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Statewide Property Tax Equalization Study Policy Report

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October 2005

**STATEWIDE PROPERTY TAX EQUALIZATION STUDY
POLICY REPORT**

by
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with
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October 2005

IFPI Report No. 24

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Foreword

Two events propelled the necessity for this Indiana Fiscal Policy Institute Policy (IFPI) Report. Beginning in the early 1990s, a series of Indiana Tax Court and Indiana Supreme Court decisions, commonly referred to as the “St. John’s Cases,” required Indiana to abandon its decades-old standard for assessment of real property and replace it with a standard that was “objective and verifiable.” In 2002, Indiana embarked on its first ever market-value general reassessment of real property.

At the same time, the O’Bannon-Kernan administration and the General Assembly enacted the first major tax restructuring in Indiana in 30 years. It was common knowledge that the old real property valuation standard had under-valued residential property relative to its market value for decades, and the new standard would shift a greater proportion of total assessed value to homeowners in particular, especially those with older homes. Ostensibly, the tax restructuring was designed to mitigate that shift.

Then-Lt. Governor Joe Kernan recognized the need for a thorough and independent evaluation of the 2002 pay 2003 reassessment results. Without such an evaluation, it would be impossible to ascertain if the constitutional requirement of “a uniform and equal rate of assessment” had been achieved. He approached then-president of the IFPI, William J. Sheldrake, to undertake the Indiana Statewide Property Tax Equalization Study. A steering committee made up of local assessing officials, state government officials, property tax professionals and others was created to guide and receive periodic progress reports on the Study.

This Policy Report is the culmination of over two years of research, analysis, and evaluation. Doubtless, when it was undertaken, no one believed that it would take that length of time to complete (in fact, five counties are still impossible to satisfactorily evaluate). The decentralization of responsibility for assessment among 1,100 locally elected assessing officials and a plethora of disparate data systems created a research challenge that was unanticipated.

Yet, the hard work and persistence of skilled professionals has produced a high quality, high value Study. We believe that its results, findings and recommendations are presciently valuable to the public policy debate as Indiana embarks on creating a 21st century process of real property assessment.

Funding and support for this study came from the State of Indiana and several private sector organizations. All of the funders believed this report’s value would come primarily from its independence. At no time did either the State or any private sector individual or entity attempt to influence any aspect of our work. The IFPI is sincerely grateful for the opportunity to contribute to this most important area of fiscal policy in the State of Indiana.

Acknowledgements

A study such as this can only be completed through the efforts many individuals. The Steering Committee provided thoughtful guidance and support, all the while asking the questions that needed to be asked and giving us the venue to discuss the issues. We thank every member for their commitment of time, energy, and insightfulness.

Mark D. Brown, the Research Director at the IFPI, is the principal author of this Report. Mr. Brown joined the IFPI in the summer of 2004 and immediately took ownership of the Study. His work went far beyond analyzing results and writing words. When necessary, he traveled to the corners of the State to stand in front of a copy machine in an assessor’s office to copy data that otherwise was unattainable. He accepted, even relished, the challenge of deciphering the many inconsistencies and anomalies in data coding structures used by local officials and thereby making it possible to perform the equalization analysis.

William J. Sheldrake, the former president of the IFPI and now president of PolicyAnalytics, LLC, has no peer with regard to his knowledge of Indiana’s property tax system. The breadth of his expertise encompasses the details of Indiana statute and rule, an intimate understanding of how property assessment is done

at the most local level, and the appropriate statistical methods necessary to analyze large and complex databases.

Richard Almy and Robert Denne of Almy, Gloudemans, Jacobs and Denne have extensive backgrounds, nationally and internationally, in property tax systems. Their work in and service to the International Association of Assessing Officers afforded the research team an unparalleled level of background and experience. The IFPI could not have completed this Study without their excellent work.

Crowe Chizek had the unenviable task of assembling a database suitable for completing the analyses in this Report from the various and variable quality data sources. Early in the data gathering stages of this effort, Thomas P. Miller and Associates provided significant assistance and facilitation.

We must also recognize the valuable assistance provided to us by local assessing officials too numerous to name. They provided us with their time, in some cases, their limited resources, and their knowledge. In addition, our sincere thanks go out to several individuals in state government, particularly the Legislative Services Agency (LSA), the State Budget Agency (SBA) and the Department of Local Government Finance (DLGF). Our work was able to advance seamlessly across the transition between gubernatorial administrations. Diane Powers and Chuck Mayfield of LSA and David Reynolds and Mike Landwer of SBA are just a few of the individuals we relied upon. Melissa Henson, Beth Henkel, and Kurt Barrow of DLGF also provided us considerable help.

This Policy Report introduces a new format for IFPI publications. We hope that you will find this and future publications more reader-friendly than our past works. Andrea Holden, Office Administrator of the IFPI, had the task of applying new software capabilities in designing and assembling this document. Her editorial skills and attention to detail added significantly to the quality of the Report.

Steven R. Johnson
President, Indiana Fiscal Policy Institute
October 2005

STATEWIDE PROPERTY TAX EQUALIZATION STUDY

EXECUTIVE SUMMARY

The Courts, in the St. John decisions, mandated a market-based standard of real property assessment be used to meet the constitutional requirement of uniformity and equity. The next issue was to determine if the administrative system of assessment could meet that standard. At the 30,000 foot level, the results look good, but at ground level, the results are problematic. Clearly, there is a great deal of work still to be done at every level of property tax administration.

With the mass general reassessment of 2002 for pay 2003 property taxes, Indiana became one of the last states to adopt market value based standards for real property assessment. After much delay, a healthy dose of consternation, and more than a little bit of legislative hedging against possible catastrophic impacts, the reassessment meant that valuation of property for taxation in Indiana took a giant step into the 21st Century.

This Study began in August of 2003, when a contract was executed that called for the Indiana Fiscal Policy Institute (IFPI) to perform a statewide Property Tax Equalization Study (the Study). The purpose of the Study was to provide the State with a determination of the strengths, weaknesses, and accuracy of the Supreme Court ordered, first ever, market value-based general reassessment process and its results. The key features of the Study are:

- ✓ **An analysis, by jurisdiction, of the quality of the reassessment by property class,**
- ✓ **A study of the assessment methodology and process, with recommendations for improvements in future years,**
- ✓ **An analysis of the data requirements for future property tax reassessments, and**
- ✓ **A school assessment sales ratio study**

The Study's Key Findings:

The adoption of the market value standard is only a first step. While the "on the surface" results show relatively good outcomes for the first-ever market-value based reassessment, the comprehensive analysis of the process reveals many serious problems, a significant number of which will require major structural changes to Indiana's property tax administration system to address.

- **The current structure does not provide for accountability across assessing jurisdictions, resulting in systematic lack of uniformity in assessment practice and assessment results. These problems plague townships within counties and cross county borders.**
- **Local governmental assessment officials and their contractors do not understand that they have a responsibility for assessment quality that extends beyond their own county.**
- **The type, quantity, and quality of data currently collected will not support a market value assessment system.**
- **Many counties and townships did not meet the International Association of Assessing Officers (IAAO) standards for level of assessment, uniformity of assessments, or consistency of assessments across assessing jurisdictions.**
- **There is inconsistency in assessment interpretation and administrative practice between the counties.**

The State has not been willing or able to perform its oversight function. The Department of Local Government Finance (DLGF) currently does not and cannot produce future independent

equalization studies, as best practice requires. The current county self-evaluation equalization system is a sham.

Hence, there is no accountability, nor has there been for several decades, which has resulted in the state of affairs that led to the Supreme Court mandated market value-based reassessment. While the standard upon which valuation is based has changed, the underlying administrative structure has not. This structure, as the Study has demonstrated in our analysis, results in a systematic lack of uniformity in assessment practice, even under a market value system.

The property tax system, its valuation methodology and ultimate accountability, is a responsibility of state government. It is the State Constitution and State statutes that undergird and form the foundation for the property tax system and the policies that flow from it. The role of the local assessment offices is to apply state policies professionally and without regard to their own philosophical views of tax policy or tax burden. The assessment function is ministerial, and not one that makes policy or represents taxpayers.

A lack of uniformity and consistency across county borders impacts taxpayers across the State. The State appropriates over \$6.0 billion per year to support local schools and reduce local property tax levies. These appropriations are made based on tax assessment information—in the case of the schools—and based on property tax liabilities determined to some extent by the shares of total assessed value born by the various classes of property.

The Study found that counties do not adhere to required data standards. The DLGF has issued extensive specifications for the transmittal of data to the State. Unfortunately, the Study found widespread non-compliance with the regulations. Inconsistencies abound between the State and counties; even within counties, assessors and auditors often use different data structures and data maintenance systems. Moreover, counties have not complied with the law requiring the submission of all sales disclosure forms (SDFs) to the State. Without the

collection, evaluation, and storage of market value information, the market value assessment process breaks down.

The table on the following page summarizes the evaluation of assessment results from our equalization analysis.

While county and township results for residential improved property were reasonably good for level of assessment as measured by the median ratios, quality stopped there. Only about half of the counties and townships met the IAAO standard for median ratios in commercial and industrial improved property. With regard to uniformity of assessment, as measured by the coefficient of dispersion (CoD), only about 15% of counties and 20% of townships met the standard for residential improved property. Only about one in ten counties and one in eight townships met the CoD standard for commercial and industrial improved property.

With regard to consistency of assessment across counties and townships, the results are not better. In 63 of 87 counties (72.4%), at least one township's assessments differed materially from the other townships. For commercial and industrial property, 34 of 79 townships, representing 25 of 52 counties, varied materially from the other townships in the county.

For residential improved property, 73.0% of the townships were within +/- 5% of the county average median ratio. For commercial and industrial improved property, 56.2% of the townships were within +/- 5%. In residential property, those townships represented 72.4% of the counties.

Evidence of sales chasing (the practice of changing an assessed value to reflect the sales price of that property after it sells to improve the apparent results) was widespread. In 27.4% of the townships tested, the Study found evidence of sales chasing. More troubling is the fact that those townships represented 51 of the 65 counties in which testing was possible, or nearly 80% of all counties.

The Study's findings demonstrate, with statistical certainty, that there is a systematic

Summary of Equalization Results			
Median Ratio		Met IAAO Standard	Did Not Meet IAAO Standard
Counties:	Residential Improved	90.8%	9.2%
	Commercial & Industrial Improved	54.2%	45.8%
Townships:	Residential Improved	86.7%	13.3%
	Commercial & Industrial Improved	54.1%	45.9%
Coefficient of Dispersion		Met IAAO Standard	Did Not Meet IAAO Standard
Counties:	Residential Improved	14.9%	85.1%
	Commercial & Industrial Improved	10.2%	89.8%
Townships:	Residential Improved	20.6%	79.4%
	Commercial & Industrial Improved	12.2%	87.8%
Consistency Across Jurisdictions		Within +/- 5%	Not Within +/- 5%
Townships within Counties	Residential Improved	73.0%	27.0%
	Commercial & Industrial Improved	56.2%	43.8%
Percentage of Counties Affected	Residential Improved	27.6%	72.4%
	Commercial & Industrial Improved	12.2%	87.8%
Sales Chasing		Townships	Counties
Number of Jurisdictions Tested		733	65
Number of Jurisdictions in Which Sales Chasing Evidence Found		201	51
Percentage of Jurisdictions Affected		27.4%	78.5%

inconsistency in interpretation of the assessment statutes and rules and assessment practice throughout the State.

In summary, the Study found comprehensive, statewide evidence of an overwhelming lack of uniformity and consistency in assessment results. Our analysis clearly demonstrates inconsistent application of the market value based assessment rule and provides evidence

of non-uniform interpretation of the rule by the local assessor (or their contractor). Both the level of assessment (measured by the median ratio) and the uniformity of assessment (measured by the coefficient of dispersion) differ across townships and counties. Inconsistencies in assessment practice statewide demonstrate that there is little accountability practically demonstrated of local assessing officials, whether it is counties holding townships

accountable or the State holding counties and townships accountable.

While some effective consolidation of assessing districts has occurred in Indiana over the years—through the use of private contracting firms and cooperation between townships and counties—there has been no systematic or structural change. Movement to consolidated assessment districts and responsibilities, independent review and equalization, increased and more sophisticated use of technology for data and analysis are all needed, yet none of these steps have been taken in Indiana.

A nearly complete lack of compliance with state data standards contributed mightily to the problems the Study found. The Study found significant resistance on the part of locally contracted vendors to assist counties' compliance with state data standards. These data compliance issues are timely to the current state of the property tax system in view of the trending process which, for its equitable implementation, will require much improved data standard compliance.

The Study makes the Following Recommendations:

- 1. Ensure Complete and Accurate Collection and Transmission of Sales Data**
- 2. Develop and Enforce Compliance with a Statewide Assessment Data Standard**
- 3. Move Primary Responsibility for Assessment to the County Level**
- 4. Introduce an Effective Equalization Study at the State Level**
- 5. Complete the Transition to Market Value Standard by Rewriting the Assessment Rule**
- 6. Upgrade Assessment Training and Certification Programs and Increase Certification Standards**

A quality assessment requires independent

evaluation of results. Having timely access to pertinent and accurate information about the price, terms, and circumstances of each sale is essential in a competent equalization study.

The problem of the county assessors selectively forwarding SDFs to the DLGF needs to be remedied in order to perform effective, periodic ratio studies. The state should control which sales are included or excluded, not the assessors. This means that the DLGF should develop a sales data processing manual. It should provide instructions for the timely transmittal of SDFs and backup documentation in convenient-to-process batches. It should instruct assessors on how to annotate the SDFs with their (coded) recommendations regarding the usability of each sale and the assessed value in effect on the date of sale. Ideally, data should be collected, maintained, and transmitted to state electronically. Sales Disclosure Forms should be available “on line.”

On the surface, current assessment data standards (50 IAC 12) appear reasonable. However, our experience with county assessment data during the course of this equalization study found that they were widely ignored. The study recommends that the State take control of this nearly chaotic administrative structure and require that local assessors meet state standards for data collection, storage, and maintenance and transfer to the State. The following actions should be taken:

- ✓ Seek county input regarding problems with existing standards and ways to improve them.
- ✓ Make adherence with assessment data standards a standard provision of county reassessment and IT contracts.
- ✓ Institute financial penalties for failures to comply with the standards for both governmental units and their contractors.
- ✓ An example of one data standard would be a consistent Geographic Information System (GIS) parcel numbering system statewide.

The delegation of responsibility for property assessment to township officials essentially is an artifact of the mid 19th Century. Although

reasonable when Indiana was being settled, this assignment is now obsolete. Assessment is a ministerial function requiring technical expertise and equipment. It is not one in which the assessor is an elected representative of the taxpayer. Because assessment in Indiana is overly decentralized, the Study found it impossible to maintain assessment accuracy and to achieve economies of scale; in other words, taxpayers are forced to pay more for less. The State should transfer responsibility for assessment from townships to counties.

The Study recommends much stronger, independent, State-mandated equalization study standards. The DLGF should implement a strict requirement that ALL sales, regardless of whether they should be included in a ratio study or not, be transferred to the State. The State should commit resources to enable a state (not local) independent, professional equalization study after every general reassessment. These studies should be conducted more often, if necessary to ensure assessment quality statewide.

The State should set as a goal the adoption of a current use (value in use) market value standard, which would imply changes to assessments whenever warranted by physical and economic changes. Frequently updated general reassessments made in accordance with professional best practice mass appraisal techniques optimize property tax uniformity. The State should establish a statutory framework for market monitoring and appropriate valuation adjustments (trending).

The Indiana assessing officer education, examination, and certification programs need to be strengthened. First, the scope of the education and examination process needs to be broadened to include at least the following:

- ✓ mass appraisal applications of the sales comparison and income capitalization approaches,
- ✓ monitoring property price trends statistically so that defensible indexing factors can be developed, and
- ✓ making sales ratio studies.

Second, an evaluation should be made of the testing process to ensure that it actually tests the examinees' mastery of the subjects covered, particularly of analytical topics like ratio studies. Third, certification needs to be made mandatory.

The School Ratio Study

The IFPI today also released the results of the School Assessment Ratio Study. This analysis, done in accordance with state statute (I.C. 6-1.1-34) provides to the DLGF assessment ratios that are to be used to equalize each K-12 school district's property tax effort within the State's school funding (tuition support) formula.

Since the formula sets the shares of school general fund resources appropriated by the State and raised via the local property tax, the ratio study allows the State to equalize those shares by equalizing the assessed values across school districts against which the property tax is imposed. If these assessment ratio adjustments are not made as part of the execution of the school funding formula, taxpayers in some parts of the State subsidize taxpayers in those school districts in which there is systematic underassessment.

As with townships and counties in the statewide equalization analysis, some school district's ratios were greater than one and some were less than one. A ratio of less than one means that property is "under-assessed relative to its market value," while a ratio of more than one means the opposite. In a simulation using only the ratios resulting from the school ratio study (and no other variables that could impact the school funding formula, such as enrollment changes), 38 school districts would see increases in property taxes while 148 would see decreases (in calendar year 2007). One hundred seven school districts would see no change in property taxes. In each school district where property taxes increase, there is an offsetting decrease in the state support while in each school district where property taxes decrease, there is an offsetting increase in state support.

The results of the school ratio study are consistent with the statewide township/county equalization study in that there is statewide inconsistency in assessment practice and results. Yet, the movement to a market value-based assessment standard enables the application of a meaningful school ratio study that makes progress in equalizing school funding across the State.

The application of these school ratios will cause changes in local and state obligations for school funding in calendar year 2007. However, in comparison with other school funding variables, such as changes in enrollments, the net impact of these ratios is minimal.