

SOMERSET'S TAX REVENUES

Somerset receives most of its revenues from two sources: the income tax and the property tax, which is mainly real property but includes a small amount for personal and utility taxes. In the most recently completed fiscal year (FY07), the income tax was almost 76% of Town revenues, while the property tax was 11%.

The income tax Somerset receives is based on taxes Somerset residents pay to the state and Montgomery County. The taxes residents pay depend on state and county tax rates. The State Comptroller pays Somerset quarterly. Maryland municipalities like Somerset do not set income tax rates; municipal tax receipts are based on state law.

Somerset sets its property tax rates. Montgomery County also sets property tax rates. Tax receipts for Somerset and for the County are based on property values assessed by the state. In 2007-08, Montgomery County's tax rate for real property is \$.627 per \$100 assessed value, while Somerset's is \$.04 per \$100 assessed value. So, when residents receive property tax bills from Montgomery County, only a small part goes to Somerset. Over time, the Town Council has reduced Somerset's property tax rate and therefore fewer revenues are currently received from this tax source.

Table 1 shows Somerset's overall revenues and the amount from income and property taxes. It presents estimates for **average** property tax, but the figure is somewhat overestimated because data aren't readily available on personal property.* Property tax bills list the amount of taxes that are returned to Somerset by the County (taxes can be calculated by multiplying .04 times assessed value divided by 100). The table also shows how Somerset has been setting aside funds over time for capital projects such as street paving and facilities. Finally, the table is in nominal dollars and does not account for inflation (if inflation were factored in, more recent figures would be lower).

Table 1. Overall Revenues

Fiscal Year (ends in June)	Total Revenue (\$1000s)	Income Tax Revenues (\$1000s)	Property Tax Revenues (\$1000s), includes real and personal	Property Tax Rate (dollars per \$100 Assessed Value of real pr.)	Average Household Property Tax Paid to Town (dollars) *see above	Capital Projects Fund (\$1000s)	Surplus (\$1000)
FY08est	\$1,343	\$1,044	\$147	.04	\$356		
FY07	1,240	940	136	.04	330	\$2,284	\$235
FY06	1,075	773	137	.045	332	2,049	390
FY05	884	617	136	.05	330	1,638	123
FY04	733	478	122	.05	295	1,515	37
FY03	698	426	115	.05	278	1,478	61
FY02	655	416	110	.05	266	1,417	-12
FY01	970	660	167	.22	404	1,429	228
FY00	906	516	185	.25	448	1,201	293
FY99	870	534	200	.28	484	908	274
FY98	716	367	218	.31	528	634	131
FY97	685	342	233	.34	564	503	77
FY96	715	322	247	.38	593	427	118

SCENARIOS FOR FINANCING FACILITIES PROJECTS

Like potential homebuyers, Somerset must consider:

- the cost of the projects,
- how much money we have for a down payment, and
- how to finance the remaining amount.

The Town has been building up its capital projects fund for many years in anticipation of needed infrastructure improvements. As of January 31, 2008, the fund stood at \$2.3 million. Of this, \$1 million has been budgeted for street improvements, although to date only a small portion has been spent on sidewalk and curb repairs. Whatever we do not spend for street paving will be available for facilities improvements, and I anticipate about **\$1.5 million will be available to invest in improvements at the pool and Town Hall.**

Currently Somerset has no debt. The Town has borrowed in the past to purchase park land and finance (together with the county) improvements in our storm drain system. On several occasions, Somerset went directly to banks for financing, which our strong asset base allowed us to do. For example, in 1987, the Town borrowed \$1 million directly from a Maryland bank to improve and extend our storm drain system, repave most streets, and make several other improvements. Once we borrowed from a Somerset resident. We could examine using these methods again. Another option is the State of Maryland Infrastructure Financing Program, which borrows funds on behalf of communities for capital projects.

Although we don't know right now how much the projects at the pool and Town Hall will cost, I have developed 4 scenarios to illustrate the costs for 2 levels of borrowing (\$2.5 million and \$4 million) and for 2 different time periods (10-year borrowing and 30-year borrowing). These are meant to be illustrations and the Town could select different borrowing levels and different time periods. In addition, the costs will vary as interest rates vary. For example, with current difficulties in the credit markets, municipal interest rates are relatively high (and have gone up close to one percentage point since I got some estimates 3 weeks ago). That means these estimates may overstate the costs Somerset will face when it is ready to borrow, which will be after it has final project costs in 1-2 years. The numbers in Table 2 are based on debt service schedules generated by the Maryland Infrastructure Financing Program on March 5, 2008.

Table 2. Debt Service.

Scenario	Amount Borrowed	Time Borrowed	Annual Debt Service	Total Cost	Interest rate
#1	\$2.5 million	10 years	\$306,000	\$3,058,178	3.85%
#2	\$2.5 million	30 years	\$162,000	\$4,839,555	4.93%
#3	\$4.0 million	10 years	\$490,000	\$4,893,085	3.85%
#4	\$4.0 million	30 years	\$260,000	\$7,743,288	4.93%

If Somerset borrowed money, the most stable source of funds to pay debt service is the property tax and I think that is the tax lenders likely would look to for repayment. If Somerset relied solely on the property tax, we can make a rough estimate of how much tax rates would need to change to cover debt service.

This year our property tax receipts are estimated to be \$147,000, most of which is from real property (data are currently unavailable to adjust for the small amount Somerset receives from personal property, which includes businesses in Somerset and utilities). So, I've estimated that about \$135,000 is from taxes on real property at the tax rate of \$.04 per \$100 assessed value. (Because Somerset has no readily available data on the actual amount of personal property, the actual amount Somerset receives from real property could be more or less than \$135,000.) Using the \$135,000 figure results in an estimate of about \$330 in property taxes that an average household currently pays in Somerset taxes (\$135,000 divided by 413 houses = \$327). This equates to an average **assessed** property value of about \$817,000.

Using the annual debt service from the Table 2, I've estimated how much various levels of borrowing and different time frames might affect property tax rates and taxes paid by an average household. These estimates are based on the assumptions above, so the numbers presented should be viewed as illustrative and I hope they are "in the ball park".

Table 3. Estimated Borrowing -- how it might affect property tax rates paid by average household.

Scenario	Amount Borrowed (millions)	Time Borrowed (years)	Annual Debt Service	Estimated Tax Rate Increase Per \$100 assessed value	Estimated total tax rate	Estimated property tax increase for Average Household	Estimated Somerset Property Tax for Average Household
#1	\$2.5	10	\$306,000	\$.09	\$.13	\$743	\$1073
#2	\$2.5	30	\$162,000	\$.05	\$.09	\$413	\$743
#3	\$4.0	10	\$490,000	\$.145	\$.185	\$1198	\$1526
#4	\$4.0	30	\$260,000	\$.08	\$.12	\$660	\$990

Property tax rates may not need to increase as much as estimated because the assessed value base will likely increase about 10% per year because assessments can only increase by 10% per year. However, if Somerset wanted to rely solely on property taxes to support debt service, the increase in the base would only affect the rate increase, not the overall property taxes residents pay.

Other Sources of Funds that Could be Used to Finance Facilities Improvements

Income Taxes

The estimates above are likely to overstate Somerset's reliance on the property tax because income tax revenues are likely to grow. In recent years, income tax receipts have grown rapidly. Although the economy is currently in a turbulent period and residents' incomes may not grow in the next few years, it is likely that Somerset will receive more income tax revenues in the future because the State has enacted a new income tax rate structure. In 2007 the tax rate was 4.75% on taxable for all income levels but starting in

2008, higher taxable incomes may be taxed at rates up to 5.5 %. Larger income tax receipts would allow for smaller increases in property tax rates. Right now, we don't know how much income receipts might grow because of the changes in tax rates, but we can look at how jurisdictions like Montgomery County are estimating the revenue increase from the tax rate increase and then make some estimates for Somerset. Somerset will have actual information in 2009 when the state receives 2008 tax payments. This is likely before Somerset would decide on its financing method.

Personal Property and Utilities Taxes

Somerset could consider increasing its rates on personal property and utilities, which currently are each \$.22. These rates are significantly lower than those of some nearby jurisdictions, many of which have rates between \$.5 and \$1.0. Given Somerset's small base, an increase in these rates would not likely result in a significant revenue increase but would add to funds available for debt service.

Fees for pool use

Somerset could consider paying for a portion of the costs of pool improvements by reinstating fees for households that use the pool. In the past, Somerset had two fees (for small and large households) and these fees contributed to ongoing capital costs at the pool. In FY 1996, which may have been the last year Somerset had membership fees, swimming pool membership and guest fees totaled \$55,000.

A fundraising campaign

Somerset could have a capital campaign and solicit donations to support facilities.

FINAL THOUGHTS

The estimates I've prepared are best guesses based on limited information and limited time to prepare them. They are intended to be illustrative and provide some educated guesses about options Somerset faces and the effect residents might expect from investing in our facilities. I hope this paper provides a good starting point for a conversation about financing facilities improvements. As we move forward, the Town will want to talk with municipal financing experts and get solid estimates for future revenues and costs.