

**TRENDS IN RETAIL SALES AND SALES TAX DEPENDENCY  
FOR THE KANSAS CITY METROPOLITAN AREA**

**NOVEMBER 2005**

**DEAN KATERNDAHL**



## **Introduction**

A major issue confronting local governments is retail development and its connection to local revenue generation. The interplay of retail development and local government revenue complicates local government decision-making when addressing physical planning, economic development, and development of local government budgets and work programs.

In order for local governments to provide their citizens with quality services they must have reliable sources of revenue. One of the most important is taxes from the sales of retail goods within their community. To the extent a community is dependent on sales taxes to fund basic services, but is unable to capture its proportionate share of retail sales, will hamper its ability to provide those basic services. Further, as other forms of local revenue are restricted or decline, such as telecommunication taxes and franchise fees, dependence on sales taxes increases.

A local government's dependence on sales taxes for revenue dictates an economic development strategy that is heavily oriented to attracting retail development. Except for a few residential-only communities most cities desire retail establishments for a number of reasons in addition to revenue generation. They provide valuable services for residents, provide a place for the community to gather, are often good neighbors supporting community and school initiatives, and contribute to a community's sense of place. However, a city's dependence on taxes can relegate these other benefits to a secondary position as a community tries to maximize the revenue benefit from retail development.

The concern is that a city's dependence on sales taxes puts it in a weak position when negotiating economic development incentives and project design issues with retail developers. In order to attract retail development a city might be willing to grant excessive incentives or approve designs that are not in the community's long-term interest. For example design decisions can impact whether a particular retail development will still be an asset to the community ten years from now or whether it is really contributing to a sense of place for the community. These issues are exaggerated when, as is reported by the development community, the metro area is overbuilt so that some developments are only economically feasible with inordinate subsidies and design compromises.

## **The Project**

Retail development and its interplay with sales tax revenue has been identified by the Managers Roundtable, an organization of city and county managers in the metro area, as a major issue. The managers and MARC, as well as the First Suburbs Coalition, have identified a number of activities that should be elements in a retail initiative. These include exchanging information and documents on incentive packages, discussions with retail developers, tours of successful retail projects, and investigation and development of new retail regulations.

However, before embarking on these specific activities it was determined that background information on retail development and sales taxes was necessary. This preliminary analysis is intended to answer the following questions:

- ✿ What are the trends in retail sales in metro cities?
- ✿ To what extent are cities attracting a proportionate share of retail sales?
- ✿ To what extent are metro cities dependent on sales taxes?
- ✿ What is the trend of sales tax dependence?
- ✿ What is the current and anticipated status of the metro retail market?

Following is a brief presentation of data and analysis intended to answer these questions.

## **Data and Analysis**

### **Retail Sales Trends**

Information in this section comes from retail sales data from the Missouri Department of Revenue and the Kansas Department of Revenue for the years 2000 and 2004. During that period, for a sample of 44 cities in the metro area, retail sales increased from \$ 22,139,441,907 to \$23,966,639,231, an increase of 8.25 percent. This increase amounted to a 3.6 percent increase in per capita sales. Per capita sales in 2004 for these 44 cities were \$14,970.43.

Of great importance to local governments is the distribution of retail sales around the metro area, since this is an important factor in determining how much revenue a community can raise through the sales tax. A common measure of this distribution is the pull factor for an individual community, which is the ratio of a community's per capita sales to the region's per capita sales. If the ratio is below 1.00 it means that the community is not attracting its per capita proportionate share of regional sales and if it is greater than 1.00 it is attracting more than its proportionate share; presumably it is attracting shoppers from outside of its community.

Of the 44 cities examined for 2004 twenty-nine had pull factors below 1.00. There are no significant correlations between a city's pull factor and other measures such as population or change in the pull factor over the last four years, except that cities on the furthest fringes of the metropolitan area tend to have negative pull factors. Three cities had pull factors over 2.00: North Kansas City, Riverside, and Merriam. The first two can be explained by the presence of casinos in small cities and the last by a significant shopping center in a relatively small city.

### **Sales Tax Dependence**

The data in this section was drawn from the 1982, 1992, and 2002 U.S. Census of Government, which reports information on local government revenues, expenditures, and debt. During the period 1982 to 2002 total revenues, all sources, for a sample of 34 cities increased by 178 percent from \$654,077,000 to \$1,821,723. During that same period general sales tax revenues increased by 390 percent, from \$54,212,000 to \$255,467,000. Property tax collections also increased significantly during this period, but at a slightly slower rate of 284 percent from \$59,492,000 to \$228,791,000. One additional change of note is that own-source revenue as a percent of all revenue during this period increased from 70 percent to 76 percent, indicating that transfers from other sources, such as federal and state, have declined.

The percent of general revenue that comes from sales tax has increased from 9.74 percent in 1982 to 16.78 percent in 2002 indicating an elevated level of dependence on sales tax. During this same period the percent of all taxes derived from general sales tax has increased from 20 percent to 30 percent and the ratio of sales tax to property taxes collected has increased from 0.91 to 1.16, indicating that sales tax has surpassed property taxes in importance. During this twenty year period the reliance on the sales tax has increased for all but four of the sample cities.

Forty-four percent of cities have a sales tax dependence that exceeds the 2002 average of 16.78 percent of general revenue, but have pull factors (see below) below 1.00, indicating that they are more highly dependent on sales tax for general revenue, but do not attract a proportionate share of sales taxes to support that dependency.

The Brookings Institution recently released a study, *Budgeting for Basics: The Changing Landscape of City Finances*, which provides some interesting comparisons to local revenue. For their national sample 76 cities charged a general sales and their per capita sales tax charge in 2000 was \$82.28, which represented 13.7 percent of revenue. This compares with the Kansas City metro sample of 34 cities in 2002 which had per capita sales tax revenue of \$205.25, which represented 16.78 percent of general revenue.

### **Future Retail Sales**

The 2005 Viewpoint 2005, Real Estate Value Trends, produced by Integra Reality Resources, provides some information on retail sales in the Kansas City market. Their analysis indicates that Kansas City is currently in an expansion cycle. However, the Gross Leasable Area Per Capita, 25.66, is 57 percent above the national average. In a presentation to the Urban Land Institute a representative of Integra indicated with the current retail projects in construction or planning that the Gross Leasable Area in the Kansas City area could reach twice the national average.

### **Analysis**

The above information and the attached tables provide the basis for answering the questions that were originally posed.

**What are the trends in retail sales in metro cities?** Retail sales have grown a modest 8.25 percent over the last four years (2000 to 2004). Per capita sales growth has been an even more modest 3.5 percent over the same period. Retail sales should increase modestly in the coming years, but retail sales, and thus sales tax revenues, will continue to be volatile and subject to fluctuations in the economy.

**To what extent are cities attracting a proportionate share of retail sales?** Two-thirds of cities do not attract a proportionate share of retail sales based on population. The data does not exhibit any strong correlations, but smaller cities on the edge of the metropolitan area tend to capture a lower proportionate share of retail sales than the metro average.

**To what extent are metro cities dependent on sales taxes?** For a sample of 34 metro cities almost 17 percent of their general fund comes from general sales taxes. This represents just over 30 percent of all taxes. However, there is a wide variation in the percent of general revenue that comes from sales taxes, from zero percent to 44 percent.

**What is the trend of sales tax dependence?** The percent of general revenue coming from sales taxes has increased between 1982 and 2002 from 9.74 percent to 16.78 percent. This increasing dependence is reflected in the fact that sales taxes have surpassed property taxes as the most prevalent form of local taxes.

**What is the current and anticipated status of the metro retail market?** Indications are that the retail market is overbuilt, especially when considering several large projects still in development.

From this preliminary analysis it appears that cities in the metro area are becoming increasingly dependent on sales tax revenue, though the rate of increase is relatively modest and cities continue to depend on property tax and other forms of revenue as well. Thirty percent of all taxes come from sales taxes. If the Brookings study is representative then cities in the Kansas City metro area are somewhat more dependent on sales tax than cities nationally and receive twice as much sales tax per capita.

An important element of sales tax and retail sales analysis is the uneven distribution of retail sales, and thus sales tax capacity, across the metro area. Two-thirds of cities in the metro area sample generated per capita retail sales less than the average per capita sales for the region. Forty-four percent of all cities in the sample have per capita retail sales less than the regional average, but are more dependent on sales tax than the regional average.

Information provided by Integra Realty Resources indicates that the retail real estate market is overbuilt and will become more so if current planned projects proceed. As the retail real estate market builds beyond capacity either some existing retail establishments will be abandoned or current retail establishments will under perform. In either case cities, especially those with older retail centers, may have to deal with abandoned facilities or ones not performing at a level that would support maintenance and redevelopment.

The retail base in the Kansas City market is fixed except to the extent the population grows, incomes grow, or retail sales are made to metro visitors. This relatively fixed pie, coupled with a local government revenue stream relatively dependent on sales tax and an overbuilt, but competitive, retail real estate market, presents local governments with a number of issues:

- ☼ What does it mean when local government operations are dependent on a source of revenue, the sales tax, that is not only volatile in terms of being closely tied to the performance of the economy, but may also be vulnerable as retail development and sales ebbs and flows between communities within the metro area?
- ☼ To what extent does dependency on retail sales affect a city's ability to negotiate retail developments that have long-term positive impacts on the community beyond the short term sales tax boost?

- To what extent does this affect the livability of our communities in terms of retail services being convenient, supportive of a sense of community, and integrated into the neighborhood fabric of our communities?
- Will this dependency create development problems for the city in the future, such as empty big boxes which are difficult to recycle in a productive way for the community?

Cities have a limited number of options for addressing these issues.

- ✿ Cities can reduce their dependence on sales tax by reducing services or broadening their revenue base. The latter is difficult because revenue mechanisms are controlled by the state and some existing revenue sources, such as utility fees and property taxes are being reduced.
- ✿ Cities can work together to do the following:
  - Become more sophisticated about retail development, what can reasonably be required and how can certain design and development approaches be encouraged
  - Develop common standards for retail development and begin to adopt them across the region
  - Begin discussions with retail real estate and development interests to explore how the retail development process and outcomes can be improved for cities
  - Develop a joint discussion about how cities can address the issue of sales tax dependency

## Conclusion

Retail development and sales tax dependency is a complicated issue for local governments. It not only affects the revenue cities receive and the impact that has on local budgets and programs, but also affects how an important part of a community's economy, its retail base, develops. Cities can most effectively deal with these issues by jointly exploring potential strategies for dealing with both sales tax dependency and encouraging quality retail development.

The program being proposed includes the following:

**RESEARCH.** One important element of retail development and the role of cities is the dependence of city revenues on retail development. The research phase will focus on retail sales and sales tax collections, trends in retail sales and sales tax collections, dependence on sales tax collections, and leakage of retail sales between communities (elements covered in this report). The research will also identify retail development incentives, how they are used and how effective they are. Retail development regulations and standards, both locally and nationally, will be investigated. Successful retail projects, and what makes them successful, will be identified.

**LIBRARY.** As a part of the research, examples of retail development agreements and packages will be assembled and shared with other local governments. The intent is to

provide cities and counties with information on what other communities are requiring and receiving. A list of public sector retail contacts, to facilitate the exchange of information, will be developed.

**EDUCATION.** A set of seminars on important retail development and sales tax issues will be developed. A couple of possibilities might be something like “Negotiating a Good Retail Deal” and “Developing Sustainable Retail Development.” An important element will be to ask one or two leading retail real estate experts, such as someone from Zimmer or RED, and discuss local government’s desire to have long term, quality retail development and how they can get it. Finally, identify successful retail developments both in KC and outside the metro area and arrange visits and explanations of how they succeeded.

**DEVELOPMENT STANDARDS.** The last element of this program will be the formulation of development standards and incentives for retail development. Having done considerable research, studied successful projects, and had extensive discussions with retail experts, cities would be in the position to make recommendations for how local governments can encourage quality retail development. A part of this is, of course, defining what is meant by “quality” and “successful” retail development.

**A FIFTH ELEMENT.** A 5<sup>th</sup> possible element is to use the research as a jumping off point to discuss how local governments should deal with their dependence on sales taxes and the possibility that there is not enough retail development for everyone and the fact that retail sales can be quite volatile.

Notes:

- ✿ The following resources were used for this report:
  - US Census of Governments 1982, 1992, 2002 (<http://www.marc2.org/finances/>)
  - Missouri Department of Revenue and Kansas Department of Revenue
  - Budgeting for Basics: The Changing Landscape of City Finances, Bruce A. Wallin, Brookings Institution Metropolitan Policy Program
  - Viewpoint 2005, Real Estate Value Trends, Integra Reality Resources
  
- ✿ Attached to this report are several charts with the data concerning retail sales and sales tax dependency for the Kansas City metropolitan area.