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## Testimony of the Boston Municipal Research Bureau

Before the

### City Council Committee on Government Operations

**August 20, 2009**

**Regarding:** Docket # 0985, an order relative to a local option tax on meals in the City of Boston and Docket #0986, an order relative to the local option room occupancy excise in the City of Boston.

Madame Chairwoman and Councilors, my name is Samuel R. Tyler, President of the Boston Municipal Research Bureau and I am submitting this testimony in support, with conditions, of Dockets #0986 and #0985, regarding the adoption of the increase of up to 2% of the room occupancy excise and acceptance of the 0.75% local option meals excise.

The issue of this hearing is the City Council's adoption of two dockets submitted by the Mayor based on state enabling legislation that would allow Boston to raise operating income from adding 2.0% to the existing room occupancy or hotel-motel excise and by imposing a 0.75% excise on meals. The combined revenue estimate this fiscal year for both sources is approximately \$17 million based on eight months collection with adjustments made for seasonal activity and post 1997 hotel separation. As will be explained below, the Bureau will recommend a limited amount of spending of this revenue in this fiscal year, making the initial revenue estimates less a concern.

The Research Bureau has expressed concern for years about Boston's heavy reliance on the property tax and the lack of revenue diversification. In recent reports, the Research Bureau has noted that Boston now relies on the property tax more heavily in fiscal 2010 than in fiscal 1980, the year Proposition 2½ was approved in response to a taxpayers' revolt. With 77% of Boston's operating revenues coming from the property tax (60%) and state aid (17%), and declining state aid, the importance of revenue diversification has become a more compelling issue.

Boston's reliance on the property tax for operating revenue is far greater than other major cities in the country. *Boston Bound*, a report by The Boston Foundation which compared Boston with six other major American cities, shows that Boston's reliance on the property tax at 58% in 2003 was more than double Seattle's 27% which was the next highest percentage. Boston's very limited diversity of revenue compared with the six cities is demonstrated by the comparison of the percent that each city's non-school budget is funded by own-source, non-property tax revenue in 2004. Boston's percentage of 27% was by far the lowest of all cities when compared with Atlanta's 80%, Seattle's 70% and Denver's 85%. (See graphs on page 4)

In addition, the application of full classification in Boston means that business property pays a disproportionate share of the tax burden, which is a factor in the City's competition for the retention and recruitment of businesses. This fiscal year, business property in Boston represents 34.1% of the taxable

property value but pays 59.6% of the tax levy. Conversely, residential property represents 65.9% of the tax value and 40.4% of the tax levy.

The Massachusetts tax structure does not work for Boston by enabling it to generate tax revenues to support the public services required of a host city that is a major economic center in Massachusetts and New England, a growing convention center and a popular tourist destination. Those who come to Boston for reasons of business, conventions, tourism or big special events generate economic activity through the state sales tax, meals tax, liquor tax, or room occupancy excise. Yet, except for the City's 4% share, these revenues are state taxes. The recent issue of who should be responsible for funding the public services tied to this summer's Sail Boston event is the consequence of the current tax structure in the Commonwealth.

The fiscal challenges facing the City of Boston will require a continuing effort by city officials to control spending by managing personnel levels and implementing greater efficiencies in delivering basic city services. Revenue diversification should be part of the mix, but by itself is not the solution. Over the last few years, the Research Bureau has focused much of its effort on the growing personnel spending in Boston and the alarming growth trends of pension and health insurance costs. Our most recent report, released on August 6, cautioned that Boston will face continued difficult financial challenges in fiscal 2011 and fiscal 2012. We noted that following the steps taken this fiscal year to balance the operating budget, the City will need to reprioritize city services and we listed a few "hard choices" that will need to be considered for fiscal 2011. Approval of the two dockets before the City Council does not diminish in any way the urgency to continue to control city spending and seek to provide basic services more efficiently.

**Room Occupancy Excise** – The proposal before the City Council (Docket #0986) is to increase the existing room occupancy excise of 4% by 2% for a total of 6%. That would bring the total hotel-motel excise in Boston to 14.45%. The current excise of 12.45% in Boston consists of three parts: state excise tax of 5.7%, Boston excise of 4.0% and the convention center debt service portion of 2.75% collected by the state. The 2.75% share applies to Boston, Cambridge, Springfield and Worcester so the room occupancy excise in other communities that previously adopted this excise is no higher than 9.7%.

The local room occupancy excise was first approved as a local option tax in 1985 along with the jet fuel excise. In the first year of collection (1986), the hotel-motel excise produced \$6.8 million in revenues for Boston and in fiscal 2010 it is projected to total \$23 million. An added 2% for eight months in fiscal 2010 is estimated to generate approximately \$6 million.

**Meals Excise** – Long sought by Mayors of Boston, the second proposal before the Council (Docket #0985) is to adopt a 0.75% excise on meals. This excise is estimated to generate approximately \$11 million over eight months in fiscal 2010. As of August 1, 2009, the state tax on meals is 6.25%, up from 5.0%, and the local share of 0.75% would raise the total meals excise to 7.0%.

### **Bureau Recommendation**

The Research Bureau recommends conditionally that the City Council vote to adopt the increase in the room occupancy excise of 2% and the establishment of the meals excise of 0.75%. We recognize that this recommendation comes at a difficult time during the current economic downturn in Massachusetts and soon after the Commonwealth increased the sales tax by 25% to 6.25%. We do believe that it is in Boston's best long-term interest to diversify its revenue sources and to share in the economic activity generated by all those individuals who utilize the services subject to these two excise taxes. The Bureau's support for these revenues is conditional on a limited and targeted application of the resulting revenues on an annual basis.

In light of the Bureau's estimate of the difficult financial challenges facing the City in fiscal 2011 as explained in our Special Report of August 6, we recommend that these new revenues be restricted to restoring the \$5 million cut in the fiscal 2010 recommended budget for the retiree health insurance

liability (OPEB) reserve. This increase would bring the total appropriation to \$25 million, which is level from fiscal 2009. Because the three-year federal COPS grant awarded the City to fund 67 police officers was less than requested, the Administration has committed to apply approximately \$1.5 million this year from the new revenues to ensure no layoff of police officers. The City has no track record for the collection of these new revenue sources in a down economy so prudent use of these funds is essential. For that reason, the balance of these funds should be reserved to help address the City's fiscal 2011 obligations.

In future years if the property tax levy is not reduced, we recommend that these funds not be used to fund normal ongoing operating expenses but instead be targeted to specific long-term liability obligations which are now underfunded or may experience extraordinary increases beyond the norm. Specifically, we believe that these new excise revenues should be applied to annual increases in the OPEB reserve to enable the City to adopt a long-term plan to reach full funding of its OPEB annual required contribution (ARC) based on an actuarial funding schedule. The City's current OPEB reserve appropriation of \$20 million is approximately \$124 million below what the ARC would be based on a recent assessment.

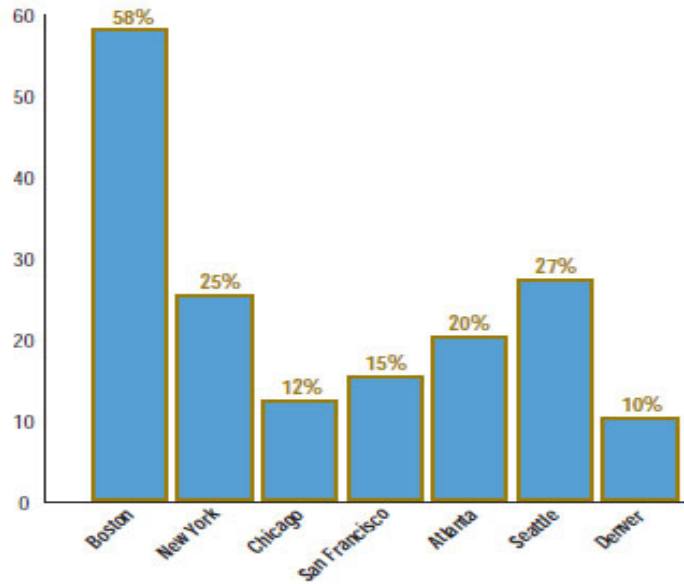
As a consequence of the State-Boston Retirement System's 25% asset loss in 2008, we expect that the next actuarial valuation as of January 1, 2010 will require significant increases in the City's annual pension appropriations even after application of a "smoothing" process to mitigate large increasing shifts in annual appropriations. During this time, utilization of a portion of the new excise revenues to fund the added increase above the norm would be appropriate and is recommended.

Given the City's high reliance on the property tax, once the economy has improved and Boston is receiving normal increases in state aid on an annual basis, the Bureau recommends that the excise revenue from these two sources be applied to reduce Boston's use of the property tax. What impact this recommendation would have on the property tax burden would depend on the extent that the excise revenue is utilized to fund the OPEB liability and the above normal pension increases.

In conclusion, the Research Bureau supports adoption of the two local option excise taxes as recommended as long as the funds are targeted to address the escalating costs of its long-term employee benefit liabilities or reduce the City's reliance on the property tax.

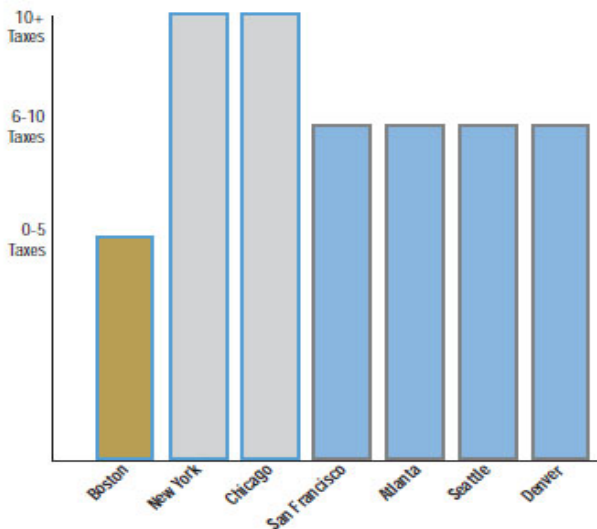
## Boston Revenue Comparison with Other Major American Cities

### Percent of Total Revenues Derived from the Property Tax in 2003



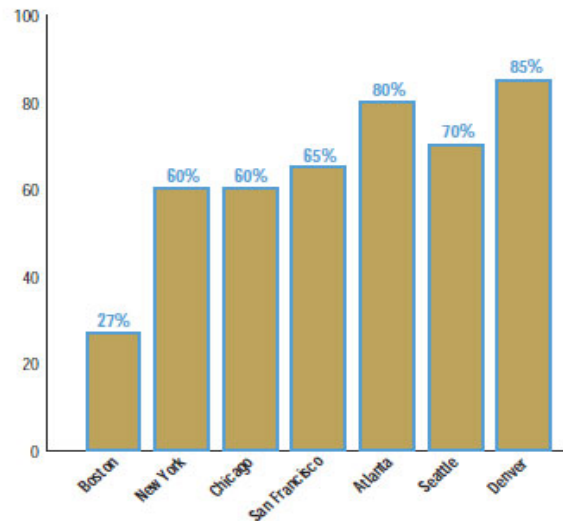
Boston's reliance on the property tax far exceeds that of the other six cities.

### Number of Taxes that Contribute to Municipal Revenues



Boston is empowered to levy a smaller number of different taxes than other cities in the study.

### Percent of Non-school Budget Covered by Own-source, Non-property Tax Revenue in 2004



Excluding state aid and property tax receipts, Boston's own-source revenues covered a smaller portion of its non-school budget than the other six cities.