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

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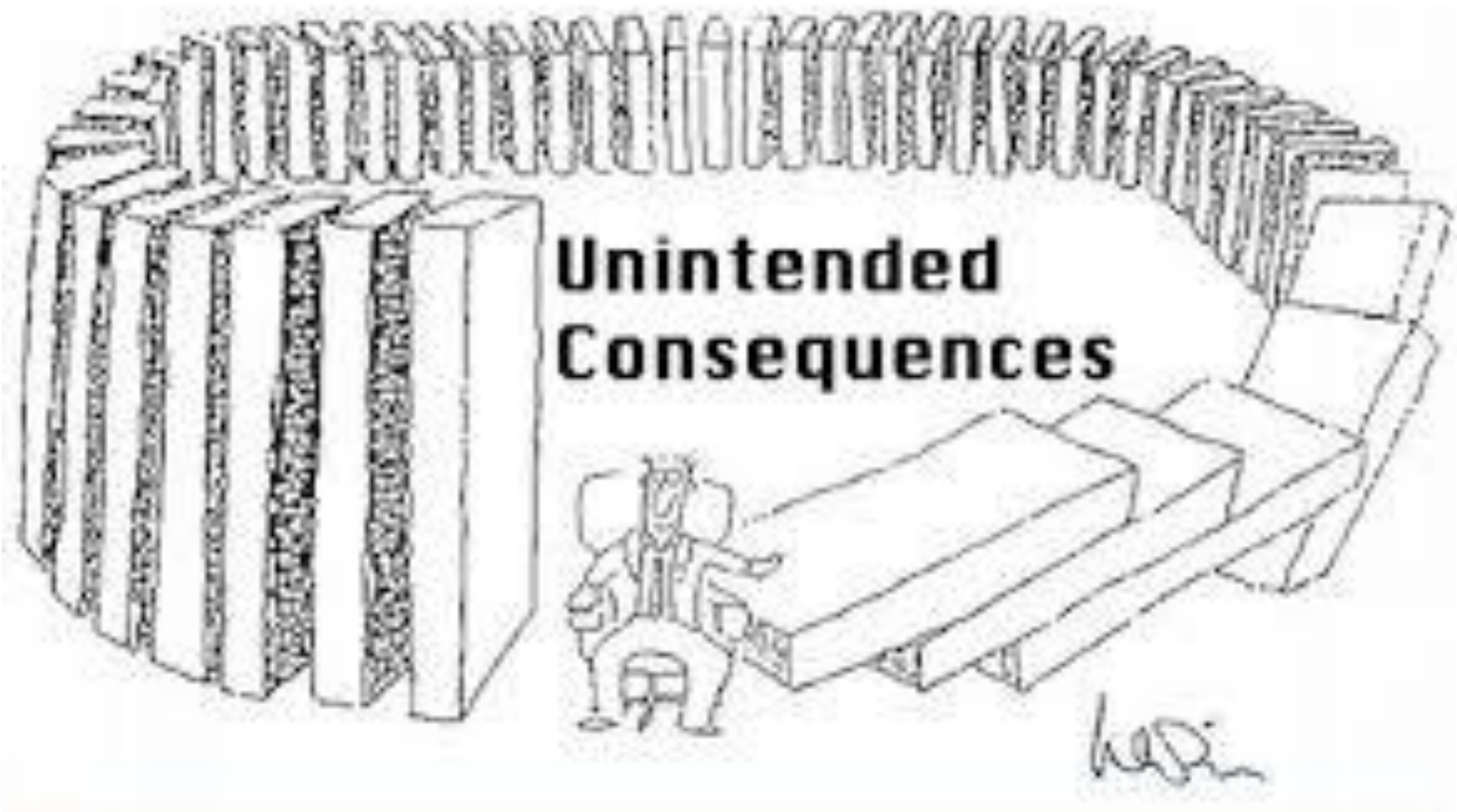
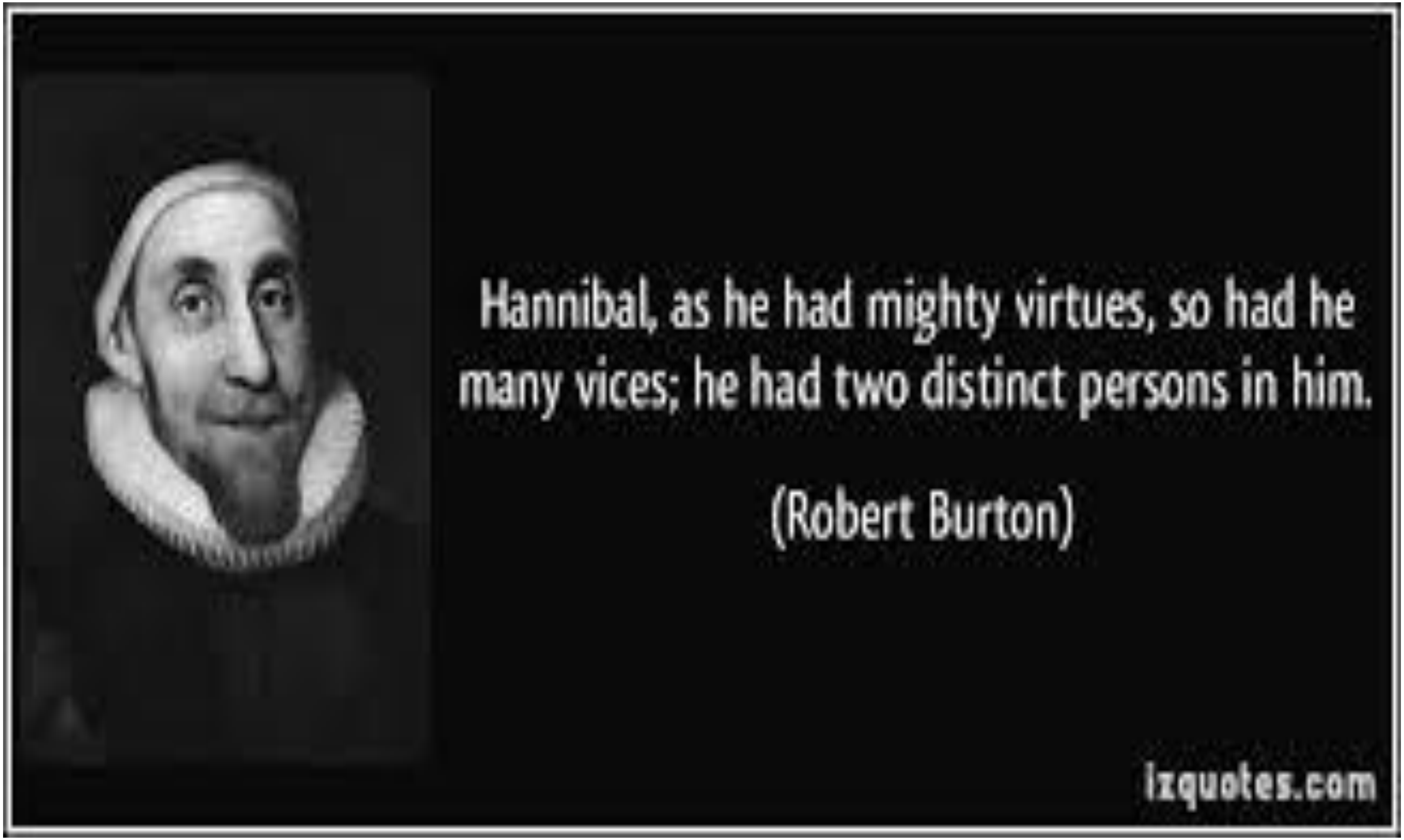
Unintended consequences



Agenda

- Property tax virtues and vices
- "Fixing" the property tax?
  A. Assessment caps
     1) Alternatives
  B. Tax increment finance (TIF)
     1) Alternatives

Property tax virtues and vices



Property tax virtues and vices

- **Virtues**
  - Revenue stability—a strong point
    - gov’ts generally set the property tax levy (dollar amount). Tax rate is calculated to get the required levy
    - real estate values generally change more slowly than other tax bases (e.g. income or sales).

  - Ease of administration (see “vices” below)
  - Predictability/visibility
    - Property tax is very visible since people see it either in their property tax bill or their mortgage statement (but this also leads taxpayer discontent)

Property tax virtues and vices

- **Virtues**
  - Fairness
    - Assessments are transparent and based on relatively objective data
    - <u>Residential</u> tax payments closely related to services received.
    - One of the few taxes on wealth (but wealth may not be correlated with income)
  - Efficiency/distortions
    - <u>land</u> tax cannot be avoided so won't result in inefficient use
    - <u>structure</u> tax is generally thought to be small enough, and closely enough related to service provision that it does not cause major distortions

Property tax virtues and vices

- **Vices**
  - Revenue stability (see "virtues" above)
  - Ease of administration
    - Costly to assess real estate especially if done well Appeals system may complicate administration
  - Predictability/visibility
    - Tax depends on share of property wealth. This can fluctuate w/o taxpayer action
    - Special features (credits, exemptions, classification, equalization, etc.) can make tax difficult to understand

Property tax virtues and vices

- **Vices**
  - Fairness/equity
    - Non-residential landowners (especially ag and business) may be taxed for services that they do not use
    - Taxpayers in high property wealth areas pay less for the same services than those low property wealth areas (unless there is equalizing aid)
    - Taxpayer may have lots of property due to past choices but little income to pay taxes
    - When property appreciates unrealized capital gains may be taxed
    - When property values fall property tax payments can lag
  - Efficiency
    - Market value may not reflect “spillovers”
    - Interjurisdictional competition (especially for business) may be inefficient.

“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

- Rationale for assessment caps are often complex
- Examples of rationales
  - Property taxes are too high or have risen too fast
  - Residential property taxes are too high (or have risen too fast) relative to the non-residential taxes
  - Certain populations (e.g. the elderly or long-term residents) can't pay their taxes

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
  - 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

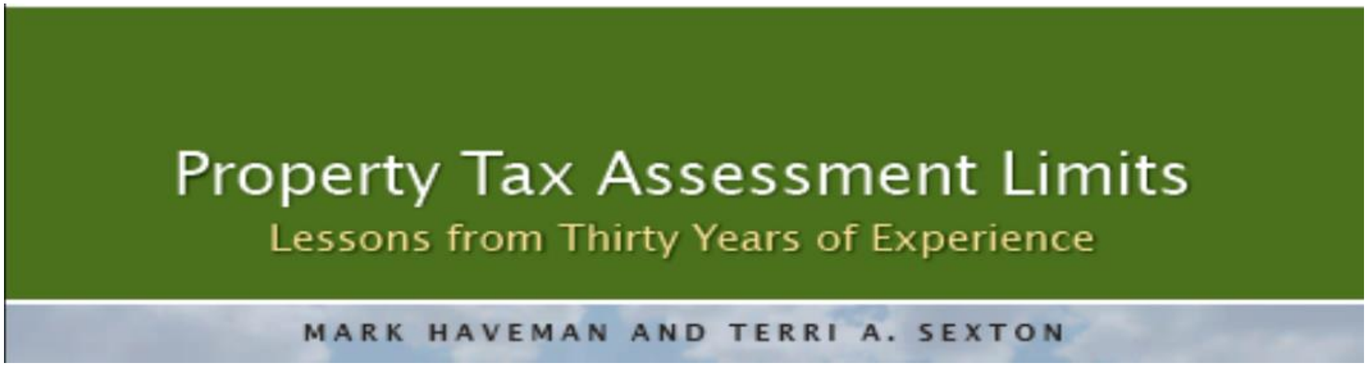
- Other effects of assessment caps (continued)
  - Effect on equity/fairness of the property tax
    - Violates principle of horizontal equity since similarly valued parcels pay different taxes
    - Violates principle of vertical equity since lower valued parcels may pay more tax than higher valued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

Assessment caps

- Other effects of assessment caps (continued)
  - Effect on visibility/predictability
    - 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."

Alternatives to assessment caps

1. Expenditure limits or levy limits---Directly address (excessive) local gov't spending.
2. Homestead exemptions or credits and/or Classified tax rates---Directly address relative tax on homes, ag and/or business
3. Circuit breakers--Directly address vertical equity
4. Tax deferrals--Directly address taxing of unrealized capital gains
5. Other—state aid directly to local gov'ts or state aid to property tax payers (e.g. property tax credit program)---may address (over) reliance on property tax.

Caution: Each may have unintended consequences.

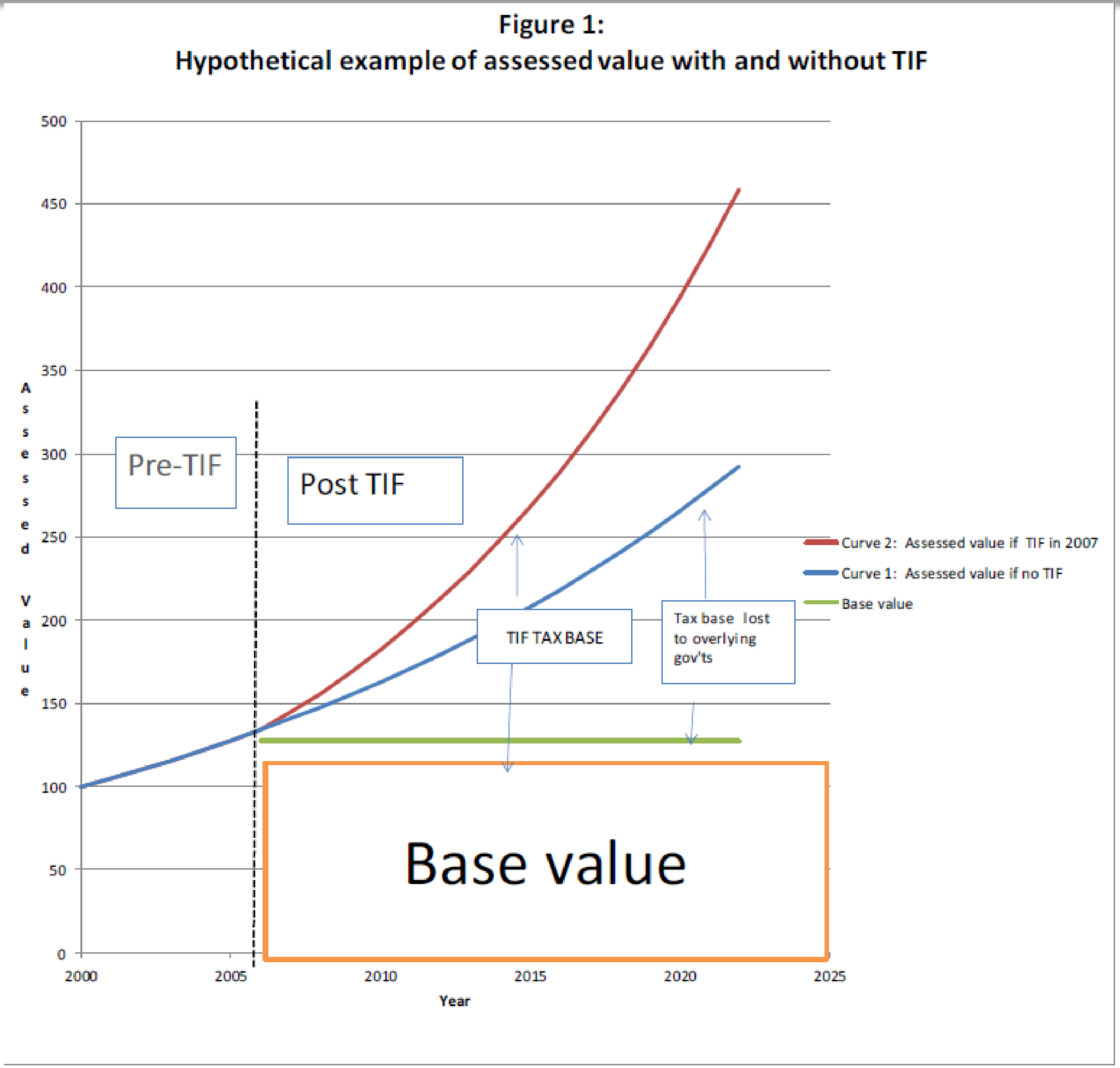
Tax increment Finance (TIF)

- What is tax increment finance and what property tax problem does it "fix"?

  - What is tax increment finance? TIF is a method of sequestering property tax revenue from appreciation in a designated area to finance economic development in that same area. While TIF rules differ in different states, core elements are:
    - use of property tax revenues generated by real estate appreciation
    - well, and narrowly, defined geographic boundaries
    - expenditures designed to encourage economic development and
    - a designated and limited time period of operation.

  - Hypothetical example on the next slide

Hypothetical example of TIF



TIF is an unusual business tax incentive because

1. Not a tax break
2. Represents a deviation from the usual budgetary process
   A. Revenues are not appropriated during the regular budgetary cycle
   B. Once initiated TIF spending is not subject to a vote of the city council
   C. Reports about TIF finances are not usually incorporated into city financial documents (e.g. the Comprehensive Annual Financial Report)

WHAT IS THE RATIONAL FOR USE OF TIF?

- TIF may solve the problem of *credible commitment* between private developer and government.
  - Economic development often involves gov't investment (infrastructure, public safety, etc) and
  - Private investment (buildings, business start, etc.)

- Each party has an incentive to act only if the other is firmly committed to the action also.

- TIF may alleviate that problem by using incentive compatible rules
  - Developer gets no public revenue unless there is appreciation
  - No appreciation unless developer credibly commits to investment

WHAT IS THE RATIONAL FOR USE OF TIF? (continued) Other explanations

1. TIF can be motivated by the desire to capture tax revenues from overlying governments (eg City capturing revenues from school district)
   A. This would not happen if the "but for" rule were strictly applied
   B. Question: To what extent does the "but for" rule constrain the use of TIF? (see next slide)

Does the “but for” rule constrain the use of TIF?

The Minnesota Legislative auditor found that Minnesota cities “interpret the ‘but for’ requirement in a variety of ways” and that reasons for providing TIF-based

A. assistance to development included finding that:unusual circumstances made the project too expensive to develop otherwise
B. even though the development would likely occur without TIF assistance it would not occur at a location consistent with the city’s development absent the assistance
C. the development would occur sooner with TIF assistance
D. the development would be bigger or better with TIF assistance
E. a company threatened to go elsewhere if it did not get TIF assistance and
F. TIF allowed the city to make public improvements that would not otherwise have happened

The auditor concluded that “[g]iven the variety of interpretations available, it is difficult to imagine a development that would not meet the "but for" test in some sense.” (Minnesota, State of 1996 p.73).

Where has TIF been used?

- It is hard to know because it is a *local* program and some states do little monitoring

Estimated number of TIF districts in selected* states

Nebraska had 716 TIF districts in 2014

Source:
http://www.revenue.nebraska.gov/PAD/research/tif_reports.html

State	Estimated Number of TIF districts
Alabama	<10
Arkansas	10 to 20
California	771
Florida	173
Illinois	1,160
Iowa	949
Kansas	4
Maine	> 200
Maryland	> 18
Minnesota	2,184
New Jersey	0
Rhode Island	2
Washington	3
Source	Merriman Table III.1

How has TIF been used?

- Two primary questions
  - Is TIF adopted to *nurture* growth (intended effect) or to *capture* growth that would otherwise go to overlying governments (unintended consequence) ?
  - Is TIF used to gain a competitive advantage over neighboring communities? (unintended consequence)

How has TIF been used? :

Empirical evidence about the reasons for TIF adoption

Table III.2
Determinants of TIF Adoption

Article	Date	Area	Data	Time Period	Dependent Variable(s)	Finding
Anderson, John E. (1990).	1990	Michigan	255 cities	1985 and 1986	probability of TIF adoption	growing cities are more likely to adopt TIF
Man, Joyce Y. (1999)	1999	Indiana	150 cities with a population above 2,500	1985 to 1991	probability of TIF adoption	cities with neighbors that adopt TIF, those suffering fiscal stress and with a lower share of property taxes paid by the median household are more likely to adopt TIF
LaPlante, Josephine M. (2001.	2001	Maine	86 larger municipalities (42 of which adopted TIF)	unclear 2001?	probability of TIF adoption at the time analyses were done	Municipal tax burden alone classified 86 percent of towns correctly as TIF adopters or non adopters. Business share or property tax base and percentage elderly also predicted a high share of adopters
Gibson, Diane. (2003)	2003	Chicago	866 Census tracts	1990 to 2000	time until Census tract became part of a TIF district	probability of being part of a TIF district increases with neighborhood distress and the presence of an Empowerment zone but falls with the tenure of the relevant Alderman
Byrne, Paul F. (2005).	2005	Chicago metro area	255 municipalities	2000	TIF adoption	Probability of adopting TIF increases with neighbors' probability of adopting TIF due to strategic interaction
Mason, Susan, and Kenneth P. Thomas (2010)	2010	Missouri	171 surveyed cities	Spring 2008	approval of a TIF and approval of a retail TIF	City's whose neighbors adopt TIF are more likely to adopt TIF as are those that use other economic development tools, have lower poverty rates, and higher unemployment rates
Warner, Mildred E., and Lingwen Zheng, 2013.	2013	US	about 800 replies to a survey of chief municipal administrative officers	2004 and 2009	use of business development incentives that reduce factor costs to business	TIF type development incentives are used when accountability, competition and unemployment are are high and when citizen opposition and per capita property taxes are low. They find evidence of increased incentive use during the Great Recession
Felix, R. Alison, and James R. Hines. (2013)	2013	US	replies to a survey of chief development officers of municipalities	1999	use of TIF alone or in combination with other business development incentives	Municipalities more likely to offer business development incentives if residents have low incomes, are close to state borders or live in states with high levels of political corruption.
Greenbaum, Robert T., and Jim Landers. (2014)	2014	US	844 municipal and county governments	2009	Use of TIF	larger and poorer (lower per capita income) gov'ts are more likely to offer TIF. Suburban gov'ts more likely to offer TIF than central city gov'ts.

How has TIF been used?

- Summary of academic research
  - Mixed evidence on 1st question (nurture vs capture)
  - Evidence of geographical competition (2nd question)

TIF and budget transparency

A reduction in budget transparency is a potential unintended consequence of TIF:

TIF spending is fundamentally different from other gov't spending. It

- benefits designated areas for a narrow purpose—economic development.
- derives from taxes levied by all overlapping governments.
- is not
  - authorized,
  - appropriated,
  - accounted for
  - or voted on during the normal budget cycle of any elected government.
- does not compete with non-TIF district priorities.
- is often combined with resources of private, sometimes for-profit, institutions
- persists for decades without being subject to ordinary democratic controls.

2011 Chicago TIF Reform Panel Recommendations

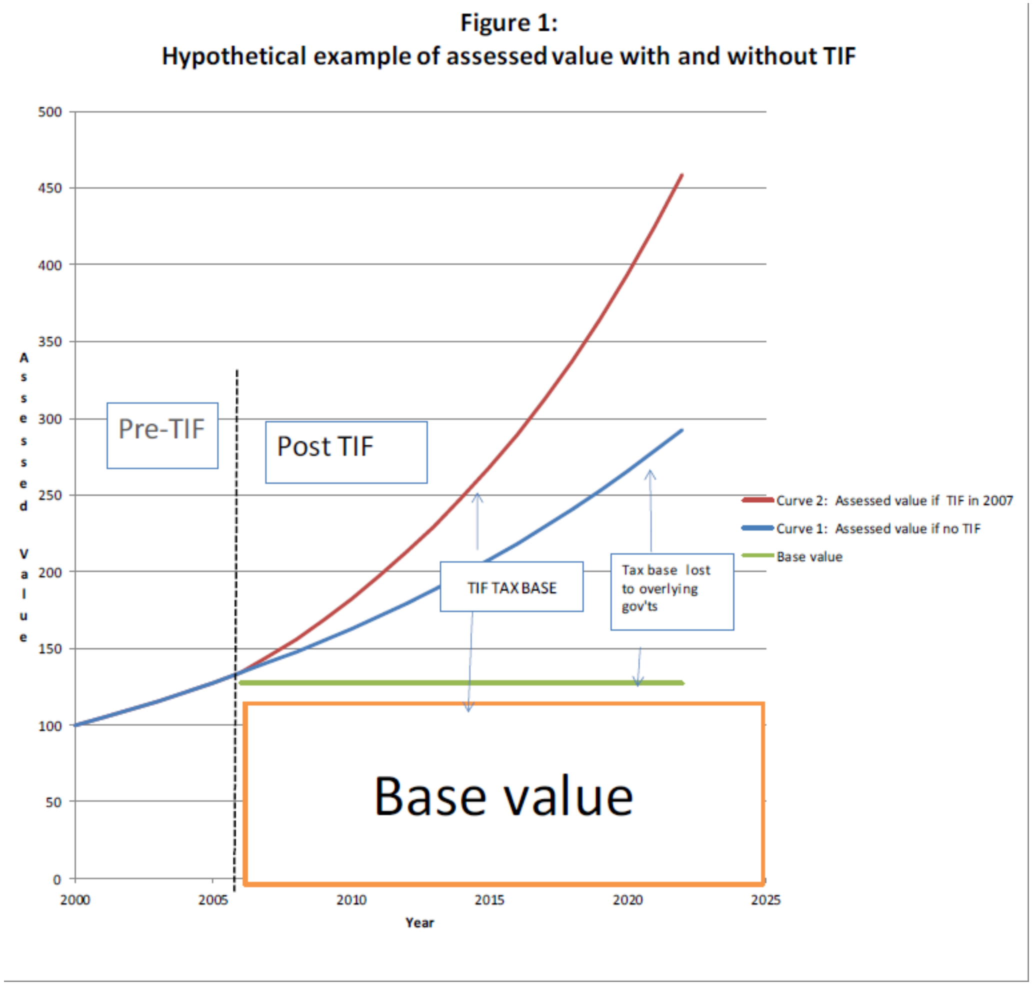
- **1. Establish the City's TIF Goals.** develop a multi-year Economic Development Plan and submit it to the City Council
- **2. Allocate Resources.** create a multi-year Capital Budget and submit it to the City Council
- **3. Monitor Performance.** establish a series of metrics to benchmark TIF
- **4. Increase Accountability.** make the justification for public funding of private projects more explicit monitor projects more systematically
- **5. Take Action.** set and manage to performance thresholds for districts and projects
- **6. Enhance Oversight and Administration.** empower an internal body with clear accountability for all aspects of TIF,

Does TIF accomplish the *intended effect* ? Is TIF an effective tool for economic development ?

- Appropriate question like all policy evaluation, is
  - How is the world different *with* the policy compared to *without* ?
  - In medicine/agriculture etc random assignment of treatment is used to answer the question. We can't do that with policy.
- Empirical question is difficult primarily because it is difficult to find "control" areas that are comparable to "treated" areas.

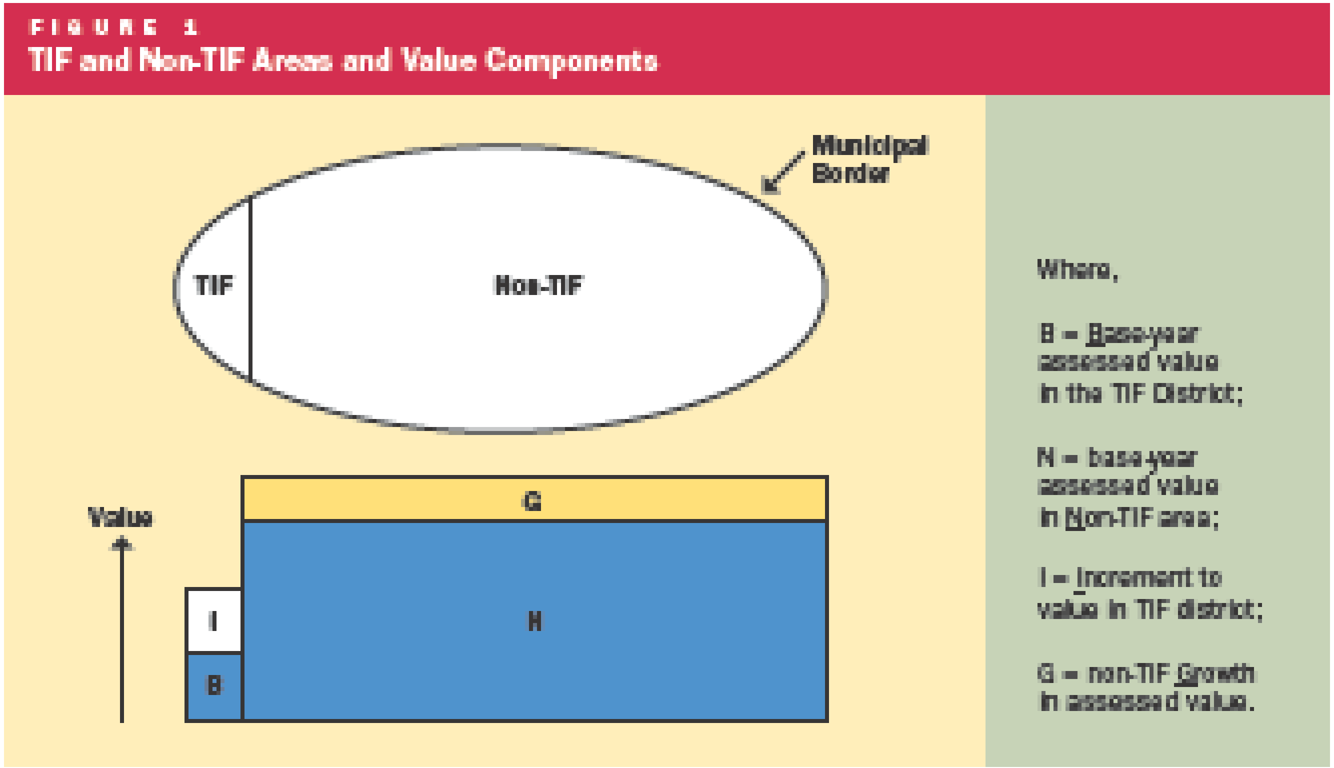
Why TIF might not work: 1

TIF might just capture growth that would have occurred anyway (unintended consequence)



Why TIF might not work: 2

TIF might just move growth from one place to another (unintended consequence?)



Source: https://www.lincolninst.edu/pubs/dl/1076_Jan2006-Final.pdf

Research on effect of TIF on Economic Activity

- Measures of economic activity include
  - Property values, Employment, Retail Sales, Median house values, Income, New building permits

- I reviewed 26 empirical studies
  - 20 studies use data from a Midwestern state
  - Many of the studies report multiple results. My judgement is that effect of TIF on economic activity is
    - primarily **positive** in 13 studies
    - primarily **negative** in 4 studies
    - primarily **neutral** in 6 studies
    - **mixed** 3 studies

Effect of TIF on school finance

- Controversial since TIF sometimes thought to be a strategic attempt to capture revenue. School districts are, biggest potential losers.
- Effect might be small because state aid may compensate for loss of tax base to TIF
- Only three studies
  - Two Illinois studies show little effect
  - More recent Iowa study shows a bigger effect especially on low wealth districts

Tax increment financing

The bottom line .

- TIF could help solve the credible commitment problem in economic development
- TIF contributes to interjurisdictional competition
- TIF potentially undermines gov’t transparency
- Mixed evidence about the degree to which TIF promotes growth
- Mixed evidence on impact of TIF on school finance

Alternatives to TIF

1. General fund spending for economic development
   A. Addresses need for public investment w/o loss of transparency
2. Entitlement economic development incentives
   A. Addresses the need for credible gov't commitment
3. Development assistance with effective clawback provisions
   A. Addresses potential private sector lack of commitment
4. Regional cooperative agreements about economic development
   A. Addresses potential wasteful interjurisdictional competition

Caution: Each may have unintended consequences.

Thank you