

# **The Fiscal Impact of Development on Indiana Local Governments**

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**Spring 2001**

## **What is Fiscal Impact?**

The fiscal impact of development is the effect of new investment, new construction, new employment, new population, new school enrollment and other changes on a government's budget. When new businesses start, new houses are built, and new people move into a community, local governments receive additional revenue. The business owners and homeowners pay new property taxes. New residents pay new local income taxes and motor vehicle taxes. New people and businesses pay more charges, fines and fees. But these new people and businesses also create new costs. New businesses and housing developments may require new roads, sewers, police and fire protection. New residents may demand new parks. Greater traffic congestion may require more roads, traffic lights and police patrols. More children in schools may require more teachers and even new school buildings.

The fiscal impact of new development compares these new revenues to these new costs. If new revenues exceed new costs, the fiscal impact is said to be positive. The local government can more than meet new demands for services, and (perhaps) provide a tax reduction for existing taxpayers. If new revenues fall short of new costs, however, the fiscal impact is negative. The local government must raise taxes to meet new service demands, and (perhaps) reduce the quantity or quality of existing services.

## **What Affects Fiscal Impact?**

Three factors appear to most influence the fiscal impact of new development:

- Development type, whether residential, commercial or industrial;
- Existing government capacity, whether new growth can be served with existing employees and infrastructure, or new employees and infrastructure must be added;
- Development concentration, whether development is concentrated near existing infrastructure or scattered throughout the jurisdiction.

Much research from Indiana and the U.S. implies that industrial and commercial development tends to have positive fiscal impacts, while residential development has negative fiscal impacts. Agriculture ranks between commercial/industrial and residential development.

A statistical study for Indiana found that each 10% increase in population increases county government costs about 8%, and county assessed value about 5%. With the tax base rising less than costs, tax increases would be needed to continue to provide existing services. Each 10% increase in employment increases costs about 1%, and assessed

value about 3%. With the tax base rising more than costs, tax decreases or service increases are possible. Similar results were found for school corporations. These are results for residential and business development in isolation. Looking at different kinds of development separately is appropriate because development does not respect jurisdictional boundaries. Business development and employment growth may take place in one county, city or school corporation, while the associated residential development and population growth may take place in another. If business and residential growth are considered together, however, these results imply that to "break even", counties must see about 7 new jobs for every ten new people. Currently in Indiana there are about 5 jobs for every ten people. Historically, then, the process of development has tended to raise tax rates--the positive fiscal impacts of added business have not been enough to offset the negative fiscal impacts of added housing.

The long expansion of the 1990s appears to be an exception to this historical trend, however. In the 1990s Indiana employment has increased by *more* than population--11 new jobs for every 10 new people. Unemployment has fallen and labor force participation has increased. Expanded business has created added revenue, while the relatively few new residents have created less in new costs.

Government capacity matters. Sometimes governments can provide services to new residents and businesses with existing employees and infrastructure. School corporations may have extra classroom space. Police departments may be able to expand patrol areas with no reduction in public safety. Park space may be underutilized by current residents. If extra capacity exists, the costs added by any new development are less, so fiscal impacts of any new development are more positive. Sometimes, however, existing demands for services exceed government capacity. If employees and infrastructure are stretched to the limit, new development of any kind may require new employees, equipment and buildings. For example, perhaps the next new housing development will force the construction and staffing of a new fire station or new elementary school. If no extra capacity exists, the costs added by any new development are more, so the fiscal impacts are more negative.

Much research has found that concentrated development is less costly than scattered development. Longer school bus routes increase school costs. The added property tax revenue from widely scattered homes may not be enough to cover the maintenance costs of rural roads. More employees, vehicles and stations are needed to keep emergency response times short enough. Furthermore, if new development is located near existing infrastructure, any existing excess capacity can be used at little additional cost. If new development is located far from existing infrastructure, new facilities usually must be provided at higher cost.

## **A Fiscal Impact Example**

Suppose an average housing development is built in an average Indiana school corporation. The housing development might have 25 homes, each selling for \$100,000, each with families of two adults and one school age child. Suppose that 18 of the families are new to the school corporation, while 7 are simply moving from another location within the corporation. The average school corporation has 3,235 pupils and 191 teachers, for an average class size of 17. It's got \$184 million in assessed value, \$57,000 per pupil, and a property tax rate of \$5.11 per \$100 assessed value.

Here are the new revenues this development generates for the school corporation:

New property taxes, for general, transportation and capital projects funds: \$18,213  
New motor vehicle excise taxes, plus added charges and fees: \$5,068  
New state aid: \$55,170  
Total New Revenue: \$78,451.

There is also \$4,663 in debt service property tax revenue, collected to pay off bonds issued to for construction of school buildings. This is not counted as new revenue, however, because the debt repayment schedule is usually fixed, and the tax rate will adjust up or down in order to raise this fixed payment. The "new" debt service revenue would actually be used to reduce (slightly) the rate paid by existing taxpayers.

State aid is distributed by a formula passed into law by the Indiana General Assembly. It is complex, but essentially delivers more aid per pupil to school corporations with less assessed value per pupil, and less aid per pupil to school corporations with more assessed value per pupil. For a new development, the higher the assessed value per pupil, and the smaller the number of new pupils, the smaller will be the added aid received. In extreme cases a very high valued, low enrollment development could reduce total state aid. The lower is assessed value per pupil, and the larger the number of new pupils, the larger will be the added aid received.

Here are the new costs this development generates for the school corporation:

New teachers, to maintain constant class size: \$40,717  
New annual debt service, to meet requirements for new classroom space: \$22,970  
Transportation expenses: \$7,751  
Costs for administration, health, cafeteria, maintenance and other services, based on average per pupil expenditures: \$60,961  
Total New Costs: \$132,398

Fiscal Impact: -\$53,947.

The fiscal impact is negative, implying that the average housing development produces more in added costs than it generates in added revenue for the average school

corporation. This is consistent with the results of many fiscal impact studies showing housing to have negative fiscal impacts.

There are a number of changes that could make the fiscal impact less negative, or even positive:

- Higher valued homes with fewer new pupils
- Added business property within school corporation boundaries, in addition to the new housing for the businesses' customers and employees
- Lower salaries for new employees and lower per pupil costs for other services
- Extra school capacity, meaning new teachers need not be hired nor new classroom space built
- New housing close to school buildings, so there are no new transportation costs

### **Implications for Indiana Local Governments**

- Indiana's property tax controls restrict most civil government operating levies to 5% annual increases. Added assessed value does not automatically increase available revenue. Instead, governments raise the controlled levy with lower tax rates. This reduces the fiscal advantage of commercial and industrial development over residential development in Indiana, compared to other states.
- The property tax controls imply that service provision can more easily keep up with slower growth. With 5% in new property tax funds available each year, and inflation running at 2% to 3%, new services for annual population growth of 3% or less probably can be funded under the controls. More rapid population growth may require diminished service quantity or quality.
- Governments can generate new revenues from new assessed value by using tax increment finance districts (for business development only), new cumulative fund rates, or new debt, all of which are outside the controls. These tools can be used for infrastructure, not for day-to-day operating funds. The Economic Development Income Tax (EDIT) can also generate funds for infrastructure.
- Indiana allows local civil governments (not school corporations) to impose income taxes, which increase the revenues generated by new residents. The County Option Income Tax (COIT) provides more "spendable revenue" than the County Adjusted Gross Income Tax (CAGIT). This is because CAGIT requires some of its revenue to be used for property tax reductions. Most states do not have local income taxes, meaning that in Indiana residential development has a less negative fiscal impact than is true nationally.
- Some counties, cities and towns generate new infrastructure revenues from impact fees, which developers must pay when new projects are constructed. State law restricts the use of these fees.
- Higher valued homes have less negative or more positive fiscal impacts than do lower valued homes. Higher valued homes add somewhat more in property taxes (though this is restricted by the controls), and since higher income people tend to live in higher valued homes, they pay more in income taxes.

- More people mean more costs. If the number of residents per house rises, or the number of people locating in a housing development from outside the jurisdiction increases, fiscal impacts become more negative.
- Bigger, more equipment-intensive, higher wage businesses provide more positive fiscal impacts. Costs are more closely related to land and buildings than to equipment, yet equipment is assessed for property tax purposes. In addition, one big firm is less costly to serve than are several smaller firms of equal assessed value, due to economies of scale and space. Higher wage employees who locate within the jurisdiction pay more in local income taxes and may build higher valued houses.
- Businesses that employ people who are already residents tend to have more positive fiscal impacts than those that cause new people to move into the jurisdiction. Existing residents are already being served by local governments, while new residents add new costs.
- Tax abatements do not reduce operating revenues. This is because the property tax controls cause the tax rates to adjust to changes in assessed value. With a controlled levy, an assessed value increase reduces the tax rate for existing taxpayers. If the assessed value increase is less because of abatements, the tax rate falls less. Tax savings are reduced, but the same property tax revenue is raised for civil unit operating budgets. Abatements reduce the tax base available for infrastructure through tax increment financing, debt service or cumulative funds, however.
- For school corporations, the greater is new assessed value relative to new enrollment, the more positive will be the fiscal impact of a development. Developments with no new enrollment almost always have positive fiscal impacts. Since enrollment is the primary cost of school corporations, school costs escalate rapidly as enrollment increases.
- Added revenue is more likely to cover added costs in jurisdictions that deliver services at lower cost, or in jurisdictions that deliver fewer services.

### **Fiscal Impact Isn't Everything**

Communities may be tempted to take a positive or negative fiscal impact as the answer to whether a development project should go forward or not. This would be a mistake. Jobs and incomes are also important. Avoiding lower value residential development because of its negative fiscal impact may make labor so scarce as to inhibit industrial development, costing the community jobs, income and possible offsetting positive fiscal impacts. The environment is important. It is easy to envision a chemical waste dump with a positive fiscal impact: lots of taxable equipment, no direct addition to school enrollment. Deciding whether to allow such development based only on fiscal impact would miss the issues that often concern citizens the most. Equity is important. Some apartments and manufactured home parks have large negative fiscal impacts. But, many believe that lower income people should pay less in taxes, yet receive the same services as all community residents. If so, lower valued housing *must* have a negative fiscal impact. Fiscal impact is important, but only one of the many factors communities must consider in setting development policy.

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