Iowa Fiscal Partnership

BACKGROUNDER

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Tying Local Governments' Hands

House bill limits more than taxes, stripping local authority

As House and Senate negotiators discuss plans to roll back the rate at which commercial and industrial property taxes are assessed, they should recognize how a poorly drawn proposal can prevent city and county elected officials from fulfilling their responsibilities to their citizens.

Provisions of an amendment (H-1735) proposed by the House Ways and Means Committee and adopted in the House-passed Omnibus Budget Bill (House File 697) would direct a commercial and industrial property tax rollback that has serious flaws.[1] Not the least of the flaws is the fact that the House passed the rollback with a provision to include replacement funds for revenues lost, but did not assure that sufficient replacement funds would be provided — and did not make such funding a condition of the rollback. However, the legislation goes further, severely restricting the amount of revenue city and county governments can raise in the future regardless of locally elected officials' and the public's views of local needs.

The Proposal

Present law limits the rates at which city and county governments can tax property; this amendment would end the current limits (for example, the $8.10 general fund levy limit for cities) and substitute a limit on the growth in property tax dollars that city and county governments could raise from one fiscal year to the next. Revenue growth would be limited by a formula: an "annual growth factor" based on the Consumer Price Index (CPI).

In addition, the city could also collect that new rate on the taxable value of new construction. In theory, this allows revenues to increase along with costs and with growth. The limit on revenue growth does not apply to debt service levies nor to most trust and agency levies; these levy rates are not limited under current law because they must be set at whatever rate is required to satisfy legal obligations (to repay general obligation bonds or to fund pensions, for example), and the new law would not change that treatment.

> **How House plan is designed**
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> Consider, as an example, a city that collected $1 million in general fund property taxes in FY2012 with the $8.10 levy. If the Consumer Price Index rose by 2 percent (the annual growth factor), the city would be limited to raising $1.02 million in general fund taxes in FY2013. (2 percent more than in FY2012) The city general fund levy would then be set at whatever rate produced $1.02 million in taxes on FY13 valuation, excluding new construction; that rate could be higher or lower than the former $8.10 rate limit.

Flawed Formula Ignores Costs of Services

This formula is flawed, vastly underestimating the yearly growth in costs faced by county and local governments.[2] The CPI tracks the prices of a basket of goods and services purchased by households. However, only a small portion of city and county budgets is spent on such goods and services. County and local government budgets are largely driven by personnel costs. The cost of hiring workers has increased faster than inflation as health-care costs have skyrocketed. Between 2000 and 2010, the CPI increased by over 26 percent; the state and local governments' price index increased by more than 44 percent over the same period.[3]

The amendment further limits city and local governments' ability to raise revenue by capping the annual growth factor at 4 percent. Since 2000, the CPI has not once exceeded 4 percent; however, the state and local governments' price index has exceeded 4 percent six times over the same period.[4] Using the CPI is a mistake.

Additionally, the formula does not recognize rapid population growth. Though not an issue in much of Iowa, the 2010 Census revealed that there are cities in Iowa experiencing rapid population growth.[5] This is particularly problematic in areas that experience rapid growth in the number of service-dependent populations, such as young children or the elderly.

Finally, the proposed formula would create incentives for local governments to engage in "fiscal zoning," encouraging only high-value property that brings with it few people and few additional demands on services. Zoning permits for homes likely to attract parents with young children or housing for low-income residents would put the locality at a fiscal disadvantage under the restrictions in the amended HF697. Thus, under the new limits, the local government might try to restrict such property.

Hamstringing Ability to Respond to New Demands

As localities grow, they begin to take on new responsibilities. At some point a volunteer fire department may be converted to a professional department, an airport may be established, a community center or a swimming pool may be built for the first time. The state or federal government may impose new requirements on local governments that necessitate additional staff. As the general standard of living has risen over the past several decades, the quality and variety of public services that people come to expect has changed: New libraries are approved by voters; bike trails are built; indoor famers' markets are established; mental health services are offered. Local governments do much more for their citizens now than they did in 1950.

Subjecting local governments to a cookie-cutter formula to determine how much they can spend hamstrings their ability to respond to new demands, or to strive for ways to excel or be special. The formula assumes that localities 50 years from now should be doing exactly what they do now, nothing more, regardless of societal changes and the changing demands on cities as they grow. This formula puts local governments in a time capsule and eliminates the ability of local elected officials to respond to the demands and needs of their constituents. It is a "big brother" approach — it assumes that state officials know better what citizens need than city councils and boards of supervisors and the people who elect them.

Limiting Local Communities' Ability to Succeed

Limiting local officials' ability to raise revenues limits their ability to serve and be accountable to their constituents. To this end, the experience of a state that has enacted local tax revenue caps is instructive. Massachusetts enacted a local government property tax cap in 1980. Though communities could override the tax cap (and many have), communities in the Bay State have seen an erosion of local services.[6] After failing to override the property tax cap, Massachusetts' cities and towns have been forced to lay off teachers, firefighters and police officers. Elementary schools, senior centers and libraries have been shut down as a result of the caps.

The amended Omnibus Budget Bill would allow cities and counties to hold special elections for voters to determine whether the city or county government may exceed the revenue cap for up to two years. However, Massachusetts experience with overrides demonstrates that this only exacerbates inequities in public services between higher- and lower-income cities and counties.[7] A study of Massachusetts' property tax overrides revealed that they were attempted more and were more likely to succeed in higher-income areas than in lower-income areas, increasing the "likelihood that an individual's access to local government resources would be determined by her household wealth and the kind of community she inhabits."[8]

Conclusion

While state and local officials debate the merits of a commercial and industrial property tax rollback, the property tax revenue limitations in the House bill potentially hold the greatest long-term significance. City and county governments' ability to meet new responsibilities in the future would be severely restricted by the House limitations. If rising commercial and industrial property tax rates are the animating concern behind the plan, they should be dealt with in ways that do not produce negative consequences elsewhere. Legislators have other tools to mitigate this problem, such as property-tax circuit breakers, which provide rebates to homeowners or commercial establishments whose taxes exceed a certain portion of their income.[9] Many politicians believe the government closest to the people governs best, but they forget that rhetoric when they choose to unnecessarily tie the hands of local officials in meeting local needs.

[1] Iowa Fiscal Partnership statement, June 6, 2011. <http://www.iowafiscal.org/2011research/110607-IFP-statement-HF697.html>

[2] HF691. <http://coolice.legis.state.ia.us/Cool-ICE/default.asp?Category=billinfo&Service=Billbook&menu=false&hbill=hf691>.

[3] Iowa Fiscal Partnership calculations of Consumer Price Index for all Urban Consumers (CPI-U) and National Income and Product Accounts (NIPA) price index for state and local governments.

[4] Iowa Fiscal Partnership calculations of CPI-U and NIPA price index for state and local governments.

[5] Waukee, North Liberty, Fairfax, and Shueyville all grew by 130 percent or more between 2000 and 2010. See Rick Smith, "NEW DATA: Urban growth still outpacing rural Iowa," *The Gazette* (Cedar Rapids), February 10, 2011. <http://thegazette.com/2011/02/10/cedar-rapids-iowas-fastest-growing-city-census-data-shows/>.

[6] Phil Oliff and Iris J. Lav, "Hidden Consequences: Lessons from Massachusetts for States Considering a Property Tax Cap," Center on Budget and Policy Priorities, May 21, 2008. <http://www.cbpp.org/archiveSite/5-21-08sfp.pdf>.

[7] Karen Lyons and Iris J. Lav, "The Problem with Property Tax Revenue Caps," Center on Budget and Policy Priorities, June 21, 2007. <http://www.cbpp.org/files/6-21-07sfp.pdf>.

[8] Phil Oliff and Iris J. Lav, "Hidden Consequences: Lessons from Massachusetts for States Considering a Property Tax Cap," Center on Budget and Policy Priorities, May 21, 2008. <http://www.cbpp.org/archiveSite/5-21-08sfp.pdf>.

[9] Karen Lyons, Sarah Farkas, and Nicholas Johnson, "The Property Tax Circuit Breaker: An Introduction and Survey of Current Programs," Center on Budget and Policy Priorities, March 21, 2007. <http://www.cbpp.org/cms/?fa=view&id=51>