Property Tax-Backed Debt Patterns in Iowa Cities, 2007-2010

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The deep and extended economic recession beginning in 2008 has been a very difficult event for state and local governments. State governments have been especially hard hit as the recession pounded their major sources of revenues. In contrast, local government’s tax revenues have held up fairly well because of their reliance on property tax revenues. Some of the fiscal pressures of state and local governments have been temporarily relieved by federal stimulus fund aid to assist with Medicaid and education funding. Despite Federal stimulus assistance, local governments have been making dramatic spending cuts in the aftermath of the 2008 recession (Fisher 2010). In addition, state and local governments are cutting capital expenditures in an effort to control costs. If general operation funds become scarcer, additional needed infrastructure projects may become more difficult to implement. Downgrading the federal government’s credit rating could also raise local governments borrowing costs.

In addition to affecting revenue for current year operations, the recession and fiscal stress is threatening the capacity for state and local government to issue debt to finance capital improvements and necessary infrastructure investments. Declines in property values in severely affected regions could affect tax capacity for servicing debt or compete with using property tax revenues for covering operating expenses. Cities have faced these fiscal crises in prior recessions as well. Other cities in rural agricultural regions have faced longer term continuous decline and fiscal stress as they depopulate. How have these cities responded to fiscal pressures? Have they continued to invest in capital improvement projects, and are there lessons for urban centers in their experiences? This paper summarizes a report analyzing how Iowa communities have responded to the threat of increased fiscal stress on their ability to use property-tax backed debt obligations at this stage of 2008 economic recession and recovery using data from the 2007 to 2010 Annual Financial Reports (Otto and Hudak, 2011).

The level and recent trends of property tax-backed debt held by local governments in Iowa are presented in Figure 1. Among units of local government, cities are by far the largest holder of general obligation debt followed by school districts and special districts. The annual rate of increase in GO debt by cities is about 11.7% between 2007 and 2010, slightly less than the 15.7% growth in property valuation in Iowa cities.

Using data collected from Annual Financial Reports filed by Iowa cities, the financial and debt information indicates a distinctive relationship to city size. Even after adjusting to a per capita basis, the level of general obligation and TIF debt increases as the size of city increases (Figure 2). Smaller cities in Iowa tend to have no commercial or industrial sectors and rely only on residential property tax base. Many of 392 Iowa cities under 500 population have limited city functions and do not incur GO debt resulting in a small average per capita debt level in this category. The average per capita GO plus TIF debt levels range from about $600 for cities in the 500 to 2500 population range to roughly $1200 for cities in the 30,000 to 100,000 population range.

Other fiscal indicators also follow a pattern of increasing with city size. Per capita spending on governmental operations (Figure 3) increases from $600 for cities smaller than 500 to $1600 per capita for cities in the 10,000 to 30,000 population range. The fiscal capacity of cities as measured by tax base also increases by about 4 percent annually during this time period (Figure 4).

This profile of debt levels by Iowa cities during this recessionary period indicates that while debt obligations have increased, the bonding capacity which is limited to 5% of taxable values, is still growing during this time frame. Iowa cities still have unused debt capacity as indicated by the difference between bonding capacity and GO and TIF debt (Figure 5). On average, cities in each size category have actually increased the amount of bonding capacity available to them by the end of the period. On average for all sizes of cities, growth in tax base has kept pace with increases in debt obligations. A plot of per capita debt obligations against taxable values within cities (Figure 6) indicates a pattern of cities with larger tax bases having higher per capita debt levels with the highest values occurring in the high end of the range.

A multivariate regression analysis was also used to assess the effect of demographic and spatial characteristics on levels of percapita GO and TIF debt taken on by Iowa cities with population greater than 500. This analysis suggests that larger cities with higher percentage of population over age 65 and higher rates of homeownership and higher home values tend to have higher levels of percapita debt. Also, cities that grew faster during the 2000-2010 period and were located closer to employment centers (as measured by mean commuting time by residents) incurred higher levels of GO and TIF debt.

**Conclusions and Implications**

Our analysis suggests that in aggregate, non-metropolitan cities in Iowa during 2010 have been using GO and TIF debt obligations to finance capital improvements at an accelerated rate during this stage of the economic recession. Growing cities within closer commuting distance of employment centers and with higher home values and tax bases are more likely to be adding debt. Per capita debt levels ranged from about $140 for cities with population under 500 to about $1480 for cities over 30,000. On average, property values for rural Iowa cities have actually risen during this period so that the debt capacity of these cities has also increased at a higher rate than new debt obligations. As a result, on average Iowa cities are staying within the GO debt limits mandated by the state and do not appear to be adding to fiscal stress.

Because federal stimulus dollars infused additional resources into state and local governments in 2009 and 2010, our results may be preliminary to additional budget cuts and fiscal stress that will be working through the system. Future research is needed to monitor the situation. In addition, the spatial aspects of local government stress where needs to be explored further. More remote and sparsely populated regions may be experiencing more severe economic and fiscal stress than implied by state averages.

