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Michigan's Overlapping Property Tax Limitations

Michigan's Overlapping Property Tax Limitations Create an Unsustainable Municipal Finance System

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October 2021

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Outline of Presentation

- Overview of Property Tax
  - Michigan's Property Tax Limitations
- Tax Limitation Analysis Model
  - 25 years of actual property tax data
  - Evaluate experience with tax limitations on local governments and taxpayers
- Key Observations from Model
- Policy Options to Make Municipal Finance System more Sustainable

Overview of Michigan Property Tax Limitations

Property Taxes in Michigan

- Critical role of property taxes in U.S.
  - 72% of all local tax collections
  - 31% of all public revenue
- Heavy burden on the property tax to fund all forms of local government
- Only tax where amount due not easily determined by taxpayer
- General dissatisfaction has led to adoption of property tax limitations

Overview of Property Tax Limitations

States generally limit property taxes paid by one of three different ways:

1. A *rate limit* puts an upper boundary on the rate that a jurisdiction can levy.
2. An *assessment limit* provides a ceiling to the amount of annual assessment increases; that is, it limits how much a taxpayer's property value can increase year-to-year.
3. A *levy limit* restricts how much tax revenue a jurisdiction can take in year-over-year.

Rate Limitations

- First attempt to limit property taxes
- 15, 18 and 50-mill limits adopted in 1932 and carried into 1963 Constitution
  - Only apply to certain local governments
  - Only apply to taxes supporting general operations
  - Lax enforcement

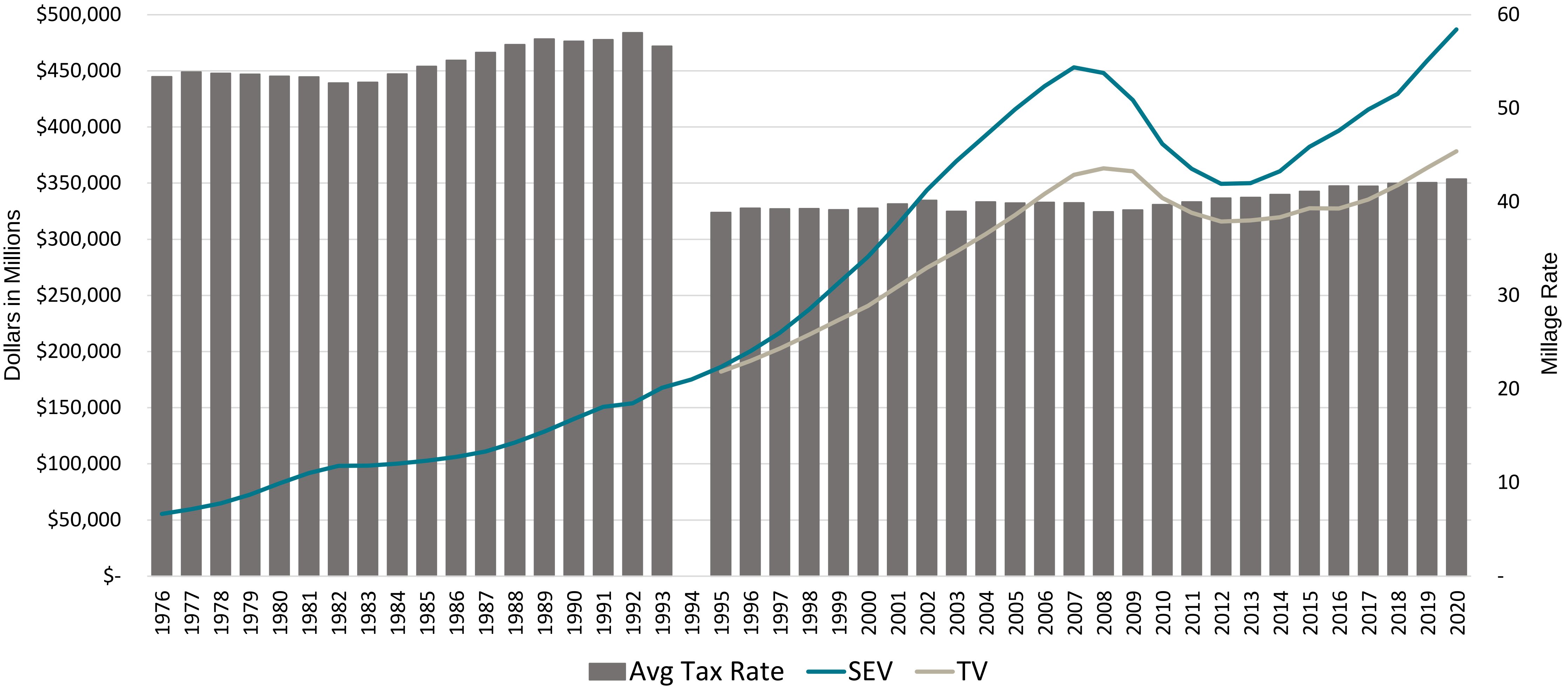
The Headlee Amendment – Levy Limit

- Adopted in 1978 to add 10 new sections to Michigan Constitution
- Article IX, Section 31, limits local property taxes in two ways:
  1. Requires voter approval to adopt new tax or increase rate of existing tax
  2. Limits total property tax revenue growth on jurisdiction-wide basis to the rate of inflation
- Created check on the growth of property tax collections overall
  - ➢Headlee rollback: requires tax rate adjustment if tax base increases by rate greater than inflation
  - ➢Headlee rollups allowed prior to 1993
  - ➢Now Headlee override vote required for tax rate to be rolled up
- Failed to protect individual taxpayers from excessive yearly increases

Proposal A of 1994 – Assessment Limit

- Market-value based system of assessing property (SEV) replaced with modified acquisition value system (TV)
  - TV increases in property limited to lesser of rate of inflation or 5%
  - Excludes value of new construction
  - When property sold, tax base reverts to SEV and annual changes capped with new owner
- Layered a new tax limitation onto the general property tax
- Instituted differential taxation of business and homestead residential property
- Impetus included
  - Relief from high property taxes
  - Changing the school funding system so that it was less reliant on local property taxes and provided more equal per-pupil funding across the state

Statewide SEV, TV, and Average Tax Rates, 1978 to 2020



Source: Michigan Department of Treasury, Ad Valorem Property Tax Reports

Example of Similar Properties in Oakland County with Very Different Tax Burden

Property "A"
Parcel capped since 1997
Fielding St., Ferndale
737 sq. ft., 1942 built
Sold 4/25/1996 for $28,000
TV $24,960 x mills (50.2377) =
Taxes of $1,254

Property "B"
Parcel uncapped for 2021
Northway St., Ferndale
744 sq. ft., 1942 built
Sold 3/13/2020 for $140,500
TV $71,290 x mills (50.2377) =
Taxes of $3,581

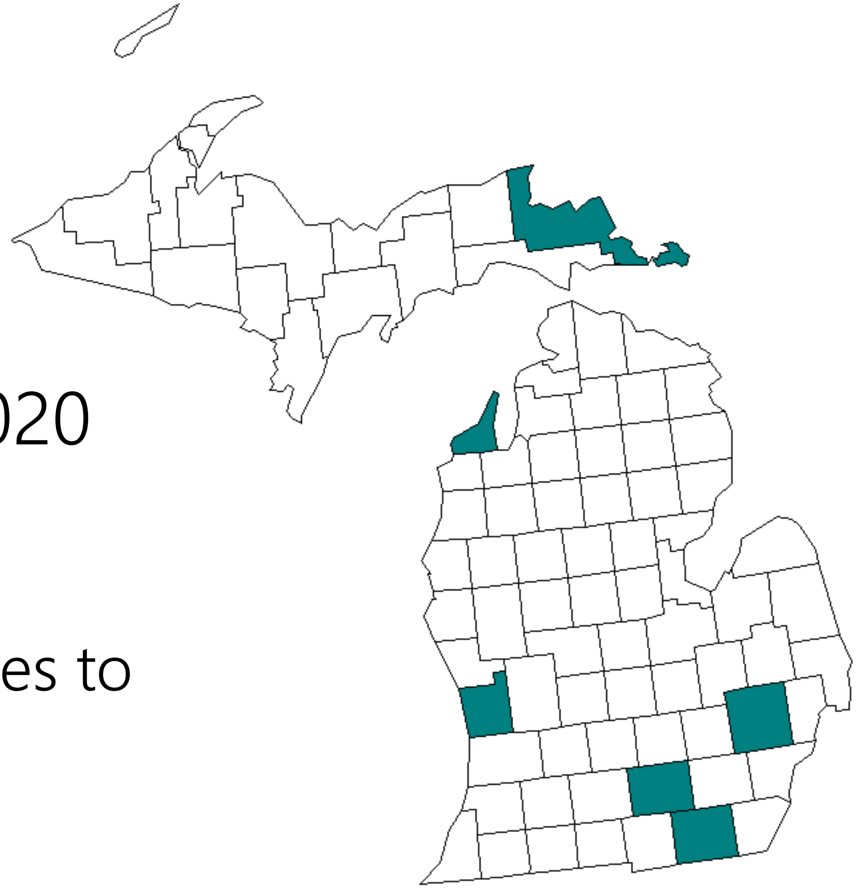
Interaction of Headlee Amendment and Proposal A

- Two property tax limitations work to control taxes in very different ways
  - Headlee Amendment limits <u>unit-wide growth of the amount of taxes collected on existing property</u> to the rate of inflation
  - Proposal A limits <u>growth in the taxable value of individual parcels of property</u> to the rate of inflation
- Key question
  - Is the combination of the two tax limitations together more restrictive to property tax revenue growth compared to the limits imposed by each limitation individually?

Tax Limitation Analysis Model

Study of Tax Limitations Methodology

- Analyzes property tax data from local governments in six counties
  - Chippewa, Jackson, Leelanau, Lenawee, Oakland, and Ottawa
- Uses actual property tax data from 1994 to 2020 to model how the tax limitations interacted retrospectively
  - Holds constant policy preferences, such as changes to tax rate
  - Applies 1993 authorized tax rate to SEV and TV
  - Calculates Headlee tax rate adjustments based on appreciation or depreciation of existing property values



Model of Study

- Three different scenarios
  1. **No tax limitations scenario** shows a property tax scenario based on market value (SEV) and the 1993 millage rate with no limitations
  2. **Headlee Amendment scenario** shows how the Headlee Amendment limitations alone impact property taxes based on the 1993 millage rate and tax rate adjustments as calculated based on SEV
  3. **Headlee Amendment and Proposal A scenario** reflects current law (using the 1993 millage rate) with levy and assessment limits that restrain property tax growth with tax rate adjustments as calculated based on TV
- Goals:
  - Better understand interaction of the two tax limitations and their individual and combined effects on property tax bases and tax rates
  - Consider how the property tax limitations have affected both local governments that are dependent on the tax revenues and the property taxpayers that are footing the bill
- Hypothetical scenarios – do not reflect actual tax revenue collections

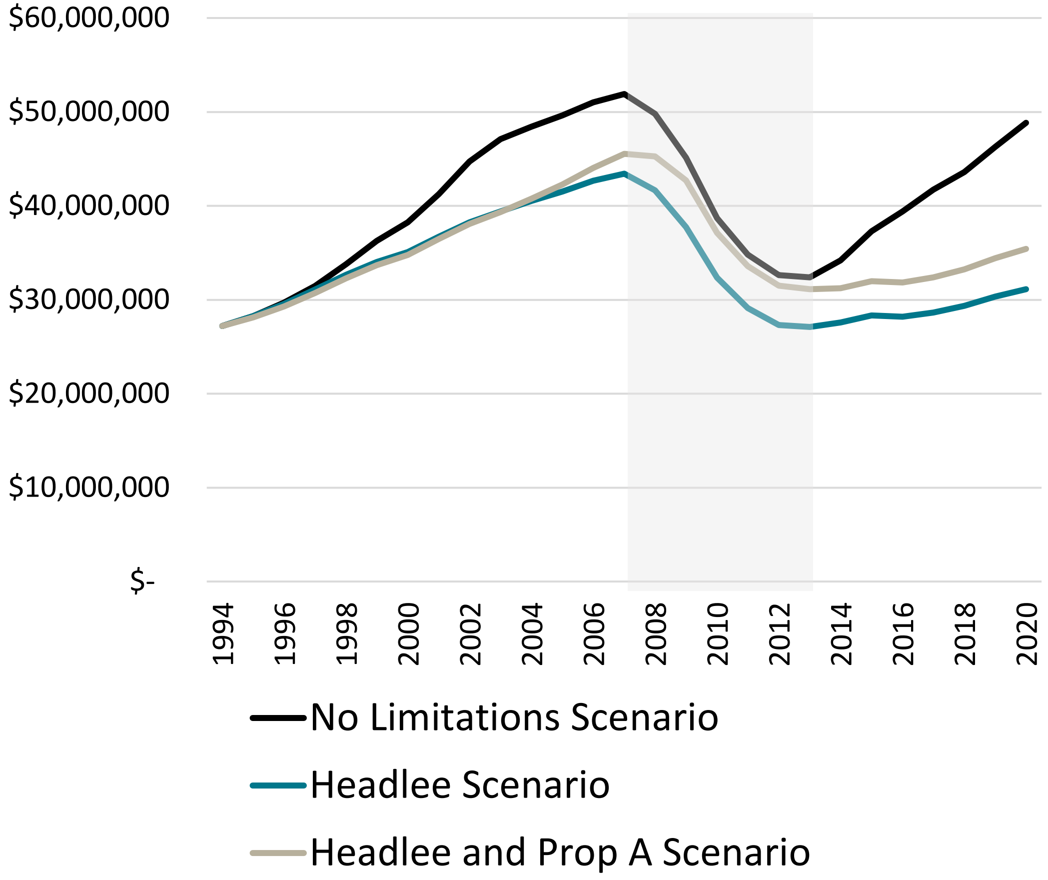
Categories of Local Governments

1. Six **counties** that vary drastically in urban/rural makeup, size and demographics
   - Counties more stable than cities/townships with less variability in property value changes over time
2. Eight **urban communities** ranging in size from less than 5,000 to over 60,000 residents
   - Categorized as growing or declining
3. Eight **suburban communities** ranging from large cities to small townships
   - Based on proximity to major city
4. Six **exurb communities** with an economic or commuting connection to central city
   - Low housing density and high rates of development and population growth
5. Thirteen **rural communities** including one small city and 12 townships

The Great Recession

- 2007 to 2009 recession with ties to financial crisis surrounding real estate markets
  - Major economic downturn that impacted most local governments' finances
  - Led to a precipitous decline in property values
  - Unusual during a recession
- Our analysis looks at how tax limitations affected tax revenues in three periods:
  1. From the adoption of Proposal A in 1994 until the onset of the Great Recession in 2007
  2. As a result of the Great Recession
  3. In the period since property values started rising after the Great Recession (around 2012)

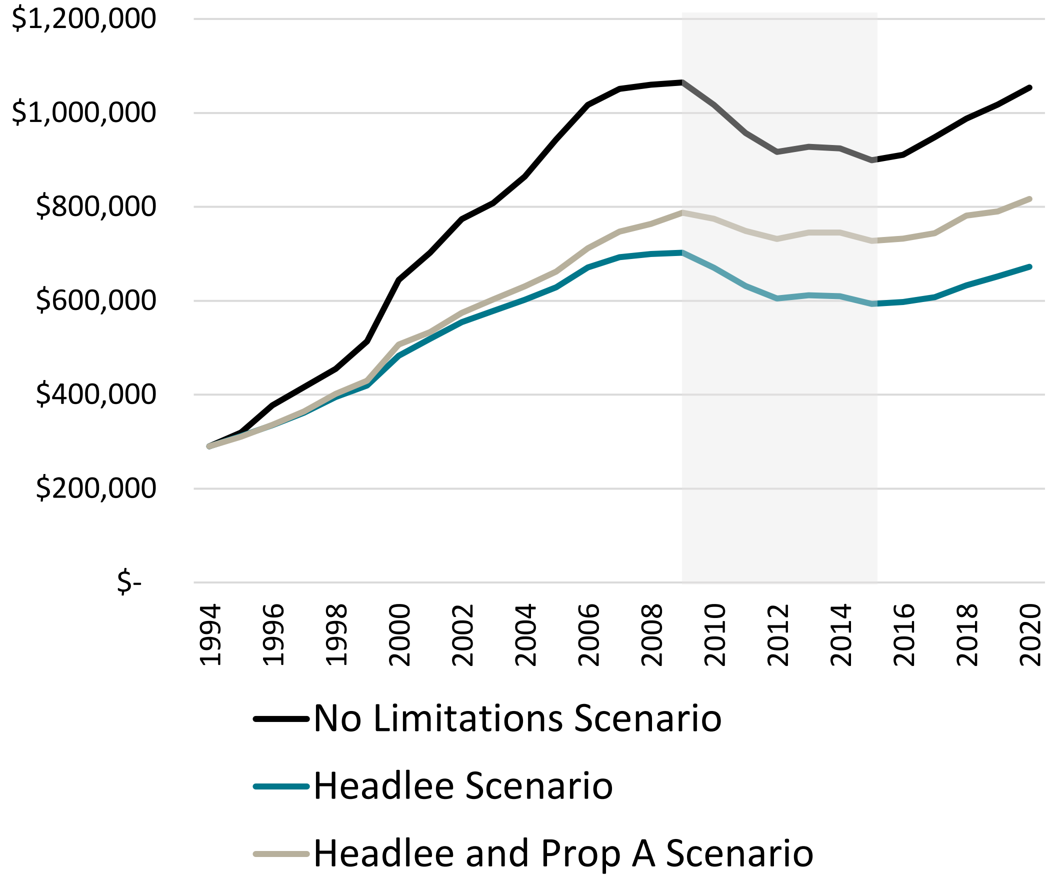
Property Tax Scenarios in Farmington Hills (Oakland County), 1994 to 2020



Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

- Suburban community in SE Michigan
- Grew in population over time period
- Two tax limitation lines same until Great Recession
  - ➢Revenues peaked in 2007/08 and reached lowest point in 2012
  - ➢Revenue growth slower post-recession with limitations
- Revenues will not return to pre-recession levels for years with limitations

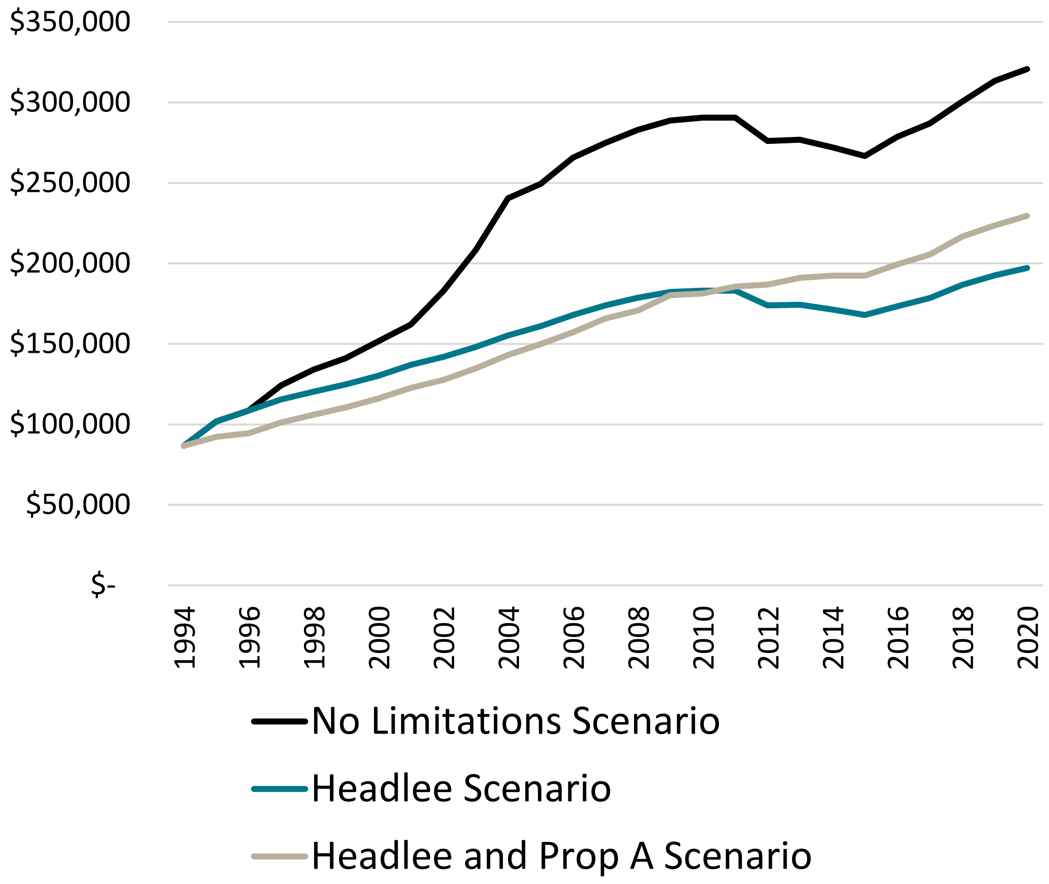
Property Tax Scenarios in Cambridge Township (Lenawee County), 1994 to 2020



Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

- Exurb community
- All exurbs grew in population and have generally high median incomes
- Have enjoyed new development, which allows for tax revenue growth
- Revenues peaked in 2007/08 and reached low point in 2012
- Post-recession revenue growth slow, but faster than for suburbs

Property Tax Scenarios in Pickford Township (Chippewa County), 1994 to 2020



Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

- Rural community
- Revenues higher with just Headlee prior to Great Recession
- Revenues higher with both limitations after recession
- Revenues never declined in scenario with both limitations
- Rural property does not change hands as often leading to less “pop ups” and tax rate rollbacks

Key Observations from Models

What is Good Tax Policy?

For Taxpayers

- Limits growth in tax burden
- Predictability
- Easily understandable process to determine property value and taxes owed
- Equity with other taxpayers

For Local Governments

- Adequate revenues that can grow with local economy
- Stable and predictable revenues
- Ability to minimize downside risk

Key to good tax policy is that it meets needs of both taxpayers and government

General Observations

- Tax limitation scenarios yield less revenue than no limitations scenario in all cases
- In almost all cases, the scenario with the combination of the Headlee Amendment and Proposal A tax limitations yields more revenue in recent years than the scenario with just the Headlee Amendment
  - Lessened tax rate rollbacks
  - Reservoir of taxable value
  - Mitigating effect on the Headlee Amendment limitation
- Annual growth rate post-recession slower than it was pre-recession
  - Relationship between appreciation of property values and tax revenues is diminishing
  - Most pronounced for rural communities

Great Recession was a Turning Point

- Without the Great Recession and its property value declines, numbers might look very different
  - Led to Headlee Amendment limitations being particularly severe
  - End of tax rate rollups enacted in 1993 had the strongest influence on limiting taxes
- Unique situation – only period in recent history that saw severe property value declines
- SEMCOG's study on property tax limitations found the effects of the Headlee Amendment were accelerated a hundred-fold during recession
- Proposal A served to mitigate some of impact of recession
- Should not base tax policy on rare events

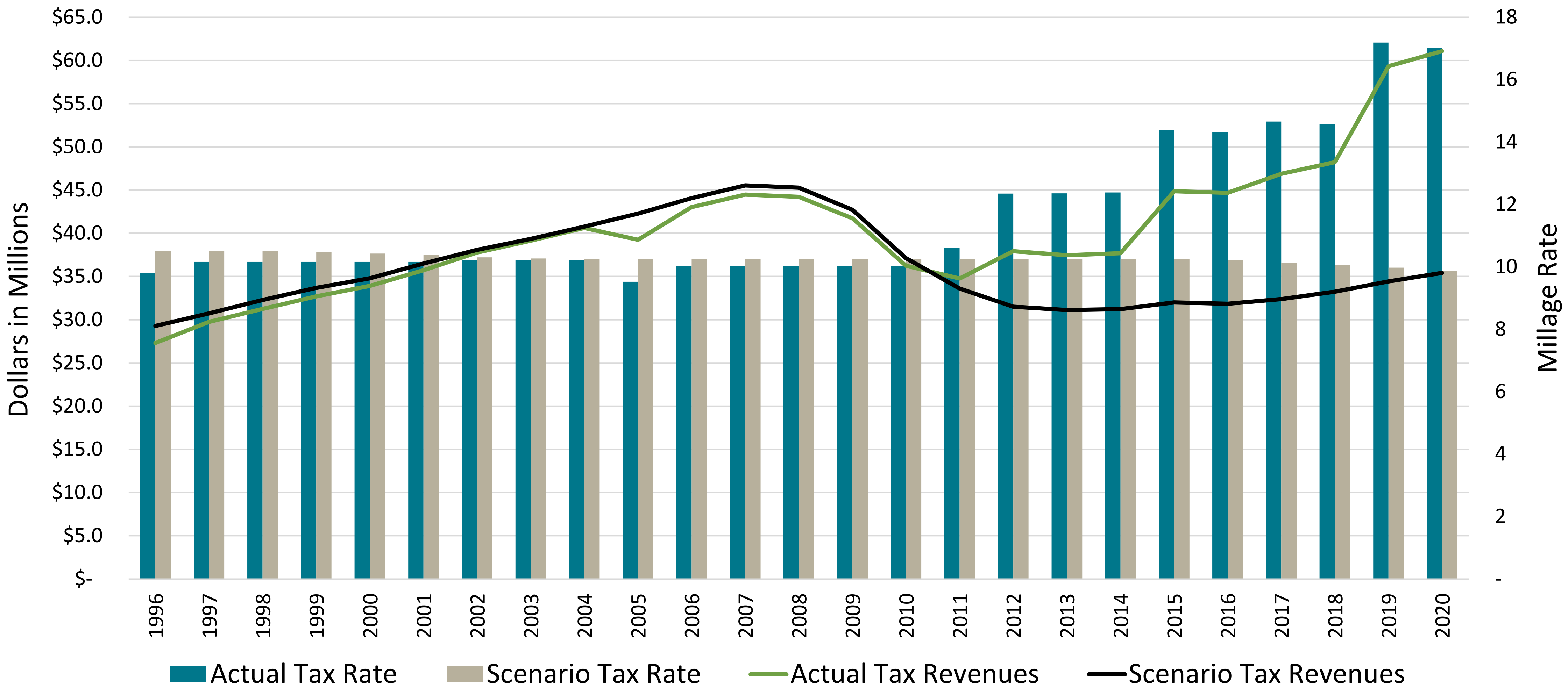
Growth is Defined as New Development

- Limitations restrict local governments from increasing revenues beyond inflation for any reason except new development
- Does not reward revitalization or redevelopment of communities
- Encourages urban sprawl
- Unsustainable – land is finite

Tax Base Limitations Create Pressure on Tax Rates

- Anecdotal evidence suggest that some local governments have responded to restrained tax base by requesting voter approval of higher tax rates
- Over 80% of local units in Oakland County increased tax rates since 2007
- May 2021 election – 79% of local tax proposals passed
- Farmington Hills went from 2 dedicated millages (9.8 mills total) in 1996 to 7 in 2020 (17 mills total)
- Constraining tax base puts pressure on tax rate

Actual Tax Rates and Revenues versus Scenario Tax Rates and Revenues in Farmington Hills, 1996 to 2020



Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

Property Tax Limitations and Policy Options

Michigan Tax Limitations: Unique and Restrictive

Four policy options:

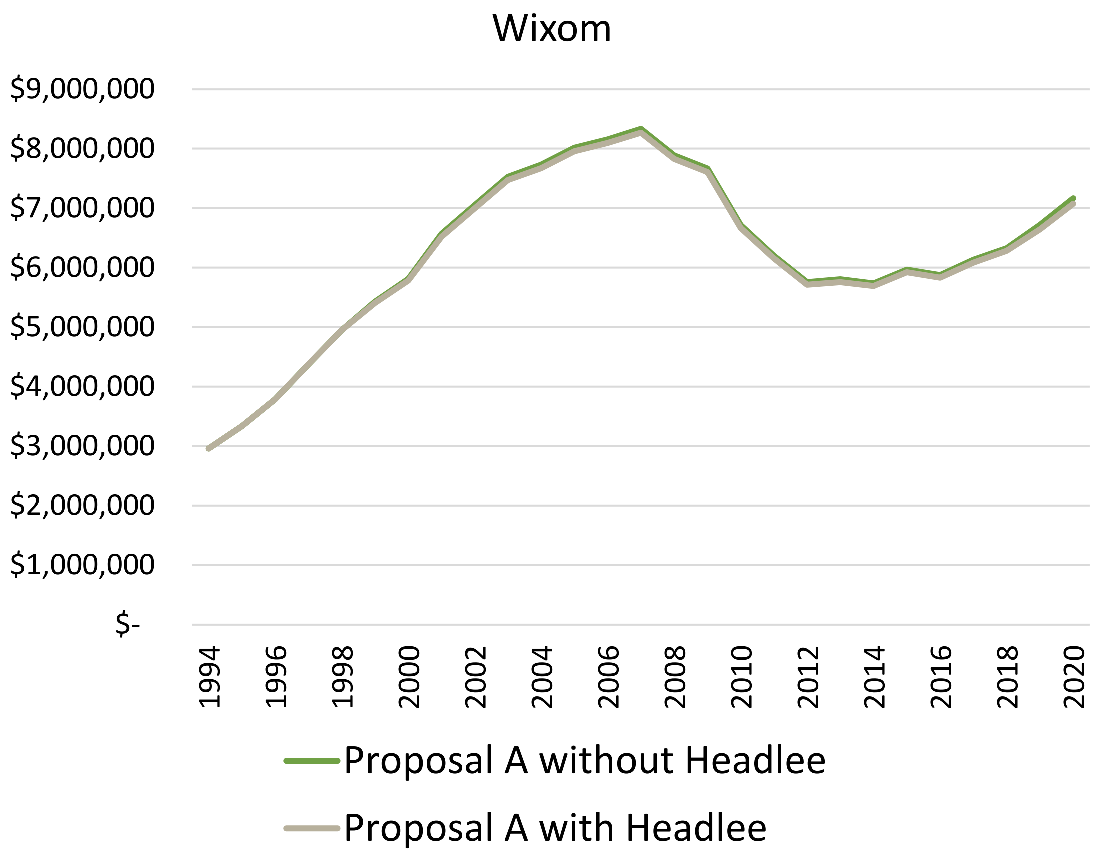
1. Diversify Local Revenue Sources and Regionalize Service Provision
2. Eliminate Headlee Amendment Limitation
3. Reinstate Headlee Rollups
4. Change Method of Measuring Taxpayers' Ability to Support Government

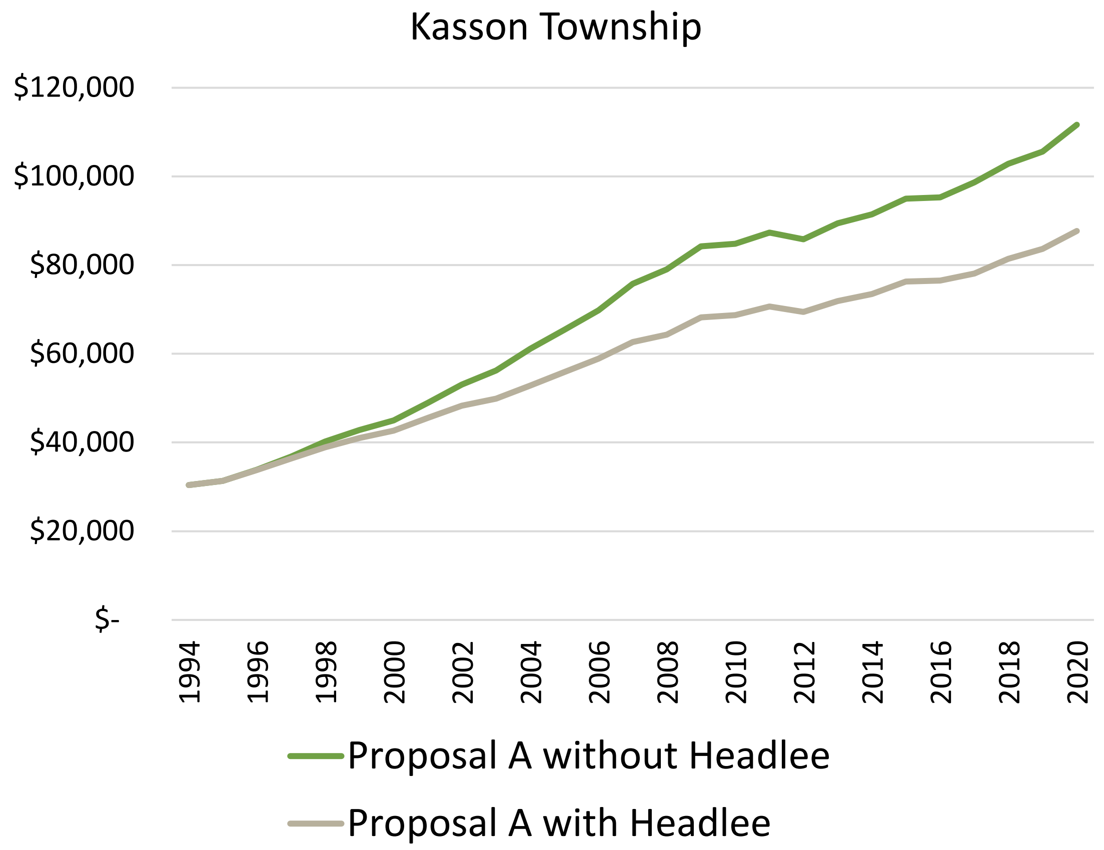
Diversify Local Revenue Sources and Regionalize Service Provision

- Michigan local governments overly dependent on property tax
- Ideal tax structure:
  - Components that respond to economic growth
  - Components that are stable through economic fluctuations
  - Does not create administrative burdens
  - Does not disrupt economic choices
- Many other states afford their local governments diverse tax options
- Problem: the smaller the taxing jurisdiction, the greater the economic competition and administrative costs
  - Reform state revenue sharing
  - Provide services and levy taxes at regional level
- May provide foundation for more stable finance system

Eliminate Headlee Amendment Limitation

Proposal A Scenario Data with and without Headlee Amendment, 1994 to 2020

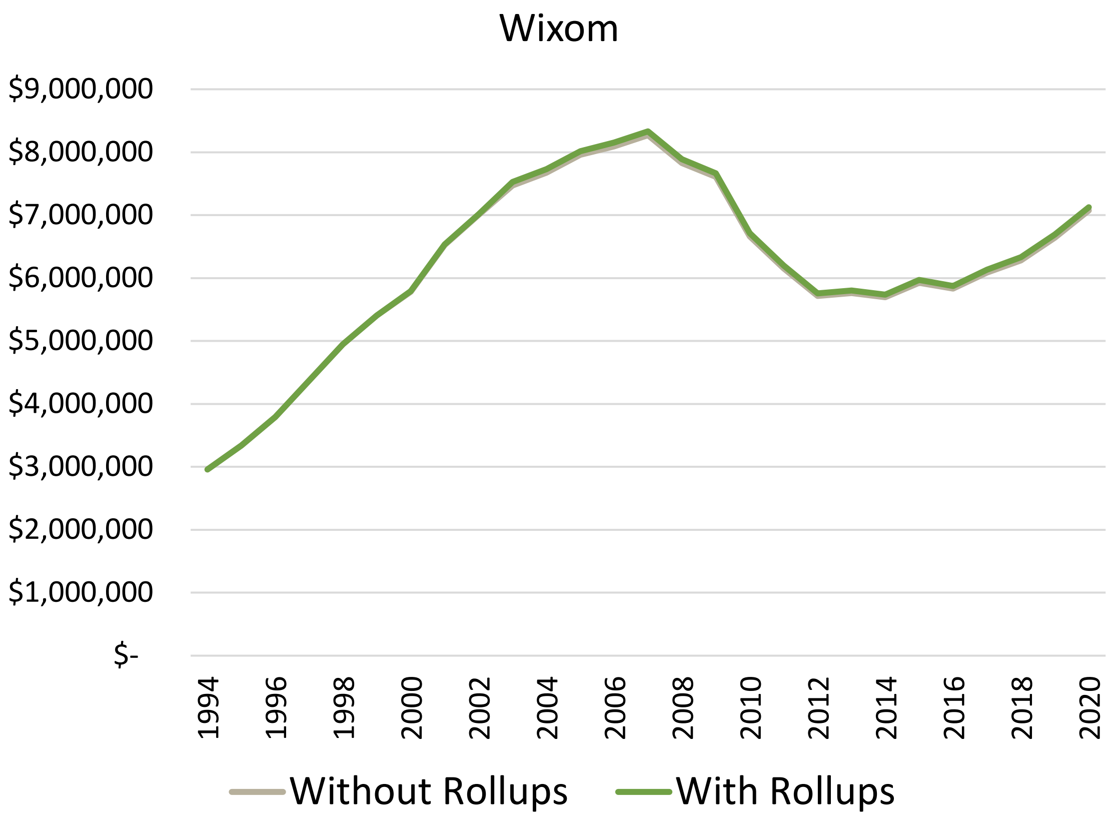


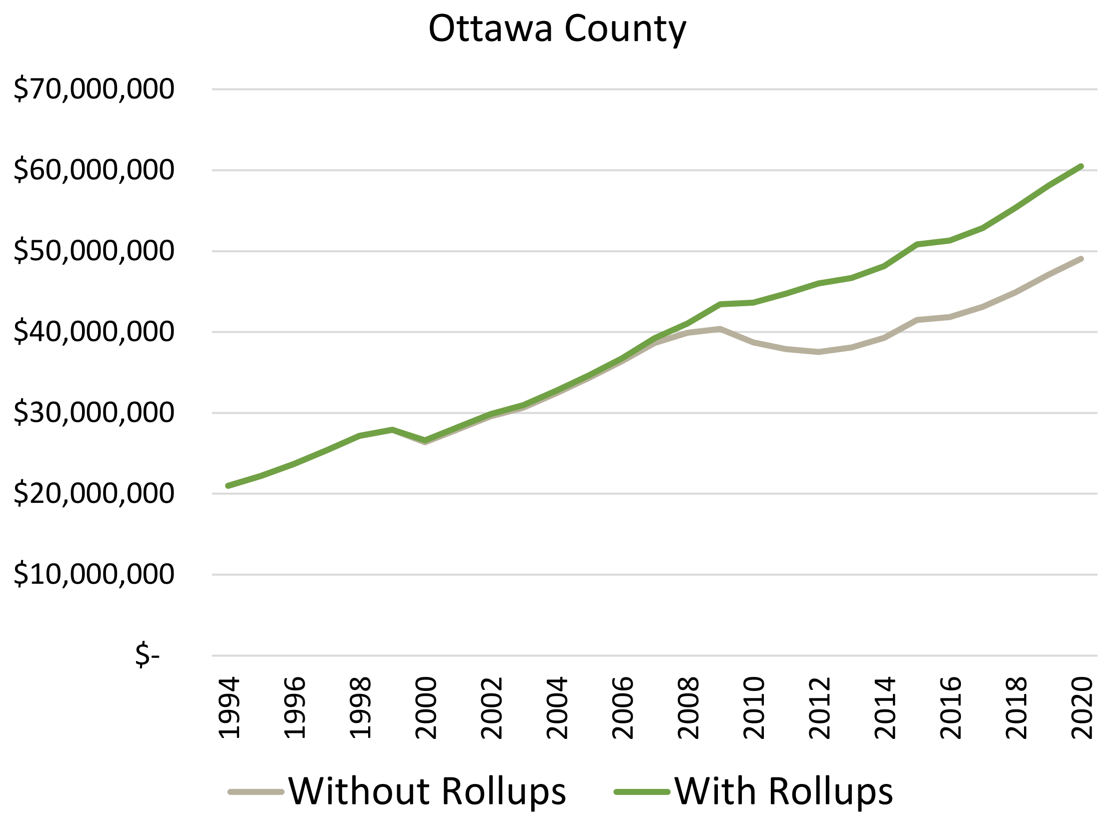


Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

Reinstate Headlee Rollups

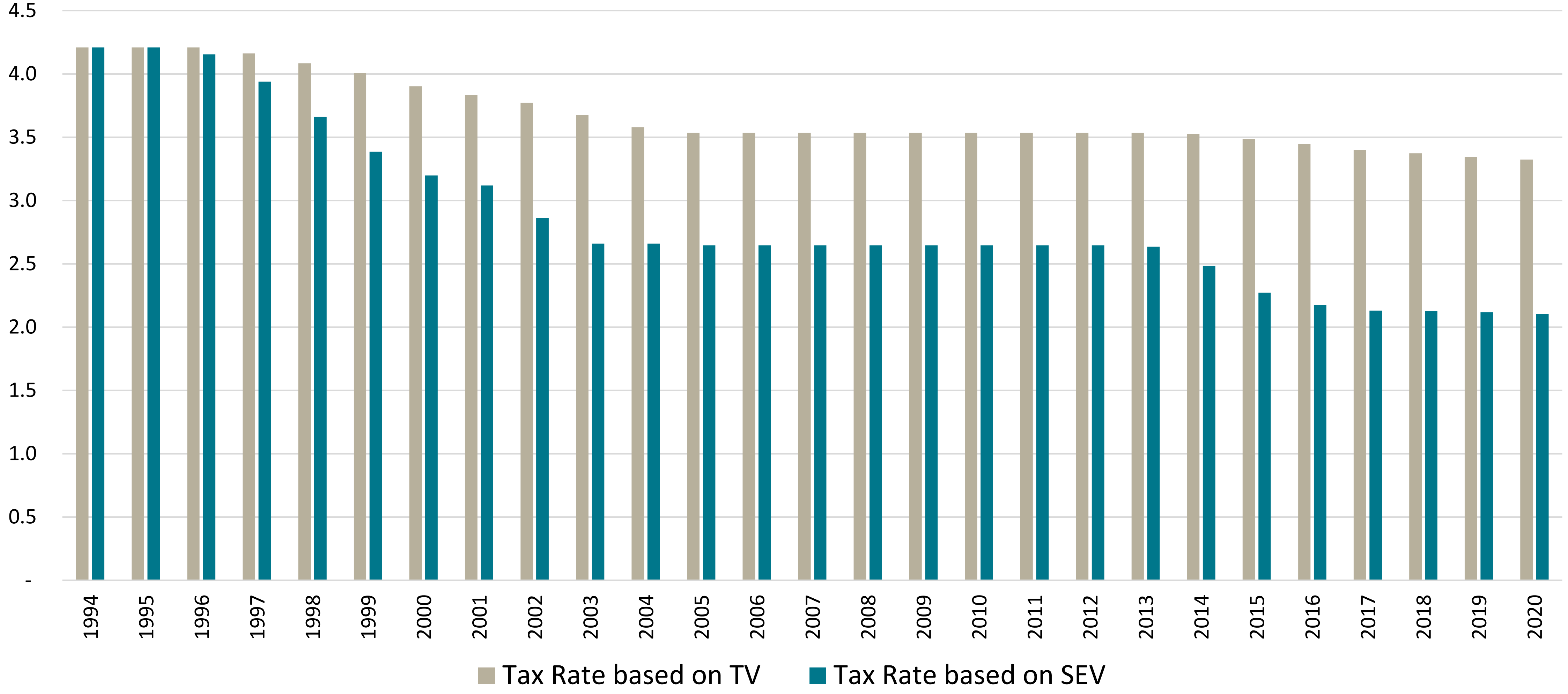
Headlee Amendment and Proposal A Scenario Revenue Data with and without Millage Rate Rollups, 1994 to 2020





Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

Hypothetical Tax Rate in Oakland Township based on 1993 Millage Rate and MRF Calculations, 1994 to 2020

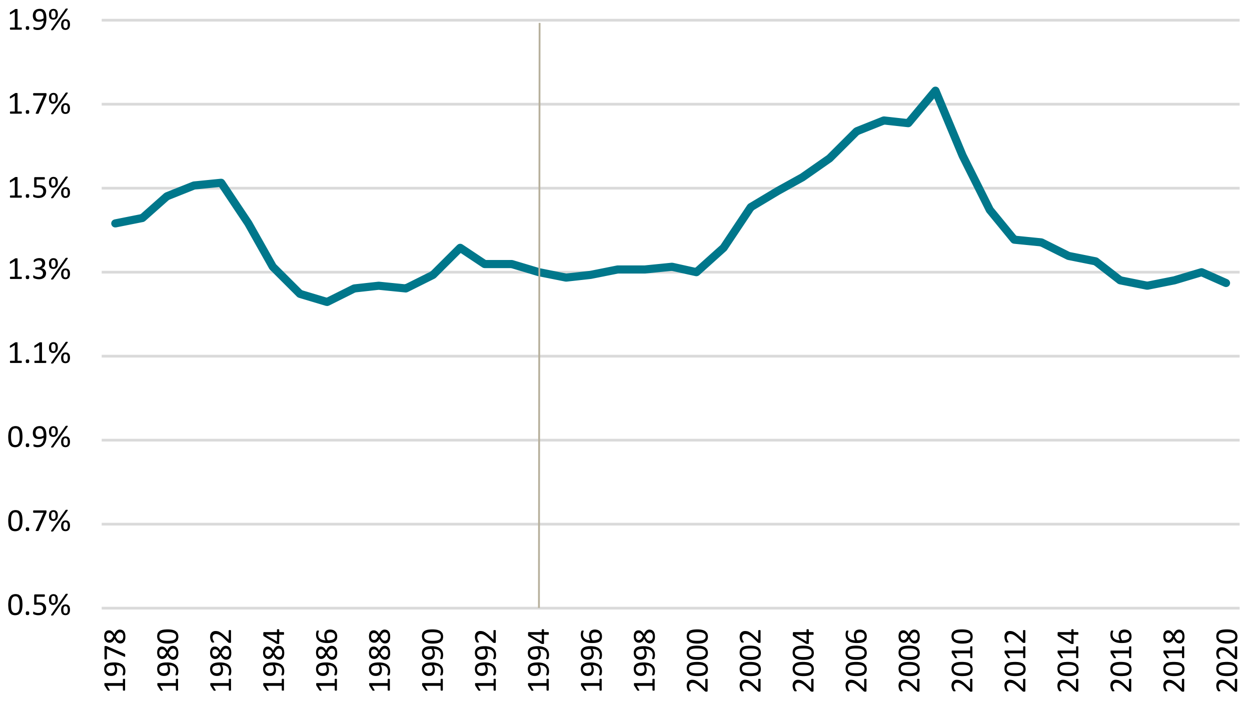


Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

Change Method of Measuring Taxpayers' Ability to Support Local Government

- Growth of local government property tax revenues pegged to inflation as measured by CPI
  - CPI has grown 305% since 1980
  - Cost of goods/services purchased by local governments grown 376%
  - Michigan personal income grown 458%
- Could tie levy and assessment limits to growth in personal income or Bureau of Economic Analysis' implicit price deflator
- Important to consider from taxpayer and government perspective
- CPI limit is written into Constitution

Local Government Property Tax Levy as a Percent of Statewide Personal Income

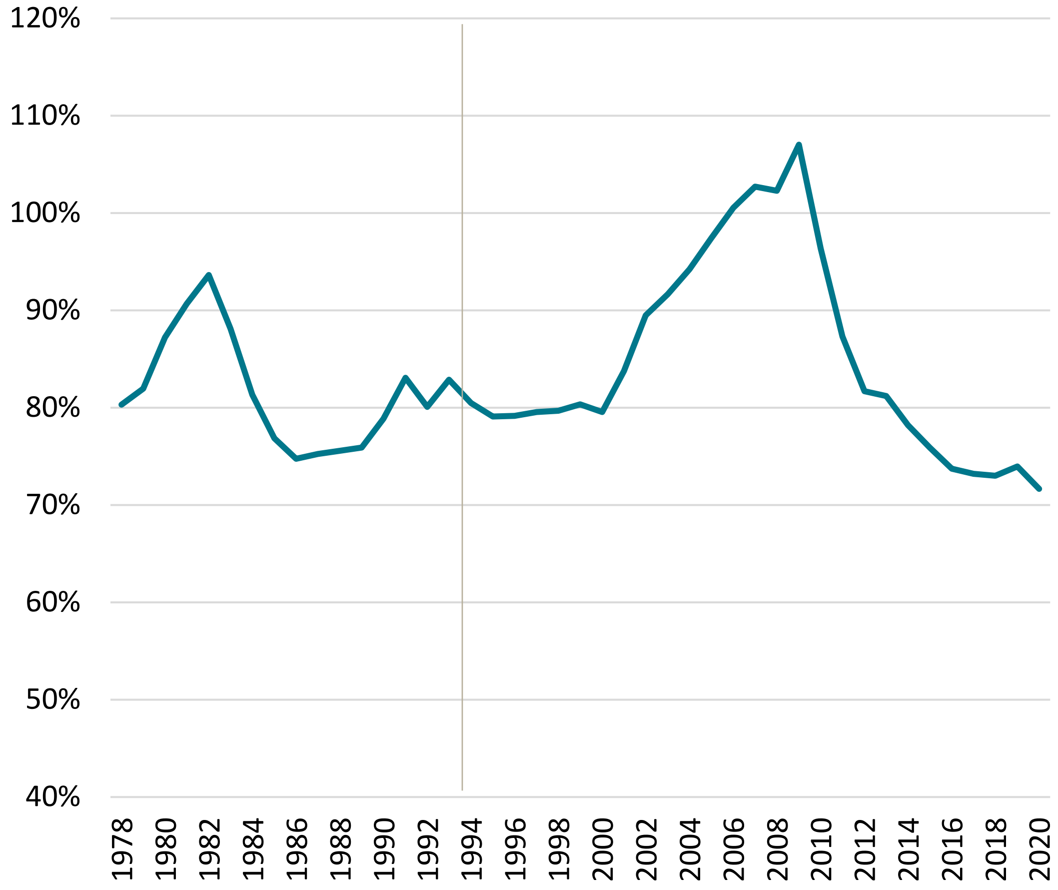


Source: U.S. Bureau of Economic Analysis, Regional Data, GDP and Personal Income; Michigan Department of Treasury

Conclusion

- Current property tax limitations:
  - ➢ Minimize tax burden
  - ➢ Increase predictability and stability
  - ➢ Minimize the downside risk of property value declines
- Have reduced tax revenue growth and set many local governments on pace for modest rates of growth
- Local governments cannot grow tax base without new development
- Local governments increasing tax rates
- Not sustainable

Statewide TV as a Percent of Statewide Personal Income



Source: U.S. Bureau of Economic Analysis, Regional Data, GDP and Personal Income; Michigan Department of Treasury

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