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MARCH · 2011

PUBLIC FINANCE REPORT

For the remainder of the 2011 session of the Nevada Legislature, the Public Finance Report will be released monthly to accommodate events in the State Capital.

For decades, as Nevada's economy was growing robustly, local governments faced steep challenges in serving rapidly increasing populations and expanding residential and commercial development. The public dis-course revolved around where growth was occurring, and how to meet the need for public services. Accordingly, the formulas for distribution of public revenues came to be based on expectations of overall economic expansion, with less attention given to the possibility that growth and decline might one day occur simultaneously in different areas within a single county.

Since 2007, property values have collapsed, population growth has faltered, and local governments have faced severe revenue shortfalls in attempting to meet continuing demands for services. Now, in 2011, the unintended consequences of a revenue distribution formula driven almost entirely by population and property growth have manifested themselves because most urbanized areas of Clark County are experiencing negative growth, while some others have modest positive growth, a circumstance not fully envisioned in the current formula used to distribute sales taxes, cigarette taxes, liquor taxes, motor vehicle registrations, and real property transfer taxes within each of Nevada's counties. Together, these taxes are referred to as Consolidated Tax, or C-Tax.

C-Tax distributions account for an average of 33.4 percent of general fund revenue for local governments in Clark County. Given the importance of these revenues, projections for their distribution in the ensuing year are critical in establishing local budgets. Preliminary estimates now show that FY 2012 allocations to several local entities in Clark County will be significantly disproportionate to their actual rate of growth, due to provisions in the distribution formula, intended to make the allocations more growth-sensitive, but which are now seen as potentially destabilizing the distribution. This is the case because each entity is assigned its own growth index, and those indices are summed un-weighted, without any relationship to the size of any entity or its historical revenue base. In some instances

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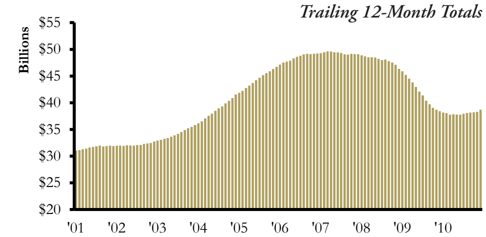
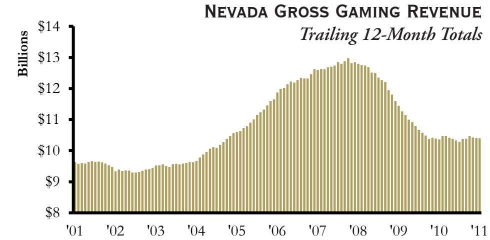
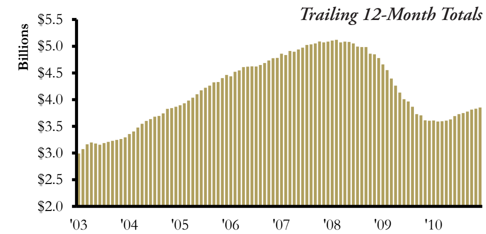
NEVADA TAXABLE SALES
Trailing 12-Month Totals



NEVADA GROSS GAMING REVENUE
Trailing 12-Month Totals



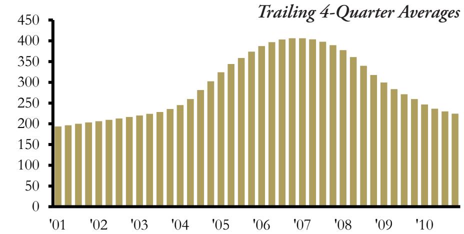
NEVADA TAXABLE ROOM REVENUE
Trailing 12-Month Totals



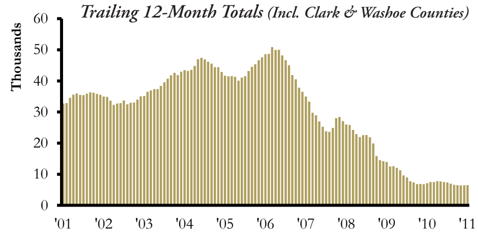
TRAILING 3-Months/Quarterly Series	Most Recent Data Available	INDICATOR VALUES: Current 3-Month Period/Qtr.	Previous 3-Month Period/Qtr.	Same 3-Months/ Quarter Prev. Yr.	GROWTH RATES: VS. Previous Period	VS. Same Period Prev. Yr.
Nevada Taxable Sales (1)	Dec-10	$10,298,137,419	$9,478,643,234	$9,740,815,878	8.6% ▲	5.7% ▲
Nevada Gross Gaming Revenue (1)	Jan-11	$2,538,299,103	$2,549,456,256	$2,615,963,331	-0.4% ▼	-3.0% ▼
Taxable Rooms Revenue (1)	Dec-10	$925,480,157	$984,221,915	$848,326,923	-6.0% ▼	9.1% ▲
Nevada Housing Price Index	Q4 2010	218.6	223.3	240.4	-2.1% ▼	-9.1% ▼
Nevada Residential Housing Units Permitted (1)	Jan-11	1,427	1,217	1,410	17.3% ▲	1.2% ▲
Clark County Commercial Permit Valuation (1)	Jan-11	$44,101,659	$55,379,551	$188,165,591	-20.4% ▼	-76.6% ▼
Slot Machines in Nevada (2)	Jan-11	165,862	165,595	169,472	0.2% ▲	-2.1% ▼
Gaming Tables and Games in Nevada (2)	Jan-11	6,366	6,362	6,466	0.1% ▲	-1.5% ▼
NV Taxable Gasoline Gallons of Gasoline (1)	Nov-10	270,780,000	283,260,000	271,400,000	-4.4% ▼	-0.2% ▼
NV Private Sector Establishment-based Empl. (2)	Jan-11	958,033	963,367	967,433	-0.6% ▼	-1.0% ▼
Quarterly Wage Payments	Q3 2010	$9,767,582,914	$9,520,200,014	$9,748,977,986	2.6% ▲	0.2% ▲
Cigarette Packages (1)	Dec-10	30,929,400	32,421,300	31,697,700	-4.6% ▼	-2.4% ▼
Gallons of Liquor (1)	Dec-10	22,296,567	22,123,819	21,923,439	0.8% ▲	1.7% ▲
Estimated Value of Real Property Transferred (1)	Dec-10	$4,959,917,155	$4,953,379,964	$5,405,478,027	0.1% ▲	-8.2% ▼
Estimated Value of Vehicles (1)	Dec-10	$2,080,840,334	$2,118,798,176	$2,201,253,983	-1.8% ▼	-5.5% ▼

NOTES: (1) Trailing 3-month totals. (2) Trailing 3-month averages.

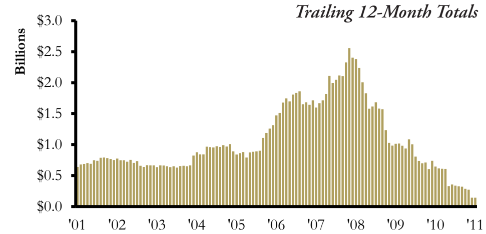
Nevada Housing Price Index
Trailing 4-Quarter Averages



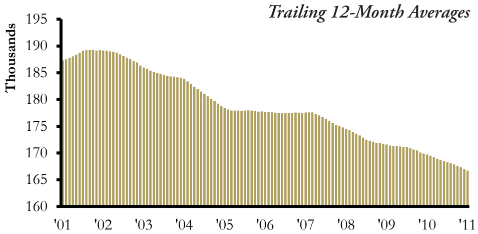
Nevada Residential Housing Units Permitted
Trailing 12-Month Totals (Incl. Clark & Washoe Counties)



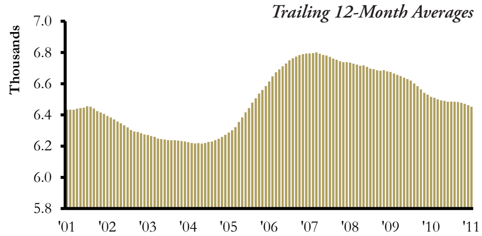
Clark County Commercial Permit Valuations
Trailing 12-Month Totals



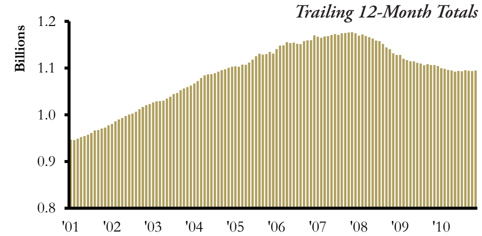
Nevada Slot Machine Counts
Trailing 12-Month Averages



Nevada Gaming Table and Game Counts
Trailing 12-Month Averages



Nevada Taxable Gallons of Gasoline
Trailing 12-Month Totals



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this can result in a single small, but growing entity in the midst of much larger, but slightly shrinking entities, receiving the majority of all revenue increases throughout the county. For example, if total Clark County C-Tax rises only 2 percent in FY 2012, the City of Mesquite's allocation could rise 141 percent. The possibility of such extreme outcomes has prompted reexamination of formula changes enacted in 2001.

To assist in examination of the issue, this paper offers a brief history of the current formula; demonstrates, in simplified form, the operation of a key component of the present method; and offers observations on policy going forward.

Brief History

Prior to 1997, six major tax revenues were distributed among local governments under a variety of different formulas. These taxes include the Basic City-County Relief Tax (sales), the Supplemental City-County Relief Tax (sales), Government Services Tax (motor vehicle), Real Property Transfer Tax, and taxes on cigarettes and liquor. These revenues were each distributed under different methods, based in various ways on population, legislative calculations, the number of cities in a county, or in proportion to the distribution of other taxes. This piecemeal approach resulted in radically different percentages of each of these revenues being distributed between a county and the cities therein, a somewhat counterintuitive situation which generated debate among local governments.

In 1997, a legislative study committee, assisted by an advisory group of finance officers, proposed consolidation of these revenues into a pool for each county, with the distribution to take place according to a single formula. The proposal passed in 1997 as Senate Bill 254, and the Consolidated Tax or "C-Tax" distribution became effective in FY 1999.

On its face, the notion of C-Tax is simple: pool the combined revenues and distribute them according to the relative growth rates of each entity – county, cities, towns, and special districts. The execution, however, has not been so simple. In 1997, to assure that no entity would instantly lose revenue in the new distribution, the Legislature established a starting point or historical "base" level of revenue to be allocated from the combined taxes from the first year of operation forward. In addition to "base" revenue, "growth", or "excess" revenue would be then be allocated according to an index including increases in the population and assessed valuation of each entity, excepting certain special districts. The intended result,

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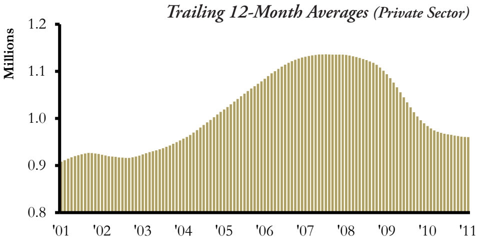
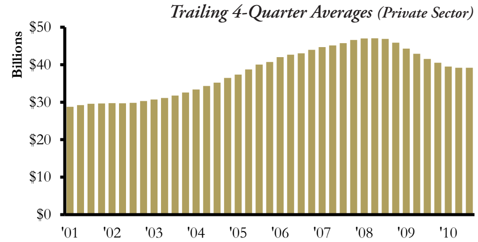
TRAILING 12-Months Series	Most Recent Data Available	INDICATOR VALUES Current 12-Month Period	Previous 12-Month Period	Same 12-Months Previous Year	GROWTH RATES VS. Previous Period	VS. Same Period Prev. Yr.
Nevada Taxable Sales (3)	Dec-10	$38,710,064,640	$38,302,157,091	$38,423,083,603	1.1%	0.7%
Nevada Gross Gaming Revenue (3)	Jan-11	$10,398,801,795	$10,404,730,610	$10,363,309,205	-0.1%	0.3%
Taxable Rooms Revenue (3)	Dec-10	$3,852,467,275	$3,831,581,179	$3,603,595,848	0.5%	6.9%
Nevada Housing Price Index	Q4 2010	224.5	229.9	259.7	-2.4%	-13.6%
Nevada Residential Housing Units Permitted (3)	Jan-11	6,527	6,457	7,133	1.1%	-8.5%
Clark County Commercial Permit Valuation (3)	Jan-11	$142,575,525	$142,657,157	$644,756,818	-0.1%	-77.9%
Slot Machines (4)	Jan-11	166,705	167,010	169,718	-0.2%	-1.8%
Gaming Tables and Games (4)	Jan-11	6,453	6,462	6,515	-0.1%	-1.0%
NV Taxable Gasoline Gallons of Gasoline (3)	Nov-10	1,095,050,000	1,093,570,000	1,106,570,000	0.1%	-1.0%
NV Private Sector Establishment-based Empl. (4)	Jan-11	960,392	960,658	983,908	0.0%	-2.4%
Quarterly Wage Payments	Q3 2010	$39,176,385,634	$39,157,780,706	$41,504,672,497	0.0%	-5.6%
Cigarette Packages (3)	Dec-10	125,263,200	125,226,900	130,675,800	0.0%	-4.1%
Gallons of Liquor (3)	Dec-10	89,108,604	88,405,851	89,110,307	0.8%	0.0%
Estimated Value of Real Property Transferred (3)	Dec-10	$19,606,091,318	$20,053,358,264	$21,243,907,809	-2.2%	-7.7%
Estimated Value of Vehicles (3)	Dec-10	$8,786,257,034	$8,844,993,698	$9,366,903,508	-0.7%	-6.2%

NOTES: (3) Trailing 12-month totals. (4) Trailing 12-month averages.

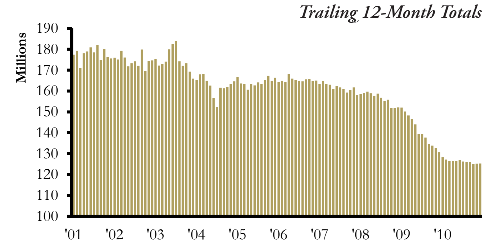
Nevada Establishment Employment
Trailing 12-Month Averages (Private Sector)



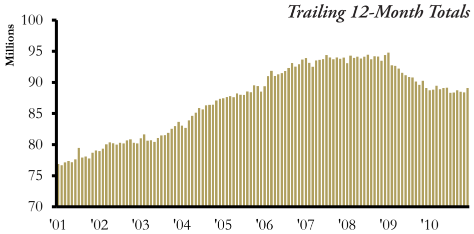
Nevada Wage Payments
Trailing 4-Quarter Averages (Private Sector)



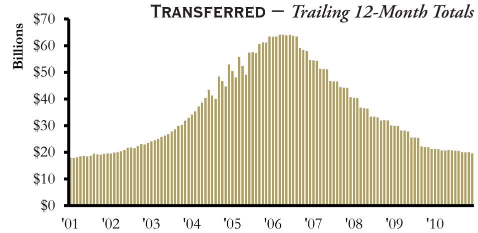
Nevada Cigarette Packages Purchased
Trailing 12-Month Totals



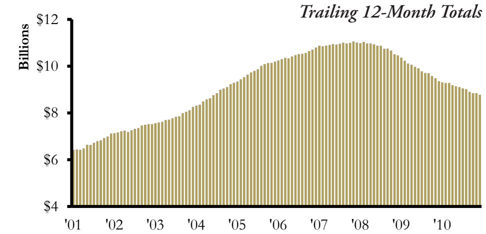
Nevada Gallons of Liquor Purchased
Trailing 12-Month Totals



Nevada Estimated Value of Real Property Transferred — *Trailing 12-Month Totals*



Nevada Estimated Value of Vehicles
Trailing 12-Month Totals



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then, was that entities would start "revenue neutral", and be rewarded for their growth going forward.

Pursuant to one of the objectives stated in the legislative study, to "discourage competition among entities for funding", the first C-Tax growth factors were geared toward stability of revenue distribution, as opposed to immediate and episodic response to such events as jurisdictional annexation or major spikes in population. This stabilizing feature came to be known as "one-plus", after the legislative language prescribing its mathematical calculation. "One-plus" is discussed further in another section of this briefing.

In a general sense, the terms "base" and "growth" are easily grasped. But, since 1997, various local governments have sought to change the formula, and every such case has centered on the definition of these two key terms.

"Base" Revenue

"Base" revenue is generally the amount of money received in the previous year, adjusted for CPI, or a pro-rated amount thereof in years of overall revenue decline. However, some entities have sought, and in one case received, legislative adjustments to their prior year "base", in effect awarding them with a revenue advantage in perpetuity. Such base adjustments increase the floor allocation going forward by artificially overriding an entity's actual revenue history with a "plugged" number, thereby increasing the entity's starting point for the next year's allocation, and for every year thereafter. Significant examples of adopted and proposed base adjustments include:

- *2001 – The City of Henderson received a $4.0 million base adjustment effective for FY 2002, and all years thereafter, in Assembly Bill 10 during a special session.*
- *2007 – The Cities of North Las Vegas, Reno, Sparks, and Mesquite proposed base adjustments in their favor of $9.9 million, $8.0 million, $4.5 million, and $0.6 million respectively as an amendment to Senate Bill 153. This amendment would have reduced the revenue of the City of Las Vegas, Clark County, and Washoe County by $6.9 million, $3.6 million, and $12.5 million, respectively. The amendment was defeated and the bill did not pass.*
- *2011 – The City of Fernley has proposed a base adjustment of $5.0 million effective FY 2012, to be carried forward to all subsequent years in Assembly Bill 47, the bill also calls for a legislative study of C-Tax.*

Other, less-controversial amendments to C-Tax have been implemented over time, generally trending toward multi-year treatment of population and assessed values, and addressing circumstances specific to mining counties.

"Growth" Revenue

"Growth" revenue is essentially the amount received in a year in excess of the amount received in the prior year. The countywide total amount of growth revenue is realized in finite dollars, is reconcilable at year's end, and has therefore not been subject to dispute within a county. However, what is periodically disputed is the calculation of the growth index for each entity, which is used to weight the distributions within each county. C-Tax "growth" revenue is generally allocated according to the proportion which each entity's growth in population and assessed valuation bears to the total of the indexes of all entities within a county. The most controversial feature of this calculation is referred to as the "one-plus" language.

When C-Tax was first enacted in 1997, the index for each entity was calculated as, "one plus" the combined percentage increase in population and assessed valuation of the entity. Therefore, an entity with a combined population and assessed value increase of 5 percent would be assigned a factor of one plus 5 percent, or 105; and an entity with a combined growth factor of 15 percent would have a factor of 115. Under one-plus, the proportional relationship between 105 and 115 then drives the distribution. Without

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the "one-plus" language, the proportional relationship would be that of 5 to 15, with a vastly different outcome as in Tables 1 and 2, showing a hypothetical distribution of $5.0 million in growth revenue between three differently -sized entities, both with, and without "one-plus".

Tables 1 and 2 illustrate two phenomena pivoting around the inclusion or exclusion of the "one-plus" language.

- ***Significant shift in revenue*** *- Elimination of the "one-plus" language shifts $1,924,603 in revenue from slower-growing Entities 1 and 3 to the faster-growing Entity 2, eliminating any increase in revenue for Entity 3, which is experiencing negative growth. Notably, the "one-plus" language allowed non-growing entities to share in distributions of increased revenues. Following passage of C-Tax, when revenues were increasing and most or all local entities were growing, questions arose as to whether the 1997 "one-plus" formula was too insensitive to the need for "growth to pay for growth", and too generous to slower-growing entities. That mindset prevailed when the Legislature passed Assembly Bill 10 in a 2001 special session, phasing out the "one-plus" language and making the formula totally growth-sensitive as Nevada's economy continued to expand.*

- ***Disproportionate benefit*** *- In the current formula, without "one-plus", Entity 2, growing at 15.0 percent, receives a 37.5 percent increase in total C-Tax revenue, while the larger Entity No 1, growing at 5.0 percent, receives a 1.3 percent increase in revenue. This is the case because elimination of the "one-plus" language in 2001 made the formula entirely reliant on the growth of each entity only in proportion to itself, independent of the relative size of entities or their existing revenue bases. The greater anomaly in this example is not that revenue growth for Entity 1 lags actual growth by 3.7 percent, but that revenue growth for the smaller Entity No. 2 exceeds actual growth by 22.5 percent.*

Now, as we approach FY 2012, it is expected that a very slight overall increase in C-Tax revenue will be distributed among Clark County local entities based on their relative growth percentages, once again without the "one-plus" factor or other stabilizer. The difference today is that some large urban entities now have negative percentage growth factors, primarily from drops in assessed value, and the mixed pattern of growth and decline throughout the county is such that some smaller entities are projected to receive C-Tax revenue increases in percentages vastly disproportionate to their size and budgets, due to the formula factors illustrated in Tables 1 and 2. This is an unintended consequence of the formula's design, which did not contemplate the hyper-growth in sales activity that occurred during the late 1990's and early 2000's much less the nation-leading rates of decline witnessed during the past few years.

There are at least two bills regarding C-Tax before the 2011 Legislature – one simply requesting a legislative study; another also requesting a study, but accompanied by an adjustment in base revenue; neither which proposes reinstatement of "one-plus" or any variation thereof. The City of North Las Vegas is now supporting Assembly Bill 71, requesting only a study. The City of Fernley is supporting Assembly Bill 47, which seeks both a study and a $5.0-million base adjustment.

Policy Considerations

Ironically, if the "one-plus" language were reinstated today, these anomalies would not be taking place. This, however, should not be construed as a conclusion that simply reinstating the "one-plus" factor is necessarily the ultimate remedy for the C-tax distribution's dual challenges - making the formula sufficiently responsive to relative changes among entities while avoiding grossly disproportionate outcomes. As shown in Tables 1 and 2, the percentage increases in revenue

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Tables 1 and 2

Illustration of C-Tax Distribution With, and Without "One-Plus" Calculation

WITH ONE-PLUS

Calculation	*Entity 1*	*Entity 2*	*Entity 3*
Pop. + AV Growth	5.0%	15.0%	-5.0%
One-Plus (Add)	1.0	1.0	1.0
Entity Growth Factor	105.0%	115.0%	95.0%
Sum Positive Growth Factors	315.0%	315.0%	315.0%
Entity Growth Factor/Sum Positive Growth Factors	33.3%	36.5%	30.2%
Distribution of $5 million	**1,666,667**	**1,826,397**	**1,507,937**
"Base" Revenue Prior Year	**$100,000,000**	**$10,000,000**	**$5,000,000**
Percent Revenue Increase	**1.7%**	**18.3%**	**30.2%**

WITH OUT ONE-PLUS

Calculation	*Entity 1*	*Entity 2*	*Entity 3*
Pop. + AV Growth	5.0%	15.0%	-5.0%
One-Plus (Add)	N/A	N/A	N/A
Entity Growth Factor	5.0%	15.0%	-5.0%
Sum Positive Growth Factors	20.0%	20.0%	N/A
Entity Growth Factor/Sum Positive Growth Factors	25.0%	75.0%	N/A
Distribution of $5 million	**1,250,000**	**3,750,000**	**–**
"Base" Revenue Prior Year	**$100,000,000**	**$10,000,000**	**$5,000,000**
Percent Revenue Increase	**1.3%**	**37.5%**	**0.0%**

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allocated can vary wildly from the actual percentage growth of an entity. In the hypothetical Table 1 and 2 examples, we see that an entity growing three times as fast as another can receive virtually the same amount of growth revenue in dollars, and more than tenfold the percentage increase, even with "one-plus". Also in Tables 1 and 2, we see how an entity growing only three times as fast can receive a percentage revenue increase more than 28 times that of the slower-growing entity without "one-plus". Although these are hypothetical examples, the range in size among Clark County local entities make such massive variations possible.

Potential Approaches

The primary near-term concerns are the unintended consequences of completely decoupling population and assessed valuation growth from the level of either the base or the incremental "growth" revenue. Since these anomalies are on the immediate horizon, some action should be considered at this time. For discussion purposes, a number of avenues including, but not limited to, the following might be considered:

More directly tying the allocation of growth revenue to the actual percentage growth in population and assessed value through a cap or other constraint – For example, if a two-tiered approach were taken wherein the first distribution is calculated without "one-plus", letting growth dollars flow to growing entities, but limiting the increase in revenue to a percentage more closely related the actual percentage growth of the entity; growth revenues could first go to those logically justified in receiving them, but in closer proportion to actual growth, not in excess of it. Any growth revenues not consumed in the first tier might be reserved for a second tier calculation, this time based on "one-plus" or other stabilizer, which would tend to provide continuity to the remainder of the distribution.

Some form of "circuit breaker" or set of conditions under which an alternative formula is applied if extreme outcomes would otherwise result - Critical in such an approach would be establishing those conditions, as beneficiaries of the existing formula might consider any expected windfall as being legitimately due them, and not extreme or inordinate. Some consideration might be given to reverting to the one-plus provisions as is allowed under certain conditions in mining counties. However, "one-plus" can also produce revenue outcomes not exactly related to growth of an entity. For example, it has been estimated that if "one-plus" were re-implemented under the above assumptions, Mesquite's allocation would increase only 2 percent when their combined growth of population and assessed value is nearly 9 percent – certainly not nearly as disproportionate as under the current language, but not exactly a perfect fit for their actual growth. In addition to seeking a reasonable proportionality between growth and revenue, the potential downside of creating revenue incentives for entities to pursue growth for its own sake should be carefully considered.

Suspension of the existing formula, possibly accompanied by a sunset provision, and substitution of an interim distribution while further study is undertaken toward a long term-solution - Existing legislative proposals for studies might be accompanied by an interim formula, designed to stabilize distributions, while further study can be accomplished and a long-term solution crafted.

As these near-term issues are addressed, it is important that a full range of scenarios be considered, and that careful observation be made of the interaction between proposed alternatives and other standing components of the C-Tax formula such as calculation of the ongoing base and treatment of special districts. As always, any deliberation of formula changes should be conducted cautiously, to avoid unanticipated consequences, and exploration of solutions to the present dilemma should not be seen simply as an opportunity to revive previous proposals. Finally, since C-Tax is a state-wide formula, scenarios should include other counties of various sizes and jurisdictional compositions.

Any of the above approaches, combinations thereof, or other avenues could be pursued. Virtually every local government tax in Nevada has undergone changes in distribution, and most such changes have drawn at least some controversy. Therefore, reaching even an interim solution may be somewhat challenging.

Conclusion

Ideally, formula distribution of revenue should be generally proportional to the relative scale and levels of change among the affected entities. No formula is perfect, and the definition of "equity" is likely to remain somewhat in the eye of the beholder. That said, under present circumstances in Clark County, it is clear the current C-Tax formula can distribute growth revenue in a fashion vastly disproportionate to an entity's rate of actual growth. The reasons for inclusion of the "one-plus" language in the original C-Tax legislation are perhaps more widely understood today than when that language was repealed, and some form of stabilizer or formula modification to limit counterintuitive outcomes might be considered. ■

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