

Facts & Figures

a publication of the Education Tax Policy Institute

SUMMER 2007 EDITION

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Homestead Exemption Expansion Comparison

The Strickland Administration proposed an expansion of Ohio's homestead exemption in the biennial budget. So far, that proposal has passed the House of Representatives without any changes, except that its implementation has been delayed until the State can determine that sufficient revenues will be available to reimburse local taxing authorities for the proposed additional exemption.

The proposed school funding amendment sponsored by Getting It Right! for Ohio's Future also includes an expansion of the homestead exemption. Here is a comparison of the current homestead exemption and the two proposals to expand it.

Current Homestead Exemption

The current homestead exemption only benefits persons with income less than \$27,000, indexed for inflation, who are elderly or disabled persons. The exemption uses three brackets

so that the benefit decreases as income increases. The maximum amount of taxable valuation exempted equals \$5,700 in 2007. This amount is adjusted for inflation in future years. Only persons with the lowest qualified income of \$0 to \$13,800 (also indexed for inflation) qualify for the maximum reduction under current law.

The exemption benefit equals gross tax rate times the exempted valuation. Gross tax rate in this context means the tax rate before accounting for the effect of any reduction mandated by H.B. 920. The average benefit equals the number of beneficiaries (220,000) divided into the total cost of the program (\$70 million) or about \$318 per homestead.

Administration Proposal

All income qualifiers are removed so that all persons who are either elderly or disabled qualify. Every homestead receives the same reduction in

market value of \$25,000.

Assuming that taxable value equals 35% of market value, \$25,000 in true or market value equate to taxable value of \$8,750. This value is not indexed for inflation.

Only the effective tax rate for residential property would apply to the exempted valuation to determine the reduction in tax liability after any reduction for the 12 1/2% rollback. Since the average tax rate for residential property equals about 54 mills, a homestead owner in an average location would receive a tax benefit of about \$413. Alternatively, dividing the estimated cost of the new exemption (\$330 million) by the estimated number of qualified homesteads (775,000) yields a similar per homestead benefit of \$426.

This proposal would add about \$260 million to the cost of the homestead exemption so that the total cost of the program would equal about \$330 million. ■

Tobacco Settlement Securitization:

What is it, and How Does it Affect Ohio's Schools?

Overview

Governor Strickland has proposed, and the Ohio House of Representatives has approved, the use of "securitization" as a method for leveraging tobacco settlement revenue to fund school facilities projects. As part of the Master Settlement Agreement (MSA) reached in

1998 between the major tobacco companies and Ohio and other states, Ohio is to receive expected annual payments totaling approximately \$18.7 billion over the next 40 years. Securitization of these tobacco settlement revenues will result in the immediate payment of \$5.4 billion to the State of Ohio by investors in bonds who will

themselves receive the annual MSA payments.

Governor Strickland and the House of Representatives propose that this \$5.4 billion in one-time revenue be used to expand the Ohio School Facilities Construction program and to retire certain other state debt obligations. The securitization (continued on next page)

Ohio's Resource for Reliable Data & Analysis

ETPI 

8050 N. High St.,
Suite 100
Columbus, OH
43230

614-540-4000
614-540-4100 (fax)

www.etpi-ohio.org

Tobacco Settlement Securitization con't from pg. 1

“In essence, Ohio will receive ‘only’ \$5.4 billion from tobacco securitization ...”

... will generate \$5.4 billion in cash. Some of this revenue will enable the State to pay cash for school facilities projects in the 2008 and 2009. By paying cash rather than using the State’s general obligation credit, the State GRF will realize roughly \$257 million in savings on the State’s debt service costs. In this way, the use of the securitization funds in place of GRF-backed general obligation debt will yield a savings and allow for an expansion of Ohio’s Homestead Exemption program which provides tax relief for disabled and senior citizen homeowners (see the accompanying article in this newsletter for more information on this program). The \$257 million in savings represents an annual amount over a period of 20 years.

What is “Securitization” and How Does it Work?

At first blush, the trading of \$18.7 billion in future payments for an upfront payment of \$5.4 billion may not appear to make much fiscal sense as the state is receiving only 29% of the revenue that it would receive if it opted to continue the annual payments. However, this simple calculation ignores the economic concept of “present value,” which is based upon the idea that a dollar you have in your possession now is worth more than one you will receive in a year, or ten years, or 40 years. This is because a dollar you have now can be invested and will be worth more in a year – and even more in 10 years



– and much more 40 years from now. In general, the higher the rate of return and the longer the future time frame, the more a dollar you have now will be worth. Depending

on the costs and fees of the investors and bondholders involved in securitizing the tobacco settlement, the \$5.4 billion revenue amount equates to an approximate annual interest rate of between 5.85% and 7.5%.

In essence, Ohio will receive “only” \$5.4 billion from tobacco securitization for the exact same reason that the winner of a \$100 million Mega Millions jackpot may receive “only” \$45-\$50 million if they selected the “up front” payment option instead of the option where they would receive an annual payment of \$5 million for 20 years.

How will Tobacco Securitization Improve Funding for School Facilities in Ohio?

According to testimony presented by State Budget Director J. Pari Sabety to the Senate Finance & Appropriations Committee on May 1, 2007, funds from tobacco securitization will accelerate the schedule by which school districts receive state funding for construction and renovation of school facilities.

Currently, state funding for school construction comes from GRF funds, GRF backed general obligation debt, and a share of the annual tobacco settlement proceeds received by the state. The Ohio School Facilities Commission (OSFC) is currently scheduled to receive an estimated \$3.3 billion in tobacco settlement revenues from FY2008 to FY2025. The present value of this revenue stream is roughly \$2.2 billion. In addition, the OSFC is also to receive \$2.0 billion in GRF-backed general obligation debt from FY08 to FY10. The present value of this revenue is slightly more than \$1.9 billion. Tobacco securitization will provide \$4.1 billion (\$2.2 + \$1.9) to be paid in one lump sum to the OSFC in FY08 in place of these revenues.

By receiving this \$4.1 billion lump sum payment, the OSFC will be able to expand funding in FY08 from 30 districts to roughly 60 districts, and

still be able to fund an additional 30 districts in FY09 and FY10 as currently planned. The Office of Budget & Management (OBM) estimates that this will provide funding for districts at the 55th -60th percentile of property wealth (OSFC funds districts according to property wealth per pupil, from lowest to highest) by the end of FY10. Beginning in FY11, OSFC funding will again return to GRF funds and GRF-backed general obligation debt in order to provide funding for the districts in the 60th to 100th percentile of property wealth.

This Sounds Pretty Good – Is There Any Cause for Concern Regarding Tobacco Securitization?

There are two reasons to be concerned about the proposal to securitize the MSA revenue that Ohio is scheduled to receive over the next 40 years. The first is that while the infusion of \$4.1 billion of upfront funding for the OSFC in FY08 will allow more school districts to receive funding sooner, the price for this acceleration is that beginning in FY11 the state will no longer have annual tobacco settlement revenue to help supplement GRF funding for the remaining school districts.

The second cause for concern is that funding for prevention and control of tobacco use – one of the initial purposes of the MSA revenue – is likely to be severely compromised as a result of the current securitization proposal. This is because the Ohio Tobacco Prevention Foundation (OTPF) will no longer receive additional revenue if the proposed securitization plan is approved in its current form. This problem can be remedied if less than 100% of future MSA payments are securitized. In turn this would require either a scaling back of the proposed homestead exemption expansion or else the need for additional GRF money to pay for it. ■

Tangible Personal Property (TPP) Tax Update

The Tangible Personal Property (TPP) Tax continues to phase down as planned as a result of House Bill 66, the biennial budget bill for fiscal years 2006 and 2007. With some exceptions, school districts and local governments are held harmless from this loss of local revenue for a period of time. The State is making payments to school districts and other local government entities out of the proceeds from the new business Commercial Activities Tax (CAT).

However, replacement payments for the TPP will soon be eliminated. School districts are to receive full payments for 5 years, with these replacement payments phasing down over 7 years after that. Because the elimination of the TPP will cause school district property values to go down, schools will see an increase in state aid related to the first 23 mills, as long as they are not on some type of guarantee (i.e., transitional aid guarantee). If they receive some payments directly from the State outside the increases in the formula aid during the phase-out period, those payments will end by 2018.

Other local governments do not have the benefit of a State funding formula that will continue to replace lost local revenue after the HB 66 replacement payments end. Once the planned phase-out of payments for

these entities is complete, local governments other than school districts will receive no replacement from the State for their losses.

A new coalition has been formed to work with legislators on making the replacement payments to local governments and schools more permanent. The group has adopted the slogan “*Tangible Personal Property Tax – Unfinished Business of Tax Reform.*” They are collecting data and producing documents to help them inform legislators about their goals.

The ETPI consultants have done some research to help aid the Unfinished Business of Tax Reform work. Data regarding school district and local government losses is being compiled to help inform legislators and other state leaders about the effects the loss of TPP will have on local governments and taxpayers.

According to the research, once the replacement payments go away, 48.8% of the revenue losses for all school districts will not be replaced through the state funding formula. This amounts to about \$548,207,282 that will have to be made up by some

other means. One could assume that this represents a significant shift to homeowners and other property tax payers.

This data does not include the loss of values for future levies.

Districts will have to increase millage rates on proposed new levies to generate the revenue they need, because they will have a smaller tax base.



The organizations working on this issue report that State Representative Jim Hughes (R-Columbus) has introduced HB 14 that would make permanent the TPP replacement payments to school districts. The bill has had sponsor testimony in the House Finance Committee.

Some other key lawmakers have indicated a willingness to work with the organizations on a long-term solution, but will not be ready for serious talks until after the budget process for the next biennium is complete (HB 119). Since replacement payments will continue through fiscal years 2008 and 2009, they believe there is still time to act. ■

... once the replacement payments go away, 48.8% of the revenue losses for all school districts will not be replaced through the state funding formula.”

Getting it Right for Ohio's Future Proposal

The proposed educational funding constitutional amendment would require a homestead reduction with certain details specified in the Constitution. Specifically, the new homestead exemption would have no income qualifications. Therefore, all elderly and disabled persons would qualify. The computation of tax relief would equal the tax rate of the required local contribution (about 20 mills) times \$14,000 in taxable value (\$40,000 in market value).

Annual adjustments would apply to the \$40,000 exemption amount based on the statewide average change in residential real property valuations.

Based on a 20 mill local contribution rate, the homestead exemption under the proposed constitution amendment would equal \$280 in the first year with adjustments for average valuation changes after that. Note that the proposed amendment addresses only the homestead exemption to the extent that it reduces school taxes. The proposal does not affect the current homestead exemption reduction related to taxes of other local governments. Whether the local government part of the homestead exemption would continue in some form would depend upon legislative action.

Comparison of Administration Proposal to Proposed Constitutional Amendment

The table shows a comparison of the current law, the Administration's proposal, and the proposed constitutional amendment.

	Current	Administra- tion	Getting It Right
Number of Qualified Homesteads	220,000	775,000	775,000
Average Tax Rate	75 Mills	47.25 Mills	20 Mills
Taxable Value Exempted	\$5,700 (Maximum)	\$8,750	\$14,000
Average Benefit Per Homestead	\$318	\$426	\$280
Total Cost	\$70,000,000	\$330,000,000	\$217,000,000

The table shows that both the Administration and the proposed constitutional amendment would expand the number of qualified homesteads to the same extent. The

proposed amendment provides a more generous valuation exemption, but it would use only the required local school contribution tax rate. In contrast, the Administration proposal would use a lower exempt value but a higher tax rate.

Future Costs

Current law permits the homestead exemption to grow in two ways. The income qualification brackets increase with inflation, and the allowable taxable value exempted also increases at the inflation rate. The number of qualified homestead applicants has not increased rapidly because income qualifications limit participation in the program to elderly and disabled persons with relatively low income. For example, in 1994, counties granted 241,604 homestead exemptions. Even after the introduction of indexing income brackets for inflation took effect in 2000, the number of homestead exemptions granted in 2004 equaled 220,525. Thus, the number of beneficiaries of the program actually declined by about 20,000 over ten years.

The removal of any income qualifications from the homestead exemption will change this trend. The cost of homestead exemptions will depend first on the number of homestead exemptions allowed in future years. Growth in the elderly population will cause significant increases in the number of qualified applicants over the next 25 years. For example, the Census Bureau predicts that the number of persons 65 and over in Ohio will grow from about 1.6 million in 2010 to about 2.4 million in 2030. That represents a 50% increase over the time period. The growth in the elderly population will expand the number of homestead exemptions and the cost of the program under both proposals. The current program's income qualification provisions will prevent it from expanding so rapidly.

Growth in the average effective tax rate could increase the cost of the homestead exemption under Administration's proposal, but such increases would not occur rapidly based on past experience. In the case of the proposed constitutional amendment, program costs will increase because the exempt value is indexed to the average increase in statewide real property values.

Under both proposals the expansion of the number of qualified participants will have a significant impact on future costs.

The Administration proposal originally identified the savings on the State's debt service obtained through tobacco securitization as the source for the funds to pay the \$260 million increase in the State's homestead exemption costs. The proposed constitutional amendment does not identify a funding source for its expanded homestead program. ■

National Economists Lend Support to Getting it Right for Ohio's Future

The Educational Tax Policy Institute Symposium sponsored a symposium entitled “Revitalizing State Economies by Investing in Public Education” on April 5, 2007 at the Athletic Club, Columbus, Ohio. Richard G. Sims, Ph.D., CEO and Economist with the Sierra Institute of Applied Economics and Michael M. Kahn, Research Manager of Education Finance and Economics with the National Education Association, presented statistics highlighting the vital importance of state investment in education.

According to Sims and Kahn: 74% of high-tech businesses look at the quality of a state's education system as the number one reason to locate there. Dollar for dollar, a state's investment in K-12 public education creates greater economic growth than economic development subsidies or tax cuts. "States get the biggest bang for their buck by investing in education," said Kahn.

This is not only because education is highly labor-intensive and a local industry, but also because we live in a new economic age in which human capacity is more important than other means of production, such as land and capital.

They discussed their research along with other leading economic studies regarding the connection between investing in public education and state economic development. Dr. Howard Fleeter, of the ETPI group, provided further perspective on Ohio's economic status and the prospects for economic recovery.

This figure to the right shows the calculation of jobs and personal income impact on the Ohio economy of raising \$100 million through additional taxes and investing the same \$100 million in public education. The net effect is positive (third row) almost 3,200 jobs. If Ohio had a budget surplus (and no additional taxes were necessary) jobs and income numbers will be much higher (first row) about 4,500 jobs. Ohio has a serious structural deficit which is projected to run until 2013. It is third worst in the country.

Taxes, Education and the Economy

\$100 Million in Additional Education Funding

YEAR	2008	2009	2010	2011	2012
Job Growth (000)	4.5	4.6	4.7	4.9	5.1
Pers Inc	\$101	\$110	\$120	\$128	\$136

\$100 Million in Additional Individual Taxes

Job Growth (000)	-1.3	-1.3	-1.3	-1.2	-1.2
Pers Inc	-\$38	-\$41	-\$45	-\$48	-\$52

Net Impact of \$100 Million Taxes & Investment

Job Growth (000)	3.2	3.3	3.4	3.7	3.9
Pers Inc	\$64	\$69	\$75	\$80	\$84

Source: Analysis by Sierra Institute on Applied Economics, using the REMI economic model for Ohio.

In the new “knowledge” economy, we must redefine education policy beyond its narrow focus on student test scores. We need to understand how our policies around tax structures (T), economic development (E) and funding for public education (F) are interconnected and how they are the pillars of creating an economic future that is second to none.

We cannot succeed in the new economy by dealing with T, E or F policies in isolation because the sum of the three policies is bigger and more profound than its parts. We must redefine education policy in terms of the overarching purpose of public education — creating a prosperous and civilized society — and in the context of TEF policies. ■

Dr. Howard Fleeter, Driscoll & Fleeter

William Driscoll &

CONSULTANTS:

Janice Smith, Treasurer

Marcella Gonzalez, Secretary

Tom Ash, Vice President

Barbara Shaner, President

OFFICERS:

Ohio's Resource for Reliable Data & Analysis



8050 North High Street

Columbus, OH 43235

Phone: 614-540-4000

Fax: 614-540-4100

www.etpi-ohio.org