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Indiana General Assembly - Session Report #2:

March Madness

This week begins the second half of the legislative session, after the Indiana House passed its version of the $36+ billion state budget last Monday. As Ways & Means Chairman Brown noted in bringing HB1001 to the floor, the basics of the budget might have seemed wildly optimistic last spring, when revenue losses from COVID seemed likely to reach $2 billion or more – increasing education spending, restoring many agencies to pre-COVID footing and funding new programs aimed at economic resilience while leaving a $2 billion surplus.

That proposal still sparked spirited debate and a slog through 40+ second-reading amendments, with a number of rhetorical barbs aimed at the size of that surplus and education policies like the expansion of school choice scholarships before a final 65-30 vote sent the bill on to the Senate.

As it stands, a few key differences separate the Governor and the House:

- On revenues, the House adds a 50-cent per pack increase to the state cigarette tax, bringing in an estimated $307 million over the biennium (supporting a growing Medicaid budget);
- With cigarette taxes adding budgetary breathing room and the added confidence of a strong January revenue report, the House spends roughly $450 million more than the Governor's original blueprint – including $150 million for the Regional Recovery Grant program floated in the State of the State;
- The House also adds $10 million for local law enforcement agencies to purchase body cameras (conforming with HB1006, the bipartisan police reform package now in the Senate), and $50 million for the public health-focused grant program envisioned by HB1007;
- The House amendment also scales back some accelerated construction and teacher pension repayment proposed by Holcomb in favor of these grant programs, choosing to capitalize on the state's credit rating and low interest rates to prioritize these investments over early debt retirement;
- The budget does maintain levels of capital spending from Governor Holcomb's plan, and funds higher education rehabilitation and repair budgets without adding new construction projects;
- Speaking of higher education, the latest budget restores funding to pre-COVID levels in FY2022 with a 1% increase in FY2023, versus the originally proposed 2% increase (1% in both years of the biennium) – mostly at the expense of regional campuses and smaller public institutions in '22.

It's also notable that HB1004 ($30 million for small business recovery grants) and HB1008 ($150 million for K-12 learning loss prevention grants) already passed the House and have been referred to Senate Appropriations – these programs are funded from the current fiscal year, and proceed outside the budget process.

But the largest spending category also draws the most scrutiny and policy debate – the $15.4 billion in K-12 tuition support that 'follows the student' to support the operating budgets of local schools. And so that's where we'll start some second-half issues to watch…

What to watch for:

To borrow a commentator's cliché from college basketball three weeks before the NCAA comes to Indianapolis, what second-half adjustments should we look for before the buzzer sounds on this socially-distant session?

Expanding school choice:
HB1005 expands eligibility for Indiana's choice scholarships and creates a new Education Scholarship Account for parents to access tuition support dollars to spend on alternative educational options. Depending on demand, this could represent a shift of roughly $70 million in tuition support over the biennium from public schools. These shifts are reflected in the House budget; but while the Senate majority if sympathetic to school choice, will they adopt a more cautious attitude towards such sweeping changes during the COVID pandemic?

Conflict on complexity aid?
Tuition support is dominated by the foundation grant, core funding equally applied to every student. The complexity grant is added for students in poverty to address resource disparities and challenges outside the classroom. In recent budget cycles, complexity has diminished as a share of total spending. The House formula would flatline complexity at $3,675 per student and limit the growth of each district's total complexity grant.

House fiscal leaders argue that adjustments are needed to smooth out large funding fluctuations based on surging enrollments in SNAP and TANF (used to calculate complexity), and that putting more resources into the foundation grant means all students share the benefits. Complexity was a point of contention between House and Senate budget negotiators in 2019 – will the Senate seek to ease the impact on high-poverty schools?

College math:
It's also the Senate's turn to weigh in on higher education, after the House halved the original recommended budget increase. With the current budget flatlining FY2022 spending for many institutions, how will they fare in preparing for next year's unique freshman class, who closed their high school careers amid COVID? And will the Senate be a more receptive audience in considering campus capital projects?

Regional reboot:
One modest surprise of the session so far is the House budget's embrace of Governor Holcomb's proposed Regional Recovery Grant Program, putting $150 million towards the premise that regional economic development will drive Indiana's post-COVID comeback.

Last year, Senator Holdman introduced SB350, creating "investment hubs" that expanded the power of Regional Development Authorities (RDAs) to raise and spend revenues on capital projects to elevate quality of life and economic competitiveness across county and city lines (the bill was narrowed to focus on Central Indiana before heading to the House). This session, Holdman has proposed a Regional Economic Acceleration and Development Initiative (SB215) to support local redevelopment projects with tax incentives and grant financing in cooperation with RDAs.

So there's support for regional development efforts in the Senate, but will there be a push for more specifics in the Regional Recovery Grant Program? Can this concept evolve into a more sustainable successor to the Regional Cities Initiative?

Limiting local budgets:
Of course, regionalism starts with resilient local governments able to provide essential services before pursuing interlocal priorities. IFPI research released in 2020 ("Capacity-Cost Indexes of Indiana Local Governments," by Dr. Larry DeBoer) confirms that fiscal pressures had been building before COVID in many Indiana communities – so one more issue to watch: Will the General Assembly add new limits to local budgets?

Plans for a "flexible freeze" on local public safety spending (the majority of most city and county budgets) stalled with the third-reading defeat of SB42. However, SB200 did make it to the House – curbing prosecutorial discretion could impact county jail populations (as local corrections budgets are a growing fiscal challenge nationally and here in Indiana).

Other legislation (SB141) takes aim at Indianapolis, specifically impounding local tax revenues dedicated to bus rapid transit routes across the city.

Putting more limits on local spending – whatever the intention – adds to the challenges of local governments dealing with the fiscal aftermath of COVID along with revenue constraints that had already been squeezing larger cities and urbanized counties most significantly.

Property taxes continue to be the largest (and most stable) source of revenue for local governments, buoyed by a surprisingly housing market in 2020. However, Indiana caps property tax bills to a percentage of assessed value, and puts an upper limit (the maximum levy) on total property taxes per county that can only grow as fast as statewide personal income. Bills to change the maximum levy formula and relax limits on infrastructure projects under tax caps (HB1051 and HB1363) weren't heard in the House, but deserve interim study looking towards 2022.

Speaking of 2022, that's when the turmoil of 2020 will hit local income tax distributions. Net earnings last year are still stuck below 2019 through three quarters of data; the results will show up on this year's tax returns, which are used to calculate county income tax distributions in '22. (2021 revenues were generated by 2019's economy, and are actually up about 6% statewide.)

This means that any local government legislation enacted this session would take effect just as local officials plan for potentially lower income tax revenues, including the shares earmarked specifically for public safety and correctional facilities in many counties, and mass transit in Marion County.

Local budgets are already lean, largely dominated by police and fire service, road repairs and debt repayment. Looking towards the second half of session, legislators should consider pausing before adding any new constraints or complications to counties, cities and towns on the front lines of COVID response, regional recovery and economic reconstruction.