Homestead Property Tax: Percent-Based Tax Exemptions

Joint Select Committee on Property Tax Relief and Reform

May 21, 2007

Percent-Based Tax Exemptions

- Current situation
- Description of the percent-based method and its variations
- Outcomes of implementing an enhanced percent-based homestead exemption
- Summary of Considerations related to different variations

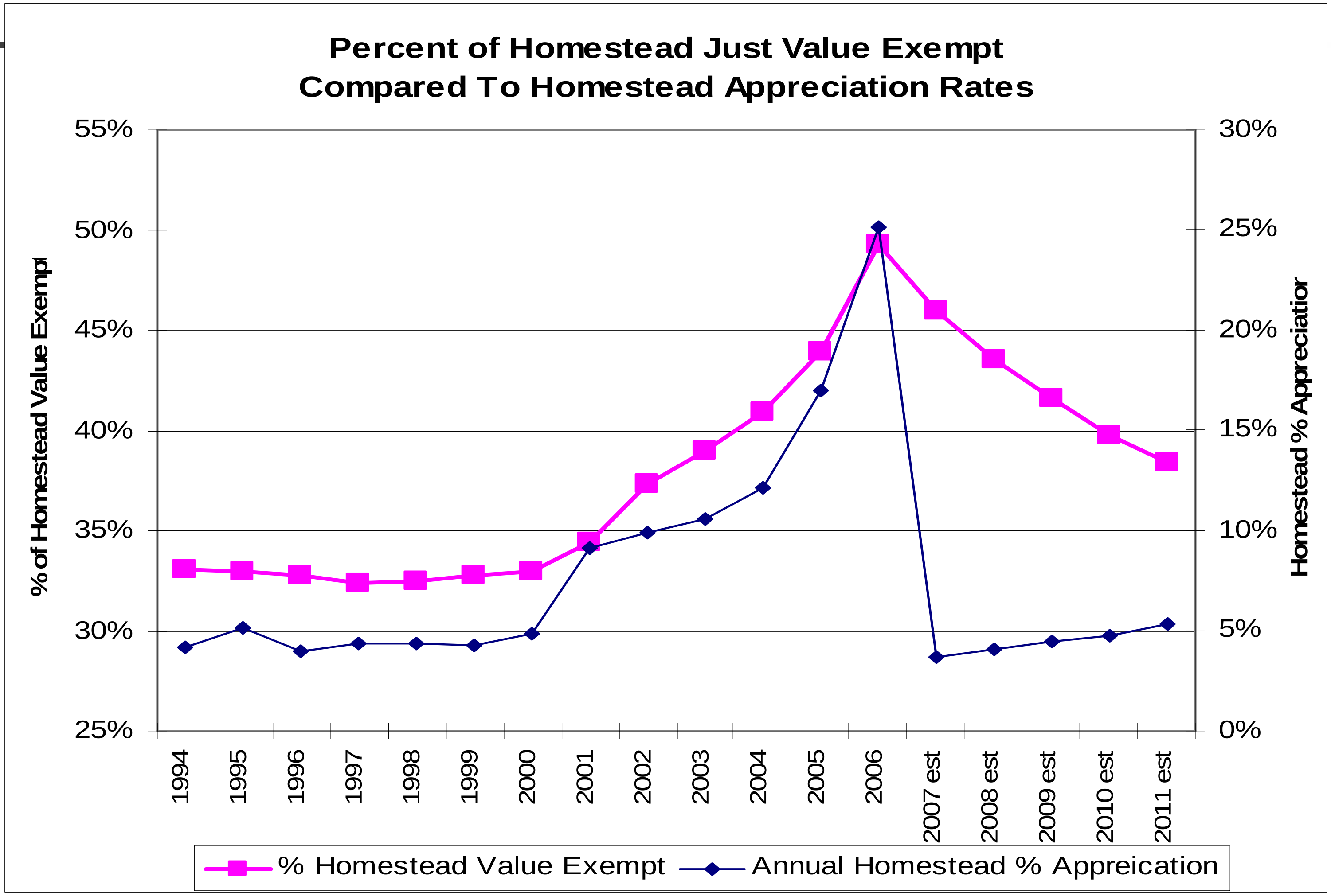
Current Situation

- Turning Point in Real Estate Markets
- Inequities
- Tax Shifting
- “Lock In” Effect
- Disinterested Taxpayers

Current Situation: Real Estate Markets

- Present exemption values are high by historical standards.
- Recent run-up in property values caused the Save Our Homes differential to grow dramatically.
- As markets return to more normal growth, the Save Our Homes differential will decline as a percentage of just value.

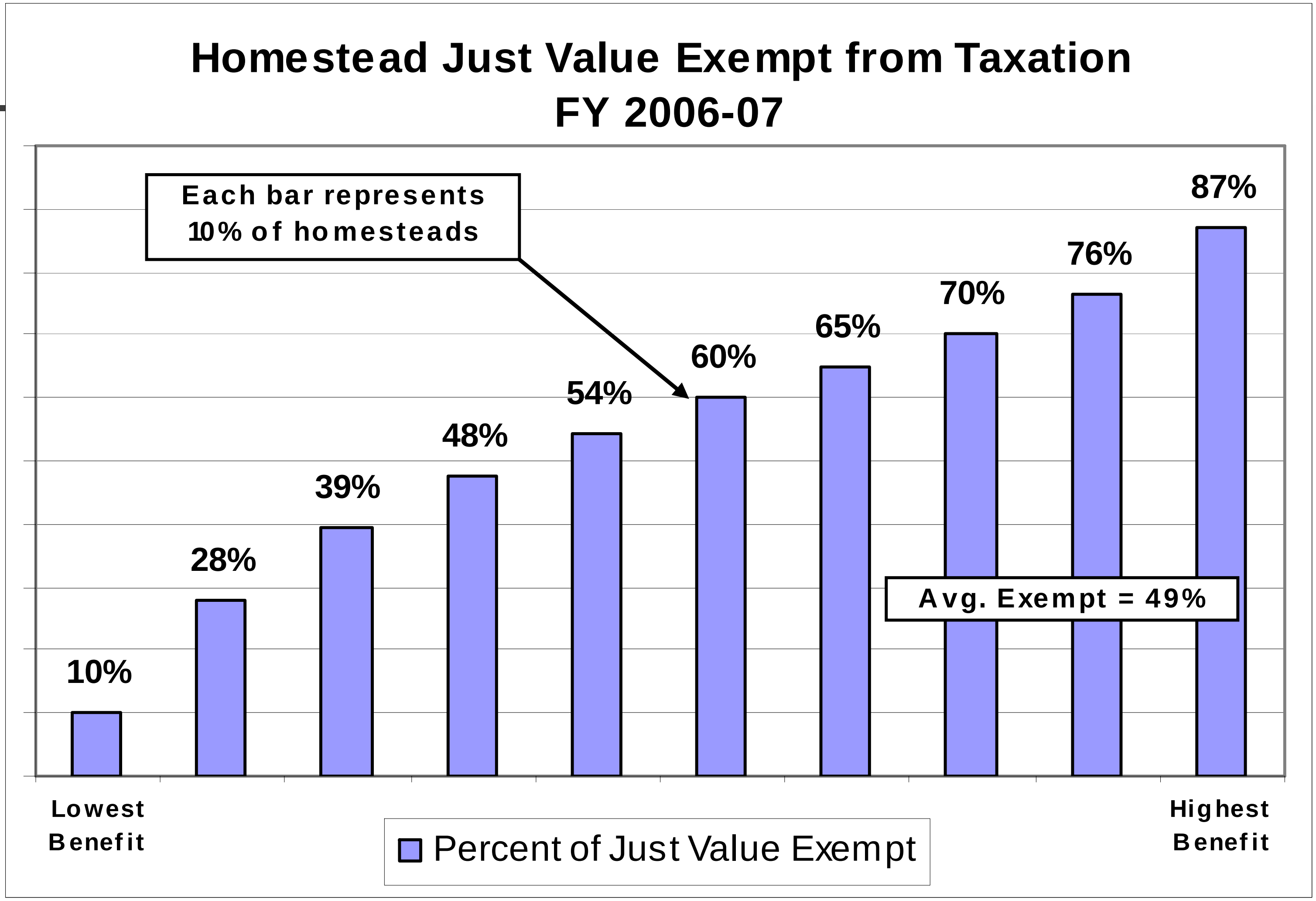
Current Situation: Real Estate Markets



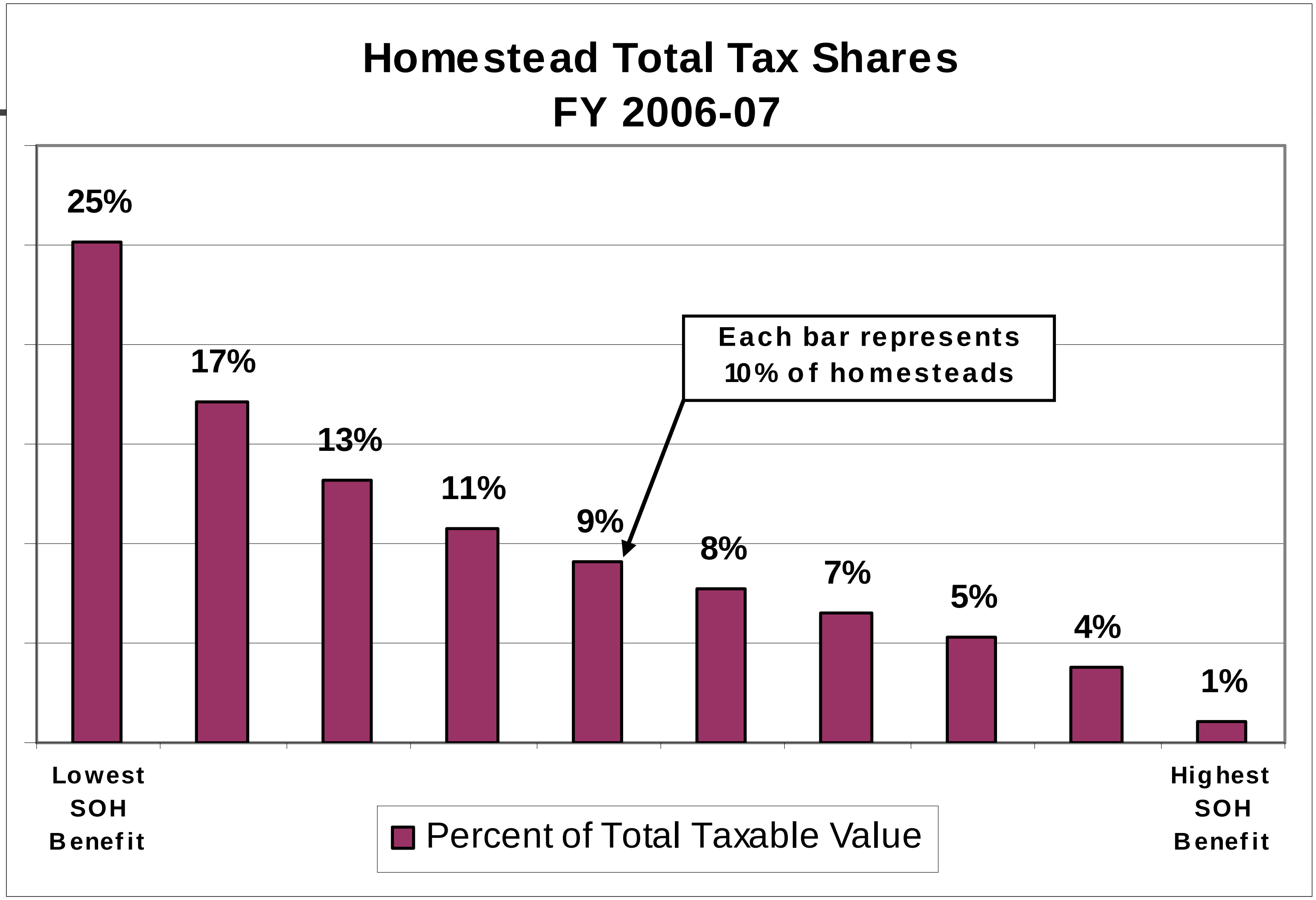
Current Situation: Inequities

- Very large differences in treatment of similarly situated taxpayers.
- High taxes for some, low taxes for others.
- The degree of inequity varies over time.

Current Situation: Inequities



Current Situation: Inequities



Current Situation: Tax Shifting

- The burden of property taxes has been shifted to:
  - Non-homesteaded properties,
  - Recently established homesteads, which have little or no accumulated Save Our Homes benefits.

Current Situation: Tax Shifting

Tax Base Shares:
With and Without Save Our Homes, FY 2006-07

	Without	With	% Diff.
Residential--Homestead	45.5%	32.1%	-29%
Residential--Non-homestead	28.4%	35.4%	25%
Non-Residential	26.1%	32.5%	25%

Revenue Neutral Tax Rates, FY 2006-07

Statewide Levies (bil $)	30.5	30.5	0%
Statewide Millage	14.8	18.5	25%

Current Situation: “Lock In” Effect

- Some homeowners are reluctant to relocate to another homestead within the state.
  - Tax benefits accumulated as a result of the Save Our Homes growth cap are lost when relocating.

Current Situation: Disinterested Taxpayers

- Save Our Homes affords homeowners protection from large tax increases.
  - Since 1995, homeowners not relocating have seen tax bills decline when adjusted for inflation.
  - Many homeowners are indifferent to local government decisions that result in significant tax increases for non-homestead properties.

Description of the Method

Method Description

- Three basic variations to the percent-based exemption approach:
  - Flat percent of just value,
  - Tiered percent of just value,
  - Percent of county-specific values.

Method Description: Flat Percent

- The value to be exempted would equal just value (i.e., market value) multiplied by a single percentage.
  - The *percentage* would be the same regardless of the market value of the property.

Method Description: Flat Percent

EXAMPLE 1

Exempt	50%	**of Just Value**	
	Homestead Just Value		
	$100,000	**$250,000**	**$500,000**
Exempt Value	**$50,000**	**$125,000**	**$250,000**
% of Just Val	50%	50%	50%
Taxable Value	**$50,000**	**$125,000**	**$250,000**
% of Just Val	50%	50%	50%

Method Description: Flat Percent

EXAMPLE 2

Exempt	35%	**of Just Value**	
	Homestead Just Value		
	$100,000	**$250,000**	**$500,000**
Exempt Value	**$35,000**	**$87,500**	**$175,000**
% of Just Val	35%	35%	35%
Taxable Value	**$65,000**	**$162,500**	**$325,000**
% of Just Val	65%	65%	65%

Method Description: Tiered Percent

- The amount to be exempted would be based on different percentages applied to specified increments of just value.
  - The *effective percentage* exemption for a property will differ with the market value of the property, depending on the tiers.

Method Description: Tiered Percent

EXAMPLE 1

		Homestead Just Value			
		$100,000	**$250,000**	**$500,000**	**$1,000,000**
Exempt %	**Value Range**				
100%	Up to 25k	$25,000	$25,000	$25,000	$25,000
70%	25k - 200k	$52,500	$122,500	$122,500	$122,500
40%	200k - 400k	$0	$20,000	$80,000	$80,000
10%	400k - 800k	$0	$0	$10,000	$40,000
0%	800k +	$0	$0	$0	$0
Exempt Value		**$77,500**	**$167,500**	**$237,500**	**$267,500**
	% of Just Val	77.5%	67.0%	47.5%	26.8%
Taxable Value		**$22,500**	**$82,500**	**$262,500**	**$732,500**
	% of Just Val	22.5%	33.0%	52.5%	73.3%

Method Description: Tiered Percent

EXAMPLE 2

		Homestead Just Value			
		$100,000	**$250,000**	**$500,000**	**$1,000,000**
Exempt %	**Value Range**				
100%	Up to 25k	$25,000	$25,000	$25,000	$25,000
60%	25k - 200k	$45,000	$105,000	$105,000	$105,000
50%	200k - 400k	$0	$25,000	$100,000	$100,000
40%	400k - 800k	$0	$0	$40,000	$160,000
30%	800k +	$0	$0	$0	$60,000
Exempt Value		**$70,000**	**$155,000**	**$270,000**	**$450,000**
	% of Just Val	70.0%	62.0%	54.0%	45.0%
Taxable Value		**$30,000**	**$95,000**	**$230,000**	**$550,000**
	% of Just Val	30.0%	38.0%	46.0%	55.0%

Method Description: County-Specific Values

- The amount to be exempted could be either a flat percent or tiered percent structure applied to county-specific homestead values.
  - The *effective percentage* exempt will differ with the market value of properties within a county.
  - The percentage exempt for a *given market value* will differ across counties.

Method Description: County-Specific Values

EXAMPLE

Exempt **50%** **of County Median Homestead Just Value**

Carlton County Median = **$200,000**
Sansom County Median = **$120,000**

	Homestead Just Value					
	$100,000		**$250,000**		**$500,000**	
	Carlton Co.	**Sansom Co.**	**Carlton Co.**	**Sansom Co.**	**Carlton Co.**	**Sansom Co.**
Exempt Value	$100,000	$60,000	$100,000	$60,000	$100,000	$60,000
% of Just Val	100%	60%	40%	24%	20%	12%
Taxable Value	$0	$40,000	$150,000	$190,000	$400,000	$440,000
% of Just Val	0%	40%	60%	76%	80%	88%

Method Description: Save Our Homes “Grandfathering”

- Some properties will be better off under the current system than under an enhanced homestead exemption.

- The current benefits for such properties can be “grandfathered.”

Method Description: Save Our Homes "Grandfathering"

- The main "grandfathering" variations are:
  - Allow current SOH growth cap to *continue as is.*
  - Set new minimum exemption at current combined SOH + Homestead Exempt value.
  - Allow SOH growth cap at a *higher annual rate.*

Outcomes of an Enhanced Homestead Exemption

Outcomes: Taxes Can be Reduced

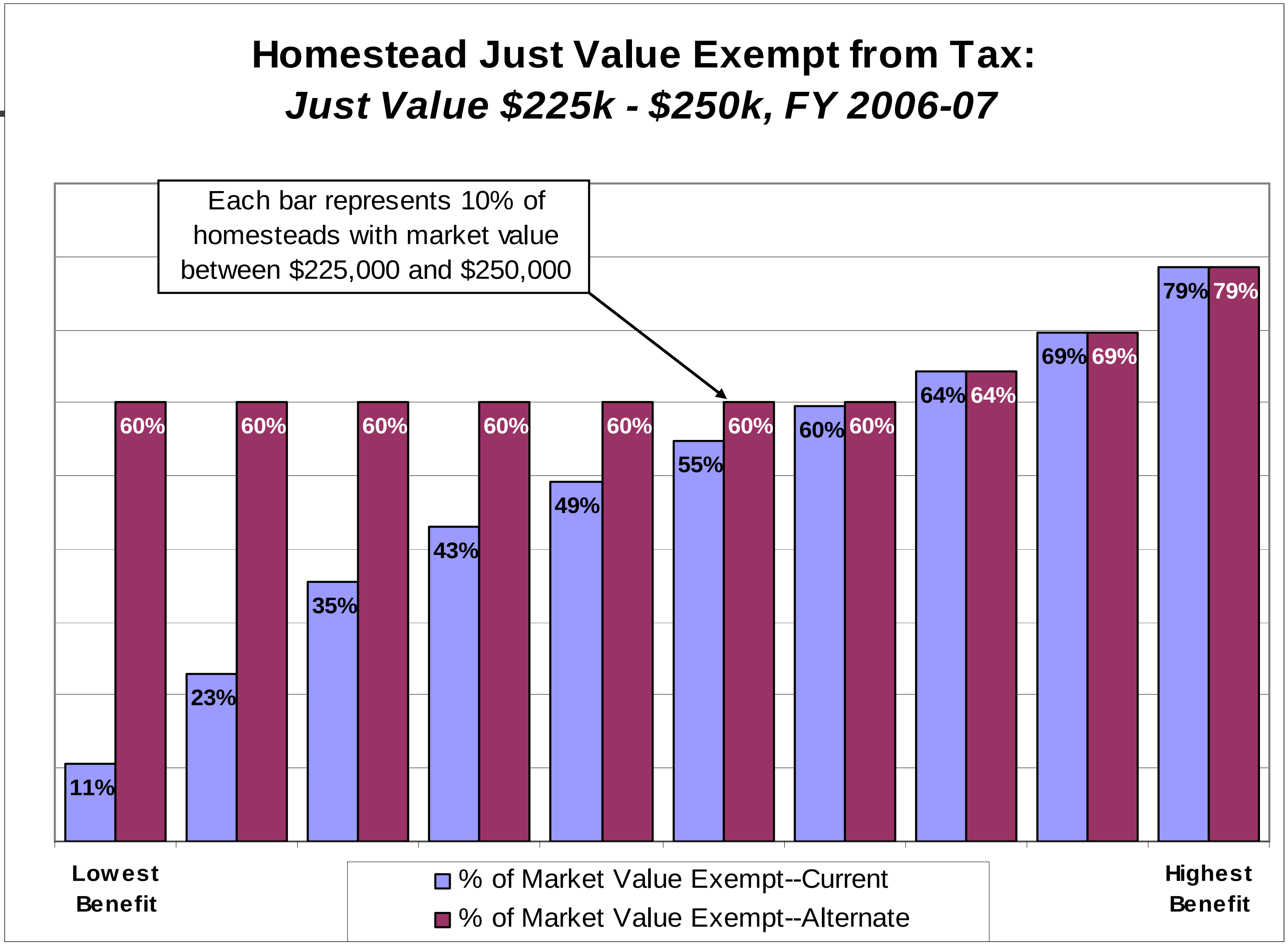
- Taxable values, and taxes paid by homesteads, can be reduced when the enhanced exemption replaces the current exemption and Save Our Homes "differential."

- Additional measures will be needed to:
  - Maintain tax savings to exemption beneficiaries.
  - Avoid shifting taxes to other classes of property in the form of increased tax rates.

Outcomes: Equity Among Homesteads Can Improve

- Under the flat or tiered percentage methods, properties with the same market values will have the same taxable value.
- Under a county-specific value approach, this will be true within any given county, but not across counties.

Outcomes: Equity Among Homesteads Can Improve



Outcomes: "Lock In" Effect Can be Eased

- An enhanced homestead exemption will be inherently "portable," regardless of structure.

- *Non-grandfathered* homesteads will not lose benefits when relocating.
  - There will be exceptions to this under a county-specific value approach for homeowners moving from "high value" to "low value" counties.

Outcomes: "Lock In" Effect Can be Improved

- *Grandfathered* properties will be partially protected from loss of Save Our Homes benefits when relocating.
  - The enhanced homestead exemption will offer immediate benefits to relocating homesteaders compared to current law.

Outcomes: Local Government Revenue Loss

- Taxing authorities will lose revenues unless other adjustments are made.

- The magnitude of these effects will depend on the size of the enhanced exemption.

Outcomes: Local Government Revenue Loss

- Revenue losses may be more problematic for some taxing authorities:
  - Fiscally limited counties and cities.
  - Jurisdictions that have an unusually large homestead property component in their tax base.
  - Jurisdictions that rely more heavily on property tax revenues.

Summary of Considerations

Considerations: Flat Percent

- Simple to explain and understand.
- Automatically adjusts to changes in real estate prices and varies with regional differences.
- All property owners will receive the same proportional benefit, regardless of property value.
  - This will result in concentration of a larger portion of the total tax savings among relatively few property owners, compared to other methods.
- For any given revenue impact, this method benefits the fewest taxpayers.

Considerations: Tiered Percent

- Can be targeted to benefit a greater number of homestead property owners than the flat tax method.
- Structure can be designed to result in a more or less rapid diminishing of benefits as homestead value increases.
- The same statewide tiers will be more or less beneficial in any given region depending on prevailing real estate prices.
- A tiered system geared to statewide average homestead values may be “too rich” for low-valued counties.

Considerations: County-Specific Values

- Automatically varies based on regional differences in homestead prices.
- Is partially sensitive to market-wide changes in prices.
- Preserves rural tax bases where average homestead values are low.
- For any given revenue impact, this method benefits the greatest number of taxpayers.

Considerations: County-Specific

- May be hard to explain on a ballot summary.
- Depending on property values, within a county the benefit for high-value homestead owners could be small.
- Creates “boundary effects.”
- Homeowners with homes of equal just value will contribute different amounts in school taxes, depending on the county they live in.