

THE CPI AND CAPITAL MOVE INDEMNIFICATION

By Britt Harvey

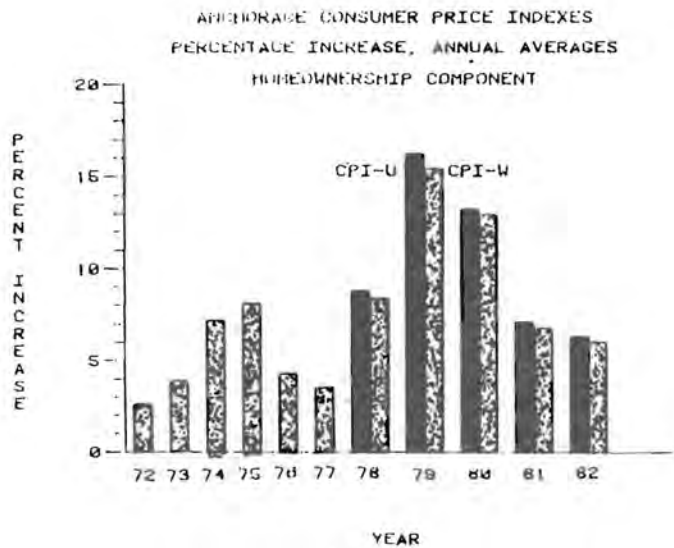
The Consumer Price Index (CPI) is used in a variety of circumstances to adjust money payments over time. The Alaska Legislature chose to use the CPI to adjust the value of residential property in Juneau indemnified by the state in the event of a capital move. Several aspects of this legislation are potentially confusing. This article reviews the legislative basis for indemnification, provides the relevant CPI data, and discusses methodological problems in the CPI data which impact the indemnification issue.

Chapter 44.08 of the Alaska Statutes is entitled "Relocation Indemnification." The law provides for the compensation of Juneau property owners for losses resulting from a capital relocation. Three categories of property are specified: business capital assets (including rental real property), mobile homes, and residential real property. Business capital assets and mobile home indemnification are not based on the CPI. All other indemnified property, essentially residential property, is adjusted in value by the CPI. Owners need not be state employees to be indemnified.

INDEMNIFICATION

A base year fair market value is arrived at for all residential property. For property in existence before January 1, 1976, the assessed value as of that date is the fair market value. Property improved or constructed after this date has the base year fair market value of its first tax assessment. If the property is sold for less than the base year fair market value in subsequent years, the sale price becomes the base year fair market value. This base year fair market value is adjusted for improvements or deterioration, and for inflation. If the property-owner sells and receives less than 95% of the adjusted base year fair market value, the state will give the owner the difference between the sale price and 95% of the adjusted base year fair market value, if the lower sale price is deemed entirely the result of the capital relocation. If no seller can be found, the state will buy the property directly for 95% of the adjusted base year fair market value.

Clearly the adjustment for inflation is an extremely important



NOTE-1982 "ANNUAL" AVERAGE IS FOR JANUARY THROUGH JULY ONLY

aspect of the law. This inflation adjustment is specified in the law as follows (Sec. 44.08.060(a)(4));

" . . .to reflect quarterly changes in value as determined by comparing the then current quarterly homeownership costs in the Anchorage consumer price index. . .with those published for July 1975; in no case shall the quarterly adjustment factor be less than the average quarterly rate of increase in the index for the calendar years 1971 through 1974 or greater than the average quarterly rate of increase in the index for the four-year period ending the preceding January 1."

At the time the law was passed there was a single Anchorage CPI issued quarterly. In 1978 a change was made. There are now two CPI's, all urban consumers (CPI-U) and urban wage and clerical workers (CPI-W). The new CPI's are issued bi-monthly, rather than quarterly. This introduces ambiguity into the interpretation of the above-quoted passage.

In July, 1975, the Anchorage homeownership component of the CPI was 145.2. The most recent Anchorage homeownership components, as of this writing, are for July, 1982. They are 252.6 for CPI-U and 248.3 for CPI-W. These figures represent 74.0% and 71.0% increases, respectively. The language of the

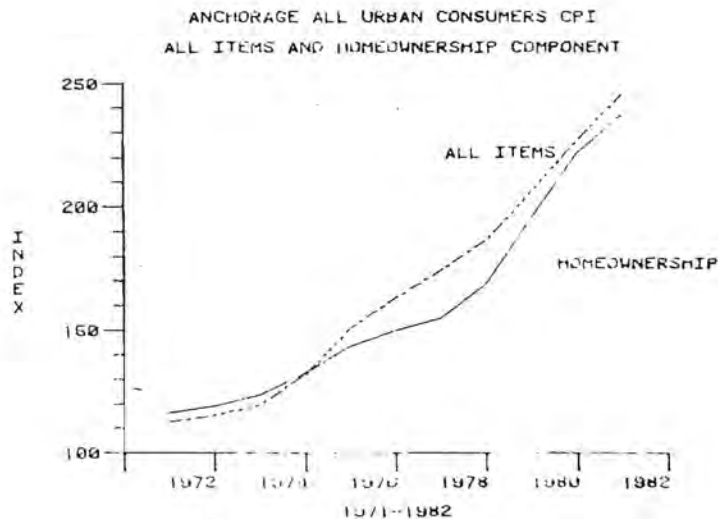
law suggests that an "average quarterly adjustment factor" must be derived from these overall percentage increases. Using the appropriate formula which accounts for compounding, the average quarterly percentage increase in the Anchorage homeownership component of the CPI's between July, 1975 and July, 1982 is 2.0% for CPI-U and 1.9% for CPI-W.

The lower bound specified in the law for inflation adjustment is the average quarterly rate of increase for the calendar years 1971 to 1975. Using the January, 1971 Anchorage homeownership component of 118.6 and the January, 1975 figure of 138.0, the average quarterly rate of increase is 1.0%.

The upper bound is the average quarterly rate of increase for the four year period ending the preceding January 1. Using January, 1978 through January, 1982 as the current four year period, the figures are 2.6% for CPI-U and 2.5% for CPI-W. It should be noted that this is a purely hypothetical upper bound, as the actual upper bound would be computed at the time applications for indemnification were received by the state. The figures given above would be effective if applications were received this year.

EXAMPLE

An example of how the state would indemnify a homeowner if an application was received in August of this year follows.



Assuming a house assessed at \$60,000 in 1976 which was maintained but not improved, for which no buyer could be found, and for which all loss of value was attributable to the capital move, the adjusted base year fair market value would be \$104,400 or \$102,600, depending on which CPI is used. The indemnification payment of 95% of this value would be \$99,180 or \$97,470.

CPI HOMEOWNERSHIP COMPONENT

A related issue is the methodology used by the Bureau of Labor Statistics (BLS), U.S. Department of Labor, to compute the homeownership component. This component consists of two subcomponents, house prices and mortgage prices. BLS uses a standard method throughout the country to survey housing and mortgage costs. While the details are complex, it is sufficient here to note that Alaska Housing Finance Corporation (AHFC)-financed houses and loans are not included in the BLS survey. AHFC currently finances almost all house sales in Anchorage. The result is that BLS has insufficient sample in Anchorage to compute the homeownership component. In such cases, BLS uses data from similar-sized urban areas in the region (western U.S.) as a proxy. This means that during the period in which AHFC has dominated Anchorage housing finance, the Anchorage homeownership component has been based on housing and mortgage prices in places such as Spokane, Washington or Fresno, California.

This situation will continue for the CPI-U until January, 1983. At this time BLS will switch to a "rental equivalency" method of calculating homeownership costs (See September *Trends*). Instead of surveying house and mortgage prices, BLS will estimate homeownership costs by surveying rental prices in equivalent houses. This methodology will render the AHFC problem moot. The CPI-W will not change until January 1, 1985, a two-year gap. In the interim, the CPI-W will continue to be calculated from proxy data from other cities, barring a change in BLS methodology or AHFC popularity. It is very likely that the Anchorage homeownership component in the CPI-U will diverge significantly from the CPI-W. The indemnification law does not specify which CPI is to be used.

The eventual impact on Juneau property owners of this complicated situation is dependent on future events, and is difficult to predict. The forecast variables are housing and mortgage prices in proxy cities for the next two years, and Anchorage rental prices through the rest of the decade. If voters elect to move the capital, if the move is carried out, if the current

indemnification law prevails, and if the legislature chooses to fund indemnification, Juneau homeowners will be indemnified on the basis of one of two probably quite different CPI figures for Anchorage homeownership, neither of which is entirely a measure of Anchorage homeownership costs. Millions of dollars will probably ride on the choice between CPI's.

SUMMARY

In summary, all Juneau residential property owners are indemnified for losses caused by a capital relocation under current law. Allowances for inflation will be a very important factor in determining the value of Juneau residential real estate. Current law specifies the Anchorage homeownership component of the CPI as the measure of inflation. There are two CPI's, with no indication of which is to be used. Both Anchorage CPI's currently estimate homeownership costs by proxy, as AHFC-financed houses are not included in the survey. This method will continue until 1985 for the CPI-W, and until 1983 for the CPI-U. The law specifies an upper and lower bound for the inflation adjustment. It appears that the adjustment figure is likely to fall within these bounds, although only future CPI's can confirm this.
