# Well Intentioned Property Tax "Fixes": Some Potential Unintended Consequences

2021 OpenSky Webinar

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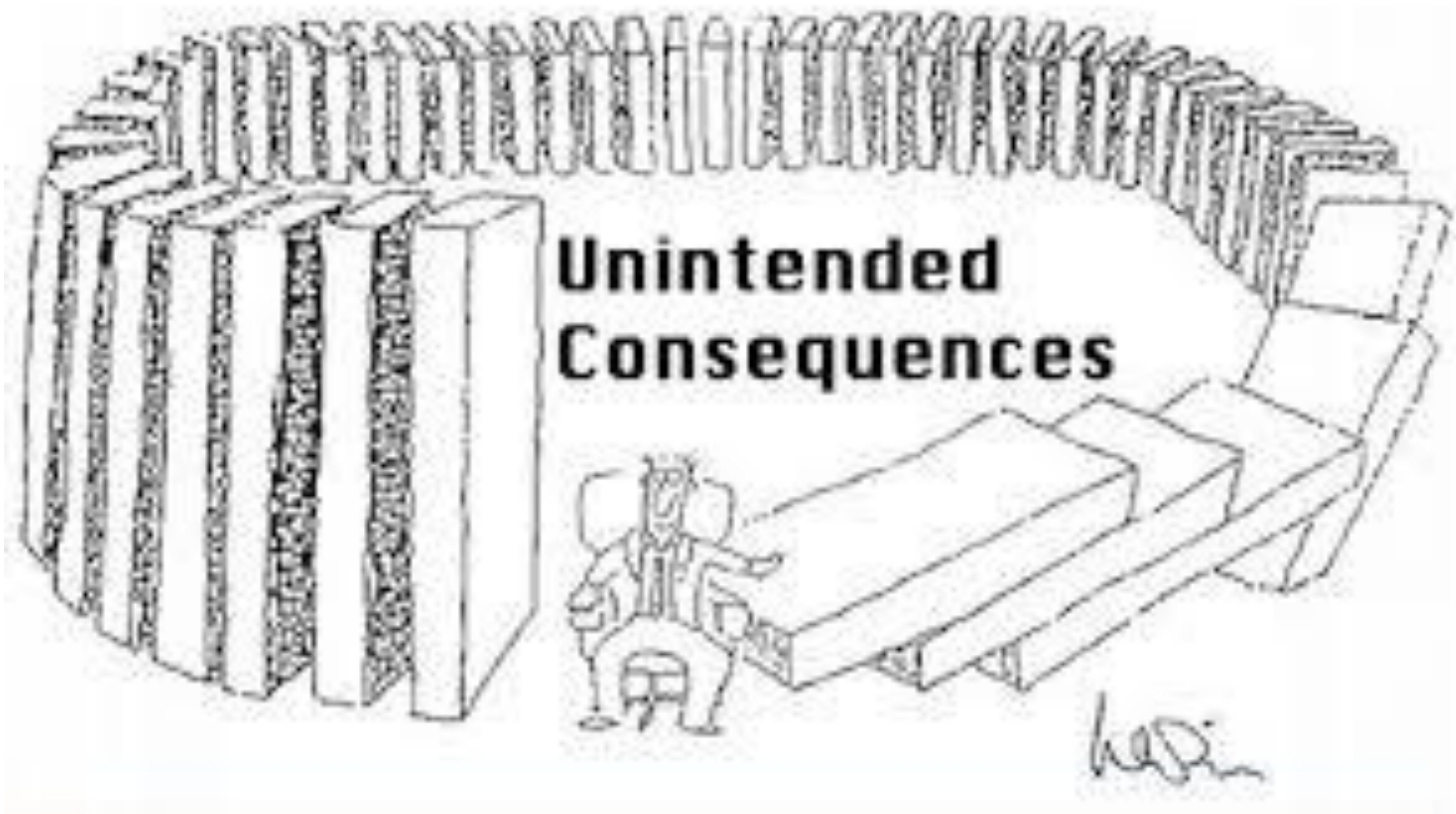
# Unintended consequences (redux)



# Agenda

- Criteria for evaluation of property tax or property tax policy change
- Covid and local governments' fiscal condition
- "Fixing" the property tax?
  A. Assessment caps
  B. Rate caps
  C. Spending/revenue caps
  D. Alternatives

# Criteria for evaluation of tax policies

- Fairness
- Efficiency/neutrality
- Revenue stability
- Ease of administration
- Predictability/visibility

# Covid and local governments' fiscal condition

## Early predictions of the impact of the COVID recession on local govt's fiscal condition

Chernick, H., Copeland, D. and Reschovsky, A., 2020. The fiscal effects of the COVID-19 pandemic on cities: An initial assessment. *National Tax Journal*, *73*(3), pp.699-732. based on data available in **Spring 2020.**

- **"Our average predictions are for a shortfall in revenues of 5.5 percent under the less severe scenario and 9 percent under the more severe scenario."**

- They studied two cities in Nebraska

| City | Less severe | More severe |
|---|---|---|
| Lincoln | 4.5% | 7.5% |
| Omaha | 4.7% | 7.8% |

# Covid and local governments' fiscal condition

Growth in
NATIONAL TOTALS OF STATE AND LOCAL GOVERNMENT TAX REVENUE, BY TYPE OF TAX
during the COVID Pandemic

| Quarter / 12 Month End | ---------------------Seasonally Adjusted--------------------- | | | | |
|---|---|---|---|---|---|
| | **Total Tax Revenue** | Property | Income | | Sales |
| | | | Individual | Corporate | |
| | (value) | (value) | (value) | (value) | (value) |
| 2021 1st Quarter | 1.10 | 1.07 | 1.18 | 1.27 | 1.04 |
| 2020 4th Quarter(R) | 1.07 | 1.05 | 1.09 | 1.32 | 1.04 |
| 2020 3rd Quarter(R) | 1.16 | 1.04 | 1.41 | 1.63 | 1.01 |
| 2020 2nd Quarter(R) | 0.87 | 1.01 | 0.72 | 0.56 | 0.86 |
| 2020 1st Quarter(R) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |

Source: U.S. Census Bureau, Quarterly Summary of State and Local Government Tax Revenue and author calculations

https://www.census.gov/data/tables/2021/econ/qtax/historical.html

(R) Indicates that the data has been revised from earlier estimates.

# Tax revenues by type Nebraska

**Growth in Nebraska State & Local Government Tax Revenue, by Type of Tax During the COVID Pandemic**

| | Income | | | | |
|---|---|---|---|---|---|
| | Individual | Corporate | Omaha Sales Tax | Lincoln Sales Tax | State Sales Tax |
| 2021 Q1 | 1.16 | 1.62 | 1.14 | 1.12 | 0.99 |
| 2020 Q4 | 1.05 | 1.23 | 1.01 | 1.01 | 1.06 |
| 2020 Q3 | 1.42 | 1.17 | 1.04 | 1.24 | 1.11 |
| 2020 Q2 | 0.73 | 0.48 | 0.90 | 1.11 | 1.01 |
| 2020 Q1 | 1.14 | 0.91 | 1.02 | 1.24 | 1.18 |

Source: Census Quarterly Summaries of State & Local Tax Revenue; Department of Revenue

Indices are relative to the prior year's tax revenue from the same quarter.

# Covid and local governments' fiscal condition

Local government revenue shares in the US and Nebraska, 2017

| | US | Nebraska |
|---|---|---|
| Intergovernmental revenue | 36% | 27% |
| Property tax | 30% | 37% |
| Sales tax | 7% | 5% |
| All Other | 27% | 31% |

Source: US Census 2017 State & Local Government Finance Tables

# Covid and local governments' fiscal condition

## Tentative conclusions

1. Though early we now know that fiscal 2021 (ended for most local governments in June 2021) was hard on local gov'ts but there was a strong recovery in the spring
2. Property tax revenues held steady through early 2021
3. In many areas, sales tax revenues fell dramatically early in the pandemic
4. Income tax revenues were very volatile during the pandemic

# Post Covid local government fiscal issues

A. There may be dramatic changes in the real estate industry
   1. **Work from home will increase** greatly and commercial real estate prices may plummet.
   2. **Demand for residential real estate may rise** and home prices may follow suit.
   3. Unclear what may happen to value of agricultural parcels.

**B. Property tax obligations may shift from non-residential** to residential.

C. There may be **regional shifts** that advantage less dense regions compared to denser regions (e.g. the east and west coast).

D. There will (probably) be **substantial reductions in federal intergovernmental aid** and this may expose weaknesses in the underlying fiscal condition of state and local governments.

# Post Covid local government fiscal issues

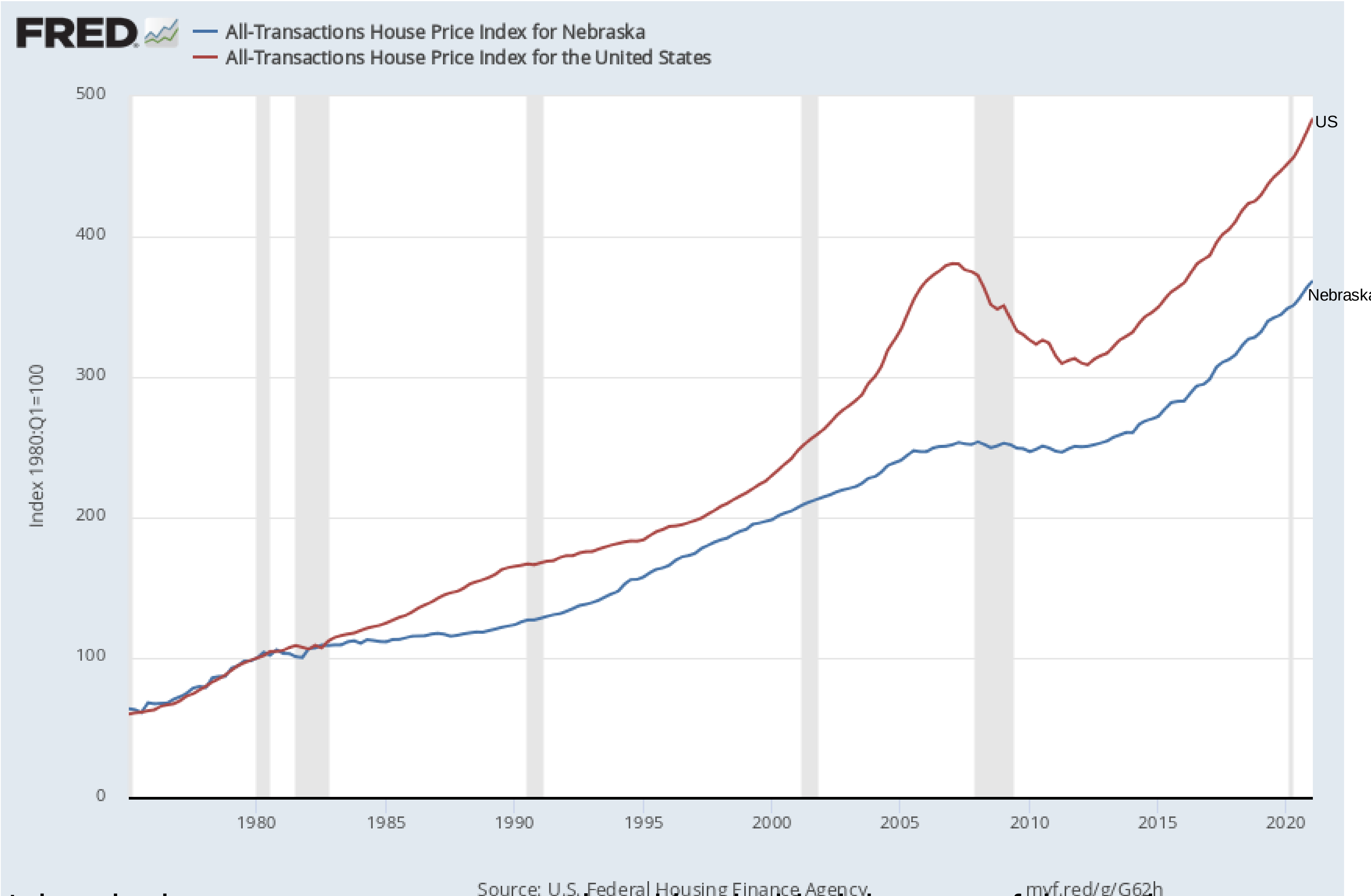
**Nebraska home prices are rising**

Overall, Douglas County's tax value on existing homes increased almost 6% this year.

That's on top of a 7% increase last year and almost 6% the year before. The increase this year alone will add $1.95 billion to the residential tax base —potentially translating to tens of millions of dollars in higher taxes paid by home and property owners.

Source: Jeffrey Robb Jun 20, 2021" As Douglas County valuations are released, assessor says don't blame her for higher taxes" Omaha World Herald -- https://omaha.com/news/local/govt-and-politics/as-douglas-county-valuations-are-released-assessor-says-dont-blame-her-for-higher-taxes/article_e9a5072c-d066-11eb-b0ee-133cbd301159.html

# Home price trends in Nebraska and the nation




Nebraska increases are not unusual and lag behind the rest of the nation.

# Post Covid local government fiscal issues

## Are increasing housing prices a fiscal "problem"?

1. Tax revenue=tax base*tax rate
2. Tax base=value of housing + value of other real estate
3. Elected officials can reduce the tax rate to prevent tax revenue from rising when the tax base grows[@].
4. But, even in this case **if housing grows much faster than other real estate, tax burden will shift toward housing** (compared to the previous situation) and this may be undesirable.

@ Anderson, J.E. and Shimul, S.N., 2018. (State and local property, income, and sales tax elasticity: Estimates from dynamic heterogeneous panels. *National Tax Journal*, *71*(3), pp.521-546.) find that a 10% increase in economic growth increases property tax revenue by about 7.8%.

# "Fixing" the property tax?

The cure may be worse than the disease.

Lawmakers want to "fix" property tax vices but may create new problems if they don't carefully think through unintended consequences.

# Assessment caps

- What is an assessment cap?
  - Assessment caps generally limit the *growth* of assessed values to either a fixed percentage (i.e. 7%) or to some measure of inflation (e.g. consumer price index)

# Assessment caps

– Effects of assessment caps—burden shifts
  - Precise effects vary with the design
  - **basic result of <u>any</u> assessment cap is a *shift* in tax burdens**

Average change (% and $) in property tax payment as a result of Assessment Cap in Cook County, Illinois

| | Percentage change | | | | Dollar value of change | | |
|---|---|---|---|---|---|---|---|
| Eligibility and Triad | | | | | | | |
| | Year | | | | Year | | |
| Eligible parcels (average for homeowners who qualified) | 2003 | 2004 | 2005 | | 2003 | 2004 | 2005 |
| Chicago | -14.20% | -11.20% | -7.90% | | ($357) | ($294) | ($218) |
| North Suburbs | 0.30% | -9.10% | -6.30% | | $13 | ($415) | ($303) |
| South Suburbs | 0.20% | 0.50% | -6.40% | | $8 | $16 | ($227) |
| | | | | | | | |
| Ineligible parcels (other residential and business property) | | | | | | | |
| Chicago | 4.10% | 4.20% | 3.30% | | $123 | $124 | $98 |
| North Suburbs | 0.30% | 6.60% | 5.30% | | $11 | $302 | $243 |
| South Suburbs | 0.20% | 0.40% | 5.80% | | $7 | $14 | $213 |

Source: Dye, McMillen, Merriman 2006. Table 3.1
https://igpa.uillinois.edu/system/files/cookcountry7percentassessment.pdf

# Assessment caps

- Other effects of assessment caps (continued)
  - Effect on fairness (equity) of the property tax
    - Violates principle of horizontal equity since similarly valued parcels pay different taxes.
    - Violates principle of vertical equity since lower valued parcels may pay more tax than higher valued parcels.
    - Ineligible parcels bear the burden of tax relief for eligible parcels.
    - This can snowball to demands for further group-specific special property tax breaks.

# Assessment caps

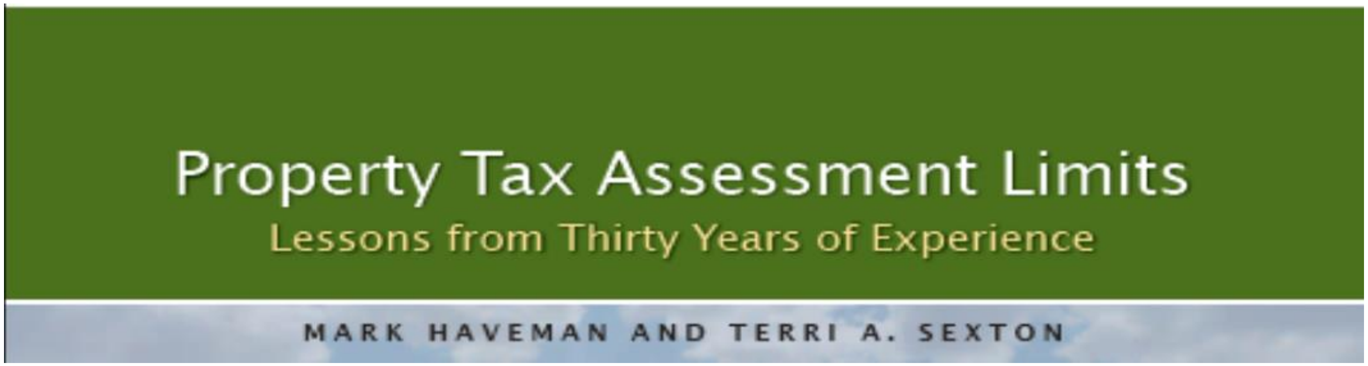
- Other effects of assessment caps
  - Effect on efficiency (mobility)
    - Often creates "lock-in" that reduces mobility. A recent study finds that average duration of property ownership increased by 7.5 years as a result of Michigan's assessment cap.
  - Effect on property tax base
    - California's Prop. 13 (1978) reduced tax base 44% by 1992
    - Florida's limit reduced tax base 17% in a single year
    - Michigan's proposal A reduced tax base by as much as 35%
  - Effects on gov't revenue
    - May have no effect if tax rates are unconstrained
    - Academic studies suggest some revenues decline

# Assessment caps

- Other effects of assessment caps (continued)
  - Effect on predictability/visibility
    - Assessment caps break the link between (observable) market value and assessments.
    - This complicates comparison of assessments and makes the property tax system more difficult for taxpayers to understand and negotiate.
    - This may be particularly true for prospective new entrants into the community
    - Also, assessment caps combined with acquisition value assessment resets make forecasting property tax bases and revenue more difficult.

# Assessment caps

## The bottom line .




Lincoln Institute of Land Policy
http://www.lincolninst.edu/pubs/1412_Property-Tax-Assessment-Limits

"Assessment limits are often put forward as a means of combating…increasing tax bills and the redistribution of tax burdens. In fact, 30 years of experience suggests that these limits are among the least effective, least equitable, and least efficient strategies available for providing property tax relief."

# Rate caps

1. More severely constrain low property wealth jurisdictions that often have the greatest need for revenue.
2. May increase borrowing costs or limit the ability of governments to borrow which may lead to deterioration of infrastructure.
3. May lead to budgetary distortion as some spending is pushed “off-budget”.

# Spending/revenue caps

1. Can lead to greater use of fees and privatization
2. Can lead to severe constraints on spending if inflation is high
3. If inflation correction is allowed, such caps can actually <u>increase</u> spending as governments attempt to preserve room for spending in future years and view spending/revenue limits as minimums.

# Alternatives to assessment, rate and spending/revenue caps

1. Homestead exemptions or credits and/or Classified tax rates---directly address relative tax on homes, agriculture and/or business
2. Circuit breakers--directly address vertical equity
3. Tax deferrals--directly address taxing of unrealized capital gains
4. Other—state aid directly to local gov'ts or state aid to property taxpayers (e.g. property tax credit program)---may address (over) reliance on property tax.

Caution: Each may have unintended consequences.