Fiscal Note & Local Impact Statement

124 th General Assembly of Ohio

Ohio Legislative Service Commission
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BILL: **Am. Sub. S.B. 5** DATE: **June 12, 2001**

STATUS: **As Enacted – Effective October 26, 2001 (Effective date is postponed pending referendum effort)** SPONSOR: **Sen. Wachtmann**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Revises the Municipal Annexation Law**

State Fiscal Highlights

- No direct fiscal effect on the state.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2002	FY 2003	FUTURE YEARS
Counties			
Revenues	Potential gain, largely offsetting the additional cost	Potential gain, largely offsetting the additional cost	Potential gain, largely offsetting the additional cost
Expenditures	Potential increase	Potential increase	Potential increase
Municipalities			
Revenues	Potential loss	Potential loss	Potential loss
Expenditures	Potential increase	Potential increase	Potential increase
School Districts			
Revenues	Potential gain or loss	Potential gain or loss	Potential gain or loss
Expenditures	Potential increase or decrease	Potential increase or decrease	Potential increase or decrease
Townships			
Revenues	Potential gain and foregone loss	Potential gain and foregone loss	Potential gain and foregone loss
Expenditures	Potential increase or decrease	Potential increase or decrease	Potential increase or decrease

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- Counties could gain fee revenue and have increased annexation hearing and legal costs. Revenue gains could largely offset any cost increase.

- Overall, the bill could have a significant negative fiscal impact on municipalities. Significant cost increases could result from the change in the payment schedule to townships after an annexation and exclusion, from increased hearing and legal costs, and potential losses in revenue from an increase in the number of annexations denied.

- The bill could result in more denials of annexations, which could have varying impacts on school districts costs and revenues, depending upon the land use of the territory at the time of annexation, after annexation, and other factors.

- Overall, the bill could have a positive fiscal impact on townships, as a township would better be able to challenge an annexation that might have a negative fiscal impact on it, and the bill would enable townships to keep more revenue or receive higher payments from municipalities in cases when an annexation is approved.

- Townships would also have to pay fees to counties permitted under the bill and could choose to incur legal costs to hire expert witnesses, subpoena testimony, and other expenses it considers necessary for any potential annexation. However, increased negotiating position under the bill could make it easier for townships to obtain negotiated agreements from municipalities and reduce costs associated with annexation hearings.

Detailed Fiscal Analysis

Bill Provisions

The bill revises existing law and enacts new standards for the approval of municipal annexations, procedures applicable to municipal annexations, and statutory schedules of payments to be made to townships for the loss of tax revenues as a result of municipal annexations. It specifies that notice to property owners is sufficient if sent by regular United States mail to the tax mailing address listed on the county auditor's records, while notice to government officers shall be made by certified mail or in person. This notice is sent from the agent for the petitioners to the owners property adjacent to the area for annexation. Current law has no provisions for property owner notification.

Impact of Changes to Normal Annexation Procedure

Most of the changes made by the bill to the normal annexation process could make it more likely that municipal annexations would be denied under the bill by giving county commissioners more discretion to deny annexations and making other changes. A 1995 LBO survey suggests that annexation petitions are typically approved.[1] Reducing the number of annexations approved could cause municipalities to forgo tax revenue gains along with increases in expenditures for services that could have resulted from an annexation. Conversely, the denial of more municipal annexation requests could prevent the loss of township property tax revenues and prevent decreases in expenditures for services. There could also be fiscal implications for other entities, particularly school districts.

The overall impact, on both the annexing municipality and the affected township, would vary from case to case. Conventional wisdom suggests that annexations result in a fiscal benefit to the municipality and a fiscal loss to the township losing land. This is not necessarily the case. Research in this area suggests that annexation can be fiscally beneficial to either entity, to neither entity, or to both entities.[2] The same can be said for the impact on taxpayers and schools in each community.[3]

For example, if an annexation results in commercial development that increases property values without bringing in many new students, a school district could gain revenue. Conversely, if an annexation resulted in a large residential development that brought many new students and relatively little additional tax revenue, a school district could have cost increases above the revenue gain. On the other hand, if the land use and development did not significantly change after annexation, there may be no notable fiscal impact.

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[1]These survey results and there implications are referenced throughout the fiscal note. Specific key results from the survey are detailed at the end of the fiscal note.

[2] Edwards, Mary. "Annexation: A "Winner Take All Process?" *State and Local Government Review*. Fall 1999. Vol. 31, No. 3. Fall 1999. Carl Vinson Institute of Government: Athens, Georgia, pg. 229.

[3]An indirect effect of an annexation can be the changing of school district boundaries. If only part of a school district is annexed, the State Board of Education must approve the transfer unless the school district has entered into an agreement with an urban school district that governs the transfer.

The fiscal impacts of annexation depend on the fiscal position of each community and the particular circumstances surrounding each annexation. The land use type of the property when annexed, and in the years after annexation, affect the fiscal impact on both the municipality and the township. Typically agricultural land uses have lower service costs and generate lower revenues than other uses. Conversely, commercial and industrial uses can have relatively higher service costs, but also can generate higher revenue, particularly for municipalities that levy an income tax.

Under current law, a regular annexation petition must be approved if the board of county commissioners (hereafter the Board) finds that all procedural steps were followed and it determines that the:

- Territory to be annexed is not unreasonably large
- General good of territory is served by the annexation, which has been defined by the courts to mean the interests of the property owners in the territory to be annexed

The bill defines the "general good of territory" so that it takes into account both the interests of the property owners in the territory to be annexed and the interests of any unincorporated territory not included in the petition that is within one-half mile of the territory to be annexed. This criterion gives the Board much more discretion to approve or deny an annexation.

The bill also requires the Board to find that no street will be divided by a boundary line creating a road maintenance problem or that the municipality has agreed to assume maintenance responsibilities for the street. This criterion adds another largely factual criterion for denying an annexation that could make it more difficult to have an annexation approved. This provision could also induce a municipality to take on additional maintenance responsibilities so that an annexation it supports is approved. This is a cost that would not have to be incurred under current law.

Another key provision in regard to fiscal impact is that the bill makes townships a necessary party in the annexation hearing and gives townships standing to appeal an annexation decision. The bill also lowers the burden of proof in cases where an approved annexation is appealed. Current law requires appellees to prove their case with clear and convincing evidence.

The bill would change this to a "preponderance of the evidence" test, which is a much lower standard. These changes, along with the expanded reasons for denying an annexation listed above, could result in longer annexation hearings, more challenges to annexations, and more appeals of annexation decisions. Therefore, the cost of the annexation process could increase and the number of annexations denied and appealed could increase. This could increase the costs incurred by counties, municipalities, townships, and property owners for the annexation process.

Impact of Special Annexation Procedures

The bill creates three "special" annexation procedures that may be used when all landowners have signed an annexation petition and have requested one of the special procedures be used. The LBO survey suggests that in most cases it is the property owners in an area that initiate the annexation process, and, in a little less than 10% of annexation cases, at least one property owner opposes the petition. The special procedures could shorten the time and cost of an annexation process, particularly in

cases where neither the township(s) nor the municipality objects to the petition. LBO survey data suggest that about one-third of annexations are opposed by at least one person or entity, with townships accounting for about two-thirds of those objections. In addition to reducing the time and cost of the process, the three procedures have unique fiscal implications that are explained below:

Special Procedure One: A county must approve an annexation *without a hearing* at its next regular session after the petition is filed when all parties, including the annexing municipality and any affected townships, have consented to the annexation and the municipality and township(s) have signed an annexation agreement or a cooperative economic development agreement (CEDA)[4]. The fiscal impact of signing an annexation or CEDA agreement could vary depending upon the agreement, but any positive or negative impact could be significant. Annexations approved under this procedure are not open to appeal, which would eliminate the possibility of parties having to incur legal expenses over an appeal of the decision. However, it seems unlikely that an appeal would occur under current law if all landowners and the township and county approved of the annexation and had signed a CEDA. On the other hand, the changes made in the bill could make it more likely that parties will seek and reach an agreement to avoid lengthy hearings and appeals.

Special Procedure Two: The major difference between special procedure two and the other special procedures or the normal procedure is that any territory annexed under this procedure cannot be excluded from the township, meaning that the township could continue to collect general property tax revenue, in certain cases, and some inside millage. Any residents in an unexcluded, annexed, area could have to pay more in taxes than other residents in the township or municipality, as they could have to pay certain property taxes to both entities. Annexations approved under special procedure two are not open to appeal.

The second procedure is more like current law in that the reasons for which the annexation can be denied are limited largely to factual determinations, making it more likely that the annexation will be approved. However, there are more factual criteria (8 in total) to be met regarding procedural matters, the size and location of the area to be annexed, and service provision, which decreases the likelihood of approval compared to current law. The eight criteria include the requirement that no street will be divided by a boundary line creating a road maintenance problem or that the municipality has agreed to assume maintenance responsibilities for the street. This provision could induce a municipality to take on additional maintenance responsibilities so that an annexation it supports is approved. This is a cost that would not have to be incurred under current law. If the board determines that the special criteria have not been met under this procedure, it must convert the annexation case back to the procedures and decision criteria for a regular annexation. These changes could reduce the likelihood of an annexation approval and increase the costs and time spent deciding an annexation request compared to current law.

Special Procedure Three: The most important aspect of the third procedure is that the petitioners must demonstrate that the purpose of the annexation is to undertake a "significant" economic

[4]All but one provision allowed under the newly created annexation agreements can currently be agreed to under the CEDA Law. The one new provision permits an agreement as to the reallocation of minimum mandated levies established under the Tax Levy Law *in areas annexed*. The potential effects of this are discussed in the "*Other notable changes*" section of the analysis in regard to inside millage.

development project. The bill defines significant to mean a project will result in more than $10 million in private investment, not including any amounts raised through tax increment financing, and more than $1 million in new payroll. If the annexation is approved, the territory cannot be excluded from the township. This could mean a reduction in lost tax revenue for townships.

The definition of a "significant" economic development is such that this provision could likely not be used in most cases, except for the larger economic development projects undertaken in the state. However, for projects that obviously would meet the criteria, the likelihood of approval would be quite high, as is the case under current law. There would also be no possibility for appeal and the costs associated with an appeal if the annexation were approved using this procedure. The Department of Development must certify that a project meets the threshold amounts set in the bill. If the Department of Development certifies that the project meets the threshold amounts, the criteria is deemed to have been met and the annexation cannot be appealed on this basis.

The third procedure is more like current law in that the reasons for which the annexation can be denied are limited largely to factual determinations, making it more likely that the annexation will be approved. However, there are more factual criteria (5 in total including the significant economic development certification) to be met regarding procedural matters and service provision, which decreases the likelihood of approval compared to current law. The five criteria include the requirement that no street will be divided by a boundary line creating a road maintenance problem or that the municipality has agreed to assume maintenance responsibilities for the street. This provision could induce a municipality to take on additional maintenance responsibilities so that an annexation it supports is approved. This is a cost that would not have to be incurred under current law.

Annexations approved under this procedure are not open to appeal, and a landowner that signed the petition can only appeal a denial of the annexation. This change would reduce the likelihood of parties having to incur legal expenses over an appeal of the decision.

Other Selected Provisions

Changes primarily affecting counties:

1. The bill allows boards of county commissioners to establish fees to cover the costs incurred in annexation proceedings and to require a deposit. Compared to current law, the change could result in a revenue gain to counties and increased costs for any property owner, municipality, or other entity filing an annexation petition. County commissioners are not currently allowed to charge for annexation proceedings. Under the bill, the responsibilities of the county commissioners with regard to annexation proceedings are greatly expanded along with the ability to charge "reasonable" fees. Therefore, counties may experience an increase in expenditures and a gain in revenues that could largely offset the cost.

2. The bill requires the county to keep a record of any annexation hearing. There should be little to no additional cost for this provision, since counties already would keep some record of these

proceedings. Also, if any party wants a court reporter to record the hearing or a transcription of the proceedings that party must pay the additional cost.

3. The legislation requires counties to serve individuals with subpoenas as requested by the parties to the annexation, which could result in increased costs. However, the bill permits counties to charge the parties fee and mileage expenses that could offset this cost.

Changes primarily affecting municipalities and townships

The bill changes payment schedules that municipalities have to pay townships for the loss of tax revenue when an area is annexed and excluded under any of the procedures of the bill, unless there is an annexation agreement or CEDA. These changes could significantly increase the cost of annexation to a municipality if it ever seeks to exclude the annexed area from the township. The bill's new payment schedule could also result in a significant revenue gain to townships if and when an annexed area is excluded from the township.

In the event that a municipality grants a tax abatement on the annexed territory, the municipality must pay the township an amount equal to what the taxpayer would have owed in taxes had the exemption not been granted. This provision could significantly increase expenditures for certain municipalities that offer tax abatements.

Municipal costs could be incurred if a city chooses to provide optional and additional services to an annexed territory.

There are two areas of the provisions with fiscal effects.

1. Fee and mileage expenses incurred by a county board of commissioners for the issuance and mailing of subpoenas for witnesses or for books, papers, correspondence, memoranda, agreements, or other documents or records relevant to the annexation petition shall be paid in advance by the party making the request for the subpoena, and the remainder of these expenses shall be paid out of fees charged by the board for the annexation proceedings. This provision has offsetting costs.

2. The second fiscal effect is found in the reparations of moneys from municipalities to townships. The reparations schedule is shown in the following table.

Reparation Schedule of Moneys Paid by Municipalities to Townships for Annexed Township Areas	
TAX TYPE: Commercial, Industrial, Real, Personal, and Public Utility	
Years Following Effective Annexation Date	Percent of Moneys Townships Would Have Kept if No Annexation Had Occurred
1-3	80.0%
4-5	67.5%
6-7	62.5%
8-9	57.5%
10-12	42.5%

TAX TYPE: Residential and Retail Property	
Years Following Effective Annexation Date	Percent of Moneys Townships Would Have Kept if No Annexation Had Occurred
1-3	80.0%
4-5	52.5%
6-10	40.0%
11-12	27.5%

For comparison, the reparations schedule in *current law* is shown in the following table.

Current Law for Reparations of Moneys Paid by Municipalities to Townships for Annexed Township Areas	
TAX TYPE: Real, Public Utility, and Tangible Personal Property	
Years Following Effective Annexation Date ("Annexation Period" of 1-12 months)	Percent of Moneys Townships Would Have Kept if No Annexation Had Occurred
1-3	100 %
4	80 %
5	60 %
6	40 %
7	20 %
Years Following Effective Annexation Date ("Annexation Period" of 13-24 months)	Percent of Moneys Townships Would Have Kept if No Annexation Had Occurred
1-2	100 %
3	80 %
4	60 %
5	40 %
6	20 %
Years Following Effective Annexation Date ("Annexation Period" of 25-36 Months)	Percent of Moneys Townships Would Have Kept if No Annexation Had Occurred
1	100 %
2	80 %
3	60 %
4	40 %
5	20 %

The bill also modifies provisions that specify when a municipality can petition to annex property. Notable differences between current law and the bill include:

- A county must approve any request to annex state land if the Director of Administrative Services consents to the annexation. There is no provision for this under current law. Such annexations would be rare.

- The bill removes a current provision that allows municipalities to put an annexation on the ballot to be voted on. This provision is rarely if ever used by municipalities and would likely have no practical impact.

- The legislation prohibits a municipality from purchasing property below its appraised fair market value, annexing the property, and then selling back to the original owner. This change could have an impact on affected municipalities, townships, and property owners by making such transactions more difficult. However, the provision could probably be circumvented by creating a corporation to sell the property back to or involving a third

party. This fact and the fact that such instances likely make up a small percentage of all annexations should severely reduce, if not negate, the fiscal impact of this change.

- The bill prohibits land annexed under a municipal petition from being excluded from the township. This change could reduce the negative fiscal impact on townships of such annexations and could mean that the property owners will have to pay more in taxes than under current law. The fact that such instances rarely occur should the fiscal impact of this change relatively small.

The bill permits townships to spend general fund moneys to cover any costs associated with an annexation proceeding, including hiring witnesses and consultants. Current law only permits townships to hire attorneys to represent the township. Townships could choose to incur increased legal costs under this provision.

Other notable changes

1. The bill specifies the procedure for municipalities and townships for sharing inside property tax millage when annexed territory has not been excluded from the township. Basically, if the municipality and township cannot reach an agreement, the millage is split equally. The bill requires other entities to be held harmless by any millage split under these circumstances. Depending on current practice in counties, this specification could have no impact or a revenue gain or loss for affected municipalities, townships, and other local governments.

2. The bill changes hearing notice requirements that could negligibly increase or decrease notification costs for a particular annexation, depending upon the number of property owners involved. Petitioners would bear any additional costs. Typically, property owners are the petitioners. Notable changes include requiring the petitioners to:

   - Publicize the hearing at least once in a newspaper prior to the meeting instead of for four consecutive weeks
   - Send mail notification about the hearing to all property owners in the territory proposed for annexation. The cost increase or decrease resulting from these changes could be minimal.

   For example, assuming a newspaper advertisement is $50, current law would require the petitioners to pay $200 in newspaper advertising. Assuming it costs 50 cents in materials and time to send out a mail notification and that there were less than 300 property owners to be notified by mail, the petitioners would realize a slight savings in notification costs after paying for the mailing and one newspaper advertisement. Every mail notification beyond 300 would cost an additional 50 cents in expense over current notification costs.

3. The bill prohibits an annexation form being denied simply due to procedural errors. There could be little to no impact from this provision over current law. In practice, under current law, denials or successful appeals for such errors are rare to nonexistent.

4. The legislation requires that all signatures on an annexation petition be obtained no more than 180 days before the filing date. This change could make it more difficult to obtain enough valid signatures for an annexation petition. In turn, this could reduce the number of valid annexations filed and/or approved.

5. The bill specifies that a person who owns more than one parcel of real estate can only be counted as one owner for purposes of signing a petition. Depending upon current practice in a county, this change may or may not make it more difficult to obtain the necessary signatures for a petition.

Annexation Activity in Ohio

According to the Secretary of State's records, 202 annexations became effective in 1999, 317 became effective in 1998, and 334 in 1997.

In 1995, LBO surveyed all 88 Ohio counties on annexation activities within each county from 1990 to 1994. Thirty-seven of 88 counties responded, reporting 957 annexation request filings in the five-year period. Among those responding, the annual average was 191 annexation filings, or 26 per county. Fourteen counties (or 38%) averaged at least one annexation filing per year. However, only two counties, Franklin and Montgomery, averaged more than 10 annexation requests per year. In fact, Franklin county accounted for nearly one-third of all the annexation filings each year with an average of 55 annexations.

Of the 957 annexation filings reported, the county commissioners approved 877. In more than 60% of the cases, property owners initiated the annexation process. From 1990 to 1994, 286 filings were opposed by one or more entities. Of the annexations opposed:

- 1 was opposed by a city
- 3 by villages
- 7 by other entities
- 83 by individuals
- 192 by townships

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