund Health Care

Should the Affordable Health Care Act be overturned, CCMR recommends the City evaluate sources other than the property tax to fund health care expenditures. These could include increases to existing alcohol and cigarette taxes, or a new tax on "junk" food.

2.0 Considerations and Constraints

2.1 Fact-finding and Deliberations

CCMR held an organizational meeting on August 15, 2011 and two weeks later began a regular series of public meetings, each approximately two hours in length, meeting frequently through the final meeting on May 21, 2012. Additionally, CCMR heard public testimony at two hearings in neighborhoods, north and south of the river. The public meetings were held November 15 at the Northland Chamber of Commerce and November 21 at the Southeast Community Center.

CCMR heard testimony and received presentations from the Mayor and City Council members, city staff, and business and civic leaders (see acknowledgements in Appendix D). CCMR reviewed past reports on the status of city finances and national studies from organizations such as the National League of Cities and the Government Finance Officers Association. Analysis conducted by CCMR frequently included a comparative review of peer cities (Midwestern cities of similar size) and other municipalities in the metropolitan area. This wealth of information from an extensive array of sources and the life experiences of the various Commissioners all served to inform its deliberations and this report.

CCMR attempted a holistic review—reaching out broadly and seeking ideas to address Kansas City's revenue needs. Various interest groups and members of the general public offered ideas. This report is the cumulative product of that work.

2.2 Overarching Themes and Beliefs of Commission Members

It is the position of CCMR that the City's revenue structure is generally sound, uses best practices (diversity and efficiency), incorporates recommended principles (horizontal equity), and has no glaring deficiencies in its current composition.[4] The City's General Fund relies upon a diverse mix of revenues from earnings, property, and utilities taxes that are relatively efficient to administer, as well as fees, charges, licenses, and permits. This is considered a "best practice" for a revenue structure, providing greater stability and protection from economic fluctuations than over-reliance on one or two key revenue streams. In addition, the City receives funding from sales taxes that are dedicated to

[4] "Kansas City Missouri Long-Term Financial Plan", The PFM Group, December 17, 2008, pp 1, 12, and 15.

purposes other than General Fund operations, further diversifying its overall revenue mix. This diverse revenue structure spreads the tax burden across businesses, residents, non-residents working in Kansas City, and visitors, each of whom benefit from and consume public services (horizontal equity). Generally, businesses taxes are low compared to national averages. Of concern is Kansas City's generally high ranking with regard to State and local combined individual tax burden for most income groups (vertical equity).

CCMR recognizes that any assessment of revenue structure must be considered in the context of other important issues, both internal and external to the City.

2.2.1 Internal Considerations

ACCOUNTABILITY TO CITIZENS

Citizens' assessment of effective use of revenues and satisfaction with services is critical, for citizens must believe they receive high value for tax dollars spent. CCMR supports current efforts to track trends in citizen satisfaction and trust. Although fewer than 20% of citizens surveyed in 2011 reported dissatisfaction with the overall quality of services and overall quality of life in Kansas City, almost 40% reported "dissatisfied/very dissatisfied" when asked to rate the value received for city tax dollars and fees paid. Too many citizens feel they are paying too much, a belief that may impact their willingness to support new tax and fee proposals or retain current ones.

The City must build on citizen trust by ensuring that all promises made are fulfilled. In this way, citizens are more likely to support new proposals. CCMR supports efforts to improve information regarding how tax dollars are spent and encourages staff to identify ways to further increase transparency and build on the recently improved public trust. (include citation from Mayor's office)

TAXPAYER BURDEN

Tax fairness is one goal of a high performing revenue structure. Tax burden can be a factor for business location decisions and a factor for individuals choosing a place to live. The recent popularity of single-purpose initiatives has produced a nearly 8% sales tax in most areas of the City, rising to as much as 10% in certain special districts, a high burden for those at the bottom of the income ladder. CCMR believes any review of revenue structure must consider the entire "package" of taxes placed on individuals and businesses.

CCMR reviewed three reports estimating State and local combined tax burdens in Kansas City, Missouri. The Finance Department of Washington D.C. publishes an annual tax burden study, estimating the combined major state and local taxes for a family of three at various income levels living in the largest city in each State. In a 2010 ranking from 1 to 51, 1 being the highest tax burden, Kansas City ranks between 6 to 13 for the five income groups studied, putting Kansas City residential tax burdens in the highest 25% across all income groups. The income tax rate for Kansas City residents is slightly above the national average across all income groups, the effective property tax rate is slightly below the national average, and the sales tax rate is about 10% higher than the national average. Additional detail and comparison to peer cities appears in Appendix E.

The Anderson Economic Group issued its 3rd annual study of business tax burden, ranking the results of all 2008 state and local taxes levied on businesses within each state. Missouri's business taxes as a share of profits are 12.1%, well below the national average of 16.7%, placing Missouri in the ranks of the ten states with the lowest business tax burden.

The Quantitative Economics and Statistics Practice (QUEST) of Ernst & Young LLP in conjunction with the Council On State Taxation (COST) released its 9th annual report of state and local taxes paid by businesses in fiscal year 2010. This is a slightly different measure in that it looks at total collections of business taxes as a share of total economic activity occurring in the state, not business profits. This measure of tax effort ranks Missouri in the mid-range nationally.

EXPENDITURE PRIORITIES

CCMR recognizes that basic services cannot be compromised and that citizens want quality services at a reasonable price. Kansas City has had too many years of deferred maintenance. Those decisions to under-fund basic services and infrastructure mean the City now faces an exponentially growing gap between sources and needs. CCMR recommends the City reinstate a multi-year revenue and expenditure forecast. This must be done in the context of a multi-year strategic plan that clearly identifies priorities for expenditures and investments. It proved difficult to consider future revenue requirements without long term strategic and financial plans that identify priorities to guide investment decisions and a detailed interactive modeling of needs with scenarios of investment priorities. CCMR recommends a similar and companion review of spending policies and practices.

2.2.2 External Considerations

ECONOMIC COMPETITIVENESS

CCMR believes the City's primary strategy and focus must be on expansion of the tax base. The City must have a clear plan and tactics to increase residents (i.e., repopulate the urban core; achieve targeted population levels for downtown, capitalize on new growth opportunities in the Northland), encourage new business formation or business location within the City, and reduce loss of the same in order to have net gains.

Since 2001, Kansas City experienced a net loss of about 14,000 jobs driven mostly by losses in construction, manufacturing, transportation, amusement/recreation, utilities, and information sectors. Losses in construction, manufacturing and information sectors mirrors the experience of other cities locally and nationwide. The City has employment gains in professional and technical services, education and health services, and health care and social assistance sectors, and today represents 55% of the region's total employment, compared to 26% of the region's population.[5]

Kansas City tax policy is just a piece, perhaps a small piece, of what impacts location decisions for individuals and businesses. Other issues such as a high quality labor pool, public safety, quality of life, housing stock, schools, transit, and access to shopping and other amenities are probably more influential. CCMR believes the best way to enhance revenues is to make the City a "preferred product" of families and businesses.

CCMR believes the Kansas City Missouri School District (KCMSD) is a strong driver of relocation decisions made by families with financial ability to move, from the core city. Some families may relocate within the City in one of the other 12 school districts but some families relocate outside the City. CCMR thinks an effort to quantify and track the effects of these decisions on both revenues and expenditures could be important for City Council deliberations regarding economic development.

[5] Economic and Demographic Trends, Frank Lenk Director of Research Services, MARC, November 7, 2011

CCMR acknowledges the work of the Economic Development Commission, AdvanceKC, in its effort to provide guidance for key investments and the efforts of the Small Business Committee and their recommendations to create a positive, business-friendly customer service culture and to have Kansas City "partner with the business community for our shared success." CCMR encourages aggressive implementation of those recommendations.

Overlapping Governments

While CCMR conducted a holistic view of the municipal tax structure and burden, from the taxpayers' perspective the municipal level is just one piece of the tax structure. Efforts to eliminate the state income tax and other tax "reform" conversations and efforts are outside of CCMR's charter, but nevertheless must remain important considerations for staff and Council.

2.3 Constraints

Revenue reform must consider challenges from the State Constitution; statutory, regional, and political obstacles; and capital market constraints.

2.3.1 The State Hancock Amendment limits local taxes in four ways: new taxes must be approved by simple majority, increases in levies of existing taxes must be approved by voters, changes that broaden the tax base require a levy reduction to yield the same estimated revenue, and increases in assessed valuation of property by a greater percentage than the increase in the general price level from the previous year requires a rollback in the property tax levy. The Hancock Amendment also specifies that any taxpayer of the taxing jurisdiction may sue to enforce its provisions, which makes challenges to new revenue initiatives easy, with the City bearing litigation costs if the taxpayer wins. In practice this means the City must seek voter approval for all new and increased taxes and some fees.

2.3.2 In the last decade, Kansas City voters have granted Kansas City new taxing powers, but for a limited period of time and specified purposes. As of the date of this report Kansas City has 7 tax levies with sunset provisions, often supporting functions that don't have a true "sunset". Elections have their own administrative and financial costs. These costs, combined with the potential nonrenewal of taxes supporting important functions whose funding could shift even more expenditures to a fiscally-strapped General Fund, are obstacles to revenue reform.

2.3.3 Because the decision to go before voters is rarely a regional conversation, special interest groups and other overlapping taxing jurisdictions submit single-purpose ballot initiatives that reduce tax capacity, and may compete with or even oppose City priorities.

2.3.4 Kansas City is located in a metropolitan region that spans two states. The City's tax structure is one determinant of its relative position to both inter-city and cross-border competition. The City must remain mindful of tax rates as they compare to surrounding jurisdictions, and ensure these do not become hurdles in efforts to attract and retain residents and employees.

2.3.5 Kansas City has benefitted from revitalization efforts that have been spurred by Tax Increment Financing (TIF) and Super TIF (STIF) agreements. Under these development agreements the City transfers (redirects) some combination of economic activity taxes and payments in lieu of taxes to reimburse qualified development expenditures. Redirections of revenue are justified by a "but for" test: the development and resulting tax revenue would not have materialized "but for" the use of TIF/STIF. But the City must remain diligent in evaluation of projects that could result in substitution effects, driving tax revenue away from non-TIF/STIF areas, and thereby resulting in lower aggregate revenues.

2.3.6 The City's credit rating directly impacts the price it pays to borrow funds. Credit rating agencies cite the City's revenue stability and diversity as important strengths. They cite the following weaknesses or concerns related to the City's financial condition: long-term risk related to earnings tax renewal, insufficient reserves, and an overall debt burden that is high relative to the City's peers. Revenue reform must protect the City's ability to access credit markets at a reasonable rate.

2.4 FINANCIAL NEED

Discussion of financial need as it relates to revenue structure addresses two key revenue characteristics: dependability and growth. Does the current structure generate adequate revenue to fund services currently demanded by citizens? And over the long term will revenues support projected expenditure needs?

Although state law and the City Charter require the City Council to adopt a balanced budget, the City has implemented significant spending reductions in each of the last five years to achieve that balance, including a 20% reduction in non-public safety positions funded through general municipal revenues. More than half of the positions eliminated were in Park Maintenance, City Planning and Development, Street Maintenance and middle management. Other significant changes include closing the Municipal Correctional Institution, closing the greenhouse, privatizing the Animal Shelter and Aquatics Operations, and reducing the number of city departments.

The fact that these reductions have been persistent, and in some cases increasing, points to a structural imbalance that without additional resources will lead to even more austerity measures and disruption of city services. With the global economic recession in 2009, the City's underlying financial problems have been magnified.

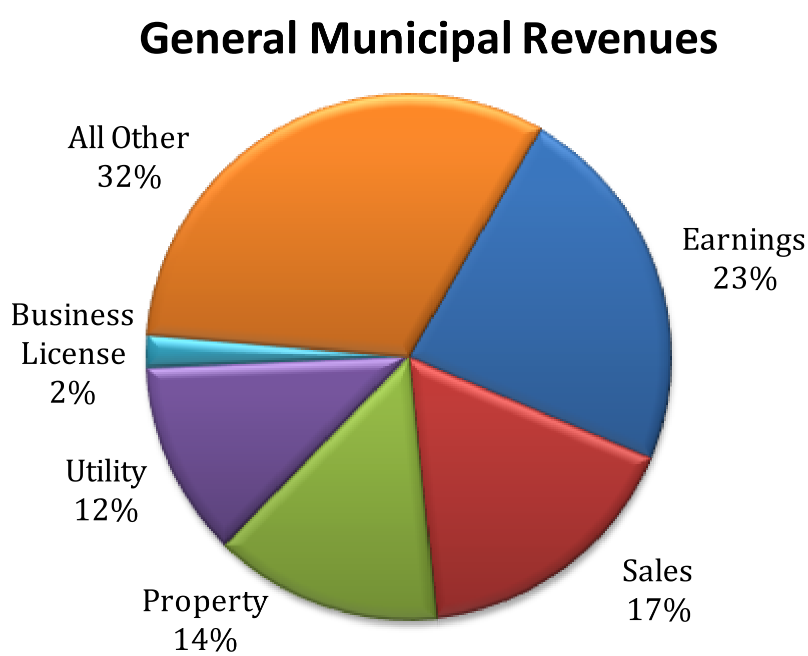
In March 2012, the Director of Finance presented a sober picture of future financial need. CCMR reviewed a 10-year forecast model of general municipal expenditures that reflected an increase in a variety of user-defined growth rates (see summary of model results in Appendix F). Without enhanced revenues, it is difficult to create a model in which the City can simultaneously maintain the service levels residents need and want, fulfill commitments to retired or vested current employees, and meet the ever growing infrastructure maintenance backlog.

The City's binding obligations for future expenses will exceed revenues unless it makes major service cuts, implements reforms, and/or increases revenues. CCMR's revenue recommendations are made within the context of the following financial pressure points:

1. Decline in revenues across the board since 2009 and uncertain timing of economic recovery
2. Uncertain future of earnings tax due to renewal mandate
3. Reliance upon and uncertain future for declining intergovernmental revenues
4. Insufficient unreserved operating fund balances equal to one month operating expenses, half of the City Council adopted policy requirement of two months
5. Significant portion of total revenues dedicated as to purpose and/or have sunset provisions, greatly impacting the City's ability to respond to changing needs
6. Infrastructure backlog estimated at $6 billion, and the unfunded federal mandate to address storm water issues
7. Unfunded pension liabilities
8. High levels of outstanding debt
9. Redirections of taxes to Tax Increment Financing projects

2.5 CURRENT REVENUE STRUCTURE AND TAXPAYER BURDEN

The City's current revenue structure is diversified and generally sound, drawing upon a variety of taxpayer types (resident/non-resident, individual/business) and tax base options (property, sales, earnings).



[6]

No single source provides more than a quarter of total revenues. Unlike many of its peer cities, Kansas City is much better positioned to survive short-term fluctuations:

	Major Revenue Source	% of Total
Tulsa	Property taxes	54%
Fort Worth	Property taxes	42%
Denver	Sales taxes	36%
Memphis	Sales taxes	31%
Minneapolis	Sales Taxes	31%

[6] Includes about $40 million in TIF redirections.

The current structure is slightly regressive, falling more heavily on low-income residents. As a percent of income/gross receipts, individual taxpayers bear higher tax burdens than businesses.

Tax Burden							
Individual				Business			
	$25,000	$75,000	$150,000		Small	Medium	Large
Earnings Tax	$248	$747	$1,500	Earnings Tax	$222	$1,104	$4,111
Property Tax	299	433	614	Property Tax	1,114	3,812	38,122
Sales Tax	280	535	786	Sales Tax	NA	NA	NA
All Other	82	253	362	All Other	1,245	5,542	56,805
Current	3.6% - $909	2.6% - $1,968	2.2% - $3,262	**Current**	1.8% - 2,581	0.7% - 10,458	0.3% - 99,038 [7]

Detailed analysis of major revenue sources includes the following discussion for each:

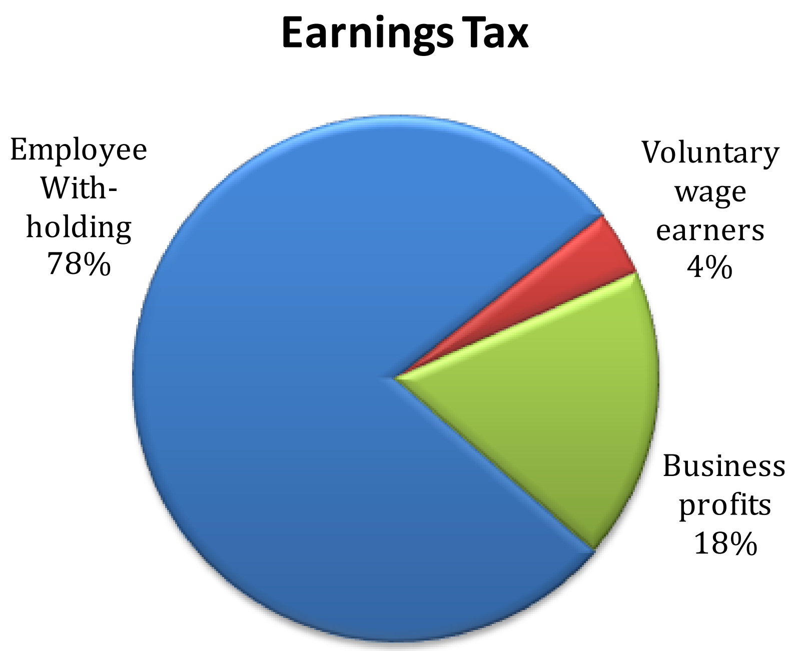
1. Overview
    - annual collections
    - percent of total
    - tax/fee rate(s) and amount generated for an incremental increase
2. Fundamental considerations
    - dedications
    - legislative issues
    - cost of collection
    - performance
    - equity
    - redirections
3. How we compare
    - to metro area cities
    - to peer cities
4. Options
    - change rate or base
    - change dedications
    - address barriers to full collection either because not everyone pays or not everyone is assessed (gap and leakage)
    - address noncompliance with proposed Revenue Policy
5. Recommendations
6. Other options considered by CCMR

[7] Business gross receipts assumptions: Small = $150,000, Medium = $1,500,000, Large = $30,000,000.

3.0 Earnings Tax

3.1 Overview

Earnings and profits taxes are the single largest revenue source and currently provide about $200 million or 23% of general municipal revenues. The tax rate is 1% and revenue is comprised of three sources: withholding on employees, individual wage earners, and business profits.



3.2 Fundamental Considerations

There are no statutory dedications of this source, although citizens remember promises attached to the last increase in 1968, including free trash pickup and trash bags.

Proposition A, passed on November 2, 2010, requires voter approval every five years, but there are legal efforts pending at the State level to overturn this requirement. Legislatively, the State could extend the renewal time period. On April 5, 2011, 78% of voters approved a five-year extension through December 2016. Credit rating agencies cite concerns related to the City's long term financial risk due to the five-year renewal requirement of this important source of operating funds.

If the earnings tax is not renewed in 2016, or in any of the renewal elections to be held every five years, the City will face an annual revenue reduction of about $20 million as the tax is phased out over a ten year period. Once local voters have rejected the renewal of the tax, the City would no longer have authority to levy the tax.

Cost of collection as a percent of total collections is 1%. Ease of collection is high for withholding, but low for profits and wage earners, as it is hard to identify and collect from non-filers and difficult to track incoming and outgoing businesses and residents. Assuming a tax collection gap similar to the experience of the IRS, the gap would be slightly over 15%.

During recession years the profits portion of the tax remains relatively constant but the remaining base does fluctuate with changes in economic activity.

The earnings tax is somewhat regressive because it is not a tax on all sources of income and earnings account for a relatively larger proportion of lower and middle-income families' income. About half of the tax is exported (paid by non-residents) which makes it consistent with the benefits principle, since people who work as well as live in the City use and benefit from City services.

Redirections of earnings tax for incentive programs has grown from $6 million in FY 2002 to over $12 million in FY 2010, and currently represent 6.3% of total collections. Redirections were $22 million in FY 2011, 11% of collections.

3.3 HOW WE COMPARE

No other city in the metro area imposes an earnings tax. The tax may influence people's decisions about where to live or work. The tax could also affect business decisions about where to locate. However, tax rates are only one factor that influence business decisions and according to the chairs of AdvanceKC, the Mayor's economic development commission, schools, crime, code requirements, and infrastructure were cited by businesses as critical decision factors.

St. Louis and Allentown, PA levy earnings taxes of 1%. Other cities in Indiana, Kentucky, Maryland, Michigan, New York, Ohio, Oregon, and Pennsylvania levy earnings taxes ranging from 1.3 to 3.98%. See table in Appendix G.

3.4 OPTIONS

3.4.1 **Change rate or base.** Proposition A caps the rate at 1%. However, the City could increase the rate with an amendment to state law and a vote of the electorate to amend the City Charter.

3.4.2 **Dedicate the tax to capital improvements.** Currently this tax is undedicated, but recent discussions regarding the next renewal have included options to dedicate the tax to capital improvements, believing that would be more popular with voters.

3.4.3 **Address tax collection gap and leakage.** Efforts discussed to address tax collection gap and leakage include: (a) limiting or removing this tax from future tax incentive projects, (b) working with the State to strengthen enabling legislation for the entertainment industry to mandate withholding, (c) eliminating refunds to employees who work part of the year outside Kansas City, which over the last five years have averaged $3 million per year, (d) improvements to financial systems and processes to maximize collections.

3.4.4 **Address noncompliance with proposed Revenue Policy.** Since the passage of Proposition A, the earnings tax is in violation of the proposed Revenue Policy, section e(5) which states "any newly authorized revenue stream with a sunset ideally shall not be used to fund recurring service delivery costs".

3.5 CCMR Earnings Tax Recommendations

3.5.1 RETAIN THE EARNINGS TAX

CCMR considered methods of eliminating or reducing the earnings tax. CCMR found those options unacceptable because it would eliminate a tax that is vital to the General Fund budget, and is paid in large part by nonresidents. A complete elimination of the earnings tax would hamper the City's ability to fund basic services; and full replacement would require large increases in sales and/or property taxes. Furthermore, since half of the earnings tax is now paid by nonresidents, the burden of funding services that benefit all metro area Missouri and Kansas residents, whether they work in the City or visit the multiple cultural and entertainment offerings in the City, would shift disproportionately onto Kansas City residents.

3.5.2 Pursue Legal and Legislative Relief at State

To protect the City's largest single source of revenue, CCMR recommends aggressive pursuit of both legal and legislative relief at the State level regarding Proposition A. This renewal requirement is cited by credit rating agencies as a significant concern, placing a major funding source for general operations at jeopardy. At a minimum, the State has the power to extend the election cycle to something longer than five years. CCMR recommends renewal periods of no less than 20 years.

3.5.3 Forego Dedication of Earnings Tax

Although there are some discussions to dedicate the earnings tax to capital improvements, CCMR recommends the tax remain undedicated for the following reasons:

- 78% of the citizens voted to continue the earnings tax in its current form. The potential loss of basic services appears more compelling than cuts to capital maintenance.
- Dedications to capital projects often lead to a "divide by six" situation—ensuring each district receives a share, but ultimately giving citizens more reason to oppose the tax, and perhaps not address the highest priority needs.
- Dedication of revenues ties policymakers' hands so they are unable to respond to changing needs without endangering taxpayer trust.

3.6 Other Options Discussed By CCMR

CCMR reviewed one option to allow a deduction for the first $25,000 of earnings. Because any deduction must be applied uniformly to all taxpayers, residents and nonresidents, low-income and high-income alike, the estimated revenue loss of this option to provide some tax relief at lower income levels would be nearly $40 million.

CCMR discussed an option to provide a credit against property taxes equal to earnings taxes paid by low-income residents. Because the databases for these two taxes are maintained by separate taxing entities (four different counties and the City), and rely upon different taxpayer identifications, linking property and earnings tax data might not be practical. Upon further review, this option was rejected because low income earners are less likely to own homes, low income senior citizens may own homes but are less likely to have earnings, and the credit could not be given to one subset of taxpayers, but must be given to all income groups.

CCMR reviewed options to eliminate refunds to nonresidents for days worked outside the City. Denying refunds would require a change to State statute and the City Charter. Additionally, at $3 million per year, refunds represent a small percentage of total collections. And CCMR reviewed other potential collection gaps related to visitors who work for short periods in the City, and non-filers. With recent investment in a new revenue system and allocation of resources to auditing functions, citizens can expect a reduction in the collections gap. CCMR has confidence in the Revenue Division's commitment to maximize collection with attention to fairness, using automated matches and federal tax data. Given the advent of a new system, we recommend staff prepare an annual report to City Council estimating the amount of gap and summarizing successful efforts to close it.

4.0 Sales Tax

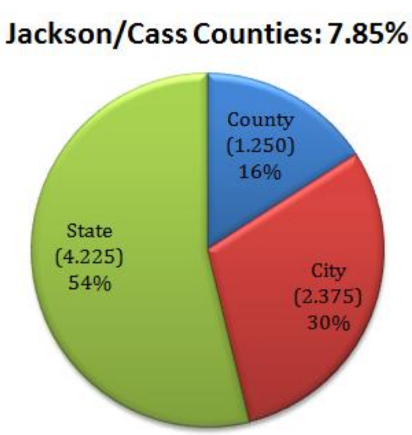
4.1 Overview

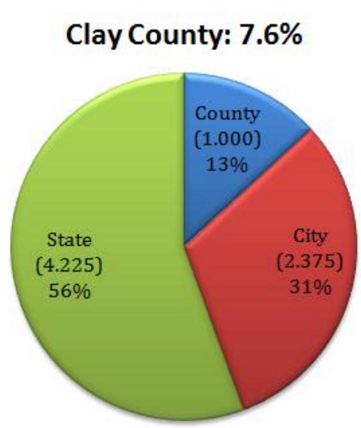
Sales taxes are the second largest single revenue source and currently provide about $150 million or 17% of general municipal revenues. Each ¼ cent levy (.25%) yields about $16 million.

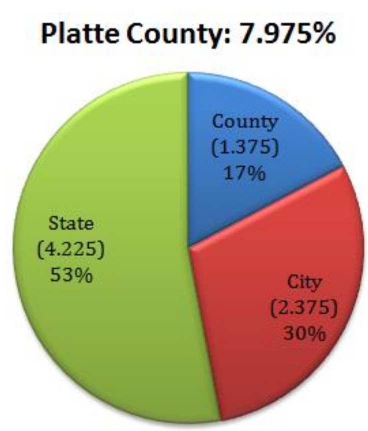
The City tax rate, not including special districts, is 2.375%. There are 33 Transportation Development or Community Improvement Districts that levy an additional 1/8 to 1% sales tax, with revenues dedicated to improvement costs in those districts. Including all overlapping governments (State and counties) and special districts, the total sales tax rate within the City ranges from a low of 7.6% (Clay County) to a high of 9.850% (Ward Parkway).

4.2 Fundamental Considerations

The City levy represents about a third of the total sales tax rate levied in Kansas City. The majority of the tax is levied for state purposes:







While some taxes are general in terms of state authorization, they are dedicated by voter approval to a specific purpose. The City tax rate of 2.375% is fully dedicated to the following purposes, in order of their expiration dates:

0.50%	Public Mass Transportation Trust (December 2015)
0.25%	Fire Protection (December 2016)
1.00%	General sales tax dedicated to Capital Improvements (December 2018)
0.375%	Kansas City Area Transportation Authority (March 2024)
0.25%	Capital improvement sales tax dedicated to Public Safety (June 2026)

Cost of collection as a percent of total collections is 1%. Ease of collection is high as the tax is collected and enforced by the State.

The revenue will fluctuate with changes in economic activity. Furthermore, significant changes in the rate could affect collections by increasing the price of goods and thereby affecting shopping patterns. In general, studies show that a 1% higher sales tax rate will result in per capita sales that are between 1% and 6% lower.[8] While small variations have not shown to significantly impact collections, the City must be mindful of surrounding jurisdictions' rates to avoid the potential negative repercussions on the sales tax base resulting from reduced demand.[9]

The sales tax is partially exported to nonresidents making purchases within the City. The sales tax is regressive as the rate is constant across the income spectrum and taxable purchases account for a relatively larger proportion of lower and middle-income families' income. Some states, including Missouri, have addressed the regressive nature of sales taxes by exempting food. Food purchases in Missouri are exempt from the State's 3% general sales tax.

Redirections of sales taxes for incentive programs have grown from $5 million in FY 2002 to about $20 million in FY 2010, and currently represent 14% of total collections. Redirections were $20 million in FY 2011, or 13% of collections.

[8] "How Different Sales Tax Rates Along Georgia's Border?" Georgia State University Andrew Young School of Policy Studies, Fiscal Research Center, February 1, 2005, and "More Evidence on the Burden Tax Effect: The Case of West Virginia", National Tax Journal, 1988.
[9] "Kansas City Missouri Long-Term Financial Plan", The PFM Group, December 17, 2008, p 17.

4.3 HOW WE COMPARE

The total City, County, and State sales tax rate in Kansas City not including special districts falls at or below most metro area and peer cities. Compared to 30 cities in the metro area, the four counties in Kansas City are lower than all cities in Kansas, and are near or below the rates levied by Belton, Gladstone Grandview, Independence, Lee's Summit, Raymore, and Raytown. Compared to peer cities, only Milwaukee and Omaha levy a lower rate. (see graph and table in Appendix H)

The sales tax is designed to tax tangible goods but many states have incorporated various types of services into the sales tax base. The State of Missouri taxes only 26 types of services, primarily utility and admissions/amusement taxes, and only eleven states have fewer taxes on services. In particular, Missouri lags behind in the taxation of personal, business, and computer services. The following shows a comparison of sales tax exemptions for Kansas City and the peer cities:

City	Number of Exemptions Classifications	City	Number of Exemptions Classifications
Milwaukee	3	Ft Worth	103
Omaha	8	Oklahoma City	42
Kansas City	120+	St Louis	120+
Denver	11	Tulsa	42
Minneapolis	113	Memphis	31

The exemptions found in RIA Thompson's Reuters are approximates and are exemptions at the state level only. Many exemptions listed had multiple exemptions listed within one category. For instance, Nebraska had only 8 classifications but within those, they had over 50 exemptions.

4.4 OPTIONS

4.4.1 **Increase rates.** The City has the following legal authority to increase tax rates with voter approval:

Transportation Sales Tax:	.125%	to yield $8 million
Capital Improvements:	.25%	to yield $16 million
Economic Development	.50%	to yield $32 million
Local Parks and/or Storm Water	.50%	to yield $32 million

4.4.2 **Change dedications.** The following sales taxes have broader statutory authority but uses are currently limited more specifically by City ordinance:

- The 1% for Capital Improvements is a more specific dedication of a state authorized General City Sales Tax
- The .25% for Public Safety is a more specific dedication of a state authorized Capital Improvements Sales tax
- The .375% for Transportation is dedicated to KCATA by City ordinance and local election. The state enabling law contains a broader authorization defined to include "development and operation of bus and light rail systems, acquisition of land for roads, bridges, airports, and construction, repair, maintenance, planning and feasibility studies of/for streets, roads, bridges, and airports."

4.4.3 **Change the base.** Missouri could achieve closer conformity with its neighboring states by removing exemptions for some services. Relief for low income households could be enacted as well by exempting basic goods.

4.4.4 **Address tax collection gap and leakage.** Efforts discussed to address tax collection gap and leakage include: (a) limiting or removing this tax from future tax incentive projects, (b) working with the State to implement the Streamlined Sales Tax which would not currently increase sales revenues but would immediately impact use tax collections.

4.4.5 **Address noncompliance with proposed Revenue Policy.** The Fire Protection Sales Tax is a dedicated tax with a sunset provision that currently funds operating costs. Renewal of this tax in its current form would be in violation of the proposed Revenue Policy, section e(5) which states "any newly authorized revenue stream with a sunset ideally shall not be used to fund recurring service delivery costs" and section e(6) which states "Whenever possible, the City shall not dedicate a revenue stream to a specific use or program. Dedication or earmarking of revenue streams does not allow the City to respond to changing economic conditions or service expectations and is dispositive to the City's general credit."

4.5 CCMR Sales Tax Recommendations

4.5.1 Support State Legislation to Implement Streamlined Sales Tax Agreement

Legislation to ensure equitable collection of sales tax is currently under consideration in Missouri and has received bipartisan support and the endorsement of the business community. Although the State cannot collect sales taxes on remote sales, a use tax is still due. There are 24 states that participate in Streamlined Sales Tax, including all of Missouri's surrounding states with the exception of Illinois.[10] Most cities in states who have implemented this have realized some increase in use tax collections. The Streamlined Sales Tax Agreement would institute a mechanism designed to make the current sales and use tax easier to compute and close a collections gap, and also sets the stage for if and when the Federal government approves taxation of internet sales.

4.5.2 Do Not Renew Fire Protection Sales Tax; Replace with Capital Improvement Sales Tax Effective January 1, 2017

CCMR recommends against renewal of the 1/4 cent sales tax for Fire Protection. This tax has a sunset and currently funds operating expenses in violation of the proposed Revenue Policy. Additionally, infrastructure is a high priority, so the City should ask voters to approve a 1/4 cent capital improvement sales tax effective January 1, 2017, upon expiration of the Fire Protection Sales Tax. The revenues would then be used to partially address the considerable infrastructure backlog in the Mayor's $1 billion plan. Given low interest rates, local capacity for construction projects, and the pressing need to begin now, CCMR recommends the Finance Department continue to evaluate the use of alternative financing structures such as capital appreciation bonds and capitalized interest secured by a capital improvement sales tax. Such a structure could fund about $150 million or 15% of the total $1 billion plan. CCMR acknowledges this recommendation related to the Fire Protection Sales Tax requires the City to plan for a $16 million operating budget gap for Fire operations.

[10] Streamlined Sales Tax Governing Board

4.5.3 Expand the Sales Tax Base to Cover More Consumer Services

CCMR recommends that a review of existing sales tax exemptions, and opportunities to expand the base, be added to the City's legislative agenda as a high priority. Recommendations to eliminate consumer services exemptions should consider the impact on low income households and on the competitive position of the City.

4.5.4 Renew General Sales Tax for Capital Improvements

CCMR recommends renewal of the capital improvement sales tax in 2018, with a longer renewal period (15-20 years) and ordinance language broad enough to allow more flexibility to respond to changing needs.

4.5.5 Use Future Economic Development, Transportation, & Capital Improvement Sales Tax Authorizations for Projects Focused on Population and Employment Growth

CCMR reviewed the statutory uses of an Economic Development Sales Tax. The City has authority to levy up to 1/2 cent for purposes that include installation of infrastructure for industrial or business parks; improvement of water and wastewater treatment capacity; extension of streets; and public facilities directly related to economic development and job creation. At this time, CCMR has no recommendation regarding this tax but believe any future use of the Economic Development, and/or Transportation, and/or Capital Improvement sales tax authorities must be invested in projects that ultimately lead to population and employment growth and retention.

4.6 Other Options Discussed by CCMR

CCMR considered ways to make the sales tax less regressive by exempting food and/or prescription drugs. CCMR does not recommend pursuing these exemptions because: (1) food is already exempted from the 3% State general sales tax levy, which partially mitigates the regressive impact, (2) the loss of revenue to the City would be significant, and (3) it requires a change in State statute.

CCMR discussed several recommendations regarding the Public Improvement Advisory Committee (PIAC), a nationally recognized model, and allocations of the 1 cent capital improvement sales tax.

CCMR's recommendation regarding the Parks & Stormwater Sales Tax can be found in the Property Tax section, 5.5.2.

5.0 Property Tax

5.1 Overview

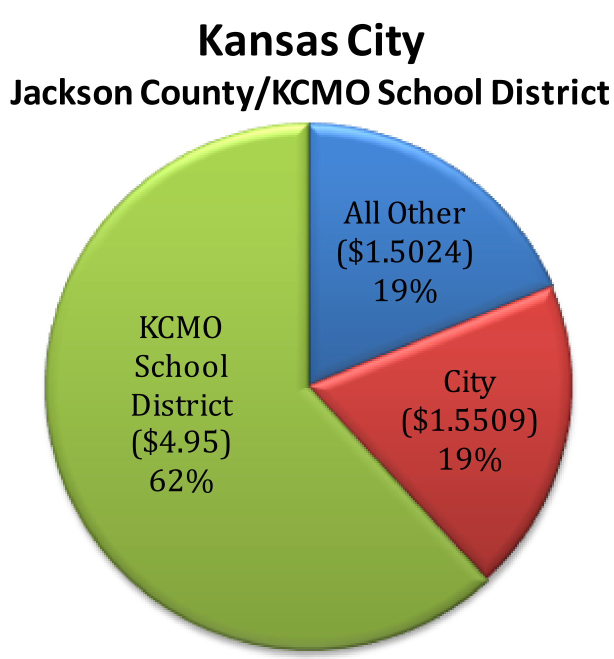
Property taxes are the third largest single revenue source and currently provide about $130 million or 14% of general municipal revenues.

The tax on real and personal property comprises the majority of revenue in this category. The 2011 property tax rate levied on real and personal property was $1.5509 per $100 assessed value, and totaled about $112 million. Each one cent yields about $720,000.

The City also receives a State-levied business replacement tax ($6 million) and assessments levied on land only for parkway, trafficway, and boulevard improvements ($10 million).

5.2 Fundamental Considerations

The City levy represents about 20% of the total property tax levy in Kansas City. There are 13 school districts overlapping the City and in every case the majority of the property tax is levied for school district purposes. The example below highlights components of the total tax levy for residents in one of the larger school districts:



About 60% of the revenue is restricted as to use. The parkway, trafficway and boulevard assessments on land only are restricted to maintenance of the City's parks and street systems. The City tax rate of $1.5509 is dedicated to the following purposes (only the temporary Health Levy has an expiration):

$0.6786	General municipal purposes
$0.4935	Health
$0.2200	Temporary health (April 2014)
$0.0188	Museum
$0.1400	Debt

The Hancock Amendment requires an annual levy certification which protects against both revenue windfalls and shortfalls. The maximum levy rates are allowed to increase by the lesser of the Consumer's Price Index or assessed value growth, not including new construction or a new voter approved levy increase. As a result, property tax revenue is mostly stable: when market value increases, levy rates are adjusted down; when market value decreases, levy rates are adjusted upward.

Cost of collection as a percent of total collections is 1.7%. Ease of collection is high for properties located in Cass, Jackson, and Platte counties as the tax is collected and enforced by the county governments. The City bills and collects on properties located in Clay County but anticipates that an agreement with Clay County will result in the County collecting taxes for tax year 2012.

Property tax has a disproportionate effect on fixed income households. The Missouri Property Tax Credit Claim gives an income tax credit to senior citizens and disabled individuals for a portion of the real estate taxes or rent they paid for the year. The credit is for a maximum of $750 for renters and $1,100 for owners. The actual credit is based on the amount of real estate taxes or rent paid and total household income. In 2009 only about 1/3 of eligible taxpayers applied for this refundable credit, administered and funded by the State of Missouri. [11]

In 2010, tax incentive projects made Payments in Lieu of Taxes (PILOT's) to the City of approximately $9.5 million.

[11] Missouri Department of Revenue, http://dor.mo.gov/personal/ptc.

5.3 How We Compare

The total property tax rate (City, County, school district and State) generally falls at or below the average for other cities in the metro area. Kansas City's direct levy falls below its peer cities.[12] (see graphs in Appendix I)

5.4 Options

5.4.1 **Increase levies.** The City has the following legal authority to increase levies with voter approval:

General Municipal:	\$0.3214	to yield \$23 million
Health:	\$0.2865	to yield \$21 million
Museum:	\$0.0812	to yield \$6 million

The City could also make the determination to utilize the full or partial debt levy capacity. By City Council action at the annual levy certification in August, the City could utilize the debt levy for payment of General Obligation debt service, freeing up as much as \$15 million of general municipal revenue per year.

5.4.2 **Authorize renewal of temporary health levy.** The temporary health levy will expire in 2013. Renewal requires City Council action and voter approval. CCMR heard expert testimony regarding the original intention of this temporary levy, failed efforts to find a regional solution to eliminate the need for this levy, two potential impacts on funding needs should the Health Care Act be either validated or struck down, and the dismal performance of the State of Missouri to fund indigent care (ranks 50th in the nation).

5.4.3 **Address noncompliance with proposed Revenue Policy.** Eliminate land only assessments that at current levels are not sufficient to address funding needs, have little to no historical growth, and are confusing to taxpayers, in violation of the proposed Revenue Policy, section e(1) "dependability" and section e(4) "growth.

[12] Rates were adjusted to reflect different assessment ratios between states.

5.5 CCMR Property Tax Recommendations

5.5.1 Implement Plan To Leverage State Property Tax Credit

Because the State of Missouri Property Tax Credit Claim has no cost to the City, but is an important way to bring tax relief to lower income Kansas City citizens, the City should implement an annual procedure to reach low to moderate income senior citizens and disabled taxpayers to encourage them to file for the State of Missouri property tax credit.

5.5.2 Repeal Motor Vehicle License Fee and Land Only Assessments, Replace with 1/2 Cent Sales Tax for Parks and Storm Water

CCMR recommends that the Mayor and City Council place before voters this August a 1/2 cent sales tax for Parks and Storm Water, 60% allocated to parks and 40% for storm water. The estimated annual amount the tax would generate is approximately $32 million. Voters would be asked in the same ballot issue to repeal the following property taxes and fees:

1. Motor Vehicle License Fee which provides approximately $3.5 million for Community Centers and park maintenance, and expires in August.
2. Boulevard Tax which is currently $1.00 per foot and generates $600,000.
3. Parkway Maintenance Tax levied on land-only and generates $6.6 million a year.
4. Trafficway Maintenance levied on land-only, and generates $3.3 million for Public Works. To replace this funding for Public Works, the General Fund transfer to the Parks Department would be reduced by the same amount.

The total of the repealed taxes would be $14 million. The net effect for the programs would be as follows: $5.2 million net annual increase for Parks to maintain existing properties and programs; $12.8 million annual increase for storm water improvements, which would be used to partially offset future wastewater rate increases.

Because the motor vehicle license fee expires this year, it is the recommendation of CCMR that this proposal be placed on the August 2012 ballot.

5.5.3 Renew Temporary Health Levy Contingent Upon Supreme Court Decision on Affordable Health Care Act

If the Patient Protection and Affordable Care Act is upheld by the Supreme Court (i.e., retains subsides targeted at low income individuals to purchase health insurance policies), CCMR recommends that voters be asked to renew the Temporary Health Levy in 2014 for no more than four more years. If the Affordable Health Care Act is overturned, CCMR recommends that the City Council determine how much, how long, or if the temporary levy should be extended in light of other priorities of the City.

5.5.4 Address Capital Infrastructure Backlog with Property Tax

CCMR supports the Mayor's vision to tackle the sizeable deferred maintenance and infrastructure backlog without further delay and considers this investment a key component for attracting and retaining population. To that end, CCMR supports property tax levy increases to pay for the Mayor's $1 billion infrastructure program, mitigated with a 1/4 cent sales tax that can spread some of the burden to non-residents (see recommendation 4.5.2). CCMR considered one scenario that funds the Mayor's plan with the new 1/4 cent sales tax and average increases to the property tax levy of about 10 cents per year beginning in 2014, resulting in a cumulative property tax impact on the average taxpayer of $200 over the ten year period. CCMR acknowledges that this is just one of many scenarios that should be considered in order to optimally structure a financial investment of this magnitude.

5.6 Other Options Discussed by CCMR

CCMR reviewed options to tax undeveloped land at a higher rate, as a way to provide incentives for development. Determining the fair market value of land without market transaction data could be challenging, and regular reassessments costly. Furthermore, a land tax would increase costs but not address other barriers to development such as access to capital and zoning regulations. Finally, a land tax is generally better suited for more densely populated urban areas.

6.0 Utility Taxes

6.1 Overview

Utility taxes are the fourth largest revenue source and currently provide about $104 million or 12% of general municipal revenues. The tax is levied on electric light and power (54% of total utility revenue), telephone (24%), natural gas (17%), and other utilities (5%).

Residential sales are subject to the base rate. Commercial and industrial sales are subject to the base rate plus emergency rate. The only remaining authority is a 4% residential emergency rate—every 1% levied on residential usage yields about $6 million.

6.2 Fundamental Considerations

There are no restrictions on the use of utility tax revenues and no expirations.

Cost of collection as a percent of total collections is very low at 0.21%. Ease of collection is high as the City receives funds directly from utility companies on a monthly and quarterly basis.

Growth in this revenue stream is dependent on utility rates as requested of, and granted by, the Public Service Commission for electric and natural gas, consumption patterns (energy conservation and "green" initiatives), weather conditions, population, and statutory exemptions.

As a flat tax levied on primary household expenses, the tax has a disproportionate effect on fixed and low income households.

Utility tax redirections have grown from $730,000 in 2002 to $2.2 million in 2010, or 2% of total collections. Redirections were $3.2 million in 2011, 3% of collections.

6.3 How We Compare

Residential electric tax rates are the median in the metro area and are comparable to rates levied by peer cities. (see graph and table in Appendix J)

6.4 Options

6.4.1 **Increase tax rate.** The City could ask for voter approval to reinstate some/all of the 4% emergency tax on residential electric, gas, telephone and steam. In total this would yield about $23 million to the General Fund.

6.5 CCMR Utility Taxes Recommendations

6.5.1 Retain Emergency Rate for Commercial Customers

Retain the 4% emergency rate levied on commercial customers but do not restore the emergency tax on residential users. Research the origins of the terminology "emergency" and consider removal of this designation.

6.6 Other Options Discussed by CCMR

CCMR considered a proposal to reinstate the residential emergency tax to provide a source of funding for no cost or low cost home improvement loans. It was unclear whether this would be a use of public money for private purpose and therefore unconstitutional. Given other initiatives now in place to address home improvements in the urban core, CCMR did not pursue this option.

Customers who purchase natural gas on the open market from facilities outside the City are not subject to a City franchise fee, utility tax or sales tax. CCMR believes this trend will likely continue, perhaps increase, and negatively impact future City franchise fee, utility tax and sales tax collections. The City should determine what options exist within State statute to close this collection gap.

CCMR considered a proposal to reinstate the 4% emergency rate on residential customers, providing additional operating revenue to the General Fund. The City Manager has identified an option to use these funds to address the significant blight issues in the urban core. CCMR recommends further evaluation and a comprehensive proposal that not only clears buildings, but specifies a long-term plan to restore property values.

7.0 Business License Fees

7.1 Overview

Business license revenue is $21 million or 2% of general municipal revenues. The rate varies dependent on the nature of the business.

Public testimony before The Mayor's Special Committee on Small Business identified the business license tax as inequitable to various business classifications and suggested the City implement alternatives that would be fair to all businesses. This issue was also considered by the Business License Task Force in 2007and the Mayor's Task Force for Occupational License Review in 1996. The Special Committee on Small Business referred this issue to the CCMR, specifically to review options for restructuring or eliminating the business license tax while maintaining General Fund revenue.

There have been three efforts over the last 15 years with recommendations to change both the rate and the base by addressing caps and exemptions. In the end, none of these proposals were implemented because they failed to adequately address revenue replacement, or faced resistance from business interest groups. The City tried to eliminate the multiplicity of rates and apply a single rate against gross receipts and that discussion stopped because the "no cap" feature necessary to ensure growth was not acceptable to business representatives. In recent years the City has only made minor cosmetic changes to clean up its code of ordinances.

7.2 Fundamental Considerations

There are no restrictions on the use of business license revenue and no expirations.

Cost of collection as a percent of total collections is high at 3.2%. Business license fees are difficult to administer and enforce. Growth of this revenue source is stagnant and the fee structure is not uniform.

There are a myriad of rate calculations in the current business license structure. Retail/wholesale, service manufacturers and contractors are billed according to gross receipts. Other businesses pay a flat rate according to occupations, and still others pay a fee per unit (per truck, per seat, per cab).

Utility taxes and the rental car license fee (also known as the arena fee) are authorized within the same section of the City's code of ordinances. Any consideration to eliminate business licensing might compromise the City's ability to collect other fees authorized under the code.

7.3 How We Compare

Kansas City levies a combination of flat fees and fees on gross receipts. Cities in the metro area rely mostly on some combination of square footage, gross receipts, and/or flat fee. Most cities in the metro area apply more than one type of rate.

In contrast, peer cities outside the metro area rely much less on gross receipts (only Memphis uses gross receipts) and much more on flat fees (Milwaukee, Minneapolis, Oklahoma City, Tulsa) and fees per employees (Omaha, Denver, and St. Louis). And none of the peer cities use a combination of rates, but rather apply one method to all taxpayers. (See tables in Appendix K)

7.4 Options

7.4.1 **Change fee structure.** The City could reduce current fees, simplify rates to a flat fee or institute a graduated uniform fee structure.

7.4.2 **Address tax collection gap and leakage.** City officials could work to change state law and the City ordinance to remove exemptions and improve equity.

7.5 CCMR Business License Recommendations

7.5.1 Bring Closure to Business License Reform

CCMR believes that it is important to address the Business License Fees. The business license taxes have been the subject of several studies or reports, all of which recommended that they either be eliminated or made more equitable. To that end, CCMR will continue its work on this issue for several more weeks, working with the business community and other stakeholders, focused solely on business license reform, with plans to issue an addendum report mid-summer that will attempt to bring closure to a 15+ year conversation.

8.0 Other Taxes and Fees

All other taxes and fees are $280 million or 32% of general municipal revenues.

8.0 CCMR All Other Taxes and Fees Recommendations

8.0.1 Expansion of Convention & Tourism Tax Base to Include Non-Profit Entities

CCMR supports the position of the Convention and Visitors' Bureau and recommends the City pursue a change in the enabling legislation for convention and tourism taxes, removing the current exemption for non-profit entities. Most cities do not offer this exemption, and the Bureau does not feel it would limit the City's ability to attract non-profit conventions.

8.0.2 Evaluate Sin & Sugar Taxes to Fund Health Care

Should the Affordable Health Care Act be overturned, CCMR recommends the City evaluate sources other than the property tax to fund health care expenditures. These could include increases to existing alcohol and cigarette taxes, or a new tax on "junk" food.

9.0 Uses and Expenditures

CCMR was not tasked with a review of spending issues. However, CCMR does recommend the following guiding principles related to expenditures.

1. The City has adopted debt, investment and reserves policies. Now, as a result of this Commission, there is a draft revenue policy. A critical next step is a similar citizens' commission on municipal expenditures. Successful implementation of a strategic plan, a primary recommendation of this report, requires a clarity of purpose that should come from a citizen-based definition and evaluation of basic services, and selection of criteria for prioritization.

2. The City's current General Fund reserve of one month is below the City's stated policy of two months, and below levels found in AAA cities. Given an ambitious plan to issue significant additional debt over the next few years, the City will need to show credit rating agencies a plan to maintain or improve its reserves. The City's stated goal of two months should be considered a minimum threshold. The City should strive to increase its General Fund balance by at least 1% per year until it reaches three months or 22%, thereby bolstering its case for AAA rating consideration.

3. The Mayor's $1 billion plan will address some of the existing infrastructure backlog. The City needs a disciplined approach to funding infrastructure maintenance, or risk facing this same costly backlog again.

4. CCMR discussed the pros and cons of asset sales, a strategy other cities have used to raise revenue, often in the face of pressing financial considerations. CCMR concluded that in most cases it would not benefit the City to sell major long term assets (such as the airport or water and sewer systems) to fund current operating and capital needs. However, the City should be open to consideration of the broad spectrum of public-private-partnership (P3) options, private management contracts, efficiency improvements and elimination of service duplications, which may be central to funding deliberations. Evaluations should be subject to rigorous analysis and transparency, and always have at their core the long term benefit to Kansas City taxpayers.

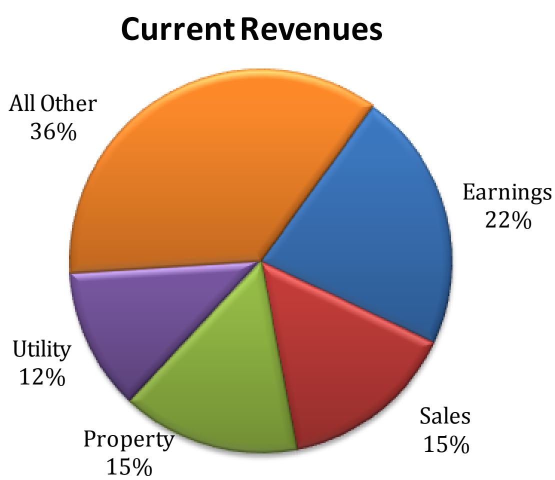
5. While acknowledging the City's geographic area exceeds many of the peer cities, and the City provides services not found in these other cities, several ratios per capita raise red

flags. CCMR reviewed a number of factors that impact the City's bottom line such as population, staffing levels, service levels, and outstanding debt, with comparisons to peer cities (see Appendix L). CCMR recommends expanded analysis of these and other measures of service level efficiency.

10.0 Comparison of Revenue Structure and Tax Burden

10.1 DIVERSITY

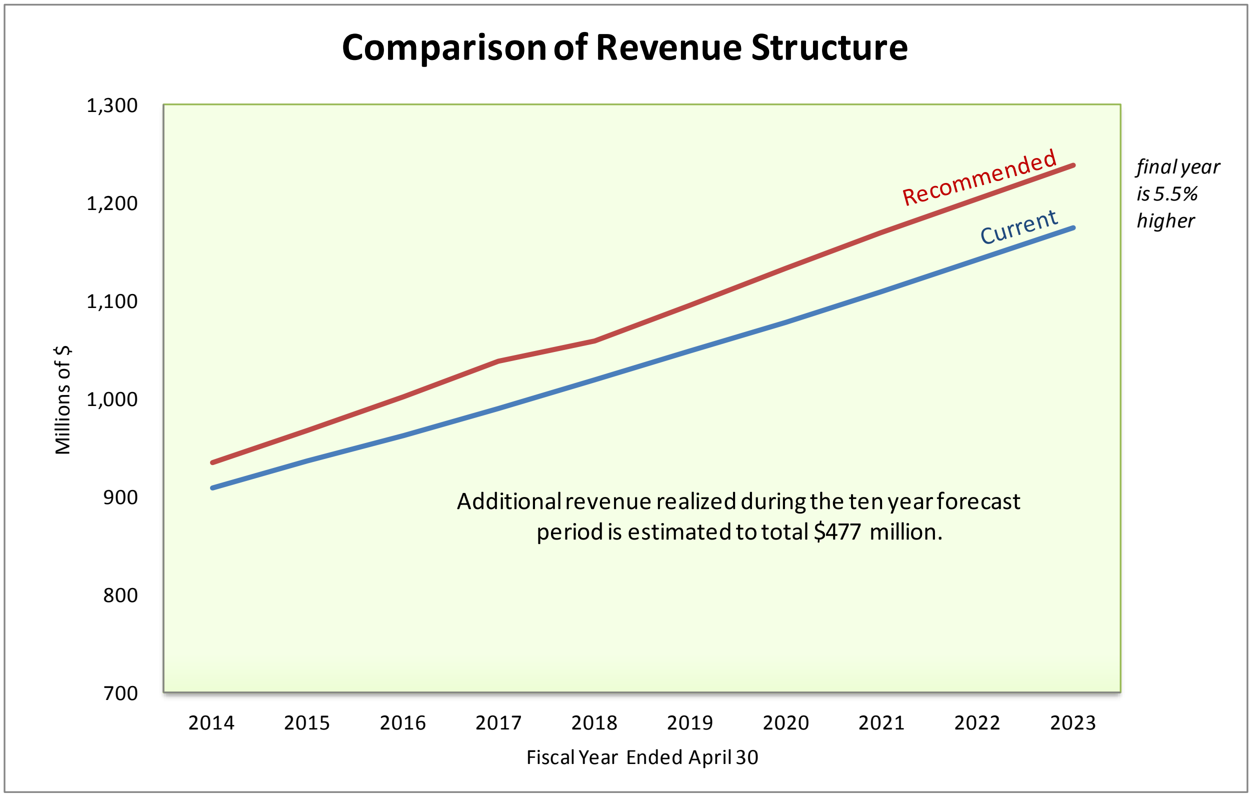
The following charts[13] graphs and tables illustrate all revenue recommendations of this report: elimination of land only property taxes, elimination of vehicle license fees, new 1/2 cent sales tax for parks and storm water, repurposing the 1/4 cent fire sales tax to capital improvements upon renewal in 2017, and estimated debt levy increases to fund a $1 billion infrastructure bond program. Assuming all recommendations of this report are implemented, the distribution of taxes changes slightly—a marginal shift to property and sales taxes.



[13] These charts are net of TIF redirections.

10.2 GROWTH

Overall revenues during the ten-year forecast period are estimated to be between 3% and 5.5% higher every year compared to the current structure. A different mix of revenues brings a slight improvement to annual revenue growth, from an average of 2.9% to about 3.2%.



10.3 EQUITY

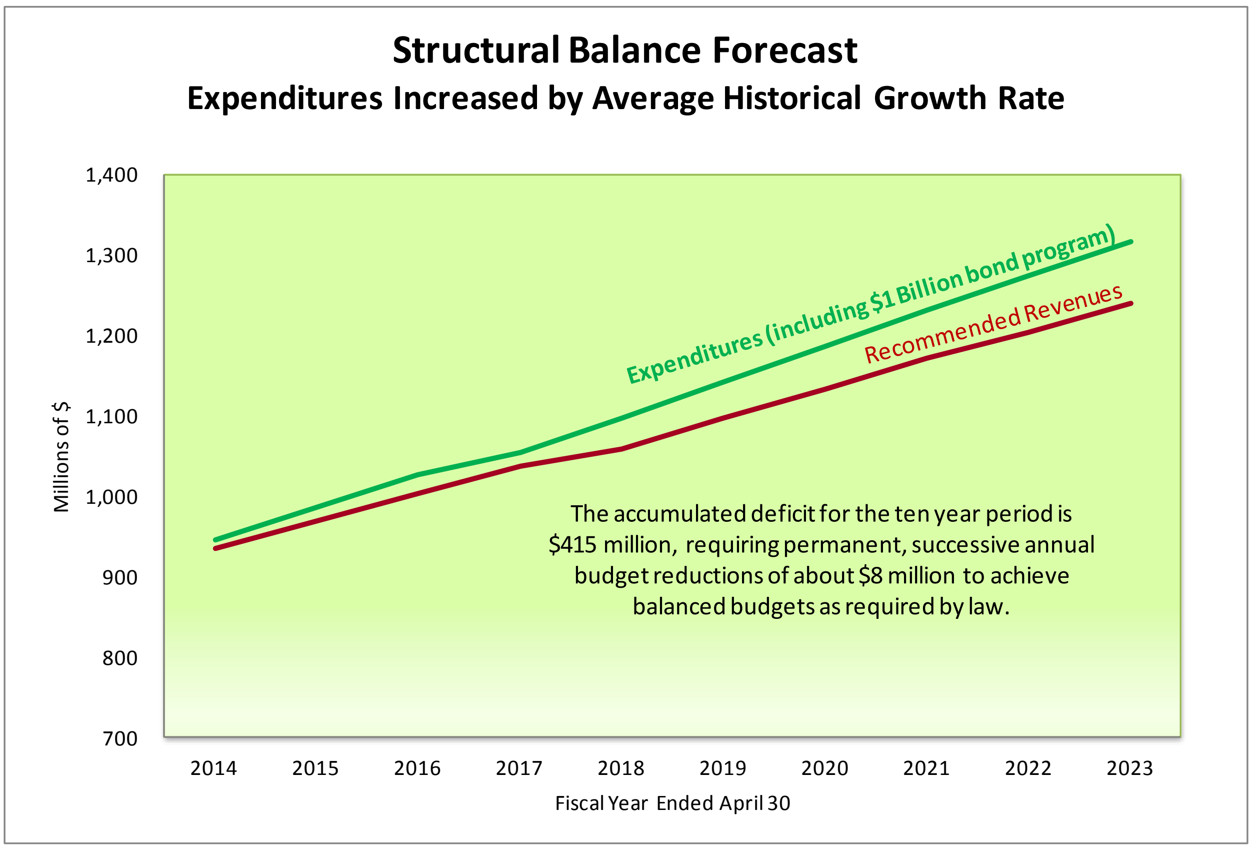
The recommended revenue package neither improves nor exacerbates the regressive nature of the City's tax structure. Relative tax burdens remain largely unchanged.

Tax Burden							
Individual				Business			
	$25,000	$75,000	$150,000		Small	Medium	Large
Current	3.6% - $909	2.6% - $1,968	2.2% - $3,262	**Current**	1.8% - 2,581	0.7% - 10,458	0.3% - 99,038
Year 1	3.9% - $971	2.8% - $2,090	2.3% - $3,454	**Year 1**	1.8% - $2,648	0.7% - $10,581	0.3% - $100,266
Year 10	4.1% - $1,033	2.9% - $2,204	2.4% - $3,618	**Year 10**	2.0% - $2,987	0.8% - $11,713	0.4% - $111,591 [14]

[14] Business gross receipts assumptions: Small = $150,000, Medium = $1,500,000, Large = $30,000,000.

10.4 FUNDING GAP ANALYSIS

CCMR reviewed a 10-year model of general municipal expenditures that incorporated a variety of user-defined growth rates. Comparison of the recommended revenue scenario to one of these expenditure scenarios underscores a sobering conclusion: little will be solved without careful examination of future obligations. The graph below compares the recommended revenue structure to a forecast of expenditures grown by the average historical expenditure growth rate, plus debt service for the $1 billion bond program. The resulting deficit would require permanent, annual reductions of $8 million to achieve the balanced budget as required by law.



10.5 CONCLUSION

The prior analysis summarizes scenarios based upon CCMR's recommendations and should be interpreted within the context of a series of assumptions outside the City's control, not the least of which includes voter approval of tax increases. Nevertheless, CCMR believes the recommendations of this report meet or exceed the requirements of the proposed Revenue Policy. Several revenue inefficiencies are eliminated (land only assessments and operating taxes with sunsets), higher priority needs are addressed (storm water improvements and infrastructure backlog), revenues remain diversified, annual revenue growth is slightly improved. Any single recommendation does not stand alone, but must be considered a critical component of an entire package that balances complex and sometimes competing goals. CCMR believes the overall impact of these recommendations may be compromised without comprehensive implementation.

We caution users of this report to accept an important limitation of our task. We quantified financial capacity but we have not answered the question: Do revenues as identified in this report meet the need? Answering that question was not part of our task but more importantly, it cannot be answered at this time. "Need" has not been defined within the context of adopted goals and disciplined planning, and the connective tissue to match capacity with need—a strategic plan—does not exist. Also outside of CCMR's charter, but an essential next step, is careful examination of municipal expenditures to ensure they are aligned with strategic priorities and reflect prudent spending and cost management practices.

The City must assess the long-term financial implications of current policies and programs, and future options and opportunities, in a way that leads to appropriate strategies to achieve its stated goals. This report is but the first step in strategic planning: to develop an in-depth understanding of available funding. But the City's work is not done and needs to continue with:

- Evaluation of financial risk. Low reserves combined with high debt levels are warning trends.
- Assessment of current service levels to measure performance, quality, and sustainability. In the last several years, departments have endured successive budget cuts, and the resulting impact on residents must be quantified.
- Assessment of the level at which capital investment can be made. The proposed $1 billion capital plan is only a first step in addressing the documented backlog.
- Identification of future commitments and resource demands. The primary pressure currently from a federal mandate to address the multi-billion dollar overflow control issue.
- Identification of key variables that cause change in the level of revenue. Kansas City tax policy is just a piece, perhaps a small piece, of what impacts location decisions

for individuals and businesses. Other issues such as a high quality labor pool, public safety, quality of life, housing stock, schools, transit, and access to shopping and other amenities are probably more influential. The best way to enhance revenues is to make the City a "preferred product" of families and businesses.

CCMR believes all of the above must be done within the context of two overriding principles. First, spending and investment priorities must focus on increasing population, employees, and tax base value. Second, after many failed attempts to remediate the high tax burden on the City's most vulnerable population, CCMR believes policymakers must focus investments on improving the quality of life for those at the lowest income levels.

CCMR submits this report to the Mayor and City Council for their consideration, and now entrusts to them the question fundamental to our work: What kind of City are we going to be, will we be mediocre or will we be great, and how do we balance the books to get there?