INNOVATIONS IN LOCAL PUBLIC FINANCE WORKSHOP

LOCAL GOVERNMENT FINANCE IN INDIANA: HOW WE GOT HERE AND WHERE ARE WE GOING?

DECEMBER 1, 2010

- Historically, the property tax has been the predominate source of revenue to fund local government in Indiana. It is estimated that in 2010 local governments in Indiana will raise over $6 billion in property taxes.

- We have been or are going through a long-term re-examination of how local government should be funded in this state. Why?
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House Enrolled Act 1001 enacted by the General Assembly in 2008 represents the most fundamental change in local government finance in Indiana since the “Bowen” property tax control program was put in place in the early 1970s.
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So what instigated this recent re-examination of local government finance in Indiana?

- A growing belief that the 1973 property tax controls were no longer effective.
  - Really started with consideration of a proposal by the Coalition to Restore Indiana Property Tax Controls (CRIPTC) in 1992
  - In 1993 the General Assembly directed the State Board of Tax Commissioners to conduct a study to determine the impact of converting the current property tax assessment system to one based on “fair market value”.
The 1998 Indiana Supreme Court decision in the Town of St. Johns v. the Indiana State Board of Tax Commissioners case really upset the applecart – the old method of assessing property violated the “uniform and equal” clause of the Indiana constitution.

- It required that we modify the way property was assessed for tax purposes
- There would be many winners and losers in the shift to an assessment methodology more based on “market value” and the losers would be previously under-assessed old residential properties (read voters)

“The General Assembly shall provide, by law, for a uniform and equal rate of property assessment and taxation and shall prescribe regulations to secure a just valuation for all property, both real and personal.”

-from Article 10, Section 1 of the Indiana Constitution (prior to November 2, 2010)
In 2002, acting under the cloud of what could happen when property taxes are due in 2003 based on the new assessments, the General Assembly enacts sweeping tax reform during a special session.

Key provisions of the “21st Century Tax Reform” legislation included:

- Increasing the State Homestead Credit (increase from 4% to 20%)
- Increasing the Homestead Deduction from $6,000 to $35,000 (not to exceed 50% of AV)
- Expanding the Property Tax Replacement Credit to include 60% of school general fund levies and eliminating PTRC on business personal property
- Increasing the State Sales tax from 5% to 6% to pay for the additional relief
- Eliminating the property tax on inventory
- Numerous other business income tax, cigarette tax, and assessment changes were made designed to improve the economic development climate of Indiana
In 2004, Indiana voters amend the State Constitution to modify the “uniform and equal clause” allowing for the exemption from property taxation of inventory (legalizing what the General Assembly had done three years previously) and allowing for special treatment of certain residential property categories.

ARTICLE 10, SECTION 1 OF THE CONSTITUTION OF THE STATE OF INDIANA IS AMENDED TO READ AS FOLLOWS: Section 1. (a) The General Assembly shall provide, by law, for a uniform and equal rate of property assessment and taxation and shall prescribe regulations to secure a just valuation for taxation of all property, both real and personal. The General Assembly may exempt from property taxation any property in any of the following classes:

1. Property being used for municipal, educational, literary, scientific, religious, or charitable purposes.
2. Tangible personal property other than property being held for sale in the ordinary course of a trade or business, property being held used or consumed in connection with the production of income or property being held as an investment.
3. Intangible personal property.
4. Tangible real property, including curtilage, used as a principal place of residence by an:
   (A) owner of the property;
   (B) individual who is buying the tangible real property under a contract; or
   (C) individual who has a beneficial interest in the owner of the tangible real property.
5. The General Assembly may exempt any motor vehicles, mobile homes, airplanes, boats, trailers, or similar property, provided that an excise tax in lieu of the property tax is substituted therefor.

- 2004 amendment to Article 10, Section of the Indiana Constitution
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- Annual growth in average wages in Indiana had not been keeping pace with the annual growth in property tax liabilities, thus putting increased financial strain on homeowners.
- As quickly as 2005 some of the new financial commitments the General Assembly had made back in 2002 began to cause difficulty. That year they began to cap the amount of money used to provide Property Tax Replacement and Homestead Credits. This was a first in the thirty-two year history of these credits and a fundamental break with the 1973 plan. As a result, the property tax burden would be gradually shifting back to the property owner.

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- Beginning with property assessments in 2006 (for taxes payable in 2007), local assessors are required to adjust for changes in the market value of property on an annual basis. This is known as “trending”. It is not the same as a general reassessment. However, because the 2002 general reassessment was based on 1999 market values, the 2006 trending will account for six years of property value change in one year. This process did not go well in several parts of the state.
The General Assembly continued to made adjustments to the property tax control program to soften the impact of the change to market value assessment on the homeowner.

- Some of these changes are short-term, such as one-year increases in the Homestead Credit and the Homestead Deduction
- One is much more far-reaching...

In 2007 the “Circuit Breaker” concept is enacted limiting a taxpayer’s annual property tax liability to 2% of gross assessed valuation beginning in 2008 on residential property and at 3% of gross assessed valuation beginning in 2010 for all other types of property. (House Enrolled Act 1478-2007)
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- This is a much different concept of a property tax circuit breaker than was traditionally found in several other states. Unlike past state created property tax credits, with the Circuit Breaker the state does not offset the property tax reduction with a corresponding payment to the local governments whom would normally receive the tax income.

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- In 2007, in anticipation of the impact of “trending” on homeowners, the General Assembly enacts additional short-term taxpayer relief measures (HEA 1001-2007):
  - $300 million in new one-time gaming revenues will be used to fund Homestead rebates in late 2007 or early 2008.
  - $250 million in new one-time gaming revenues will be used to fund additional Homestead Credits in 2008, 2009 and 2010
The General Assembly keeps allocating more money to soften the impact of assessment changes to the homeowner. The original (1973) property tax control program is being altered to the point that it is no longer making sense and many legislators and tax experts are questioning how much useful life it has left.

In 2007 the General Assembly enacts HEA 1478, which gives individual counties a variety of methods for increasing local income taxes to reduce property tax burdens – a voluntary method for local government to move further away from the property tax and toward a more diversified tax structure.

These new “LOIT” options allowed for:
- Increasing local income taxes to replace property tax increases for annual permitted levy growth
- Increasing the local income tax for new property tax replacement credits
  - only for homesteads
  - only for residential property
  - for all property categories
- Increasing the local income tax to raise new money for county and municipal public safety expenses
Most counties choose not to immediately take advantage of these new tools because they either do not want the blame for raising taxes or they are becoming skeptical of what the General Assembly might do next.

HEA 1478 – 2007 also created Local Tax and Capital Project Review Boards in each county. However, the concept is repealed the following year before it is ever implemented. It introduces a new concept in local government finance, units that share a property tax base have a cumulative impact and a responsibility to communicate and coordinate.
2007 – “The Summer of Our Discontent” – a combination of factors led to widespread taxpayer dissatisfaction with the level and administration of property taxes in numerous Indiana communities. Increases in local government spending, confusion about how property taxes are calculated, unpredictability in annual tax liabilities, and the manner in which trending was implemented in some townships all contributed to the outcry to “do something about property taxes”.

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The blame game
What does the latest tax flap mean for property owners?
Marion County is at the heart of the storm and state legislators hear the outcry loud and clear. From the perspective of many legislators, we have a property tax “crisis”.

In the Summer of 2007, the General Assembly’s Commission on State Tax and Financing Policy holds public hearings on the property tax. At these hearings, many citizens push for a complete repeal of the property tax.
The Commission ultimately pushed for a major overhaul of the property tax system.

In October, Governor Daniels responds to the crisis proposing fairly specific legislation for introduction into the General Assembly.

Both political parties and both houses of the General Assembly sign on to the concepts contained in the Governor’s proposal.

We are off and running toward the enactment of HEA 1001 – 2008.

By March of 2008, HEA 1001 is enacted – dramatically altering many of the underlying concepts of the property tax system in Indiana. It contains at least 52 significant changes for local government finance, including:

- It puts new Circuit Breaker limits into effect starting in 2009 – capping a homeowner’s annual property tax liability at 1.5% of their gross assessed valuation in 2009 and 1% in 2010 and thereafter. Other residential property and agricultural land are capped at 2.5%/2%; and non-residential real property and personal property are capped at 3.5%/3%. 
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- It provides for referendums on significant capital projects proposed to be financed with property tax supported bond issues – a change from the former petitions for/petitions against process.

- In all but the largest townships, the property tax assessment responsibility is shifted from the township level to the county level.

- It increased the Homestead Deduction to $45,000 or 60% of the gross assessed value, whichever is less, and created a new Supplemental Homestead Deduction of an additional 35% on the net AV for the first $600,000 and 25% for any net AV exceeding $600,000.

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- The remainder of the property tax support for K-12 public schools is eliminated and school general funds will now be almost exclusively be supported through the State’s general fund.

- The Property Tax Replacement Credit and the state-funded Homestead Credit are phased out.
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- Child Welfare funding is completely removed from the county property tax and will be paid from the State General Fund.
- The local property tax levy to support municipal police and fire pension obligations is eliminated beginning in 2009 with the State Pension Relief Fund assuming full financial responsibility for these obligations.

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- The new local option income taxes (the LOITs) originally authorized in HEA 1478-2007 are modified but retained. Local governments are encouraged to implement them to provide further property tax relief.
- The state sales tax is increased from 6% to 7% to help pay for the additional property tax relief.
The Conference Committee report passes the House by a 82-17 margin and the Senate by a 41-6 margin – amazingly wide margins for such sweeping legislation. These margins are a good indication of the heat legislators were feeling on the property tax issue. The Governor signs the bill five days later.

The General Assembly also begins the process for amending the Indiana Constitution to place the “property tax caps” into Article 10, further modifying the concept of “uniform and equal taxation”. (House Enrolled Joint Resolution #1)

It passes the measure a second time – as is required to trigger a public referendum to amend the state constitution – with enactment of House Joint Resolution #1 in 2010.
The final “enactment” of the 2008 changes occurred this past November with the passage of the referendum measure placing the “property tax caps” or “circuit breakers” into the Indiana Constitution by a 72% to 28% margin statewide.

"SHALL PROPERTY TAXES BE LIMITED FOR ALL CLASSES OF PROPERTY by amending the Constitution of the State of Indiana to do the following: (1) Limit a taxpayer's annual property tax bill to the following percentages of gross assessed value: (A) 1% for an owner-occupied primary residence (homestead); (B) 2% for residential property, other than an owner-occupied primary residence, including apartments; (C) 2% for agricultural land; (D) 3% for other real property; and (E) 3% for personal property. The above percentages exclude any property taxes imposed after being approved by the voters in a referendum. (2) Specify that the General Assembly may grant a property tax exemption in the form of a deduction or credit and exempt a mobile home used as a primary residence to the same extent as real property."
What have been the major impacts, to date, for local government finance arising from the impact of HEA 1001/2008?
Percent Change in Property Tax Payments by Property Type
Indiana (91 Counties) 2007-2010

Total: -11.4%
Business Personal: -5.6%
Comm/Industrial Real: 11.4%
Agriculture: 14.7%
Apartments: -18.1%
Non-Hmstd Residential: -25.0%
Homesteads: -26.3%

Tax Cap Credits by Property Type, 2010
Total Tax Cap Credits: $471.9 million

- Homesteads: 22.3%
- Other Residential: 33.7%
- Other Real: 18.9%
- Apartments: 12.0%
- Personal Property: 9.8%
- Ag Business: 0.7%
- Farmland: 0.5%
- Mobile Home Land: 0.6%
- Long Term Care: 1.5%

91 counties plus Estimates for LaPorte
Indiana School Referenda Results, 2008-2010

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<th>All Referenda</th>
<th>Capital Projects</th>
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Local Option Income Tax Rates and Property Tax Credits, 2010

<table>
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<tr>
<th>City/County</th>
<th>LOIT-1 (State Level Pass Rate)</th>
<th>LOIT-2 Distribution</th>
<th>Property Tax Credit Rates</th>
<th>LOIT-3 (County)</th>
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Note: Cass County has adopted a property tax relief rate and public safety rate for 2011.
Effects of LOIT Adoption

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<tr>
<th></th>
<th>Homestead Tax Bill 2007-10</th>
<th>Tax Cap Credit % of Levy</th>
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<tr>
<td>LOIT Adopting Counties</td>
<td>-44.2%</td>
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<td>Non-Adopting Counties</td>
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<td>All Counties</td>
<td>-33.6%</td>
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What lies ahead?

- Can the property tax assessment system sustain yet another round of changes and still be able to produce property tax bills on their normal cycle?

- Several new modifications were considered in the 2010 session of the General Assembly, will they be reconsidered in 2011?:
  
  - moving to rolling pattern of general reassessments (where only a portion of the parcels are reassessed in a single year rather than the current method of doing all parcels at the same time)
  
  - Undertaking “trending” every other year, rather than annually
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- How will the public respond to local government service reductions made necessary by the tax cap revenue losses?
- Will local governments consider reorganizations, such as consolidation, in order to reduce costs?
- Will local government adopt new charges and fees to conserve scarce property tax revenues?
- Will the General Assembly authorize new optional revenue sources for local governments?

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- Will HEA 1001 satisfy the demand for property tax relief or will there be continued pressure for total elimination of the property tax, at least on owner-occupied homes?
- Will more counties move to adopt one or more of the local option income taxes (the LOITs) to provide additional property tax relief and revenue or will they be inhibited by the mood for “no new taxes” or other complexities associated with the LOITs?