

Outlook on Local Revenues: Optimism or Out-of-Luck?

Summit on Local Government Sustainability
Presentation by
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Economic Outlook

- The great recession is over, long live the great recession!
- This means, we are not out of the grip of the recession and may not be for quite some time

Economic Outlook

- Employment will likely continue to decline until the middle of 2010
- Continued declining employment will keep retail activity from rebounding in the near term
- Inflation will continue to be tame

Economic Outlook

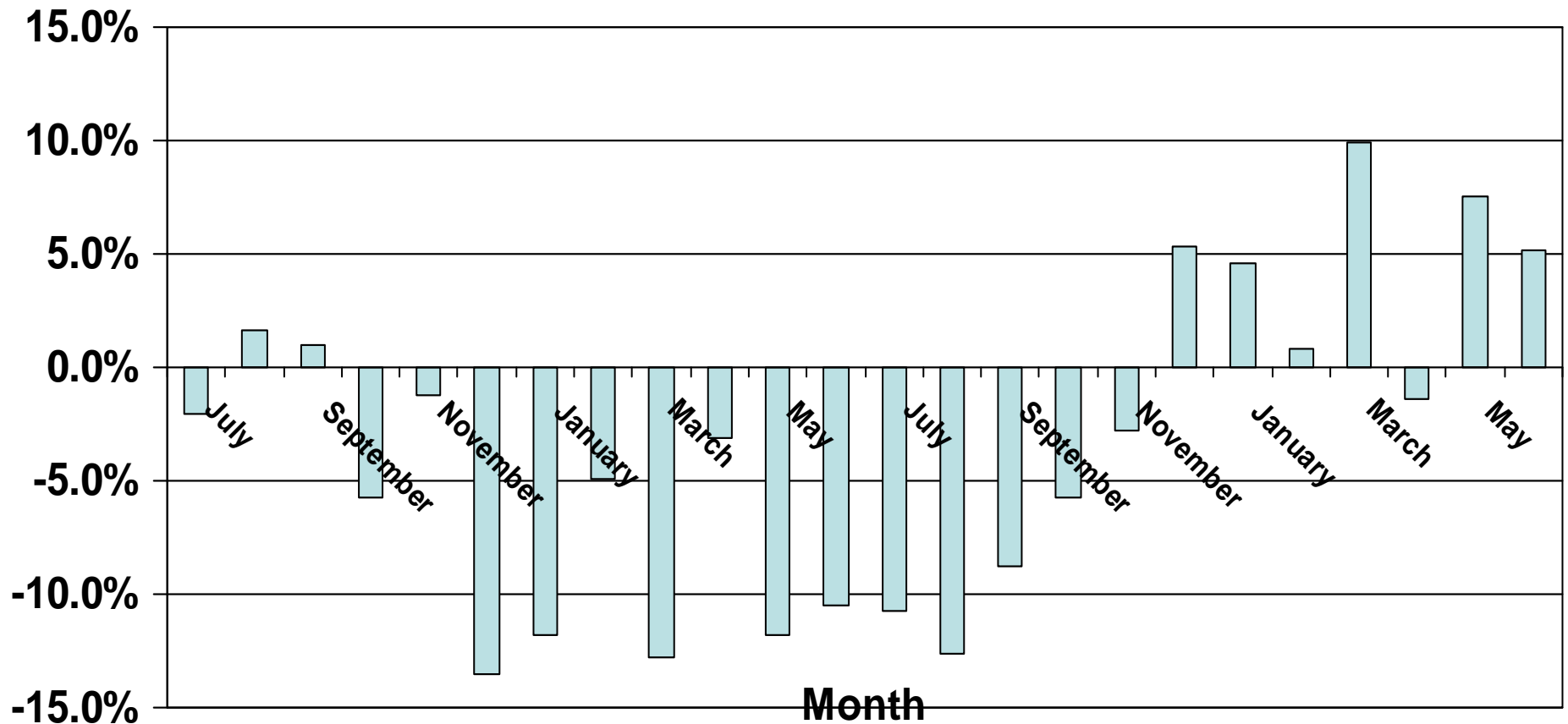
- Preliminary numbers show GDP nationally grew 3.5 percent in the third quarter.
- The fourth quarter is expected to show similar rates of growth
- Much of this growth has been driven by the federal stimulus program

Economic Outlook

- As federal stimulus spending fades, GDP growth will moderate
- Overall, the consensus among economists is that the recovery will be a weak one, especially given how far and fast the economy declined during the recession

Revenue Outlook

Year over Year Percent Change in Auto Sales Tax Collections, July 2008 - October 2009 Actuals, November 2009 - June 2010 Estimates

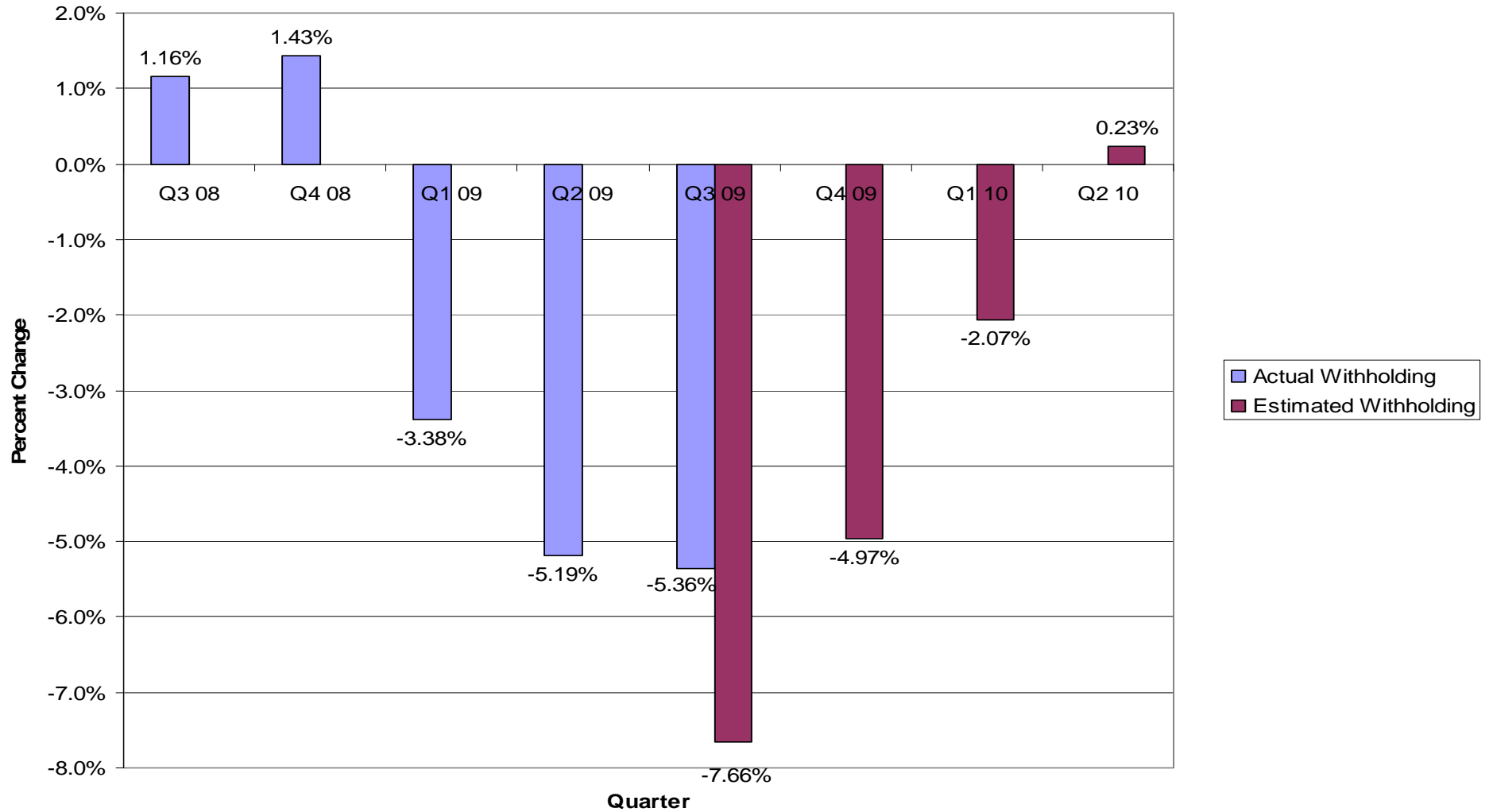


Revenue Outlook

- We expect November to be the last month with year-over-year declines
- Beginning in December, we will be coming off prior year months that already had huge declines
- In addition, revenue from the new medical providers tax provisions begin being remitted in December

Revenue Outlook

Percent Year-Over-Year Change in Quarterly Withholding Adjusted for State Rate Cut



Revenue Outlook

- State withholding drops have been just over 5% the last two quarters
- We expect the drops to remain near the 5% level through this quarter
- Beginning in 2010, the drops moderate, coming off large decline the previous year

Revenue Outlook

- In the second quarter of 2010, withholding is expected to be flat, consistent with the employment forecast discussed earlier
- Slow growth should begin in the second half of next year

Property Values

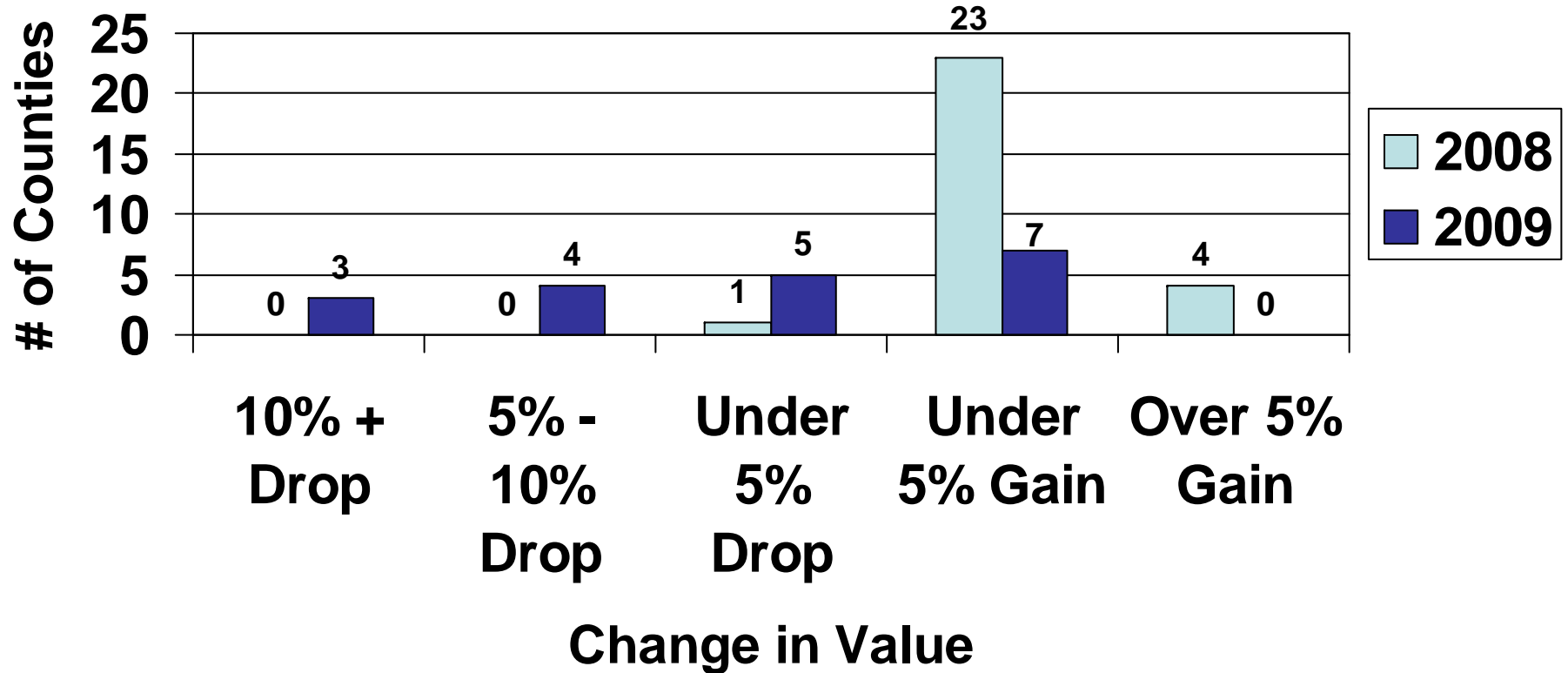
- Real property values in Ohio are updated every three years, either through reappraisal or triennial update
- Values reflect the impacts of changes in activity over the prior three years
- So for counties in 2009 reappraisals or updates, we would look at activity in 2006-2008

Property Values

- Not surprisingly, in general values have been declining
- However, because of the three-year averaging, it takes longer for the negative values to work their way into taxable values
- The averaging also means it will take longer for the resumption in growth in values to work its way into taxable values

Property Values

Changes in Residential Values in Triennial Update Counties



Only 1 of the 7 counties with a gain in 2009 is above 1.5%, compared to 13 of the 23 in 2008.

Property Values

- How long it takes for taxable values to begin growing again will depend on when housing price declines bottom
- Parts of the state have seen some growth in housing sales prices over the last few months

Property Values

- Some of that growth is likely from demand spurred by the first time home-buyers credit, which is expiring and may not be renewed
- The moratorium on foreclosures may also be keeping sales prices from declining
- If the credit expires and the moratorium is lifted, there are fears that home prices may again begin to drop in early 2010

Property Values

- Even if prices have now bottomed, it will likely not be until tax year 2013 (taxes paid in 2014) before there will be any growth in values
- If prices begin to fall again next year, the time horizon for growth would be pushed out even further

Property Taxes

- In general, taxes on inside millage will decline at the same rate at valuations
- The same is true for municipalities with charter millage, which works just like inside millage
- For voted tax levies, tax reduction factors do work in reverse

Property Taxes

- As real property values are growing, tax reduction factors cause the effective tax rate to decline to prevent tax increases; if valuations are declining, effective millage rates are increased to prevent tax decreases
- So taxpayers whose values decrease will generally see a smaller percentage decline in tax liability than their decline in taxable value

Local Government Fund & Public Library Fund

- LGF and PLF are the state's primary "general purpose" revenue sharing funds
- Funds were "frozen" July 2001 to December 2007 (no growth)
- Starting CY 2008, state LGF and PLF receive a dedicated percentage of state GRF tax revenues: 3.68% for LGF; 2.22% for PLF (decreased to 1.97% in FY10-11 as part of current state budget)
- Distributions are made monthly to each county undivided LGF and PLF; such amounts are distributed by the county among eligible subdivisions. (Note: A small portion of the LGF is distributed directly from the state LGF to most municipalities.)

Local Government Fund & Public Library Fund

- LGRAF repealed beginning in CY 2008 – essentially consolidated into the LGF
- LGF distribution formula – two components:
 - “Base formula”: Each county fund’s share of total state LGF distributions is based on its percentage share of combined CY 2007 LGF and LGRAF distributions.
 - “Excess formula”: Once total LGF distributions exceed their CY 2007 level, such “excess” distributions are allocated based on each county’s share of population.
- PLF distribution formula: Statutory formula went back into effect after the “freeze” expired

Local Government Fund & Public Library Fund

- Decline in state tax revenues during the recession have led to decline in LGF distributions (figures below are in millions)

	LGF Dist	yr-yr % change
Act 2007	\$757	--
Act 2008	746	-1.4%
Est 2009	638	-14.5%
Est 2010	628	-1.5%

Local Government Fund & Public Library Fund

- Decline in state tax revenues and reduction in funding percentage have led to decline in PLF distributions (figures below are in millions)

	PLF Dist	yr-yr % change
Act 2007	\$458	--
Act 2008	451	-1.6%
Est 2009	370	-17.9%
Est 2010	336	-9.1%

Local Government Fund & Public Library Fund

- If state GRF tax revenue projections hold up, the LGF and PLF distributions for CY 2009 and 2010 will perform reasonably close to the estimates shown here
- Proposed “freeze” in state income tax rates to balance the budget is not included in the 2010 distribution estimates
- Distribution estimates for CY 2011 will not be issued until July 2010

Estate Tax

- 80% of estate tax revenue goes to the locality in which a decedent's assets are located (mostly to decedent's place of residence)
- In total, municipalities and townships receive \$200 mil to \$250 mil per year from estate tax
- Localities have greatly varying levels of dependence on the estate tax – see estate tax study produced by Dept of Taxation at:

http://tax.ohio.gov/channels/research/documents/A_Distributional_Analysis_of_Ohio_Estate_Tax.pdf

Estate Tax

- Efforts by some parties to repeal the Ohio estate tax.
- HB 326 (Hottinger) would allow local voters to exempt that community's estates from the estate tax.
- A group is gathering signatures for an initiative petition (entitled the "Ohio Estate Tax Elimination Act) to be presented to the General Assembly. The act would repeal the estate tax beginning in CY 2013. If the act is not enacted within four months, an additional petition may be circulated to put the issue on the state ballot.

Casino Gross Receipts Tax

- The passage of Issue 3 on Nov 3 allows four casinos to be located in Ohio
- Once operational, the casinos will pay a 33% tax on their “gross casino revenue” (GCR is total proceeds net of payouts)
- Dept. of Taxation estimates the tax will generate just over \$643 million in annual revenue (assuming all four casinos are in operation and there are no VLTs at racetracks)

Casino Gross Receipts Tax

- 51% of tax revenue goes to counties based on population. (In counties whose largest city has over 80,000 residents, one-half of the county distribution is provided to that city.)
- 34% of tax revenue to school districts
- 5% of each casino's tax revenue provided to its host city
- Remaining 10% for various purposes

Casino Gross Receipts Tax

- General Assembly will need to enact legislation to provide statutory authority for the casino licensing & regulatory structure and for the casino gross receipts tax
- Casinos will be regulated by the Ohio Casino Control Commission
- Upfront \$50 million casino license fee – proceeds to be used for regional job training efforts

Tangible Personal Property Tax Replacement Payments

- Tangible personal property tax on general taxpayers was phased-out starting in 2006 - fully repealed in tax year 2009. (Telephone property also phased-out, on a slightly different timeline; all other utility property remains taxable.)
- TPP tax repeal is a centerpiece of tax reform legislation enacted in 2005 – HB 66
- As the tax was phased-out through 2009, “replacement” payments were phased-in; this is followed by phase-out over seven-year period

Tangible Personal Property Tax Replacement Payments

- Payments provided to each local jurisdiction begin with the “base year amount”: tax year 2004 values multiplied by qualifying tax levies
- As the tax was phased-out, the payments were phased-in – accomplished by multiplying the “base year amount” by a percentage which is the difference between the pre-HB 66 assessment rate and the HB 66 assessment rate
- To implement the payment phase-out, a “reimbursement rate” is applied to the above-described computations (100% through FY 2011, declining thereafter)

Tangible Personal Property Tax Replacement Payments

- Payments made in May, August, and October
- Payments sent by the state to county auditors who forward the proper amounts to jurisdictions
- “Full” replacement payments through May 2011
- Replacement payments (on levies still in place) phase-out thereafter, with final payment made in October 2018
- Note that school districts are guaranteed to receive 70% of CAT revenue; a method for allocating this revenue (the portion remaining after the replacement payments are made) has not yet been determined

Tangible Personal Property Tax Replacement Payments

- Payments are primarily funded by commercial activity tax (CAT) revenue, with subsidy from the GRF if needed
- To reiterate: the payments are guaranteed, and are not dependent on the amount of CAT revenue collected
- In the current biennium, CAT revenue will not be sufficient to cover the payments, requiring a significant GRF subsidy

Tangible Personal Property Tax Replacement Payments

- Enacted budget bill for current biennium (HB 1, enacted July 2009) contained a provision to permanently continue the full reimbursement payments
- This provision was vetoed by Governor Strickland
- We expect to work with local government associations to look at the impact of the phase-out on local governments and examine various options to address those impacts within the context of constrained state finances

Conclusion

- Will local revenues breed optimism or more “bad luck” over the next few years?
- Barring an unforeseen renewed downturn, there is increased evidence that the economy has bottomed out, and has already begun a recovery
- But unemployment remains a major issue
- The challenge to craft realistic revenue forecasts continues. That said, the “freefall” is over, and the current expectation is that revenues will remain fairly stagnant through mid-2010, followed by a modest upward trajectory

Conclusion

- Additional tax information and data available on Dept of Taxation web site:
www.tax.ohio.gov
- Questions?