STATE MANDATES: HOW DO THEY IMPACT PROPERTY TAXES?

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I. Introduction

Nebraska is facing an opportunity and a political challenge. As of November 2014, the state's cash reserve fund balance stood at $707 million, or about 16.7 percent of the general fund.[1] Nebraska is well on its way to expanding that cushion, with the Nebraska Economic Forecasting Advisory Board projecting that reserves will grow to a record $769 million by the end of the current fiscal year.[2] This surplus will inevitably draw an assortment of stakeholders to the table during budget-making to discuss uses for spending down excess reserves. Some will want to increase spending on state programs, but a growing number of advocates are looking at the fund as a means for providing refunds to property owners for the high property taxes to which they are subject. The focus of this paper is to understand some of the reasons why property taxes are so high in the first place. Specifically, this report examines mandated programs and spending for which the financial burden falls on counties. While there are numerous mandates originating from higher levels of government, and these burdens fall on a variety of local government entities, this report chiefly investigates mandates from the State of Nebraska on county governments.

In recent years, the Nebraska Legislature has examined a variety of tax reform options, some of which were relegated to a legislative committee for further study, and some of which have been enacted as law. Interim study findings confirm that there is significant concern in Nebraska over high property taxes. This concern is justifiable. Nebraskans pay more in property taxes than a majority of the nation and pay a much larger percentage of their home value in property taxes than all but a few states (see Section II). However, the property tax has historically been seen as a good way to raise revenue for local governments because it is reliable and stable.

A fundamental question that must be answered is whether or not property taxes in Nebraska are too high. Property taxes currently average 1.76% of home value, which translates to $2,164.00.[3] The answer to whether that level of taxation is excessive, as with any complex policy issue, will likely depend on what group is

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[1] Young, JoAnne. "Forecasters predict growth to Nebraska economy." *Lincoln Journal-Star*. November 1, 2014. [URL: http://journalstar.com/legislature/forecasters-predict-growth-to-nebraska-economy/article_c98b8757-486c-5843-a810-33d18fd94fba.html]

[2] Stoddard, Martha. "State's tax receipts projected to top $9 billion." *Omaha World-Herald*. November 1, 2014. [URL: http://www.omaha.com/news/nebraska/state-s-tax-receipts-projected-to-top-billion/article_f0c0b95e-c603-580a-adcd-b6b8183a1032.html]

[3] The highest average is in Sarpy county at $3,281.00, or 2.07 percent of median home value. The lowest average is in Grant country at $800, or 1.95 percent of median home value. This is the 5th highest property tax by value of the 50 states and the 14th highest of the 50 states by percentage of income. *See* Tax-rates.org [URL: http://www.tax-rates.org/nebraska/property-tax]

providing the answer. In Nebraska, the interests of property owners are often discussed in terms of two broad cohorts of taxpayers: residential, commercial, and industrial property owners, and property owners whose land is used for agriculture. Alternatively one might distinguish between individuals living in owner-occupied housing, in contrast with those who reside in non-owner-occupied housing, a distinction more useful in the densely populated areas like Omaha and Lincoln. Each of these groups will have distinct interests. All too often, related tax policy debates are carried out under the assumption that relief for one group can only come at the expense of another.

If taxes were to generate revenue in excess of budgeted expenditures, as a rule of thumb, policymakers should consider lowering the rate of taxation to avoid any unnecessary burden on taxpayers. Unfortunately for property owners, the more routine discussion by local officials is about how to raise additional local revenue to cover expenses. A 2014 Nebraska Department of Revenue report indicated that of Nebraska's 93 counties, 89 saw a property tax increase in 2013, with an average growth of more than five percent.[4]

Even in years for which actual revenues do yield a surplus over budgeted expenses, officials worry that lean years are yet to come. Combined with existing controls on local authority to raise taxes, this means that local entities have the incentive to generate surpluses when years are good and spend them down during lean years. The incentives at play here help explain much of the popularity of tax rebates as an alternative to lowering rates when public coffers are flush with cash. Because all local governments have mandated expenditures from the state and federal government that put pressure on local government finances, complaints to local policymakers about high local property taxes are often deflected. The answer too often heard by concerned taxpayers is that high property taxes are not the result of discretionary local spending but rather spending mandated by the state.

In the following paper, we will explore the state of property taxes in Nebraska by comparing the policy to other states. We will also discuss the mandated spending that local governments face in Nebraska. After a brief discussion of the implications of these policies for state governments in general, we will discuss our recommendations for lawmakers in Nebraska who wish construct a more responsible model for carrying out essential government functions while best avoiding negative unintended consequences.

In this discussion of mandated spending, the overriding goal is to provide an estimate for how much local government spending in Nebraska is mandated by some higher level of government and how much of the spending is attributable to

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[4] Stoddard, Martha and Faiz Siddiqui. "Report shows property taxes up in much of Nebraska." *Omaha World-Herald*. January 17, 2014. [URL: http://www.omaha.com/news/report-shows-property-taxes-up-in-much-of-nebraska/article_fd0cfc98-855c-5817-a75e-d6c92911b20d.html]

local decision-making. While estimates of spending related to unfunded mandates is an important first step, it is entirely possible that some local spending currently mandated by the state or federal governments would take place even without the mandates. For this reason, it cannot be assumed that removal of a particular mandate would correspond perfectly with a subsequent reduction in spending at the local level. This paper will not and cannot address precisely what local government spending would look like without mandated spending.

Instead, this report attempts to provide clarity as to how much county spending is comprised of mandated spending, and consequently how much responsibility for high property taxes is properly assigned to state and local lawmakers respectively. While it is useful to catalog and quantify federal mandates, Nebraskans have much more direct control over mandates coming from their own state legislature. For that reason, this paper focuses primarily on the latter.

II. Property Taxes in Nebraska Compared with other States

Nebraska has long relied heavily on property taxes to fund local government operations, including expenditures on schools. Property taxes are a stable source of revenue as long as real estate values are constant or increasing at a steady rate. If revenue is growing faster than spending, this either gives leeway for increased and targeted spending, or this allows for rate cuts to slow down the revenue generated. In the past, local property tax rate-setting authority was more flexible, but since FY 1998-1999 levy limits were imposed on "all political subdivisions with authority to levy a property tax."[5] This means that local revenue collection is limited, and local government instead came to rely to a greater extent on various forms of state aid. As in other states, property tax increases have also been limited in terms of the percentage increase that may be imposed. Because property taxes are a principal source of local government revenue, policymakers have been reluctant to further tinker with how property taxes are set by local authorities.

The option of leaving in place the property tax status quo is unlikely to satisfy Nebraskans for much longer. As expenditure commitments are rising across all levels of government, there is much discussion of various strategies for reforming taxation and spending policy in Nebraska. Property taxes as a source of revenue are a big part of the story.

Revenue:

Nebraska raises 41 percent of its tax revenue at the state level from income tax, 33 percent sales tax, 16 percent from excise taxes, and 4 percent from corporate

[5] "Major Tax Policy Trends: The Shift from Property Tax Support to Sales and Income Tax Support of State and Local Government." Revenue Committee. Nebraska Legislature. 2007. [URL: http://www.legislature.ne.gov/app_rev/source/proptax_trendsshift.htm]

income taxes. For local governments, the revenue picture looks very different; the property tax accounts for 79 percent of tax revenue.[6] Nebraska's policy will be affected by the 1998 legislation to cap local levies on property tax. At the time of that legislation, revenue beyond this amount was expected to come from state aid to local governments.[7] However, during the 2011 budget crisis the Nebraska Legislature rolled back provisions providing state aid to counties but did not meaningfully reduce mandates that exert upward pressure on local spending.[8]

Nebraska property taxes at a glance: [9]

- Nebraska ranks 16th highest of 48 in 2010 property taxes per capita at $1,487
- Average property tax for the 48 states in 2010 — $1,275.36 — implies Nebraska is 116.6% of the 2010 average.
- Average for the 15 states ahead of Nebraska — $1,928.87 — 77%
- Average for the 31 states below Nebraska — $1,010.55 — 138.2%
- Nebraska ranks 18th of 50 in 2010 share of state and local revenue from property tax at 36.8%
- The 17 highest shares of 50 state property tax average at 43.15%
- The lowest 31 lowest shares of 50 state property tax average at 28.67%

In addition to these state and local taxes, Nebraska's federal tax bill for taxpayers paying individual income tax in 2012 was almost $15.9 billion, collected from over 874,000 taxpayer returns.[10]

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[6] Henchman, Joseph and Scott Drenkard (2013). "Building on Success: A Guide to Fair, Simple, Pro-Growth Tax Reform for Nebraska." Joint publication: Tax Foundation and The Platte Institute. October 2013. Accessed September 10, 2014: http://www.platteinstitute.org/Library/docLib/20131002_Building_on_Success_Final_Low_Res.pdf

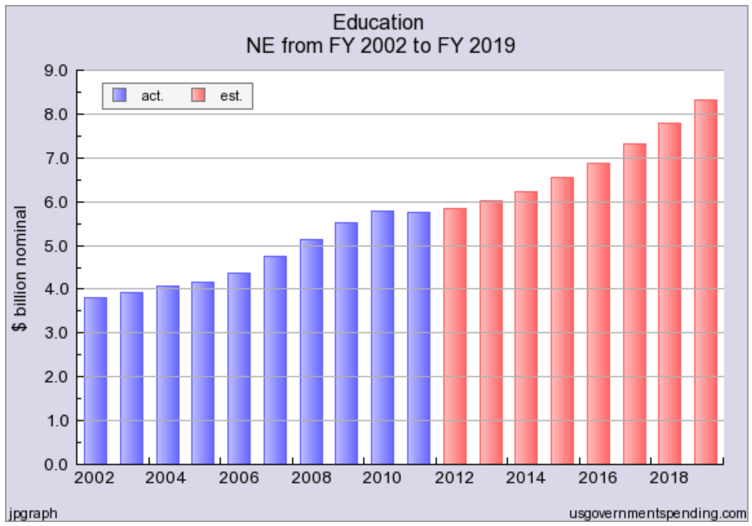
[7] "Major Tax Policy Trends: The Shift from Property Tax Support to Sales and Income Tax Support of State and Local Government."

[8] Hammel, Paul. "Legislature willing to look at ideas that could help reduce property taxes." *Omaha World-Herald*. October 6, 2014. [URL: http://www.omaha.com/news/metro/legislature-willing-to-look-at-ideas-that-could-help-reduce/article_d4d2c183-e108-5d8b-aea7-f84c9bdcb284.html]

[9] Estimates in this list are compiled from the Tax Foundation website: http://taxfoundation.org

Spending:

In Nebraska, $7.05 billion was spent by the state in 2012 compared with $12.46 billion by local governments the same year. This is roughly $3,800 per capita at the state level and $6,730 per person at the local level. Of the total collected, $5.85 billion was spent on education alone, a per capita expenditure of approximately $3,250.[11] Growth in education spending is shown in table one below:



These spending rates, both the actual in blue and the projected in red are showing a reality that existing educational revenues, which are capped at $1.05 per $100 of taxable value, will soon fail to meet these obligations.[12] Currently there are levy limits in Nebraska on school districts or multi-district schools that prevent the rate from rising. The amount of tax revenue may also increase if the underlying property value increases, unless the rates are lowered. The revenue might also change if changes are made to the rate at which the taxable value is set or to the method of estimating market value. Nebraska currently sets agricultural land value at 75% of fair market value, but recent bills propose lowering this rate.[13]

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[10] "Internal Revenue Service Data Book." Internal Revenue Service. Department of the Treasury 2013. *See* Table 3 for number of filers and Table 5 for the total collections.

[11] http://www.usgovernmentspending.com/spending_chart_2002_2019NEb_15c1li111lcn_20c -- population estimate 1.855 million.

[12] "Major Tax Policy Trends: The Shift from Property Tax Support to Sales and Income Tax Support of State and Local Government."

[13] Examples of bills with related proposals introduced in Nebraska in 2014 include LB 670, LB 721, and LB 813. *See* "Bills of Interest in the 104th Legislative Session." Platte Institute for Economic Research. January 23, 2014. [URL:

Table 1 below shows local government spending in Nebraska by function, according to the most recent data from the Census Bureau for Fiscal Year 2011 (dollar amounts in thousands).

Table 1: Local Spending in Nebraska (Expressed in Thousands)[14]

Education	$4,000,635	32.2%
Utilities	$3,977,116	32.0%
Environment and Housing	$897,672	7.2%
Social Services and Income Maintenance	$835,596	6.7%
Transportation	$656,080	5.3%
Public Safety	$635,325	5.1%
Governmental Administration	$390,733	3.1%
Interest on General Debt	$277,090	2.2%
Employee Retirement	$239,866	1.9%
not elsewhere classified	$520,093	4.2%
Total Local Expenditures	$12,430,206	

This paper seeks to better understand how much of each of the categories in Table 1 are required by mandates from higher levels of government. Doing so provides an estimate for the upper limit by which property taxes could be lowered in absence of these mandates, realizing that many local governments may continue certain spending even without being required by the state to do so.

Federal spending is also relevant to this, because as budgets become tight at the federal level more and more pressure can be felt on budgets at the local level. Currently, direct federal spending is disbursed to 470,000 residents of Nebraska. These categories and amounts are enumerated below in Table 2. Many of these programs are eroding in value as monetary inflation lowers the real value of the assistance received. This reduces the effectiveness of the programs and creates pressure to shift responsibility for some additional portion of this assistance to Nebraska taxpayers.

http://www.platteinstitute.org/research/detail/bills-of-interest-in-the-104th-legislative-session]

[14] US Census Bureau, "2011 Annual Surveys of State and Local Government Finances."

Table 2: Federal Spending in Nebraska[15]

Social Security Retirement Benefits	$2,688,000,000	35.28%
Social Security Disability Benefits	$578,000,000	7.59%
Temporary Assistance for needy Families (TANF)	$59,000,000	0.77%
Low Income Energy Assistance	$44,000,000	0.58%
Supplemental Nutritional Assistance Program (SNAP)	$244,000,000	3.2%
School Lunches and Breakfasts	$110,000,000	1.44%
Child Care and Adult Care Food Assistance	$600,000	0.01%
Supplemental Food for Women Infants and Children	$33,000,000	0.43%
Medicare, Parts A&B	$2,196,000,000	28.82%
Medicaid	$1,410,000,000	18.5%
State Children's Insurance Program	$55,000,000	0.72%
Head Start	$42,000,000	0.55%
Pell Grants	$149,000,000	1.96%
Supplemental Educational Opportunity	$4,000,000	0.05%
Vocational Education	$7,000,000	0.09%
TOTAL	$3,369,000,000	

III. Mandated Spending in Nebraska

Mandates are often intended to create equivalent conditions for citizens between jurisdictions. When this appeal to equity becomes state policy, it means that a higher level of government sets standards that have to be met by its political subdivisions. That some uniformity ought exist between different parts of the same state or country is an idea with broad appeal, but mandates must be considered at least in part in terms of how they are funded. Each mandate falls into one of two general categories: Funded mandates are specifically tied to an expenditure at the level of government where the mandate is imposed. Unfunded mandates are those that must be followed even without financial support from the authority imposing them, or with support that is insufficient to cover the costs of the mandated activity. A state that requires operation of an after-school program but does not earmark spending in the budget to pay for it will create an unfunded mandate on the local government entity charged with operating that program. Federal mandates for many programs, such as Medicaid, come with funding already earmarked. Such federal mandates include provision for a variety of activities, including programs relating to general civil rights, discrimination, emergency aid (disaster relief),

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[15] "How does Federal Spending Benefit Nebraska?" Friends Committee on National Legislation. 2012. [URL: http://fcnl.org/pdfs/issues/budget/Nebraska- Field.pdf]

mandatory auditing procedures, homeland security, and Social Security and Disability.

Federal programs set mandated levels of either spending or outcome that then has to be met by states. As federal budgets decrease, either by explicit cuts or by failure to inflation-adjust, the funding obligations for states tend to rise. In January 2013, the proposed budget submitted by Governor Dave Heineman addressed the impact on Nebraska of one class of federal mandate in particular, directives from the federal government relating to the administration of Medicaid:

> "The most significant challenge in enacting a biennial budget for 2013–2015 will be the financing of the Medicaid program in Nebraska. I have placed the highest priority on financing education, but the requirements presented by the current Medicaid program and the implications of new federal mandates cause an explosive demand for state resources."[16]

While Federal mandates are important to catalog, Nebraskans have little control over most of these. But Nebraskans do have a great deal of control over mandates imposed by the Nebraska Legislature on counties on Nebraska. These mandates create a burden on local taxpayers, whether they want the service or not, and must be funded primarily by increasing local property taxes.

To examine mandated spending by the state of Nebraska on county governments, three counties were selected to represent Nebraska's counties. Douglas County, as the largest by population in the state, was chosen to represent urban counties. We chose two counties to represent rural counties: Butler and Sheridan.[17] Butler was chosen because its population is closest mean population of all rural Nebraska counties. Sheridan was chosen because its population is the median among rural counties.[18]

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[16] "Executive Budget in Brief: 2013–2015 Biennium." Administrative Services – State Budget Division. State of Nebraska. January 15, 2013. p. 6. [URL: http://budget.nebraska.gov/das_budget/budget13/brief.pdf]

[17] We define "rural" counties as all counties outside of Nebraska's four metropolitan-statistical areas, as defined by OMB (Omaha-Council Bluffs, Lincoln, Sioux City, and Grand Island).

[18] Technically the median is the average of the populations of Sheridan and Polk counties, since there is an even number of rural counties. But Polk County sits next to Butler, as well as two MSAs, so Sheridan was used to get more geographical representation in the state.

The following tables show the net mandated expenses for major mandated spending categories in the three representative counties selected. These expenses are net of any related revenues directly identified in the official county budgets.

For this report, only General Fund expenditures were examined for mandated spending, and only County-level expenditures were used. Thus, this report does not include mandated spending for taxing authorities with function-specific roles, such as school districts, nor have we included other local government taxing jurisdictions, such as municipalities. For reference the total General Fund spending is also listed, as well as the percent of the General Fund spending that is composed of mandated spending.

Table 3: Net Mandated Expenses for Douglas County, 2013-14

	Douglas
Clerk of District Court	$1,177,477
County Clerk	$1,517,023
County Court	$285,620
County Court Probation	$132,825
Elections	$1,120,250
Juvenile Court	$3,894,170
Juvenile Court Probation	$181,343
Public Defender	$3,950,426
Total Mandated	**$12,259,134**
Total Expenditures (General Fund)	$169,185,167
Mandate Percent	7.2%

Source: adopted county budgets for FY 2013-14 for Douglas County

Table 4: Net Mandated Expenses for Butler County, 2013-14

	Butler
Clerk of District Court	$169,474
County Clerk	$95,851
County Court	$5,500
Diversion Program	$16,880
Elections	$50,066
Juvenile Contractual Services	$15,000
Probation	$6,023
Public Defender	$122,000
Total Mandated	**$480,794**
Total Expenditures (General Fund)	$5,235,784
Mandate Percent	9.2%

Source: adopted county budgets for FY 2013-14 for Butler County

Table 5: Net Mandated Expenses for Sheridan County, 2013-14

	Sheridan
Clerk of District Court	$67,200
County Clerk	$111,270
County Court	$23,150
Elections	$22,300
Indigent Defense	$30,000
Juvenile Boarding Costs	$19,000
Probation	$7,000
Public Defender	$64,060
Total Mandated	**$343,980**
Total Expenditures (General Fund)	$4,241,190
Mandate Percent	8.1%

Sources: adopted county budgets for FY 2013-14 for Sheridan County

Comparing the percentages the bottom of each table show that there is some variation in the amount of the most obvious mandated expenditures in each county budget, but they are all in the high single digits.

However, caution should be used when interpreting these percentages. For example, this data does not indicate that property taxes in Douglas County could be lowered by 7.2 percent. First, the General Fund is only a portion of all local spending; there are also other funds, such as those dedicated to road construction and maintenance, and other taxing authorities, such as school districts. Second, even if the functions are mandated, counties might choose to carry out the functions even in the absence of a state mandate to do so. Finally, even if funding for this spending were to come from the state general funds or another government source, the funds would still come from Nebraskans, having the effect of merely shifting taxes rather than reining them in.

These tables do reveal an interesting difference in the amount of mandated spending for urban and rural counties. While the figures for these major spending items are roughly comparable in scale, major mandated spending items as a percent of general fund spending is higher in the rural counties than in Douglas County. Further investigation will be necessary to see if this trend persists across all urban and rural counties, but it suggests that unfunded mandates could represent some implicit redistribution from rural counties to urban counties.

Additionally, the mandated spending listed in the table is only a first approximation of the mandated spending. This report surveys research into county budgets and the identifiable mandated spending that they contain. However, many forms of mandated spending are more difficult to uncover in a review of county budgets. A number of mandates are subsumed under various budget items and do not consume the entire budget line. This report only includes those line items identifiable as consisting entirely of mandates. Thus, this analysis represents a first step in the process of understanding mandated spending. Further research will be required to understand the full extent of mandated spending and the associated property taxes required to fund this spending.

Several other studies on mandated spending have been conducted recently, including a 2014 interim study by the Government, Military and Veterans Affairs Committee of the Nebraska Legislature. The study was published by the Legislature in December 2014. The more limited results presented in this paper are quite conservative compared with the claims of various stakeholders whose input was sought for the interim study report. For example, the interim study reported approximately $50 million in unfunded mandates for Douglas County, compared with the $12 million reported in Table 3 above.[19]

Reports on Mandates in Other States

For an understanding of the likely scale of unfunded mandates in Nebraska, it may be informative to look at some of the studies conducted on similar mandates in other states. In 2013, the Commonwealth of Virginia conducted a comprehensive investigation of the number and kind of mandates in Virginia from both the Federal government and Virginia itself. The report found nearly 500 distinct mandates across a wide variety of expenditure categories. The list of mandates in Virginia is presented here for two reasons. First, the federal mandates on the state of Virginia will be nearly identical to the federal mandates placed on the state of Nebraska. Second, while the list of mandates that Virginia places on its local governments will not exactly mirror Nebraska's mandates, there will likely be a high degree of overlap and this gives us a starting point for the analysis.

A study commissioned by the South Carolina Association of Counties took a different approach. Rather than constructing an exhaustive list, they put together a limited list of mandated expenditures, and surveyed county governments on the costs related to those programs. For FY 2009-10, they found a net unfunded mandate of over $130 million after deducting related state revenues.[20] To put these figures in

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[19] "Examination of Unfunded and Underfunded Mandates to Counties and their Impact on Property Taxes." Legislative Resolution 582 Interim Study Report. Government, Military and Veterans Affairs Committee. Nebraska Legislature. December 2014. p. 35. [URL: http://www.nebraskalegislature.gov/pdf/reports/committee/government/lr582report_2014.pdf]

[20] Saltzman, Ellen, Holley Ulbrich, Johnathan Munn, Fred Sheheen, and Bill Thomes. "The Fiscal Impact of Selected State Mandates on County Governments." South Carolina Association of County Governments. December 2012.

perspective, total local spending in South Carolina in the same year was $19 billion.[21]

IV. Summary and Possible Proposals for Reform

Nebraska is fortunate that it is one of the states in a relatively good fiscal position. Nebraska has an opportunity to permanently lower tax rates on property, to offset the lower revenue by reducing unfunded mandates, and to deal with the transitional phase during a time when revenues continue to come in at greater than anticipated levels.

The central tool for reducing property taxes is ultimately spending discipline. Reductions in spending must ultimately be considered if counties and other local taxing authorities are to draw down their taxation of property in Nebraska. The difficulty of cutting spending in some areas — namely, those relating to social welfare programs — is that many of the recipients of the monies are path-dependent and rely on these programs.

County services that are currently mandated by the state without provision of corresponding financial support could be reformed in one of two ways: either these services should be paid for more directly by state government, or local governments to whom duties are mandated should be provided with earmarked funds from the state specifically for the provision of these services. In the aggregate, this would not necessarily mean that Nebraskans would face a lower burden of taxation, merely that taxation would take place at a different level of government, and possibly be funded through a different form of taxation such as sales tax. While there may be no aggregate effect, there is a redistributive effect.

Based on the preliminary data presented in this paper, unfunded mandates may have a disproportionately large effect on rural counties. This not only implies a transfer from rural to urban counties, but also a transfer from lower-income to higher-income individuals, as urban counties have on average greater incomes. Thus, reforming unfunded mandates can allow Nebraska to make their tax system more transparent, efficient, and equitable at the same time, a rare opportunity in political economy.

[21] "2010 Annual Surveys of State and Local Government Finances." United States Census Bureau. [URL: https://www.census.gov/econ/overview/go0400.html]