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Policy Profile

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Financing Local Public Services: Pending Issues

Prepared by Norman Walzer and Andy Blanke¹

Projections of the aging of the Post World War II “Baby Boom” generation have caused discussions about adjustments to meet both changing needs for services and residents’ ability to afford them under the current local public service delivery system. Demographic changes will also reduce the size of the workforce and perhaps the economic viability of some areas. The trends will affect most rural areas in the U.S. but adjusting to them in Illinois may require more creative local responses, given the large number of governments and an already heavy reliance on local property taxes. Combined efforts by both state and local governments will be needed to address pending trends that will pressure local policymakers to find workable solutions and continue financing essential services.

This *Policy Profile* is intended to advance discussions about ways in which local officials can change the governmental structure to meet changing demographics. It will continue recent efforts by the General Assembly to provide local officials with more leeway to modernize arrangements for delivering local services.

Projected demographic trends will likely impact how local public services will be financed. The discussion starts with demographic trends and then turns to how financing approaches have changed in the post-recovery period. Finally, possible strategies for realigning service delivery or more collaboration in light of successes in other states are described.ⁱ

In some cases, other states are ahead of Illinois in adjusting to these trends and there are opportunities to learn from their experiences. High on the list of goals is to reduce pressure on property taxes to make Illinois more competitive in attracting businesses and residents alike.

Discussions include several key points including the current status of property taxes in Illinois compared with other states and how analysis of financing local services has changed. Also discussed are possible tools that could be used to modernize the local delivery system to provide the same or higher quality services at reduced costs through more collaboration among government agencies. Pursuing this goal is especially timely because population projections indicate that 66 Illinois counties can expect declines in numbers of residents plus a shift in age structure toward older residents with possible adverse effects on local finances.ⁱⁱ

Subsequent discussions are based on several premises. Successful and lasting remedies for property tax concerns will depend on informed local decisions and actions. These solutions require informed voters with transparency of information to minimize vested interests exerting undue influence on decisions and outcomes. Different conditions and governmental arrangements within Illinois make it difficult to impose an effective one-size-fits-all remedy which further emphasizes the importance of local engagement in implementing remedies.

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How Will Populations Change in the Future?

Two major demographic trends are underway. First, nonmetropolitan areas especially have had population declines during the post-recession period due to declining birth rates and outmigration, as shown in Figure 1. The population changes are shown by township area to provide more detail than using counties which can average out changes. The population declines are spread across Illinois but more common in rural areas such as southeastern, northwestern, and western Illinois, which are rural and rely heavily on agriculture.

Second, and perhaps even more important, residents 65 years and older are the fastest growing population cohort. In the future, many will participate part-time in the workforce; spend less due to lower retirement incomes; qualify for property tax concessions e.g., Senior Homestead Tax exemptions; and will need more healthcare services. Residents will be lured to other locations when these elder-friendly services are not available locally.

Financing public services will be even more challenging in the future due to growing concern about property taxes and mounting pressures for relief from taxpayers and businesses.ⁱⁱⁱ Although a long-time stable revenue source for local governments, property taxes are recognized as regressive in impact which brought adjustments for special groups including senior citizens. These adjustments shift the burden to other taxpayers. Recent changes in the Federal income tax law capped the deductibility for state and local taxes (SALT) in computing deductions which adds to the burden in high property tax states including Illinois.

Local property taxes are affected by many factors including level of state support for education and state or federal mandated local services. These issues are well understood with sufficient concern that an Illinois House Subcommittee on Property

Tax Reform was created to address this issue. This action was triggered by proposed state income tax changes that could offer property tax relief if state support for education increased.^{iv}

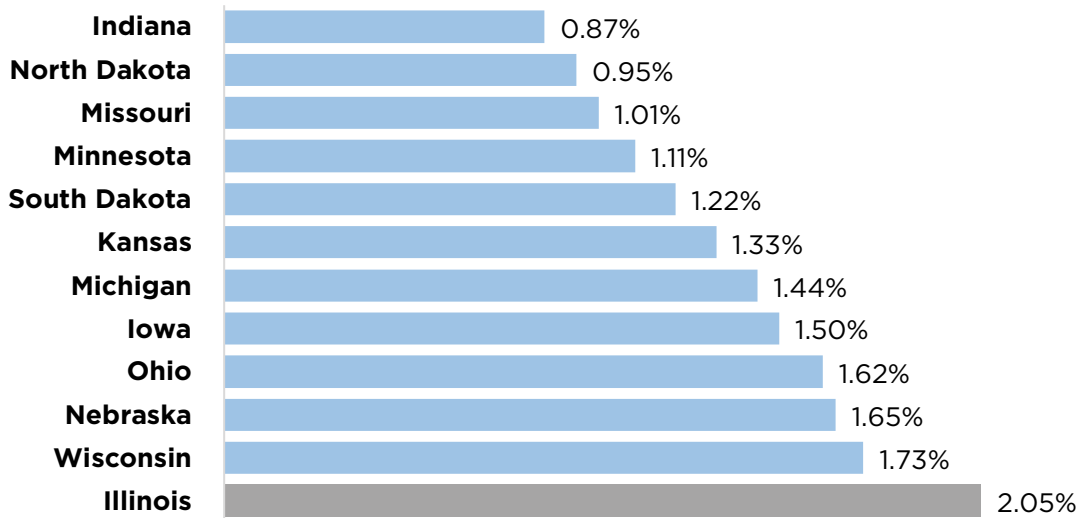
Finally, the relatively unstable fiscal condition in Illinois complicates long-term decision-making. This fiscal uncertainty and restrained state support increase the burden on local governments limiting their options for solutions. Thus, seriously constraining growth in property taxes will necessitate collaboration between state and local governments working with informed policymakers and voters to find new arrangements that better reflect population trends. Other states have worked on these issues as is discussed in more detail later.

How Do Tax Burdens in Illinois Compare with Other States?

Illinois is in the unenviable position of ranking second among states in *effective* property tax rates (EPTR)—property taxes paid as a percentage of house value. New Jersey often ranks highest but alternates positions with Illinois, depending on tax base used and rating agency.^v In 2018, the most recent data available, the EPTR in Illinois was 2.32, meaning that an average taxpayer pays 2.32% of the house value in property taxes annually in Illinois.

Adding further to the concern is that tax rates in neighboring states--Indiana (.87), Iowa (1.50), Wisconsin (1.63), and Missouri (1.01) are much lower (Figure 2). These differences can distort decisions by both residents and businesses regarding where they choose to live or conduct business especially in Illinois counties that border neighboring states. Local governments feel compelled to provide tax concessions to lure employers, further shifting tax burdens to residents.

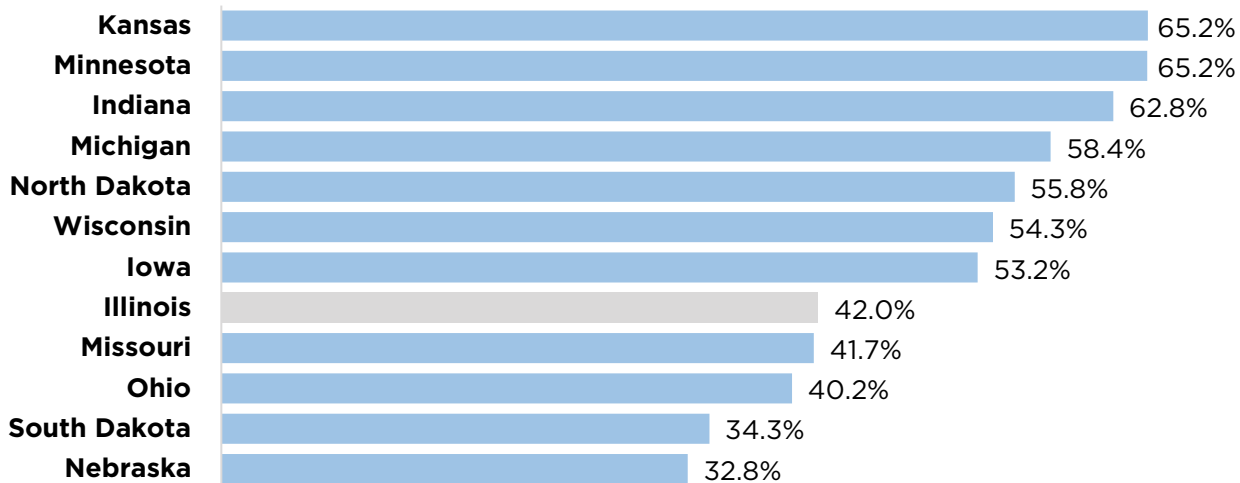
Figure 1. Effective Property Tax Rates by State, Residential Property, 2018.



Source: Tax Foundation, 2020 Facts and Figures, Table 34.

Property taxes finance mainly public education services which is key to a strong workforce needed to attract and retain quality jobs. In terms of state support for local education, Illinois (42.0%) ranked 31st among states compared with Wisconsin (54.3%), Iowa (53.2%), Michigan (58.4%), and Minnesota (65.2%). This low funding adds to already high local spending for school administration in Illinois resulting partly from numerous small school districts. Recent attempts to pass legislation addressing this issue have not yet passed (Figure 2).

Figure 2. State Share of Public Elementary & Secondary Education Funding, FY2017



Source: U.S. Census Bureau, Annual Survey of School System Finances, Table 5, 2018.

What Else Impacts Effective Tax Rates?

Illinois has by far the most decentralized arrangements for delivering local public services with 6,918 units of government in 2017, down slightly from 6,963 in 2012. By Census of Governments figures, it still exceeds Texas, Pennsylvania, and other states^{vi} (Figure 3). These estimates, however, include only independent decision-making governments and underestimate actual numbers, according to the Illinois Office of the Comptroller, which claims more than 8,500 units of government with still others not counted.^{vii}

Comparing states only by number of governments can be misleading, however. Minimum threshold sizes to deliver public services cause rural areas to have more governments per capita than densely settled urban areas that spread fixed costs over a larger number of taxpayers. Illinois ranks 14th among most decentralized structure in number of governments per 10,000 population. Small highly rural states such as Kansas and North Dakota have far more governments per resident.^{viii}

Figure 3. Numbers of Governments in Illinois

Year	2012	2017	Change
Total	6,963	6,918	-45
Counties	102	102	0
Municipalities	1,298	1,297	-1
Townships	1,431	1,429	-2
School Districts	905	886	-19
Special Districts	3,227	3,204	-23

Source: U.S. Census Bureau, *Census of Governments, Table 2, 2012 & 2017*.

Nevertheless, areas in Illinois with many small governments and likely duplication of effort also have higher effective property tax rates when other characteristics are considered.^{ix} Current arrangements for delivering services were created in the 19th Century with totally different transportation and communication systems. Relatively little systematic modernization in overall

structure has occurred since that time other than reorganizing school districts.

A need to increase services and restrictive property tax rate limits on funds leads to creation of additional governments to expand the revenue base. General purpose governments at fund rate limits create new governmental units with additional property tax revenues. In 1987, there were 2,783 special districts plus 1,029 school districts statewide, but with 3,204 special districts and 886 school districts in 2017. The number of school districts decreased 13.9% while the number of special districts increased 15.1%.

Special districts in Illinois peaked in 2007 and then decreased (45 fewer districts) with reductions in drainage, sanitary, and cemetery districts. Some declines in single-purpose sanitary districts involved reclassifications as multi-purpose districts providing sewer and water supply services, but with slight increases in library districts and single-purpose water authorities since 2007 (Figure 4). Even though drainage districts represent most of the reductions, these districts are sometimes benefits-based with low expenditures compared with other units of government.

While more governments do not always mean higher aggregate expenditures for services countywide, the number of governments per 1,000 residents is statistically correlated with effective tax rates for several reasons.^x Adding single purpose districts shifts more reliance on property taxes because of few other revenue options. Small units of government often cannot afford specialized expertise so they may be less aware of more efficient management approaches. Large numbers of governments can cause duplication of functions leading to higher operating costs than needed with better coordination.

Even when potential inefficiencies are recognized, local leaders may have difficulties combining or eliminating governmental agencies without enabling legislation. The 2015 Commission on Government Consolidation and Unfunded Mandates recommended ways to adjust numbers of local governments with possible cost savings. State legislation passed following the Commission report in 2016 empowers local groups to merge, consolidate, or collaborate internally or with neighboring jurisdictions through intergovernmental agreements. Efforts are also underway to pass legislation that would merge small school districts. Incentives for small governmental units to collaborate and/or combine operations could help reduce costs. These approaches work best with local options and incentives to streamline or modernize public service delivery systems.

Figure 4. Changes in Numbers of Special Districts, 2007-2017

Special District Type	2007	2017	Change
Total Special Districts (Excl. Schools)	3,249	3,204	-45
Miscellaneous, Multi-Function Districts, e.g., auditorium & office building authorities, multi-purpose drainage districts	45	23	-22
Sewerage	116	96	-20
Drainage & Flood Control	909	894	-15
Cemeteries	70	60	-10
Fire	841	838	-3
Soil & Water Conservation	113	110	-3
Highways	26	23	-3
Air Transportation	32	31	-1
Hospitals	19	18	-1
Housing & Community Development	113	113	0
Health	29	30	1
Solid Waste Management	10	11	1
Libraries	345	352	7
Water Supply	102	109	7
Sewerage & Water Supply	18	25	7
Parks & Recreation	389	399	10
All Other, Not Consistently Classified Between Years	72	72	0

Source: U.S. Census Bureau, Census of Governments, Table 9, 2007 & 2017.

How are Services Financed Now?

Since 2007, the composition of expenditures by type of local government has remained relatively the same. The proportion of expenditures by counties and municipalities decreased less than 0.5% while the shares by school districts and special districts increased (Figure 5). These trends were consistent across county sizes (not shown). Small municipalities may be unable to deliver the levels of services needed, especially those with high fixed costs. A fire protection district, for example, may serve several municipalities and surrounding unincorporated areas.

Figure 5. Share of Total Expenditures by Government and County Size, 2017

County Type	Township	County	Municipality	School District	Special District
Statewide Total (% in 2007)	1.0% (1.0%)	10.3% (10.6%)	30.4% (32.1%)	41.3% (39.9%)	17.0% (16.3%)
Nonmetro, Below 10,000	2.8%	20.8%	14.2%	38.4%	23.8%
Nonmetro, 10,000-24,999	3.3%	15.1%	22.1%	43.4%	16.2%
Nonmetro, 25,000-49,999	2.6%	12.3%	24.9%	47.3%	12.9%
Nonmetro, 50,000+	1.8%	11.5%	32.6%	45.9%	8.2%
Metropolitan Counties	0.8%	10.0%	30.9%	40.9%	17.4%

Source: U.S. Census Bureau, 2017 Census of Governments.

On average, special districts represented 17.0% of expenditures by local governments statewide in 2017. However, in rural counties smaller than 10,000 population, special districts represented 23.8% compared with only 8.2% in nonmetro counties larger than 50,000. Efficiencies might be gained from merging several small units of government into an intermediate government when countywide delivery of services is not feasible. Given their broad spending authority, perhaps townships could replace several special districts in the future to lower pressures on property taxes.

The relative share of property taxes collected by townships decreases by county size—from 8.8% in small counties to 4.8% in those with populations of 50,000 or more. School districts show relatively little differences, except in the smallest counties which may reflect somewhat similar basic spending per student but lower salaries and fewer program offerings in small rural schools. There is some trade-off between townships and special districts which are more important in larger counties where townships collect smaller shares of property taxes.

Also important is share of taxable property available by type of local government. For instance, the share of property tax revenue collected by townships and special districts is less than their share of total equalized assessed value (EAV).

Municipalities and school districts represent a larger share of the taxes collected, compared to share of EAV.

Figure 6 shows school districts collect more than half of the property taxes in all county size groups. Special districts, while representing 10% or less in property taxes, are more important in metro counties. Townships collect less than 10% of the property taxes in *rural* counties, comparable to the shares collected by special districts—relatively small, but still important components of the property tax burden. The large numbers of districts and townships that combined collect 15% to 20% of property taxes may offer opportunities to realign service delivery arrangements, in some cases using collaborative efforts.

The distribution of property tax revenues by type of government has remained largely unchanged since 2007 and was consistent by county size groups. The share of property taxes collected by townships, school districts, and special districts changed less than 1%, with the share collected by county governments decreasing from 9.6% of total in 2007, to 8.4% in 2017. During the same period, the share for municipalities increased from 14.5% to 15.7%.

Figure 6. Share of Total Property Tax Revenue by Government and County Size, 2017

County Type	Townships	County	Municipalities	School Districts	Special Districts
Statewide (% of Total in 2007) Share of Total EAV in 2018	2.1% (2.2%) 9.2%	8.4% (9.6%) 11.7%	15.7% (14.5%) 10.0%	63.5% (62.9%) 28.1%	10.3% (10.7%) 41.1%
Nonmetro, Pop. Below 10,000	8.8%	23.7%	6.5%	53.5%	7.5%
Nonmetro, 10,000-24,999	8.7%	14.5%	8.4%	59.8%	8.5%
Nonmetro, 25,000-49,999	6.8%	12.0%	10.0%	62.8%	8.3%
Nonmetro, 50,000+	4.8%	13.1%	11.6%	63.2%	7.3%
Metropolitan Counties	1.7%	7.9%	16.2%	63.7%	10.5%

Source: U.S. Census Bureau; 2017 Census of Governments; Illinois Department of Revenue, Property Tax Statistics, Table 28, 2018.

Costs of local public services will continue to increase because of rising wages and other operating costs such as pension obligations. Population declines combined with outmigration and an aging population needing additional services such as healthcare are likely. Less spending by residents and tax relief may slow the growth or even reduce the property tax base, in some areas. These trends will stretch local resources, increasing the need to raise effective property tax rates for remaining residents. Higher effective tax rates will render Illinois less competitive in attracting industry and could even increase outmigration in some cases.^{xi}

Successfully addressing these concerns will take a multi-pronged approach implemented by state and local governments. Fortunately, other states have used strategies to address similar issues and Illinois might learn from their successes. Some of these efforts incentivize local governments to take actions, along with metrics to help guide local strategies. Support from local leaders and engagement by residents is enhanced by giving voters easy to understand information and insights from best practices. Unfortunately, small nonmetro areas, without substantial internal expertise on these topics, may have the greatest need for efficiencies from modernizing their governmental structure but be least informed about potential gains.

What Options Does Illinois Have?

Based on experiences in other states and recent programs in Illinois, several avenues can be pursued to help relieve pressures on local property taxes through more efficient operations while not reducing service quality. Options to consider are discussed next.

- *Pass Task Force Recommendation.* The Task Force on Government Consolidation and Unfunded Mandates recommended several ways to reduce costs of delivering services. Some approaches would simplify procedures for mergers or agency consolidations while others reduce mandates on local governments. The recommendations, based on survey responses from 500 local governmental units, could be further reviewed and adopted as appropriate. Going forward, implementing provisions of the State Fiscal Mandates Act could also help slow property tax increases.
- *Incentivize local governments to implement efficiencies.* Modifying arrangements for delivering public services is difficult due to vested interests and resistance to change even though current arrangements for delivering services started under different transportation, technology, and other arrangements. Mergers of school districts often are triggered by small class sizes but the immediate need for collaboration or consolidations may go unnoticed in other agencies.

Alternative arrangements for delivering similar services may not always be readily available especially in rural areas. For instance, small county governments may not currently have the resources or capacity to deliver countywide services other than law enforcement and legal systems. Delivering other services countywide will take additional resources.

Counties with very small populations could consider merging or providing services jointly through intergovernmental agreements. However, these agreements or mergers raise additional issues such as responsibility for debt, tax rates possibly increasing in a county, equalizing wages, and so on. Those issues must be resolved before moving forward.

Also important is that cost savings from innovations are not always realized immediately or may not mean better services for all residents in every case, which will be an obstacle in decisions. Thus, it is worth considering incentives to local governments to closely examine options that update delivery arrangements to achieve cost savings.

New York has a County-wide Shared Services Initiative as part of its statewide program that works with local governments to reduce property taxes. In 2019, it allocated \$225 million in competitive grants to match cost-savings by local agencies.^{xii} This program and others could be examined for use in Illinois to encourage local agencies to consider alternative service delivery systems.

- *Offer technical assistance to local agencies.* Small governments, especially in rural Illinois where projected population declines are most serious, have a part-time staff with insufficient time to research best practices. Similarly, gathering accurate detailed data to compare their

operations with other units of government can be difficult. The Illinois Office of the Comptroller Warehouse Data can be overwhelming for non-technical users not familiar with analyzing this data set. Thus, technical assistance could help local leaders evaluate and implement cost-saving collaborations.

An outgrowth of the 2015 Task Force was the Local Efficiency Assessment Plan with a guidebook and electronic database (LEAP©). The plan helps local officials and community leaders identify opportunities to reduce duplication and inefficiencies. The locally driven process informs users about costs of current services, how they compare with other agencies using alternative delivery arrangements, and it suggests future implications for finances. The LEAP© materials were created by the Center for Governmental Studies at Northern Illinois University and are available to users at no cost.^{xiii} The intended outcome is a locally-designed action plan to generate cost-savings and possibly lessen the need for higher property taxes.

Local groups could be encouraged to use LEAP or other programs through incentives to participate in property tax reduction initiatives. New York has a Municipal Consolidation and Efficiency Competition that rewards groups of local governments that share services, consolidate, or take other approaches to permanently reduce property taxes. It also offers a comprehensive review of operations by an external agency to help local officials identify potential cost-savings. This relatively low-cost program could be tried in Illinois.

Ohio uses a website (*SkinnyOhio.org*) to provide examples of cost-savings and discussions of actions used by government units to achieve efficiencies through collaborations.^{xiv} The system

also places interested users in contact with other groups engaged in similar efforts. Illinois could use a similar method to encourage local leaders to examine and determine viable options.

Along these lines, the Illinois Office of Lt. Governor Evelyn Sanguinetti surveyed local units of government in 2016 and 2018. The surveys asked them to report examples of how they collaborated, merged agencies, or took other actions to reduce costs along with cost-savings realized.^{xv} The Metropolitan Mayors Caucus surveyed collaboration efforts in the Chicago Metropolitan Area. These surveys can be continued and shared with local leaders considering similar actions. While not as extensive as *SkinnyOhio.org*, they could inform local leaders about options and outcomes.

Previously, a state agency in the Department of Local Government Affairs, and then the Department of Commerce and Community Affairs, provided technical and financial management assistance to local governments regarding procedures and management issues. Reinstating a unit with these responsibilities could help local leaders find and implement cost-saving initiatives. Similarly, educational programs highlighting successes can inform and encourage local leaders to innovate with these options. Several university agencies, including the UI-Extension and the Illinois Township Management Academy at NIU, currently offer educational programs.

- *Pass statewide legislation eliminating specific governmental agencies.* A more direct approach tried in several past attempts was to eliminate governmental units by legislation. The efforts were not successful and transferring responsibility for area-wide services to an intermediate level government. may be as, or

more, useful. For example, a township could then have responsibility for these services rather than relying on several special districts. These decisions are best made by local taxpayers and the one-size-fits-all approach may not generate the desired outcomes. Providing incentives for local governments to share administration and common functions can offer economies of scale while retaining needed diversity in levels and types of services. Again, the choice remains local. New York has examples of building incentives into these decisions.

General Observations

Addressing the issue of potentially rising property taxes is a crucial and daunting task especially in difficult fiscal scenarios for some governments, but it is time to move past describing the situation and go to the action stage. At the very least, effectively addressing the issues will require proven strategies and collaboration between state and local leaders. This *Policy Profile* discusses possible alternatives, suggests components of successful strategies, and presents examples that have worked in other states. The changing demographics and potentially rising per capita property taxes in many counties will be difficult to address. Solutions will not be quick, but nevertheless, are needed. Fortunately, Illinois has been working on these issues and has tools available. What may be missing are incentives for quick actions to overcome local opposition.

Endnotes

- ⁱ A previous version of this report was submitted as written testimony to the Government Consolidation Sub-Committee for the Property Tax Working Group in 2019.
- ⁱⁱ Illinois Department of Public Health, 2015 Population Projections.
- ⁱⁱⁱ See, for example: Moretti, E., & Wilson, D. (2017). The Effect of State Taxes on the Geographical Location of Top Earners: Evidence from Star Scientists. *Federal Reserve Bank of San Francisco Working Paper 2015-06*. <https://www.frbsf.org/economic-research/files/wp2015-06.pdf>; Lai, A., Cohen, R., & Steindel, C. (2011). The Effects of Marginal Tax Rates on Interstate Migration in the U.S. *Report commissioned by the New Jersey Department of the Treasury*. <https://www.frbsf.org/economic-research/files/wp2015-06.pdf>
- ^{iv} <https://www2.illinois.gov/rev/research/taxresearch/Pages/Property-Tax-Relief-Task-Force.aspx>
- ^v Tax Foundation, *2019 Facts and Figures*, Table 34. <https://taxfoundation.org/publications/facts-and-figures/>
- ^{vi} U.S. Bureau of the Census. Census of Governments, respective years.
- ^{vii} Task Force on Local Government Consolidation and Unfunded Mandates. 2015. *Delivering Efficient, Effective, and Streamlined Government to Illinois Taxpayers*. <https://www2.illinois.gov/sites/lrg/issues/localgovernments/Pages/default.aspx>
- ^{viii} U.S. Census Bureau, 2017 Census of Governments.
- ^{ix} Based on county-level data without adjusting for other factors, the effective property tax rate in 2017 is significantly and positively correlated with a Herfindahl-Hirschman index of government structure in 2012, where values closer to 1 indicate more government fragmentation.
- ^x Op. cit.
- ^{xi} Outmigration related to property taxes is prevalent on border counties. See, for example, the discussion in the Comprehensive Economic Development Strategy for the Rockford area: http://www.rmapil.org/assets/documents/2016_2020_ceds.pdf
- ^{xii} New York County-Wide Shared Services Initiative, see: <https://www.budget.ny.gov/pubs/archive/fy19/exec/fy19book/LocalGovernment.pdf>
- ^{xiii} A guidebook to help local governments modernize delivery of public services is available at: <https://www.cgs.niu.edu/Reports/modernizing-local-service-delivery-systems-oct-2019.pdf>
- ^{xiv} For additional information on efforts in Ohio, see: <http://skinnyohio.org/>
- ^{xv} Two volumes of the Local Government Shared Service Best Practices were released in 2016 and 2018. See: <https://www.cgs.niu.edu/Reports/journal-of-local-government-shared-services.pdf> and <https://www.cgs.niu.edu/Reports/local-government-shared-services-journal-vol-2.pdf>



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