

## The Effects of TABOR on Municipal Revenues and Spending in Colorado

Colorado's cities and towns face some of the most restrictive constitutional limits on spending and taxing found in the nation.<sup>1</sup> First, the Gallagher amendment has eroded municipal property tax bases by reducing the residential assessment ratio. In addition the TABOR amendment imposed revenue and spending limits.<sup>2</sup> The impacts of both these amendments, working together and separately, have changed municipal governance significantly.

### Gallagher Amendment (1982)

The Gallagher amendment mandates that residential properties will pay 45% and other properties (primarily commercial and agricultural) will pay the remaining 55% of all property taxes, on a statewide basis. Every two years the residential assessment ratio (the percentage of residential property value that is considered taxable) is adjusted to maintain this mandated 45-55 ratio. While nonresidential properties are assessed at a constant 29% of actual value, the residential assessment ratio has declined from an initial 21% in 1982 to an estimated 9.35% for 2001-02.

This study is based on financial data for all Colorado municipal governments for 1975 through 1997, interviews with municipal officials in all parts of the state, and data from municipal TABOR-related elections from 1993 through 1998. The results show that TABOR has had significant fiscal effects on municipalities, particularly on smaller towns outside the fast-growing and prosperous Front Range and mountain resorts. Only a very strong economy has mitigated the constraints of TABOR for Front Range and mountain cities. It is likely that these governments will encounter tighter fiscal constraints when their growth in population, construction, and property values slows in response to the economy.

### TABOR Amendment (1992)

The Taxpayer's Bill of Rights (TABOR) amendment limits the revenue municipalities can keep and spend to last year's amount, plus a percentage based on change in the Denver-Boulder Consumer Price Index and on change in the value of property within the municipality.

In addition, all new taxes, tax increases, renewal of expiring taxes, increases in tax rates, and increases in mill levies must be pre-approved by a majority of voters at a general election. David Broadwell, *TABOR: A Guide to the Taxpayer's Bill of Rights*, (Denver, CO: Colorado Municipal League, 1999 and earlier editions), is perhaps the most comprehensive and practically useful guide to understanding the amendment.

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<sup>1</sup> Brown, Tom, "Constitutional Tax and Expenditure Limitation in Colorado." *Public Budgeting & Finance* 20 (Fall, 2000):29-50,31.

<sup>2</sup> Whether TABOR is a revenue limit, a spending limit, or both as been debated since its adoption. It specifically sets a spending limit for local governments in section (7), "Spending Limits. (b) The maximum annual percentage change in each local district's fiscal year spending equal inflation in the prior calendar year plus annual local growth . . . ." Despite this language, the amendment operates by limiting the amount of revenue a local government can keep by requiring that "(7)(d) If revenue from sources not excluded from fiscal year spending exceeds these limits in dollars for that fiscal year, the excess shall be refunded . . . ."

## **TABOR Elections**

The most obvious consequences of TABOR are the many elections in which cities and towns have asked the voters for permission to keep revenues that are generated by existing taxes, but cannot be kept and used without voter permission because of the amendment's revenue limits. Through 1998, there had been 356 of these exemption elections, with permission granted in 325 of them. This 91 percent pass rate is a remarkable record, but it is clearly no mandate for increasing taxes. In another 149 elections, municipal governments asked voter permission for new, increased, or extended taxes. In 26 of these elections, the issue involved property taxes and 58 percent of them failed. By contrast, 123 sales tax issues reached the ballot and 43 percent failed.

City officials reported in interviews that they are being more careful than in the past to propose only tax rate increases that are absolutely necessary and that are most likely to be supported by voters. Voter education efforts are being emphasized, and citizen input is being sought earlier and more aggressively.

Few of the larger municipalities have obtained the broadly inclusive exemption from TABOR that is often termed "de-Brucing" and their record on tax and debt issues is decidedly mixed. For example, Denver has neither sought nor obtained a tax increase or an exemption, although it has received approval for seven debt issues and failed to get four others approved. Colorado Springs has received voter approval only for some limited exemptions, a small sales tax increase, and one bond issue. Aurora voters denied an exemption, but did get approve a small tax increase for police and jail purposes, along with three of nine proposed debt issues. Lakewood voters granted one limited exemption and debt issue, but voted down a much larger debt and tax increase proposal. Pueblo has received approval for some limited exemptions, one small, specific purpose sales tax increase and two bond issues. Of the large Front Range cities, only Fort Collins has had a general TABOR exemption approved (in 1999), although it defeated an earlier debt increase proposal.

## **Municipal spending**

Trends in spending and revenues confirm that TABOR and Gallagher have restrained the growth of city government spending, despite municipal election successes. The effects of these amendments has been somewhat obscured because the state economy has been very strong during the period TABOR has been in effect. Between 1992 and 1997, personal income rose from \$79 billion to more than \$105 billion. Retail sales rose from \$34 billion to \$45 billion and the state's population grew by 476,000, enough to create another Colorado Springs and Pueblo.<sup>3</sup>

This study uses an interrupted time-series economic model to measure the rates of change in real, per capita spending in a "typical" Colorado municipality during three different periods. The

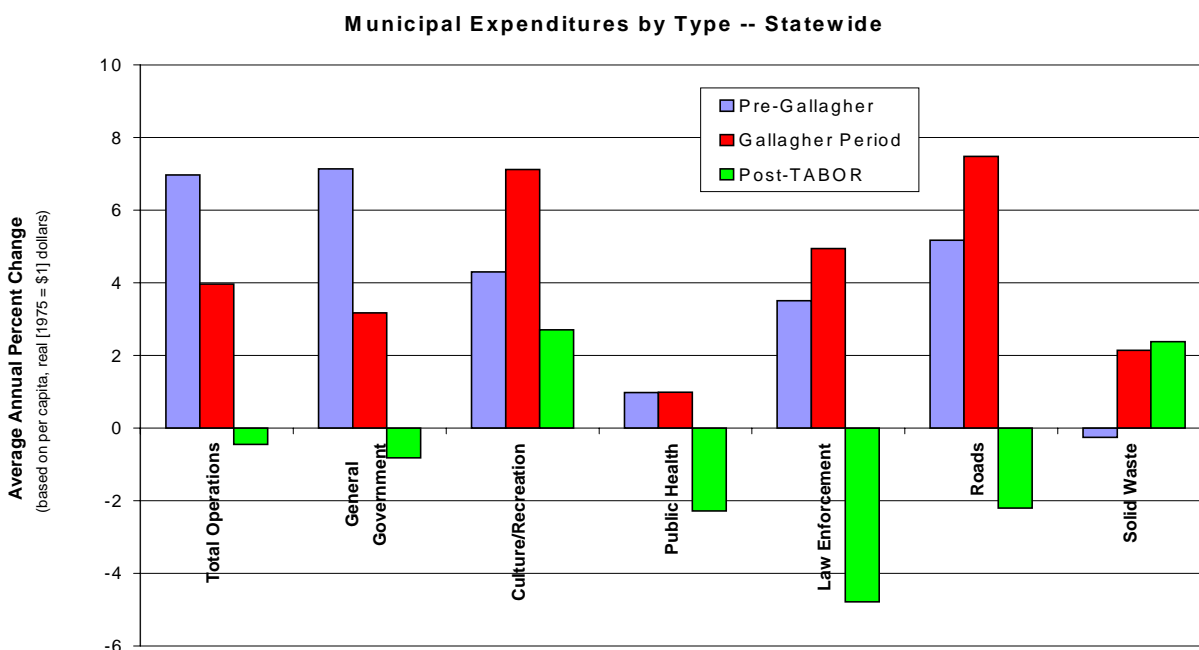
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<sup>3</sup> The State Demographer estimated that Colorado's population in July, 1992 was 3,478,378 and that in July, 1997 the population was 3,954,452, an increase of 476,054. In July, 1997, the estimated Colorado Springs population was 338,016 and Pueblo's was 102,723, for a total of 440,739.

first is from 1975 through 1984, before either the Gallagher or TABOR amendments had passed. The second is the period from 1985 through 1992, when the Gallagher amendment re-shaped the property tax base. The third is from 1993 through 1997, when both Gallagher and TABOR (and their interaction) shaped municipal fiscal policy. The model tracked fiscal trends while accounting for economic conditions as indicated by unemployment, personal income, farm income, manufacturing income, retail sales, and construction income.

The results show that TABOR has indeed restrained the growth of spending and taxes by municipal governments. For a typical municipality, operating expenditures had been increasing in per capita real purchasing power by an average of about seven per cent a year prior to 1985, and by almost four percent annually between 1985 and 1992. Since the passage of TABOR, these expenditures have decreased slightly. Despite municipal election successes, Gallagher and TABOR each had a significant restraining impact on spending and revenue growth for a typical Colorado municipality.

**Figure 1**

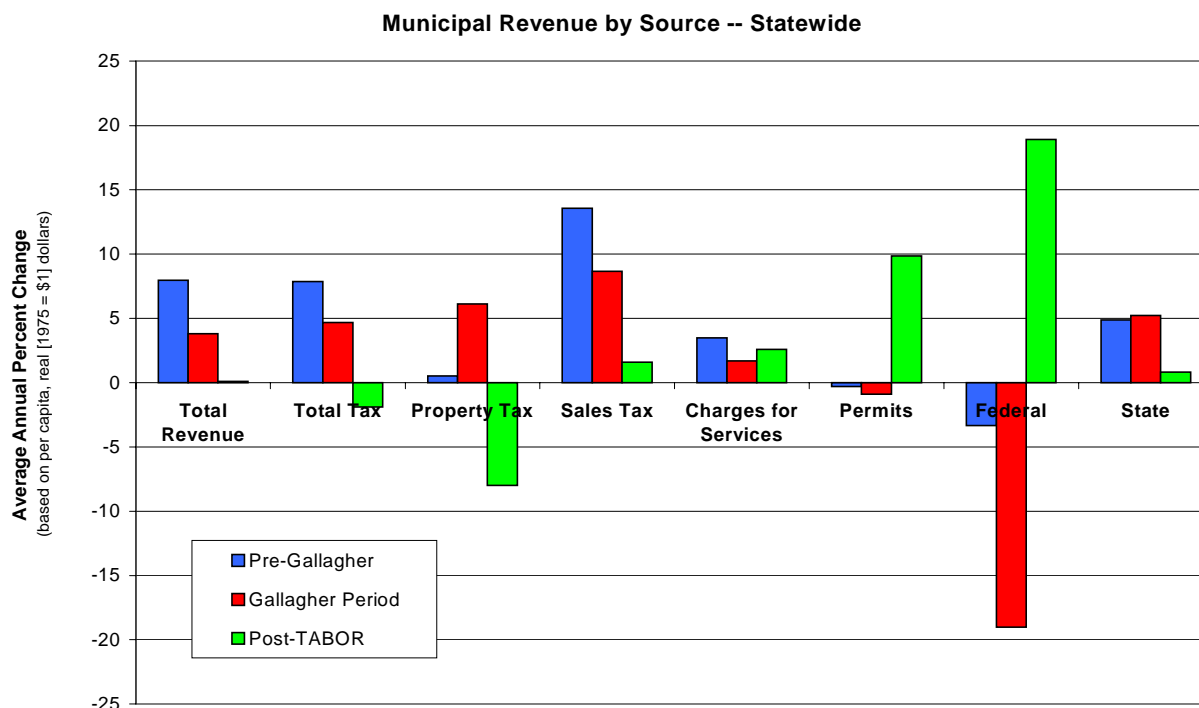


These amendments have also led cities to substantially reorder their spending priorities. Since TABOR, the typical municipality has reduced per capita real spending on total operating expenditures, general government, public health, law enforcement, and street maintenance. Spending has continued to increase only for cultural and recreational functions and for solid waste services.

**Revenues**

The amendments also restrained the growth and changed the composition of revenues in a typical municipality. Total revenues (from all sources) had been increasing at an average annual rate of about eight percent prior to Gallagher, and by almost four percent yearly during the Gallagher period. After TABOR, these revenues have been going up by only about a tenth of one percent yearly.

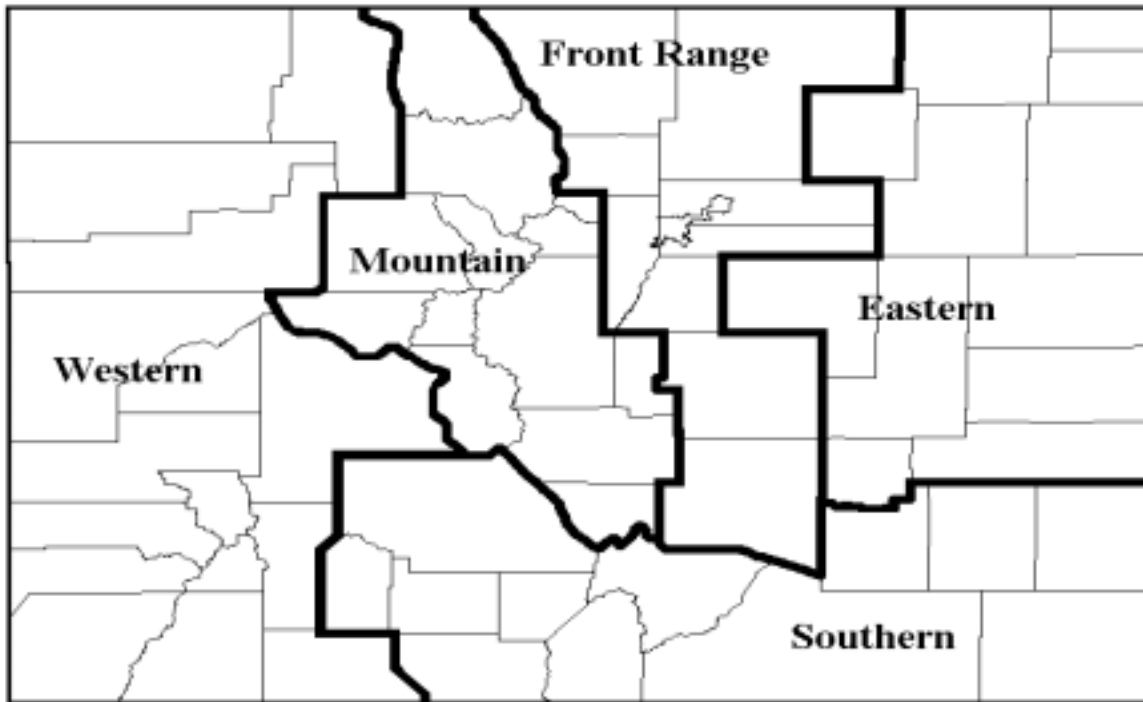
**Figure 2**



Revenues from property taxes have been decreasing sharply since TABOR. Growth of sales tax revenues has slowed markedly in the typical Colorado municipality, although these revenues continue to rise along with their share in total revenues. Cities and towns have increased their reliance on user charges, permits, and aid from the federal government. With the state government subject to its own TABOR limits, state contributions to municipal coffers have slowed significantly.

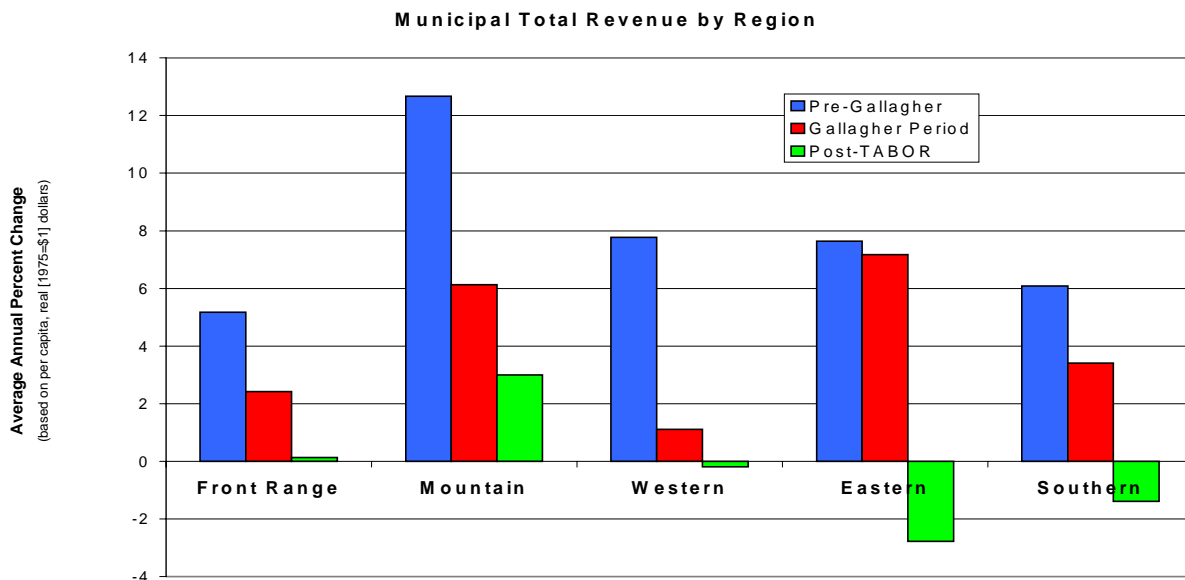
Just as economic and population growth have been distributed unevenly across the state, the effects of Gallagher and TABOR have varied considerably, also. Regional differences can be clearly seen when comparisons are made among municipalities in the five different county commissioner districts.

Figure 3



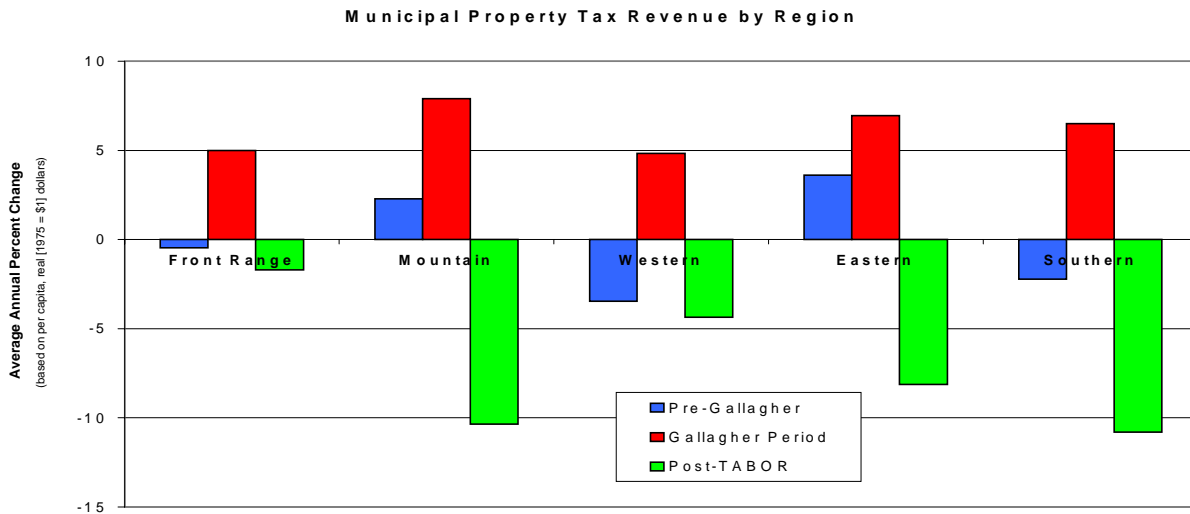
Since TABOR, total revenues have risen more slowly than before, but, nevertheless, have continued to go up for the typical Front Range or Mountain region municipality. They have been falling for the typical town in the Western, Eastern, and Southern regions of Colorado.

Figure 4



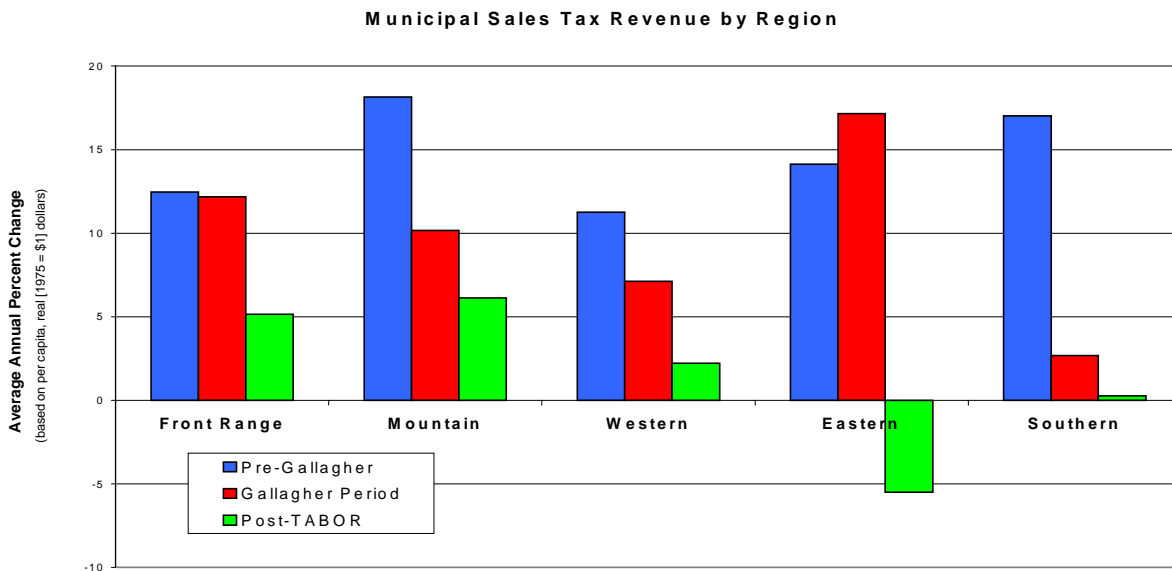
Among the major sources of municipal funds, property tax revenues have been falling in every region since the TABOR amendment, but they are going down much more slowly along the Front Range than elsewhere. On the Front Range since 1993, property taxes have fallen in real per capita terms by about two percent a year. In the Mountain and Southern regions of the state, municipal property tax revenues have fallen by over 10 percent a year since TABOR.

**Figure 5**



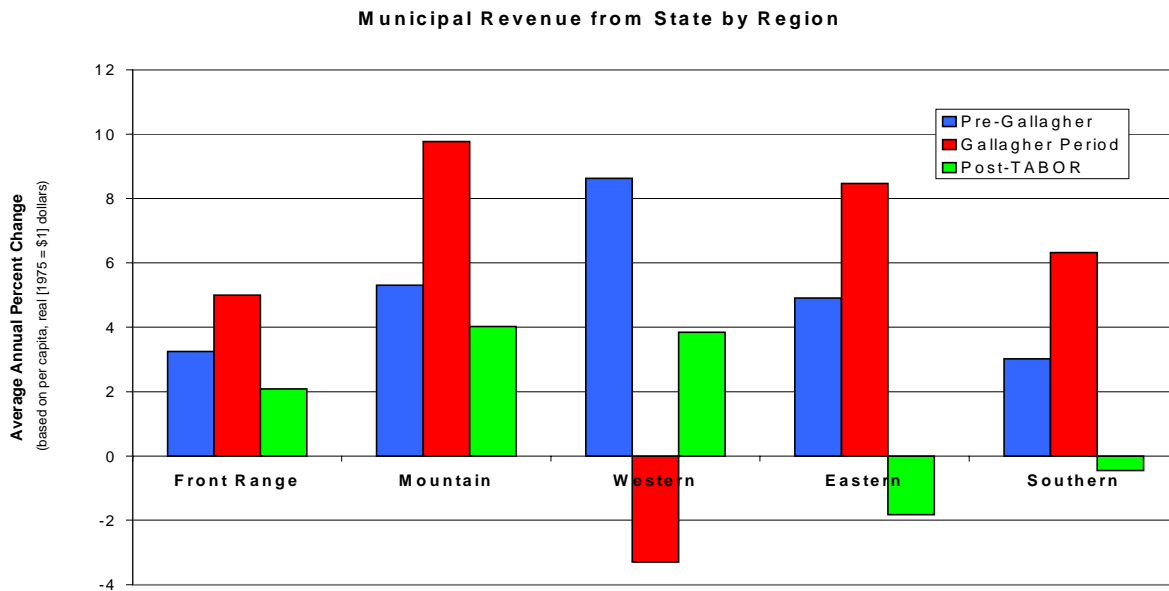
Even sales tax revenues have been shrinking at an annual average rate of more than five percent on the eastern plains. In the more prosperous Front Range, Mountain, and Western regions sales tax revenues have continued to grow even after the TABOR amendment.

**Figure 6**



Municipal revenues from the state government have also continued to increase for municipalities in the Front Range, Mountain, and Western regions, but they have been decreasing in the Eastern and Southern regions.

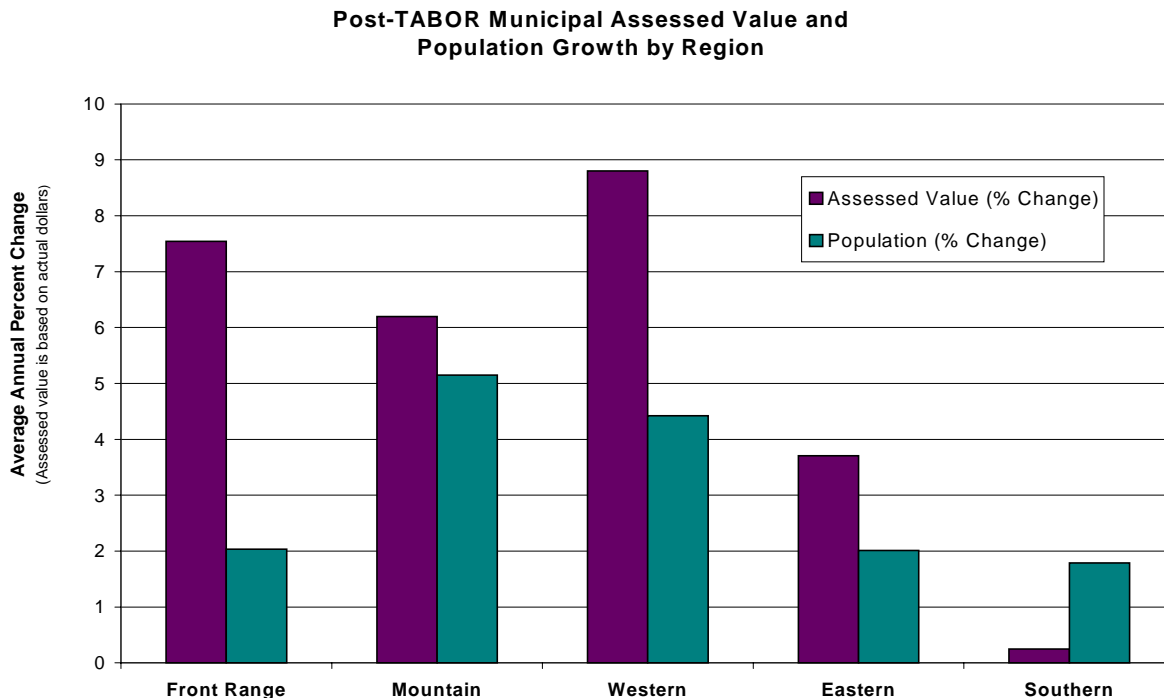
**Figure 7**



Because municipal TABOR limits are based on growth in property values, cities and towns with the slowest growth in new construction and annexation that might spur economic development are faced with the tightest limits. There is danger that TABOR could forestall services and investment that might spur economic development in areas that have the weakest local economies.

So far, this has meant that spending limits have been highest on the Front Range, where property values have risen much more rapidly than population. In the Southern region, population has been rising faster than property values. In 1997, the Front Range accounted for more than 86 percent of the state’s municipal population; 85 percent of the personal income; and 82 percent of assessed property value. Thus, TABOR has permitted the greatest revenue and spending growth in cities with the largest populations and budgets and has imposed the tightest limits where municipal populations and budgets are typically small.

**Figure 8**



**Long Term Implications for Municipal Governments**

What are the implications of these two amendments and their consequences for the future of Colorado? Clearly, the limits imposed offer declining revenue growth as a strong incentive for cities to become more efficient and selective in the services they provide.

Responsiveness to citizens becomes even more crucial as voters with their power over the purse will be in a position to decided spending priorities, projects, and programs. Voter education, public relations, and electioneering may become critical to obtaining voter approval for mundane infrastructure and programs. Municipal leadership of community opinion will become increasingly valued.

Privatization may increase, both as a means of providing services outside municipal TABOR budgets and, in some instances, as a more efficient method of delivery. If privatization increases, then managing contractors and contracts will become ever more valuable as a municipal skill.

Cities and towns have markedly increased their reliance on sales taxes. The evidence suggests that this is likely the result of both voter sentiment, that seems generally to favor sales taxes over property taxes and TABOR. Although the amendment’s limits apply to revenues regardless of source, sales or property tax, if municipal officials foresee the need to temporarily reduce revenues



to stay under their TABOR limit, it is easier to do this with property tax mill levies than with sales tax rates. For the mill levy, it is only necessary to that the county assessor implement the temporary change. For temporary sales tax rate reductions, implementation requires the efforts of many businesses and individuals.

In 1992, municipal governments collected \$3.84 of sales tax revenue for every \$1 of property tax revenue (in actual, per capita dollars). By 1997, this had changed to \$4.74 from sales taxes for every \$1 of property tax. This trend suggests that growth management decisions may favor businesses likely to generate large amounts of sales taxes from nonresidents, even at the risk of reaching TABORs limits in a good economy.

In many parts of the state, tourists and Wal-Marts have become the new “mother lode.” In this competition for nonresident (and nonvoting) shoppers, municipalities in the Mountain region are the clear winners with 1997 sales tax revenues of \$887 per resident. Western region cities and towns generated \$463 per resident; for the Front Range it was \$293; and for towns in the Eastern and Southern regions these figures were \$137 and \$157, respectively.

The winner in this competition goes to the city or town that lands a shopping center, but does not have to house the shoppers (and often not even the retail workers). The competition is “won” by large retail businesses that attract nonresidents from afar over small retail stores that attract only nearby residents. Increased travel and traffic congestion are a natural result. Increasing dependence upon point-of-sale taxes may not bode well during the next (surely, there will be a next) economic slow down. When the real estate market cools, the disconnect between population growth, which requires more services, and property values, which govern revenue limits, will become more apparent.

In summary, the Gallagher and TABOR amendments to the Colorado constitution have had substantial effects on the revenue structure and the spending patterns of most municipalities in Colorado. Some of these effects appear to have been intended by voters, but others may be unanticipated and unintended.

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