★ Chapter Five ★

Property Tax Abatements and Your Local School

> For our clients, education has been found to be the single most important service, greatly exceeding the value of all other services combined. . . . The single most important factor in site selection today is the quality of the available workforce . . . in fact, a qualified workforce may be the single most important determinant in the economic development success of any community.
>
> *—Robert Ady, longtime Fantus executive, said to be the nation's most experienced living site location consultant*[1]

Companies love to locate in areas with good schools; they just don't like to pay for them. American families care a lot about their schools, too. They often move and accept higher housing costs to gain access to better schools. And they support bond issues for public schools at a greater rate than they do any other service except healthcare.[2] The trouble is, families don't get a 10-year holiday on their property tax for moving into their preferred school district, but companies often do.

When corporations seek to avoid paying their fair share for schools and other local services, the issue is bigger than who bears the burden. The corporate assumption that businesses are *entitled* to property tax abatements—or the related subsidy, tax increment financing (TIF)—is threatening our economic future by harming our schools.

Now that's a harsh thing to say; let me explain. First, property taxes are the largest tax many companies pay, so when a company gets a property tax break, it can be a very lucrative subsidy. This is especially true for companies with lots of land, buildings, or equipment.

Second, property taxes are also the largest single source of revenue for public education, providing on average almost a third of school funding. Schools used to be even more reliant on property taxes, but many states have changed their school-funding formulas because state supreme courts have found what author Jonathan Kozol called "savage inequalities" in funding levels between inner city schools and those in wealthy suburbs. So on average, state governments today provide almost half (49 percent) of school funding and local sources provide 43 percent, two-thirds of which is property taxes. These are national averages; in some states, property taxes are still far more important. (Despite all the brouhaha about No Child Left Behind, the feds only contribute 8 percent of K-12 budgets.)

Given these facts—property taxes matter a lot for schools, but they can also be a lucrative subsidy if a business gets an abatement—there's a direct collision between companies avoiding their property taxes and children having good schools. Along with suburban sprawl, harm to state budgets, and the problem of burden-shifting, the harm that subsidies do to public education is a prime example of the massive collateral damage subsidies are causing because they have grown so costly and unaccountable.

To be sure, school finance is complicated, and state formulas vary widely. Some states help school districts make up for revenue they lose to abatements or TIF; others don't, or they only cover part of the losses. The bottom line: when a company gets an abatement or a TIF, less money goes into the local hopper for schools.

There is a second bottom line here: at the state capitol. Since schools now get almost half their funding from the states, many other kinds of subsidies I discuss in this book that erode state revenue (such as income and sales tax breaks) mean less money is available for schools—from the state hopper. It's just a little less obvious because it involves sources of revenue that are not traditionally identified with schools, but are nonetheless a growing component of how schools are financed.

Giveaways That Keep on Giving: Abatements and TIF

Especially on new investments, companies routinely receive property tax abatements—that is, discounts or outright 100 percent exemptions—that run for years: 5, 7, 10, 20, even 40 years in Dell's case in Nashville. Some states restrict abatements to manufacturing or other heavy industries; other states restrict them to enterprise zones, or give extra kinds of abatements in zones. Some states give localities a lot of latitude about how much of an abatement or for how long; others have fixed rules. Forty-three states plus Washington, DC, allow abatements.

I spoke briefly about tax increment financing (TIF), another kind of subsidy that is usually based on property taxes, in chapters 2 and 3. When a TIF district gets redeveloped and property assessments go up, all of the resulting increase in tax revenues—the increment—is diverted away from schools and other local services. Instead, the increment is used to subsidize the redevelopment within the district. This diversion can last 15, 20, 23, even 30 years, depending on state rules. The traditional justification for allowing this diversion is that the property in the TIF district is "blighted" or "distressed." But as I explain in chapter 6 on sprawl, many states have loosened their rules so much those terms are meaningless. Forty-seven states and Washington, DC, have TIF.

These subsidies are often more than one-shot deals; many states allow abatements, TIF districts, or both to be extended for additional terms.

Despite the long duration and high cost of these subsidies, abated companies often fail to deliver, and cities often hesitate to seek repayment or simply fail to monitor outcomes. Fort Wayne and the surrounding Allen County, Indiana, have long used abatements as part of their aggressive recruitment strategy. But a 2003 investigation of almost two hundred abated companies by the *Fort Wayne Journal Gazette* found that more than half had fallen short of their job promises—yet no government body in the county has ever rescinded an abatement (or ever turned down a request for one). In the city of Fort Wayne itself, 89 out of 136 abated companies—65 percent—had fewer employees than promised. The paper estimated other taxpayers pay $3.5 million more than they would if abatements were not used. "It's the tax-bill version of five people splitting the check for a six-person meal at a restaurant," the paper concluded. "Those companies with tax abatements still get to eat, but their doing so raises the price for everyone else."[3]

After Sony announced the closure of its Springfield, Oregon, CD factory, which had enjoyed a five-year enterprise zone property tax break, the *Eugene Register-Guard* investigated 76 other abated companies—6 big firms that got 95 percent of the tax break dollars and 70 smaller ones. It found that three of the big companies—Hynix, Weyerhaeuser, and Symantec—had fallen short of their job projections but renegotiated deals to keep some or all of the breaks. The net outcomes with the smaller companies were far better. Although 11 had closed, the small companies as a group created almost as many new jobs as the six big companies did—with just 5 percent of the dollars. Cost per job at the small companies: about $2,100. At the big companies: $32,000.[4]

Harris County (Houston), Texas, got stingier after three high-profile abatement disputes, including the closure of an MCI call center. After the county took a hard line, two companies expanded in the area even though they got turned down for the tax break: Albertson's built a grocery warehouse, and Sonangol, the Angolan national oil company, built a new headquarters. As the *Houston Business Journal* editorialized: "Authorities also are starting to wise up after watching companies pit cities against each other in bids to obtain tax abatements, only to discover that many of the relocation decisions had already been made."[5]

Louisiana: Big Breaks for the Big Boys in Cancer Alley

The stretch of the Mississippi River between Baton Rouge and New Orleans has one of the nation's largest concentrations of oil refineries, chemical plants, and paper mills. The region suffers from extremely high rates of toxic emissions—hence its nickname, "Cancer Alley."

When these factories are rebuilt, expanded, or upgraded, the projects routinely get ten-year property tax exemptions. The decision whether to grant these exemptions is not controlled locally by a county board in the way most states do it. Instead, property tax breaks in Louisiana are initiated by the state's Board of Commerce and Industry, dominated by gubernatorial appointees and including the governor him- or herself.

The Louisiana Coalition for Tax Justice compiled all of the state's property tax exemption records for the 1980s and published a devastating set of findings. The exemptions had cost local governments $2.5 billion. The harm to schools, the most costly local service, was the greatest. The state ranked last in high-school graduation rates, while $941 million of the tax exemptions could have gone to improve the schools. Just nine big, profitable companies got more than half of the tax benefits: Louisiana Power & Light (Entergy), Gulf States Utilities, Cajun Electric Power, Shell Oil, Exxon, Texaco (Star Enterprise), International Paper, Dow Chemical, and Mobil Oil (Exxon and Mobil later merged).

Incredibly, almost three-fourths of the projects that got exempted created no new permanent jobs (some created temporary construction jobs). Most of the tax breaks went to the big toxin-emitting industries. Exxon, for example, got 282 exemptions over the 10 years—251 of which created no new permanent jobs! The Exxon deals cost taxpayers a total of $93.3 million, including $42 million lost for the schools. The subsidies also failed as overall job creators: the oil, chemical, and paper industries actually lost almost eight thousand jobs.

Louisiana also gave out enterprise zone rebates and credits; in just four years, these totaled another $188 million. One of the zone subsidies is a $2,500 tax credit for each new employee hired. Shell Oil collected seven such credits for hiring workers at its plant in Norco—to replace seven workers killed in a 1988 explosion. The tax credits far exceeded the $3,630 fine imposed by the Occupational Safety & Health Administration for the fatal tragedy.[6]

There was one brief, shining moment in Louisiana's property tax history. Dr. Paul Templet directed the state's environmental agency in 1991. He created a scorecard system that used the exemptions to give companies an incentive to comply with state environmental rules, reduce their toxic emissions, install recycling systems, and use recycled materials. In just one year, the system reduced toxic emissions by 8 percent, helped create 3,500 jobs (as companies spent on pollution-reduction systems) and even improved revenue to local governments.[7]

When Governor Edwin Edwards took office in January 1992, his first official act was to eliminate Templet's scorecard system.

Ohio: The Poor Pay More

Ohio is one of those states where property taxes still provide a very large share of school funding, about half. It has both TIF and property tax abatements. The abatements are especially generous in its 339 enterprise zones, where it also exempts personal property (machinery and inventory). One analysis found that in 1999, TIF and abatements cost $102 million per year for schools. Three years later, an *Akron Beacon Journal* investigation put the annual loss at $115 million.[8]

Indeed, the *Beacon Journal* found, by 2002 Ohio had exempted $3.9 billion of corporate real estate from property tax—more than "religious institutions, charities, private universities, or city, state, federal, or county governments." Fifteen years earlier, religious institutions had three times more real estate exempt than did companies. Back then, only 2 percent of corporate real estate was abated; by 2002, that figure was 10 percent.[9]

The largest revenue losses tend to be concentrated in the state's biggest urban areas with the highest numbers of poor people. For example, an audit found that abatements cost schools $13.7 million a year in Toledo, or 14 percent of their budget. Since the state changed its definitions due to the federal No Child Left Behind

Act, the Toledo School District is no longer in a state of "academic emergency." But it fails to meet 11 of 18 standards, and almost a third of its students don't graduate from high school. As the *Wall Street Journal* pointed out, Toledo businesses complain that the poor schools make it hard to find well-trained workers—at the same time those businesses are taking big property tax breaks.[10]

The state tax department found that Hamilton County (Cincinnati) loses more than $20 million a year. And an audit in 2001 found that more than a fifth of the abated companies in the county were falling short on jobs or investment. "They're a slippery slope," said the county auditor. "Once you start [abatements], they never end. Eventually, there'll be one little old guy in Price Hill paying all the taxes because everyone else will be abated."[11]

A state audit found schools in Cleveland losing $9.2 million a year—on just eight subsidized projects—at a time when the district was closing schools, cutting sports programs, and laying off teachers. The issue of lost school revenue got so hot in Cleveland, it went to a ballot initiative in 1997; the proposal to shield the school share from abatements failed, but the city has been more cautious about handing out abatements since the vote.[12]

The problem of funding disparities among school districts has been the subject of more than a decade of litigation and state supreme court rulings in Ohio. Among the court findings: K-12 overdependence on property taxes is a root cause of inequality. That overdependence also makes TIF and abatements especially harmful.

Illinois: TIF on Steroids

Schools in Illinois are also more dependent than average on property taxes, and the big problem there is TIF. The state now has more than 870 TIF districts diverting revenue away from schools and other public services—135 in Chicago alone.[13] TIF districts in the Prairie State typically last 23 years, and when a district expires, the increased tax revenues created by the redevelopment are supposed to finally start going to the schools and other local services. But already, more than 30 localities in the state have applied to extend their TIF districts—for 12 more years.[14]

In Chicago, the Neighborhood Capital Budget Group (NCBG) has documented the fact that properties in many of the city's TIF districts were growing in their assessed value before being designated (suggesting they were hardly "blighted"). That means that the TIF diversion is capturing a lot of tax-base growth that would have occurred naturally anyway—because once the TIF district is created, *all* increases get diverted away from schools and other public services, even if they aren't caused by the TIF-subsidized redevelopment. For just 36 of the city's TIF districts, NCBG estimates that this diversion—of revenue captured by TIF but not caused by it—will cost public services $1.3 billion over the 23-year life of the districts, including $632 million lost to the Chicago public schools and $53 million lost to the community college district.[15]

Sharon Patchak-Layman is an active parent and school board member in Oak Park, a diverse suburb on Chicago's western border that has extended its TIF after much debate produced some concessions. She spoke out at a national press conference about her frustrations with TIF and later told a reporter: "When the TIF was first formed, my children were very young. Now they are adults and living on their own, and they have yet to receive the [promised] benefits of that boon for education."[16]

Maine: Turning Property Taxes into Profits

Maine has created a perverse subsidy situation that can be twice as lucrative as an abatement. The state offers two different subsidies that reimburse companies for property taxes—*and some companies are eligible to claim both.* So instead of property taxes being a cost, they can become a profit source. The more you "pay," the more you profit!

The first reimbursement subsidy is TIF. In Maine, the property taxes a company owes on new machinery and equipment (the tax increment in TIF) can be paid back to a company via TIF; that is, from local property taxes. The second subsidy is called the Business Equipment Tax Reimbursement (BETR) program. Under BETR, a company gets a 100-percent refund on business equipment taxes from the state, even if those taxes have already been refunded under a TIF. For capital-intensive manufacturers located in a TIF district, this presents a lucrative "double dip" opportunity.

The Maine Citizen Leadership Fund reports that about 50 companies qualify for the TIF/BETR double-dip. It estimates that double-dippers cost BETR more than $15 million a year (over and above their first 100-percent reimbursement), including $3.4 million to National Semiconductor and $2.1 million to International Paper in 2001. The scandal has festered publicly for several years, while the state has cut funding for both schools and low-cost drugs for the elderly. The Leadership Fund finds that double-dipping is rising sharply and estimates that it will cost the state $256 million through 2012.[17]

"Free Growth"? Just Ask South Carolina

Finally, a common argument made in favor of abatements and TIF is that they are actually cost-free because the project would not occur "but for" the subsidy. Therefore, *any* tax revenue the project creates (aside from its unpaid property taxes) is a plus.

This argument has several fatal flaws. First, as I discuss in chapter 2, for the vast majority of companies, subsidies don't actually determine where they will expand or relocate, so the basic "but for" assumption is rarely valid. Second, there is no such thing as free growth. If a company does arrive and the community gains jobs, workers with their families are going to move to the area. That means local governments are going to have to build more classrooms, hire more teachers, widen some roads, hire more police and fire department personnel, pick up more trash, and so on. All of those things cost money. If the newly arriving companies are not paying their fair share of the costs for those services, government must either (1) raise everyone else's tax rates and fees, (2) reduce the quality of public services (increase classroom size, allow roads to stay congested, or the like); or (3) some of both.

Taxpayers in South Carolina understand this squeeze play. As Jay Hancock of the *Baltimore Sun* described in a 1999 investigation, the Palmetto State has been very aggressive in offering multiple subsidies to new companies, including property tax breaks, corporate income tax credits, and other subsidies. As a result, many of the shiny, outsider-owned facilities that dot the I-85 corridor are contributing very little directly to public services.[18]

Indeed, South Carolina has two other kinds of subsidies that reduce property tax revenue for schools and give school boards no say in the matter; both are controlled by county councils. Three tax scholars there estimated in 2000 that just one of these subsidies costs school districts $121 million a year.[19]

Instead of good new jobs, workers are getting low wages and taxpayers are getting poor public services. The South Carolina Department of Commerce brags, on its website, that the state has the lowest rate of unionization and that its manufacturing wages are almost 10 percent below the national average. But as jobs and population grow, public systems get strained and services suffer. With overcrowded roads, South Carolina has the nation's sixth highest rate of auto fatalities. With poorly funded public healthcare systems, its infants are the sixth most likely to die. With low school funding, its children fare poorly on SAT scores: lowest among the states in verbal and second lowest in math.[20]

As the three tax scholars put it: "Property tax incentives no doubt were put in place with the best of intentions. But so was kudzu."[21]

The Root Problem: School Boards Usually Have No Say

When one part of government gets a free lunch at the expense of another, that's a recipe for irresponsible behavior.

Like some other development subsidies, abatements and TIF really amount to an intergovernmental free lunch. School boards are legally charged with the duty of educating our children, and they are assigned certain sources of revenue, including property taxes, to fulfill that duty. But then other government bodies—such as county boards and city councils—mooch in and grant abatements and TIF that undermine the schools.

Can you imagine your local school board passing a resolution that allows a company to pay no property tax for the fire department and the police department—without those departments having any say in the matter? Of course not. But that is exactly what is happening to school boards in most states. This is terrible public policy, a telling sign of our collective disrespect for public education, at a time when education matters more than ever for our economy.

A study issued in 2003 surveyed the issue nationally, looking at states with abatements and TIF and whether they protect schools from them. In particular, it looked at what say—if any—the school boards have. It found that in the vast majority of states, school boards have nothing to say about the granting of abatements or TIF. They have no seats on the boards that make the decision; they don't even get consulted.[22]

Only five states—Kansas, Minnesota, Ohio (sort of), Pennsylvania, and Texas—say that school boards must approve the abatement of the school "increment"—the share of property taxes assigned to schools. Only seven states do the same for TIF, and two of those have only limited power; the seven are Colorado, Michigan (limited), Ohio (limited), Oklahoma, Pennsylvania, South Carolina, and Texas.

A handful of other states give school boards some sort of notice or advisory role, but no real power. And at least 14 states make it possible for school boards or localities to negotiate what is called a "Payment in Lieu of Taxes" or PILOT. However, the amount of money a company pays in a PILOT is often just a fraction of what it would pay if it did not get an abatement.

Only four states, by virtue of their subsidy and school funding rules, were found to shield schools from losing revenue to abatements and TIF: Alaska, Florida, Maryland, and South Dakota.

Even taking into account the fact that some states' school-funding formulas offset the losses school districts suffer to abatement or TIF, school board associations and other sources indicate that schools in at least two-thirds of the states—and perhaps as many as four-fifths—are vulnerable to lost funding due to abatements, TIF, or both.

Would the "business climate" suffer if school boards got to say whether or not their property taxes got abated? The experience in Texas clearly says no. Between 1993 and 2001, the state stopped reimbursing school districts for revenue they lost to abatements. School boards had the power to participate or not. In just two years, the share of school districts that participated in new abatements plunged, from 55 percent to 8 percent. Did the sky fall? Not at all. During those nine years, the Lone Star State gained about 2 million private-sector jobs, a one-third gain.[23]

There has been very little media coverage, but at least 21 states' school board associations have researched or lobbied on the issue of abatements or TIF hurting schools. Many have sought to convince their legislatures to protect school revenues from subsidies or to at least give school boards some say. Like many aspects of subsidy abuse, there is a tendency for people to think "this only happens to us."

Schools: A Key to Creating Good Jobs

Given the fundamental importance of public education for growing good jobs, it's especially tragic that so much property tax gets given away in the name of boosting the economy.

Veteran site location consultant Robert Ady said it well in the quotation that opens this chapter. When companies seek a place to relocate or expand to, the single most important thing they are looking for is an adequate supply of skilled labor. And the most important quality of life issue they look at is the schools. They look at data such as test scores, spending per pupil, and teacher salaries. And they will likely talk to local sources for more subjective impressions. Companies do this both for the employees they hope will agree to move to the new location *and* to make sure the location will be attractive to talented people they will seek to recruit in the future.[24]

A good education system boosts job creation not just because it helps attract employers, but also because it produces smart learners who grow up to become skilled workers, making companies more productive and the region more competitive. *Expansion Management,* one of several national site location magazines, publishes an annual "Education Quotient" survey rating secondary school districts, with an emphasis on results: test scores and graduation rates. It also publishes a "High Value Labor Quotient" survey of metro areas, analyzing college-educated workforces, and a "Quality of Life Quotient" that includes school quality.[25]

Education is also the key to individual success; as our economy has changed over the past 30 years, the long-term value of an education—in terms of a person's lifetime earnings and other measures of well-being—has greatly increased. College-educated men on average now earn about twice as much over their lifetime as men with a high school education.[26] As I'll argue in the closing chapter, those regions with the most skilled labor are destined now more than ever to be the job development winners of the twenty-first century.

These payoffs—an advantage for recruiting employers and a more productive workforce—explain why the quality of education, along with infrastructure, consistently shows up as a top predictor of an area's economic performance.[27] That's why I believe that slashing corporate property taxes in the name of job creation actually *harms* the business climate. It bears repeating: when big companies pay less, governments are forced to either raise the tax rates on homeowners and businesses that don't get the tax break, cut the quality of public services (with education often taking the biggest hit), or some of both.