Iowa League of Cities

Special Report

Iowa's Property Tax System

Additional information and resources can be found at www.iowaleague.org, including the League's Property Tax Model which helps cities gauge the impact of the 2013 property tax reforms.

Property taxes play a significant role in municipal government as the primary funding source for city budgets. Iowa's property tax system can be complex and at times confusing for local government officials and property owners alike. The assessment limitation, or rollback, and various tax credits can be difficult to understand. In addition, several major changes to the system were adopted in the 2013 legislative session that will impact cities now and in the future.

The Property Tax Special Report details Iowa's property tax system and how it relates to city governments. This includes a review of how property taxes are computed, the rollback's effect on taxable property values and how the property tax system impacts city budgets.

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The Property Tax System

Local governments in Iowa rely on property taxes as the primary source of revenue for their budgets. The property tax system is established in the *Code of Iowa* and regulates the ability of cities to generate revenue through taxes to sufficiently fund needed services. To properly understand the property tax system it is necessary to know the factors that are used, including how property is classified and taxed, how the rollback affects calculations, and how much property is subject to taxation.

Property Classifications and Valuations

Iowa's properties are divided into classifications based on land use. For example, property that is used primarily for farming activities is classified as agricultural while property used for habitation is listed as residential.

Classes of Property
Agricultural
Commercial
Industrial
Railroad
Residential
Multi-Residential

The next determination is the value of the land, which is mostly done by the county assessor (or city assessor for cities that have one). Residential, commercial and industrial properties are assessed on 100 percent of their market value. To arrive at the value, assessors generally use three approaches – the market approach, which looks at comparable property sales; the cost approach, which estimates how much it would cost to replace the property; or the income approach, which estimates a property's ability to produce income, such as an office building. Agricultural property is assessed at 100 percent of its productivity and net earning capacity. Railroad and utility property is assessed by the state.

Assessors then send valuation reports to the Iowa Department of Revenue, which is required to complete an equalization every two years. Equalization is a process that reviews property assessments and sales assessment ratio studies, which compare property sale prices to assessed values. If assessments in a property class are 5 percent more or less than the sales ratio study, the state increases or decreases assessments to help maintain equitable assessments across property classes. The statewide assessment limitation, or rollback, is then applied to each property class as stipulated by state law to determine taxable values.

Taxing authorities around the state, including city governments, approve their budgets and property tax rates (for cities this must be done by March 15 of each year). County auditors and treasurers then work on applying the consolidated tax rates (which includes all taxing authorities a property owner might owe taxes to, such as the city, county, school district, etc.), factor in any tax credits a property owner has applied for and received, before finally sending out property tax bills in March and September each year. The taxing authorities typically receive their revenues the following months (April and October).

Assessments Limitations (The Rollback) and Taxable Values

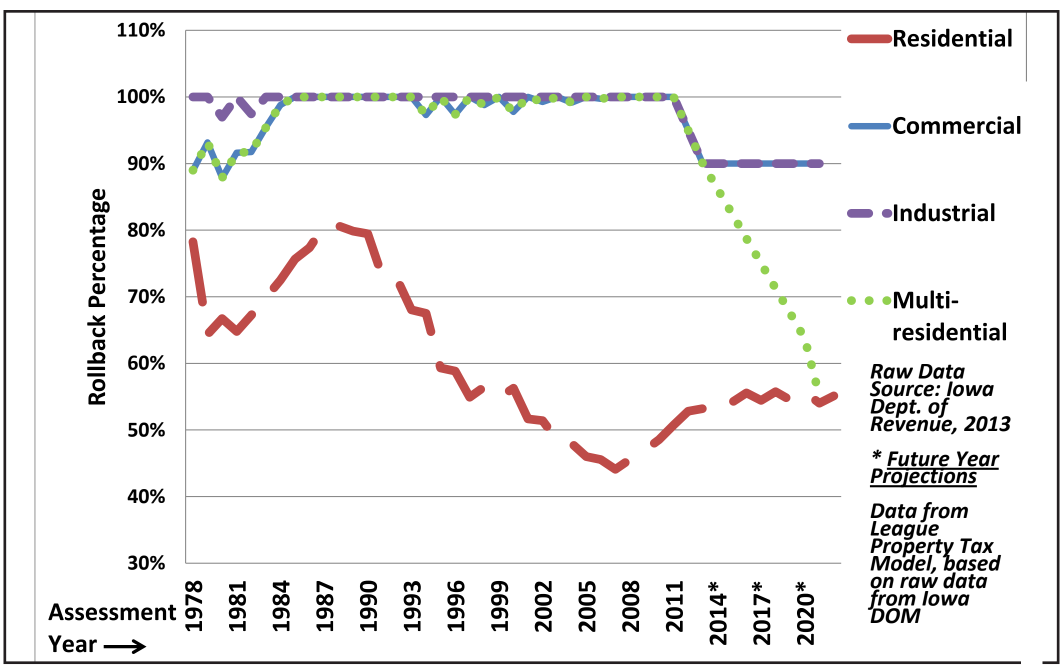
Before calculating property tax revenues it is necessary to know the taxable value of each property to be taxed. The taxable value is the value upon which the local government property tax rate is applied. The taxable value of a property is often significantly different than its assessed value and knowing the difference is fundamental to analyzing a city's property tax revenues.

A key aspect in Iowa's property tax system going back to 1978 is the assessment limitation, or rollback, which is designed in part to restrict the taxable valuation growth of properties. The original law placed a 6 percent cap for all properties except railroad and utilities (10 percent) on the growth of values. The cap was moved lower in 1980 to 4 percent for agricultural, commercial, industrial and residential properties and 8 percent for railroad and utilities. If a property class grew statewide by more than 4 percent its taxable value was reduced (which is where the term "rollback" came from) to comply with the assessment limitation law.

In addition to the overall taxable value growth limitation, increases in the valuations of residential and agricultural properties were tied together, often called "coupling". This provision of the law limited the valuation increases of either property class to the smaller of the two – if residential property grew by 4 percent and agricultural grew by 2 percent, the increase in taxable valuations for both classes would be 2 percent.

Historically, residential property grew at a much faster rate than agricultural property, resulting in a considerable decline in taxable values. Meanwhile, the other property classes did not grow as much and were usually taxed at their full assessed value. However, projections for rollback percentages show a different story, due in large part to property tax reforms approved in the 2013 legislative session.

Historic and Projected Property Tax Rollback Trend



2013 Property Tax Reform

New Limitation for Agricultural and Residential Properties

Several major changes were made to the property tax system in 2013, including adjusting the assessment limitation for agricultural and residential properties from 4 percent to 3 percent. This new cap pertains only to agricultural and residential properties and began immediately. The coupling provision remains in place as the two property classes will continue to be further restricted if one grows by a lower percentage.

New Rollback Created for Commercial, Industrial and Railroad Properties

For much of the time since the rollback's inception, commercial and industrial taxable values were not rolled back as their valuation growth did not typically exceed 4 percent. Railroad property followed a similar path, only occasionally exceeding its 8 percent cap and forcing a rollback of its taxable value.

However, changes made during the 2013 legislative session included a new rollback for these properties as they will be taxed at 95 percent of their 2013 assessed value (affecting the Fiscal Year 2015 budget) and 90 percent in 2014 and beyond. The rollback percentage for these properties will remain fixed at 90 percent regardless of how fast or slow valuations grow.

In addition, the legislature created a standing appropriation to fund a reimbursement claim, often called a backfill, for the property tax revenue reduction resulting from the new rollback. The backfill provision is only for commercial and industrial property and the legislature capped future appropriations at the FY 2017 funding level. The state will disburse funds through the county governments who will then deliver the funds to city governments in a similar fashion as property tax revenue. This process will function in a comparable manner as property tax credits such as the Homestead Credit.

Creation of Multi-Residential Property Class

This new property class takes effect in FY 2017 and will likely have long-term impacts for many cities around the state. The definition of multi-residential property is broad and includes:

- Mobile home parks
- Manufactured home communities
- Land-leased communities
- Assisted living facilities
- Property primarily used or intended for human habitation containing three or more separate living quarters
- For buildings that are not otherwise classified as residential property, that portion of a building that is used or intended for human habitation can be classified as a multi-residential property, even if human habitation is not the primary use of the building and regardless of the number of dwelling units located in the building*

**At the time of this writing, the Iowa Department of Revenue is considering the adoption of an administrative rule that would require assessors to determine the primary use of such property and classify it as either fully multi-residential or as dual classification (mix of multi-residential, commercial and/or industrial)*

Multi-Residential Rollback Schedule

Fiscal Year	Rollback Percentage
2017	86.25%
2018	82.50%
2019	78.75%
2020	75%
2021	71.25%
2022	67.5%
2023	63.75%
2024 (and beyond)	Equal to residential

Excluded properties include, hotels, motels and other buildings where rooms or dwelling units are typically rented for less than one month. Eligible properties will be assessed for the first time in 2015, affecting the FY 2017 city budget.

Multi-residential properties will be subject to a separate rollback schedule for eight years, as shown in the table below, before reaching the residential rollback percentage. As opposed to the new rollback for commercial and industrial properties where cities will receive backfill funding from the state for property tax revenue reductions, there will be no backfill for the multi-residential property rollback.

Telecommunications Property Tax Exemption

A new exemption for telecommunications companies was created that is based on "the actual value that is used by the companies in the transaction of telegraph and telephone business." The actual value for telecommunication companies focuses primarily on the lines used to operate telegraph and telephone services. Once the properties have been assessed, they will receive partial property tax exemptions based on their total value as detailed in the table below.

Total Assessed Value	$0-20 million	$20-55 million	$55-500 million	Over $500 million
FY 2015 Exemption Percentage	20%	17.5%	12.5%	10%
FY 2016 (and beyond) Exemption Percentage	40%	35%	25%	20%

Tax Credits and Taxable Values

In addition to the rollback percentage for each class of property, cities need to also include any tax credits a property owner has received when computing taxable values. Credits are approved by the state legislature to help reduce the tax obligation on property owners as well as to provide relief, incentive or recognition. The most common residential property tax credit is the Homestead Credit, which was initially created to encourage home ownership. The current credit is equal to the actual tax levy on the first $4,850 of actual value. Other credits include those for military veterans, the elderly and the disabled. City officials must also account for any tax rebate or abatement programs that property owners are using.

Property Tax Rates

The last piece to the puzzle in figuring a city's property tax revenues is the tax rate (or levy rate). The tax rate is the amount of tax per $1,000 of taxable property valuation that a city may charge property owners. Although cities have a number of different levies available, the levies are limited to what state law allows, including the particular purposes and maximum amounts.

Cities finance many of their services, such as police, fire, parks, recreation and library, out of the general fund. The general fund is primarily supported by property taxes and cities are limited to a general fund levy rate of $8.10 per $1,000 of taxable valuation. In FY 2015, over 80 percent of cities used the full $8.10 levy for the general fund (cities may go lower than $8.10, but not over). This rate is applied to all classes of property within a city except for agricultural, which has a set levy rate of $3.00375 per $1,000 of valuation.

Example of Rollback on Property Taxes

City general fund tax rate of $8.10 per $1,000 of valuation - FY2015 percentages

Property	Assessed Value	Rollback	Taxable Value & Tax Calculation	Tax Obligation (city taxes only)
Residential	$100,000	54.4002%	($54,400.20/$1,000)x Tax Rate of $8.10	$440.64
Commercial	$100,000	95%	($95,000.20/$1,000)x Tax Rate of $8.10	$769.50

Impact on City Budgets

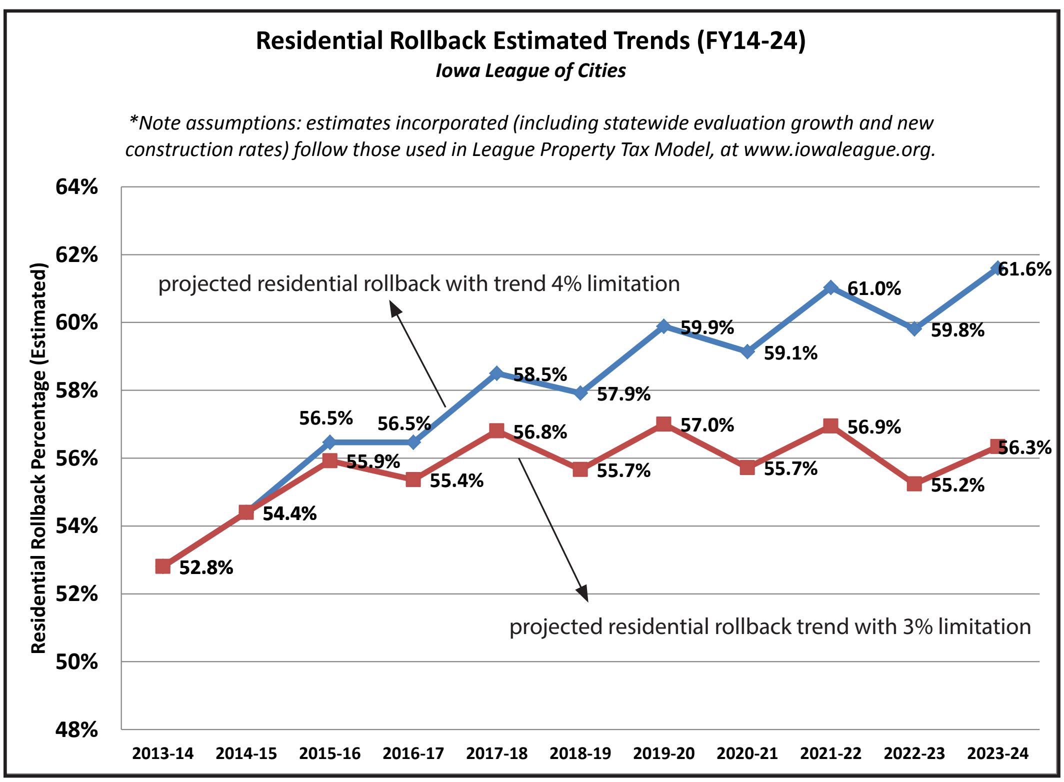
The rollback has clearly had an adverse impact on city budgets, particularly those cities with significant residential property bases, as the taxable values of residential properties have substantially declined. A reduced residential tax base combined with a cap on the levy rate puts many cities in a precarious financial position. Meanwhile, expenses only continue to rise and cities have seen dramatic increases in retirement pension and health insurance costs over the last several years.

The sweeping changes made to the property tax system in 2013 will only exacerbate this problem. The following is an analysis on how the different changes to the system will affect city budgets.

New Agricultural and Residential Assessment Limitation

Much of the assessment limitation system is predicated on property valuation growth (or decline). When property valuation growth outpaces the limitation set by law, the rollback kicks in and reduces taxable valuations. While the residential rollback percentage has slowly increased in the past six years due in large part to a sagging residential real estate market, one can look back over 35 years of data and see that trend is unlikely to continue.

Considering this and adding the lower taxable growth restriction of 3 percent, it is fair to assume the change to the system will likely have a negative impact to city budgets over the long term. The chart below depicts the projected difference in the residential rollback percentage with 4 percent and 3 percent limitations. With many city budgets heavily dependent on property taxes and a big share of those property taxes coming from residential property owners, a lower residential rollback percentage could be harmful to a large number of cities.



New Rollback Created for Commercial, Industrial and Railroad Properties
The arbitrary rollback for commercial, industrial and railroad properties (5 percent in FY 2015, 10 percent in FY 2016 and beyond) will affect cities differently and correspond directly to the amount of such property a city has. An important factor will be the amount of backfill revenue the state legislature appropriates each year. It is possible that a lower amount is appropriated or for the backfill to not be funded at all.

Below you will find a table that illustrates the effect the new rollback has on a sample city's total assessed commercial and industrial property values, the taxable valuation, property tax revenues from these properties, and the state backfill (assuming a full backfill appropriation).

Fiscal Year	Assessed Property Value*	Taxable Value with Rollback	Tax Revenue to City**	Tax Revenue to City (without rollback)	State Backfill to City
2015	$10,000,000	$9,500,000	$131,005	$137,900	$6,895
2016	$10,200,000	$9,180,000	$126,592	$140,658	$14,066
2017	$10,404,000	$9,363,600	$129,124	$144,471	$14,347
2018	$10,612,080	$9,550,872	$131,707	$146,341	$14,347
2019	$10,824,322	$9,741,890	$134,341	$149,267	$14,347
2020	$11,040,808	$9,936,728	$137,027	$152,253	$14,347

**Assumes a 2 percent valuation growth rate*
***FY 2014 statewide average city property tax levy of $13.79 per $1,000 of valuation is used (source: Legislative Services Agency); this is not the consolidated tax rate*

As the table shows, commercial and industrial properties will have less taxable valuation with the new rollback. The table also details the backfill amount related to the reduction of property tax revenues. However, the backfill appropriation is capped at the FY 2017 level as the law stipulates. Assuming commercial and industrial property values continue to steadily grow over time, the maximum backfill appropriation does not stay level with the revenue local governments would have received under the previous property tax system.

New Multi-Residential Property Class and Rollback
The impact of the new multi-residential property class will be proportional to the amount of such property in a city. Given the eight-year rollback schedule and the eventual matching of the residential rollback percentage along with no backfill provision, it is fair to assume that cities could see a significant loss in property tax revenue. Many of the properties in the new class were formerly classified as commercial property and did not receive as steep of a rollback as the multi-residential class provides, pointing to a potential loss of revenues.

Telecommunications Property Tax Exemption
At present, it is difficult to accurately estimate the effect the telecommunications property tax exemption will have on city budgets due to a lack of data relating to such property and telecommunications lines in the state. What is clear is that cities with telecommunications property will see a reduction in property tax revenues. The reduction will be proportional to the amount of such property in a city, and some cities could face significant revenue losses while others may see little change.

The League encourages cities to carefully review the different components of Iowa's property tax system and analyze how the city budget will be affected. Working with the county or city assessor to examine property valuations will be helpful in identifying any recent valuation trends or projections. Using the League's Property Tax Model, available at www.iowaleague.org, can also provide assistance in showing how the recent property tax system changes are projected to impact the budget. These tools and others will give city officials the ability to closely monitor property taxes in their community and make sound plans for future budgets.

Resources

Iowa League of Cities | www.iowaleague.org

Iowa Department of Management | www.dom.state.ia.us

- Current and historical data on property tax rates and valuations.

Iowa Department of Revenue | www.iowa.gov/tax

- Current and historical information on the rollback and tax credits.

Timeline of Property Tax Changes

The following timeline shows the implementation schedule for the various changes made to the property tax system.