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Memphis City Property tax Collections : analysis
of proposal from Shelby County Trustee /

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November 12, 1992

Mr. David Hansen
Chief Administrative Officer
City of Memphis
125 North Mid-America Mall
Memphis, Tennessee 38103

Dear Mr. Hansen:

I have completed my review of the proposal made by Shelby County Trustee Bob Patterson to collect City of Memphis property taxes. Included with this letter you will find a one page executive summary of my findings along with a more detailed report.

My review indicates that the trustee's proposal would not benefit the City of Memphis and in fact may cost the city more money over the term of the proposed contract. The proposal does offer some benefits to the taxpayers of Memphis in that both city and county taxes could be paid at the same location. However, without further compelling reasons not outlined in the proposal or otherwise brought to my attention, I would recommend that the City Treasurer's office continue to collect property taxes for the City of Memphis. I believe a thorough review of the enclosed report will verify this finding.

I appreciate the opportunity for MTAS to be of assistance in this matter. I am especially grateful to Mr. Osbie Howard and his staff and members of the Finance Division and Information Services Division for their time and assistance in this study.

Sincerely,
MUNICIPAL TECHNICAL ASSISTANCE SERVICE



C. Richard Phebus, CPA
Finance & Accounting Consultant

Enclosure

cc: Mr. Osbie Howard w/enclosure

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EXECUTIVE SUMMARY

Memphis City Property Tax Collections Proposal from Shelby County Trustee

Trustee's Proposal

The Shelby County Trustee has proposed to begin collecting City of Memphis property taxes, both current and delinquent. The terms are to be negotiated in a four year contract between the City of Memphis and the Shelby County Trustee. Initial cost to the city would be \$540,000 annually with a 5% per year escalator clause, bringing the city's total expenditures to \$2,327,468 over the term of the contract. The proposal projects savings to the City of Memphis of \$500,000 annually.

Benefits Stated in Trustee's Proposal

The proposal made by the Shelby County Trustee outlines the following benefits to be derived from the transfer of city property tax collections to the trustee's office.

- o Provide city with on-line real-time banking function
- o Enhance city's cash flow
- o Minimal disruption to trustee's operation
- o Significant hard dollar savings to City of Memphis
- o Dramatic increase in collections of property tax revenue

Analysis of Trustee's Proposal

The Treasurer's office currently has a remittance processing system (proof machine) which provides processing of receipts and same day banking functions. Receipts are recorded in a manner which provides on-line real-time inquiries of customer records. Tax collections by the City of Memphis over the past several years have equalled or exceeded percentage collections of current and delinquent taxes by the Shelby County Trustee's office. Transfer of this function to the county at the stated contract price would not save hard dollars for the City of Memphis. In fact, transfer of this function might cost the city \$34,000 over the term of the contract. While this transfer may not disrupt the Shelby County Trustee's operation, transfer of this function to the county would have a significant and possibly adverse affect on the City of Memphis operations.

Conclusions and Recommendations

The Shelby County Trustee's proposal is not without merit. Advantages to the taxpayers of Memphis would be obvious in that they would have a central location to pay property taxes. However, based on an overall analysis, the City of Memphis would not realize a significant savings. Short of negotiating a more favorable contract price with the trustee, it would seem more practical to upgrade the current computerized system for the City of Memphis and continue to provide this service through the Treasurer's Office.

MEMPHIS CITY PROPERTY TAX COLLECTIONS

ANALYSIS OF

PROPOSAL FROM SHELBY COUNTY TRUSTEE

Prepared by

**C. Richard Phebus, CPA
Finance & Accounting Consultant**

**The University of Tennessee
Municipal Technical Advisory Service**

November 12, 1992

Memphis City Property Tax Collections
Proposal from Shelby County Trustee

TRUSTEE'S PROPOSAL

The Shelby County Trustee has proposed to take over the collection of all City of Memphis property taxes. Written proposals made to Mayor W. W. Herenton in December, 1991, and again to Mayor Herenton and the Memphis City Council on June 18, 1992 outlined stated benefits to both the City of Memphis and Shelby County under such an arrangement.

Under the proposal, the trustee's office would begin the collection of all city real and personal property taxes, both current and delinquent. As stated in the proposals, the time frame for implementing this process ranged from six to nine months after approval of a contract. More recently, representatives from the Shelby County Trustee's office indicate that the county would be operational (i.e., collection of city property taxes would begin) within 30 to 45 days after the city property tax data base was loaded onto the county's computers and balanced.

The proposal purports to reduce operational costs to the City of Memphis of approximately \$500,000 annually. The county would use state-of-the-art computer technology along with professional telephone collection techniques to dramatically increase tax collections and provide Memphis with timely and accurate reports as needed by the finance and accounting division.

According to the proposal, the benefits would be numerous. Three or four benefits are stated in the proposal. It is left to the reader of the proposal to infer or imagine other unstated benefits under such an arrangement. The stated benefits include 1) utilizing an on-line real-time banking cashier function, 2) enhance cash flow of city by dramatically increasing collections and reducing lag time between receipt of funds and deposit of good funds at the bank, 3) minimal disruption of trustee's operations due to different billing and collection cycle of county and city taxes, and 4) savings to city by transfer of treasurer's office personnel and budget to other areas of priority within the city.

The cost to the City of Memphis was originally set at 0.75 percent of total property tax collections (approximately \$870,000). Actual costs would vary depending upon the number of personnel in the City Treasurer's office required to be absorbed by the trustee's office. No dollar amount was mentioned, however, the proposal did refer to the Treasurer's office personnel budget of \$520,189 for fiscal year 1992. However, this became a moot point when the trustee made his most recent proposal, dated June 22, 1992. The cost to the city would be \$45,000 per month (\$540,000 annually). Further, the trustee would commit to the possibility of hiring only one employee from the treasurer's office to implement this transfer. Representatives from the trustee's office later indicated that the collection of City of Memphis property taxes

could be accomplished with existing personnel in the Shelby County Trustee's Office and therefore the trustee could not promise to hire anyone from the treasurer's office should this transfer occur.

The proposal recommended that the City Treasurer's position be transferred to some other function within the City of Memphis operating budget, such as cash management or debt service and that the 14 to 18 remaining employees be transferred to vacant positions in other divisions of the City of Memphis operation budget.

ANALYSIS OF TRUSTEE'S PROPOSAL

On-Line Real-Time Banking Cashier Function

This function generally means that receipts are recorded to the customers accounts and credited to the city's bank account at the time of receipt. The city currently utilizes a remittance processing system or proof machine much like ones used by commercial banks to process its receipts for property taxes. The machine batches payments for processing by the bank. All funds are deposited on a daily basis at Union Planters Bank in Memphis.

Tellers process payments by posting receipts to customer accounts at the time of payment. Once posted, the customer's tax information is updated on the city's mainframe computer immediately. The posting to the customer's account and the deposit to the bank are two separate functions. In that respect, the system is not considered a "real-time banking cashier". In discussions with the trustee's office, it was determined that the trustee had a contract with a local bank to provide the same service that the proof machine provides for the City of Memphis. If this is the case, the county would have no better system for providing real-time banking functions than the city has at the present time. There was even consideration given by representatives of the trustee's office to negotiate for the use of the city's proof machine. It would seem apparent that at the present time, the city's system of processing payments at least equals, and might possibly exceed, the system utilized by the trustee's office.

Enhancement of Cash Flow for City of Memphis

The trustee offers to enhance the cash flow for the city by reducing the lag time between receipt of check payments and "good" funds deposited at the bank. The proposal further states that "... (city) collections would increase dramatically as a result of the trustee's proven methods." If in fact the city's collections did increase dramatically, cash flow from these collections would increase.

In regard to the lag time mentioned, the city now has in place, as described above, a system for insuring that all receipts are accounted for in a timely manner and deposits of funds are made on a daily basis. During large volume work days deposits are made

twice daily.

No attempt is made here to critique the system utilized by the county trustee's office. Indeed, from conversations with representatives from that office and from a brief tour of their operations, it would appear that the trustee is operating efficiently in this respect. The point that this writer would make is that the city would realize little if any increase in cash flow by turning over this operation to the county. In fact, in a June 22, 1992 letter to Mayor Herenton the trustee proposes that "...deposits can be made on a **next-day** basis in any account the city chooses." (Emphasis added) The city is now making daily deposits and could apparently lose one day's interest on some deposits under the trustee's proposal.

The other item contributing to increased cash flow is described by the trustee as a dramatic increase in collections. In order to assess the reasonableness of this claim, a review was made of several prior year collection ratios of taxes collected versus taxes levied. The results showed that the City of Memphis had as good a collection ratio of taxes collected as the trustee's office. The following table compares collection ratios for the treasurer's office and the trustee's office. The information was obtained from the annual audits for Shelby County and the City of Memphis for the year ended June 30, 1991 and reports generated by the treasurer's office.

<u>Taxes Levied</u> <u>During Tax Year</u>	<u>First Year Collection Ratios</u>	
	<u>City of Memphis</u>	<u>Shelby County</u>
1991	93.33%	N/A
1990	95.54%	94.02%
1989	96.25%	95.91%
1988	96.66%	95.57%
1987	96.63%	96.70%

The above table shows that the City of Memphis actually has a slightly better collection percentage on first year taxes than does the Shelby County Trustee. The audits show that the county does have slightly better ratios for delinquent taxes that are four or five years old and over. However, this may be due to the fact that the county writes off personal property taxes which it deems uncollectible. The city has not adopted this practice. Factoring this into the comparisons, the City of Memphis does quite well in collecting both current and delinquent taxes.

Again, no attempt is made to assess the effectiveness of the trustee's collection system or of its collection ratios. The point made here is that the Treasurer's office is doing an efficient job of property tax collection with its small complement of 18 employees. Based on the city's deposit methods and its collection percentage ratios, it is doubtful that the city's cash flow could be enhanced significantly by transferring this operation to the trustee's office.

Minimal Disruption to Trustee's Office Operations

The City of Memphis levies property taxes which become due on June 1 and delinquent on September 1. Shelby County, as with all counties in Tennessee, levies property taxes which become due on October 1 and delinquent on March 1 of the following year.

It is true that the trustee's operations are at their lowest level during the time when City of Memphis taxes are due and payable. The trustee would obviously be able to handle the city's tax collections during this time, and with collection of the fee from the City of Memphis, cover a substantial amount of operating and overhead costs of the trustee's annual budget.

No argument is made here that the trustee's operations would be disrupted. However, the city would not receive any benefit regardless of when the taxes were due other than knowing that the trustee should have sufficient personnel and resources available during this time to collect city taxes. All other things being equal, the city should be better able through knowledge and experience of its own employees to collect city taxes.

Substantial Savings to Memphis

Aside from all other considerations, the primary concern for the city of Memphis in deciding to turn over its property tax collections to the trustee is cost. Both operations could be very efficient and provide for timely and accurate collections and financial reports. Only if the trustee's operation could perform this function at substantial savings to Memphis, should a transfer be seriously considered.

The trustee has proposed to take over this function at a cost of \$45,000 monthly or \$540,000 annually with a 5% annual inflator over the four year contract. This would bring the total four year expense to the city to \$2,327,468 in contract payments. The contract would be subject to renegotiation at the end of four years, possibly at a higher price.

The City Treasurer's office budget for fiscal year 1993 totals \$919,980. Of this amount \$201,794 was budgeted for the line item data processing. This is a non-cash item which is charged by the city's data processing department for internal services it performs in connection with the treasurer's office. It is a paper transaction recorded in November of each year. Communications with John Hourican, Director for the Division of Information Systems, have revealed that the fiscal year 1993 data processing charge of \$201,794 is incorrect. After a review by the IS staff, the correct charge for 1993 will be \$52,272. While this a substantial reduction in DP charges, the amount really does not matter. The charge should not be considered when analyzing true costs of the treasurer's operations. This is because if the treasurer did not utilize this service, the charge would be absorbed by other divisions in the city budget. According to Mr. Hourican, there would be no reduction of personnel or savings to the city in the Division of Information Services if the county took over the function of property tax collections.

The true hard dollar cost of the treasurer's operations should therefore be reduced by this charge. The true cost for fiscal year 1993 is calculated at \$718,186 (\$919,980 budgeted expenditures less \$201,794 data processing charge).

If the county took over the collection of property taxes for the city, the treasurer's office would still be responsible for collection of miscellaneous taxes and receipts. Items such as landfill fees, industrial sewer fees, alcohol tax, beer tax, inspection fees, mowing fees, Central Business Improvement District tax levies, and others comprise a list of taxes and receipts which the treasurer would still be required to collect. Transfer of these taxes to the trustee's office is not realistic for several reasons and was not considered in any proposal by the trustee. Their office simply does not have experience in collection of these funds nor do they know how the amounts are calculated or the frequency of collections. The treasurer would also be required to keep the vault function for receipts which need to be safeguarded overnight.

If the treasurer's operation shed the property tax collection function, the remaining functions detailed in the preceding paragraph would require an annual budget of \$145,000. This represents a staff of three positions, i.e. the Treasurer, a Vault Clerk and an Accounting Clerk, along with associated operating expenses. The total first year outlay for the Treasurer's office and payment to the Shelby County Trustee would be \$685,000 (\$145,000 Treasurer's office expense plus \$540,000 payment to Shelby County). The projected savings for the first year using this analysis would be \$33,186. However, in the fourth year, assuming no increases at the city level other than the 5% inflator written into the trustee's contract, the city would actually spend \$51,932 more on treasury operations and contract expenses than if the city collected its own taxes. The following table shows the four year outlay by the city under both scenarios.

<u>Year</u>	<u>Costs</u>		<u>Savings (Cost)</u>
	<u>With Contract</u>	<u>Without Contract</u>	<u>To Memphis</u>
YR 1	\$685,000	\$718,186	\$33,186
YR 2	712,000	718,186	6,186
YR 3	740,350	718,186	(22,164)
Yr 4	<u>770,118</u>	<u>718,186</u>	<u>(51,932)</u>
Totals	<u>\$2,907,468</u>	<u>\$2,872,744</u>	<u>\$(34,724)</u>

While it could be argued that costs without the contract would increase due to inflation, there is no guarantee that the treasurer's office would receive increased funding. On the other hand, the 5% inflator would be part of the contract with the trustee's office and could not be reduced. The table reflects no increases other than the built-in 5% inflator.

CONCLUSIONS

After a thorough review of the proposal made by the Shelby County Trustee's office, the conclusion which the writer would make is that the City of Memphis should reject the proposal and continue collection of city property taxes by the Treasurer's office. This conclusion is based on both the current and future operations of the treasurer's office and the stated benefits derived from contracting the collection of property taxes with the trustee.

The concept of merging the city collections with the county is not without merit. If true duplication of effort along with duplication of costs could be avoided, the taxpayers of Memphis would reap the convenience of paying city and county property taxes at the same location. Add to that the benefit of reduced costs, which should be translated into reduced taxes or at the very least the use of existing city resources on other priority projects.

One office, under this merger concept, would be responsible for the collection and reporting of all tax revenues, both current and delinquent. Such an operation, if true duplication by both city and county would be eliminated, would indeed be an efficient use of taxpayer resources. However, in the true sense, the current operations are not a duplication of effort. The city collects different taxes, albeit on the same parcels. A true savings would only occur if one entity could take over the operations of the other at a fraction of the cost to the other entity. Under this scenario such a merger would indeed seem advisable. Unfortunately, such is not the case in this instance.

This report shows that while the city and county are engaged in similar functions and collect different taxes on the same parcels of property within the corporate boundaries of Memphis, the merger of these functions under terms stipulated by the Shelby County Trustee would not result in any significant savings to the City of Memphis. Indeed, the report shows that the City of Memphis might very well spend \$34,724 more over the term of the contract than it would otherwise.

The city of Memphis collects taxes on approximately 260,000 parcels of property and other receipts using 18 employees in the treasurer's office. Given this small operation in comparison with the trustee's office, it can be argued that the city is indeed efficiently collecting property tax revenue, as evidenced by the collection ratios of taxes collected to taxes levied. Without a substantial reduction in contract price and a better understanding of what would happen if the city should have to resume collection of these taxes in the future, a prudent course of action would seem to require a rejection of the latest trustee's proposal and a continuation of treasurer's office operations. The ability of the City of Memphis to be in charge of its own operations, absent any compelling reasons to the contrary, would seem to dictate this decision.

RECOMMENDATIONS

Based on current assumptions as summarized in the above narrative, Memphis would be better served by continuing property tax collections in the City Treasurer's office. However, if the City Council decides now or in the future to contract this function to the trustee's office, an agreement between both the city and county legislative bodies may be in order.

Tennessee Code Annotated § 8-11-110 allows the trustee a 2% commission on all funds received and paid over to rightful authorities. This section further allows a different percentage to be negotiated for the collection of municipal taxes if set out in an approved intergovernmental agreement. Such an agreement would normally be approved by both governmental legislative bodies. In this case, the agreement would be approved by both the Memphis City Council and the Shelby County Board of County Commissioners. Some authorities would argue that as a constitutional officer, the trustee has authority to enter into such an agreement with the municipality. The writer, having no legal background, would not argue that point. The only recommendation, in the city's interest, would be for any contract to be signed off on by both the City Attorney and the County Attorney as to form and content. Any such approval would necessarily involve a review of any legal requirements to satisfy the letter and spirit of the law.

The computer software used by the City of Memphis in its property tax collections and reporting system is approaching 15 years old. The system has been revised extensively with little documentation provided to users. Through years of experience, the staff of the City Treasurer's office has become familiar with the system. This point is made because if the city turned over the tax billing and collection operation to the county and at some time in the future, for whatever reason, wanted to reacquire this function from the county, it would not be an easy task. Reloading the data from the county to the city computers may or may not be an easy operation. Add to this the fact that all employees currently familiar with the system would probably no longer be with the city. With new employees and little or no system documentation, the learning curve to get the system operational would be very steep indeed.

Because the system as it now stands is very old and with the possibility of new employees being hired to replace positions through retirements or terminations, the city should consider the replacement of the property tax software in the near future. An in-house Unix or Novelle network system would be ideal for the treasurer's operation, thereby removing the function from the city's mainframe computer. The cost for hardware and software, although substantial, would be a one-time expense. If the city is to continue in the business of property tax billing and collection, as this writer thinks it should, the City Council should consider this acquisition as a real possibility in the near future.