January 20, 2006

Senate President Ben Stevens
Room 111
State Capitol
Juneau, Alaska 99801

House Speaker John Harris
Room 208
State Capitol
Juneau, Alaska 99801

Dear Senate President Stevens and House Speaker Harris,

We present this report to the 24th Legislature in response to SCR 14.

Introduction

Senate Concurrent Resolution 14 (SCR14) created the Advisory Commission on Local Government during the first session of the 24th Legislature. This resolution was the result of longstanding concern, revisited in 2005 during hearings in the House and Senate Community and Regional Affairs committees, over the state of local government and the perception that the standstill in the evolution of the unorganized borough was adding to the weakening health of local governments throughout the state. The Resolution directed Commission members to:

- Study the specific reasons for the hardships that communities in Alaska have experienced and develop proposals to continue the evolution of local government;
- Define the role of state government in the financing of local public services;
- Recommend specific means by which local governments, when desired, can move towards borough formation;
- Review findings of previous local government studies and incorporate useful information in its report; and
- Deliver a report of its findings to the Legislature.

This report highlights two main areas the commission focused and reached consensus on during the effort to examine the hardships, along with several closely related issues that were identified and perceived to be roadblocks or disincentives to borough formation.

The first area of focus centered on revenue sharing. Recognizing its important history in Alaska, and other states, the commission has recommended reconstituting the program and creating a new disbursement formula, based on services provided and category of the local government, with a basic grant and a per capita allocation, in conjunction with a sustainable funding source.

Keeping in mind the role of state government in relation to local governments, a second major focus and recommendation was to identify a 'next step' to allow the creation of a new category of borough to move toward regionally organizing areas of the vast unorganized borough, and to put in place incentives to do so.

Forward

Under SCR 14, there were nine positions to be filled on the Advisory Commission. Three members were selected from the House of Representatives by the Speaker of the House, three were selected from the Senate by the Senate President, and three were filled by public members who were selected by both the Senate President and the Speaker of the House. The Commission included Senator Gary Stevens, Chair, Representative Bill Thomas, Co-Chair, Senator Bert Stedman, Senator Tom Wagoner, Representative John Coghill, Representative Woodie Salmon, Lisa Von Bargen, Marvin Yoder and Scott Brandt-Erichsen.

The Commission held four public meetings between September 2005 and January 2006. Membership, materials reviewed, minutes and other information considered by the Commission during its short existence can be found at the Commission's website: www.aclg.com. The Commission met at the expense of individual members, and there was a zero fiscal note associated with the enabling resolution. The outcome of SCR 14, and meetings held during the fall of 2005 including the review of previous related studies are three draft pieces of legislation that are attached to this report that represent the consensus on behalf of all members.

There is a vast body of knowledge and critical analyses, not to mention a fluid legislative history on these subjects. Many of the research papers can be found as links on the Commission's website. The Commission spent several days reviewing two major studies: The Local Government Symposium held in August of 1979 focused on service delivery in the unorganized borough and local/state responsibilities and relationships. The other major study reviewed by the Commission was the Task Force on Governmental Roles that occurred in 1992. Overviews on the topics were provided by the Alaska Municipal League and the Department of Commerce, Community and Economic Development's Division of Community Advocacy Director Mike Black, an individual who has decades of experience with communities and the department.

Revenue Sharing

Charged with identifying key issues leading to the economic hardships of local governments across the state, the Commission recognized the loss of income to communities with the termination of the program, and examined the history of revenue sharing in Alaska and in other states, as well as invited testimony by the Alaska Municipal League. The Legislative Research Agency prepared a report at the Commission's request containing a detailed history of the program and the changing statutory authority that guided revenue sharing up until the program was vetoed in 2003, when it was forecast that state revenues would decrease and the program would be unsustainable; a link to the entire study is included in the appendix.

Full History of Municipal Revenue Sharing in Alaska
Excerpted from House Research Agency Request 87.073:

- Revenue Sharing started in 1969, long before oil revenue.
- Revenue Sharing was a bigger percent of the State budget in 1969 than it was last year.
- In 1979 the Legislature ended sharing the Gross Business Receipts Tax with municipalities in exchange for a promise to replace the revenue with equivalent "Municipal Assistance."

1969 to 1980 - State Revenue Sharing Program

The state revenue sharing program (SRS) came into being on July 1, 1969 with the passage of HB 350 (Chapter 95, SLA 1969). Its five purposes were:

1. Help ease fiscal problems facing local governments.
2. Stabilize or reduce local property taxes.
3. Encourage local governments to provide adequate levels of public services.
4. Inject a measure of budget planning and stability into local governments.
5. Improve allocation of State funds by sharing them with local governments.

Approximately 75% of the funds were distributed on a per capita basis for services provided, and 25% based on other criteria (e.g. miles of road maintained). The categories and evolution of the program are shown in the table below:

Comparison of State Revenue Sharing in FY 70 to FY 80

Category of Service Provided	1970	1980
Police	$5.00 / capita	$12.00/capita
Fire Protection	$2.50 / capita	$7.50/capita
Road Maintenance	$1,000/ mile	$1,500/mile
Air/water Pollution	$1.00 / capita	$2.00/capita
Land Use Planning	$1.00 / capita	$2.00/capita
Ice Roads	NA	$900/mile
Parks and Recreation	NA	$5.00/capita
Transportation Facilities	NA	$5.00/capita
Health Services	NA	$2.00/capita
Hospital (facility)	NA	$25,000to$75,000
Health Facilities	NA	$1,000/bed,$4,000/facility
Hospital Construction	NA	$2,500 / bed
TOTAL Revenue Sharing	$2.0 million	$26.9 million
TOTAL / Capita Sharing	$9.50 / capita	$35.50 / capita

1979 - "Municipal Assistance" Program created to replace municipal share of the Gross Business Receipts tax: Until 1979, the State shared 20% of the Gross Business Tax

Receipts generated in each municipality. When the State repealed its tax on January 1, 1979, *the State promised to replace the lost revenues to municipalities*. Revenues were distributed with a “hold harmless” amount (based on what each municipality received in 1978), plus a per capita distribution.

1980 - Revised State Revenue Sharing Programs: HB 192 (Chapter 155, SLA 1980) repealed and replaced the “per capita” revenue sharing program primarily with an “equalization” revenue sharing program. Key elements of the new State Revenue Sharing Program are:

1. “per capita” type categories were abolished except Roads, Fire Protection and Health Facilities. Road revenue sharing was increased to $2500 / mile
2. A “minimum entitlement” was created to protect the smallest municipalities.
3. A cost of living differential was established.
4. The majority of funds were distributed under an “equalization” formula that takes into account: population; local tax base; and actual local tax effort.

1997 - “Municipal Assistance” changed to “Safe Communities”: The Municipal Assistance Program did not direct how the money was to be used by municipal governments. The Safe Communities Program directs that revenues be allocated to various public safety and health services in priority order. However, a municipality may allocate the funding to other public services.

2004 – All Revenue Sharing Programs eliminated:

- Local property taxes have gone up 29% in the last six years largely due to revenue sharing cuts, underfunding education inflation, and state/federal mandates.
- Over 40 small communities have ended or severely cut key municipal services including police, fire, road maintenance, etc.
- By 2005 at least 14 small communities have closed their doors

State Revenue not trickling down

Contrary to conditions when oil prices were predicted to steeply decline, oil prices continued upwards, and Alaska’s unrestricted general fund revenues have grown; yet cities across the state are increasingly unable to provide basic services or are shutting down completely. More than 14 communities across the state have shut down their local governments and many more are seriously close to doing so. With increasing costs and decreasing revenues, communities are feeling the crunch. This is, of course, compounded annually by inflation.

Ironically, as high oil prices benefit the State of Alaska (currently projected as a $1.2 billion surplus for FY 06, with likely similar surplus in the next fiscal year), people are paying fuel prices at the pump end much higher than last year. Not only are high fuel prices causing enormous problems for individuals and cities large and small, but those cities are also paying higher costs for important basics such as insurance and required retirement contributions in lieu of Social Security.

To compensate for the extensive list of additional expenses on local governments, many areas have had no choice but to raise local property and sales taxes. However, despite increases in tax revenue, many cities are still not able to provide the basic services that they were once able to provide. As well, many cities have a small tax base due to the close proximity for purchasing goods from larger municipalities outside the community, or a geographically limited property tax base, due to large federal landholdings.

Statement of Support for a Community Dividend/Revenue Sharing by Alaska Businesses

The following is excerpted from the State Chamber of Commerce's letter of support to reinstate revenue sharing. They offer evidence of the economic health implications in support of a sustainable community dividend program using an endowment management method (POMV, Amerada Hess) to provide local tax relief to business and families, to assist in providing basic public services throughout Alaska:

- "It is time for long-term local tax relief for businesses and families;
- A community dividend maintains good private sector jobs in urban Alaska; and
- A community dividend gives small local governments the revenue boost they need to afford to provide basic public services and a reasonable quality of life for rural residents.

Upward pressures on local taxes in all Alaskan communities are accelerating due to federal and state unfunded mandates, state and federal budget cuts, the elimination of all municipal revenue sharing programs, a $3 billion local government debt from the state's retirement programs, very high fuel prices and insurance costs, and general inflation."

Additionally the State Chamber recognizes, as does the Commission, that:

"Anchorage, Fairbanks, and Juneau are the *economic downtown* for rural Alaska. Rural Alaska spending supports at least one out of eight jobs in urban areas: Why do small communities matter economically to Alaska's larger communities? In rural communities there are very few service or retail businesses, so "coming downtown" means calling or visiting Anchorage, Fairbanks, Juneau, and a few other larger communities. In addition, whether goods are purchased in the larger communities or on-line, Alaska's huge intrastate transportation and communication systems are also based in Anchorage, Fairbanks, and Juneau. As rural local governments continue to fail and urban migration continues, urban communities gain unemployed residents and lose jobs at the same time.

The bad news for small communities is that they have almost no local tax base due to very high levels of non-taxable federal land, and very little money spent directly in the community. While most small communities have substantial local sales taxes, they simply can't generate enough local revenue to support minimum local public services. A smaller community can usually expect to generate only $8,000 to $12,000 from local sales tax.

The good news for urban communities is that rural residents spend most of their money in Anchorage, Fairbanks, Juneau, and a few other larger communities. This supports a lot of urban jobs in retail, services, construction, and, especially, transportation. According to economic studies, trade with other parts of Alaska is directly or indirectly responsible for 1 out of 5 to 1 out of 8 jobs in the Anchorage-Mat-Su area.

In the past year several of Alaska's small local governments have closed, and more than half are in financial crisis significantly worsened by the elimination of revenue sharing by the State."

Local Government Structures – the Administrative Borough Concept

The Commission acknowledged the need to continue to form regional government structures and to identify and support the missing link to full boroughization: economic incentives. The Department of Commerce Community and Economic Development, Alaska Municipal League and individuals with economic development organizations contributed their input. In addition, former Senators Vic Fischer and Arliss Sturgulewski provided members with a vast amount of personal knowledge and historical data on the genesis of borough government in Alaska. The Commission reached consensus on a concept that they believe will bridge the gap between existing communities without an organized borough structure, and a phased approach to borough self governance, termed the "Administrative Borough". They reviewed the Constitutional and statutory basis for boroughs as well as getting first person interpretations of actual intent by drafters of the constitution itself through Senator Fischer's testimony. Primary focus related to the factors linked with the lack of incentive to organization, and the presence of real disincentives to borough formation, resulting in stagnation in the evolution of self-sustaining local governments. It was Senator Arliss Sturgulewski who called the single unorganized borough the "amorphous mass."

The website contains a link to fact sheet on the structures of city and boroughs in the state. There are only three unified home rule municipalities (Anchorage, Juneau, Sitka); 6 home rule boroughs (Denali, Haines, Lake and Peninsula, North Slope, Northwest Arctic, and Yakutat); 7 second class boroughs (Aleutians East, Bristol Bay, Fairbanks-North Star, Kenai Peninsula, Ketchikan Gateway, Kodiak Island, Mat-Su), 20 first class cities, and 114 second class cities. There are also numerous unincorporated organized communities.

The Commission recommends recognizing all forms of city and government in a revised revenue sharing program including the unorganized communities.

Regionalization Concepts

The Commission heard from a subcommittee of the Denali Commission, known as the Council for Economic Policy for Rural Alaska (CEPRA), that creating regional governmental structures was critical to economic development. They also noted that the Alaska Regional Development Organizations (11 throughout the state) are a dynamic force more fulfilling regional goals with multiple resources: state, federal match, and local funds.

The commissioners' reason for proposing a new level of borough government is to encourage new borough formation. However, there is an additional issue that needs to be addressed.

The commissioners have received testimony that rigid adherence by the Local Boundary Commission (LBC) to regulations regarding borough boundaries have been a detriment to new borough formation. The commissioners therefore state their intent that the LBC apply flexible rules when reviewing local proposals. Priority should be given to the standards listed in statute. Minor consideration will be given to the model borough boundaries and other administrative boundaries.

Issues identified but not addressed by recommendations

In the course of its deliberations, the Commission discussed a number of hardships and challenges to communities and impairments to borough formation. There is a value in identifying those issues so that future efforts may attempt to address these topics, including:

- The resolution of the dual track educational funding system using Regional Educational Attendance Areas (REAAs) and Municipal School Districts.
- Orderly dissolution of insolvent municipalities.
- Allocation of payments, such as federal timber receipts, as a factor impeding borough formation.
- Regionalization of state provided services.

1. The dual track educational funding system refers to the fact that city school districts and borough school districts fund educational services with a mandatory minimum local contribution while REAAs are primarily state funded and do not have a mandatory local contribution. This system of funding causes friction between the two divisions. Those who are in city or borough school districts feel that residents in REAAs should bear some of the funding burden. Most REAAs counter that 1) they lack the tax base to meet the minimum contribution, and 2) the treatment of federal educational funding is such that there is the functional equivalent of a local contribution, which is as large as that in city or borough districts. The proposed Administrative Borough legislation does not address this issue directly, but aims at creating an environment that should encourage areas of the state to move toward boroughs with educational powers. The Commission recognizes that it does not resolve the conflict in this area. The Commission believes that any legislatively imposed resolution of the conflict would not be a consensus solution.

2. Currently, dissolution of a municipality calls for a petition of the dissolving government or findings by the Local Boundary Commission. One of the guidelines is that all debts are paid. There is not a clear process for dealing with an insolvent non-functioning municipality that would address resolving debts and assumption of the authority to operate existing public infrastructure such as sewer or water infrastructure. While the Commission identified this as an issue requiring attention, it could not be adequately addressed in the time available.

3. The Commission received information regarding the current system for allocation of federal timber receipts (AS 41.15.180), which indicated that the method provides a significant disincentive to borough formation. Currently, areas in the unorganized borough in Southeast Alaska receive funds on a per capita basis, which are generated from the land area in the unorganized borough. Areas in boroughs receive funds based on land area. The result is that any annexation or borough formation will result in a reduction in revenues to all communities in the unorganized borough. Therefore they oppose borough expansion and resist borough formation.

The Commission recognizes the issue, but declines to propose a specific solution.

4. The Commission heard suggestions regarding the orientation of state services on a regional basis in ways that would have common boundaries or districts. It was suggested that this approach would promote regional thinking and thereby encourage regional (borough) organization.

The organization and delivery of services by state agencies is beyond the scope of the Commission's charge.

Thank you for providing us the opportunity and the support to examine these important topics during the summer and fall, the Co-chairs plan to introduce House and Senate Community and Regional Affairs Committee sponsored legislation next week.

Signed,

Senator Gary Stevens, Chair Representative Bill Thomas, Co-Chair