Iowa General Assembly

2008 Committee Briefings

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LEGISLATIVE PROPERTY TAX STUDY COMMITTIE

Meeting Dates: January 7, 2009 | November 14, 2008

Purpose. *This compilation of briefings on legislative interim committee meetings and other meetings and topics of interest to the Iowa General Assembly, written by the Legal Services Division staff of the nonpartisan Legislative Services Agency, describes committee activities or topics. The briefings were originally distributed in the Iowa Legislative Interim Calendar and Briefing. Official minutes, reports, and other detailed information concerning the committee or topic addressed by a briefing can be obtained from the committee's Internet page listed above, from the Iowa General Assembly's Internet page at http://www.legis.state.ia.us/, or from the agency connected with the meeting or topic described.*

LEGISLATIVE PROPERTY TAX STUDY COMMITTEE
January 7, 2009

Co-chairperson: Senator Joe Bolkcom
Co-chairperson: Representative Tyler Olson

Consultants' Final Report on the Property Tax Study. Dr. Michael Bell and Dr. David Brunori, both research professors of public policy at George Washington University, and Ms. Kristina Connolly, research assistant, reviewed the final report that they prepared on the property tax study contracted for by the Committee. The five chapters of the final report are entitled: 1) Valuing Commercial and Industrial Properties for Tax Purposes: A 50 State Survey; 2) Indirect Property Tax Relief: Trends and Success; 3) Local Revenue Raising Patterns Across 50 States; 4) Local Spending Patterns Across 50 States; and 5) Smart Growth and Property Tax Incentives in State Statutes.

For purposes of comparison with Iowa, the consultants identified 12 states similarly situated to Iowa based on geographical proximity, dependence on agriculture, and dependence on manufacturing and finance industries. The 12 states are: Arkansas, Idaho, Illinois, Kansas, Kentucky, Minnesota, Missouri, Nebraska, North Carolina, North Dakota, South Dakota, and Wisconsin. The consultants, when not referring to all states in the final report, provided information on these 12 states and Iowa.

Property Valuation. Dr. Brunori stated that all six of the similarly situated states neighboring Iowa require a highest and best use standard for valuation of all property except agricultural land. An initial review of all states found that no state mandates that specific valuation methods be used when assessing property for purposes of property taxation. Commercial property accounts for 30 percent of the property tax base in Iowa and accounts for less than 25 percent of the property tax base in the similarly situated states. Dr. Brunori provided information on the effective commercial property tax rates in cities located in seven of the similarly situated states.

Property Tax Relief. Dr. Brunori stated that indirect property tax relief, such as intergovernmental aid, user fees and charges, and payments in lieu of taxes, reduce pressure on the property tax but do not directly reduce property tax liabilities of taxpayers. In general, such indirect property tax relief measures have some of the following strengths in common: 1) they reduce pressure on local own-source revenues, 2) they compensate for benefit spillovers, 3) they are economically efficient, 4) they provide diversity to local own-source revenues, and 5) they provide some measure of local control. In several states, charities and nonprofit organizations make payments in lieu of taxes to local governments, but these are typically negotiated on a case-by-case basis by the individual local governments. He further noted that virtually all states authorize local government to charge fees for some public safety services, and all of the states similarly situated to Iowa grant this authority to their local governments.

Local Revenue Raising Patterns. Dr. Bell stated that local governments in Iowa generate 82 percent of their tax revenues from the property tax. Four of the similarly situated states are more dependent on property taxes than are Iowa local governments. Forty states have some sort of real estate transfer taxes. However, three of the states similarly situated to Iowa — Idaho, Missouri, and North Dakota — do not impose a real estate transfer tax. Local governments in Iowa receive 11.4 percent of their tax revenues from the general sales tax. For local governments in states similarly situated to Iowa, the range is from 47.4 percent of taxes in Arkansas to zero percent in Idaho.

Dr. Bell stated that selective sales taxes are typically not a large piece of local government revenues in the 50 states. Examples of selective sales taxes are an alcoholic beverages tax, motor fuels tax, public utilities tax, tobacco products tax, amusement taxes, and hotel and motel taxes. Only 12 states allow local governments to impose a local income tax. However, two similarly situated states, Kentucky and Missouri, generate 27.8 percent and 4.1 percent, respectively, of tax revenues from a local income tax.

Local Spending Patterns. Dr. Bell stated that across the states, the four largest local government expenditures are on education, public welfare, transportation, and public safety. There is wide variation across states in local revenue raising and spending responsibilities and in the composition of revenues and expenditures. These variations are a result of historical, cultural, and political differences across states.

Smart Growth and Tax Incentives. Ms. Connolly stated that the common elements in state statutes that address smart growth are requirements to update local comprehensive plans, establishment of a commission to study the problem, one primary program to direct smart growth, state reimbursement for authorized property tax incentives, and imposition of some type of impact fee. The most commonly mandated tax incentive is property tax abatement for conservation easements. Some others are full or partial tax exemptions or preferential assessments for property that is put to a certain use, such as agricultural or open space. Findings indicate that tax incentives for smart growth do not work particularly well on the urban fringe. Ms. Connolly reviewed for the Committee the state statutes of three leading smart growth states — Maryland, Tennessee, and Wisconsin.

Local Income Surtax. Mr. Shawn Snyder, Legislative Services Agency, made a presentation to the Committee on an issue review he prepared entitled "Income Surtaxes." In Iowa, school districts and emergency medical services (EMS) districts are allowed to impose a local income surtax. The surtax is an additional tax applied to the amount of state individual income tax liability less any nonrefundable credits. It is paid by individuals residing in the jurisdiction on the last day of the tax year. School districts in Iowa are authorized to impose the income surtax to pay for an instructional support program or a physical plant and equipment program. At the current statutory maximum rate of 20 percent, the total income surtax capacity is $475.8 million. Currently, school districts and an EMS district are collecting $86.7 million of that total capacity.

Property Assessment Trends. Mr. Dale Hyman, Department of Revenue, reviewed for the Committee assessment trends for the 2009 assessment year. The department has seen some indication of a downward trend in value for commercial properties in the last quarter of 2008. Agricultural land values will increase in 2009 but will be limited to a 4 percent increase statewide. He noted that the department is considering a rule change to require that market value used to calculate the agricultural factor will be based on a five-year rolling average, in the same manner that the productivity formula is calculated on a five-year rolling average.

Committee Recommendations. The Committee concluded its work after making the following six recommendations:

1. Revenue diversification will be allowed for cities and counties. Any new revenue will be coupled with the following requirements:

   At least 75 percent of the new revenue will be used to reduce property taxes. Of that new revenue, at least two-thirds will be used to reduce commercial property taxes and the remainder will be used to reduce taxes on other classes of property.

   The remaining new revenue will be used for:

   - Public safety
   - Disaster recovery and prevention
   - Infrastructure
   - Energy efficiency improvements
   - Service sharing that reduces the cost of government

2. The following nine alternative revenue options are commended, without recommendation, to the General Assembly for consideration:

   - Franchise fee – language to include legalizing provisions, up to 5 percent
   - Locally imposed hotel/motel tax increase of up to 2 percent or a $1.50 per room/per night fee
   - Local option income surtax
   - Entertainment tax
   - Local option cigarette/tobacco tax
   - Real estate transfer fee
   - False alarm fees

- Development impact fees
- Payments in lieu of (property) taxes (PILOTS)

3. The General Assembly should consider an expenditure limitation component of any revenue diversification program.
4. Give cities and counties flexible bonding authority for disaster recovery if they meet a strict definition of disaster impact.
5. Sunset the LOST-TIF (local option sales tax for tax increment financing).
6. The state of Iowa should establish a Commission on Smart Growth.

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LEGISLATIVE PROPERTY TAX STUDY COMMITTEE

Legislative Property Tax Study CommitteeNovember 14, 2008

Co-chairperson: Senator Joe Bolkcom
Co-chairperson: Representative Philip Wise

Consultants' Initial Progress Report on the Property Tax Study. Dr. Michael Bell and Dr. David Brunori, both research professors of public policy at George Washington University, and Ms. Kristina Connolly, research assistant, reviewed the Initial Progress Report that they prepared on the Property Tax Study contracted for by the Committee. The four chapters of the Initial Progress Report are entitled: (1) Valuation of Commercial and Industrial Properties for Tax Purposes; (2) Indirect Property Tax Relief; (3) Local Revenue Raising and Spending Patterns Across 50 States; and (4) Smart Growth and Property Tax Incentives in State Statutes.

Property Valuation. Dr. Brunori stated that the three approaches to property valuation for property tax purposes are the market value approach, the income approach, and the replacement cost approach. The market value approach is a sales comparison approach and is the preferred method for valuing residential property. The income approach is the preferred method for valuing rental and retail property, with its most difficult component being calculation of a capitalization rate. The cost approach involves valuing the land and the replacement cost of improvements on the land. The cost approach method is used most often for commercial and industrial property, but it is also used for all property when it is infeasible to use the other two approaches or when valuing unique property. No state mandates the use of any specific valuation method to the exclusion of the other two.

Property Tax Relief. Dr. Michael Bell stated that direct property tax relief reduces property tax liabilities directly, and indirect property tax relief, such as intergovernmental grants and user fees and charges, reduces pressure on the local property tax. In his review of the 50 states, there appears to be a strong correlation between less property tax being imposed in those states that appropriate a higher amount of state funding to local governments. Nationally, local reliance on state aid declined between 1992 and 2006. In Iowa, local reliance on state aid also declined during that time period, keeping it below the national average. Iowa's local reliance on property taxes also declined during that time period, he said, and is now about 10 percent above the national average. Although user charges and user fees provide revenue diversification while maintaining local control, these sources have limited growth potential, they give rise to fairness concerns, and they can be prone to administrative difficulty in terms of collection. Iowa's local reliance on user charges and user fees increased between 1992 and 2006, staying above the national average. There is no discernible pattern nationwide between reliance on property taxes and reliance on user charges/fees.

Patterns Among the States. Dr. Bell stated that local spending patterns across states reveals that the bulk of expenditures is on education, public safety, transportation, general administration, and public welfare. There are variations across states in local revenue raising and spending responsibilities and in the composition of local revenues and expenditures. These variations are a result of historical, cultural, and political differences across states.

"Smart Growth" and Tax Incentives. Ms. Connolly stated that, in general, the term "smart growth" is used to describe a policy intended to result in extensive land use planning, development, and revitalization of urban and rural areas to curb urban sprawl and improve quality of life. Whether or not smart growth is their stated purpose, many states offer preferential tax programs for conservation of land, such as agricultural land, open space, and forestland, and also offer tax incentives for redevelopment and infill development, including mediating brownfields and constructing affordable housing. The property tax incentives used include preferential assessments; tax abatements, exemptions, or credits; and tax increment financing. Zoning and other land use regulations are the primary tools used by states and local governments to control development and curb urban sprawl.

Assessment of Telecommunications Companies. Mr. Michael Duster, Legislative Services Agency, summarized a research memorandum briefly describing the method by which states located in the Midwest assess the property of telecommunications companies for purposes of property taxation. Mr. Duster highlighted the difficulty many states are having in responding to the rapid service delivery changes in this industry.

Iowa Policy Project. Dr. Peter Fisher and Research Associate Beth Pearson reviewed their policy paper on city revenue and smart growth. They emphasized the need for cities to balance economic development by ensuring that this development is sustainable, responsible, and fair. Current development strategies used by cities forego the possibility of regional cooperation and planning and are resulting in economic competition between localities. When a city utilizes property taxes as economic development incentives, it reduces its tax-generating ability, and this often results in a disproportionately negative effect on the budgets of low-income persons. The following sources of revenue could be utilized by cities as an alternative to property taxes: (1) local option sales tax; (2) hotel/motel tax; (3) utility franchise tax; (4) local alcohol, cigarette, and tobacco excise taxes; (5) gambling taxes; and (6) local option income tax. Dr. Fisher averred that the most progressive and sustainable of these is the local option income tax.

Local Governments' Ability to Respond to Natural Disasters.

City of Cedar Rapids. Mayor Pro-Tem Brian Fagan and City Manager Jim Prosser described the magnitude of the summer flooding in Cedar Rapids and its effect on citizens, property, and city government. There is a great need for construction and reconstruction of housing and business and government buildings. Seventy-two percent of the city's general fund is supported by property taxes. The loss in property tax value due to the flood is estimated to be $81.7 million. They stated that the city cannot afford to support its recovery and rebuilding efforts within the existing state policies regarding funding for economic development. Current city debt limits are likely to curtail the ability of Cedar Rapids to reinvest in infrastructure, and the current state formula for funding transportation does not reflect the cost to maintain roads in regional centers like Cedar Rapids. Also, Cedar Rapids must be able to continue to offer property tax incentives, like tax increment financing, in order to compete nationally and internationally for commercial and industrial development. The loss in property valuations due to the flooding makes it difficult to utilize this economic development tool.

Linn County. Ms. Dawn Jindrich, Linn County Budget Director, stated that Linn County does not have the general fund money available for repair or replacement of county buildings damaged during the flooding, and Federal Emergency Management Agency money will not be adequate. The county will experience a county jail revenue loss of $3 million because of the inability to house prisoners there. There will also be a decrease in property tax collections due to flood-damaged buildings. Ms. Jindrich recommended that the current project cost limits on nonreferendum bond issuances be raised, that the reverse referendum requirement for authorization to use local option sales tax to retire debt be suspended, and that the maximum local hotel/motel tax rate be raised. Committee member Lu Barron, who is a Linn County Supervisor, distributed information on the effects of the flooding and provided a list of flood-related services provided by Linn County.

Local Governments' Fiscal Flexibility in Responding to Natural Disasters/Emergencies.

City Perspective. Mr. Alan Kemp, Executive Director, Iowa League of Cities, provided a variety of statistical information on Iowa city budgets. On average, general fund expenditures for all cities are comprised of expenditures on public safety (44 percent), culture and recreation (20 percent), general government administration (14 percent), public works (12 percent), health and social services (4 percent), community and economic development (4 percent), and capital projects (2 percent). On average, property taxes account for 52 percent of a city's general fund revenues. He stated that 784 of Iowa's 947 cities are at their $8.10 general fund property tax levy limit, and 334 cities are utilizing their emergency levy. Mr. Kemp outlined several proposals for statutory and regulatory changes related to debt issuance, contracting for emergency repairs, and city budgetary requirements in times of emergency. He concluded by stating that cities should have alternative revenue options in order to decrease the reliance on property taxes and to allow individual cities to determine the most appropriate revenue alternative for their community.

County Perspective. Jay Syverson, Fiscal Analyst, Iowa State Association of Counties, reviewed the current statutory authorizations that counties may utilize in responding to natural disasters or other emergencies. A county may abate or suspend payment of property taxes any time if the board of supervisors determines that the person is "unable to contribute to the public revenue" and may abate property taxes on property destroyed by natural disaster or other unavoidable casualty to the extent that insurance does not cover the loss. He recommended several statutory changes, relating primarily to debt issuance, that would allow counties more flexibility to respond to, and recover from, natural disasters/emergencies. He also proposed other statutory changes affecting county budgets, including authorization of a local option income tax, repeal of sales tax increment financing, and increased state funding for mental health services.

Committee Discussion. The Committee instructed Legislative Services Agency staff to communicate with the property tax study consultants on the direction of their research in anticipation of the Final Report to be issued on December 30. Staff was also instructed to communicate with interest groups on prioritizing the recommendations they have made to the Committee.

Next Meeting. The fifth, and last, meeting of the Committee is scheduled for Wednesday, January 7, 2009.

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