Arkansas Advocates for Children & Families
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PAYCHECK$ and POLITICS

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Introduction & Summary Points

In May 2001, Judge Collins Kilgore issued a historic ruling in the *Lake View School District v. Huckabee et al* – the state's current school funding formula is unfair to poorer school districts and provides inadequate funding for education. Early estimates suggest $500 million to $1 billion in new funding will be required annually for education. The case is expected to have major implications on education funding, other programs serving children and families, tax equity and fairness, and state and local tax systems.

This brief, the fifth in a series devoted to the Lake View School District case, examines the use of industrial revenue bonds and their impacts on local property taxes and public-school funding:

- Arkansas has no reliable system for tracking the amount of revenue that schools are losing each year because of property tax exemptions associated with industrial revenue bond issues.
- A study of industrial revenue bond issues in Pulaski County found 14 companies benefiting from property tax exemptions associated with bond issues.
- During 2002, the school districts in Pulaski County are scheduled to receive $132,352 in payments in bond issues involving exempt industrial properties. If the properties had been assessed and on the local tax rolls, the districts would have received $828,889 in property taxes, a net loss of $696,548.
- School districts in seven counties receive over 70 percent of the payments in lieu of property taxes reported by Arkansas schools.
- During the 2000-01 school year, Arkansas schools received $1.6 million in payments in lieu of property taxes. If the properties had been on the local tax rolls, the schools would have received $9.9 million. This represented a net loss of $8.3 million in local tax receipts to Arkansas schools.

What's the Impact on Funding for Public Education?

Industrial Development and Property Tax Exemptions

By Richard Huddleston

During the last several months, the fiscal crisis in state government has worsened. The budget for the 2002 state fiscal year was recently revised downward by another $56 million, resulting in a record $227 million shortfall (actual revenues were less than budgeted expenditures) for the year. Because the latest budget cut occurred with only three weeks remaining in the current fiscal year, the Huckabee Administration was forced to call the legislature back into special session to adopt special emergency measures (such as using reserve trust funds from various state accounts) to avoid layoffs of state government employees.

The need for revenue will only grow in the future. The Arkansas economy is projected to grow slowly during the coming year, resulting in tax revenues that will be less than anticipated. Rapidly rising health care costs associated with the state Medicaid program will continue to squeeze the state budget, thereby setting the stage for additional budget shortfalls later in 2003. Late in 2002, an anticipated Supreme Court decision in the Lake View school funding case likely will require $500 million to $1 billion in new spending annually on education.

Previous issues of *Paycheck$ and Politics* (issues 9 and 10) examined the potential of sales tax exemptions and other business tax incentives as a potential funding source for public education and other critical services for children and families. During 2000, discretionary sales tax exemptions benefiting business cost the state approximately $374 million (the amount is actually $582 million if exemptions benefiting non-profits, local government entities, and individuals are included). This estimate does not include revenue lost from not taxing services, which is not tracked by DF&A. Other types of business tax incentives, such as state income tax credits or incentive payments, cost the state over $44 million in lost revenue.

In the same issues of *Paycheck$ and Politics*, we noted that a "great unknown" in the debate over business tax incentives was the amount of property tax revenue that schools lose annually because of the use of industrial revenue bonds, also known as "Act 9 bonds." The purpose of this issue brief is to provide a closer look at the impact of property tax exemptions associated with many industrial revenue bond issues.

The Basics

Industrial revenue bonds are a favored financing tool for economic developers. The major Arkansas players involved in industrial revenue bond deals utilizing local property tax exemptions are local governments, the Arkansas Development Finance Authority (ADFA), and the Arkansas Department of Economic Development.

Industrial revenue bonds generally offer favorable financing to businesses, usually manufacturers, to purchase land, buildings, and equipment to locate or expand their operations. When such bonds are issued, local governments often maintain ownership of the property for the life of the bonds, usually 20-30 years. The property is leased or sold to the business at a favorable rate. The lost property tax revenue occurs when companies are exempted from paying local property taxes if they agree to develop the land for industrial purposes. In many cases, companies make negotiated payments to local governments in lieu of local property tax payments. Local property taxes, of course, are a major funding source for schools.

A major problem with payments in lieu of property taxes is that such payments are usually lower than the amount of property tax revenue schools would have received if the exempt property had been assessed and part of the local tax rolls. This, of course, means less revenue for schools.

The Acme Pickle Company A hypothetical example illustrates the potential revenue loss to schools. Suppose that Razorback City issues an industrial revenue bond that is used to finance the building of a major pickle plant (let's call it the Acme Pickle Company) within the county. After the construction is completed, the market value of the property and improvements is $5 million. Since most industrial property is assessed for tax purposes at 20 percent of market value, the assessed value of the property is $1 million. In Razorback City, the school property tax rate is 46 mills. At that rate, the company would have owed $46,000 in property tax revenue to the local schools ($1 million X 0.046).

Let's further assume that as part of the industrial revenue bond agreement in this example, the city agreed to retain ownership of the plant property and lease it back to the company at a favorable rate, thus exempting the company from local property taxes on the plant property and its improvements. In return, the company agreed to make a payment in lieu of property taxes of $10,000. Compared to the $46,000 in school property taxes the company would have owed, the schools had a net loss of $36,000 ($46,000 -$10,000).

Supporters of the property tax exemptions associated with some industrial revenue bonds often take issue with claims that such exemptions result in lost tax revenue for schools. The argument goes something like this. Were it

Payments to Schools In Lieu of Property Taxes
School Year 2000-01

School District	County	Payment
Conway	Faulkner	$304,531
Little Rock	Pulaski	$169,450
Fort Smith	Sebastian	$146,694
Booneville	Logan	$108,961
Armorel	Mississippi	$100,211
Hope	Hempstead	$96,667
Hector	Pope	$55,202
Pulaski County	Pulaski	$55,111
Siloam Springs	Benton	$45,889
West Memphis	Crittendon	$44,849
Searcy	White	$43,232
Newark	Independence	$34,237
Texarkana	Miller	$31,645
Dover	Pope	$31,172
Prescott	Nevada	$30,503
Strong	Union	$26,202
Osceola	Mississippi	$24,110
S. Conway County	Conway	$19,451
Jonesboro	Craighead	$18,513
Paragould	Greene	$18,082
Pine Bluff	Jefferson	$10,087
Huttig	Union	$10,037
Manila	Mississippi	$9,596
Marked Tree	Poinsett	$9,167
Cotton Plant	Woodruff	$8,915
Newport	Jackson	$8,669
Blytheville	Mississippi	$8,458
Brinkley	Monroe	$7,493
Umpire	Howard	$7,370
Trumann	Poinsett	$7,000
England	Lonoke	$6,623
Riverview	White	$6,349
Ashdown	Little River	$5,941
Clarendon	Monroe	$5,928
E. Poinsett County	Poinsett	$5,875
DeQueen	Sevier	$4,951
Marmaduke	Greene	$4,825
Ola	Yell	$4,682
Bald Knob	White	$4,573
Parkin	Cross	$4,408
Salem	Fulton	$4,355
Russellville	Pope	$4,185
Sloan-Hendrix	Lawrence	$4,111
Ozark	Franklin	$3,500
Dierks	Howard	$3,312
S. Mississippi County	Mississippi	$2,765
Nettleton	Craighead	$2,525
Dumas	Desha	$2,292
Des Arc	Prairie	$2,149
Gurdon	Clark	$2,098
McCrory	Woodruff	$2,097
Riverside	Craighead	$1,951
Mineral Springs	Howard	$1,944
Wynne	Cross	$1,679
Beebe	White	$1,530
Foreman	Little River	$1,407
Star City	Lincoln	$1,262
Greenwood	Carroll	$1,255
Horatio	Sevier	$1,164
Magazine	Logan	$1,058
Rison	Cleveland	$1,048
Hatfield	Polk	$1,032
Cross	Cross	$957
Gould	Lincoln	$910
Hot Springs	Garland	$817
Wickes	Polk	$759
Weiner	Poinsett	$483
TOTAL		**$1,598,007**

Source: Arkansas Department of Education not for the industrial revenue bond and the property tax exemption, the Acme Pickle plant would not have located in Razorback City and the land would not have been valued at $5 million (its value after the plant was built) and the school district would never have seen the $46,000 in property taxes anyway.

Unfortunately, in our hypothetical example, there is simply no way to know, at least with any certainty, whether the Acme Pickle Company would have located or made the investment on the site without the bond issue and the property tax exemption. Most of the research on location decisions of plants suggests that other factors, such as a well-educated workforce or access to customer markets or supply lines, are more important factors.

How much revenue do schools lose because they receive payments in lieu of property taxes for exempt industrial properties? There are no reliable statewide estimates of how much local property tax revenue is lost annually because of the issuance of industrial revenue bonds. The state has no data system for tracking the property tax revenue lost because of industrial revenue bonds, and many assessors don't even bother to assess the property involved in such a bond issue because they know it is exempt from local property taxes.

Arkansas law (the Revenue Bond Reporting Act, A.C.A. 19-9-502) requires that all cities, counties, and state agencies annually report revenue bonds that are outstanding as of July 1. The law also requires that the Secretary of Treasury's State Board of Finance compile an annual report using this data. The report, however, is inadequate as a tool for tracking the impact of revenue bonds on school property tax revenue. The data compiled in this report is often incomplete, and not all cities and counties file the report. Those that do may fail to list all of their outstanding revenue bonds. Most importantly, the law does not require that local governments and state agencies filing the report specify which bonds involve exempt properties or negotiated payments in lieu of property taxes.

Education finance data reported by school districts to the Arkansas Department of Education provide a starting point for assessing the fiscal impact of industrial revenue bond issues on school property tax revenue. Schools receiving payments in lieu of property taxes are required to report the revenue to the Arkansas Department of Education. During state fiscal year 2001, school districts reported only $1.5 million paid in lieu of property taxes. Only 68 of 311 school districts reported receiving any in-lieu-of payments. Only five school districts — Conway, Little Rock, Fort Smith, Russellville, Booneville, and Armorel — reported receiving at least $100,000 each in such payments.

Where are the schools that receive the most in payments in lieu of property taxes? The 68 school districts that received payments were located in 39 counties. Seven counties – Faulkner, Pulaski, Sebastian, Mississippi, Logan, Hempstead, and Pope – received about 70 percent of all payments in lieu of property taxes during the 2000-01 school year. Two counties – Faulkner and Pulaski – accounted for one-third of all in-lieu-of payments reported by schools to the Department of Education.

Payments to Schools In Lieu of Property Taxes
Grouped by County, School Year 2000-01

County	Payment	% of State Total
Faulkner	$304,531	19.1
Pulaski	$224,561	14.1
Sebastian	$146,694	9.2
Mississippi	$145,140	9.1
Logan	$110,019	6.9
Hempstead	$96,667	6.0
Pope	$90,559	5.7
White	$55,684	3.5
Benton	$45,589	2.9
Crittendon	$44,849	2.8
Union	$36,239	2.3
Independence	$34,237	2.1
Miller	$31,645	2.0
Nevada	$30,503	1.9
Craighead	$22,992	1.4
Greene	$22,907	1.4
Poinsett	$22,525	1.4
Conway	$19,451	1.2
Monroe	$13,421	0.8
Howard	$12,626	0.8
Woodruff	$11,012	0.7
Jefferson	$10,087	0.6
Jackson	$8,669	0.5
Little River	$7,348	0.5
Cross	$7,044	0.4
Lonoke	$6,623	0.4
Sevier	$6,115	0.4
Yell	$4,682	0.3
Fulton	$4,355	0.3
Lawrence	$4,111	0.3
Franklin	$3,500	0.2
Desha	$2,292	0.1
Lincoln	$2,172	0.1
Prairie	$2,149	0.1
Clark	$2,098	0.1
Polk	$1,791	0.1
Carroll	$1,255	0.1
Cleveland	$1,048	0.1
Garland	$817	0.1
All Others	$0	0.0
TOTAL	**$1,598,007**	**100.0**

Source: Arkansas Department of Education

The amount of revenue a school district receives from payments made in lieu of property taxes, however, is only part of the picture. It does not tell us how much property tax revenue is being lost because of property tax exemptions. This requires data about the location and assessed values of any industrial properties exempt from property taxes. Unfortunately, this data is not reported to the state, nor is it available in some counties. County property tax assessors often don't maintain updated assessments of the properties involved in industrial revenue bond issues if they know the properties are exempt from local taxes.

The Case of Pulaski County

To get a clearer picture of how much school property tax revenue is lost annually because of industrial revenue bond issues, the Arkansas SFAI project obtained data on industrial revenue bonds issued in Pulaski County, the most populous county in the state. During the 2000-01 school year, the three school districts in Pulaski County accounted for over 14 percent of all payments in lieu of property taxes reported by schools. While the experience of the school districts in Pulaski County may not be representative of every school district in the state, it should provide some important clues as to the impact of industrial revenue bonds on school property tax revenue.

At press time, 14 companies in Pulaski County were participating in industrial revenue bond issues that included a property either wholly or partially exempt from local property taxes. Complete data for 12 of these companies was available from the City of Little Rock Finance Department. During the current fiscal year, these 12 companies are scheduled to make nearly $132,352 in payments in lieu of school property taxes. This revenue will go directly to public schools.

According to data from the Pulaski County Assessor's office, if these properties had been assessed and on the tax rolls, an additional $18 million in assessed property value would have been subject to local property taxes (i.e., if the property

PAYMENT IN LIEU OF PROPERTY TAXES vs. POTENTIAL PROPERTY TAX REVENUES
Industrial Revenue Bond Issues, Pulaski County

Company[1]	Bond Issue	Market Value of Exempt Property[2]	Assessed Value @ 20% of MV	Millage Rate[3]	Potential Property Tax Revenue	In-Lieu Payments, Schools Only[8]	Lost Revenue[4]
Acxiom	$38,000,000	$240,870	$48,174	46.4	$2,235	$0	$-2,235
Alltel[5]	$6,500,000	$54,362,350	$10,872,470	46.4	$504,483	$819	$-503,664
Archer Daniels[5]	$6,750,000	$1,885,050	$377,010	46.4	$17,493	$819	$-16,674
Arkansas Aerospace	$7,215,000	$11,351,000	$2,270,200	46.4	$105,337	$54,219	$-51,118
Arkansas Systems	$5,211,723	$5,431,400	$1,086,280	40.6	$44,103	$12,146	$-31,957
Falcon Jet	$1,000,000	$2,040,980	$408,196	46.4	$18,940	$9,439	$-9,501
J&M Properties	$240,000	$36,160	$7,232	46.4	$336	$1,965	$1,630
Jacuzzi[6]	$1,400,000	$4,301,690	$860,338	40.6	$34,930	$3,264	$-31,666
Lexicon Inc.	$4,575,000	$4,627,600	$925,520	46.4	$42,944	$11,191	$-31,753
Omega Tube & Conduit	$10,000,000	$742,210	$148,442	46.4	$6,888	$23,773	$16,886
A.O. Smith[6]	$2,500,000	$4,200,500	$840,100	40.6	$34,408	$6,527	$-27,581
Vinyl Building Products[7]	$4,000,000	$1,842,950	$368,590	46.4	$17,103	$8,189	$-8,914
TOTAL		**$91,062,760**	**$18,212,552**		**$828,889**	**$132,352**	**$-696,548**

1. Dillard's and Hoover Universal were excluded from the analysis because of incomplete data for both payments and market value estimates.
2. Includes land and improvements.
3. Little Rock School District millage rate is 46.4. Other properties are located in the Pulaski County Special School District, and its millage rate is 40.6.
4. Lost revenue is the difference between potential property tax revenues the schools would have received if the property were not exempt and actual in-lieu-of payments received by the schools.
5. No in-lieu-of payment paid, only administrative fees.
6. Bonds matured and tax exempt leases extended.
7. Bonds issued by the Arkansas Development Finance Authority.
8. The payments made by Alltel and Archer Daniels are not in-lieu-of payments, but administrative fees paid to process the deal.

Sources:
1. Value of land and improvements from the Pulaski County Assessor's Office.
2. Data for in-lieu-of payments, bond amounts and maturity from the City of Little Rock Finance Office.
3. All other data are AACF estimates.

was assessed at the usual 20% of market value).

The Little Rock and Pulaski County Special School Districts levy school millage rates (property tax rates) of 46.4 mills and 40.6 mills, respectively. At these rates, the properties would have generated approximately $828,889 in local property tax revenue for schools. As a result, schools are scheduled to lose a net of $696,548 in revenue ($828,889 -$132,352). Put another way, the school districts in Pulaski County likely will recover only 16 cents in in-lieu-of payments for every $1 they might otherwise have received in local property tax revenue from exempt properties involved in industrial revenue bonds.

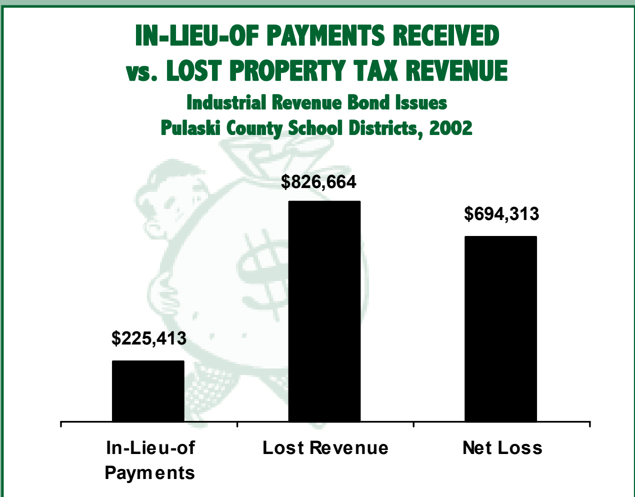
What do industrial revenue bond projects in Pulaski County tell us about the fiscal impact of such projects on school property taxes in other areas of the state? Admittedly, it is very problematic to generalize about statewide impacts on the basis of schools in one county, even in a county as large as Pulaski County that comprises 14 percent of all payments Arkansas schools received in lieu of property taxes. We have no reason to believe, however, that Pulaski County's use of payments in lieu of property taxes is significantly different than other parts of the state. In fact, one could make the argument that because the Little Rock/Pulaski County area is a major economic hub in Arkansas, it is in a position to demand higher payments in lieu of property taxes than are other areas of the state.

During the 2000-01 school year Arkansas schools reported $1,598,007 in payments in lieu of property taxes. Using the experience of Pulaski County as a guide, we estimate (based on a 16% recovery rate) Arkansas schools would have received $9,987,544 in property tax revenue if the properties exempt because of industrial revenue bonds had been assessed and on the local tax rolls. Arkansas schools lost a net of $8,389,537 in revenue that they otherwise might have received ($9,987,544 in potential property tax revenues - $1,598,007 in payments in lieu of property taxes). This represents an additional $8.3 million that would have been available to fund the state's public schools.

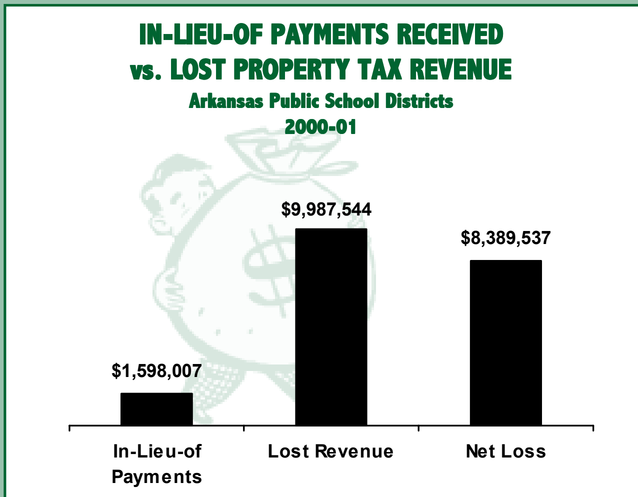
Recent Legislative Steps

During the 2001 session, the Arkansas General Assembly passed temporary legislation to address the problem of schools losing property tax revenue because of exemptions associated with industrial revenue bonds. Act 1629 requires any city or county entering into a lease, contract, or sale of property to a private entity for industrial or economic development purposes to negotiate payments in lieu of property taxes. The amount of the payment cannot be less than 35 percent of the property taxes that would have been paid if the property were on the tax rolls.

Act 1629, however, contains several major loopholes. The major limitation is that the law sunsets June 30, 2003. It would have to be reauthorized to have any impact beyond that time. Another is that a lesser in-lieu-of payment can be levied if approved by the director of the Arkansas Department of



Source: AACF estimates based on data from City of Little Rock Finance Office and Pulaski County Assessor's Office.



Source: AACF estimates based on data reported to the Arkansas Department of Education.

Economic Development and the chief fiscal officer of the state. The law also does not require that a 35 percent payment (or any payment for that matter) be made in the following cases:

- Agreements existing or entered into prior to July 1, 2001;
- Agreements entered into on or after July 1, 2001, pertaining to a project covered by a financial incentive proposal from ADED or by resolution of the governing body of a city or county;
- Any reissue or refinancing of bonds subject to an existing in-lieu-of tax agreement;
- Any contract for sale with a qualified steel manufacturer.

Thus, the act effectively exempts many deals and properties from the law's intent, which is to mitigate the potential negative impacts on local funding for public schools.

Act 1629 also requires several Senate and House interim legislative committees – Education, Insurance and Commerce, and Revenue and Taxation – to conduct a study of the impact of in-lieu-of tax payments on funding for public schools and of the process of negotiating in-lieu-of tax payments. It also requires that interim study committees draft any legislation necessary to improve the process. To date, the interim committees have yet to begin such a study.

Assessment and Future Steps

This study provides a more complete picture of the impact of industrial revenue bonds on school property tax revenue. Granted, $8.3 million is not a major revenue loss for the state's schools on a statewide basis. This is especially true when one compares it to the $741 million in local tax revenues or the $1.4 billion in state equalization aid the schools received during the 2000-01 school year, according to the state Department of Education's 2000-01 Annual Statistical Report.

However, it should be noted that the impact of industrial revenue bonds and property tax exemptions was concentrated in a small number of counties during the 2000-01 school year. Seven counties accounted for 70 percent of the payments received by schools in lieu of property taxes. While property tax exemptions may not be a major drain on the property tax base of most of the state's schools, the lost revenue could have a major impact on the school districts in counties that make significant use of industrial revenue bonds. Moreover, if cities, counties, and state agencies were to significantly increase their use of industrial revenue bonds and/or property tax exemptions as an economic development tool, the amount of lost revenue could increase in the future.

Arkansas should consider policy changes to Act 1629. A major shortcoming of the law is that there is no monitoring or enforcement mechanism for ensuring its implementation. The interim study that is required under Act 1629 should provide useful information when it is completed. It also represents one of the state's first major attempts to promote greater public disclosure and accountability of the impacts of economic development incentives on other parts of the state and local fiscal systems, such as funding for public schools. It's about time that economic development incentives receive the same scrutiny that human service programs have long received from policy-makers.

However, while the intent of Act 1629 is good, it is not the same as establishing an ongoing monitoring or enforcement mechanism to make sure the law is followed. In the short-term, it will be up to school districts, parents and other concerned citizens to apply political pressure on governmental entities issuing the bonds to make sure the intent of the law is followed. After Act 1629 sunsets on June 30, 2003, stronger and more permanent legislation will be needed to enforce the intent of the act, monitor the impacts of payments in lieu of property taxes, and prevent any further erosion of the property tax base of public schools. The state should also consider increasing the level of in-lieu-of payments required when industrial revenue bonds are issued.

For More Information
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