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NEWSLETTERS

Res Gestae - The Future Of Municipal Growth: Can Government Reorganization Become The New Annexation?

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After nearly a decade of attempts, the General Assembly enacted comprehensive municipal annexation reform during the 2015 Session. These authors would agree that reform was needed; the pre-2015 version of the annexation statute was a cacophony of specialized legislation to address isolated needs and reactionary "fixes" that were well-intended to prevent the recurrence of previous annexations perceived to be unwise or unfair. But the 2015 reforms fell short of the mark because they have failed to address the core problems with annexation and have unwisely impeded municipal growth. The reforms were aimed at curbing what is more commonly known as "involuntary" annexation -- an annexation initiated by the municipality that is, perhaps, opposed by at least one[2] of the affected landowners. The reforms lengthen the process, introduce new bureaucratic requirements, and generally make it more difficult and cumbersome to complete an annexation, even one that is supported by the vast majority of voters in the annexation territory and municipality.

Simultaneously with these legislative changes, a chill wind has been blowing against involuntary annexation from the judicial branch. In 2014, remonstrators won a victory at the Indiana Supreme Court in *American Cold Storage v. City of Boonville*,[3] which was the first ruling by the Supreme Court against a municipality in a remonstrance action in over forty years. Since *Boonville*, the Supreme Court has ruled against an annexing municipality twice more.[4]

The newly treacherous terrain has generally produced reluctance for municipalities to grow their borders, which, in the long run, does not bode well for Indiana. While it may have been politically expedient for legislators to block or curtail involuntary annexation, the truth is that in order for cities and towns to be vibrant centers of growth, they will need to expand their boundaries and occasionally include someone who does not wish to be included. Municipalities are the engines of growth. They have the infrastructure (e.g., utilities); they offer the services (e.g., police and fire); and they have the amenities (restaurants, hotels, shopping, entertainment, parks, etc.) that are needed to attract the type of economic development that Indiana wishes to attract. The problem is that our current annexation statute is deeply flawed. The 2015 reforms do nothing to address the core problems from expanding municipal boundaries. The revised process continues to rely upon judicial proceedings to resolve what is essentially a political question, and it places in the hands of affected property owners the ability to block decisions made by elected officials that are calculated to benefit the entire community.

There is a better way to address the competing interests of democracy

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and property owners. The dichotomy is revealed in two decisions from the Supreme Court issued in the first half of 2016. In the latter, the Court blocked an annexation by the Town of Fortville in a traditional remonstrance action, and, in doing so, expanded the role of the judiciary to decide whether local legislative bodies truly need the territory they seek to annex.[5] Four months earlier, the Supreme Court blocked annexations by the Town of Whitestown; but in this case, the litigation was not between the municipality and annexation territory landowners. In *Whitestown*, the litigants were two municipalities, and the Court held that Whitestown's annexations must stand down and give way to a government reorganization between the Town of Zionsville and Perry Township.[6] The Zionsville/Perry Township reorganization had been negotiated pursuant to the Government Modernization Act[7] by the local legislative bodies of both the town and the township and then approved at a referendum of the voters of both. The Government Modernization Act and its reorganization option were originally enacted in 2006, but it has been rarely used since then.[8] The purpose of the Government Modernization Act is to grant "broad powers to enable political subdivisions to operate more efficiently by eliminating restrictions under existing law."[9] Reorganization allows local units to create their own charter, enabling a local government structure that is tailored to the needs of the community. The resulting charter can establish service areas and taxing districts that allow municipalities to foster and capture economic development, that mitigate or eliminate subsidies, and that preserve rural lifestyles. The charter is then ratified as it should be – by voters in the privacy of the voting booth. Despite the limited use of reorganization to date, nearly every difficulty posed by annexation can be addressed by choosing reorganization. In short, reorganization can become the new and preferred path for municipal growth.

In reaching this conclusion, we will first examine why municipalities should and do seek to expand their boundaries. We next will identify the problems under the current statutory annexation mechanism. Finally, we will explain how reorganization can be used to address the problems that exist with annexation.

Why Municipalities Need to Expand Their Boundaries

While there may be a multitude of reasons why a particular municipality has pursued a particular annexation, most annexations are generally motivated by one of three reasons (or a combination of the three): economic development, matching borders to service areas, and eliminating subsidies.

1. Economic Development: Municipalities are the drivers of economic development in this State. Nearly every significant economic development project that this State sees depends upon significant municipal support to make it happen, including water and sewer service, a greater level of fire protection service than most volunteer fire departments are equipped and staffed to provide, and more frequent police patrols and quicker response times. The municipality generally has no interest in participating in such efforts unless it can share in the benefits that the economic development provides, through annexation, or at least through a waiver of the right to remonstrate against annexation. In addition, sometimes municipalities will annex to preserve the ability to

control how an area on its borders will develop.[10] Sometimes annexations will occur so the municipality can prevent an area on its outskirts or at its gateway from developing in a fashion that will be harmful to the rest of the city (e.g., by attracting existing businesses away from their in-town locations or allowing development that is inconsistent with the municipality's objectives for the area).

2. Matching of Borders to Service Areas. Many municipalities have extended various services outside town, sometimes on the understanding (or even express promise) that later annexation will not be opposed. There is a common misconception that municipalities are somehow in the business of providing utility services and that municipalities benefit from providing utility services outside the corporate limits. This is simply not true. Municipalities have one mission: to provide essential government services to their constituents. There is generally not a profit motive to municipal utility service, and more customers is not necessarily a good thing. In fact, connecting additional customers can cause the exhaustion of available capacity and catalyze future construction and rate increases. To the extent such service is extended outside town, it is always on the expectation and belief that these additional customers will someday become constituents. Annexation bridges this gap and properly aligns the corporate limits with the service boundaries.

3. Elimination of Subsidies. Densely populated areas located just outside the corporate boundaries strain municipal services without compensation by those who receive such services, creating a subsidy by the municipal taxpayers. Many times the municipality's extension of utility service is what allows the area to develop with greater density. The residential development then attracts families who will use the city parks, who will drive on the city streets, and who will occasionally have emergencies requiring a response of the city police department or fire department. Annexation eliminates this subsidy.

The Problems With the Current Annexation Statute

To understand the problems with the current statute, it is necessary first briefly to review the process for annexation. The first requirement of nearly every annexation is contiguity. With a few special exceptions, a municipality may only annex territory that is at least 12.5% contiguous, meaning that 1/8 of the external boundaries of the annexation territory must touch the current city limits.[11] Assuming the territory is contiguous, the steps for annexation are: conduct six noticed informational meetings prior to introduction of the annexation ordinance, adopt a written fiscal plan that details how and when municipal services will be provided, hold a public hearing, and adopt the annexation ordinance.[12] Then starts a 90-day remonstrance period, during which time landowners can sign a petition remonstrating against the annexation. If 65% of the property owners, or the owners or 80% of the assessed valuation sign the remonstrance petition, the annexation ordinance is void.[13] If at least 51% of the property owners or 60% of the assessed valuation sign, there will be a remonstrance hearing in court.[14] If there is no remonstrance, the annexation is effective.

The remonstrance hearing tests the adequacy of the municipality's fiscal plan. The written fiscal plan essentially sets forth the services the municipality will provide, how they will be provided (and funded), when they will be provided, and the estimated financial impact on affected landowners and other political subdivisions.[15] In *Bradley v. City of New Castle*, 764 N.E.2d 212 (Ind. 2002), the Indiana Supreme Court held that errors and technical omissions in the fiscal plan will not serve to defeat the annexation. The Courts have said repeatedly that a remonstrance hearing is not a forum to conduct an "audit" of the fiscal plan.

In addition to the adequacy of the written fiscal plan, the municipality must also prove at the remonstrance hearing:

> 1. The territory to be annexed is one-eighth contiguous and has a population density of at least three persons per acre, is at least 60% subdivided, or is zoned commercial, business, or industrial; or
>
> 2. The territory is at least one-quarter contiguous, and the territory is needed and can be used by the municipality for its development in the reasonably near future.[16]

Note that the statute does not require that the annexation area *will* be developed; what is required is that the municipality needs the annexation territory for the municipality's development. Assuring that growth in the annexation territory is consistent with the city's overall growth strategy has historically satisfied this requirement; however, the Supreme Court holding in *Fortville* vests the trial court with latitude to review the municipality's determination of need.

The final piece of a remonstrance hearing is a potential complete defense to annexation for the landowners. Even if the municipality proves the adequacy of the fiscal plan, contiguity and the degree of subdivision/zoning/population density/"needed and can be used," the annexation will still fail if the trial court finds: (1) that the annexation will have a significant financial impact on the residents or owners of the land; (2) that at least 51% of the owners or the owners of 60% of the assessed value are opposed; and (3) that the annexation is not in the best interests of the owners of the land.[17]

The outline of this process has been extremely abbreviated for purposes of this article, our intent being to highlight the process for a more complete understanding of the problems with the current statutory mechanism. There are essentially four problems: the difficulty of the remonstrance process itself; potential unfairness to other units of government with respect to economic development; potential adverse impacts on other governmental entities from the constitutional property tax caps; and unnecessary interference with landowners uninterested in being annexed in order to reach territory that needs to be annexed.

> A. The remonstrance process itself is extremely difficult and places the ultimate decision on annexation in the hands of the wrong people. Fighting an annexation requires a group of landowners who are sufficiently motivated and organized, who have adequate time, and who have adequate resources to fight the fight. Voters have no rights in annexation. Further, unlike voting, remonstrance is not secret. Friends and neighbors will know whether one

supported the remonstrators or the municipality, which can inappropriately influence one's decision. Growth in municipal boundaries for the good of the community is essentially a political decision; remonstrance places that decision ultimately in the hands of judges.

B. There is a potential unfairness to other units of government in the context of annexation. Recall the economic development objective, which motivates many municipalities to pursue annexation. One of the most useful tools in the toolbox to pursue economic development is the creation of a tax increment financing ("TIF") district. All of the property taxes assessed on the incremental assessed value of business property that is added in the TIF district after the TIF district's creation are captured by the district for reinvestment. The district captures 100% of the property tax rate, not just the rate of the unit which establishes the TIF district. And the district can leverage future streams of property taxes by issuing bonds repayable from TIF. The creation of the TIF district can finance much of the infrastructure that will be needed to attract the economic development. The problem in the context of annexation is that many times, a municipality annexes a territory for economic development, immediately creates a TIF district, and then captures all other units' property tax rates applicable to all of the economic development that ensues. Notably, this problem is not limited to involuntary annexation as it has been described, because many times economic development annexations are 100% voluntary.

C. The tax caps also cause a problem. The Indiana Constitution has been amended to place caps of one percent (homestead residential property), two percent (agricultural property) and three percent (all other property) on the overall tax bill. When the cap is exceeded, the property owner receives a credit against the tax bill, which is shared among all the taxing units proportionately through a reduction in tax receipts. Schools usually represent the largest portion of the overall tax rate and generally see the largest impact from the tax caps. When a municipal tax rate is layered on top of the existing tax rate, it may force the combined tax above or further above the tax cap. Since all taxing units share proportionately in the loss from the tax cap credit, this reduces tax revenues that other taxing units were receiving. In other words, when a municipality annexes, it can affect the budget for every taxing unit covering the property. This is not a problem unique to involuntary annexations. The tax caps must be considered in all annexations.

D. With the contiguity requirements, municipalities frequently must include property they have no interest in annexing in order to reach a property that they do seek to annex. Perhaps there is an economic development project to be located near the corporate limits, and a few residential properties or maybe even a farm must also be annexed in order for the annexation territory to be contiguous to corporate limits. If the purpose of the annexation is to secure planning and zoning jurisdiction over an area on the outskirts that is prime for development, sometimes the annexation must include many acres of agricultural land. Property which is assessed as agricultural for tax purposes will be exempt from the municipal tax rate,[18] but not all "agricultural" property is assessed

as agricultural. For instance, the farmer's homestead and the farm equipment will see the full municipal rate. As a result, an annexation that may be very important for economic development must sometimes include and affect landowners who would rather be left alone.

The 2015 reform efforts did little or nothing to address any of these problems with annexation. The primary targets of the reform efforts were to discourage all but 100% voluntary annexation and to eliminate involuntary annexation if the landowners are willing to undertake the organizational effort to gather signatures. But curbing or stopping all but unanimous voluntary annexation should not have been the goal – remember that economic growth which will drive this State's economy will occasionally require that people be annexed over their objections. The mission should have been to allow annexation, but to do so in a fashion that would minimize the impact on other governmental units and on territory that is not needed. On these points, the reform has utterly failed. Instead it has provided people in unincorporated areas a trump card to stop literally all annexations.

How Does Reorganization Replace Annexation?

Reorganization is the restructuring of local government through consolidation of political subdivisions.[19] Through reorganization, participating political subdivisions may consolidate into one of the participating political subdivisions or into a newly created political subdivision. In doing so, boundaries may be adjusted; legislative, executive and fiscal bodies may be created; and functions of offices may be transferred to newly created offices.[20] As explained by the Indiana Supreme Court in *Kole v. Faultless*, 963 N.E.2d 493, 497-98 (Ind. 2012): "The [Modernization] Act gives to all local governments what it calls 'full and complete authority' to reorganize, exercise governmental functions under a cooperative agreement, and transfer responsibilities between offices and officers. . . . Except as otherwise provided in the Act itself, no other law, procedure, proceeding, or other act by a political subdivision, or by the state, is a prerequisite before the political subdivision exercises that authority. . . . Finally, the Act controls over any inconsistent law unless specifically provided otherwise." In short, the Government Modernization Act invites local governments to replace any or all of the constraints that may be found in Title 36 as limitations. Said another way – ignore everything you know about local government law; if you can dream it, it likely can be done.

At its core, reorganization consists of consolidating participating political subdivisions either into a new political subdivision or into one of the participating political subdivisions. All of the participating subdivisions except the surviving political subdivision cease to exist as government entities; the executive, legislative and fiscal bodies and powers are transferred from the participating political subdivision to the surviving entity; and the reorganized entity has all of the powers that are held by an entity of the same type plus, if authorized by the plan of reorganization, all of the powers that any of the participating political subdivisions had.[21]

A reorganization requires at least two participating political subdivisions, and a municipality has many potential reorganization partners: an adjacent municipality, a county, a township in which part of the

municipality is located, or any other local governmental entity[22] (except schools) in which a majority of the population of the local governmental entity resides. A municipality can reorganize with a school corporation if a majority of the school's students have legal settlement in the municipality. If a municipality were to reorganize with the township, the entire township could be included within the boundaries of the reorganized entity, and the new entity could exercise both township powers and municipal powers throughout the expanded territory. The same would be true of a reorganization with any other type of local government entities, creating the prospects for novel and innovative government structures.[23] As suggested earlier, the Government Modernization Act invites us to think big and not to feel constrained by what we previously understood to be limitations.

Reorganization starts with the adoption of a resolution inviting reorganization by one of the potential reorganization partners, which is then accepted by resolution of the other reorganization partner(s).[24] The legislative bodies of the participating entities then jointly prepare the plan of reorganization, which is the equivalent of a charter.[25] That plan must include a fiscal impact analysis, which is submitted for comment to the Department of Local Government Finance ("DLGF") before the plan is adopted. Then the participating entities adopt the reorganization plan by resolution after two public meetings and one public hearing.[26] Assuming it is adopted by all participating entities, the issue is then presented as a public question at the next general election in all precincts of the participating political subdivisions.[27] Holding reorganizations with townships and counties to the side, the reorganization is approved if a majority of votes cast in each of the participating subdivisions approve. Again excluding counties and townships, if the municipality's geographic boundaries are entirely included within the boundaries of the other entity, then voters in the municipality only count in the municipal tally; otherwise, some municipal voters may count in both totals.[28] In the case of reorganizations with townships or counties, the reorganization must be approved by a majority in the incorporated municipality, a majority in the unincorporated area, and a majority in the total area.[29]

Reorganization can provide the flexibility needed to address issues driving the desire for expanded territory while at the same time avoiding the problems inherent in the current municipal annexation process.

First the process itself is much less controversial and litigious. Whereas annexation is geared ultimately towards a judicial proceeding, reorganization is not. There is no remonstrance or other court proceeding which is created by the Government Modernization Act. True, there are statutory ambiguities that remain to be answered, but the Supreme Court has already declared that the "General Assembly has given us a guiding principle for resolving such subtleties": Reorganization wins all ties.[30] Rather than being structured for judicial resolution, reorganization is resolved by democracy, and the question is ultimately answered in the privacy of the voting booth by registered voters. Property owners do not have a greater voice, and decisions are not made with a determined neighbor at the doorstep holding a remonstrance petition and a pen. The powerful message sent by the voting booth then drives all of the remaining benefits of the reorganization.

Second other units of government will likely participate and share in growth from economic development. A municipality must attract at least

one other reorganization partner and then secure approval from the voters. The municipality is unlikely to do so if it comes to the table demanding that 100% of TIF revenues are captured by the municipality. Before the first reorganization resolution is even adopted, the municipality likely will need to work with its partners on a fair mechanism to share the growth. A rising tide lifts all boats, and reorganization provides the flexibility to ensure all taxing units are lifted equitably.

Third reorganization provides flexibility to address the tax cap credit, sometimes referred to as the circuit breaker credit. If growth in the boundaries will cause a circuit breaker loss for other taxing units (most likely schools), there is no definitive and enforceable methodology to mitigate that circuit breaker credit through annexation. Reorganization powers are to be "liberally construed"; there is no need to comply with "any other law, statute or rule" in order to carry out the plan of reorganization; and reorganization "in the form and under the conditions specified . . . in the plan of reorganization" occurs even if those terms and conditions are "inconsistent with the provisions of any other general, special or local law."[31] And so, if it is necessary to build flexibility in the plan in order to address the allocation of circuit breaker credits, reorganization affords that flexibility.

Fourth is the elimination of the contiguity obstacle. A reorganized municipality may establish different service districts, complete with different tax rates and fees.[32] A reorganization can ensure that people in currently unincorporated areas are left alone until whatever process set forth in the reorganization plan is implemented. And there need not be any contiguity requirement to make that move. So, if a municipality reorganizes with a largely rural township, the reorganized municipality can implement a rural district and an urban district whereby the areas that are currently unincorporated continue to be taxed and served as if there had been no change. For instance, in the Zionsville rural district, the Boone County Sheriff and Highway Department continue to be responsible for police patrols and road maintenance, and Boone County continues to count the road mileage and population for purposes of tax distributions. With these differential service/taxing districts initially established, reorganization can then allow the seamless movement of a particular parcel to the full tax rate without affecting neighboring properties. The decision of how/why/when areas are moved from rural to urban is a matter set forth in the reorganization plan, which must be accepted by the participating political subdivisions and ultimately ratified by the voters.

Conclusion

The 2015 Session of the General Assembly brought annexation reform which, when coupled with the shift in attitude towards remonstrance actions at the Judicial Branch, has essentially brought annexation to a standstill. But expansion of municipal boundaries remains an essential component of economic growth in this State. Reorganization through the Government Modernization Act provides an opportunity and a vehicle to listen to all sides of the growth debate, to recognize that all sides have legitimate interests to be considered, and to craft a plan that addresses the specific concerns about the current process while balancing those competing interests.

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[1] The views expressed herein are those of the authors and do not represent the views or positions of the firm or its clients.
[2] The only type of annexation that is not subject to the new processes is an annexation that is initiated by a petition signed by 100% of the affected landowners.
[3] American Cold Storage, Inc. v. City of Boonville, 2 N.E.3d 3 (Ind. 2014).
[4] Town of Fortville v. Fortville Annex. Terr. Landowners, 51 N.E.3d 1195 (Ind. 2016); Town of Zionsville v. Town of Whitestown, 49 N.E.3d 91 (Ind. 2016).
[5] Fortville, 51 N.E.3d 1195.
[6] Zionsville ,49 N.E.3d 91.
[7] Ind. Code art. 36-1.5
[8] Indeed, of the four successful reorganizations completed, two of them involved the Town of Zionsville. A third involves the Town of Yorktown and Mount Pleasant Township. The fourth is a reorganization of two school corporations to form the North Central Parke Community School Corporation.
[9] Ind. Code §36-1.5-1-1(1).
[10] Even if the municipality presently has planning and zoning jurisdiction in its buffer zone, the county can eliminate that authority.
[11] Ind. Code §36-4-3-1.5.
[12] Ind. Code §§36-4-3-1.7, 2.1 and 3.1.
[13] Ind. Code §36-4-3-11.3(b).
[14] Ind. Code §36-4-3-11.3(c).
[15] Ind. Code §36-4-3-13(d).
[16] Ind. Code § 36-4-3-13(b).
[17] Ind. Code § 36-4-3-13(e) and (f).
[18] Ind. Code §36-4-3-4.1.
[19] The Government Modernization Act also authorizes increased cooperation through agreements between political subdivisions that are not consolidated through reorganization. Ind. Code §36-1.5-1-2(2).
[20] Ind. Code §§36-1.5-2-5, 36-1.5-4-3 and 4.
[21] Ind. Code §36-1.5-4-38(a).
[22] The list of qualified other local governmental entities (aka municipal corporations) is broad. The only real qualification is that the entity be capable of suing and being sued. Ind. Code §36-1-2-10.
[23] As an example, in Zionsville, the executive powers have been transferred to the office of the Clerk-Treasurer, which has been renamed as the "Mayor." The former functions of the Clerk-Treasurer's office have been transferred to a newly created and appointed position – the Director of the Department of Finance.
[24] Ind. Code §§36-1.5-4-10 and 13.
[25] Ind. Code §36-1.5-4-18.
[26] Ind. Code §§36-1.5-4-19 and 20.
[27] Ind. Code §36-1.5-4-28(d).

[28] Ind. Code §36-1.5-4-32(a).
[29] Ind. Code §36-1.5-4-32(b) and (c).
[30] Kole, 963 N.E.2d at 497.
[31] Ind. Code §§36-1.5-1-4 through 6 and 36-1.4-4-34.
[32] Ind. Code §36-1.5-4-39.5.