Property Taxation in Michigan

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Presentation Outline

- Key features of the property tax
- Interactions with other policies
- Taxable value cap, falling home values, and foreclosure
- Taxable value cap, tax base erosion and tax burden distribution
- Conclusions

Features of the Property Tax

- Headlee amendment implemented in 1978
  - Growth in property tax revenues cannot exceed the rate of inflation plus taxes generated from new construction
  - If the value of existing property exceeds the limit, a rate rollback is required. (Headlee rollback)
  - Prior to 1994, rollbacks were fairly common…rollbacks were applied to all properties in the jurisdiction.
  - Michigan is not alone in implementing such limitations, and research shows that such constraints limit property tax revenue growth.
- Special assessments (levied without voter approval, not subject to constitutional limits
  - Finance street improvements, sewer, police, fire, trash collection
- Mobile home park exemption

Proposition A

- Proposition A was implemented in 1994
- Professor Papke will cover education spending policy on Tuesday. I focus on the property tax changes.
  - Cut homestead millage rates
    - Cut statewide average school millage rates from 34 mills to 6 mills (state education tax)
  - 18 mill limit for schools on non-homestead property
  - Increased the cigarette tax
  - Increased the sales tax rate
  - *Placed a constitutional cap on the growth of assessment increases for tax purposes

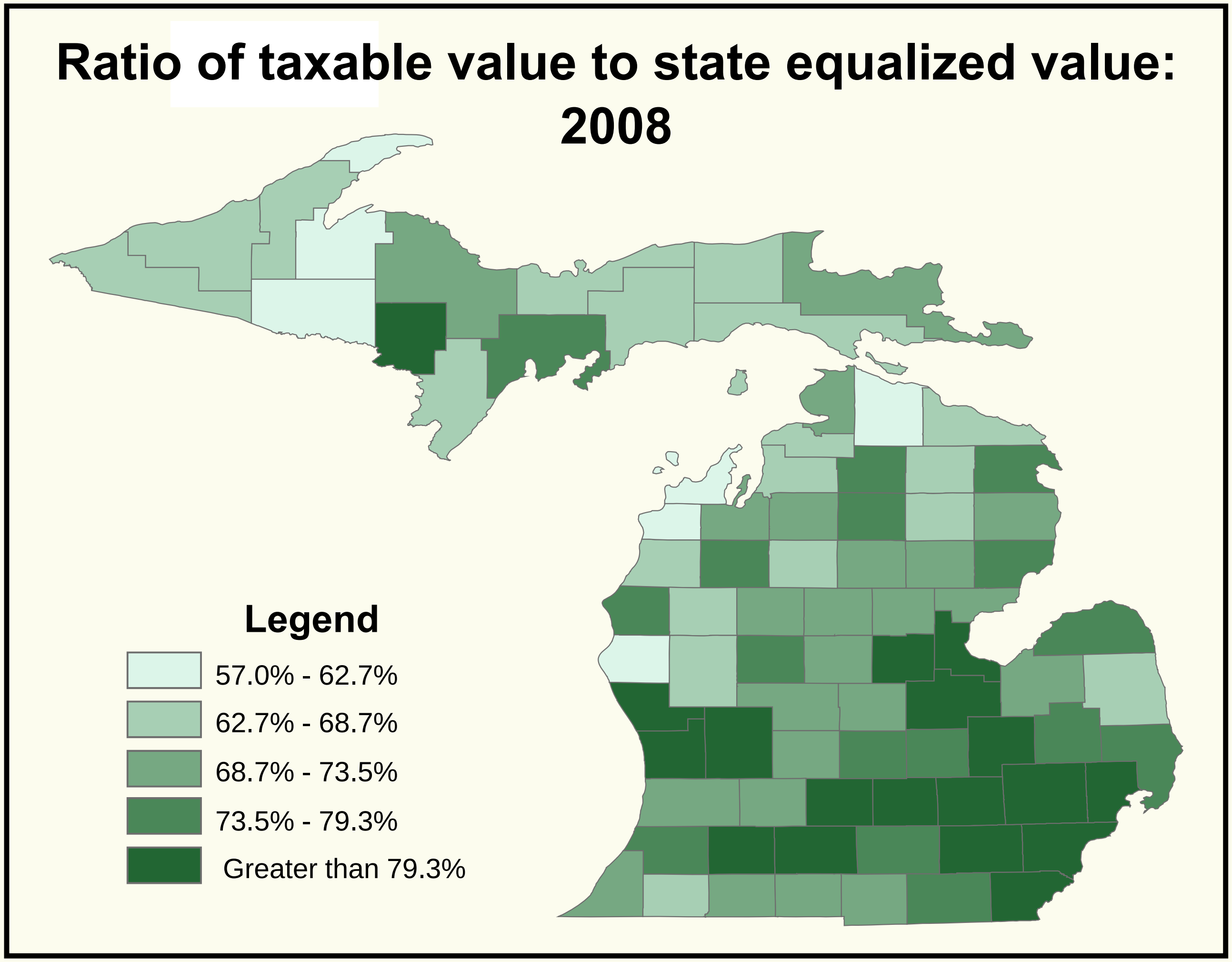
Proposition A

- The taxable value of a property is allowed to increase by the lesser of the rate of inflation or 5%.
  - Historically, taxable value (TV) grew less slowly than state equalized value (SEV)
    - Growth in TV < Growth in SEV so that (TV/SEV)↓
      - Tax Base Erosion
- A couple rules
  - TV increases to SEV when a home is sold (“pop up”)
  - For new construction, TV = SEV
  - Applies to each individual property, not a jurisdiction’s in aggregate property values
- Growth in SEV and TV depend on:
  - The rate of property turnover
  - The rate of new construction
  - The rate of growth (or decline) in actual property values

TV/SEV by Property Type

Statewide Tax Base Erosion

Year	TV/SEV
1994	1.00
2006	0.77
2007	0.78
2008	0.81



Source: Michigan Department of Treasury

Interactions with Other Policies

- Income tax
  - Circuit-breaker property tax credit available:
    - available to those with income under $82,650

      and
    - if property taxes exceed 3.5% of income
  - Over the age of 65—100% credit on income taxes
  - Under the age of 65—the credit depends on income level
    - phased out as income increases
- Professor Menchik discussed the circuit-breaker and other preferential income tax treatments

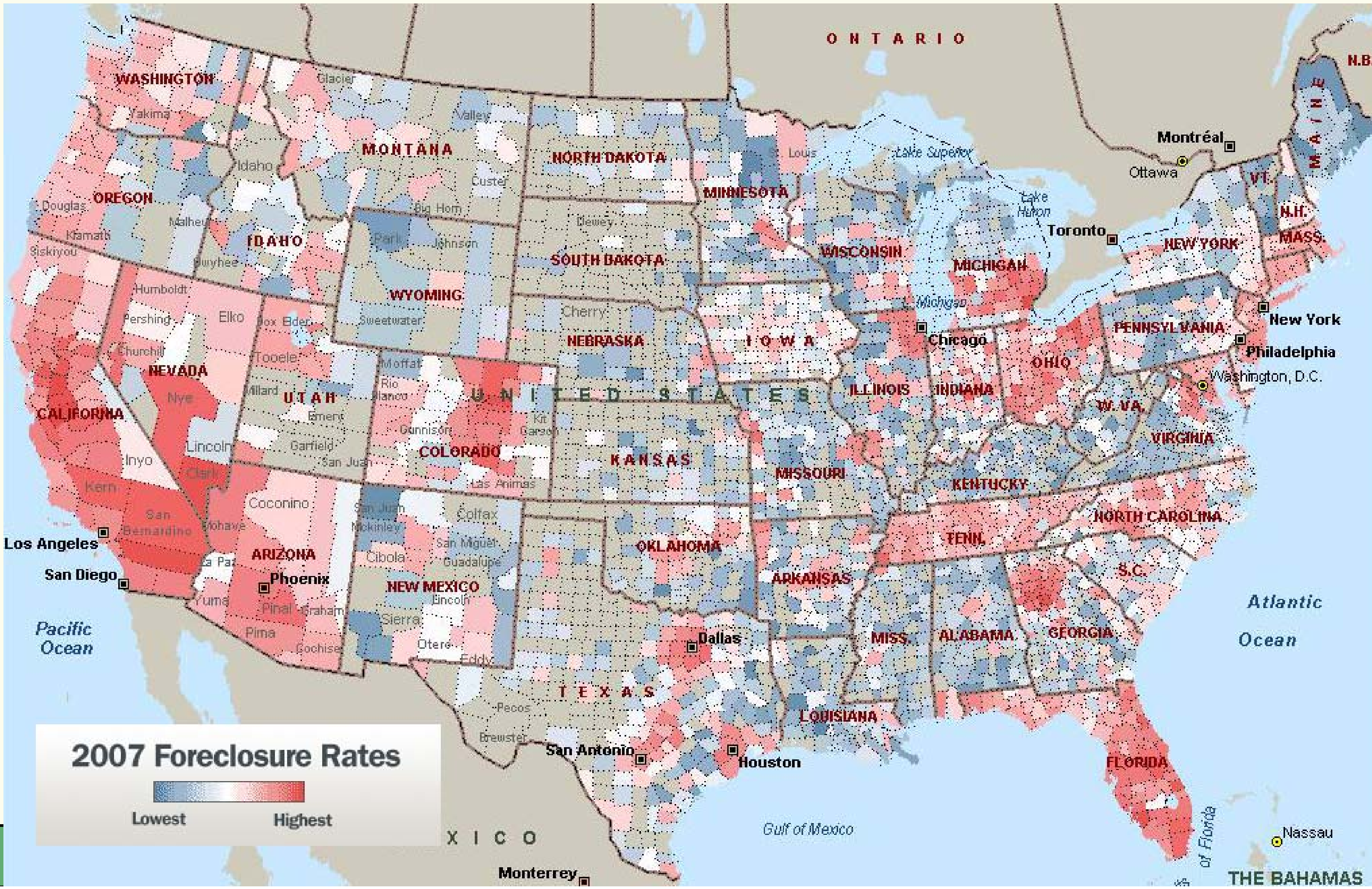
Interactions with Other Policies

- Education finance (Papke)
- Tax abatement programs (Sands)
  - Such programs may serve to spur development in designated areas, BUT there is a cost:
    - Hold public services/spending constant, others pay more taxes

Falling Home Values, Foreclosure and Property Tax Revenues

- Falling home values and foreclosure reduce the tax base
- Under the taxable value cap, tax base reductions have short-run and long-run implications
  - Short-run: Insulates local revenues from the declining home values
  - Long-run: Leads to significant fiscal challenges

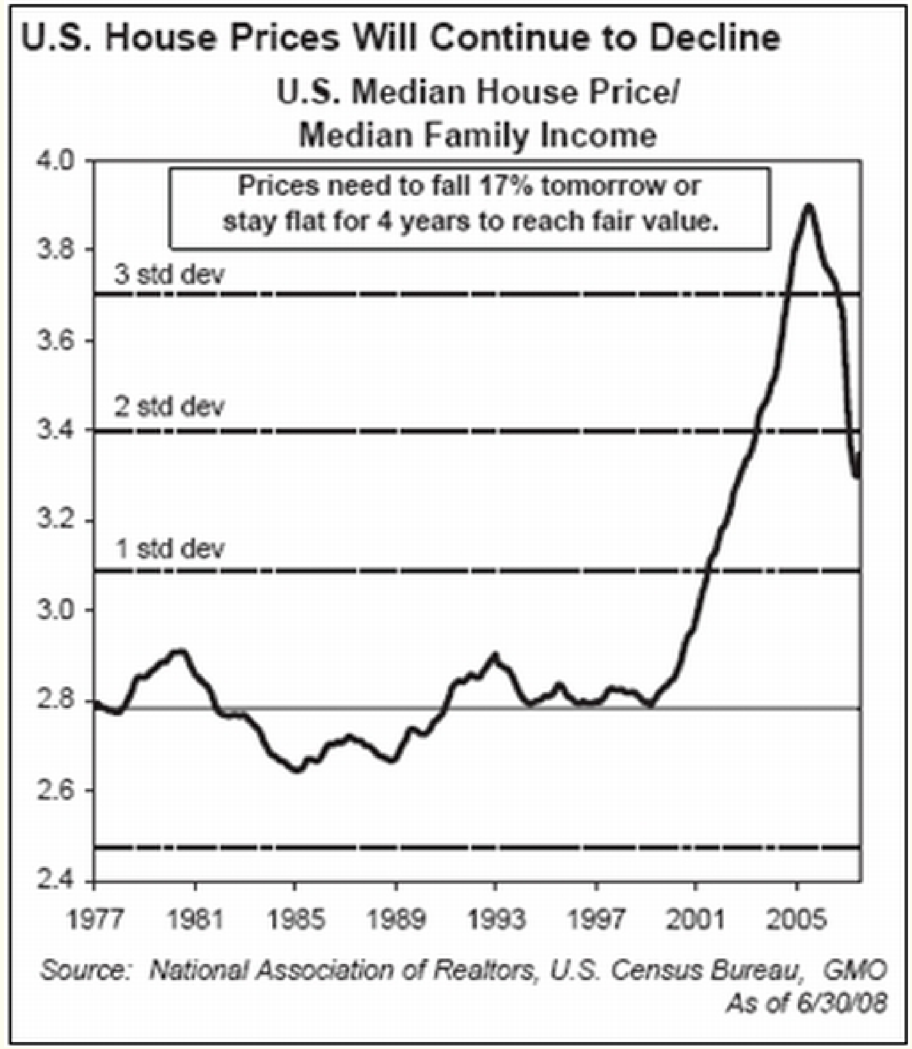
Foreclosures across the Nation

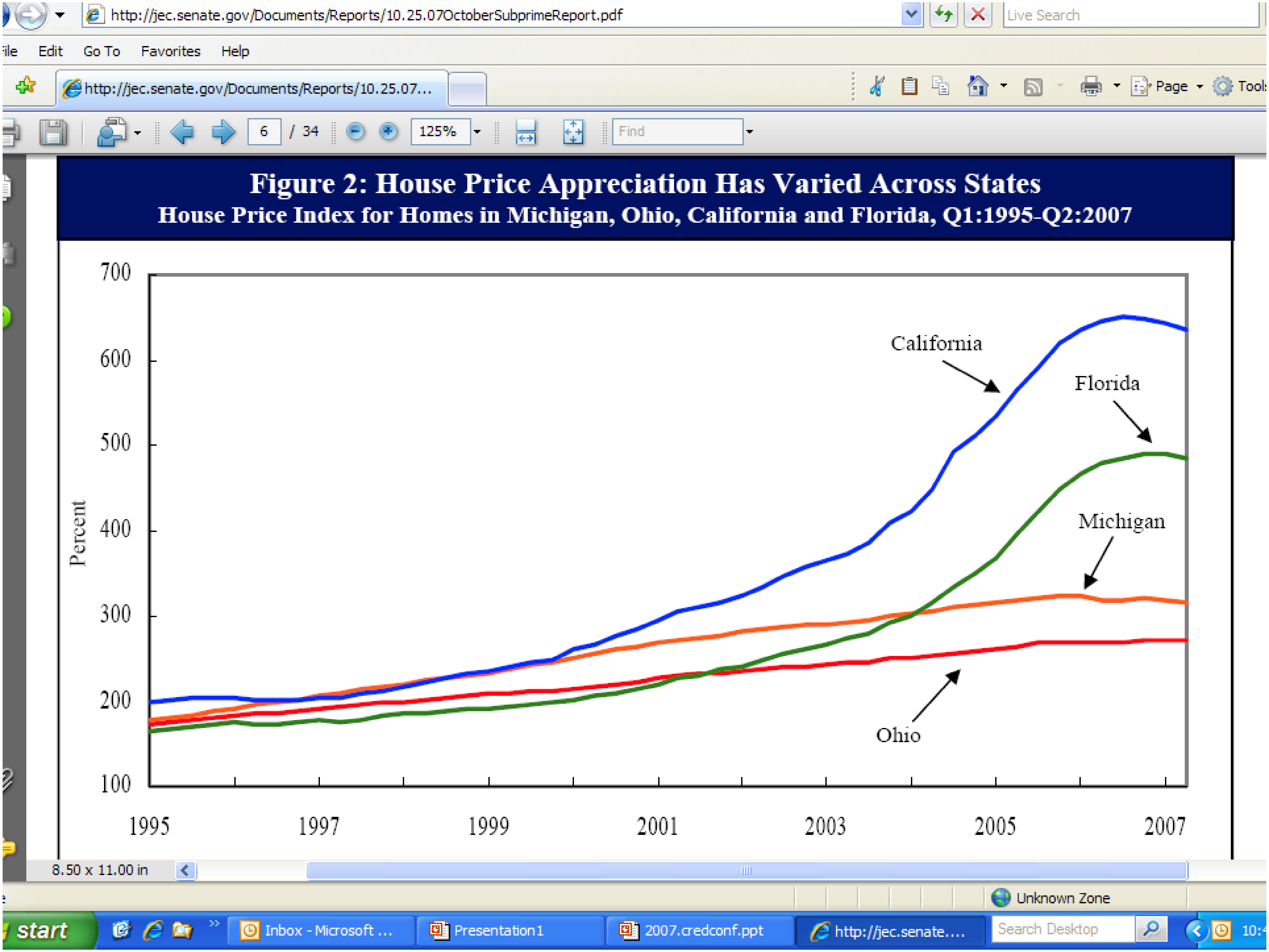


"I THOUGHT WE WERE JUST BUYING A HOUSE!"

Housing Prices

- **Housing prices will continue to fall if we are to return to historical trend.**




http://jec.senate.gov/Documents/Reports/10.25.07OctoberSubprimeReport.pdf
Figure 2: House Price Appreciation Has Varied Across States
House Price Index for Homes in Michigan, Ohio, California and Florida, Q1:1995-Q2:2007
Percent
700
600
500
400
300
200
100
1995
1997
1999
2001
2003
2005
2007
California
Florida
Michigan
Ohio
8.50 x 11.00 in
Unknown Zone
start
Inbox - Microsoft ...
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2007.credconf.ppt
http://jec.senate....

Property Values

- The motivation behind the assessment growth limit was to protect property owners from "excessive" growth in property taxes due to increasing property values.
- Falling home values was unanticipated.
- Consider the following graph to understand the implications…

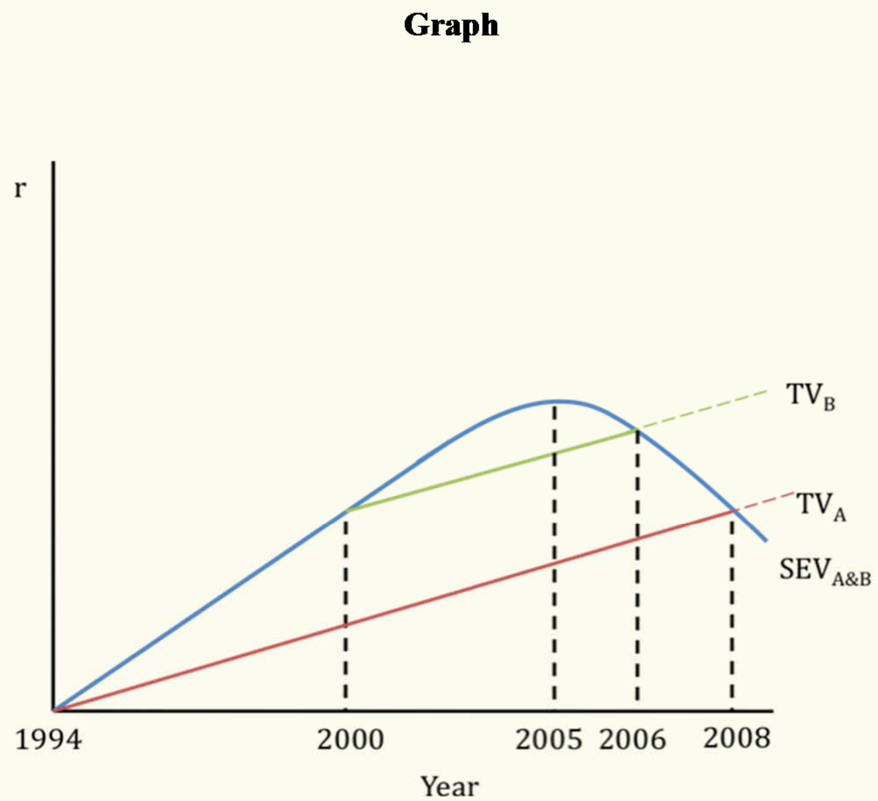
Tax Payment with Falling Home Values

What if SEV falls below TV for a particular property?

Assessors increase TV by the rate of inflation even in the face of falling housing prices….until TV=SEV.

Then TV follows SEV.

When house prices stabilize and begin to increase, TV is ratcheted down….local unit fiscal capacity may not recover for years.



Implications for Local Government Fiscal Health

- **Under the taxable value cap, local government fiscal capacity (especially in areas of significant housing price declines) may be severely curtailed for years to come.**
  - **The taxable value cap constrains property tax revenue recovery**
    - **Housing values will eventually recover, but taxable values are only allowed to grow at the rate of inflation**
    - **Extend fiscal problems…unless voters support a rate increase via referenda processes**

Tax Burden Redistribution under the Taxable Value Cap

- **If all property value were taxed fully, statewide average statutory property tax rates could fall by about 19 percent.**
  - **Long-time homeowners who experienced housing price appreciation received tax relief.**
  - **Recent home buyers experience a tax penalty.**

Property Tax Burden

- Anyone who has recently bought a home understands this
  - The tax payment of the previous owner does not necessarily reflect what you will pay when you purchase the home
    - The previous owner's tax payment was based on the taxable value
    - Your payment is based on state equalized value (the "pop up" effect)

Property Tax Burden

- Little is known about how property tax burdens have been redistributed across socio-economic groups
- Using the State of the State Survey (administered by MSU), Ballard, Hodge, and Skidmore are in the process of evaluating this issue
  - roughly 1,000 respondents on the survey
  - Detailed economic and demographic information
  - Questions on property tax payments and perceived home values
  - Match survey data with community-level data

Property Tax Burden

- What are the tax savings associated with length of tenure in a home?
- What demographic characteristics are associated with length of tenure in a home?
- Which demographic groups have benefited (or been hurt) by the taxable value cap?

Property Tax Burden

- **Calculate *effective* tax rates for each homeowner in the survey**
  - **Identify the determinants of *effective* tax rates**

- **The difference between statutory rates and effective tax rates:**

  - Statutory Rate = Tax Payment/Taxable Value

  - Effective Rate = Tax Payment/State Equalized Value

$$\mathrm{EffectiveRate}_i = \left(\frac{\mathrm{TaxPayment}_i}{\mathrm{SEV}_i} \right) = f(\mathrm{comm}_i, \mathrm{years}_i)$$

Property Tax Burden

- **Community Characteristics:**
  - population
  - per capita state equalized value in community (wealth)
  - urban indicator defined by Census
  - city indicator (as opposed to township)
  - Detroit indicator (very high statutory rates)
  - mobile home park indicator (no tax)
- Years
  - Years of tenure in a home

Property Tax Burden

- **On average, for every year a person owns a home, property tax rates (and tax payments) are reduced by 0.34 millage points relative to a person who recently purchased a home.**

- **Since 1994—tax savings accrues to nearly 5 millage points or about 17% over new homeowners.**

- **For communities defined as "rural" there is a 20% differential.**

- **For communities with populations between 10,000 and 40,000, this differential is about 45%.**

Table 2: Regression Results
(t-statistics in parentheses)

	Dependent Variable			
Independent Variable	**Effective Rate**	**Effective Rate**		
Population	**4.41e-06** **(0.27)**	**4.80e-06** **(0.28)**		
Wealth	**5.53e-06** **(0.30)**	**5.08e-06** **(0.28)**		
Mobile Home Park	**-26.486***** **(-18.11)**	**-26.623***** **(-19.14)**		
Detroit Indicator	**10.379** **(0.75)**	**10.030** **(0.71)**		
Urban Indicator	**6.287***** **(3.56)**	**5.039** **(1.23)**		
City Indicator	**2.063** **(1.61)**	**2.064** **(1.61)**		
Years	**-0.345**** **(-2.20)**			
Years*Urban		**-0.285** **(-1.01)**		
Years*Rural		**-0.401***** **(-2.74)**		
R^2	**0.255**	**0.256**		
Number of Observations	**474**	**474**		

Notes: All regressions are done using the robust command to account for heteroscedasticity.

*** Indicates significance at the 90 percent confidence level for a two-tailed test.**
**** Indicates significance at the 95 percent confidence level for a two-tailed test.**
***** Indicates significance at the 99 percent confidence level for a two-tailed test.**

Property Tax Burden

- Consider socio-economic characteristics
  - What characteristics are potentially correlated with length of tenure in a home?
    - Age*
    - Income
    - Race (average length of tenure is about 6 years less for African Americans than for Caucasians)
    - Other socio-economic characteristics

Property Tax Burden

•AGE

- On average, tax savings accrue by 0.16 millage points for each year of age (estimates vary depending on location)

- Average tax savings for a 63 year old over a 23 year old is about 16% annually, controlling for other factors

Age	Income
20	$ 38,303
25	$ 42,336
35	$ 47,777
45	$ 49,721
55	$ 48,167
65	$ 43,114
75	$ 34,564
85	$ 22,515

<u>Other findings</u>:

• As income, rises effective tax rates fall slightly

• Controlling for age, race has no bearing on tax burden

Conclusions

- The taxable value cap was perceived to be a tax relief measure (above and beyond the Headlee amendment)
  – Falling home values was unanticipated
    - Significant long-term fiscal stress will likely result under the current legal environment
  – Distributional consequences unanticipated
    - One average, older high income homeowners have benefited…at the expense of younger lower income homeowners

Conclusions

- One might argue that because home values are falling, the distribution issue is no longer relevant
  - BUT now is a excellent time to seek its repeal
    - With falling home values, long-time homeowners have less to lose by repeal than in previous years
    - Voter approval is required
- Other research shows that such restrictions reduce mobility (“lock in effect”)

Conclusions

- Repeal of the taxable value cap would
  - Reduce statewide average statutory rates by 19%
  - Eliminate differences in effective tax rates across owners of equivalently valued homes
    - Reduce rates for new homeowners
    - Increase rates of long-time homeowners (with no impact on the low to moderate income elderly…circuit-breaker)
    - Eliminate any “lock-in” effects
  - Reduce rates for new businesses not already receiving tax abatements, and raise rates of long-time existing businesses
  - Provide local (and state) officials with more flexibility in managing fiscal challenges in the coming years
  - Circuit-breakers still protect elderly and low/moderate income homeowners