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Innovative Solutions to the Municipality of Jerusalem's Fiscal Problem

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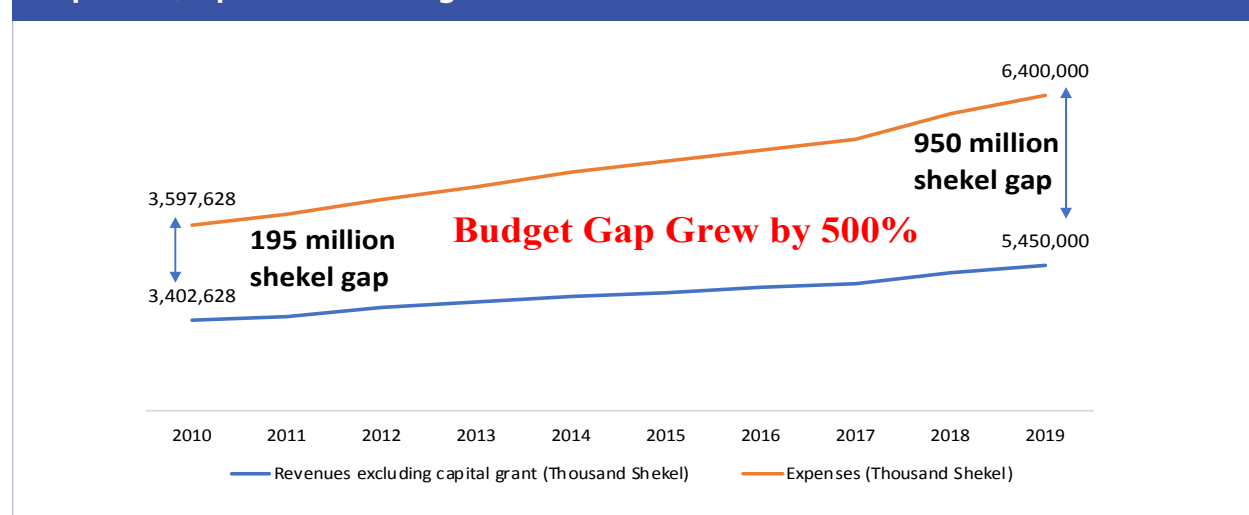
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Introduction

Local government leaders across the world can identify with one another when discussing the challenges they face day to day. Some challenges are new, like how to deal with emerging market disrupting technologies like Uber and Airbnb. Other challenges have been around for many years, like finding a suitable fiscal mechanism, for example a fair market value property assessment method, which allows for the local government to raise sufficient revenues to cover their outlays on mandated local services, such as education, sanitation, recreation and culture, and desirable strategies, such as economic and community development.

Finding a suitable fiscal mechanism is of critical importance for local governments in Israel where only 12% are operating under a balanced budget without a balancing grant from the central government. Those few governments have a couple main things in common; a positive ratio of business property space to housing property space and a high socio-economic population. The balancing grant is supplemental after central government participation of up to 75% in local government education and social service outlays, amounting to 40% of total operational budget outlays in Jerusalem's case. It is in the interest of the Ministries of Finance and Interior, who regulate and finance local governments, to offer local governments a suitable fiscal mechanism so that they can operate independently without a high reliance on balancing grants and uncertainty about what level of service they will be able to finance even just one year ahead.¹

Figure 1: Municipality of Jerusalem Revenue (excluding capital grant) and Expenses, Operational Budget



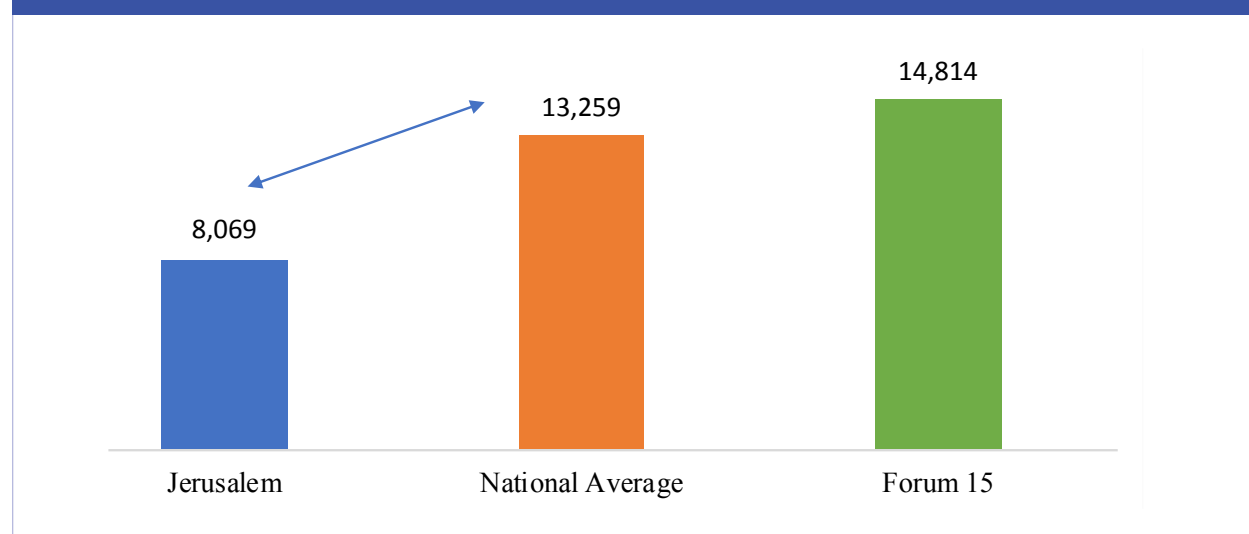
Source: Central Bureau of Statistics, Municipality of Jerusalem, 2019.²

¹ Local Governments, Central Problems and Potential Solutions. The Knesset, 2004.

² 10-20% of capital city grant has gone to the development budget over the past 4 years.

The Municipality of Jerusalem is a prime example of a local government whose available fiscal mechanisms are not suitable and do not allow for a balanced budget without rapidly growing dependence on the central government. That can be seen clearly in the results. Jerusalem's operating budget deficit, has grown by more than 500% since 2010 to 950 million NIS in 2019, 15% of the operational budget (10% of the total budget, including also the development budget). The operating budget deficit is financed by a capital city grant from the central government, which is unsustainable, given a growing central government budget deficit, and plans for budget cuts starting this year.³ The city's property tax exemption rate is more than double the national average, due to a large number of religious and non-profit institutions and a large section of the population with low socio-economic status, which totaled 750 million NIS in 2019, or 12% of the operational budget (8% of the total budget). Outlays per capita overall and specifically on education are well below the national average, 70% and 61% of the national average respectively.^{4,5}

Figure 2: Education Outlay per Student (Shekel)



Source: Central Bureau of Statistics, Municipality of Jerusalem, 2017.⁶

So, what can they do about it? This research will examine the relevant literature on the topic and review several innovative solutions to address Jerusalem's fiscal problems.

³ עוד לא ראינו כלום: שמונה דברים שחשוב לדעת על הקיצוץ בתקציב. חגי עמית. דה מרקר, 2019.

⁴ Central Bureau of Statistics, 2019.

⁵ Municipality of Jerusalem, 2019.

⁶ The Forum 15 is a group of leading local governments in Israel, most of whom operate under a balanced budget.

Context and Background

This section will begin with a brief overview of local governments in Israel, with a focus on the fiscal mechanisms available to them. Second, it will explore worldwide examples of local government fiscal mechanisms and the effectiveness and suitability of different methods. Lastly, it will review basic tax revenue principles and how the use of varying fiscal tools fit within the tax revenue principles framework.

Background

First, a brief review of Israel's population and how they've been organized across the country. As of 2019, Israel's population stands at approximately 9 million residents, about the size of New York City.⁷ These 9 million residents are spread across 257 local government bodies which are classified into three categories based on size; cities, local councils, and regional councils.⁸ One can imagine the complexities that arise when a population the size of one large city is split into 257 separate governing bodies, with competing interests. This structure is one of the underlying challenges that local governments in Israel need to grapple with.

Next, a short history on how local government was set up in Israel and where it stands today. Local government in Israel was initially established under the British Mandate, starting with the Municipalities Order of 1934. This order provided a basis for how local governments would function such as the process for election of representatives, the role and authority the local government exercises and the sources of revenue available to local governments in order to fund local services. The Local Authorities Order of 1945 established a local business tax, allowing local governments to collect taxes from businesses within their borders. This is a starting point from which we can begin to examine how local governments revenue collecting authorities have changed over the last 70+ years in Israel.^{9 10}

Relationship with the Central Government

Israel is a highly centralized state where local governments exercise limited control over their finances and services. There are 3 major areas of interaction: budgetary and operational supervision, authority for local income and revenue, and planning and construction. Many committees have been formed over the years to discuss and recommend courses of action to improve the ability of local governments to raise enough revenue in order to provide better services. In addition, several laws have

⁷ New York City, Population, 2019.

⁸ Central Bureau of Statistics. Population of Israel, 2019.

⁹ Accounting Review of Local Governments, 2018.

¹⁰ Local Government in Israel. The Knesset, 2009.

been passed affecting the relationship between the local and central government. As such, it is critical to review the history of the relationship between the central government and local governments. The following table offers a brief description of the major laws and recommendations that have been passed or suggested on the topic of local government fiscal authority.¹¹

Table 1		
Committee/Law	Description/Recommendation	Effect on Centralization
1964 Vitkon Committee	<ul style="list-style-type: none"> Rescind local government authority to collect income or consumption tax Central government to distribute share of taxes to local governments 	Increased Centralization
1976 Kovorski Committee	<ul style="list-style-type: none"> Central government grants to local governments based on basket of services Central government participation of 75% in state services provided by local governments 	Increased Centralization
1976 Zanbar Committee	<ul style="list-style-type: none"> More control to local government to manage their activities Revenue collecting authority should be based on the services being provided 	Decreased Centralization
1985 Budget Foundation Law	<ul style="list-style-type: none"> Granted wide ranging authority for local government regulation to the interior and finance minister, from human resource decisions to debt and finance decisions 	Increased Centralization
1991 Hermlich Committee	<ul style="list-style-type: none"> Open local education and welfare offices Expand government participation in local education and welfare budgets 	Increased Centralization
1992 Soari Committee	<ul style="list-style-type: none"> Budget balancing grants from central government Minimum outlay per resident across local governments 	Increased Centralization
1993 State Economy Organization Law	<ul style="list-style-type: none"> Rescinded authority from local governments to design local tax policy, including tax rate and exemption policy 	Increased Centralization

¹¹ Local Government in Israel. Daniel Elazar. Pages xxi-37, 48-52.

Table 1 (Cont.)

Committee/Law	Description/Recommendation	Effect on Centralization
1995 Shahar Committee	<ul style="list-style-type: none"> Consolidate the number of local governments 	No effect
2007 Barzilai Committee	<ul style="list-style-type: none"> Property tax assessments according to fair market value Raise VAT by 2% to replace property tax Country-wide property tax system 	Decreased Centralization

Source: Local Governments, Central Problems and Potential Solutions. The Knesset. Local Government in Israel. Daniel Elazar. Page 48-52.

Benchmarking Best Practices- A Survey Across Countries

Local governments across the world face the challenge of finding a fiscal mechanism that satisfies its need to cover its expenses on the demanded local services. One of the main variables across countries in regard to available fiscal tools, is the level of decentralization. Depending on the degree of centralization in the country, a local government has a number of choices for fees and taxes they can levy to fund their local operations. When a country is largely centralized, their local governments depend primarily on central government transfers. This section will provide a brief survey of fiscal mechanisms local governments across the world have at their disposal, the process of decentralization they have undergone and the level at which the fiscal tools available satisfies the local governments needs in covering their local service expenses and financial planning needs.

Local fiscal mechanisms vary from place to place. The primary local fiscal mechanism that the Municipality of Jerusalem and many local governments around the world have at their disposal to raise revenues is property taxes. The property tax is considered by many tax experts as the proper local tax revenue mechanism because it satisfies widely accepted tax standards, which will be discussed later, particularly at the local level. Some subnational governments in the United States and Europe have added sales tax or business tax as an option for local government revenues, an option which has been discussed in the Barzilai Committee and a source of revenue local governments in Israel once had. Government transfers make up a substantial percentage of local government revenues across the world, particularly in highly centralized countries.^{12,13}

¹² Subnational Governments Around the World, Structure and Finance, OECD, 2014.

¹³ The State of State and Local Tax Policy, Tax Policy Center, 2016.

Eastern Europe provides an interesting case study for local governments undergoing decentralization after a period of transition in the early 1990's. Several laws were passed with the intention of providing local governments autonomy over their local responsibilities. However, the results show a very slow process where the central government is hesitant to hand over autonomy over many local services such as education or social welfare.^{14, 15}

In comparing local government autonomy and decentralization in Eastern Europe to Israel, the direction in which they are headed seem to be opposite. Eastern Europe has realized that greater local autonomy provides for better economic and social outcomes at the local level and therefore is headed in that direction, although the central government has certainly been hesitant to hand over more control. Israel on the other hand has largely moved away from local autonomy and towards further centralization, despite consistent efforts and advice from expert committees to decentralize. Based on local tax revenue data, comparing trends in own sourced revenues and governments transfers, it can be seen that Eastern Europe has moved further along the process of decentralization in less than 30 years than Israel has in more than 70 years.

A critical aspect of the decentralization process is establishing private ownership rights for properties and registering those properties in the state or city's records. This process has been neglected for too long in Israel. Most properties are leased on a 50-99-year lease from the Israel Lands Authority instead of properly transferring ownership to private owners, thereby creating market distortions and confusion as to what will be at the end of the lease. Further, most properties in east Jerusalem, nearly 40% of the property tax base in Jerusalem, does not have established ownership rights and the municipality has no record of ownership. These are problems that all transitioning countries have faced. Much can be learned from the process Africa is currently undertaking and the process that took place in Latin America.^{16 17}

The OECD provides an analysis of subnational government structure and finance. One comparable measure used is subnational tax revenue as a percentage of total tax revenue and as a percentage of GDP. Countries which are considered to have high levels of human and economic development and quality local services, such as Switzerland, USA, Canada and Germany, have a significantly higher percentage of public tax revenue which goes to the subnational government, or in other words decentralization, between 45%-55%, compared to Israel, 10%. The OECD average is 32%. Another

¹⁴ Fred Lazin. Local Government Reforms in Eastern Europe after the Collapse of the Soviet Union, 2014.

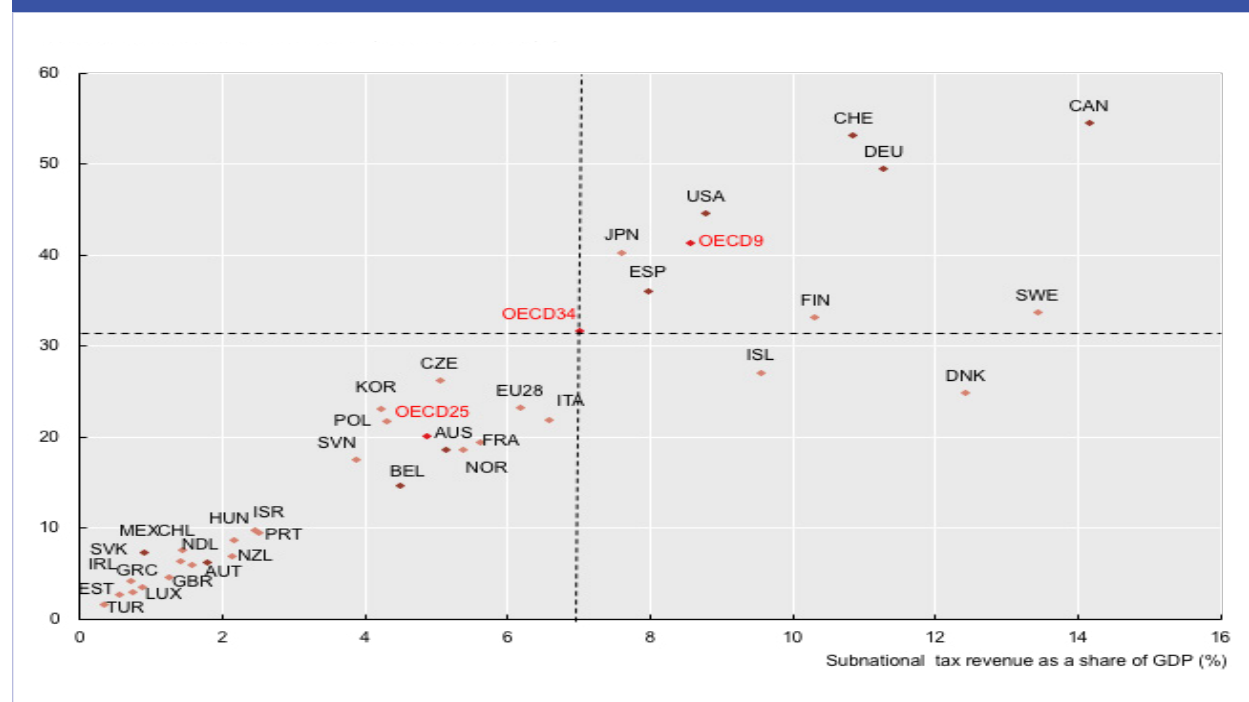
¹⁵ Eugen Dogariu. Study on the Local Financial Self Government in Romania, 2010.

¹⁶ For further reading on the decentralization process and local taxes in Latin America see: Overview of the Property Tax in Latin America, Claudia M. De Cesare, Lincoln Institute of Land Policy, 2010.

¹⁷ For further reading on the decentralization process and local taxes in Africa see: Property Tax in Africa, Riel Franzsen and William McCluskey, Lincoln Institute of Land Policy, 2017.

interesting data point from the research is the level of correlation between subnational government expenditures as a percentage of GDP and GDP per capita. The coefficient of determination between these two measures is .36, meaning 36% of the variation in GDP per capita can be explained by the level of subnational government expenditures as a percentage of GDP.^{18 19} Although this correlation measure does not tell the whole story, it can be viewed as a statistically significant contributor to GDP per capita. The level of government expenditure at the local level appears to have a significant impact on per capita GDP.

Figure 3: Subnational tax revenue as a share of public tax

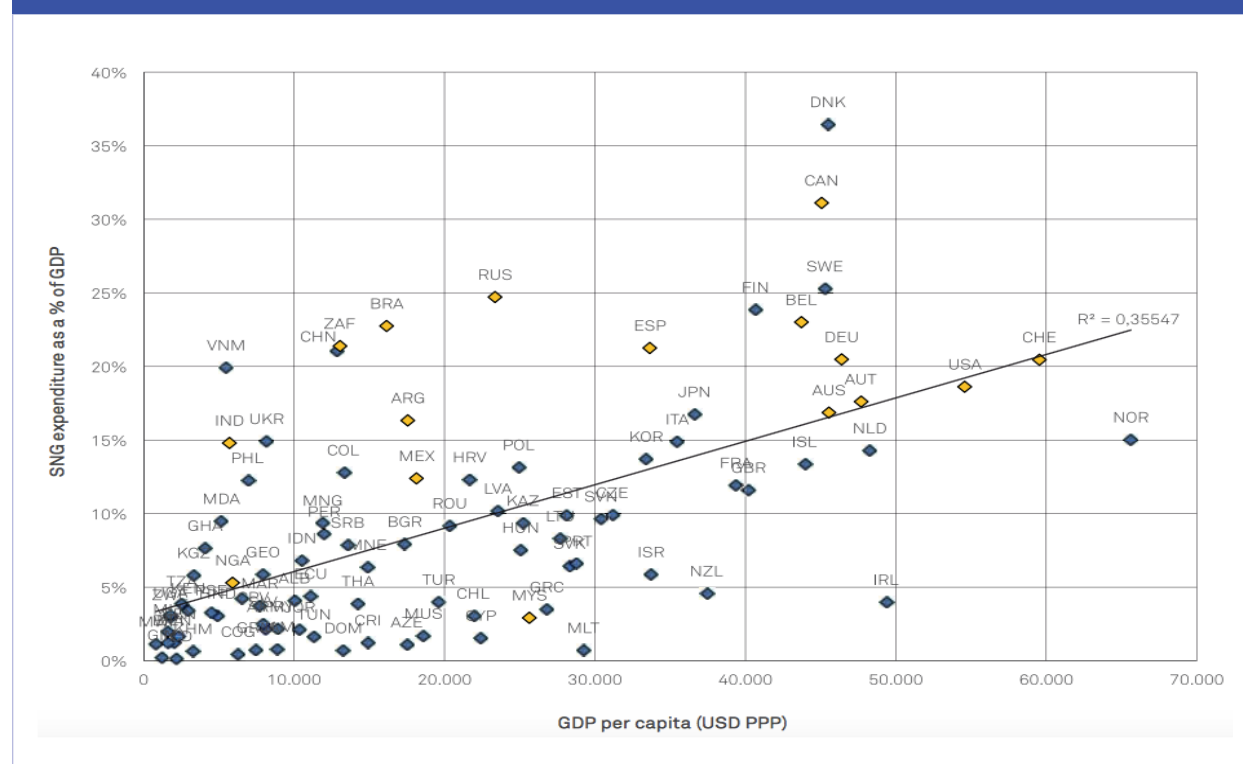


Source: Subnational Governments Around the World, Structure and Finance, OECD, 2014.

¹⁸ Subnational Government Finance for Regional Development, OECD, 2014.

¹⁹ Subnational Governments Around the World, Structure and Finance, OECD, 2014.

Figure 4



Source: Subnational Governments Around the World, Structure and Finance, OECD, 2014.

Benchmarking Capital Cities

Washington D.C. and Hartford, Connecticut in the USA provide an interesting case study for comparison to Jerusalem due to similarities in high property tax exemption rates and high levels of reliance on the state or central/federal government. Both of these local governments were in dire fiscal situations until the state or federal government stepped in to enforce fiscal discipline. In the case of Washington DC, an independent chief financial officer was appointed with broad authority to manage the local governments finances. This case of intervention was successful in significantly reducing federal government reliance, while at the same time growing own sourced revenues.²⁰ While a similar process of intervention from the central government occurred in Israel in the 1980's and 1990's, the results were quite different. In Israel's case the central government intervened to implement fiscal controls, however they were unsuccessful in growing local own sourced revenues, apparently because that was not an intended outcome of the intervention.

²⁰ Milken Innovation Lab, Towards Financial Sustainability for Jerusalem, 2018.

Revenue Decentralization and Fiscal Disciplines

A study carried out by the World Bank, which included both developed and developing countries, researched the importance of revenue decentralization and fiscal discipline mechanisms for local governments. The study found that one without the other does not provide the intended result of a well performing and independent local government. Further, the study found that when the central government steps in to provide stability, if it provides government transfers without accompanying fiscal structure and discipline the local government will simply grow more dependent on bailouts, like in Jerusalem's case. At the same time, if the central government implements strict fiscal controls without accompanying fiscal autonomy the local government will not be able to provide the demanded local services at an adequate level.²¹

Tax and Revenue Principles and Sources

When evaluating a tax system, a number of standards have been established by experts to measure the tax systems quality. The standards for evaluating a tax system include: yield, equity, economic neutrality, collection cost and transparency. Some experts include simplicity as another evaluation measure, however simplicity is not politically advantageous. Complicating the tax structure essentially provides varying interest groups with a tool to lower their taxes owed. It is however critical to simplify compliance. The chart below offers a description of the 6 standards for evaluating a tax system.²²

Table 2	
Tax Standard	Description
Yield	Absolute revenue potential and its distribution (horizontal/vertical). Must look at rate/revenue curve to determine ideal rate.
Equity	Benefits received vs ability to pay, question is how to measure ability to pay (income, consumption, wealth). Look at ratio of effective rate of high-income group to effective rate of middle-income group to effective rate of low-income group.

²¹ Jonathon Rodden, Gunnar Eskeland and Jennie Litvack. Fiscal Decentralization and the Challenge of Hard Budget Constraints, 2003.

²² John Mikesell, Fiscal Administration, 2015.

Table 2 (Cont.)

Tax Standard	Description
Economic Neutrality	Taxes create market distortion and interfere with economic choices. Creates a tax wedge, the difference between price seen by buyer vs seller. Objective is minimal interference.
Collection Cost	Deadweight cost, objective is lowest cost to achieve desired level of revenue. In principle some revenue is not worth collecting.
Transparency	Avoid hidden taxes, people are generally more willing to pay if they know what is being taxed, how much and why.
Simplicity	Most important to simplify compliance, tax structure itself can be used to create desired adjustments.

Source: John Mikesell, Fiscal Administration, 2015.

Two additional measurements that are critical to the effectiveness of a tax system are elasticity and buoyancy. Elasticity is a measure of the automatic response of tax revenue to change in income ($\% \text{ change in tax base} / \% \text{ change in income} / \text{economic activity}$). Buoyancy measures the total response of tax revenue to change in income ($\% \text{ change in revenue} / \% \text{ change in income} / \text{economic activity}$). A high tax elasticity is generally desirable because it allows for growth in expenditures to be financed by growth in tax revenues without the need to raise rates. However, major local government revenue sources like property taxes are generally considered to be inelastic and therefore would demand an increase in rates to drive higher revenues. An alternative to raising property tax rates is to improve property assessments, in Jerusalem's case to move towards a fair market value assessment structure. Major gaps between a taxes measure of elasticity to buoyancy can generally be explained by discretionary changes, essentially changing the size of the tax base.²³

Next, an explanation of some of the fiscal tools used by local governments around the world. Those include user fees, property tax, business tax, consumption tax and excise tax.

User charges are a fee for services provided. Generally, voluntary transactions (user charges) are preferred over coercive payments (taxes). Particularly at the local level where the government services are being provided, user fees make sense. User fees "main economic values are to ensure that what the public sector supplies is valued at least at marginal cost by citizens, and, second, to promote

²³ Charles Mansfield, Elasticity and Buoyancy of a Tax System, 2013.

economic efficiency by providing demand information to public sector suppliers.”²⁴ Some examples of user charges include business and vehicle license fees, and special assessments for services provided like street paving or additional garbage disposal. The challenge with user charges is the difficulty in identifying the direct beneficiary. Even when the direct beneficiaries can be identified, the desire by many governments for redistribution complicates their implementation.

The property tax is considered the ideal local tax by many experts. It is a tax on the value or size of a property. This tax can be viewed as a sort of user charge because all properties receive direct services, like water and electricity, from the local authority they reside in. They are also ideal for local governments because land and buildings are largely immobile and therefore dodging the tax by going to a place where that specific tax or fee isn't in use is not possible.

Property tax systems can be split into two main categories; fair market value or area assessments. Connolly and Bell of the Lincoln Institute on Land Policy conducted research across 122 countries on the benefits and costs of varying property tax systems. Of the 122 countries surveyed, 38 countries use some form of area-based property valuation while the remaining countries use some form of market value property valuation. Generally, developed countries use the fair market value system and developing countries use the area assessment system, primarily because they lack a developed and established property market. The charts below provide a general comparison of the two main assessment methods and ranks them according to the tax standards reviewed above.

Table 3

Fair Market Value Assessment	Area Based Assessment
Local services impact property values, we want to capture this additional value created.	Does not capture the value of local services provided.
More equitable in ability to pay, less in benefits received.	More equitable in benefits received, less in ability to pay.
Potentially higher administration and collection costs. (Depends on method used)	Upfront administration and collection costs, afterwards not many changes, less costs.
Market values are more volatile, change year to year.	Area is not volatile, if additions are made, expect local authority to know and enter into equation.
Considers all relevant variables.	Leaves out many variables.

²⁴ Richard Bird. Local and Regional Revenues: Realities and Prospects. 2003.

Table 4 ^{25, 26}

Tax Standard (1-5)	Fair Market Value Assessment	Area Assessment
Yield	4	2
Equity	3	2
Economic Neutrality	3	2
Collection Cost	3	3
Transparency	3	3
Simplicity	3	3
Average Score	3.2	2.5

Excise taxes are a discriminatory tax. They charge people for the social cost or negative externalities associated with the good or service being used. From a pure economic standpoint excise taxes are distortionary and should be avoided. Some examples of goods which incur an excise tax in many places around the world include tobacco, alcohol and automobiles. Congestion pricing is a type of excise tax which is gaining popularity around the world. There is a movement in some major cities to discourage automobile use within the city.

Business taxes can be implemented in the form of an income, property or consumption tax. Businesses within a locality receive local services and are therefore considered an ideal tax target. If possible to tax businesses for services received with a user charge, that is preferred. The local authority must be careful in designing this tax to minimize market distortions. Another issue that arises is that taxes are ultimately passed on to households and therefore expect business good and service prices to rise. Politically, it is one of the most preferred taxes.

Consumption taxes can come in the form of a value added tax or sales tax, most countries use the value added tax. Each person reveals their ability to pay by how much they choose to consume. However, consumption taxes tend to be regressive in nature, lower income households bear a larger relative burden. If a good is taxed at each level of production, it creates a pyramiding problem which creates an incentive for vertical integration. The effective tax rate will differ based on how many levels

²⁵ Katrina Connolly and Michael Bell, Area Based Property Tax Systems: Current Practice and Equity Concerns, 2009.

²⁶ CMI Brief, Property Taxation in Developing Countries, 2017.

of production exist for a given product. Another issue which must be considered is how to tax services within this framework.^{27,28}

Challenges

The Municipality of Jerusalem faces several significant challenges which must be considered when designing a suitable fiscal mechanism. Those challenges include: increasing centralization which has led to an unsustainable dependency on central government balancing grants, a population double the size of the next largest municipality, within which two major sectors largely don't participate in the labor market and underdeveloped assets from which the municipality is tasked with generating the vast majority of available own sourced revenue.

Table 5

Challenge	Description	Result	Opportunity
The structural budget deficit and Centralization	<ul style="list-style-type: none"> ▪ Municipalities do not control municipal fiscal policy, it is controlled by the ministries of interior and finance ▪ Finance and budgeting formulas negatively effect Jerusalem 	<ul style="list-style-type: none"> ▪ Capital city grant (budget deficit) grew 500% over past 9 years ▪ Property tax exemption rate more than double national average ▪ Property tax tariffs above national average, disincentive for businesses to locate in the city 	<ul style="list-style-type: none"> ▪ Give the municipality control over local tax policy with accompanying budget constraints thereby reducing growing reliance on central government and encouraging smart fiscal policy

²⁷ Richard Bird. Local and Regional Revenues: Realities and Prospects. 2003.

²⁸ John Mikesell, Fiscal Administration, 2015.

Table 5 (Cont.)

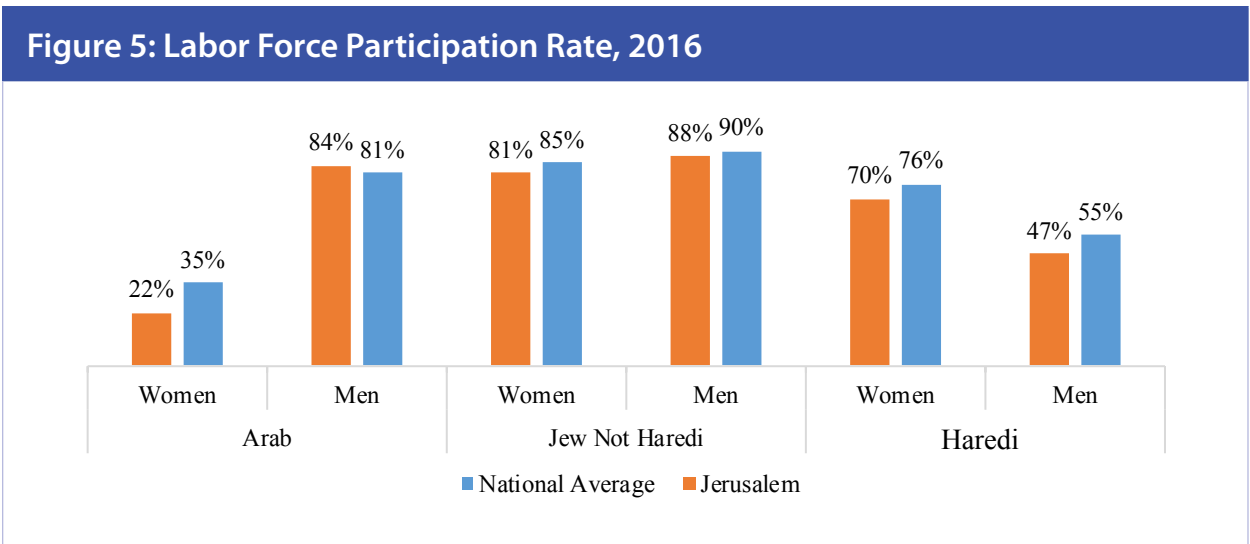
Challenge	Description	Result	Opportunity
Large, low socio-economic population	<ul style="list-style-type: none"> Large portion of population either don't work or work in low productivity jobs 	<ul style="list-style-type: none"> Poverty rate double national average Large cash market amongst these populations 22% labor participation Arab women, 47% labor participation Haredi men 	<ul style="list-style-type: none"> Vocational training and job market assistance, focus on industries other than high tech ie mechanic, plumber, carpenter, gardener etc. Align education system with job market opportunities Offer incentives for joining labor market Disincentivize cash market
Underdeveloped assets	<ul style="list-style-type: none"> -Assets within the city have been neglected for 50 years, the municipality does not have record or understanding of many of its assets -Organizational thinking does not consider on how their services can become income producing or revenue neutral 	<ul style="list-style-type: none"> -East Jerusalem property tax collections well below relative share -Property assessments method limiting tax collections -City properties not well managed or utilized 	<ul style="list-style-type: none"> -Record east Jerusalem properties -Transition to fair market value property assessments -Complete asset survey and fully utilize city properties -Encourage department heads to change thinking to how to maximize revenue potential of the services they provide

Source: Central Bureau of Statistics, 2019. Municipality of Jerusalem, 2019. Jerusalem Institute for Policy Research Statistical Yearbook, 2019.

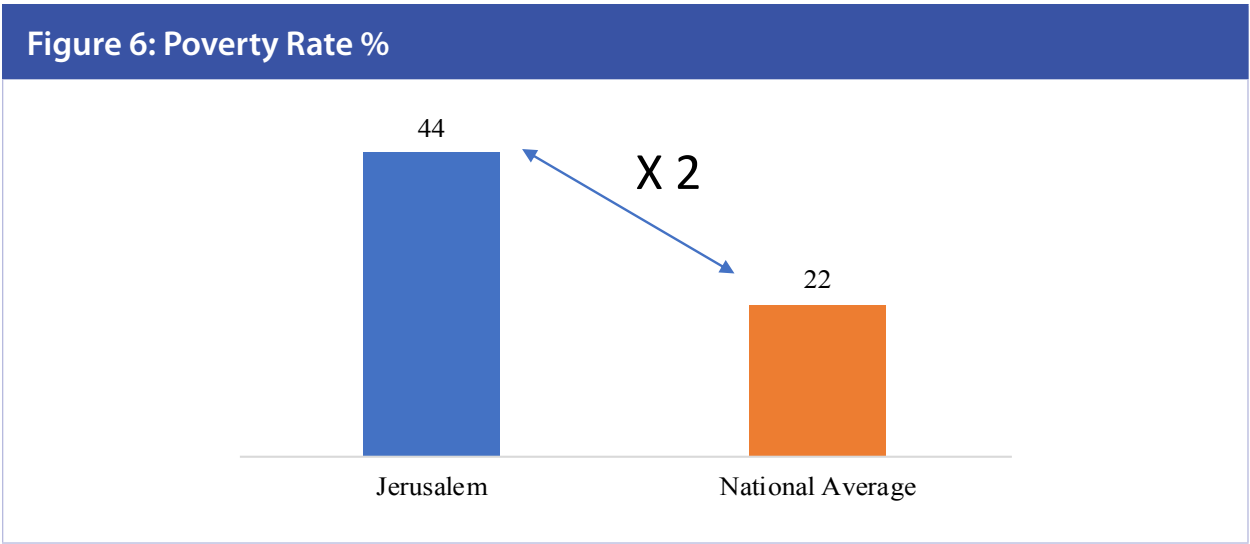
Large, Low Socio-Economic Population

The City of Jerusalem is the largest city in Israel, more than two times the size of the next largest city. The city’s population is diverse, containing the largest Haredi and Arab populations in Israel. These two sectors of the population share several commonalities, including low labor force participation as a result of cultural pressures. Further, as the result of previous political and legal settlements many Haredi men are ineligible to work legally until their late 20’s. This has led to a high poverty rate in the city, double the national average, and to a low socio-economic status, a 2 out of 10 based on the central bureau of statistics formula.

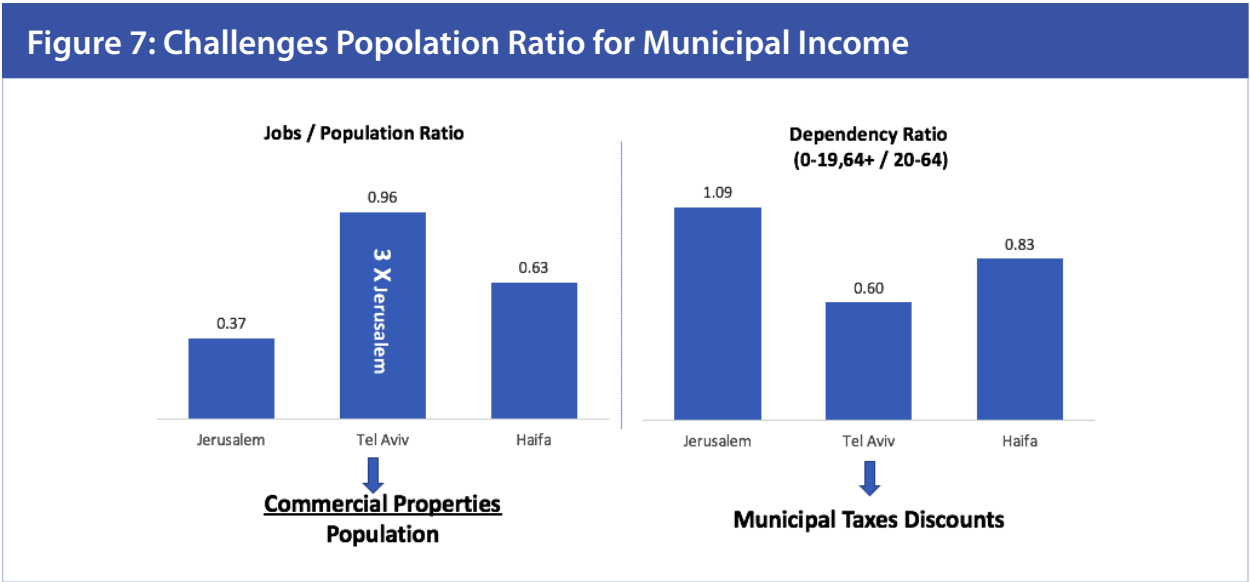
Jerusalem’s population structure has a negative effect on the current local government financing tools allowed by the Ministry of Interior and Finance. The current financing method must be updated to properly reflect Jerusalem’s characteristics. The graphics below show Jerusalem’s population challenge and its structural effect on the current local government financing method used by the Ministry of Interior and Finance.



Source: Central Bureau of Statistics, Municipality of Jerusalem, 2016.



Source: Central Bureau of Statistics, Municipality of Jerusalem, 2017.



Source: Central Bureau of Statistics, Municipality of Jerusalem, Strategy Division, 2018.

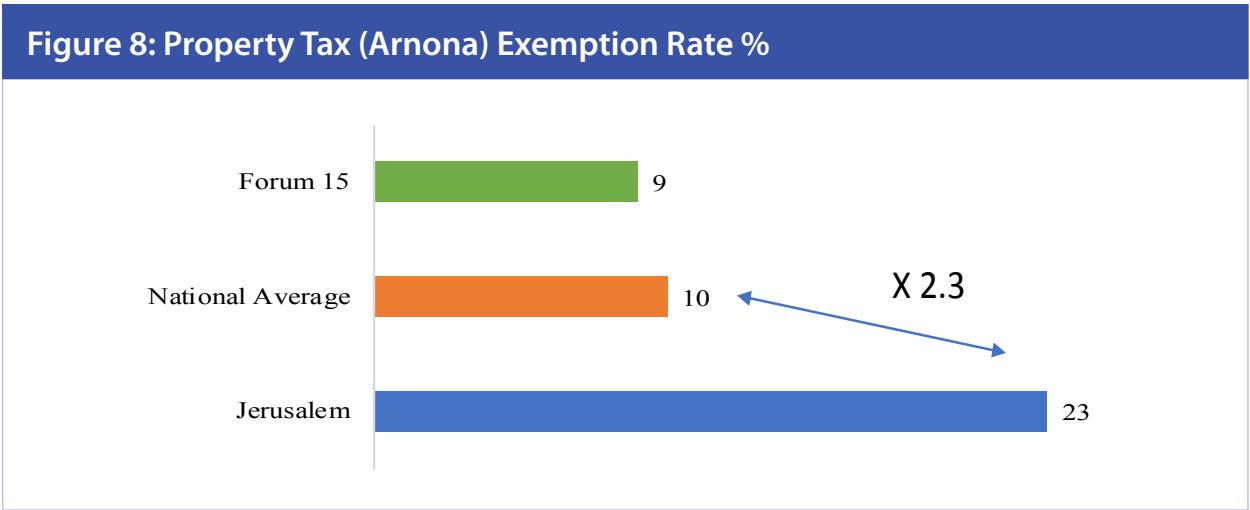
Local Governments Structural Budget Deficit in Israel and Centralization

Governments across the world face the same financing question. Should local governments be primarily financed by the federal or central government through transfers and grants, or should they be given the proper financing flexibility, accompanied by budget discipline, to operate primarily independently.

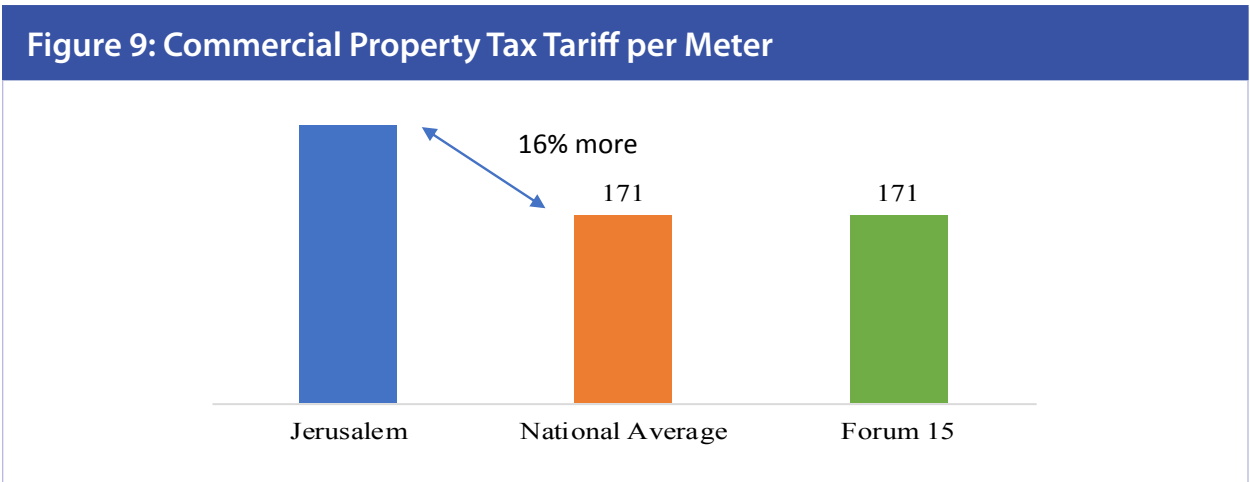
As described in the previous section on the relationship between municipalities and the central government, Israel has moved further and further in the direction of centralization. This has resulted in an operating deficit, currently financed by a capital city grant from the central government, that has grown by 500% over the past 9 years.

Almost all local financial decisions are in the hands of the central government. For example, property tax exemption and discount policy are in the hands of the central government. Jerusalem has a property tax exemption rate more the double the national average which totaled 750 million NIS in 2019, or 12% of the operational budget (8% of the total budget).

This high exemption rate forces the municipality to raise their commercial Arnona tax rates putting them at a strategic disadvantage in attracting businesses.



Source: Central Bureau of Statistics, Municipality of Jerusalem, 2017.

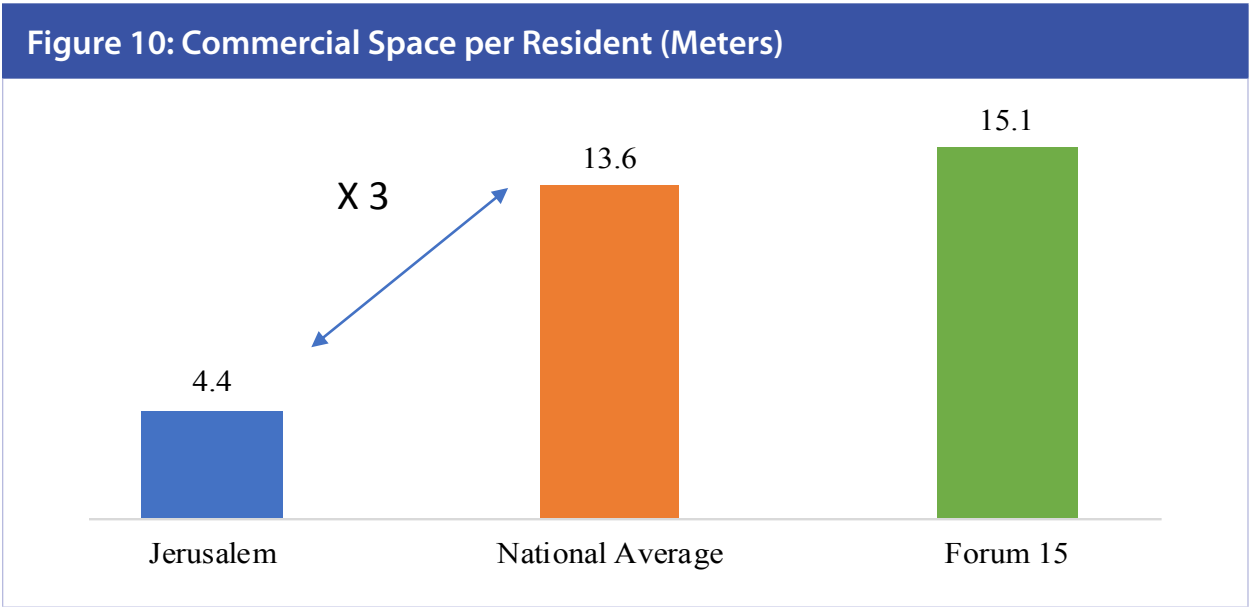


Source: Central Bureau of Statistics, Municipality of Jerusalem, 2017.

The current local government finance and budgeting formula has a couple key structural features which greatly disadvantage a city like Jerusalem. The first key structural feature is it rewards commercial property space over residential property space at a significant difference. Residential space is estimated to generate a loss for the municipality of 11,000 shekels per household, or per approximately 80 square meters. Commercial space is profitable, on the other hand. A second key structural feature is the matching formula used by the Ministry of Interior to determine education and welfare budgets provided to local governments. The central government will provide 75% of local education and welfare budgets, if the local government matches with an equal 25%. If the local government is unable to match at 25%, they will receive less than the 75% the central government is supposed to provide. This negatively effects weaker local governments, who are already struggling to provide adequate local services.

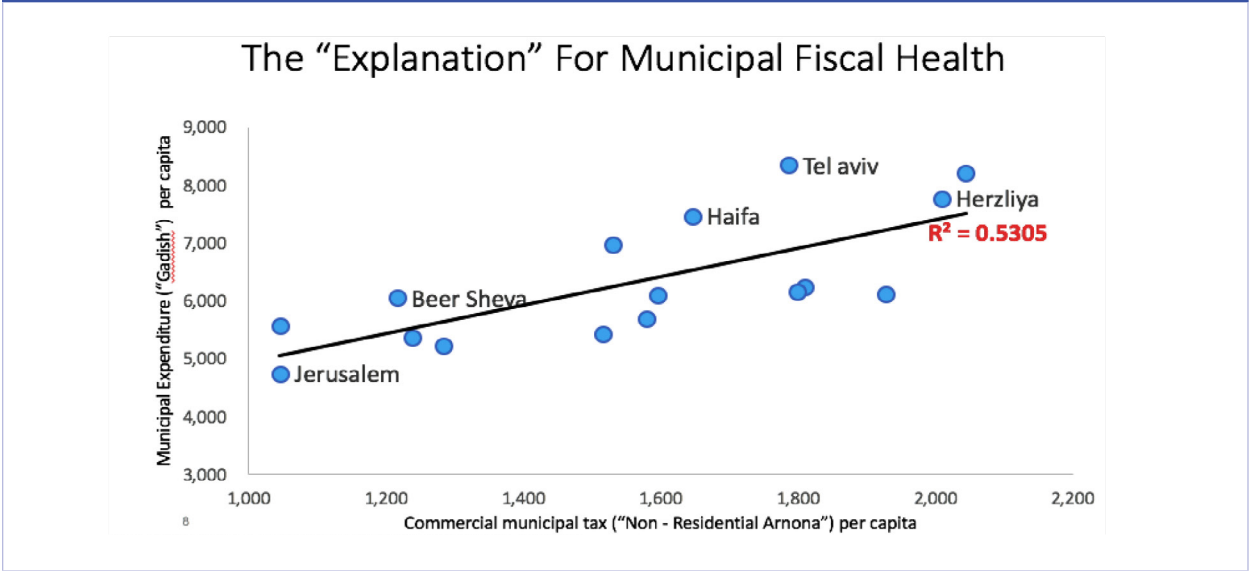
The local revenue sources currently available to the Municipality of Jerusalem cannot keep up with the natural growth in the municipalities operating budget. This operating deficit is currently financed by the capital city grant. Considering the planned budget cuts by the central government, this financing source is in jeopardy. The municipality must consider other financing methods, like issuing bonds or taking loans, to prepare for the possibility that this quickly growing financing source will not be sustainable.

The graphics below shows the commercial space per resident in Jerusalem compared to the national average and Forum 15, and the statistically significant correlation between municipal expenditure per capita and commercial Arnona tax per capita. The graphic following that, shows how this plays out, showing the difference in municipal per capita outlays of the three largest cities in Israel.



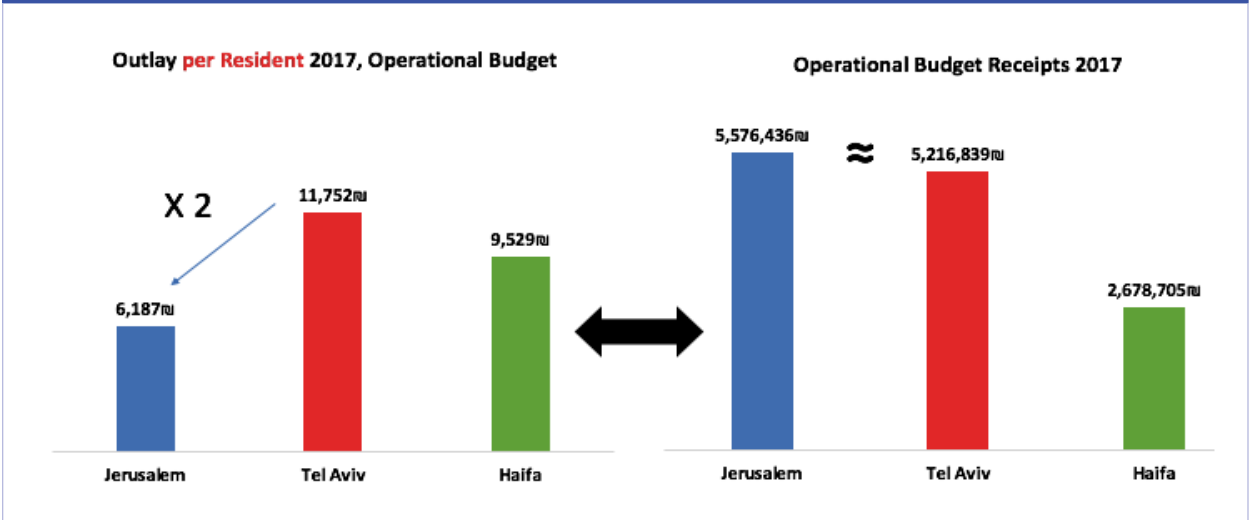
Source: Central Bureau of Statistics, Municipality of Jerusalem, 2017.

Figure 11: Commercial Space per Resident (Meters)



Source: Central Bureau of Statistics, Municipality of Jerusalem, Strategy Division, 2018.

Figure 12: Perspective of the Largest Municipalities



Source: Central Bureau of Statistics, Municipality of Jerusalem, 2017.

Underdeveloped Assets

Jerusalem has been inhabited for thousands of years and is home to many culturally sensitive properties and areas. This has led to an organizational thinking in the municipality that the status

quo is the only way to continue forward with these sensitive issues. Beyond the sensitive issues, organizational thinking does not reward or encourage revenue neutral programming or services.

This style of thinking has led to east Jerusalem properties, 40% of the municipality's property tax base, largely being unrecorded by the municipality. This presents an opportunity for millions in new independent revenues that can be reinvested into those communities.

Another result of this organizational thinking is the properties under municipal management, like schools, community centers and event centers, are being underutilized, usually only in use for half the day. Additional programming can take place in off hours that can produce additional social and economic benefit to the city.

A third area that this style of thinking has impacted is the current property tax assessment method. The current assessment method does not capture all the added value the municipality is providing with all of the developments around the city, like the light rail and public spaces. This is another example of underdeveloped municipal assets, that could provide the necessary funding to close the municipalities operating deficit. The government must offer better solutions.

Solutions for a Suitable Fiscal Mechanism

This section will review a number of innovative fiscal mechanisms that the municipality can add to its current own sourced revenue tool box. It will provide an explanation of what the tool is and past examples of how it has been used.

New Assets (earmarked for the development budget)

Air Rights

Air rights are the property interest in the space above any property, whether a structure currently sits on the property or not. These rights can generally be bought and sold, leased or transferred.

Currently, there is a similar program in Israel called Tama 38. Property owners can apply for additional building rights under this program and are exempt from improvement taxes. There needs to be 80-100% approval from the current tenants of the building depending on the improvements applied for²⁹

²⁹ Land Law, Tama 38, 2008.

There are many examples of local governments utilizing air rights from around the world. One well known example is the Chicago Prudential Building built above railroad tracks, on the lake. This underdeveloped piece of land has the potential for \$100's of millions in air rights value.³⁰

Land Leasing

Land leasing in this instance refers to an arrangement with the Israel Land Authority (ILA), the owner of the majority of land in Israel, under which the ILA transfers property ownership to the local authority to develop or lease the land, which in turn provides annual revenue to the municipality.

This arrangement can be viewed as a government transfer in-kind. This is preferable to the current set up of annually negotiated upon capital city grant transfers currently totaling 950 million NIS, because it provides the municipality annual predictable cash flows which allows for long term city planning.

There is a history of gifts or other property transfers between the ILA and local governments.

Energy Producer

The municipality has the opportunity to become an energy producer. They can install solar panels or other energy producing tools on city assets, roofs, parking garages, or other city properties.

First, the energy produced can be used for the cities needs and then in the future potentially sell it to other city businesses or organizations. The city of Eilat is an example of a city in Israel where residents have taken it upon themselves to produce energy.³¹

Another example is Kibbutz in the north that produces its own energy and sells to its neighbors?

Value Capture (earmarked for the operational budget)

Fair Market Value Arnona (property tax) Model

Municipalities in Israel currently operate under an area-based property tax assessment model. This model scores below average when compared to fair market value assessment according to widely accepted tax standards, and most importantly does not produce sufficient revenues for the municipality.

A survey of local governments around the world that are currently operating under this assessment method found that they are largely governments that are transitioning towards fair market value

³⁰ American Planning Association, Air Rights. 2019.

³¹ "תושבי אילת מייצרים את החשמל שלהם בעצמם ועוזרים לעיר להפוך ל-100% סולארית. 75% Rotter.net, מצריכת האנרגיה ביום סולארית"

assessment or do not have a stable or decentralized enough property market to do so. Most developed countries operate under a fair market value property assessment method.

Asset Survey

An asset survey is a process under which the municipality will select a number of data points and information it would like to collect about the properties it currently has under management. The survey will provide the municipality with a better understanding of the properties it is currently operating and where inefficiencies and underutilization is occurring. There is potential to capture billions in value without raising taxes.

There are examples from the USA of cities realizing billions in asset value they previously did not recognize, allowing them to leverage this new-found value for other uses.³²

Professional City Property Management

Professional property managers understand the significant difference in value that fully utilized properties offer when compared to underutilized properties. Schools and community centers in the city, which are under the management of the municipality, are largely used for half the day and are empty for the other half of the day.

There is an example of a local government in Israel, Tel-Aviv, encouraging tenants of the municipality's properties, to rent the space at hours that they are not being utilized. The program is called "yesh makom".³³

Transit Oriented Development and Financing

Transit oriented development and financing refers to the opportunity new transit developments provide to municipalities both in expanding property development along the new transit, and in the opportunity to leverage the additional value created to finance additional projects.

In Jerusalem, there is an opportunity to develop properties along the light rail development. This adds value to properties, because businesses want to be close to transit, it's good for employee satisfaction and it will attract more tenants.

An example in Jerusalem is the city entrance project, where the municipality is developing millions of square meters for commercial and residential space, next to the central bus station and train station.

An example from Japan where they offered development rights to private company who in turn financed the train development.

³² Dag Detter & Stefan Folster. The Public Wealth of Cities, Citi GPS, 2018.

³³ יש מקום - השכרת מתחמים בעיר, עיריית תל אביב-יפו, 2019.

Tourism Service Charge

Tourists in Israel currently receive Value Added Tax refunds. Cities across the world have instituted a local service tax on tourists, as a form of compensation for the local services tourists utilize.

The elasticity of tourists is generally considered low. This provides an opportunity to raise significant annual revenues to reinvest in tourism infrastructure.

Private Public Partnership (earmarked for the operational budget)

Advertising on City Assets

The Municipality of Jerusalem currently generates revenue from advertisements on boards around the city. There is an opportunity to multiply this revenue by setting up electric JCDecaux machines, in place of current advertising stands and to sell them at an hourly rate. The municipality can also utilize properties it manages around the city to advertise on them.

There is an example from Chicago, utilizing bus stop stands to generate advertising revenue. This is also seen in cities around the world.

Business Improvement District (BID)

A Business Improvement District is a defined geographical area where business owners are interested in additional services or events and work with the municipality and other businesses in their area to provide those services and events.

This needs to come from the businesses desire. The city can show business leaders examples of past successes, and a framework for how the arrangement could function.

An example from the Mahane Yehuda market in Jerusalem, where the businesses came together to accomplish a goal of cleanliness. Another well-known example is Bryant Park, New York. Bryant Park was a poorly run area which was transformed from a BID arrangement which created value, improved park operations and maintenance.

Privatize Municipal Services

Privatizing municipal services is an option for providing services on a higher level. This is something that cities across the world, including Jerusalem in the case of water, have implemented.

The municipality can issue a request for proposal (RFP) for services that are lagging in the city, like cleaning. The municipality must make sure the contract puts them in charge, using performance goals and short-term contracts that are reviewed annually.

For privatization to occur, the municipality must deal with the labor unions, potentially using current city workers but under new management which demands higher service quality.

Energy Efficiency

The first step in increasing energy efficiency is gaining an understanding of current uses. The municipality must measure the current sources of energy use and establish a baseline.

First, the municipality must review the use of HVAC systems and complete a building envelope inspection to check where there is need for better insulation and where air-conditioned areas are leaking, which lead to higher energy bills.

Next, the municipality must review lighting usage. LED lighting should be considered to replace incandescent lighting. Incandescent uses 5X the energy for the same amount of lighting as LED.

Structuring Financial Tools

After reviewing what each financial mechanism is and examples of how it has been used, this section will offer recommendations in the structuring and implementation of the innovative fiscal mechanisms in Israel.

Fair Market Value Arnona (property tax) Model

Valuation approaches

There are three main valuation approaches for property tax assessment: 1. Summation/cost 2. Income 3. Sales comparison

- The summation method for property assessment is based on the principle of substitution. The assessment is calculated by adding the value of the land, structure and improvements. This is the recommended method.
- The income method is based on the principle of anticipation. It is calculated by determining the discounted flow of return from owning the property.
- The sales comparison method is based on the principle of equivalence. This method is determined by the value of recently sold comparable properties. This is the method currently used by the Department of Justice, Land Assessment Division.³⁴

³⁴ John Mikesell, Fiscal Administration, 2015.

Best Practice for Assessment

The best recommended course of action to complete the property assessments is to issue a request for proposal for property assessors to go around house-house, building-building. The preference is for using in-house assessors, but the RFP can be used as motivation for them to be best.

Currently, banks require an assessment before giving a mortgage, so the data needed exists.

The municipality must update the assessment valuations every 2 years using available data after the initial property assessments. There are 261,000 units according to the municipalities Arnona data. How many units can be done per month? Performance measures must be included in the contract and checked regularly.

Next Best Practice for Assessment

The next best recommended course of action for the assessments is a computer assisted mass assessment valuation method, using a decided upon model. The model could be qualitative, data based, or based on recent selling prices. This method allows for easier set up and lower initial costs.

Tax Rate

Calculate the mill rate as a way of determining a suitable property tax rate. The mill rate equation is $(\text{planned expenses} - \text{expected revenue from non-property tax sources}) / (\text{net assessed value of housing} + \text{rate multiple applied to non-housing property} * \text{net assessed value of non-housing base})$.

- Apply a mix of residential and commercial increases. The current commercial to housing tariff ratio is heavily misbalanced, leading to economic distortions. Ideally, the municipality should move towards more balance with more increases on residential rates.
- Property tax rates vary significantly from city to city and country to country, ranging from less than 0.1% of market value to 4% of market value. The differences are largely based on reliance on the property tax in the place's revenue source mix. Jerusalem relies heavily on the property tax for local revenues and their rates should better reflect that reliance.^{35 36}
- The municipality must determine what is a feasible rate. Slowly roll out the program, raising rates over 5-10 years, starting with certain zones.
- The next question is how to decide who and where? Who are the least elastic areas and tenants? Are certain types of buildings suitable for the initial pilot?

³⁵ Real Property Taxes in Europe, Elke Asen, The Tax Foundation 2019.

³⁶ 50 State Property Tax Comparison Study, Lincoln Institute of Land Policy, 2018.

- An appeal process is necessary. It is critical to be transparent. Show the resident or business exactly how their rate was determined and comparable examples. Expect mass appeals to start with. Once the initial wave is over, things will quiet down.
- Ideally, avoid any tax credits or exemptions. If discounts or exemptions are necessary, then use targeted credits for low income households or senior citizens using caps. Another discount method is the deferral option, under which, low income households wait until the sale of the property to pay the tax and pay additional interest.
- Whether to tax common areas or only usable space is another decision to consider.

Air Rights

An opportunity exists to sell air rights in low density areas, already designated to build at a higher density. The municipality can also target transit development areas. Are there other undeveloped areas in the city where air rights can be sold?

Pricing considerations should include current margins in the property construction market.

If the current property owner is not interested in building in the air above their property then offer the opportunity to other land developers through public auctions. The air rights must include performance measures and guarantees. Another question to consider is whether there should be a penalty if air rights are not utilized.

Require current tenant approval of 75%. Determine damages or other mechanisms, like an appeal process, for tenants opposing.

Land Leasing

The land leasing structure can be as follows: 50%-50% split on land transferred from ILA to the municipality. Part of the municipalities share goes into an investment fund to provide 5% returns which are then directed to development or other outlay needs.

The ILA and municipality should move away from capitalized, long term leases and move towards yearly or multi-year leases.

The municipality should set up a municipal company that deals specifically with this arrangement, under which the invested funds go back into city development or other uses.

Professional Management of City Assets

Complete a comprehensive review of the municipality's current assets. What do they cost us between rent paid, maintenance, insurance, etc.? Is there potential to create more social or economic value or generate additional revenues?

The municipality must consider insurance needs and if current insurance plans will cover additional activities.

The additional revenue can be reinvested back into the school, community center, gym or library etc. Another option to consider is utilizing a sales lease back as a method for selling depreciation on city properties that the municipality is not legally allowed to utilize but offers significant value to private businesses.

Transit Oriented Development and Finance

The municipality should incentivize development along the upcoming light rail expansion.

This opens the opportunity to connect development rights with the demand for additional parking in the city center and along transit development.

Future opportunities include emek refaim and an innovation district.

Tourism Service User Fees

The municipality should implement user fees to cover the services currently being used by tourists in the city.

The easiest point of collection is at hotels.

The service user fee can be based on the sanitation budget per square meter, or 10-20 shekel per night at a Jerusalem hotel.

Advertising on City Assets

The municipality should install digital screens in place of the current boards and sell hourly advertising. Advertisements can also be placed on municipal properties in strategic locations.

The municipality must determine cost per hour, through discussions with the advertisement company and other players. One option is to create membership discounts for weekly, monthly or yearly contracts.

Energy Producer

The municipality can partner or form some other arrangement with the Israel Electric Company, utilizing existing infrastructure.

Install solar panels on all available roofs of city properties to first become energy independent and then potentially provide energy services to other city buildings.

Fiscal Mechanisms- Costs, Complexities, Benefits, and Actors

The sections above provide background information, examples and structure for implementation for each of the proposed fiscal mechanisms in pursuit of closing the Municipality of Jerusalem's operating budget deficit. Next, the relevant costs, complexities, expected revenues, elasticities and actors will be explored. The table below provides a comprehensive summary of those variables.

Table 6							
Fiscal Tool	Type	Description	Cost to Municipality	Complexity of Implementation	Low End Expected Revenues	Who pays? Elasticity?	Actors
Fair Market Value Arnona (property tax) model	Value Capture	Shift to FMV model to improve assessments and capture true value of tax base and assets within city	Market Value Assessment of all city properties, less costly to do mass appraisal method using available technologies	Politically difficult, assessment process itself not complex Requires law from Knesset	223 million NIS annually, after full implementation	Residents pay, property tax is generally considered inelastic	Municipality Finance & Legal Departments, Israel Lands Authority Assessors Department, Knesset

Table 6 (Cont.)

Fiscal Tool	Type	Description	Cost to Municipality	Complexity of Implementation	Low End Expected Revenues	Who pays? Elasticity?	Actors
Professional City Property Management	Value Capture	3000 properties currently under municipality management, which have been neglected for many years	Loss of potential annual cash flow, paying millions in rent while at the same time not maximizing use of current properties. Management fees to professional management team	City properties are used widely as political tools, handed out as gifts. Asset survey has been under way for several years. Current expectation is for survey to be completed in mid 2020	30 million NIS annually, after full implementation	Whoever chooses to rent the properties, likely residents looking for a small office or a place to hold events or aftercare	City Manager, Property management, Legal Department, Outside professional management team
Tourism Service User Fees	Value Capture	Tourists currently use city services, charge them for service use	Collection cost, can come in the form of VAT refunds going to municipality or nightly hotel municipal user charge	Risk of reducing tourism	33 million NIS annually	Tourists, generally considered inelastic	Tourism, Legal, Finance Department
Transit Oriented Development & Finance	Value Capture	Light rail expansion throughout the city should be leveraged for commercial property development and for capital market financing	Costs associated with marketing the property,	Low complexity	Link development rights with public parking facilities at public transit stops	The developers, if it is profitable they will do it	Planning, Finance, Business Advancement Department

Table 6 (Cont.)

Fiscal Tool	Type	Description	Cost to Municipality	Complexity of Implementation	Low End Expected Revenues	Who pays? Elasticity?	Actors
Land Leasing	New Asset	Transfer land from ILA to municipality	Cost of managing, maintaining and marketing properties	Land is largely used as a political tool, ILA likely won't agree	80 million NIS, potential for future annual cash flows from leases	Land transfer, future payments from leasers	ILA, Property management, Finance Department
Air Rights	New Asset	Sell air rights in places where higher density is wanted	Marketing and sales costs	Requires law?	26.5 million NIS, one-time payments	Future payments from purchasers	Legal, Finance, Planning Department
Energy producers	New Asset	Install energy producing tools on city assets	Cost of energy production tool, installation, maintenance	Forming partnership with Israel Elect	Potential to sell energy, savings of X million NIS per year	Tenants of city properties, whoever else the city provides energy for	Outside energy tool company, Israel Electric Company, Finance Department
Advertising on City Assets	PPP	Offer advertising on city properties, JCDecaux screens	Marketing, administering program, fees to JCDecaux	Low complexity	13 million NIS annually	Companies that want to advertise have standing budgets	Property Management, Business Advancement Department
BIDS	PPP	Business Improvement District, a tool for local businesses to come together and use increased purchasing power for additional services or events	Share costs of additional services, events	Must come from businesses, can't be pushed upon them by the municipality, municipalities job to show the businesses it is worth it for them	Minimal economic impact for municipality, however increased cleanliness, more customers for businesses,	The businesses pay, they are elastic so they must be shown the value in it	Business Advancement Department, Eden

Table 6 (Cont.)

Fiscal Tool	Type	Description	Cost to Municipality	Complexity of Implementation	Low End Expected Revenues	Who pays? Elasticity?	Actors
Privatizing Services	PPP	Issue RFP for services like cleaning where the city is lagging	Likely to save the municipality money, and improve service	Strong labor unions in Jerusalem Municipality	Significant savings over the long run, in addition to improved services	Municipality pays	Sanitation Department, Labor Union, City Manager
Energy Savings	Cost Savings	Use LED lighting in place of incandescent Check use of HVAC	Cost of envelope inspection & installation of new lighting	Must complete survey of current energy use	Significant savings over the long run	Savings for municipality	Buildings, Public Works Department
Enforcement		Enforce city laws on garbage disposal, peeing in public, dog poop	Opportunity to utilize existing enforcement staff for this purpose	Low complexity, identify problem areas then send enforcement staff there	Parking enforcement in Jerusalem, 60 million shekels, in Tel-Aviv, 300 million shekels	Residents and others in city	Enforcement Division

Revenue Projection Calculations

The following revenue projections represent the new own sourced revenue potential the Municipality of Jerusalem has at its disposal. Following the high, medium and low-end revenue projections, the accompanying methodology and assumptions are provided. Each fiscal tool is evaluated according to the tax revenue standards previously outlined.

Fair Market Value Arnona

High	Medium	Low
1.7 billion shekels	490 million shekels	223 million shekels

Methodology and Assumptions

- Current tax collections on residential property total 0.214% of their market value (0.25% of their market value when removing exemptions and discounts). (The revenue estimates assume collections at 0.3%, 0.25% and 0.5% of residential property market value. These increases would come into effect over a 10-year ramp up, starting with a pilot on targeted areas and buildings, to minimize potential negative effects.
- Current tax collections on other properties, which includes all other properties except for institutions, government buildings and city properties, because of their special tax status, total 0.55% of their market value. The revenue estimates assume collections at 0.6%, 0.58% and 0.75%. Like the residential increases, these increases would come into effect over a 10-year ramp up, starting with a pilot on targeted areas and buildings.

Tax/Revenue Standard (1-5)	Fair Market Value Arnona
Yield	5
Equity	3
Economic Neutrality	3
Collection Cost	3
Transparency	4
Simplicity	4

Professional Property Management

High	Medium	Low
400 million shekels	100 million shekels	30 million shekels

Methodology and Assumptions

- The revenue estimates are based on the following assumptions: a 6% return on 20% of property space, a 3% return on 10% of property space and a 3% return on 3% of property space. This program would roll out over a 1-3-year period.

Tax/Revenue Standard (1-5)	Professional Property Management
Yield	3.5
Equity	5
Economic Neutrality	4
Collection Cost	2
Transparency	3
Simplicity	3

Tourism Service User Charge

High	Medium	Low
148.5 million shekels	82.5 million shekels	33 million shekels

Methodology and Assumptions

- The revenue estimates are based on historical data and assume 1 to 1.5 million tourists visiting Jerusalem per year for an average of 3.3 nights, at a per night tax of between 10 to 30 shekels per night. This program can be rolled out over 1-3 years, first implementing the 10 shekel per night tax. If there is no negative reaction, further incremental increases can be implemented.

Tax/Revenue Standard (1-5)	Tourism Service User Charge
Yield	3
Equity	3
Economic Neutrality	3
Collection Cost	3
Transparency	4
Simplicity	4

Land Leasing

High	Medium	Low
107 million shekels	91 million shekels	80 million shekels

Methodology and Assumptions

- The revenue estimates are based on the assumption that the Israel Lands Authority will transfer 2000 undeveloped dunams to the municipality. A further assumption is that this land will be developed with a ratio range of commercial: residential development of between 70:30 to 50:50. The next assumption in the estimates is a lease rate on commercial land with a value of between 700,000-900,000 per dunam discounted over 15 years, and a lease rate on residential land with a value of 500,000-700,000 per dunam discounted over 15 years. This program will take 5-10 years to implement.

Tax/Revenue Standard (1-5)	Land Leasing
Yield	3.5
Equity	3
Economic Neutrality	2
Collection Cost	2
Transparency	3
Simplicity	3

Air Rights

High	Medium	Low
331.9 million shekels	118 million shekels	26.55 million shekels

Methodology and Assumptions

- The revenue estimates are based on the assumption that between 10-30% of existing building space are in low density areas. Further, of those 10-30% of existing low-density building areas, the municipality grants between 15-25% additional air rights for these spaces at a lease rate of

between 200-300 shekels per meter with a 30-50% leasing uptake. This program can be rolled out over 3-5 years.

Tax/Revenue Standard (1-5)	Air Rights
Yield	3.5
Equity	3
Economic Neutrality	3
Collection Cost	3
Transparency	3
Simplicity	3

Advertising on City Assets

High	Medium	Low
149.76 million shekels	63.2 million shekels	13.1 million shekels

Methodology and Assumptions

- The revenue estimates are based on the assumption of the municipality installing between 250-500 electronic advertisement boards throughout the city, selling ads at a per hour rate of 10-50 shekels and subtracting operational and other costs of 20-30%. The boards can be targeted to high traffic areas like the city center, city entrance and bus stops throughout the city. This program can be rolled out in 1 year or less.

Tax/Revenue Standard (1-5)	Advertising on City Assets
Yield	3
Equity	5
Economic Neutrality	5
Collection Cost	3
Transparency	4
Simplicity	3.5

Institution Service User Charge

High	Medium	Low
40.68 million shekels	30.51 million shekels	million shekels

Methodology and Assumptions

- The revenue estimates are based on current per meter sanitation outlays by the municipality. Further, the revenue projections assume a 20-40% exemption rate amongst institutions, based on historical data. This program can begin with targeted areas and be rolled out over 1-3 years.

Tax/Revenue Standard (1-5)	Institution Service User Charge
Yield	2.5
Equity	4
Economic Neutrality	3.5
Collection Cost	3
Transparency	4
Simplicity	2.5

Figure 13: New Own Sourced Revenues

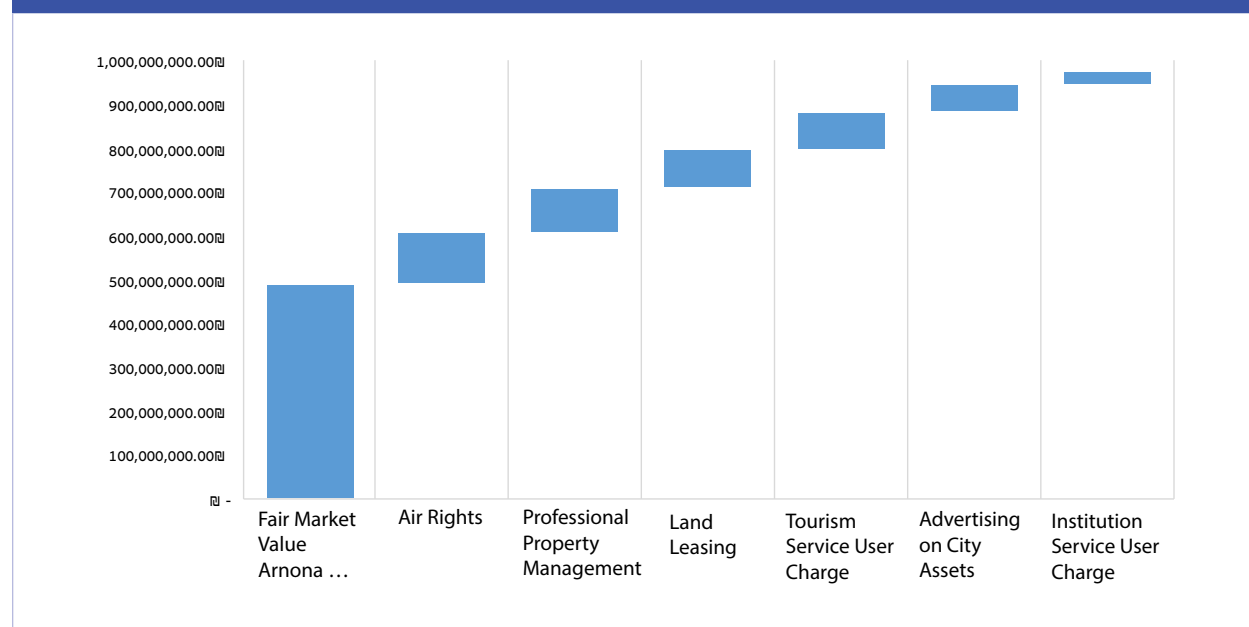
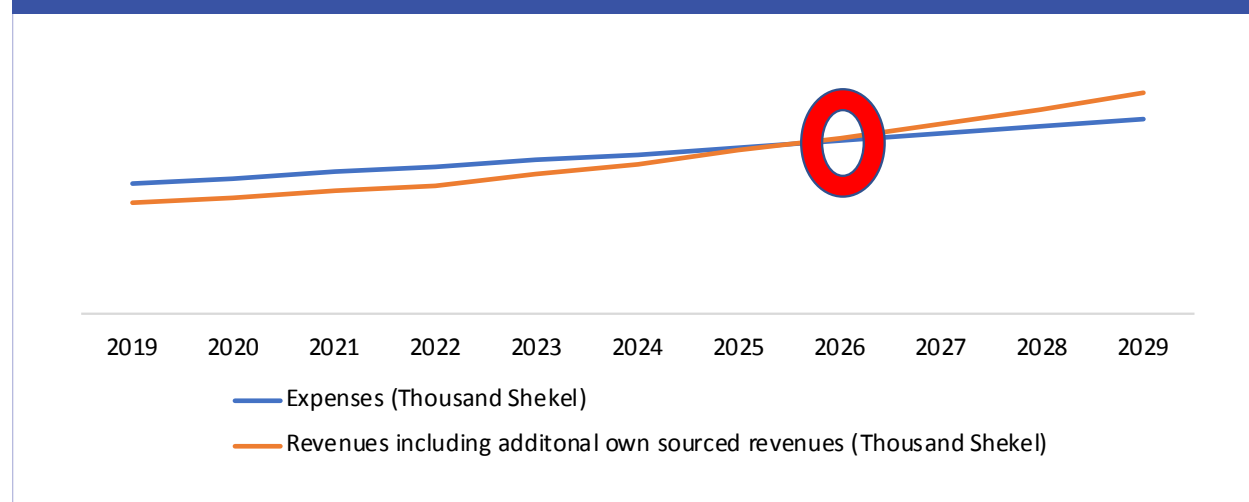


Figure 14: Municipality of Jerusalem Operating Budget Projection with Additional Own Sourced Revenues (Thousand Shekels)



Assumptions and Methodology

There are up to 3 billion shekels in additional annual own sourced revenues discussed in this research. In addition to those revenues, there are also significant potential annual revenues from the transfer of government offices to Jerusalem and the recording of east Jerusalem properties.³⁷ The projection above assumes a 5% annual growth in revenues and a 4% annual growth in expenses per year.

Program Performance Measures

- Increase own sourced revenues 5% per year for next 3 years, then 10% per year.
- Reduce reliance on central government by 3% per year.

Other Recommendations to Improve Fiscal Health of Municipalities in Israel

- Increase local fiscal authority, with accompanying fiscal controls.
- Open local government access to the public bond market. The infrastructure exists in the Ministry of Finance as well as in the United States with the Development Corporation for Israel Bonds.

³⁷ For further reading on the potential revenues from transfer of government offices to Jerusalem and the recording of east Jerusalem properties see: <https://jerusalem-institute.org.il/publications/הינב-דילימ-ינשו-סימד-יכוסכס-תיקוח-יתלב/> and <https://jerusalem-institute.org.il/publications/ויתלשמם-תודיחי-תרבעהמ-תילכלכה-תלעותה/>

- Tie transfer payments to a stable and predictable source, enable longer term planning, 5-10 years.
 - Education and Social welfare actually 75% participation, get rid of current matching system that penalizes weaker localities + capital grant tied to property tax exemptions for operational budget + other measure for development budget
 - Move away from process of yearly negotiations for capital grant and other transfer payments
- Remove or limit exemptions, service cost/benefit gap at an unsustainable rate. As of 2015, about 27% of Jerusalem population receive an average discount of 34%. Must deal with institutions, house of worship exemption.
- Implement program to maintain university graduates in the city. Align the education system with the job market.
- What is the narrative to get over political hurdles?

Conclusion and Next Steps

The Municipality of Jerusalem faces many challenges which at the same time can be approached as unrealized opportunities. The amount of underdeveloped assets in the city that have not been tapped provide an opportunity to realize potentially hundreds of millions in annual revenues. The extremely low labor participation rate among two major sectors of the city's population provides an opportunity to dramatically raise the standard of living in the city and to give a significant boost to economic development in the city. Lastly, the steadily increasing centralization occurring provides an opportunity to switch gears and to provide the city with the tools it needs to become less dependent on a central government who itself is facing budgetary issues.

The issue of finding a suitable fiscal mechanism for local governments in Israel must be dealt with. There are many tools available to solve this problem. However, implementing additional tools without accompanying proper management and budgetary constraints will not provide the desired outcome. The primary source of own sourced revenue, Arnona, must be made suitable for the municipalities needs. The significant impact of a fair market value Arnona assessment method needs to be carefully examined and implemented. The Municipality has billions of assets under its management that have been neglected for years and it is past time to form a professional asset management team. These assets represent a significant opportunity for the municipality to narrow its budget gap. In addition to these two significant sources of new revenues, this paper provides many more innovative tools that offer an attractive cost/benefit for the municipality.

These additional own sourced revenue streams will not be created overnight. The municipality must address short terms steps to cover its operating deficit, which is currently being financed by a rapidly

growing central government grant. One option is tapping the capital market, by taking out more loans or issuing bonds. Another option is to look at the other side of the budget, spending. However, given the relatively high financing costs associated with going to the capital market, and the municipalities already lagging services, these options may not be attractive.

Once the central government is ready to deal with this issue that they have been kicking the can down the road for 50+ years, this paper will provide them the relevant information and tools that have helped local governments across the world generate adequate revenues while at the same time operating under a balanced and manageable budget. It is my hope that rather than waiting until disaster hits, the central government will take preemptive action and implement the necessary policies that will allow Jerusalem and all municipalities in Israel to provide the high-quality services that their residents deserve.

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