Legislative Services Agency

FINAL REPORT

Legislative Property Tax Study Committee

January 2009

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Mr. Charles Krogmeier, Department of Management
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AUTHORIZATION AND APPOINTMENT

The Legislative Property Tax Study Committee was established by the Legislative Council for the 2007 and 2008 Legislative Interims to "perform a comprehensive review of the property tax system. The Study Committee may contract for analysis or other services. The cost for such contracting shall not exceed $150,000."

I. Committee Proceedings

The Committee was authorized to meet three days during the 2007 Legislative Interim and two days during the 2008 Legislative Interim. The Committee met on September 12, 2007; November 7, 2007; December 5, 2007; November 14, 2008; and January 7, 2009, at the State Capitol, Des Moines, Iowa.

In 2008, the Committee retained consultants from the Institute for Public Policy at George Washington University to study property taxation and other forms of revenue generation used by local governments in Iowa and other states.

II. September 12, 2007, Meeting

Assessment of Property. Mr. Dale Hyman, Administrator of the Property Tax Division in the Department of Revenue, made a presentation on assessment of property for taxation purposes. The presentation included information on the assessment calendar, qualifications and continuing education of assessors, and duties of assessors and the Department of Revenue pertaining to assessment of property. Mr. Hyman also presented information relating to statewide assessed valuation changes by class of property for the 2007 assessment year and predictions for the 2009 and 2011 assessment years. He provided an explanation of the capitalization of agricultural income for purposes of the productivity formula, and discussed the issue of the market value to productivity value ratio that is applied to agricultural building values. The goals of the Property Tax Division are fewer equalization orders, more assessor revaluation, and open communication to county officers and taxpayers.

Urban Renewal and Tax Increment Financing (TIF). Mr. Mike Albers, Local Government Division of the Department of Management, and Mr. Jeff Robinson, Senior Legislative Analyst with the Legislative Services Agency, made a joint presentation to the Committee on urban renewal and TIF. Mr. Albers explained how urban renewal areas and incremental valuations are established, the growth in incremental valuation over the years, types of local governments utilizing TIF, how assessment limitations (rollbacks) are applied in urban renewal areas, statutory limitations on urban renewal areas and on the use of incremental revenues, and certification to county auditors of urban renewal debt payable with TIF revenues.

Mr. Robinson provided detailed financial information on the use of TIF, including historical trends in the amount of property tax dollars devoted to economic development through TIF and historical trends on the impact that TIF has had on state school aid. Mr. Robinson also distributed information on recent increases in the in the amount of TIF revenue collected and recent increases in urban renewal debt reported as outstanding. To provide perspective on the use of urban renewal areas and TIF as an economic development tool, Mr. Robinson distributed information showing comparative rates of growth in Iowa economic indicators.

Local Revenue Sources and Cost of Government. Mr. Jim Prosser, Cedar Rapids City Manager, discussed in general the factors that affect state and local tax policy and the negative impact of Iowa local governments' overreliance on property taxes. He then used specific facts about property taxes in Cedar Rapids to illustrate that negative impact. Mr. Prosser presented some "best practices" that need to be utilized by cities in regards to local government revenue sources and cost of government, including developing sustainable development and in-fill development policies and diversifying revenue sources to meet city needs and costs and to lower the property tax burden on commercial and industrial property.

School Finance. Mr. Jim Addy, Administrator of the Division of School Support and Information in the Department of Education, provided an overview of how K-12 education is financed in Iowa. Mr. Addy also described the school foundation formula and the role of school district property tax collections in the formula. For FY 2004-2005 public school general fund revenues, on average, were comprised of 57.4 percent state funds, 37.4 percent local property taxes, and 5.2 percent federal funds. Mr. Addy also described current statutory efforts aimed at providing additional state aid to those school districts whose additional property tax levy rate under the school foundation formula greatly exceeds the average additional property tax levy rate under the formula.

III. November 7, 2007, Meeting

Taxation of Assisted Living Facilities. Dr. Cindy Baddeloo, Iowa Health Care Association, and Ms. Jeanine Chartier, owner and operator of assisted living facilities in Lawton and Holstein, spoke to the Committee about the fiscal problems associated with assisted living facilities being classified as commercial property for property taxation purposes. Dr. Baddeloo stated that property taxes comprise $100 to $200 of the monthly assisted living rates charged to residents. She noted that a number of residents receive Medicaid assistance which means their income is about $600 per month. Ms. Chartier noted that many of the residents at the two assisted living facilities that she owns and operates are paying more in property taxes at the facilities than they did when they lived in their homes. Both Dr. Baddeloo and Ms. Chartier recommended that assisted living facilities be classified as residential property for property tax purposes.

MH/MR/DD Funding. Mr. Charles Leist and Mr. Jim Overland, both representing the Division of Mental Health and Disability Services in the Department of Human Services, described the sources of funding for adult mental health, mental retardation, and developmental disabilities (MH/MR/DD) services, with the lion's share of funding being from the federal government.

Ms. Linda Hinton, Government Relations Manager, Iowa State Association of Counties (ISAC), gave an overview of the legislative history of MH/MR/DD funding. She also presented information on the responsibilities of counties in providing human services, the most current MH/MR/DD levy rates by county, and historical information on county MH/MR/DD fund balances. Ms. Hinton briefly described an Iowa MH/MR/DD system redesign proposal adopted by ISAC. Any system redesign undertaken by the state must include adequate state funding to support the changes. On the local funding level, ISAC recommends that the dollar cap on county levies for MH/MR/DD services be replaced with a levy rate cap. The ISAC also recommends allowing counties to move to an "equalized" property tax contribution specific to each county's current levy rate for MH/MR/DD services.

Iowa League of Cities. Mayor Jim Fausett, Coralville, and Mr. Alan Kemp, acting Executive Director, Iowa League of Cities, presented the top four legislative priorities of the league. The first priority is to authorize cities to implement alternative revenue choices that fit the specific needs of the city, including but not limited to increasing the hotel/motel tax, imposing gas and electric franchise fees for general purposes, and implementing a sales tax rebate for specifically defined economic development. The second priority is increased funding for transportation and water/wastewater infrastructure needs of cities. The third priority is to preserve or expand economic development initiatives available to cities at the state level through programs such as Vision Iowa, Great Places, and Community Attractions funding and to prevent any changes to urban renewal law (tax increment financing or TIF) that would impair its use as an economic development tool. The fourth legislative priority is to control public pension costs, particularly by limiting any increased requirements imposed upon local governments by the state. Mr. Kemp provided the Committee with a great deal of fiscal information showing cities' heavy reliance on property taxes for general fund revenues, general fund revenues and expenditures by city size, and use of TIF by city size.

Rollback History. Mr. Robinson, Senior Legislative Analyst, LSA, gave a brief history of economic changes over time, the historical share of taxable value by class, the percent of value due to new construction since 1988, and the growth in the use of tax increment financing since FY 1981-1982. He focused primarily, though, on the history and impact of the assessment limitation (rollback), particularly the assessment limitation tie between agricultural and residential property. Mr. Robinson illustrated for the Committee what the taxes on a residence and on a parcel of commercial property would be if there had not been an assessment limitation tie between agricultural and residential property, and the actual amount of taxes on those two properties under current law. He noted that the residential property taxes would be much higher if not for the assessment limitation tie. Mr. Robinson also provided projections on the residential rollback and on future taxable value growth among agricultural, residential, commercial, and industrial property.

Private Developer Perspective. Ms. Loree Miles, President, Miles Properties, LLC, discussed the impact of property taxes from the perspective of a private developer of commercial property. She has developed commercial property in California, Colorado, and Iowa (metro Des Moines area). She noted that development impact fees in Colorado and California are numerous and costly; in Iowa such fees are limited in number and extremely inexpensive. However, the property taxes assessed in Colorado and California are relatively low compared to Iowa. She stated that developers of commercial property favor paying high impact fees upfront, rather than an annual high property tax bill, because those impact fees can be capitalized as the initial cost of development and the developing finance costs are eventually retired. She said it also makes more sense for local governments to charge high impact fees to cover the cost of infrastructure necessitated by development, rather than collecting revenue slowly over time through property taxes. Ms. Miles provided the Committee with examples of the types of impact fees charged in Colorado and California.

City of Des Moines Perspective. Mr. Richard Clark, City Manager, stated that there are many reasons for Des Moines' high tax rate relative to surrounding suburban communities, including high demand for professional police and fire services, reduction in state appropriations over time, the large amount of exempt property located in Des Moines, the cost of supporting an aging infrastructure, and Des Moines' lower average residential valuations. He outlined for the Committee many of the actions taken by the city to reduce property taxes. The action taken that had the biggest impact was to raise the franchise fee. This accounted for $14.1 million annually, resulting in a 70-cent reduction in the city's property tax rate. Des Moines relies too heavily on property taxes, he said, noting that property taxes comprise 58 percent of the general fund and debt service funding sources of the city. He provided examples showing that this is a much larger percentage than of other cities of comparable size around the country. He noted that residents of Des Moines surveyed indicated that property tax is the least preferred method to pay for city services, while user fees and sales tax are the most preferred methods. Mr. Clark stated that the method of financing local government in Iowa must be changed by diversifying revenue streams, providing incentives for consolidating services, and encouraging smart growth development initiatives. In the short-term, however, he urged enactment of legislation affirming a city's authority to impose a franchise fee on gas and electric consumption.

Local Economic Development Panel. A panel comprised of representatives from the cities of Council Bluffs, Coralville, Humboldt, and Des Moines related their experiences in undertaking economic development activities in each of their cities.

- For the city of Council Bluffs, Mayor Tom Hanafan and Mr. Donald Gross, Community Development Director, described the project which brought Google to Council Bluffs. The project utilized TIF and the High Quality Job Creation Program. Mr. Gross described other urban renewal projects in the city and the amount of TIF involved in those projects. He noted that the property tax disparity between Iowa and Nebraska has negatively affected Council Bluffs' economic development efforts.
- Mr. Kelly Hayworth, Coralville City Administrator, described the extensive brownfield redevelopment undertaken by the city as part of its economic development and revitalization efforts at Coralville's Iowa River Landing. Coralville utilized TIF, revenue bonds, and general obligation bonds, in addition to state and federal funding, for redevelopment of the land in the project to an entertainment, retail, and residential district. Cleanup of 160 acres of brownfields was a major aspect of the project. Brownfields are idled, abandoned, or underused industrial and commercial property whose resale or redevelopment has been hindered by known or suspected environmental contamination at the site. He stated that over the past six years the federal and state government have invested over $16 million for acquisition, assessment, and clean-up of brownfield sites in Iowa. He described state brownfield incentives in Missouri, Wisconsin, and Michigan.
- Ms. Lorie Bennett, Humboldt City Administrator, stated that 80 percent of economic growth in the county comes from the expansion of current industries within the county. For purposes of economic development, the city of Humboldt utilizes state programs, such as High Quality Job Creation Program, Enterprise Zones, and Revitalize Iowa's Sound Economy (RISE) Programs, in addition to local incentives and the United States Department of Agriculture’s rural development programs. Tax increment financing is the largest tool in Humboldt's economic development toolbox. Tax increment financing is used for infrastructure improvements, brownfields cleanup, residential development, and to provide rebates on property taxes after completion of a project. She noted that the affected school district, county, and community college have all supported Humboldt's

use of TIF because of the long-term benefit to all of these entities of the higher taxable valuation created by the development.

- Mr. Clark outlined the key issues affecting Des Moines' economic development efforts. The cost of development is high in older urban centers because of the cost of land assemblage and relocation, demolition, environmental remediation, structured parking, vertical construction, and rehabilitation/restoration of existing buildings. Even with these high costs, urban center development is more desirable than greenfield development because urban center development takes advantage of existing infrastructure and other public and private investments in the area. At the local level, Des Moines provides financial assistance to development through use of TIF and tax abatement, infrastructure assistance, reduced land prices, and parking. He noted that TIF is the single most important economic development tool available to cities. Mr. Clark stated that a statewide policy needs to be developed that helps sustain and rebuild older urban centers. This policy needs to include continued ability to use TIF, more collaboration among the various public entities providing economic development assistance, a commitment by the state not to give preference in the award of state incentives to businesses that are relocating from one Iowa city to another Iowa city, and continued and expanded use of "fair play agreements" among cities in a region.

IV. December 5, 2007, Meeting

Sales and Use Tax Exemptions. Mr. David Casey, Administrator, Compliance Division, Department of Revenue, provided information relating to Iowa's sales and use tax exemptions, including exemptions related to the sale of services, and the estimated cost, in lost revenue, of providing certain exemptions.

Assessment of Agricultural Property. Mr. Hyman, Administrator, Property Tax Division, Department of Revenue, reviewed the results of a survey of local assessors regarding assessment of agricultural buildings and changes to assessments that have occurred subsequent to adoption of a 2005 administrative rule requiring that agricultural buildings be assessed at the same ratio of market value to productivity value, expressed as a percentage, that is applied to agricultural land. Mr. Hyman stated that the primary concern of the department is uniformity of assessment among assessors.

Mr. Tim Johnson, Research Specialist, Iowa Farm Bureau Federation, outlined the current method of valuing agricultural property for purposes of property taxation. Agricultural property is valued based on a productivity formula which involves computation of five years of data on income (yield times acres times crop price plus certain government payments) and expenses, such as crop inputs, fertilizer costs, insurance, and taxes, capitalized at a statutory rate of seven percent. For illustrative purposes, Mr. Johnson provided fiscal information on the taxes paid on a 400-acre farm in Palo Alto County. Fiscal year 2007-2008 taxes on the land and buildings of such a farm will exceed $13,000.

Mr. William Greazel, Johnson County Assessor, testified on the problems with the productivity formula for assessing agricultural property, particularly livestock confinement feeding buildings. Mr. Greazel stated that after application of the agricultural factor to the replacement cost of a building and after subtracting the value of the pollution control exemption, if granted, livestock confinement buildings are assessed at 10 to 15 percent of replacement cost. He recommended that a study of the true productivity of agricultural buildings be initiated and utilized. He stated that this would result in a more equitable distribution of the costs for services between the livestock intensive entities and the grain producers.

Commercial Valuation Process. Mr. Greazel stated that the income approach should be the preferred method when valuing commercial property with the understanding that all three approaches have their utility and, when possible, all three should be used in the valuation process. The benefit of the income approach over a market adjusted cost approach is that it gives weight to obsolescence, depreciation, entrepreneurial profit, vacancy, and extraordinary cost. It also factors the effective property tax rate into the capitalization rate of the net operating income of the property.

Impact Fees. Ms. Flora Schmidt and Mr. Ted Grob testified on behalf of the Homebuilders Association of Iowa. Ms. Schmidt provided data on beneficial effects to the overall economy of a strong housing market. A strong housing market means increased jobs and wages in the community, purchase of materials within the community, and an increase in the property tax base, the sales tax base, and the income tax base. Ms. Schmidt stated that regulatory fees and impact fees are passed on directly to the homeowner and a home price increase of just $5,000 would cause over 23,300 Iowans to be priced out of buying a home at the median Iowa value of $95,901. Mr. Grob noted that there is a correlation between high impact fees and high housing prices in other states. He stated that allowing more impact fees to be charged in Iowa will set in motion a very large tax increase in Iowa and will impede growth.

Mr. Patrick Murphy, representing the Iowa Association of Realtors, echoed the comments of Ms. Schmidt and Mr. Grob, stating that houses under $250,000 are selling robustly in the Des Moines metro area and increased impact fees will take affordable housing out of the picture for many people. He stated that, rather than focusing on ways to increase local government revenue, it is time for the state to take a look at government expenditures and consolidation of services between local governments.

Iowa State Association of Counties (ISAC). Mr. Jay Syverson, Fiscal Analyst, and Ms. Hinton, Government Relations Manager, presented to the Committee on ISAC's legislative priorities related to property tax. These include changes to the laws on tax increment financing (urban renewal) and tax abatement (urban revitalization), mental health funding, assessment of agricultural buildings, condominiums, and certain cablevision property, flood and erosion control levies, manufactured home taxes, and authorizing a local option income tax. The overall effect of enactment of these priorities would be to stabilize the tax base, improve the fairness of the tax base, increase accountability for local governments, and impose a reasonable limit on local property taxes.

Association of Business and Industry (ABI). Mr. William Brown, Treasurer, ABI Board of Directors, stated that ABI members and the business community at large understand and appreciate the necessity of property tax collection to pay for municipal services and for education of Iowa's children. However, the growth in property taxes - $1 billion over the last decade - is of great concern to the business community because it hinders economic and population growth. The ABI recommends eliminating and/or merging political subdivisions and programs, eliminating the shift in tax burden between classes of property, requiring local governments to fund property-related services first, requiring city councils and boards of supervisors, when raising taxes, to vote separately from the vote on the budget, abolishing the county compensation board and requiring the board of supervisors to set elected officials' salaries, and enacting a spending limitation for all political subdivisions.

Taxation of Telecommunications Industry. Mr. Brian Pappaducas, Manager of Tax and Financial Analysis for Iowa Telecom, Mr. Andy Randol, General Manager of Panora Communications Cooperative and Board President of Rural Iowa Independent Telephone Association, and Ms. Kristin Kunert, Director of Government Relations, Iowa Telecommunications Association, testified about the lack of equity and fairness in property taxation of communications providers in Iowa. They noted the disparity of property tax burdens within the communications industry, with wireless services paying $3.50 per cell phone per year, cable TV services paying $12.42 per subscriber per year, and telephone companies paying $40.32 per phone line per year. Furthermore, because of the outmoded method of assessing property of telecommunications companies, the companies are assessed at approximately 350 percent of their market value. The telecommunications providers recommended that the property of telecommunications providers in Iowa be assessed and taxed the same as all other commercial property.

V. November 14, 2008, Meeting

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. 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, Legal Counsel, 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. 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. Mr. 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.

VI. January 7, 2009, Meeting

Consultants' Final Report on the Property Tax Study. Dr. Bell and Dr. Brunori, both research professors of public policy at George Washington University, and Ms. 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, Senior Legislative Analyst, 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. 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.

VII. 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.

VIII. Materials Filed With the Legislative Services Agency

The following materials listed were distributed at or in connection with the five meetings of the Legislative Property Tax Study Committee and are on file with the Legislative Services Agency. The materials may be accessed from the <Additional Information> link on the Committee's Internet webpage:

http://www.legis.state.ia.us/aspx/Committees/Committee.aspx?id=209

1. 1/7/2009 – Recommendations Approved by Legislative Property Tax Study Committee.
2. 1/7/2009 – Iowa Property Tax Study Final Report – Powerpoint Presentation – George Washington Institute of Public Policy.
3. 1/7/2009 – Local Income Surtaxes Powerpoint Presentation – Legislative Services Agency.
4. 1/7/2009 – Overview of 2009 Assessment Trends – Iowa Department of Revenue.
5. 11/14/2008 – Iowa Property Tax Study November Presentation – George Washington Institute of Public Policy.
6. 11/14/2008 – Executive Summary – City Revenue and Smart Growth – The Iowa Policy Project.
7. 11/14/2008 – City Revenue and Smart Growth – The Iowa Policy Project.
8. 11/14/2008 – Local Governments' Ability to Respond to Natural Disasters/Emergencies – City of Cedar Rapids.
9. 11/14/2008 – Local Governments' Ability to Respond to Natural Disasters/Emergencies – Linn County.
10. 11/14/2008 – Linn County Flood Fact Sheet – County Supervisor Lu Barron.
11. 11/14/2008 – City Fiscal Flexibility in Responding to Natural Disasters/Emergencies – Iowa League of Cities.

12. 11/14/2008 – County Fiscal Flexibility in Responding to Natural Disasters/Emergencies – Iowa State Association of Counties.
13. 12/5/2007 – Iowa Sales and Use Tax Law – Department of Revenue.
14. 12/5/2007 – Sales and Use Tax Exemptions – Department of Revenue.
15. 12/5/2007 – Taxable and Exempt Services by Category – Department of Revenue.
16. 12/5/2007 – Sales and Use Tax Exemptions Expenditures – Department of Revenue.
17. 12/5/2007 – Assessment of Agricultural Property – Iowa Farm Bureau Federation.
18. 12/5/2007 – Property Assessment Issues – William Greazel, Johnson County Assessor.
19. 12/5/2007 – Iowa Housing Market Data and Impact Fees – Home Builders Association of Iowa.
20. 12/5/2007 – Legislative Proposals Related to Property Taxes – Iowa State Association of Counties.
21. 12/5/2007 – Iowa Association of Business and Industry – Testimony of William Brown.
22. 12/5/2007 – Iowa Telecommunications Association – Property Taxation of Communication Providers.
23. 12/5/2007 – FY 2007-2008 Property Taxes by County – Iowa State Association of Counties.
24. 12/5/2007 – FY 2005-2006 County Local Option Sales Tax Revenues – Iowa State Association of Counties.
25. 11/7/2007 – 2007 Legislation Summaries – Legislative Services Agency.
26. 11/7/2007 – LOST Revenues by City – Legislative Services Agency.
27. 11/7/2007 – City Nonproperty Tax Revenue – Department of Management.
28. 11/7/2007 – Taxation of Assisted Living Facilities – Dr. Baddeloo and Jeanine Chartier Presentation.
29. 11/7/2007 – MH/MR/DD Funding Report – Charles Leist and Jim Overland Presentation.
30. 11/7/2007 – 2006 County MH/MR/DD Expenditures Chart.
31. 11/7/2007 – MH/MR/DD Funding – Iowa State Association of Counties – Linda Hinton Presentation.
32. 11/7/2007 – Iowa Property Taxes – Iowa League of Cities – Mayor Jim Fausett and Alan Kemp Presentation.

33. 11/7/2007 – City of Humboldt Budget – Iowa League of Cities Presentation.
34. 11/7/2007 – Rollback - Past and Future – Jeff Robinson, LSA, Presentation.
35. 11/7/2007 – Private Commercial Developer Perspective – Loree Miles Presentation.
36. 11/7/2007 – City of Des Moines Property Taxes – Richard Clark Presentation.
37. 11/7/2007 – Local Economic Development Panel – Council Bluffs – Mayor Hanafan and Don Gross.
38. 11/7/2007 – Local Economic Development Panel – Coralville – Kelly Hayworth Presentation.
39. 11/7/2007 – Local Economic Development Panel – Humboldt – Lorie Bennett Presentation.
40. 11/7/2007 – Local Economic Development Panel – Des Moines – Richard Clark Presentation.
41. 9/12/2007 – Public Member Statement – Margaret Buckton.
42. 9/12/2007 – Public Member Statement – Joanne Mangold.
43. 9/12/2007 – Public Member Statement – Tom Zucker.
44. 9/12/2007 – Public Member Statement – Terry Wegener.
45. 9/12/2007 – Public Member Statement – Tim Johnson.
46. 9/12/2007 – Public Member Statement – Christine Hensley.
47. 9/12/2007 – Assessment of Property – Dale Hyman Presentation.
48. 9/12/2007 – Urban Renewal and Tax Increment Financing – Mike Albers, Department of Management, Presentation.
49. 9/12/2007 – Urban Renewal and Tax Increment Financing – Jeff Robinson, LSA, Presentation.
50. 9/12/2007 – Local Revenue Sources and Cost of Government – Jim Prosser Presentation.
51. 9/12/2007 – School Finance Overview – Jim Addy, Department of Education, Presentation.

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