The Plan for Real Property Tax Relief in Illinois

Two of the largest fiscal issues facing Illinois for the past few decades have been our states' massive **unfunded pension liability** and our **sky-high property taxes.** While there is still much work to be done to address our state's unfunded pension liabilities, it may be a surprise to hear that a corner has been turned. This plan will outline a way **to use the increasing savings from our gradual reduction in pension payments to lower property taxes.**

Plan Summary:

Capture future pension savings as a portion of the state budget and convert that money into property tax relief instead of allowing special interests in Springfield spend the newly found money on more/new government programs.

This is a 23-year plan to reduce property taxes by 50**%** — real property tax relief.

Why Have We Turned the Corner on Pensions?

There are three reasons why Illinois has turned the corner on pensions. The first reason: **Tier 2.** There is no doubt the switch to Tier 2 roughly a decade ago is producing savings. Our state is near the point where 50% of employees in one of the five state pension systems are under the Tier 2 program instead of the overly generous Tier 1.

The second reason is our **payment schedule** which has referred to as the "ramp," which requires Illinois' pensions systems to be 90% funded by 2045. The systems are reaching the point of the schedule where the state is no longer in a negative amortization situation where larger payments are required while the unfunded liabilities continue to grow.

The third reason is **inflation.** This may be the least-recognized factor that has helped reduce Illinois' pension liability in real dollars. Inflation is generally bad, but in a debtor's situation, it can actually *ease* a difficult financial situation.

Here's how it works: $1 of debt in 2022 is certainly not as bad or expensive as $1 in debt in 1970. The same holds true with our unfunded pension liabilities. If our liabilities stay flat in terms of dollar amount, 8% inflation for 2 years essentially wipes off 16% of our debt. This shows up in our budget by our pension payment going towards the unfunded liability becoming a smaller percentage of the overall budget.

Another aspect of inflation helping our pension situation is the compounding automatic annual increase (AAI) for Tier 1 pensioners set at 3%. The AAI probably seemed like a sound idea when it was passed during years of high inflation. In that inflationary environment, a structured AAI of 3% would seem very affordable. However, when inflation dropped below 3% that approach caused liabilities to increase at a greater rate than economic growth, making it much more difficult to keep up with payments. Consequentially, all those years of low inflation made our ramp more difficult since the AAI outpaced inflation.

Why Use Future Pension Payment Savings on Property Tax Relief

High property taxes are among the most regressive types of taxes – and we ALL pay.

- Homeowners pay them—no matter how much they make or whether or not they even have a job.
- Renters pay higher rents through their landlord whether or not they see the tax bill.
- Companies pay them whether or not they turn a profit.

Illinois' outrageously high property taxes are a result of our pension system being underfunded for too long. When the state had to dramatically increase budgeted spending on pensions, other spending was crowded out – especially education funding. With the state sending less money to school districts, property taxes went up (WAY UP) to make up the difference.

Illinois property taxpayers had to pick up the tab when the state prioritized pension funding instead of school funding and they deserve real property tax relief when the pension system turns the corner.

Most significantly, less affluent areas of the state pay a higher property tax rate than richer areas. To secure the tax dollars needed, local governments are forced to tax properties in a lower-value region at a *higher* rate (sometimes way higher) to achieve the same dollar amount as a wealthier area.

This system has created areas of the state where economic growth is nearly impossible. A truly unfortunate example of this can be found in the south suburbs: Lansing. Commercial property taxes in Lansing can be as high as *13% of market value* – ***every year***. The south suburbs have great infrastructure advantages: access to river, rail, and road along with a talented and diverse workforce. But the property tax rate makes it economically unviable for most companies to invest there in spite of the tremendous infrastructure.

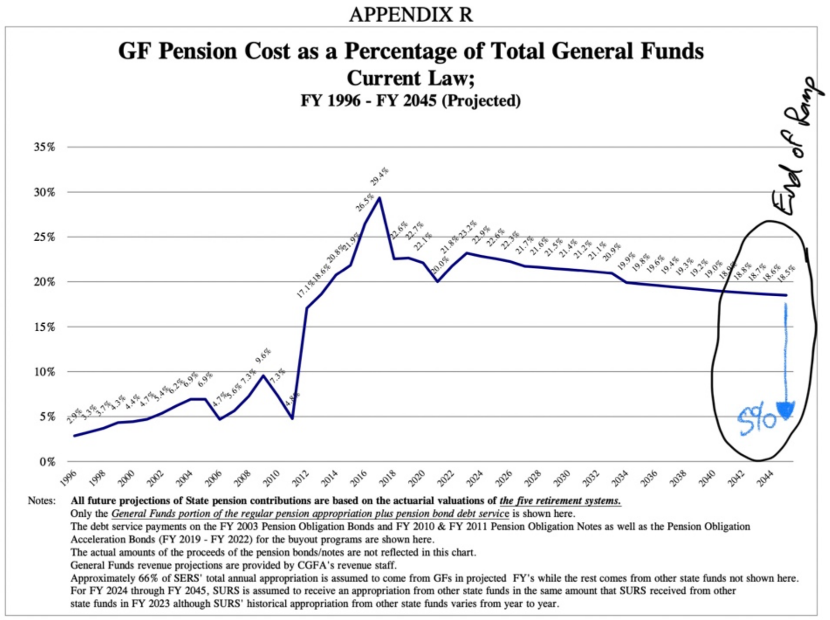
Instead, corporate investors have been building on farm fields in Will County and nearby counties to the west. Why? Because it doesn't make sense to build a $200 million warehouse in a location that would generate a $26 million property tax bill.

Dramatically lowering property taxes will have a compound effect, but it will increase impact in the parts of Illinois that are hurting the most. It will spur economic growth which, in turn, will organically work to lower property taxes, benefitting everyone – especially our neighbors who are trying to get by on fixed incomes.

On a larger economic scale, lower property taxes will lead to increased jobs in these underserved areas, which could decrease crime and reinvigorate these communities. This is truly a foundation of success for these great Illinois towns that have been disproportionately impacted due to unreasonably high property taxes.

How to Implement the Relief

Referencing **Appendix R** of a recent Commission on Government Forecasting and Accountability report (link here) we find that in **Fiscal Year 2017,** our pension payment as a percentage of state spending peaked at **29.4%** of our budget. It has been decreasing since, getting as low as 20% in FY21. There is a bump in the current budget (FY23) resulting from a one-time additional pension payment. Next year, the pension as a percentage of our state budget is scheduled to drop to **22.9%.** It then continues to drop until 2045, where it will be **18.5%** of the budget. Then the ramp ends and Illinois finally reaches the point where only normal pension costs are due, which should be about **5%** of the budget.



This plan would designate that **25%** of the general revenue fund budget toward the traditional pension payment and a new property tax relief component. If the pension payment in any given fiscal year is less than 25%, then the dollar difference would go directly to property tax relief.

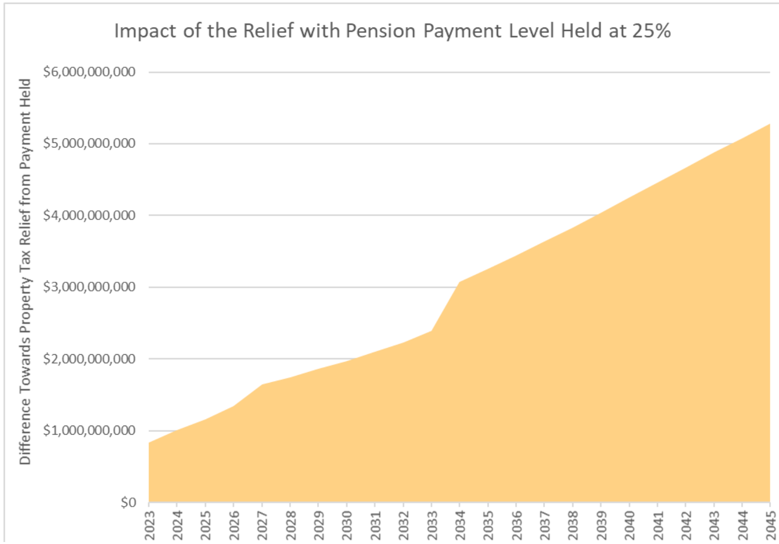
The savings would be distributed to local school districts on a per-pupil basis, which would then be used to reset the levy to account for the relief on a dollar-for-dollar basis. Plainly, this means that $1 in additional funding to a school district would, in turn, lower the base levy by $1. The additional money would add to what is referred to as **"local capacity"** (an ability to self-fund schools through property tax revenue under the current Evidence Based Funding (EBF) formula). The EBF formula would then be implemented on top of the new, lowered base levy in order to distribute the normal state funding for schools. In the end, areas with lower local capacity and high tax rates would win the most.

> Using the formula in a local school district would roughly equate to a 4% reduction in property taxes in ear one.

This plan would designate nearly $1 billion in property tax relief in the next fiscal year. Using the formula in a local school district would roughly equate to a 4% reduction in property taxes in year one. By 2046, we will be able to designate 20% of the budget to property tax relief. If we could do that now, that would equate to approximately $4,000 per student. Imagine how much that would lower property taxes! Obviously, this would vary per district, but lower income areas should see the most relief.

Impact of the Relief

Below, you will see data on the proposed scenario for alleviating property tax relief with pension reform. The graph below represents the difference that will go towards property tax relief over time from FY23 to FY45. This difference is determined by subtracting the projected pension payment from the payment held at a flat level of 25% over time, which is then directed towards property tax relief.



Conclusion: Setting the Foundation

Property taxes are a regressive tax that hurt Illinoisans who need relief the most. A long-term **plan to reduce property taxes will spur economic growth everywhere**. Instead of letting future pension payment savings be slowly whisked away into future new programs and/or pork spending, let's do something that will dramatically improve our future economic fortunes. Lawmakers talk a big game about supporting property tax relief, but nothing ever comes of it. Instead of letting future pension payment savings be spent on legislator pet projects, let's target those savings towards property tax relief that will result in additional investment in communities and relief in everyone's pocket. Let's solve the property tax issue with a strong foundation of pension reform.

Last Thing: What happens if the pension system falters on its expected returns and needs additional funds? If that happens in any given year, there is just less property tax relief distributed that year. If it's substantially lower, then the state budget will have to pick up the difference – just as it is supposed to under the current approach.

KEITH
WHEELER
STATE REPRESENTATIVE