REPORT OF OFFICIAL RECOMMENDATIONS

Borough of Princeton and Township of Princeton
Joint Consolidation / Shared Services Study Commission
June 2011

Approved June 22, 2011

"Additional Financial Aspects of Consolidation"

Introduction

The purpose of this document is to address questions and concerns posed by members of the Commission and members of the public, regarding the potential financial consequences of the decision whether or not to consolidate Princeton Borough and Princeton Township into one, beyond those already addressed in the Commission's Report of Official Recommendations and Summary of Residential Tax and Non-Tax Impacts from Consolidation.

Phase-in of Commission Recommendations

In certain cases, notably the police department merger, the Commission is recommending a phased implementation of the consolidated staffing model. As a result, the full tax impact of consolidation will not be realized until the staffing transition is complete, which may take up to three years.

Comparison of Municipal Budgets and Services

One question asked in public meetings is whether or not the full budgets and the non-tax revenues of each municipality have been factored into the tax impact calculations. The short answer to that question is yes, all revenues and all costs have been accounted for in the tax impact calculations. A more detailed discussion of this point follows.

In their respective 2011 budgets, Princeton Borough has higher costs than Princeton Township, relative to their respective municipal property tax bases. This is due largely to the higher costs associated with servicing the downtown area. There are also residential service differences: municipal solid waste pickup, which is offered in the Borough and not in the Township, and leaf/brush pickup, which is offered more frequently in the Borough than in the Township. The Commission addressed the higher costs and service differences as follows:

- The services provided to the downtown area, and the associated higher costs, are generally assumed to carry forward into a consolidated Princeton.

- There is of course the expectation that costs would be reduced by savings due to municipal consolidation throughout Princeton, including costs associated with services specific to the downtown area.

- The Commission has recommended that solid waste pickup be extended into the entire municipality, and has included an estimate for that cost in the tax impact calculations.

- The other residential service difference identified by the Commission was leaf/brush pickup, which is offered more frequently in the Borough than in the Township. The Commission has recommended that current service levels be maintained and proposes establishment of a position of Assistant DPW Superintendent for the Downtown to address the differing service needs in that area of the community. Exact details of how this service will be structured will be considered by the DPW task force during the transition year of 2012, and if consolidation is approved, it will be up to the government of the new municipality to determine how to implement it.

Princeton Borough also currently has higher revenues from non-municipal tax sources than Princeton Township, relative to their respective property tax bases. These revenue sources include aid from the State and donations from Princeton University for both municipalities, and the parking utility for the Borough.

The tax impact calculation previously reported by the Commission takes into account all municipal costs and revenue, using the 2011 municipal budgets as the starting point. All of the cost differences and revenue differences noted above between the Borough and the Township have been accounted for in that calculation.

Longer Term Budget and Tax Impact Issues

The tax impact analysis performed by the Commission uses 2011 as the baseline. The use of any particular year as a baseline raises the question about whether the results will change over the long term. The Commission has explored that question, and identified the following issues which should be taken into account when considering the longer term financial implications of the decision by the municipalities to consolidate or remain separate.

1. Equalization

Equalization is currently used in the calculation of school and county taxes. Equalization is the application of a ratio calculated annually that is applied to the total aggregate assessed value of all taxable parcels in each municipality, thereby adjusting the assessed value to reflect market value. The Mercer County Board of Taxation calculates the equalization ratio used in determining county taxes, and the State Director of Taxation calculates the equalization ratio used in determining regional school board taxes.

One potential impact of consolidation would be to change the school taxes and county taxes on properties in the former Borough and Township. When calculating the change using 2011 as a baseline, the outcome would result in $442 in annual savings for the average Borough residential property, and $248 in annual costs for the average Township residential property. (Note that these figures are already accounted for, as "secondary impacts", in the tax impact calculation presented by the Commission.)

The characterization of the changes to county and school taxes as impacts of consolidation is accurate, but members of the Commission feel that it requires some explanation, because the impacts on school and county taxes are fundamentally different from the tax impact of the anticipated savings from consolidation. If the Borough and the Township were to consolidate, equalization would factor into the calculation of county taxes in a different way than it does presently, and equalization would no longer factor into the calculation of school taxes. As a result, the changes in these tax rates due to equalization would be different under consolidation than under separate municipalities, as described below.

The Borough and the Township currently each have separate equalization ratios, which are used in the determination of school and county taxes. If the Borough and the Township were to consolidate, then the Mercer County Board of Taxation would calculate a single equalization ratio for the consolidated municipality. The impact of consolidation on county taxes is due to moving to a single shared equalization ratio for the combined towns. If the Borough and the Township were to consolidate, the change in the county tax rate as a result of equalization would not necessarily be the same from year to year, but it is a real impact, that has a repeated effect, year after year.

The impact of consolidation on school taxes is similar but not quite the same. Under consolidation, school taxes would be based on assessed property values. Equalization would no longer factor into the calculation. The impact of consolidation on school taxes is due to this change. This is also a real impact that has a repeated effect, year after year.

However, even if the Borough and the Township were to remain separate municipalities with separate equalization ratios, there would still be an impact on school and county taxes, due to changes in each municipality's equalization ratios that would occur with the passage of time. Because equalization ratios fluctuate more or less randomly over time, we cannot predict precisely what that tax impact would be a few years out, but it is most likely to be approximately the same as the tax impact calculated for consolidation. While this is the most likely outcome, it is not the only one possible. There are also two other possible outcomes for any given year: (1) the tax impact from separate equalization ratios changing over time could be more favorable for Borough property owners, and less favorable for Township property owners, vs. what would result under consolidation; or (2) the exact opposite could result, e.g. the tax impact from separate equalization ratios changing over time could be more favorable for Township property owners, and less favorable for Borough property owners, vs. what would result under consolidation. Either outcome is equally likely in any given year. Also, if the Borough and Township remain separate, then the tax impact of equalization would not be the same for properties in both municipalities, as it would be under consolidation, but instead would vary independently for each municipality from year to year, just as it does today.

2. Budgeted Spending from the Capital Funds Balance

In 2011, Princeton Borough expects to spend approximately $1.3M from its capital funds balance, which started the year at just under $4.7M. The planned spending from the capital funds balance helped avoid an increase in property taxes for Princeton Borough residents in 2011. The Borough's capital fund balance is large enough that it could be used to keep taxes down for the next two years in roughly the same way as in 2011. However, longer term, all other things being equal, the Borough would have to cover its expenses either through service cuts or through increased taxes or an increase in other non-tax revenue.

The Township's 2011 budget does not include a similar net spend from its surplus balance.

If the Borough and the Township remain separate, and if the Borough were to make up all of the $1.3M shortfall through raising taxes, then it would need to raise the tax rate by 0.059, which would result in a tax increase of $442 on an average residential property in the Borough.

If the Borough and Township consolidate, then the combined municipality must eventually cover the same shortfall, although not necessarily in the first year. If it were to do so entirely through raising taxes, then it would need to raise the tax rate by 0.019, which would result in a tax increase on average residential properties in the former Borough and Township of $142 and $157, respectively. Under this scenario, the net annual savings for the former Borough taxpayer due to consolidation is the difference, $442 - $142 = $300, and the net annual cost for that Township taxpayer is $157.

The calculations above, while they appear precise, should be considered inexact, for the following reasons:

i. The $1.3M net spend from the Borough's capital funds balance in 2011 is an estimate, not a precisely known value. It is at the midpoint of an estimated range of $1.0M - $1.6M. Furthermore, future events could conceivably move the net spend from the Borough's capital funds balance outside of this projected range.

ii. The Borough currently covers approximately 45% of its spending through tax levies. The remaining costs in the budget are covered through non-tax revenues. As such, it is reasonable to assume that the Borough may raise half or even more of the $1.3M through increases in parking rates or other fees, rather than through direct property taxes.

    An estimate for the corresponding figure in a consolidated Princeton is that it would cover approximately 52% of its spending through tax levies, so a consolidated Princeton would have a similar option to raise revenues from non-tax sources.

    If that were to occur, the tax impact from consolidation would be adjusted by the percentage actually raised through taxes. For example, in round numbers, if 50% of the $1.3M were covered through taxes, then the differential tax impact from consolidation would be approximately 50% as large, or an annual savings of $150 for the average Borough residential property, and an annual cost of $79 for the average Township residential property.

iii. The net impact of making up the $1.3M revenue from the capital funds balance may be larger or smaller than what is shown here, based on several other factors which impact the municipal budgets, including whether the municipality decides to cut services rather than raise revenue to address the gap, debt service levels in future years, the increase or decrease in net property valuations in future years, a potential increase in revenue from the parking utility due to increased parking fees and/or increased rents, etc.

These same factors contribute to uncertainty in the overall tax impact calculations as well. The tax impact calculation looks at the impact of consolidation, as if the Princetons had consolidated in 2011. As the preceding paragraphs point out, there are a number of items that are subject to change in both municipalities' budgets between the spring of 2011 and January 1, 2013.

3. Open Space Funds

Princeton Township's Open Space Fund is approximately in balance in 2011. However, preliminary estimates by the Township's Citizen's Finance Advisory Committee (CFAC) indicate that at the current open space tax rate, the Township's Open Space Fund would be expected to run a surplus of $300,000 to $500,000 each year from 2012 through 2017. As a result, if the Princetons were to remain separate, the Township may opt to propose a referendum to cuts its open space tax rate, from the current rate of 0.020, to somewhere in the range of 0.010 to 0.015.

The Borough's Open Space Fund is approximately in balance, and its current open space tax rate is 0.010.

The impact of consolidation on open space taxes results in an annual savings of $24 from the 2011 baseline for the average Township residential property, and an annual cost of $52 for the average Borough residential property. If the Township were to remain separate and were to reduce the open space tax rate as described above, the savings for the average Township residential property due to the change in the open space tax rate would be approximately $41 to $82 annually, which is greater than the anticipated annual savings of $24 due to the expected change in the open space tax rate under consolidation.

4. Real Property on the Date of Consolidation

Both municipalities own land, buildings, and equipment, which CGR has documented in the Commission's Baseline Report. If the Borough and Township were to consolidate, then the consolidated municipality would succeed to ownership of these assets regardless of whether they are now titled to the Borough or the Township. The actual value of the assets owned by each municipality is not available. This is not something unique to the Princetons, it is a general limitation of municipal accounting. (The Baseline Report uses replacement value, which is not the same, and it is not a valid approximation for actual value.) The Commission did not have the resources available to attempt to determine the actual values of the Borough's and Township's municipal assets. There is no realistic cost-effective way to determine whether taxpayers in either municipality come out ahead from combining property and other assets in a consolidated municipality, or whether it is a wash.

The factors noted above may each alter the details of the results of the tax impact analysis, which relied on 2011 as the baseline. The combined impact of these factors is difficult to estimate with precision, but taken together, they would most likely somewhat reduce the total annual benefit to Borough residents vs. the tax impact calculation for 2011, and somewhat increase the total annual benefit to Township residents.

Bond Ratings

Both Princeton Borough and Princeton Township have excellent credit ratings today. The Township's bond rating from Standard and Poor's is the top-rated AAA, while the Borough's is only one "notch" below at AA+. These high ratings place the Borough and Township in the top-quality tier of municipal credits nationwide. Credit ratings are important in at least two respects: first, they evidence a municipality's overall fiscal health and general creditworthiness; second, they impact borrowing costs. Governments with better credit ratings typically secure better interest rates, which keep borrowing costs as low as possible. Taxpayers in both the Borough and Township have benefited from their high ratings, as borrowing costs have been low for both municipalities. Recent short-term notes have been issued at interest rates of 0.5% to 1.0%, and recent long-term bonds have been issued at interest rates of 3.0% to 5.0%.

In the event of consolidation, rating agencies will review the financial health of the combined municipality and assign it a credit rating. While the Commission cannot predict with certainty the credit rating that would be assigned to a consolidated Princeton, there is every indication that the rating will be either AAA (the current Township rating) or AA+ (the current Borough rating). Moreover, it is likely rating agencies will see consolidation as a net positive for at least two reasons: first, the consolidated municipality will be realizing savings through efficiencies; second, it will afford the community a larger combined tax base from which to pay any debt obligations going forward.

Reassessment

Consolidation would require a reassessment in 2012, to take effect in 2013. It is important to point out that a reassessment is not a revaluation. It is conducted locally by the joint municipal assessor, and would be consistent with recommendations made by the joint revaluation task force. Under a reassessment all properties are reviewed administratively (not on site), and the assessed values of more than 50% of all parcels must be reviewed. The average effect of a reassessment would most likely be similar to the changes due to equalization discussed earlier. There is the possibility that a reassessment could alter the average impact of consolidation somewhat, and results may vary more significantly for individual property owners.

Sewer Rates

Sewer rates may change as a result of consolidation. The impact of this change has not been estimated by the Commission.

Sewer Debt Service Adjustment

The hospital will be relocating in 2012. When it does so, Princeton Borough expects to receive a "debt service adjustment" from the Stony Brook Regional Sewer Authority over a period of seven years. The total adjustment over that period is estimated at just under $2M, and it would be expected to go to sewer rate payers in the Borough if the municipalities remain separate, and to sewer rate payers in the combined Princeton if the municipalities consolidate. Therefore, the benefit to rate payers in the Borough would be reduced but not eliminated under consolidation. For a home in the Borough with a current median sewer bill of $396.80, the total effect of consolidation with respect to this debt service adjustment would be to increase sewer fees by an estimated total of $153 over seven years, vs. what they would be without consolidation. That works out to an average of $22 more per year under consolidation vs. unconsolidated, for each of the years 2013 through 2019. If consolidation is approved, Township residents would see a reduction of approximately the same amount. The impact varies with water usage. Those with a higher or lower sewer bill would see a higher or lower impact, respectively.

Transition Costs

As with any merger, there are associated costs, both in expenditures and in the staff time necessary to combine two entities into one. The Commission has estimated the transition costs of consolidation at $1,703,591. As provided for by State law, the Commission has requested financial assistance from the State to defray transition costs, and we are assured of a prompt response to our request. The amount that the state will agree to cover is not known at this time, but the maximum impact of the estimated transition costs on Princeton taxpayers can be calculated. If the State does not agree to defray any of the transition costs, then the entire cost of the transition would have to be borne by the consolidated municipality. If that were to occur, it would result in an estimated one time reduction in savings from consolidation of $187 for an average home in the Borough and $207 for an average home in the Township.

Limitations of the Analysis

Analysis of financial impacts has been a focus of the Commission's work and we believe that we have presented our conclusions fairly. All factors that we have been made aware of and that we have been able to quantify have been included in the Commission's reports. However, the Commission wishes to acknowledge that there may be other financial factors that additional analysis of the Borough and Township budgets may disclose.