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

<table>
<thead>
<tr>
<th>Year</th>
<th>TV/SEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>1.00</td>
</tr>
<tr>
<td>2006</td>
<td>0.77</td>
</tr>
<tr>
<td>2007</td>
<td>0.78</td>
</tr>
<tr>
<td>2008</td>
<td>0.81</td>
</tr>
</tbody>
</table>

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
"I thought we were just buying a house!"
Housing Prices

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

Source: National Association of Realtors, U.S. Census Bureau, GMO
As of 6/30/08
Figure 2: House Price Appreciation Has Varied Across States
House Price Index for Homes in Michigan, Ohio, California and Florida, Q1:1995-Q2:2007
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
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

\[
\text{Effective Rate}_i = \left( \frac{\text{Tax Payment}_i}{\text{SEV}_i} \right) = f(\text{comm}_i, \text{years}_i)
\]
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
• 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)

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Effective Rate</th>
<th>Effective Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>4.41e-06 (0.27)</td>
<td>4.80e-06 (0.28)</td>
</tr>
<tr>
<td>Wealth</td>
<td>5.53e-06 (0.30)</td>
<td>5.08e-06 (0.28)</td>
</tr>
<tr>
<td>Mobile Home Park</td>
<td>-26.486*** (-18.11)</td>
<td>-26.623*** (-19.14)</td>
</tr>
<tr>
<td>Detroit Indicator</td>
<td>10.379 (0.75)</td>
<td>10.030 (0.71)</td>
</tr>
<tr>
<td>Urban Indicator</td>
<td>6.287*** (3.56)</td>
<td>5.039 (1.23)</td>
</tr>
<tr>
<td>City Indicator</td>
<td>2.063 (1.61)</td>
<td>2.064 (1.61)</td>
</tr>
<tr>
<td>Years</td>
<td>-0.345** (-2.20)</td>
<td>-0.285 (-1.01)</td>
</tr>
<tr>
<td>Years*Urban</td>
<td>-0.401*** (-2.74)</td>
<td>-0.285 (-1.01)</td>
</tr>
<tr>
<td>Years*Rural</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

R²        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

<table>
<thead>
<tr>
<th>Age</th>
<th>Income</th>
</tr>
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<tbody>
<tr>
<td>20</td>
<td>$38,303</td>
</tr>
<tr>
<td>25</td>
<td>$42,336</td>
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<tr>
<td>35</td>
<td>$47,777</td>
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<tr>
<td>45</td>
<td>$49,721</td>
</tr>
<tr>
<td>55</td>
<td>$48,167</td>
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<tr>
<td>65</td>
<td>$43,114</td>
</tr>
<tr>
<td>75</td>
<td>$34,564</td>
</tr>
<tr>
<td>85</td>
<td>$22,515</td>
</tr>
</tbody>
</table>

Other findings:

- 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