

Property taxes 101: Taking the mystery out of the process

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Property tax levies and property tax cycles often generate many questions for school board members. But just knowing a few definitions and simple formulas can help simplify and demystify the process.

A property tax levy is the amount of property tax dollars a school district requests to operate the district for the subsequent fiscal year. The property tax cycle is the annual process of adopting a levy and then receiving the tax money.

A generic definition of an "aggregate property tax levy" is the total annual property tax dollars that a school district is entitled to receive from its combined individual fund rates, exclusive of the bond and interest fund.

School districts must deposit property tax revenue into appropriate accounting funds as determined by the *Illinois School Code* and the *Illinois Program Accounting Manual*. A formula determines the amount of property tax revenue each fund is entitled to receive: "tax rate" multiplied by a school district's total taxable "equalized assessed valuation" (EAV) equals "property tax revenue."

County clerks calculate the final property tax billings using this formula and direct these billings to owners of parcels of land located in each school district. The process of preparing property tax billings is the "property tax extension."

To understand EAV, examine a property tax bill for a single parcel of land. Look for the cell marked "Fair Cash Value" or "Fair Market Value." The dollar amount in this beginning cell is divided by three to determine the EAV for that parcel of land. Even though several legal deductions are available to eligible property owners, this is the starting point.

Eventually all the parcels of land in a school district are added together to yield a total EAV for the entire district. That's the number to which the levy will be applied.

The amount a district can levy for each fund account is limited to an amount also set in the *Illinois School Code*, unless the district's registered voters approve a fund increase at an election. The levy for each fund is multiplied by each \$100 of EAV to equal the amount of property tax revenue a school district is entitled to receive.

This process of setting a levy is completed annually and must be approved by a school board prior to the last Tuesday of December. Levies are often tentatively approved in November.

The term "property tax cycle" includes the entire annual process of the board adopting a property tax levy in December, submitting that levy number to the county clerk and receiving the distribution of property taxes from the county treasurer.

The cycle can be easily compared to the seasons in a year. In the winter (December), a property tax levy is approved. In the spring (by June), county clerks process billing statements for property owners. In the summer, the county treasurer distributes

property taxes collected from the first installment payment. In the fall, the second installment payment is distributed. And the cycle begins again.

Figuring the levy

Calculation of property tax levies in some districts also is strongly affected by whether the district is limited by the Property Tax Extension Limitation Law (PTELL) or "tax cap" restrictions. Whether a district is governed by PTELL or not, school boards still need to address their levy annually by the last Tuesday in December.

In all districts, a process known as "truth-in-taxation" must be completed if a levy is greater than 5 percent of the previous year's extensions, excluding bond and interest. This process requires a notice in a local newspaper.

The truth-in-taxation notice must be published not more than 14 days or less than seven days prior to a public hearing to review the proposed final property tax levy. This notice must announce the time and place of the public hearing. Usually, the public hearing is held immediately prior to the December board meeting at which the final property tax levy will be adopted.

When a board of education adopts its final property tax levy prior to the last Tuesday in December, it will not have its final EAV figure for that calendar year. The school district typically learns this number after the calendar year has ended.

Because of this discrepancy, school districts routinely increase their annual property tax levy by a percentage to cover any unreported increases in the EAV. This process of increasing the levy by an amount greater than what the school district anticipates it is entitled to receive is sometimes referred to as "ballooning" or inflating the levy.

School districts not subject to PTELL are only limited in the levy process by the maximum tax rates of the individual funds. For example, if school district "A" levies in the education fund for more dollars than the maximum tax rate times the EAV will produce, the county clerk will only extend an amount equal to the district's maximum education fund tax rate times the EAV, which is called the "education fund extension."

Property tax cycles have several inherent problems associated with the time required to complete all components of the cycle, especially when a new parcel of land has been added to the district's total EAV.

For example, a significant increase in a parcel's valuation such as the construction of a new house may become evident in January 2008 but it would not be available for tax levy calculation until the following December 2008. County clerks typically adjust such parcels in the following spring 2009 and collect the increased property tax revenue in the summer of 2009. Therefore, the revenue that results from a significant increase in a parcel's EAV will not be received by a school district until a year and a half later.

The property tax revenue resulting from an increased EAV for this parcel will assist in operating the school district for the fiscal year beginning July 1, 2009 and ending June 30, 2010. If this new house contains school age children, the school district will need to spend money immediately to begin educating these children. However, the property tax revenue from this house, which would assist in educating its children, would not be received for one and one half years. This time delay can result in a serious cash flow issue for the school district.

Another timing problem in the tax cycle occurs when voters approve a tax rate increase. For example, if the registered voters in a school district approve a tax rate increase in the spring of 2008, the benefits of the increased tax rate are not calculated in the levy until December 2008 following the referendum. Therefore, the increased revenue for the school district will not be received until the summer of 2009, which benefits the 2009-10 fiscal year.

Adhering to these time requirements often has significant negative cash flow problems for school districts.

PTELL districts

School districts in Illinois subject to PTELL or "tax caps" must comply with the same procedures as non-PTELL school districts, but they face even more limitations.

School districts subject to PTELL are limited not only by the maximum tax rates of the individual funds for which the district levies but also by the calculated total maximum tax rate for the district as determined by PTELL. This total maximum tax rate for the district is referred to as the "limiting rate."

The "limiting rate" is the tax rate that allows the school district to impose the maximum amount of property taxes allowed under the extension limitation. The sum of all tax rates for funds subject to the PTELL cannot exceed the limiting rate. The formula used to compute the limiting rate is:

$$\text{Limiting rate} = \frac{\text{PYEAV} \times (1 + I)}{\text{CEAV} - \text{NP} - \text{AX} - \text{TIF} + \text{DIS}}$$

Where:

PYEAV = aggregate extension base (prior year total taxes billed for funds subject to the PTELL) 1

I = inflationary increase (CPI or 5 percent, whichever is less; or other amount approved by referendum)

CEAV = current EAV used in setting preliminary rates

NP = new property

AX = current EAV of any annexations

TIF = recovered tax increment value (after the TIF expires)

DIS = current EAV of any disconnections

The key to levying effectively in a PTELL school district is to understand that PTELL does exactly what it was intended to do: *limit* the increase of the current levy to either the increase in the Consumer Price Index or 5 percent, whichever is less, over the previous year's extension.

PTELL levy scenarios

The following scenario shows how a PTELL school district can lose revenue even when the district maximizes its levy from the previous year.

Table I illustrates the basic concept of PTELL in which the levy for the current year is limited to the increase in the CPI (3.4 percent for the 2006 tax year) over the previous year's extension. It is important to note that in **Table I**, the increase in the district's assessed valuation is strictly due to inflation.

As long as the district levies the extension limit or more, provided it does not exceed its individual tax rates, the school district will maximize its levy. However, comparing this school district to a district *not* subject to PTELL under identical conditions, the school district subject to PTELL loses access to its entire assessed valuation as illustrated in **Table II**.

As a result of PTELL, the school district is limited to a total tax rate of \$1.29626 and is not able to reach its maximum tax rate of \$1.379. PTELL effectively limits the school district's extension to the increase in the CPI. The district not subject to PTELL is able to access the maximum tax rate.

The school district subject to PTELL, when compared to the extension of the non-PTELL district, loses \$182,028 in tax revenue for that year. The reason for this loss is that the PTELL district's tax rate is compressed by the formula so that the limiting rate times the school district's EAV results in an increase over the previous year's extension equal to the increase in the CPI.

Another way of explaining this is that the PTELL district is able to access only 3.4 percent of the 10 percent increase in its EAV. The EAV over 3.4 percent merely serves to drive the district's tax rate down. A 3.4 percent increase in the PTELL district's equalized assessed valuation over the previous year is \$206,800,000. When multiplied by their operating tax rate, the PTELL district equals an extension limit of \$2,851,772, as compared to the \$3,033,800 limit that can be accessed by the non-PTELL district.

The inclusion of new property, current EAV of any annexations and recovered tax increment value (after the TIF expires) are all positive factors in the PTELL formula because they reduce the EAV, which allows the limiting rate to increase, resulting in a larger extension.

Successful property tax referenda also allow for an increase in property tax extensions in PTELL districts.

TABLE I
Basic Function of PTELL

Previous Extension		2,758,000
CPI or 5%	×	1.034
Adjusted Extension Base		2,851,772
Current Net Equalized Assessed Valuation		220,000,000
New Property	-	0
Annexations	-	0
Adjusted Valuation Base		220,000,000
Adjusted Extension Base		2,851,772
Adjusted Valuation Base	÷	220,000,000
Limiting Rate	×	*1.29626
Extension Limit		2,851,772
Extension Percent Increase over Previous Year		1.034

Note: *The school district's maximum tax rate for all funds, excluding bond and interest, is the limiting rate in this table.

TABLE II
Comparison PTELL versus Non-PTELL

		PTELL District	Non-PTELL District
Operating Tax Rate		1.379	1.379
Prior Year Equalized Assessed Valuation		200,000,000	200,000,000
1. Previous Extension		2,758,000	2,758,000
2. CPI or 5%	×	1.034	
3. Adjusted Extension Base		2,851,772	
4. Current Net Equalized Assessed Valuation		220,000,000	220,000,000
5. New Property	-	0	0
6. Annexations	-	0	0
7. Adjusted Valuation Base (line 4 minus lines 5 & 6)		220,000,000	220,000,000
8. Adjusted Extension Base (line 3)		2,851,772	
9. Adjusted Valuation Base (line 7)	÷	220,000,000	
10. Limiting Rate (line 3 divided by line 9)		1.29626	1.379
11. Extension Limit (line 10 times line 4)	×	2,851,772	3,033,800
12. Extension Percent Increase over Previous Year (line 11 divided by line 1)	÷	1.034	1.100

Table II illustrates how the school district subject to PTELL with the same operating tax rate as a non-PTELL district with the same previous year's extension, and a 10 percent increase in assessed valuation due to inflation results in a loss of revenue to the PTELL district or the *inability to access its full increase in the assessed valuation.*

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