

M O N T A N A
Policy Review

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THE PROPERTY TAX PUZZLE

Property Taxes and School Finances: 1989-97

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School Finance Reform Since 1989: What is "Equalization" and
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*A biannual analysis of public policy issues confronting Montana's communities and those who serve them.
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REFLECTIONS ON LOCAL GOVERNANCE

As the Legislature moves toward conclusion, only a few observers remain who believe that genuine tax reform can yet emerge from the several competing and generally ill-advised property tax relief bills. Gordon Morris, Executive Director of the Montana Association of Counties (MACo), may be the exception which is at least a little heroic of him since the MACo tax reform proposal is the only one that has made any sense at all.

While we too remain hopeful that the Legislature may yet pull the tax reform rabbit out of its collective hat, we are also concerned that legislative "sleight-of-hand" in dealing with property taxes may do still more harm to city and county government. Ironically, it was the inability of the Legislature to achieve tax reform throughout the 1970's and 80's that led to the poorly conceived and mis-directed I-105 property tax freeze in the first place.

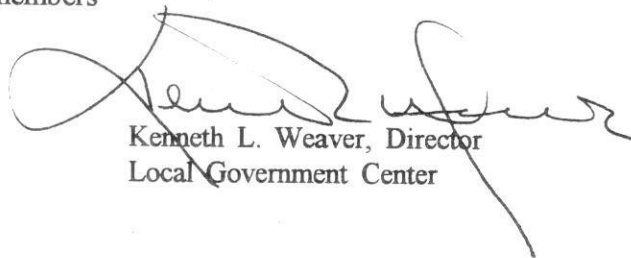
As a result, it has been city and county governments that have had to make do with frozen property taxes - not the state. The result has been increasing local dependence upon electronic gambling revenues to fund essential services while avoiding bankruptcy.

It must, therefore, be especially frustrating for those who govern at the grass roots to watch legislative posturing on the property tax issue. Has it not occurred to any of the 150 legislators that 179 county commissioners and 736 mayors and council members

were also elected to office to mind the public purse? Most would be quick to remind their legislators that they are perfectly competent to adjust mill levies to offset the effects of inflated valuation, if any. Local officials know full well that it is excessive property taxes and not inflated valuation that cause taxpayer resentment.

To be sure, many local government have simply done without during the decade long property tax freeze. Many no doubt need a bit of catch-up to offset the effects of low wages for workers, deferred maintenance and capital replacement. But, local officials also know that to grab windfall property tax revenues is about as smart as using a "hot stick" on a grizzly - the results may be unpleasant, but not for long. Legislators go home after 90 days while city and county officials have to face their voters day after day, year after year.

Why in the world those perfectly nice people who go to Helena for 90 days every other year come to believe that they are obliged to protect local voters and taxpayers from their own locally elected officials remains a mystery for the ages. Perhaps it is because the Legislature can't seem to figure out a way to create a balanced, fair and reliable (e.g. the MACo proposal) tax system for the state. It therefore must feel obliged to fix something...even if "it ain't broke."



Kenneth L. Weaver, Director
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PROPERTY TAXES AND SCHOOL FINANCES: 1989-97

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Property taxes have indeed increased rapidly in recent years, especially on residential property. The largest part of the increase has gone to fund schools. Yet school budgets have failed to keep up with inflation and enrollment growth.

Montana property taxes - particularly those on residential property - have increased rapidly in recent years. What accounts for the dramatic escalation? Is it true that schools have been the major beneficiaries? Was all this the result of court ordered reforms to school finances - so called equalization - or were other factors at work? This paper briefly reviews recent trends in property taxes and their relation to school finances, with the aim of providing answers to these questions.

In 1989 the Montana legislature substantially altered school finances in response to a court decision finding the existing system to be unconstitutional.¹ The new system, including an increase from 45 mills to 95 mills in the state-mandated levy for equalization, took effect in fiscal year 1991. Additional significant reforms to school finances were undertaken during the 1993 legislative sessions. Accordingly, the data in the accompanying table are for fiscal years 1989, 1991, and 1997, in order to illustrate the situation under the old system, the impact of the initial reforms, and the current situation.

Total taxes on all types of property increased by almost 50 percent between 1989 and 1997. Property taxes on residential property have increased even more dramatically - by almost 80 percent over the eight year period. The latter increase outstripped both inflation (33 percent) and growth in personal income (62 percent). These data raise another question as well: Why have residential property taxes risen so much faster than property taxes in general?

Are schools the chief culprit? Property taxes levied for schools - including state, county and district levies - grew by 58 percent.² In fact, the additional \$174 million levied for schools accounted for about 2/3 of the total increase in property taxes. In this sense, then, funding for schools has in fact driven property tax increases.

Are schools "rolling in dough" as a result? Total school budgets increased by a third, but enrollment also grew eight percent.³ Thus budget per student grew 23 percent, trailing inflation by 10 percentage points. Consequently, schools are not "rolling in dough" - indeed they have not kept up with the cost of living.

How can this be? Total property taxes, including property taxes for schools and especially taxes on residential property, have increased rapidly. Why then are school finances deteriorating?

Part of the answer, as we have already seen, is inflation and enrollment growth. Even with moderate inflation of about 3.5 percent per year and modest total enrollment growth, budgets needed to increase by more than 40 percent just to keep the purchasing power of school resources per student constant. But in fact the increase has been smaller.

Another part of the answer is that schools are increasingly dependent on property taxes to fund their programs. Property taxes were 47 percent of school budgets in 1989. School finance reform initially decreased dependence on property taxes as the state used income taxes and other revenues to fund equalization. However, the state's share of budgets has declined since 1991, shifting funding back to the local level where property taxes dominate. Thus, while local property taxes declined from 34 percent of budgets to 22 percent with the initial reform, reliance on local property taxes is now higher than before the reform process began.

Changes in the property tax base in Montana have also contributed to the rise in tax rates and the burden on residential property. Effective with fiscal year 1991, most natural resource production has been exempted from property taxes.⁴ While the property tax base has increased substantially since 1991, it remains somewhat below its level in 1989. Thus, a larger amount of property taxes is being raised from a smaller tax base, and inevitably rates have risen.⁵ The statewide

average mill rate has indeed increased 55 percent, accounting for most of the increase in taxes on residential and other property.

Residential property has also increased in both quantity and, in the western part of the state, price. Reappraisals of existing residential property averaged a modest 11 percent during the 1987-97 period.⁶ However, reappraisals varied greatly from county to county and even house to house, so many homeowners saw substantially larger increases or declines. New construction also bolstered the stock of

The days in which fully 25 percent of the tax burden was borne by natural resource industries are over.

residential property. All of these factors together resulted in a substantial increase in residential property's share of the total tax base, from 24 percent in 1989 to 31 percent in 1991 (mostly because natural resources were exempted), and to 35 percent currently. Thus, not only have property taxes risen, but a larger share is borne by residential property.

Summary

Property taxes have indeed increased rapidly in recent years, especially on residential property. The largest part of the increase has gone to fund schools. Yet school budgets have failed to keep up with inflation and enrollment growth.

These somewhat paradoxical results are explained by a few factors: Other funding for schools - that is, other than property taxes - has grown relatively slowly. Consequently, property taxes are picking up a larger share of total budgets. At the same time, a larger share of property taxes is paid by owners of residential property, because residential taxable value has increased while natural resources diminished. The net effect is that residential property taxes have increased much faster than school funding.

(continued page 4)

Property Taxes and School Finances: 1989-1997

Calendar (Tax) Year	1988	1990	1996	Change
Fiscal Year	1989	1991	1997	1989-97
I. Property Taxes, Inflation and Income				
Total Property Taxes Levied (millions)*	\$498	\$514	\$740	49%
Residential Property Taxes (millions)*	\$148	\$172	\$265	79%
Consumer Price Index (1982-84=100)	118.3	130.7	157.0	33%
Montana Personal Income (millions)	\$10,353	\$11,790	\$16,738	62%
II. Schools				
Property Taxes for Schools (millions)	\$299	\$314	\$473	58%
Total School Budgets (millions)	\$631	\$736	\$840	33%
School Enrollment (K-12)**	151948	151942	163905	8%
Total School Budget per Student	\$4,153	\$4,843	\$5,124	23%
Property Taxes as Percent of Total Budget	47%	43%	56%	9%
Local Property Tax as Percent of Total Budget***	34%	22%	35%	2%
III. The Tax Base				
Taxable Value of All Property (millions)	\$1,943	\$1,573	\$1,868	-4%
Average Total Mill Rate*	256	327	396	55%
Residential Property as Percent of Tax Base	24%	31%	35%	11%

Notes:

* Excluding SIDs

** FY1997 Enrollment is for Fall, 1996

*** Local Property Taxes Defined as Total Property Tax for Schools minus the State Required Portion (45 mills in FY89, 95 mills beginning in FY91).

Sources:

Property Tax Data from Research and Information Division, Montana Department of Revenue

School Budgets and Enrollments from Montana Office of Public Instruction

CPI data reported in "National Economic Trends," Federal Reserve Bank of St. Louis

Personal Income from "Survey of Current Business," USDC, and

Bureau of Business and Economic Research, UM (1996 projected)

Ten years ago Montana state and local governments received as much revenue from natural resource taxes as a typical state would generate from a general sales tax.⁷ Lower oil and gas prices that signaled the end of the "energy crisis" also resulted in much diminished resource revenues. Inevitably, the burden of paying for public services has shifted - income taxes and fees as well as property taxes have increased. While specific decisions about natural resource taxation affected the details of this picture, Montanans would have been required to pay for an increasing share of public services in any case.⁸

The days in which fully 25 percent of the tax burden was borne by natural resource industries are over. With the 1997 reappraisal, residential and commercial property are expected to constitute over half of the property tax base. This means that Montana home and business owners, along with farmers and ranchers, will pay the vast majority of property taxes. Citizens in Montana must continue to consider how best to finance public services - and at what level to fund them - in light of the current economic realities in the state.

¹ For a fuller discussion of school finance equalization, see the accompanying article in this issue.

² These figures include levies for the general and other budgeted funds for K-12 education. Levies for the university system and vo-techs are not included.

³ These figures are for all budgeted funds.

⁴ Two other taxes, the Local Government Severance Tax and the Coal Gross Proceeds Tax, were imposed in place of property taxes on most resource production.

⁵ The new taxes on resources were at approximately the same rates as the old property taxes, but resources were effectively exempted from increases in mill levies that were applied to other property. See Douglas J. Young, "Montana Property Taxes Since I-105: 1996 Update," EB 129, MSU Extension Service, for further information.

⁶ Ibid.

⁷ See Douglas J. Young, "Montana Taxation and Expenditures: Trends and Comparisons (1995 Update)," EB 114, MSU Extension Service.

⁸ See Douglas J. Young, "A Primer on Montana's Taxes," Montguide MT 9601, MSU Extension Service.



SCHOOL FINANCE REFORM SINCE 1989: WHAT IS "EQUALIZATION" AND HAS IT BEEN ACHIEVED?

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In 1988 the First District Court of Lewis and Clark County ruled that differences in expenditures among school districts violated the Montana constitutional requirement to provide equal educational opportunity for all persons.¹ The Montana Legislature has since changed the funding system in an apparent attempt to spread funds more evenly among districts. This paper reviews the reform legislation and the concept of school equalization, and then provides data on changes in finances after the reforms.

SUMMARY

In the late 1980's, Montana courts ruled that the state's method of funding K-12 education violated "the fundamental [Montana] constitutional right of persons in the State to equal protection of the law and to equality of educational opportunity." In particular, the courts found that spending levels differed dramatically among districts in the state. Districts with high property wealth tended to have both higher expenditures and lower tax rates than low property wealth districts.

The Montana legislature substantially altered K-12 funding in a 1989 special session, and then made further significant changes in regular and special sessions in 1993. The policies adopted by the legislature appear to reflect two motives: An effort to reduce the budget disparities between districts, and a concern that equalization might result in substantial increases in spending and corresponding tax burdens.

The school finance goals set by the state and how progress toward them is measured depend on what exactly is meant by the constitutional mandate to provide equal educational opportunity. Equalizing educational outcomes - in the sense of all students leaving school with the same set of skills - is neither possible nor desirable because of the diverse aptitudes and occupational choices of young people.

Equalizing school budgets has the advantage of preserving local decision making with regard to the composition of spending. However, the state is now in the position of forcing some districts to increase their spending without providing the resources to pay for the increases. The state intrudes on other districts by limiting their budgets, even when the local voters are willing to levy the taxes to pay for them.

the recent finance reforms. The basic finding is that general fund budgets are significantly more equalized in 1995 than in 1989. For example, the ratio between the 95th and 5th percentiles of budget per pupil at the elementary level has shrunk from 2.11 to 1.54. At the high school level the ratio declined from 2.36 to 2.02. The Federal target for these figures is 1.25. It is unclear whether or not the courts would view the current system as meeting constitutional requirements.

I. INTRODUCTION

In 1988 the First District Court of Lewis and Clark County ruled that differences in expenditures among school districts violated the Montana constitutional requirement to provide equal educational opportunity for all persons.¹ The Montana Legislature has since changed the funding system in an apparent attempt to spread funds more evenly among districts. This paper reviews the reform legislation and the concept of school equalization, and then provides data on changes in finances after the reforms.

The court's decision was based on data like that in Table 1 for elementary schools in 1989.²

Table 1. Elementary Districts Ranked by Budget per Pupil
(Fiscal Year 1988-89)

	Budget	Mill Value	Mills Levied
Top 10%	\$10,536	\$216	18
Top 20%	\$8,274	\$181	22
Second 20%	\$4,571	\$62	36
Middle 20%	\$3,558	\$33	44
Fourth 20%	\$3,034	\$32	40
Bottom 20%	\$2,570	\$25	30

Here districts are ranked according to their general fund budget per pupil. Among the 10 percent of districts with the largest budgets, the average was \$10,536 per student. Among the top 20 percent of districts, the average budget was \$8,274, and so forth, down to the bottom 20% of districts, where budgets averaged \$2,570 per student.³ In other words, budgets in the highest spending group

of schools were four times as large as budgets in the lowest spending group.

Judge Loble found a denial of equal educational opportunity, because the differences in budget levels were so large. As he succinctly put it, "Baker spends \$6,000 per student and comparably sized Darby spends \$2,000 per student. Darby students are being shortchanged."⁴

Judge Loble further concluded that differences in spending were inextricably tied to differences in local property tax base. Table 1 also shows the amount of revenue per student raised by levying one mill at the district level: a district's "mill value" per student. It is evident that districts with larger mill values tend to have larger budgets. Often, a high mill value indicates the presence of oil and gas, industrial or utility property. Thus, when local mill levies are set, much of the revenue may come from nonresident owners who have little to say in the decision. In these circumstances, it is understandable that districts with higher mill values tend to levy and spend larger amounts.

....differences in spending were inextricably tied to differences in local property tax base.

Larger budgets are not, however, necessarily associated with higher tax rates. As the last column of Table 1 indicates, the highest spending districts actually had the *lowest* tax rates. Again the explanation lies in the local tax base: Districts with very large tax bases can raise substantial amounts of revenue while levying fewer mills. Thus, residents in the wealthier districts tend to enjoy both higher school spending *and* lower taxes than residents in poorer districts.

Judge Loble noted that the state's Foundation Program accounted for just over half of general fund budgets, and that "the vast majority of districts find it necessary, in order to properly fund a basic quality education, to resort to funds derived from the voted local levy. This being so, under Montana's school financing system, school districts with high property valuations (wealthier

school districts) have more money available to them and, thus, are able to offer better educational opportunities than school districts with lower property taxable valuations (poorer school districts)... The net result ... is that Montana has not met its burden of providing equality of educational opportunity. The disparate wealth of the districts beings about this inequity."⁵

II. LEGISLATIVE REFORM SINCE 1989

House Bill 28

The Montana Legislature substantially reformed school finances in a 1989 special session.

Payments from the state to districts under the Foundation program were increased 17 to 28 percent. This was the largest increase recorded in Montana history.⁶

Comprehensive insurance and special education costs were folded into the general fund budget, so that greater state support was provided.

The state also began a limited *guaranteed tax base* program to support local levies and retirement costs. A guaranteed tax base insures that a mill levied in any district will generate a certain minimum amount of revenue, no matter how low the actual tax base in the district might be. All of these provisions tended to reduce the degree to which districts depended on their local tax base, and thus were expected to have an equalizing effect on spending.⁷

The increased state commitment to school funding was financed primarily by an increase in the mandatory school levy from 45 mills to 95 mills. In addition a 5% surtax on individual and corporate income taxes, and reallocated coal, lottery and income tax revenue were designated for the School Equalization Account.

House Bill 28 made other important changes in the property tax system. Specifically, most oil, gas and coal production was taken off the property tax rolls, and alternative taxes were imposed (the Local Government Severance Tax and Coal Gross Proceeds Tax). While these changes were revenue neutral as of fiscal year 1990, they effectively exempted oil, gas and coal from the 50 mill increase in statewide property taxes. As a result, the burden of paying for schools was (partially) shifted to other forms of property, including agricultural, residential, commercial and industrial.

A second effect of exempting most oil, gas and coal was to make district tax bases much more equal. That is, one of the reasons that mill values varied so much in the 1980's was that some districts had valuable natural resource production while others did not. As will be seen below, disparities in mill value per student were dramatically reduced between 1989 and 1991, mostly because of the change in natural resource taxes.

House Bill 667

In 1991 the Under Funded Schools Coalition and the Montana Rural Education Association filed follow up law suits contending that HB 28 failed to alleviate spending disparities among districts. They noted that large expenses such as transportation, (most) retirement and capital/debt outlays were still primarily dependent upon locally raised property taxes. They also argued that HB 28 locked in existing disparities between districts. Under HB 28 districts were restricted in their ability to increase budgets, so that lower spending districts were not brought any closer to the higher spending districts. In part to forestall this second law suit, the legislature passed HB 667 in the 1993 regular session.⁸

HB 667 established new maximum and "minimum" (80% of the maximum) general fund budgets for districts, and instituted a variety of provisions intended to get more districts into the target range.

The state provides full funding for the first 40% of the maximum budget.

The state provides guaranteed tax base aid for the next 40%; that is, up to the minimum budget.

Districts currently below the minimum are required to increase gradually their budgets over a 5 year period, whether or not local citizens want the increases.

Districts currently above the maximum are prohibited from further increases, again regardless of the wishes of the local citizens.

House Bill 22

The fiscal situation of state government changed dramatically after the regular legislative session was completed. A tax reform (sales tax) package was defeated in a June, 1993 vote, and a successful initiative campaign forestalled an increase in income taxes. In addition, fall enrollments were significantly higher than expected, creating a projected budget shortfall. The legislature then reconvened in a special fall session with the principal aim of balancing the state's budget. HB 22 attempted to reduce spending for schools from the levels implied by HB 667, and shifted responsibility for budget decisions from school trustees to the voters.

The minimum and maximum general fund budgets established earlier in the year, and the associated state aid, were reduced by 4.5%.

Despite the cuts, enrollment increases meant that the state's education budget remained higher than what had been envisioned when HB 667 was passed.

voter approval is now required for almost all increases in general fund budgets, including growth due to enrollment or inflation.⁹

Summary

The policies adopted by the legislature appear to reflect two motives: an effort to reduce the budget disparities by concentrating state aid on poorer districts, and a concern that equalization might result in substantial increases in spending and corresponding tax burdens, especially at the state level. The results to date of these efforts will be discussed in Section IV. First, however, the concept of equalization is examined more closely.

III. THE CONCEPT OF EQUALIZATION

Several alternative interpretations of Montana's constitutional requirement for "equal educational opportunity" are possible. One's evaluation of recent trends in school finance depends, in part, on what interpretation is applied.

Equalization of Outcomes - One interpretation is that all students should receive the same education, in the sense that all would leave school with the same or a similar set of skills. Because student abilities differ, attempts to equalize outcomes generally require that educational resources be distributed on a *compensatory* basis. That is, more resources must be devoted to students who are initially more disadvantaged.

Improving the educational attainment of disadvantaged students is often desirable on both efficiency and equity grounds. However, efforts to equalize outcomes may require reducing resources devoted to more able students - investments that might have even higher private and social rates of return. Even if all students are not suited for high school calculus or college prep physics, it is almost surely desirable that such

classes continue to be offered to the more able students. Furthermore, equalizing educational outcomes at the individual level is probably impossible, because the differences among students in genetic, family background and other social factors are simply too large to be overcome by any known educational programs.

Equalization of Resources - Equal educational opportunity can be interpreted as providing the same educational resources throughout the public school system. Even though not all students will receive the same benefit or even choose to take exactly the same classes, all students are presumably provided with the same opportunities.

Equalizing resources may require preventing some districts from increasing their offerings, because other districts are unwilling or unable to provide the same offerings. For example, French classes may be of interest to parents and students in some districts, but not in others. Similarly for vo-ag courses, diesel mechanics, and college physics. Does equalizing educational opportunity then require that all courses must be offered in any district, if they are to be offered in any district?

Equalization of Spending - Alternatively, school finances might be judged to provide equal opportunity if expenditures are (approximately) the same in all districts. This concept of equalization has the advantage that it allows for diversity in the actual course offerings across districts.

Equalizing spending may still significantly infringe on local decision making. As established in HB667 and HB22 discussed above, some districts are required to increase their spending and taxes, even when their citizens do not wish to do so. Other districts are prevented from spending as much as they would like. That is, citizens in some districts would like to increase the educational op-

portunities available to their students and are willing to pay for them, but the state prevents them from doing so on the grounds that it would create inequality of opportunity.

Another objection to equalizing spending is that it may focus attention on the wrong things: dollars and budgets as opposed to actual educational outcomes. A number of studies from around the nation have failed to find a systematic relationship between educational achievement and spending.¹⁰ The most important factor affecting student performance is family background. Schools also matter, in the sense that some schools do a much better job than other schools do. But these differences in school performance are not necessarily related to spending totals. Funds can be spent on carpets, buses and/or athletic facilities without have much impact on how much students learn. It is worth noting, however, that this “frills” argument was specifically rejected by Judge Loble, who concluded that districts were forced to rely on local voted levies “necessary to fund essential educational programs and services.”¹¹

Equalization vs. Providing a Minimum - A final notion of providing equal opportunity is that the state should insure that every student has access to an education which meets a minimum standard. Beyond this minimum, districts may choose to provide additional or higher quality educational services, or simply newer band uniforms or more comfortable seating at football games, but this decision would be left to the local citizens.

As indicated earlier, the state currently defines the “minimum” budget to be 80 percent of the “maximum” budget, and the state directly provides half of the funds to reach the minimum. As an alternative, the state could fully fund the minimum bud-

get, thus insuring that this goal would be reached without having to “force” districts to increase their local taxes. The fiscal impact of fully funding the minimum would be fairly small, since almost all districts are already at that level. The main element would be a substitution of state taxes for local taxes.¹²

The principal argument against just guaranteeing the minimum is that substantial differences in spending are likely to continue, because some districts will inevitably choose budgets substantially exceeding the minimum.

Summary

The school finance goals set by the state and how progress toward them is measured depend on what exactly is meant by the constitutional mandate to provide “equal educational opportunity.” Equalizing educational outcomes - in the sense of all students leaving school with the same set of skills - is neither possible nor desirable because of the diverse aptitudes and occupational choices of young people. It makes no more sense for all students to study calculus than it does for all students to study diesel mechanics. It probably doesn’t even make sense for all *districts* to offer classes in both calculus and diesel mechanics.

Equalizing school budgets has the advantage of preserving local decision making with regard to the composition of spending if not the total amount. However, the current approach embodied in HB667 and HB22 puts the state in the position of forcing some districts to increase their spending without providing the resources to pay for the increases. The state intrudes on other districts by limiting their budgets, even when the local voters are willing to levy the necessary taxes.

Guaranteeing a minimum budget financed with state funds would eliminate half of this problem. In addition, extending the guaranteed tax base to include spending between the minimum and maximum amounts would insure that poorer districts are not disadvantaged in this range. If both strategies were adopted, the state's budgetary commitment would be substantially increased. An alternative would be to eliminate the full state support it now pays for the first 40 percent, while extending the guaranteed tax base to the 100 percent level.¹³

In the final analysis, the goals of equalization and local control are at least partially competing. Even if the state fully funded a basic education and guaranteed the same tax base to every district, citizens in different districts would choose different budget levels and class offerings, because of the diverse incomes and educational backgrounds of the residents. Thus, if equalization is to be pursued to its logical conclusion, some degree of local control will be sacrificed.

IV. EQUALIZATION TRENDS SINCE 1989

This section provides data on trends in school equalization in recent years. The principal question addressed is: Have general fund budgets in fact become more equalized since the introduction of the various reforms described in section II.¹⁴

The data set consists of observations on 301 elementary districts and 118 high school districts for which consistent data are available for fiscal years 1989, 1991 and 1995 (Table 2).

Table 2. Data Means

	FY 89	FY91	FY95	% Change 1989-95
Means for Elementary Districts (301 observations) weighted by enrollment, in constant 1995 dollars				
General fund budget per student	3394	3602	3493	2.9%
Mill value per student	19	15	15	-21.1%
General fund mills levied (district-level)	71	39	67	-5.6%
State revenues per student	1577	2682	2309	46.4%
Federal revenues per student	NA	174	125	-28.2%*
Means for High School Districts (118 observations) weighted by enrollment, in constant 1995 dollars				
General fund budget per student	5213	5431	4745	-9.0%
Mill value per student	54	41	37	-31.5%
General fund mills levied (district-level)	46	27	37	-19.6%
State revenue per student	2290	3662	2997	30.9%
Federal revenues per student	NA	281	128	-54.4%*

NA = Not Available

* % change 91-95

Nominal values have been converted to 1995 dollars using the CPI. General Fund budgets amount to over half of all spending including most general educational costs, but exclude retirement, transportation and other functions.¹⁵ Note that average per pupil budgets rose dramatically with expansion of state aid in the initial reform in 1991, but then decreased significantly by 1995.

Mill value per student measures the number of dollars of property tax revenue per student that is raised when a school district levies one mill. The sharp decline in these values in 1991 is primarily attributable to minerals (oil, gas, coal) being removed from the property tax base.¹⁶ The initial impact of school reform was to reduce the extent to which districts relied on local mill levies, but those levies increased significantly during 1991-95. State aid to local districts mirrors the pattern of local efforts: The initial impact of reform was to increase greatly state contributions to schools, but these have since failed to keep up with inflation and enrollment growth.

Federal impact aid is not separately available for 1989, although it is included in the total of general fund expenditures. Although the average amounts per student are not very large, Federal impact aid is very important to particular districts, and Judge Loble cited these funds as contributing to inequality.¹⁷ These revenues have also fallen dramatically relative to enrollment and inflation in the last few years.

Budget Ratios

Table 3 displays budget ratios by enrollment percentiles. That is, districts are ranked from lowest to highest according to their budget per pupil. Then the ratio of budgets at the 95th and 5th percentiles of students is computed. For example, the first entry indicates that in 1989 spending at the 95th percentile was 2.11 times as large as spending at the 5th percentile.

Table 3. Budget Ratios by Enrollment Percentiles

Percentile of Enrollment	Ratios			% Change 89-95
	FY 89	FY 91	FY 95	
Elementary (302 observations)				
General fund budget per student				
95TH/5TH	2.11	1.91	1.54	-27%
90TH/10TH	1.64	1.42	1.33	-19%
75TH/25TH	1.13	1.15	1.12	-0.88%
High School (118 observations)				
General fund budget per student				
95TH/5TH	2.36	2.36	2.02	-14%
90TH/10TH	1.69	1.80	1.64	-3%
75TH/25TH	1.20	1.24	1.22	2%

There are substantial declines in budget ratios between 1989 and 1995 for both elementary and high school districts, indicating that budgets have become considerably more equalized. On the other hand, the 1995 values remain higher than the 1.25 target of Federal policy.¹⁸

These budget ratios significantly overstate inequality of educational opportunity, because they do not account for economies of scale associated with district size. As recognized in the legislature's schedule of maximum general fund budgets, it is significantly more expensive to provide education in small schools than large. An alternative approach would be to compute budget ratios relative to the legislative schedules; that is, how much each district is spending relative to the maximum budget set by the legislature. Curt Nichols reports that such calculations for 1995 yield values of 1.36 for high schools and 1.32 for elementary schools - much closer to the 1.25 target implicit in the state's definition of minimum and maximum.¹⁹

Even if the 1.25 target were actually reached, it is not clear whether or not the courts would agree that this constitutes "equalization." For example, if the minimum budget level for a school is \$4,000 per student, then a school at the maximum would budget another \$1,000 per student. With about 20 students per class, the school at the maximum would have about \$20,000 more to spend per class, and presumably be able to offer additional educational opportunities.

Standard Deviations

Table 4 displays standard deviations across students in per pupil budgets and other magnitudes.²⁰ The results for budgets confirm the previous finding of substantial equalization: The standard deviations of per pupil spending declined 33 and 28 percent, respectively, at the elementary and high school levels. District tax bases also became substantially more equalized, again principally because minerals were removed from the tax base. In 1989 the distribution of mill values was highly skewed by the presence of some smaller districts which contained important amounts of oil, gas or coal production. District mill levies also became more equalized.

Table 4. Standard Deviations

	FY 89	FY 91	FY 95	% Change 89-95
Elementary Districts (301 observations)				
weighted by enrollment, in constant 1995 dollars				
General fund budgets per student	943	937	633	-33%
Mill value per student	36	28	22	-39%
General fund mills levied (district-level)	38	19	18	-53%
State revenues per student	239	313	281	18%
Federal revenues per student	NA	657	395	-40%*
High School Districts				
(118 observations)				
weighted by enrollment, in constant 1995 dollars				
General fund budgets per student	1917	2188	1389	-28%
Mill value per student	81	46	40	-51%
General fund mills levied (district level)	18	12	12	-33%
State revenues per student	534	766	652	22%
Federal revenues per student	NA	1394	531	-62%*

NA = Not Available

* % change 91-95

State revenues became more unequally distributed over the period, but this would not necessarily imply greater inequality of district budgets. In particular, if state aid became more concentrated on low wealth districts it would be expected to have an equalizing effect on budgets.

Finally, note that the reduction in Federal impact aid greatly reduced the inequality of such aid. This is because relatively few districts received very much in the first place, so a reduction in such aid resulted in greater equality.

Correlations with Mill Value

The legal case against the old school funding policy was substantially based on correlations between property wealth, budgets and other variables such as those reported in Table 5. The 1989 data imply that districts with higher mill values tended to have larger budgets while levying fewer mills on their residents. Perhaps most strikingly, these “wealthier” districts also tended to receive more state aid than poorer districts.

Table 5. Correlations with Mill Value
Data in 1995 dollars, weighted by enrollment

	BUDGET	MILLS	STATE
Elementary Districts (301 observations)			
FY89: MILL VALUE	0.38	-0.28	0.29
FY91: MILL VALUE	0.30	-0.21	0.10
FY95: MILL VALUE	0.46	-0.37	-0.26
* 0.05 % critical value for $H_0: R = 0$ is $ R \geq 0.12$.			
High School Districts (118 observations)			
FY89: MILL VALUE	0.45	-0.42	0.20
FY91: MILL VALUE	0.28	-0.25	0.10
FY95: MILL VALUE	0.35	-0.31	-0.08
*0.05% critical value for t-test: $ R \geq 0.19$.			

MILL VALUE = mill value per student

BUDGET = general fund budget per student

MILLS = general fund mills levied

STATE = general fund state revenues per student

Somewhat surprisingly, the situation appears similar in 1995: Higher wealth districts still have larger budgets and lower tax rates. State aid, however, appears to be less directed toward the high wealth districts.

One explanation for some of these results is that they reflect, in part, the correlation of each of these variables with school size. Smaller districts tend to have larger tax bases and larger budgets, the latter in part because they are more expensive (per student) to operate. State aid may also be directed toward smaller districts for the latter reason.

Table 6 reports the same set of correlations while controlling for enrollment.²¹ Indeed, it appears that state aid is directed toward poorer districts (controlling for size), and this tendency has become more pronounced under the reforms. However, the other findings remain robust even when controlling for size: Wealthier districts tend to have higher budgets and lower tax rates, and this tendency does not appear to have changed much between 1989 and 1995.

Table 6. Partial Correlations with Mill Value

	BUDGET	MILLS	STATE
Elementary Districts (301 observations)			
FY89: MILL VALUE	0.31	-0.21	0.08
FY91: MILL VALUE	0.24	-0.16	-0.02
FY95: MILL VALUE	0.39	-0.31	-0.30
* 0.05 % critical value for $H_0: R = 0$ is $ R \geq 0.12$.			
High School Districts (118 observations)			
FY89: MILL VALUE	0.41	-0.38	-0.11
FY91: MILL VALUE	0.17	-0.23	-0.22
FY95: MILL VALUE	0.35	-0.29	-0.37
* 0.05 % critical value for $H_0: R = 0$ is $ R \geq 0.19$.			

V. CONCLUSION

Montana school finances are clearly more equalized now than at the time of the court decision finding the system unconstitutional. General fund budgets, property tax wealth, and tax effort (mill rates) all display marked trends toward greater equality across districts. A combination of circumstances has led to these results: Declining oil and gas prices reduced disparities in wealth across districts, and legislative action removed most natural resources from the property tax base entirely. Other reforms included a larger state contribution to local schools, focusing that aid on poorer districts via a guaranteed tax base, and measures which require local districts to bring their spending into closer alignment with state norms. Reductions in PL 874 funds from the Federal government also contributed significantly to equalization of budgets, because these funds were very unequally distributed

It is not clear whether the results will satisfy the court. While budget disparities have been significantly reduced, there still remain significant differences in spending levels across school districts. While the state has assumed a larger share of the cost of K-12 education, that share has di-

minished since the income reform in 1991. While local tax efforts are more equalized than prior to the reforms, there remains considerable variation from district to district. As Table 6 demonstrates, it remains generally true that wealthier communities have both larger budgets and lower tax rates than poorer communities.²³

¹ "Opinion and Order," Helena Elementary School District No. 1, et al vs The State of Montana, et al, Montana First Judicial Court, Lewis and Clark County (1988). The State Supreme Court in 1989 upheld the district court decision.

² The trial commenced in May of 1987 and relied extensively on Fiscal Year 1985-86 data. The 1989 data above are similar, because school finances had not been substantially altered in the meantime. Table 1 data are in 1995 dollars and have been adjusted to include comprehensive insurance. For details, see John Joseph Gilboy, *Equalization of School Funding in Montana*, M.S. thesis, MSU-Bozeman, 1996.

³ Smaller schools tend to have higher costs per student, which explains some of the differences in Table 1. But budgets vary widely even among districts with similar enrollments. See Gilboy, op. cit.

⁴ "Opinion and Order," pp. 10-11.

⁵ "Opinion and Order," pp. 9-10. Judge Loble also noted that PL 874 funds and the many funds outside the general fund (retirement, insurance, transportation, etc) contributed to spending inequalities.

⁶ Montana Education Association, *Montana's Promise: Funding a Quality Public Education for All*, 1996.

⁷ In addition, HB 28 limited maximum general fund budget increases, contributed state funds to transportation and created reserve limits. See Gilboy, op. cit.

⁸ The lawsuits remain unresolved as of this writing, while the effects of the various reforms are examined.

⁹ *Declining enrollment* also triggers a public vote, if the *per pupil* budget rises as a consequence. This has occurred in a number of districts around the state.

¹⁰ See Eric Hanushek, *Making Schools Work*. Washington, D.C.: The Brookings Institution, 1994. For an opposing view, see David Card and Alan B. Krueger, "Labor Market Effects of School Quality: Theory and Evidence," National Bureau of Economic Research Working Paper #5450, NBER, Cambridge, MA, 1996. The Fall, 1996 issue of *The Journal of Economic Perspectives* also contains a number of articles on this issue.

¹¹ "Findings of Fact," Helena Elementary School District No. 1, et al vs The State of Montana, et al, Montana First Judicial Court, Lewis and Clark County (1988), p. 44.

¹² However, it may be more difficult for the state to raise funds that it is for districts, as is evidenced both by the 1993 experiences and passage of an overwhelming majority of local mill levies.

¹³ I am grateful to Curt Nichols for this suggestion.

¹⁴ An accompanying piece, "Property Taxes and School Finances," describes budgets in relation to enrollment, inflation and property taxes.

¹⁵ Comprehensive insurance expenditures are added to the 1989 data, and Federal Impact Aid is added to the 1995 data, in each case to make definitions consistent across years. For details, see Gilboy (1996).

Similarly, changes in commodity prices will affect productive value assessments for property such as farmland and timber land. Because the valuation of these lands is based on their productivity, the tax liability is not dependent upon local supply and demand for property. Changes in commodity prices will change the assessed value of these lands. For example, grazing fees have increased by 20.9% over the previous reappraisal cycle, so the assessed value of grazing land has increased correspondingly.

Total assessed value also reflects the quantity of property in the various classifications. Expansion, improvements, and new construction add to market valuations. Shifts in property classifications are also reflected in assessed values by class. For example, when non-irrigated cropland becomes irrigated, there will be a decline in the assessed value of dry farming and a rise in the value of the irrigated farm class.

The Montana Department of Revenue has estimated an increase in the taxable value of residential and commercial real estate (class 4) for 1997 to be 44% over the previous tax year. Of that 44% increase, 38% reflects changes in real estate price, and the remainder is due to new construction and improvements. Agricultural land (class 3) has an estimated increase of 6%. When broken down by farmland type, however, the changes are relatively small—except for a 21% increase in grazing land. Because this percentage is so

large, it has been suggested that tax increases on grazing land should be phased in over several years. This analysis does not incorporate incremental increases for grazing land taxable value. Most of the change in agricultural land value is the result of changes in price and shifts in land types. Table 2 (page 25) shows the taxable values of various property classifications for 1996 and 1997. Values reported in this table reflect only changes in price, and do not include any new construction or improvements which will further increase the 1997 taxable value.

Concern over the increased property values has encouraged politicians to consider alternatives to ameliorate the resulting tax increases. The last column in Table 2 shows the effect on taxable value for each property class if an adjustment is made such that the statewide taxable value in 1997 is equal to 1996, but still reflects changes in the relative value of property.

Neutralizing the increases in the total taxable value can be accomplished by adjusting the taxable rate for each class of property. If the rate for each class is reduced by 15%, the total taxable value in 1997 would be equal to the total taxable value in 1996.¹ The estimated

¹ This is expressed by the following formula: $15\% = [1 \div (1 + 18\%)] - 1$, where 18% is the percent change from 1996 to 1997 total taxable value (Table 2). The same results would be achieved by dividing taxable valuation for each class by 1.18.

change to each property class is shown in the last column of Table 2. This is an aggregate change at the total state level and does not neutralize values of individual tax districts. As noted, individual sectors of the economy would be affected differently.

If all taxable rates were reduced by 15%, agricultural property assessed as grazing land would incur a 2% increase in taxes, but agricultural land overall would see a tax bill reduction. Residential and commercial real estate would experience a 17% rise in taxes. Under this scenario, urban centers with growing development would face a disproportionately larger share of the tax burden, as would timber lands, whose tax revenues would nearly double.

A second alternative is to reduce the mill levy (as opposed to the tax rate) in each taxing district, forcing revenue neutrality

across the state. Reducing the state mill levy from 101 to 85.6, a 15% decline, will result in 1997 total state property tax revenues equal to those of 1996. However, because individual taxing districts are made up of different combinations of property classifications, no single taxing district will be revenue neutral unless all local taxing districts agree to adjust mill levies to obtain revenue neutrality. Even so, such a mill levy adjustment will not leave individual taxpayers unaffected.

In summary, various policy alternatives exist to ameliorate property tax increases. Adjustments in taxable rates or mill levies may reduce the impact of the increase and still reflect changes in the relative value of property. On the other hand, if the objective is to leave individual taxpayers unaffected, the only alternative may be to freeze taxes at their 1996 levels.

(Continued see tables following)

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Table 1. Montana's Property Classifications and Tax Rates

Property Class ^a	Description	Taxable Rate (%)
1	Mines and mining claims except coal and metal mines: <i>net proceeds</i>	100.00
2	Metal mines: <i>gross proceeds</i>	3.00
3	Agricultural land, nonproductive mining claims: <i>productive value</i>	3.86
	Nonagricultural land (more than 20 but less than 160 acres): <i>productive value</i>	27.02
4	Residential, commercial, and industrial land; idle agriculture; timber processing; mobile homes; farmsteads; and one-acre home sites: <i>market value</i>	3.86
	Golf courses: <i>market value</i>	1.93
5	Air and water pollution control equipment, real and personal property of rural electric and telephone cooperatives, new industrial property, machinery and equipment for electrolytic reduction facilities, real and personal property for research and development, real and personal property to produce gasohol: <i>market value</i>	3.00
6	Livestock, rental or lease equipment valued less than \$5,000, machinery and equipment for canola seed oil processing: <i>market value</i>	4.00
7	Real and personal property of independent telephone and electric cooperatives: <i>market value</i>	8.00
8	Business and agricultural personal property (including equipment): <i>market value</i>	6.00 ^b
9	Real and personal property of centrally assessed companies: <i>market value</i>	12.00
10	Forest/timber land: <i>productive value</i>	0.79
12	Real and personal property of railroads and airlines: <i>market value</i>	7.51

^aMontana has had up to 20 tax classifications. This number has subsequently been reduced to 11. Because old class code number 11 was combined into class code number 4, the eleventh class code in the current system actually is identified as class code number 12 (i.e., there is no longer a class code 11).

^bThe taxable values for business and agricultural equipment are on a sliding scale, to be reduced from 9% of market value in 1995 to 6% beginning in fiscal year 1997.

Table 2. Property Tax Changes (\$ mil.)

Property (class)	Taxable Value		Percent Change	Change in Taxable Value
	1996	1997		
Agricultural Land (3)	139.0	147.0	6	-.10
Irrigated	17.4	16.9	-3	-.17
Dry Crop (summer/fall)	74.0	74.4	1	-.15
Grazing ^a	39.4	47.6	21	.02
Dry Hay	7.3	7.2	-2	-.17
Dry Crop (continuous crop)	.8	0.8	0	-.15
Livestock (6)	24.5	24.5	0	-.15
Business Equipment (8)	241.5	217.1	-10	-.24
Residential/Commercial Real Estate (4)	884.3	1,220.3	38	.17
Utilities (9)	446.5	452.7	1	-.14
Timber Land (10)	7.3	16.5	126	.92
Other	124.6	124.8	0	-.15
Totals: ^b	1,867.6	2,203.0	18	0

Source: Unpublished estimates from Montana Department of Revenue.

^aData shown here for grazing land do not include a phase-in for the increase in the taxable value.

^bDue to rounding errors, columns may not sum to total.



THE PROPERTY TAX FREEZE AND OTHER PROPOSALS

by **Dennis M. Burr**, President of Montana Taxpayers Association

The bill (SB195) requires that the same values used in 1996 be used until the Year 2000.

...The major impact of SB195 is to the taxable value of residential property. Without the delay in the reappraisal, the taxable value of residential property in Montana will increase by 44% in 1997, a total of \$288 million.

however...Freezing livestock values at the 1996 level will result in the taxable value of this class of property being \$2.9 million higher than it would be without the tax freeze of SB195.

The Senate Taxation Committee held a hearing on Friday, January 24, on SB195. This bill, sponsored by Senator John Harp from Kalispell, would delay the reappraisal of land and buildings in Montana until the Year 2000. Current law requires that new values, with an average increase of 43% statewide, be used for tax purposes in 1997. SB195 also freezes the values of other classes of property to be consistent with the treatment of Class 4 real estate.

Agricultural land and forest lands are scheduled for revaluations in 1997. Delaying the implementation of the reappraisal will prevent a \$10.1 million increase in the taxable value of agricultural lands and a \$9.2 million increase in the taxable value of forest lands. On the other hand, business machinery and equipment and livestock will carry higher values as a result of the freeze. The bill requires that the same values used in 1996 be used until the Year 2000. Livestock are valued on an average of past years market prices. Since cattle prices dropped in 1996, the 1997 taxable values would normally be lower than those in 1996. Freezing livestock values at the 1996 level will result in the taxable value of this class of property being \$2.9 million higher than it would be without the tax freeze of SB195. Similarly, business machinery depreciates annually, but will not be depreciated under the provisions of this bill. Business equipment, including pollution control equipment, will carry taxable values \$13.7 million higher in 1997 than would occur if normal depreciation were applied to the property. The higher taxable value of livestock and business equipment will be more than offset by the \$10.1 million decrease in the taxable value of agricultural land and the \$55 million decrease in the taxable value of commercial land and buildings proposed by SB195.

The major impact of SB195 is to the taxable value of residential property. Without the delay in the reappraisal, the taxable value of residential property in Montana will increase by 44% in

* Census and Economic Information Center Montana Department of Commerce

Despite reservations concerning SB195 by local governments, schools and some business interests, no one spoke against the bill at the hearing before the Senate Taxation Committee. The reason for this lack of opposition is partly explained by the following table on page 31. This table contains estimates of the impact of proceeding with the reappraisal and the effect of two options which the legislature will consider as alternatives to SB195.

The first column shows the effect of the reappraisal of Class 4 property (land and buildings) in each of Montana's 56 counties. Average changes in value range from a 3% decrease in value in McCone County to a 79% increase in value in Sweet Grass County. In general, counties in western Montana experienced sharp increases in value while eastern Montana counties had increases but less than the 44% state-wide average. The wide range of changes in value between counties makes it difficult to mitigate the tax effect of the reappraisal in manners acceptable to both eastern and western Montana.

The second column shows the change in total taxable value in each county as a result of the 1997 reappraisal. This column demonstrates why a reduction in state and local government tax rates (mill levies) will not eliminate a tax increase on Class 4 property. The property subject to reappraisal is approximately one-half the taxable value of Montana. Therefore, a 44% increase in value for Class 4 property causes a 21% increase in the total taxable value of the state. Under existing law, property taxes on Class 4 property would increase an average of 22.4% in 1997, even if local governments raised no more revenue from the property tax than they did in 1996. The reduction in tax rates of 21% to offset the total taxable value increase of 21%, offsets only about one-half of the 44% increase in the value of Class 4 property.

Column three, based on current law, also allows the state to take full advantage of the reappraisal through the 95 mill school equalization levy

collections would increase by more than \$40 million per year as a result of reappraisal if the state levies are not reduced to compensate for taxable value greatly increases. Sixteen of Montana's 56 counties would have more than a 30% increase in property taxes on Class 4 real estate under existing law even with no additional property tax revenue collected by cities and counties.

REDUCTION OF STATE-WIDE MILL LEVIES

The Racicot administration has proposed reducing the statewide levies for school equalization and the university system to insure that state government does not receive a windfall from the 1997 reappraisal. Although Class 4 property values increase 44% as a result of the reappraisal, the mill levy reduction is only 19%, from 101 mills to 82 mills. This is because part of the 44% increase is the result of new construction and is excluded in calculating the mill levy reduction and also because Class 4 property is only part of the tax base to which the state levies are applied. 82 mills will produce the same amount of property tax as 101 mills did before the reappraisal. Property taxes would be lower on property not subject to the reappraisal but still, on average, 15% higher on Class 4 property than before the reappraisal. Twenty of Montana's 56 counties would still have average tax increases on Class 4 property of more than 20%.

REDUCE TAX CLASSIFICATION RATE

In past reappraisal cycles, the percentage rate used to arrive at taxable value from market value has been changed to reduce the impact of reappraisals on property taxes. In 1978, the classification rate for Class 4 property was reduced from 12% to 8.55%. Market values, as a result of reappraisal increased by 40% in 1978. The reduction in the classification rate from 12% to 8.55% exactly offset the market value increase resulting from revaluation. For example, a home valued at \$100,000 in 1977 had a taxable value of \$12,000, or 12% of market value. In 1978 the same home on average was valued at \$140,000. The new classification rate of 8.55% produced a taxable value of \$11,970, very close to the property's taxable value the previous year. This process was re-

Class 4 property from 8.55% to the current 3.86%. No reduction was made to the classification rate as a result of the 1993 reappraisal. The revenue neutral classification rate for the 1997 reappraisal is 2.78%, 39% lower than the current rate of 3.86%. Property

with a market value of \$100,000 in 1996 had a taxable value of \$3,860. The new market value, as a result of reappraisal would be \$139,000. The proposed classification rate of 2.78% would yield a taxable value of \$3,864, very close to the value before re-

appraisal. The statewide impact of reducing the classification rate shown at the bottom of Option 2 on table is an increase in taxes on Class 4 property of only 1.8%, due solely to taxes on newly constructed property. This method of dealing with the impact of reappraisal results in shifts in tax liability between property classes in the various counties. In eastern counties, Class 4 values increased less than the statewide average. Reducing the classification rate in these areas will reduce tax liabilities on real estate and shift it to other classes of property. A reduction in the classification rate reduces the tax liability for Class 4 property by more than 20% in seven counties in eastern Montana. Property tax revenues to government are assumed to be the same as in 1996 so mill levies have increased and other classes of property (utilities, business and farm machinery, and agricultural land) pay for the reduction in taxes on Class 4 property.

Average changes in value range from a 3% decrease in value in McCone County to a 79% increase in value in Sweet Grass County... The wide range of changes in value between counties makes it difficult to mitigate the tax effect of the reappraisal.

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In many western Montana counties, the average percentage increase in Class 4 property value exceeds the percentage reduction in the classification rate. In these counties, real estate will pay higher

DELAYING THE REAPPRAISAL

The last option, and that proposed by SB195 is to delay the reappraisal until the Year 2000 to allow time for this legislature, the next legislature and the voters to decide on the future of property taxes in Montana. Reappraisals shift tax burdens between individuals and among the various classes of property in Montana's tax system. That is not a bad result because it aligns tax payments with a measure of wealth based on the market value of property. However, rapid changes in property values in Montana have added a new dimension to the property tax system and that is large and unexpected changes in tax liability. Property taxes are, like all other taxes, paid from income and savings. Incremental changes in property values and tax rates are anticipated by property owners and accepted as the cost of maintaining government services. But tax systems depend on predictability. Homeowners cannot deal with an unanticipated doubling of their property tax when personal income in Montana is increasing at a rate between 2% and 4% per year. Average residential valuation increases in western Montana exceed 50%, meaning large tax increases under any of the options except a freeze on valuations. In addition, the following table is based on a very optimistic assumption. The assumption is that local governments will not receive any more property tax revenue as a result of the reappraisal than they received in 1996. Current law does not contain this restriction. Counties and cities that lose valuation as a result of reappraisal are allowed to raise tax rates to extract as much money from property taxes as they received in 1986. In areas where reappraisals increase the tax base, local governments are not required to reduce mill levies to offset taxable value increases. Local governments are permitted to turn some, or all of a valuation increase caused by reappraisal into a property tax increase. The popularity

* Teton County, Idaho Planning Department

of SB 195 is that it restores predictability to the property tax system at least until the Year 2000. The impact of delaying the reappraisal is that the total value of Class 4 property will vary only by the amount of new construction in each county in each year. The final column of the table shows the variation in tax liability under the freeze to range from -8.6% in Petroleum County to a high of +5.4% in Stillwater County. Although a freeze on valuations

may appear less equitable to some than using the new valuations, it will leave the system more predictable for property owners, and still capable of funding government services for the next three years.

Since 1972, the Montana Department of Revenue has averaged one reappraisal cycle every seven years. Extending the current reappraisal cycle to the Year 2000 would produce another seven year cycle.

(see following table)

	in Class 4 Taxable Value	in all Taxable Value	Appraisal on Tax Liability	State Mills	Tax Rate	Class 4
	TY96 to TY97	TY96 to TY97	FY97 to FY98	FY97 to FY98	FY97 to FY98	FY97 to FY98
Beaverhead	55.8%	24.4%	32.5%	25.3%	6.8%	2.1%
Big Horn	23.2%	4.5%	18.6%	9.6%	-8.5%	3.8%
Blaine	6.2%	3.5%	3.3%	-1.5%	-19.8%	1.6%
Broadwater	45.4%	10.6%	36.0%	27.9%	6.9%	3.5%
Carbon	71.1%	35.8%	39.9%	31.1%	14.9%	1.6%
Carter	3.0%	5.5%	-0.9%	-6.4%	-24.4%	0.0%
Cascade	31.0%	20.6%	15.4%	9.0%	-2.9%	1.2%
Chouteau	30.8%	2.2%	24.5%	18.0%	-4.3%	5.2%
Custer	30.3%	15.6%	17.5%	12.5%	-4.6%	1.2%
Daniels	6.9%	0.8%	5.4%	0.8%	-17.8%	3.3%
Dawson	26.3%	8.3%	18.5%	13.7%	-6.7%	2.7%
Deer Lodge	52.8%	35.1%	26.3%	19.4%	5.7%	0.8%
Fallon	3.7%	0.8%	2.2%	-3.7%	-20.3%	2.4%
Fergus	48.3%	18.4%	28.4%	22.1%	3.4%	1.9%
Flathead	39.9%	29.9%	17.4%	10.3%	-1.1%	0.4%
Gallatin	65.4%	46.9%	27.9%	20.1%	9.2%	1.7%
Garfield	4.0%	7.2%	0.3%	-6.1%	-24.3%	-0.9%
Glacier	24.1%	8.6%	15.2%	9.9%	-10.4%	0.8%
Golden Valley	38.9%	8.6%	30.8%	23.1%	-2.5%	0.3%
Granite	69.6%	24.7%	44.8%	36.0%	13.3%	-0.2%
Hill	25.6%	9.5%	16.2%	10.7%	-5.0%	2.9%
Jefferson	49.3%	15.2%	34.5%	25.9%	4.6%	3.6%
Judith Basin	32.0%	7.4%	26.4%	18.4%	-4.4%	1.5%
Lake	60.4%	45.7%	30.0%	20.5%	12.4%	1.3%
Lewis & Clark	52.0%	34.4%	26.0%	18.8%	5.7%	1.5%
Liberty	22.2%	3.2%	16.4%	10.4%	-12.1%	3.9%
Lincoln	53.0%	33.1%	32.2%	22.1%	5.0%	0.4%
Madison	62.9%	28.3%	38.6%	28.7%	12.0%	2.2%
McCone	-3.0%	-0.3%	-3.5%	-8.2%	-26.0%	2.6%
Meagher	44.7%	14.1%	29.7%	21.2%	-0.1%	0.2%
Mineral	51.2%	20.1%	31.0%	23.9%	0.3%	1.0%
Missoula	52.2%	36.3%	22.0%	15.3%	4.8%	1.3%
Musselshell	29.4%	13.4%	18.7%	12.5%	-7.6%	0.4%
Park	71.7%	38.8%	39.6%	30.0%	14.2%	2.5%
Petroleum	44.8%	11.7%	23.7%	14.9%	-8.3%	-8.6%
Phillips	9.2%	1.8%	6.0%	-0.2%	-19.0%	2.5%
Pondera	33.5%	7.8%	23.4%	17.2%	-3.2%	3.6%
Powder River	3.0%	3.3%	-0.2%	-4.5%	-23.5%	0.9%
Powell	32.1%	14.8%	18.6%	11.6%	-7.5%	0.1%
Prairie	3.6%	1.4%	2.2%	-2.8%	-22.2%	2.4%
Ravalli	55.8%	42.8%	31.7%	22.0%	7.3%	1.5%
Richland	20.2%	6.5%	13.5%	7.9%	-9.3%	3.0%
Roosevelt	11.8%	1.2%	9.9%	4.2%	-16.5%	3.3%
Rosebud	9.6%	0.1%	8.9%	-2.8%	-18.3%	3.3%
Sanders	64.3%	17.2%	48.9%	38.8%	14.4%	1.1%
Sheridan	10.0%	1.2%	7.9%	3.3%	-14.9%	3.5%
Silver Bow	38.7%	20.5%	22.2%	15.6%	0.5%	1.7%
Stillwater	51.5%	14.8%	43.0%	34.0%	11.4%	5.4%
Sweet Grass	79.0%	30.2%	46.9%	38.4%	18.1%	0.9%
Teton	43.7%	11.7%	30.4%	23.5%	2.2%	3.3%
Toole	28.6%	4.7%	20.8%	14.7%	-5.0%	3.9%
Treasure	26.4%	4.0%	20.9%	14.0%	-8.3%	2.2%
Valley	27.4%	6.4%	19.9%	13.6%	-6.3%	2.9%
Wheatland	42.9%	7.0%	34.2%	26.7%	0.8%	1.8%
Wibaux	5.2%	0.0%	5.2%	0.4%	-20.0%	3.6%
Yellowstone	34.6%	19.5%	17.5%	11.2%	-1.5%	2.3%
Total	44.3%	21.0%	22.4%	15.3%	1.8%	1.6%

Each mitigation option assumes local gov'ts raise no additional revenue, except schools to offset GTB tax shift. In each option, new property is assumed to generate new revenue for the state.

Option 1: all state mills are reduced by 19 percent, including equalization, university, welfare and vo-tech levies.

Option 2: Class 4 tax rate is reduced from 3.86 to 2.78 percent.

Option 3: Class 4 is frozen at TY96 values; allows new property to enter tax base.

TRENDS IN MONTANA LOCAL GOVERNMENT

During 1995-96 the Local Government Center gathered information from 126 municipal governments, 54 county governments and 2 city/county consolidated governments. Averages were then calculated by classification for a number of different characteristics describing local government in Montana. Trends over a five year period (fiscal years 1992-1996) were measured by averaging data according to city or county class. Classification for cities is measured by population, but for counties it is measured by county taxable value.

MUNICIPAL GOVERNMENT

Municipal Government Classification and Population

Table 1

CLASS	POPULATION	NUMBER	AVERAGE POPULATION 1994	% CHANGE POP. 1990-94
1	more than 10,000	7	37,832	6.4
2	5,000-10,000	3	7,509	6.1
3	1,000-5,000	38	2,570	5.3
TOWN	less than 1,000	78	509	3.0
AVERAGE			3,371	3.9

Average city populations increased statewide between 1990-94 in all municipal classes in contrast with that of the previous decade (Table 1). From 1980-90 populations declined statewide except in class 1 which showed slight growth (2.9%).

Average Municipal Taxable Valuation

Table 2

CLASS	MILL VALUE 1996	% CHANGE 1992-96
1	51,855.04	14.1
2	7,323.95	15.0
3	2,767.28	13.8
TOWN	469.55	10.1
AVERAGE	4,180.47	11.5

During the five year period 1992-96 property tax mill valuations increased in all classes of cities (Table 2). Considering the fact that inflation increased on average 2.4% per year during this time, the growth in real taxable valuation at 2.3% per year did keep pace with the rate of inflation.

Average Municipal Mill Levies

Table 3

CLASS	GENERAL FUND MILLS 1996	% CHANGE 1992-96	TOTAL MILLS LEVIED 1996	% CHANGE 1992-96
1	72.85	-2.4	105.18	0.5
2	109.40	1.8	129.84	0.6
3	78.97	2.7	98.85	-3.6
TOWN	70.39	1.2	84.23	1.5
AVERAGE	74.04	1.5	90.89	-0.1

The modest growth of taxable value from 1992-96 helped to keep increases in mill levies fairly minimal, and even negative in the case of third class cities. The average decline in total property tax mill levies in all cities between 1992-96 was -0.1% (Table 3).

Average General Fund Appropriations and Per Capita Appropriation

Table 4

CLASS	GENERAL FUND APPROPRIATION 1996	% CHANGE 1992-96	GENERAL FUND APPROPRIATION PER CAPITA 1996
1	\$11,746,828	36.8	313.88
2	2,246,181	26.3	294.77
3	694,960	33.0	264.67
TOWN	120,101	28.7	242.16
AVERAGE	1,018,544	30.5	254.58

During the five year period 1992-96 general fund appropriations grew at about 6.1% per year on average (Table 4). The average annual change in mill value during the same period of time was 2.3%, while the average change in total mills levied was -0.02%. With the average annual change in general fund appropriations at 6.1% per year for the five year period, one must conclude that the increases must have come from non-tax revenues such as gambling revenues distributed by the state to jurisdictions of origin.

Per capita appropriations averaged \$254.58, and ranged from \$242.16 for towns to \$313.88 for first class cities (Table 4). This statewide average decreased slightly from the FY 95 average of \$258.50.

Average Municipal Fund Balances

Table 5

CLASS	GENERAL FUND BALANCE 1996	% CHANGE 1992-96
1	\$2,903,692	44
2	480,414	347
3	226,290	63
TOWN	52,342	416
AVERAGE	287,390	275

General fund balances increased over the five year period suggesting that municipalities are, in general, maintaining their fiscal stability (Table 5).

Average Municipal Full Time Employees

Table 6

CLASS	AVERAGE NUMBER FTE 1996	% CHANGE 1992-96
1	314	11.8
2	68	21.6
3	18	7.0
TOWN	3	-1.0
AVERAGE	26	2.7

The increase in the number of full time employees was significant in classes 1 & 2, during the 1992-96 period. The largest increase occurred in second class cities with about 4.3% per year (Table 6). Population growth occurred in all classes of cities from 1990-94.

COUNTY GOVERNMENT

County Classification and Population

Table 7

CLASS	TAXABLE VALUATION	# OF COUNTIES	AVERAGE POPULATION 1994	% CHANGE POP. 1990-94
1	Over \$50 million	10	52,706	6.8
2	\$30-50 million	12	14,324	6.0
3	\$20-30 million	10	7,504	3.2
4	\$15-20 million	3	8,248	0.8
5	\$10-15 million	9	3,878	1.9
6 & 7	Under 10 million	12	1,879	0
AVERAGE			15,289	3.4

Population gains occurred in all classes except for classes 6 & 7 (Table 7). This contrasts with an average population decline of -4.3% from 1980 - 90.

Average County Taxable Valuation

Table 8

CLASS	MILL VALUE 1996	% CHANGE MILL VALUE 1992-96
1	\$107,977.41	17.6
2	29,350.13	14.4
3	19,503.29	8.3
4	15,674.58	5.4
5	9,386.89	8.6
6 & 7	6,595.84	6.9
AVERAGE	32,819.01	10.9

Taxable value increased in all county classes during the 1992-96 time period (Table 8). Over the five year period the average annual increase in mill value was 2.2%, while the rate of increase in inflation was 2.4%, so that taxable value nearly kept pace with inflation.

Average County Mills Levied

Table 9

CLASS	GENERAL FUND MILLS LEVIED 1996	% CHANGE GEN. FUND MILLS 1992-96	TOTAL MILLS LEVIED 1996	% CHANGE TOTAL MILLS 1992-96
1	25.98	14.9	79.78	14.0
2	19.96	4.8	72.02	14.9
3	27.53	4.5	91.51	28.7
4	30.72	-2.6	110.46	20.7
5	44.43	7.2	108.79	18.4
6 & 7	37.12	1.4	94.56	1.4
AVERAGE	30.57	5.8	89.69	15.2

Change in total mills levied ranged from 1.4% in Class 6 & 7 counties to 28.7% in class 3 counties over the five year period (Table 9). The average annual change in total mills levied for all counties was 3 % each year.

Average County General Fund Appropriation

Table 10

CLASS	GENERAL FUND APPROPRIATION 1996	% CHANGE GENERAL FUND APPROPRIATION 1992-96
1	\$5,896,442	12.3
2	1,851,851	-7.1
3	1,380,047	-4.2
4	919,626	-21.8
5	1,101,778	6.8
6 & 7	621,579	17.4
AVERAGE	2,055,731	3.6

The average change in general fund appropriations was 0.7%, less than the 2.4% rate of inflation. The increases in all classes ranged from -21.8% in class 4 counties to 17.4% in classes 6 & 7 over five years (Table 10).

Average County Total Appropriation (17 Funds)

Table 11

CLASS	TOTAL 17 FUNDS* 1996	% CHANGE 17 FUNDS* 1992-96	PER CAPITA EXPENDITURE 17 FUNDS* 1996
1	\$16,696,975	16.9	\$517.17
2	5,405,465	20.7	466.03
3	4,457,469	9.7	710.18
4	3,209,838	21.0	437.22
5	2,545,771	6.1	933.13
6 & 7	1,574,941	27.4	840.60
AVERAGE	5,854,478	17.2	672.55

Seventeen fund totals increased in all classes with a range of 6.1% in class 5 to 27.4% in classes 6 & 7. The average increase for all counties over five years was 17.2% or 3.4% per year which exceeded the average inflation rate of 2.4% per year (Table 11). Counties do not have as much gambling revenue as cities, and rely more heavily on the property tax to support their operating budgets.

Expenditures per capita were lowest in class 4 counties, at \$437.22, and highest in class 5 counties at \$933.13 (Table 11). The average for all counties was \$672.55. This increased from the FY 95 average of \$617.20.

County Full Time Employees

Table 12

CLASS	FULL TIME EMPLOYEES 1996	% CHANGE FULL TIME EMPLOYEES 1992-96
1	286	7.8
2	96	9.2
3	75	-9.7
4	65	-14.8
5	43	4.4
6 & 7	30	-1.4
AVERAGE	102	1.2

The number of full time employees changed an average of 1.2% during the five year period for all counties. Changes ranged from a low of -14.8% in class 4 counties to 9.2% in class 2 counties (Table 12). From 1990-94 population was increasing except in class 6 & 7 counties.

*** 17 FUNDS INCLUDED IN COUNTY APPROPRIATION**

- | | |
|------------------------|----------------------------------|
| 1. General Fund | 10. Extension Fund |
| 2. Public Safety Fund | 11. Airport Fund |
| 3. Road Fund | 12. Health Fund |
| 4. Poor Fund | 13. Planning Fund |
| 5. District Court Fund | 14. Hospital Fund |
| 6. Bridge Fund | 15. Bond Interest Fund |
| 7. Weed Fund | 16. Senior Citizens Fund |
| 8. Fair Fund | 17. Comprehensive Insurance Fund |
| 9. Library Fund | |