Prepared Comments Regarding H.B. 1004
Gary Malone, CPA
December 9, 2009

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to speak today regarding H.B. 1004.

My name is Gary Malone. I am a CPA and a Partner with H.J. Umbaugh & Associates, Certified Public Accountants, LLP located in Indianapolis. Our firm serves as independent financial advisors to several cities, towns, counties, schools and libraries throughout Indiana.

The Indiana Association of Cities & Towns and the Association of Indiana Counties have asked us to review H.B. 1004 and offer our comments as to the possible fiscal impact of the Bill to local governments.

H.B. 1004 provides new limits on the growth of local property taxes by limiting the growth in assessed value of homeowners to 1% annually and the growth in assessed value of other residential property owners, agricultural land and long-term care facilities to 2% annually. There are no limits in the growth in assessed values from other types of property owners. These limits relate to changes in value due to trending, and not improvements to the property.

By limiting the growth in assessed value, this Bill, in effect, expands the circuit breaker tax caps which become effective for all taxpayers beginning with property taxes payable this year. The circuit breaker tax caps limit the amount of a property tax bill to a fixed percentage of the assessed value of the property. This Bill would limit the rate of growth in the amount of the property tax bill, once the circuit breaker limit is reached.

In other words, once a homeowner's property tax bill reaches 1% of the assessed value of the property; the taxpayer bill could not increase by more than 1% each year thereafter.

To help illustrate the effect of HB 1004, we have prepared a comparison of property tax rates and property tax bills where the growth in assessed value is not limited, assuming both property tax levies and property tax assessments grow at the same rate, with property tax rates and property tax bills where the growth in assessed value is limited. These illustrations are summarized in your handouts.

The comparison illustrates that if growth in assessed values does not keep pace with the growth in property tax levies, property tax rates will increase. By limiting the growth in assessed value for certain taxpayers, future property tax rates and property tax bills for other taxpayers will be higher than they otherwise would have been.

Since the assessed values for different classes of property are subject to different growth limits or no limits at all, the property tax burden will be shifted from taxpayers with residential, agricultural and long-term care properties to taxpayers with commercial and industrial property.

(This same shifting occurs whenever the assessment of any group of taxpayers is limited while others are not.)

As mentioned earlier, the circuit breaker tax caps limit the total property tax bill to a fixed percentage of a property's assessed value. HB 1004 will affect these tax caps in a couple of ways. First, property tax rates will be higher, so more taxpayers will reach the circuit breaker limits. Secondly, the circuit breaker tax limits will grow more slowly, allowing more property taxpayers to reach the circuit breaker tax caps over time.

The combination of higher property tax rates and the slower growth in assessed values and related circuit breaker tax limits will increase the number of property taxpayers reaching the circuit breaker tax caps and reduce the rate of growth in property tax revenues collected by taxing units to fund local services. If you recall the LSA data estimate of Circuit Breaker impacts and revenue losses, these revenue losses would be increased, especially in heavily residential and agricultural areas.

Once a property taxpayer reaches the maximum property tax cap, the growth in property tax revenues from that taxpayer will be limited to the growth in assessed value of their property. If we limit the annual growth in assessed value to only one or two percent, then it is likely that the growth in property taxes paid by that taxpayer will be less than the increased cost to provide services to that taxpayer. This is simply because the increase in the property tax bills will be less than the rate of inflation in most years. This will make it difficult for local governments to continue to provide the same level of services they now provide unless other revenues are used to replace the additional revenues lost.

While HB 1004 limits the growth in assessed value for homeowners, other residential taxpayers, agricultural land and long-term care facilities, it doesn't limit the amount of reduction in assessed value that might occur.

If a property assessment is reduced in a given year due to economic conditions, it will likely never be assessed at its full market value when economic conditions reverse and property values recover. For instance, if a property's value declines by 10% in one year due to poor economic conditions and returns to its original value two years later, it could never be assessed at its full market value if we limit future increases to 1% per year.

If the market value of homes in Indiana increases by more than 1% annually, limiting growth in assessed value for homeowners to 1% annually will eventually result in property owners with different property tax assessments for homes with identical market values. For example, if a homeowner purchased his / her home ten years ago for $100,000 and the value of the property increased by 3% annually, it would have a market value today of $134,000. If we had limited the growth in the assessment to 1% annually over this period of time, its assessed value today would only be $110,000. If another taxpayer purchased an identical home at today's market value of $134,000, its assessed value would be $134,000. So we could have two homes with the same market value, but with two very different assessments.

Finally, general obligation bonding capacity is based upon the assessed value of the taxing unit. Limiting growth in assessed values also limits the growth in borrowing capacity as well. While this doesn't limit a taxing unit's ability to borrow, it does lead to the use of more expensive financing techniques, such as lease financings that are not included as general obligation debt.

This concludes my testimony. Thank you once again for the opportunity to speak. I would be happy to answer any questions.

HB 1004

Illustrative Impact of Proposed Changes to Assessed Value Growth

December 7, 2009

Gary Malone, CPA

Changes in Property Tax Rates When Assessed Values and Levies Grow at the Same Rate

	Without Growth	Illustrative Growth Factor	With Growth
Property Tax Levies	$20,000,000	3.0%	$20,600,000
Assessed Values	$1,000,000,000	3.0%	$1,030,000,000
Property Tax Rate	$2.00		$2.00

Typical Homestead Assessment

	Without Growth	With 3% Growth
Assessed Value	$125,000	$128,750
Less Homestead Deduction	($45,000)	($45,000)
Less Supplemental Homestead Deduction (35%)	($28,000)	($29,313)
Less Mortgage Deduction	($3,000)	($3,000)
Net Assessed Value	$49,000	$51,438

Typical Homestead Property Tax Bills When Assessed Values and Levies Grow at the Same Rate

	Homesteads	With 3% Growth
Net Assessed Values	$49,000	$51,438
Property Tax Rate	$2.00	$2.00
Property Tax Bill, before Circuit Breaker Tax Credit	$980	$1,029
Circuit Breaker Tax Credit	$0	$0
Net Property Tax Bill	$980	$1,029
Percentage Increase		5.0%

Typical Other Residential Property Tax Bills When Assessed Values and Levies Grow at the Same Rate

	Other Residential *	With 3% Growth
Net Assessed Values	$100,000	$103,000
Property Tax Rate	$2.00	$2.00
Property Tax Bill, before Circuit Breaker Tax Credit	$2,000	$2,060
Circuit Breaker Tax Credit	$0	$0
Net Property Tax Bill	$2,000	$2,060
Percentage Increase		3.0%

* Includes Agricultural Land and Long-Term Care Facilities.

Typical Commercial and Industrial Property Tax Bills When Assessed Values and Levies Grow at the Same Rate

	Commercial & Industrial	**With 3% Growth**
Net Assessed Values	$250,000	$257,500
Property Tax Rate	$2.00	$2.00
Property Tax Bill, before Circuit Breaker Tax Credit	$5,000	$5,150
Circuit Breaker Tax Credit	$0	$0
Net Property Tax Bill	$5,000	$5,150
Percentage Increase		3.0%

Changes in Property Tax Rates When Assessed Values Grow Slower than Levies

	Without Growth	Illustrative Growth Factor	With Growth
Property Tax Levies	$20,000,000	3.0%	$20,600,000
Assessed Values	$1,000,000,000	1.5%	$1,015,000,000
Property Tax Rate	$2.00		$2.03

Typical Homestead Assessment

	Without Growth	With 1% Growth
Assessed Value	$125,000	$126,250
Less Homestead Deduction	($45,000)	($45,000)
Less Supplemental Homestead Deduction (35%)	($28,000)	($28,438)
Less Mortgage Deduction	($3,000)	($3,000)
Net Assessed Value	$49,000	$49,812

Typical Homestead Property Tax Bills When Assessed Values Grow at a Slower Rate

	Homesteads	With 1% Growth
Net Assessed Values	$49,000	$49,812
Property Tax Rate	$2.00	$2.03
Property Tax Bill, before Circuit Breaker Tax Credit	$980	$1,011
Circuit Breaker Tax Credit	$0	$0
Net Property Tax Bill	$980	$1,011
Percentage Increase		3.2%

Typical Other Residential Property Tax Bills When Assessed Values Grow at a Slower Rate

	Other Residential *	With 2% Growth
Net Assessed Values	$100,000	$102,000
Property Tax Rate	$2.00	$2.03
Property Tax Bill, before Circuit Breaker Tax Credit	$2,000	$2,071
Circuit Breaker Tax Credit	$0	$31
Net Property Tax Bill	$2,000	$2,040
Percentage Increase		2.0%

* Includes Agricultural Land and Long-Term Care Facilities.

Typical Commercial and Industrial Property Tax Bills When Assessed Values Grow at a Slower Rate

	Commercial & Industrial	With 3% Growth
Net Assessed Values	$250,000	$257,500
Property Tax Rate	$2.00	$2.03
Property Tax Bill, before Circuit Breaker Tax Credit	$5,000	$5,227
Circuit Breaker Tax Credit	$0	$0
Net Property Tax Bill	$5,000	$5,227
Percentage Increase		4.5%

Possible Consequences of Limiting Growth in Assessed Value for Certain Classes of Taxpayers

- If growth in assessed values do not keep pace with the growth in property tax levies, property tax rates will increase. By limiting the growth in assessed value, future property tax rates will be higher.
- Since some classes of taxpayers would be subject to different growth limits and others with no limits, the property tax burden would be shifted to commercial and industrial property taxpayers. The result occurs from reducing assessments of any group of taxpayers.
- As property tax rates rise, more taxpayers will reach the property tax caps, further limiting property tax revenues available to support local services.

Possible Consequences of Limiting Growth in Assessed Value for Certain Classes of Taxpayers

- Limits on the growth in assessed value means that property tax limits will grow more slowly allowing a greater number of taxpayers to reach the property tax caps and a greater portion of their tax bill will be reduced by circuit breaker tax credits, further reducing the growth in property tax revenue for local governments.
- If growth in assessed value is less than the rate of inflation, then the growth in property taxes will likely be less than the rate of inflation over time.

Possible Consequences of Limiting Growth in Assessed Value for Certain Classes of Taxpayers

- While HB 1004 limits growth in assessed value for homeowners and other residential taxpayers, including agricultural land and long-term care facilities, it doesn't limit the amount of reduction in assessed value that might occur.
  - For instance, if a property assessment was reduced by 10% in one year due to current economic conditions, it would likely never be assessed at its market value when the conditions reversed and property values began to recover. This will result in different property tax bills for properties with identical market values.

Possible Consequences of Limiting Growth in Assessed Value for Certain Classes of Taxpayers

- General obligation bonding capacity is based upon assessed value of the taxing unit. Limiting growth in assessed values limits growth in borrowing capacity as well.
  - This leads to the use of more expensive financing techniques, such as leases, etc.
- Certain bond rating agencies have expressed concern over the property tax caps in Indiana. Should bond ratings fall, the cost of borrowing will increase.