How State Policies Impact Local Property Taxes

Adam H. Langley
Pennsylvania Tax Swap

• Property Tax Independence Act (SB 67)
• Eliminate school property tax, except for debt service
• Income tax: 3.07% to 4.34%
• State sales tax: 6% to 7%
  • Expanded tax base
• 2015 Senate Vote: 24-24 tie
  • Lt. Gov. voted against bill
  • Bill sponsors will try again
• Efforts in other states
  • FL, TX, WA
Chicago Tax Increase (2015)

- $588m increase over four years
  - Primarily for police/fire pensions
- 2016: Average residential bill 13% ↑
  - ≈ 60% of four year hike of city tax
- $250m increase for Chicago Schools expected this month
  - Teachers pensions
Think tank focused on solving major challenges through creative approaches to use and taxation of land

Property tax matters because it’s the linchpin of municipal fiscal health
Outline

• Data on property tax rates
• Why property taxes vary across cities
• State policy options
Data on Property Taxes

• Effective tax rate
  \[ \text{ETR} = \frac{\text{Tax Bill}}{\text{Market Value}} \]

• Accounts for:
  • Differences in assessment ratios
  • Exemptions and credits
  • Accuracy of assessments
  • All overlying governments

• Report
  • Largest city, rural city in each state
  • 4 property types (Homestead, commercial, industrial, apartments)
Homestead Property Tax Rate (2015)
Effective Tax Rate on Median Valued Home

- CT: Bridgeport (1) 3.88%
- MI: Detroit (2) 3.81%
- IL: Aurora* (3) 3.72%
- NJ: Newark (4) 3.05%
- WI: Milwaukee (5) 2.68%
- U.S. Average 1.50%
- MA: Boston (49) 0.67%
- CO: Denver (50) 0.66%
- AL: Birmingham (51) 0.66%
- WY: Cheyenne (52) 0.65%
- HI: Honolulu (53) 0.30%

*Report includes two cities in IL and NY, because tax systems for Chicago and New York City are very different than rest of state.
Property Taxes on Median Valued Home (2015)

<table>
<thead>
<tr>
<th>Rate Rank</th>
<th>Bill Rank</th>
<th>Effective Tax Rate</th>
<th>Tax Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>CT: Bridgeport (1, 2)</td>
<td>3.88%</td>
<td>3.88% (≈ $2,800)</td>
<td></td>
</tr>
<tr>
<td>MI: Detroit (2, 42)</td>
<td>3.81%</td>
<td>3.81% (≈ $4,200)</td>
<td></td>
</tr>
<tr>
<td>IL: Aurora (3, 3)</td>
<td>3.72%</td>
<td>3.72% (≈ $5,600)</td>
<td></td>
</tr>
<tr>
<td>NJ: Newark (4, 4)</td>
<td>3.05%</td>
<td>3.05% (≈ $7,000)</td>
<td></td>
</tr>
<tr>
<td>WI: Milwaukee (5, 16)</td>
<td>2.68%</td>
<td>2.68% (≈ $7,000)</td>
<td></td>
</tr>
<tr>
<td>MA: Boston (49, 20)</td>
<td>0.67%</td>
<td>0.67% (≈ $1,400)</td>
<td></td>
</tr>
<tr>
<td>AL: Birmingham (50, 53)</td>
<td>0.66%</td>
<td>0.66% (≈ $2,800)</td>
<td></td>
</tr>
<tr>
<td>CO: Denver (51, 34)</td>
<td>0.66%</td>
<td>0.66% (≈ $2,800)</td>
<td></td>
</tr>
<tr>
<td>WY: Cheyenne (52, 48)</td>
<td>0.65%</td>
<td>0.65% (≈ $4,200)</td>
<td></td>
</tr>
<tr>
<td>HI: Honolulu (53, 37)</td>
<td>0.30%</td>
<td>0.30% (≈ $4,200)</td>
<td></td>
</tr>
</tbody>
</table>

Tax Relative to U.S. Average

(≈ $1,400) (≈ $2,800) (≈ $4,200) (≈ $5,600) (≈ $7,000)
Commercial Property Tax Rate (2015)
Effective Tax Rate on $1 Million Property

MI: Detroit (1) 4.13%
NY: New York City (2) 3.96%
RI: Providence (3) 3.71%
IL: Chicago (4) 3.60%
CT: Bridgeport (5) 3.59%
U.S. Average 2.11%
DE: Wilmington (49) 1.04%
VA: Virginia Beach (50) 1.03%
HI: Honolulu (51) 0.91%
WA: Seattle (52) 0.88%
WY: Cheyenne (53) 0.64%
Commercial-Homestead Classification Ratio (2015)
(Effective tax rate on $1-million commercial property vs. median valued home)

NY: New York City (1) 4.22
MA: Boston (2) 4.00
SC: Columbia (3) 3.69
HI: Honolulu (4) 3.62
CO: Denver (5) 3.62
IL: Chicago (6) 2.73
IN: Indianapolis (7) 2.65
LA: New Orleans (8) 2.20
AL: Birmingham (9) 2.19
KS: Wichita (10) 2.18
DC: Washington (11) 2.17
PA: Philadelphia (12) 2.12
WV: Charleston (13) 2.11
MN: Minneapolis (14) 2.09
AZ: Phoenix (15) 2.07
ID: Boise (16) 2.04
U.S. Average 1.68

40 of 53 cities favor homesteads:
-27 have lower assessment ratios and/or nominal tax rates
-13 cities, classification solely the result of exemptions/credits
Why do Property Tax Rates Vary?
Key Factors that Explain Differences in Effective Tax Rates on Median Valued Homes

- Home Values: 31%
- Property Tax Reliance: 27%
- Property Tax Classification: 8%
- Local Gov't Spending: 7%
- Other: 27%

Source: 50-State Property Tax Comparison Study: For Taxes Paid in 2015 (Page 8).
Property Values

Low property values > Need high tax rates
High property values > Modest tax rates raise a lot of revenue

Detroit
Median home value: $42,000
Tax rate: 3.14%
Tax bill ≈ $1,300

San Francisco
Median home value: $847,000
Tax rate: 0.83%
Tax bill ≈ $7,000

Average tax bill in our study: $3,039
Detroit would need a tax rate 20x higher than San Francisco
## Property Tax Reliance

High property tax reliance: Property tax rates ↑
High local sales/income taxes: Property tax rates ↓

<table>
<thead>
<tr>
<th></th>
<th>Bridgeport (CT)</th>
<th>Birmingham (AL)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Property tax rate</strong></td>
<td>Highest</td>
<td>4th Lowest</td>
</tr>
<tr>
<td><strong>Per capita taxes for local governments (2013)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property tax</td>
<td>$1,891</td>
<td>$767</td>
</tr>
<tr>
<td>Sales tax</td>
<td>0</td>
<td>866</td>
</tr>
<tr>
<td>Income tax</td>
<td>0</td>
<td>353</td>
</tr>
<tr>
<td>Other taxes</td>
<td>23</td>
<td>443</td>
</tr>
<tr>
<td><strong>Total Taxes</strong></td>
<td><strong>$1,914</strong></td>
<td><strong>$2,429</strong></td>
</tr>
</tbody>
</table>

Source: Per capita taxes from *Fiscally Standardized Cities* database (Lincoln Institute of Land Policy).
Classification
Preferences built into property tax system for homesteads
Tax rates for homesteads ↓
Tax rates for business properties ↑

New York City
- Commercial-homestead ratio: 4.2x
- Apartment-homestead ratio: 5.1x
- 7th lowest tax rate on homes
- 2nd highest commercial tax
- Highest tax on apartments
Local Government Spending
Higher local gov’t spending → Property tax rates ↑

Per Capita Expenditures by Local Governments (2013)

- DC: Washington 18,680
- CA: San Francisco 12,904
- NY: New York City 12,229
- CA: Oakland 9,986
- CA: Los Angeles 9,074
- Average for Cities 6,015
- MS: Jackson 3,507
- OK: Oklahoma City 3,425
- MT: Billings 3,193
- ID: Boise 2,829
- HI: Honolulu 2,464

Source: Direct expenditures from *Fiscally Standardized Cities* database (Lincoln Institute of Land Policy).
Four Key Factors Driving Property Taxes

<table>
<thead>
<tr>
<th>Property Values</th>
<th>State aid necessary to offset differences in property wealth across communities</th>
</tr>
</thead>
</table>
| Property Tax Reliance | Local tax options determined by state law  
State aid can substitute for local taxes |
| Property Tax Classification | Local gov’t ability to impose higher tax rates on business and use homestead exemptions determined by state law |
| Local Gov’t Spending | State mandates 
State vs. local service responsibilities |
State Policy Options
Think Twice Moving Away from Property Tax

• **Tax swaps** are popular, but have serious downsides:
  – Tax revenues more volatile
  – Tax system more regressive (If sales taxes increased)
Revenue Changes During Great Recession

(\% Chg. in Real Per Capita State-Local Tax Revenues, Peak to Trough)

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Tax</td>
<td>-6.5%</td>
</tr>
<tr>
<td>Sales Tax</td>
<td>-11.2%</td>
</tr>
<tr>
<td>Income Tax</td>
<td>-19.5%</td>
</tr>
</tbody>
</table>

Source: U.S. Census Bureau, Annual Surveys of State and Local Government Finances.
State-Local Taxes as % Family Income

Tax Limits

• **Assessment limits** (CA Prop. 13)
  - Constrains annual growth in assessed value of individual properties
    → Severs connection between property values and taxes
    • Large horizontal inequities
    • Unpredictable winners and losers
    • Create disincentive to move

• **Levy limits** (MA Prop. 2 ½)
  - Constrains annual growth in tax levy for entire municipality
    • But individual tax bills still based on market values
  - Limits property taxes without as many unintended consequences
Circuit Breakers

• Circuit breakers prevent households from being overburdened by property taxes

• **Targeted** and cost-effective approach
  • Focuses on households with heaviest tax burdens
  • Seniors on fixed incomes; People who lost their job

• “Classic” approach sets a **threshold** percentage of income that property taxes must exceed before any tax relief is available
  → Circuit breaker benefit offsets taxes above this point
5% Threshold Circuit Breaker

Circuit breaker kicks in above 5%
Property Tax Escrow

- People pay tax **monthly** → $ goes to account to pay off **annual** or **bi-annual** property tax installment

- **Mortgage escrow** (2014 American Community Survey)
  - 44% of homeowners pay property tax as part of mortgage bill
  - 20% have mortgage, but not property tax escrow
  - 37% do not have mortgage
Property Tax Escrow

• 46% of Americans couldn’t come up with $400 in emergency (Federal Reserve survey)

Property Tax Escrow

• Local option programs where tax collectors manage property tax escrow systems
  – a.k.a. Prepayment agreements, escrow plans, monthly payments
  – Low participation, but big potential
  – Monthly automated payments via credit/debit card, checking account
  – Pay monthly via check
  – States could help set-up billing system

• Indiana: Monthly Installment Plans (IC 6-1.1-22-9.7)
  – Most widely used program

• Washington [RCW 84.56.020(11)]
  – Passed in 2015; Spokane County has payment agreements
Conclusions

• Large differences in property taxes due to **four factors**
  – **Property values**: Low values → Tax ↑
  – **Property tax reliance**: Low sales/income tax → Property Tax ↑
  – **Local gov’t spending**: Higher spending → Tax ↑
  – **Property Tax Classification**: Homestead tax ↓, Business tax ↑

• State options for cost-effective property tax relief
  – **Circuit breakers**: Relief for those w/highest tax relative to income
  – **Property tax escrow**: Break large lump-sum into monthly payments

• States should be cautious about
  – Tax swaps: Make tax system more volatile and regressive
  – Tax limits
    • Assessment limits (CA Prop 13): Horizontal inequities, lock-in
    • Levy limits (MA Prop 2 ½): Fewer unintended consequences
Thank You!

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