GO #1
May 16, 2011
Action

MEMORANDUM

May 12, 2011

TO: Government Operations and Fiscal Policy Committee

CHS

FROM: Charles H. Sherer, Legislative Analyst

SUBJECT: Property tax options for FY12: amount of property tax; property tax rates; and the income tax offset credit, 2nd meeting

Additional options the Committee requested on May 3 are presented on page 3.

The purpose of this meeting is for the Committee to decide on a recommendation regarding property taxes to make to the Council on May 18. The Committee and Council must make **two** decisions. The first decision is how much property tax revenue to raise to fund the FY12 budget. The Executive recommends property tax at the Charter limit, which permits increases for inflation and for new construction (see below for more explanation). The six year Fiscal Plan the Council approved on June 29, 2010 also assumed that property tax would be at the Charter limit in each of the six years. After you make the decision on the amount of property tax, you must then make the second decision, which is to select a combination of property tax rate and the income tax offset credit (ITOC) that will result in the amount of property tax revenue you want.

As shown in the table on page 5, property tax at the Executive's Charter limit in FY12 is (only) 0.8% more than the FY11 budget, which was also at the Charter limit. The average increase from the FY11 budget would be 0.8%. However, as with any average, some bills will increase more than the average and some will increase less and may even decrease. For example, one tax bill might increase 20.0% and another might decrease 18.4%, for an average of +0.8%.

Brief comparison of options to reach the Charter limit In an attempt to facilitate the discussion, here are the main points of comparison of the two "extreme" options as described below. More discussion and analysis follows this section, including the Committee's three additional options on page 3.

1. Two Charter limit options are:
    a. Keep the rate the same in FY12 as in FY11, which was $0.904 (or 90.4¢) and reduce the credit $285, from $692 in FY11 to $407 in FY12 (same rate/decrease credit, Option 1, Mr. Andrews' option).
    b. Increase the rate 4.2¢ from 90.4¢ in FY11 to 94.6¢ in FY12 and keep the credit the same in FY12 as in FY11, which was $692 (increase rate/same credit, Option 2, the Executive's option).

2. Option 1 (same rate/decrease credit) results in **lower** tax bills than option 2 (increase rate/same credit) for residential properties with taxable values greater than $678,571 and for all non-residential properties. Approximately 16% of residential properties have taxable values greater than $678,571.

3. Option 1 (same rate/decrease credit) would or might be more beneficial **for apartment renters,** because the property tax bills their landlords pay would be less than with option 2 (increase rate/same credit), so there would be less expense to pass on to the renters. The State assessor's office told Council staff that the range of taxable values for individual apartments is $45,000 to $225,000, with most between $80,000 and $160,000. For a taxable value of $100,000, the Executive's proposed 4.2¢ increase in the rate for option 2 would increase the property tax bill per apartment by $42 per year.

4. Option 2 (increase rate/same credit) results in **lower** tax bills than option 1 (same rate/decrease credit) for residential properties with taxable values less than $678,571. Approximately 84% of residential properties have taxable values less than $678,571.

5. Residential properties pay a lower % of total property taxes with option 2 (increase rate/same credit) than with option 1 (same rate/decrease credit): 61.9% versus 63.6%. Non-residential properties pay a lower % of total property taxes with option 1 than with option 2: 36.4% versus 38.1%.

6. The latest calculations on May 10, 2011 from Finance show that option 2 (increase rate/same credit) results in $3.1 million more total property tax at the Charter limit than option 1 (same rate/decrease credit). See rows 5 and 6 in Table 1 below. The short explanation of why this is true is that as the rate increases, the tax on new construction and the tax on personal property both increase, and the tax on existing real property stays the same for all options as limited by the Charter (FY11 tax + inflation). Since two components of property tax increase and one component stays the same, the total must increase as the rate increases.

Additional information and analysis follows, including the three additional options the Committee requested on May 3.

Income tax offset credit (ITOC) The State authorizes counties to approve an ITOC for eligible properties (owner occupied as the principal residence) to "offset" the amount of county income tax resulting from an income tax rate greater than 2.6%. Montgomery County's income tax rate is 3.2%, the maximum rate the State permits. For FY11, the Council approved an ITOC in the amount of $692 per eligible residence ($168.6 million in total for 243,600 estimated eligible properties). The maximum amount of ITOC in FY12 is $948.

The amount of property tax revenue is calculated by multiplying the taxable value of all taxable property by the tax rate, and then subtracting the total amount of the ITOC. Finance estimates that taxable value of all real property in FY12 will be 2.75% less than in FY11. Therefore, if the Council wants to raise more property tax revenue in FY12 than in FY11, the Council will have to increase the property tax rate and/or decrease the amount of ITOC.

Committee meeting on May 3 Council staff presented two options for achieving the Charter limit in FY12. Option 1 keeps the rate the same as in FY11 and reduces the ITOC. Option 2 increases the rate and also increases the credit. The Committee discussed these two Charter limit options and asked for three additional Charter limit options with tax rates in between the two options: increase the tax rate 1¢, 2¢, and 3¢ from the FY11 rate of 90.4¢. Finance then calculated the amount of ITOC for each rate that would result in the Charter limit. All five options are shown in the table below, and the three new options are labeled A, B, and C. All options are at the charter limit.

The latest calculations on May 10, 2011 from Finance show that higher rates result in more total property tax at the Charter limit (see rows 5 and 6). The short explanation of why this is true is that as the rate increases, the tax on new construction and the tax on personal property both increase, and the tax on existing real property stays the same for all options as limited by the Charter (FY11 tax + inflation). Since two components of property tax increase and one component stays the same, the total must increase as the rate increases. All options are progressive, with option 2 being the most progressive and option 1 being the least progressive.

TABLE 1	FY11	Option 1	Option A	Option B	Option C	CE Option 2
1. Property tax rate	0.904	0.904	0.914	0.924	0.934	0.946
2. ITOC	(692)	(407)	(476)	(543)	(610)	(692)
3. Change rate from FY11	0	0.000	0.010	0.020	0.030	0.042
4. Change credit from FY11	0	285	216	149	82	0
5. Total tax in $millions	1,430.0	1,458.9	1,459.5	1,460.4	1,461.3	1,462.1
6. Change tax from CE	$millions	(3.1)	(2.6)	(1.7)	(0.7)	0

As can be seen, option 1 has the lowest tax rate and also the lowest ITOC. Option 2 has the highest tax rate and the highest ITOC. Option 1 keeps the rate the same and reduces the ITOC. Option 2 increases the rate and also increases the credit. Option 1 results in the lowest total tax and option 2 results in the highest total tax. Options A – C are in between options 1 and option 2.

<u>The five options are compared on ©6.</u>

<u>The Executive recommends option 2. In a memorandum distributed to the Council dated May 3, 2011, Mr. Andrews recommends option 1 (©7).</u>

<u>Historical data</u> A table of the tax rates and the ITOC each year since FY78 is on ©3, followed by a graph of the rates. The rate decreased from FY78 through FY93 (FY92 was the first year of the spending affordability process), stayed at about the same rate through FY05, then decreased slightly in FY06 and again in FY07, and has stayed about the same since FY07.

A table of property tax data is on ©5. In the 20 years in which the Charter limit on property taxes has been in effect, FY92 through FY11, the Council exceeded the limit in four years: FY03-05 and FY09.

<u>Basis for your decision</u> In making your decision, consider the following characteristics of each option. The three new options will have characteristics in between options 1 and 2.

A. With respect to individual property tax bills:

<u>Option 1</u> results in lower tax bills than option 2 for residential properties with taxable values greater than $678,571 and for all non-residential properties. Option 1 results in higher tax bills than option 2 for residential properties with taxable values less than $678,571. (In FY12, the median taxable value will be about $390,000, and the average taxable value will be about $446,000.)

Option 1 would or might be more beneficial **for apartment renters**, because the property tax bills their landlords pay would be less than with option 2, so there would be less expense to pass on to the renters. The State assessor's office told Council staff that the range of taxable values for individual apartments is $45,000 to $225,000, with most between $80,000 and $160,000. For a taxable value of $100,000, the Executive's proposed 4.2¢ increase in the rate for option 2 would increase the property tax bill per apartment by $42 per year.

<u>Option 2</u> results in lower tax bills than option 1 for residential properties with taxable values less than $678,571. Option 2 results in higher tax bills than option 1 for residential properties with taxable values greater than $678,571 and for all non-residential properties.

The above descriptions are summarized in the table below. TV = taxable value.

Which option results in lower/higher bill?

Property		
Residential w TV < $678,571	Option 1 is higher	Option 2 is lower
Residential w TV > $678,571 and all non-residential property	Option 1 is lower	Option 2 is higher

B. With respect to the share of property taxes paid by residential versus non-residential properties:

Residential properties pay a lower % of total property taxes with option 2 than with option 1 (61.9% versus 63.6%). Non-residential properties pay a lower % of total property taxes with option 1 than with option 2 (36.4% versus 38.1%).

C. Would the increase in the tax rate the Executive recommends be a "permanent" increase? Mr. Andrews raises this point in his memorandum. The Council does, of course, set the tax rate each year and can reduce the rate. However, if the Council wanted to reduce the rate in some future year, but raise the same amount of revenue, the Council would also have to reduce the ITOC. What is the result or impact of reducing the ITOC?

Reducing the ITOC results in a large % increase in property tax bills for properties with low taxable values, but only a small % increase in property tax bills for properties with high taxable values.

Suppose the tax bill before the ITOC was $1,000 for a property with a low taxable value and $10,000 for a property with a high taxable value. An ITOC of $700 would reduce the low bill by 70% to $300 (a huge impact); would reduce the high bill by only 7% to $9,300; and would have no impact on a property not eligible for this credit.

As just shown, this credit results in a large % decrease in tax bills of low valued properties. However, if this credit is reduced (or eliminated), then there will be a large % increase in the tax bill from one year to the next. Suppose the Council eliminated the credit the next year. For the low value example above, the tax bill would increase $700, from $300 to $1,000, a % increase of 233%! The high bill would also increase $700, from $9,300 to $10,000, but in marked contrast, the % increase would be only 7.5%. The large (233%) increase in the tax bill for the low value property results from a low tax bill in the prior year, not from a high tax bill in the following year.

The above example shows why reducing the tax rate in some future year, and therefore also reducing the ITOC, would, or might be difficult. Reducing the ITOC in FY12 (options 1, A, B, and C) would also have this impact.

D. Total property tax revenue. As explained above, as the rate increases, the amount of property tax revenue increases, as shown in rows 5 and 6 in table 1 above.

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Additional information, background, and explanation follow.

Charter limit For FY12, the Executive recommends property tax at the Charter limit. This is also the amount shown in the six year Fiscal Plan the Council approved on June 29, 2010 in Resolution 16-1416. The so-called "Charter limit" permits two increases:

1. an increase on **existing** real property from FY11 **actual** (not budgeted) property tax revenues for inflation in CY2010 (+1.7%);

2. whatever increase results from new construction and personal property, at whatever property tax rates the Council sets for FY12.

If FY12 property tax exceeds the Charter limit as just defined, then nine Councilmembers must approve the tax rates.

Finance estimates that the increase in property tax from new construction will add 0.6%, so the total increase in property tax at the Charter limit would be +2.3% more than the FY11 actual. Since FY11 actual property tax revenue is $20.1 million less (1.4% less) than the budgeted amount, FY12 property tax at the Charter limit is only 0.8% more than the FY11 budget. The table below may clarify these relationships. $ amounts are in millions. Additional data are on ©1.

FY11 budget	$1,450.1
FY11 actual	$1,430.0
FY12 CE (increase rate 4.2¢, no change ITOC)	$1,462.2
% change from FY11 budget to FY12	0.8%
% change from FY11 actual to FY12	2.3%

Distribution of the property tax between residential and non-residential Based on data from the Department of Finance, for option 1, residential property tax payers pay 63.6% of property taxes (real plus personal), and non-residential property tax payers pay the remaining 36.4%. For option 2, residential property tax payers pay 61.9% of property taxes (real plus personal), and non-residential property tax payers pay the remaining 38.1%.

Information item Finance estimates that the average taxable value in FY12 will be $446,000. Council staff estimates that the median taxable value in FY12 will be $390,000.

	A	C	D	G	H	I	J
1	PROPERTY TAX						
2	ITOC = Income Tax Offset Credit						
3							CE
4		FY11 actual	FY12 option 1	Option A	Option B	Option C	FY12 option 2
5	Rate per $100 of taxable value	0.904	0.904	0.914	0.924	0.934	0.946
6	Change from FY11 budget		0.000	+0.010	+0.020	+0.030	+0.042
7	ITOC per elegible household	(692)	(407)	(476)	(543)	(610)	(692)
8	Change from FY11 budget		285	216	149	82	0
9	Tax after ITOC	1,429,976,896	1,458,945,886	1,459,461,122	1,460,397,940	1,461,334,758	1,462,068,860
10	Change tax from CE (option 2)		(3,122,974)	(2,607,738)	(1,670,920)	(734,102)	0
11							
12	% change from FY11 budget		0.60685%	0.64238%	0.70698%	0.77158%	0.82221%
13	% change from FY11 actual		2.02584%	2.06187%	2.12738%	2.19289%	2.24423%
14							
15	SHARE OF TOTAL REVENUES						
16	Residential		63.6%				61.9%
17	Non residential		36.4%				38.1%

	A	B	C	D	E
1	TAXABLE VALUE OF OWNER OCCUPIED PRINCIPAL RESIDENCES, FY12				
2					
3					
4	Range		# accounts	%	Cumulative %
5	$0	$99,999	6,795	2.7%	2.7%
6	100,000	199,999	17,791	7.2%	9.9%
7	200,000	299,999	50,265	20.2%	30.1%
8	300,000	399,999	54,971	22.1%	52.3%
9	400,000	499,999	37,807	15.2%	67.5%
10	500,000	599,999	26,958	10.9%	78.3%
11	600,000	699,999	17,582	7.1%	85.4%
12	700,000	799,999	11,166	4.5%	89.9%
13	800,000	899,999	7,320	2.9%	92.8%
14	900,000	999,999	5,304	2.1%	95.0%
15	1,000,000	1,499,999	9,207	3.7%	98.7%
16	1,500,000	1,999,999	2,062	0.8%	99.5%
17	2,000,000	2,999,999	957	0.4%	99.9%
18	3,000,000	3,999,999	170	0.1%	100.0%
19	4,000,000	4,999,999	58	0.0%	100.0%
20	5,000,000	No upper limit	23	0.0%	100.0%
21	Subtotal		248,436	100.0%	
22	Other residences		83,491		
23	Total		331,927		
24					
25	Residences in the category above of "Other residences" are not				
26	owner occupied as the principal residence, and therefore are not				
27	eligible for the homestead property tax credit nor the income tax				
28	offset credit.				

WEIGHTED MONTGOMERY COUNTY REAL PROPERTY TAX RATES

ITOC = income tax offset credit per eligible household

FISCAL YEAR	Total County-ONLY Weighted Average Property Tax Rate (Per $100 Taxable Value)	Change Rate	ITOC
1978	$1.484		
1979	1.424	-0.060	
1980	1.276	-0.148	
1981	1.304	+0.028	
1982	1.300	-0.004	
1983	1.284	-0.016	
1984	1.264	-0.020	
1985	1.162	-0.102	
1986	1.139	-0.023	
1987	1.172	+0.033	
1988	1.206	+0.034	
1989	1.145	-0.060	
1990	1.135	-0.010	
1991	1.072	-0.063	
1992	1.053	-0.018	
1993	0.991	-0.062	
1994	1.004	+0.013	
1995	1.024	+0.019	
1996	1.024	0.000	
1997	1.024	0.000	
1998	1.024	+0.001	
1999	1.017	-0.008	$50
2000	1.006	-0.011	0
2001	1.006	0.000	0
2002	1.006	0.000	0
2003	1.005	-0.001	0
2004	1.005	0.000	0
2005	0.995	-0.010	0
2006	0.953	-0.042	116
2007	0.903	-0.050	221
2008	0.903	0.000	613
2009	0.903	0.000	579
2010	0.904	+0.001	690
2011	0.904	0.000	692

This is the rate resulting from taking all rates approved by the County Council, all other municipal tax rates and the State of Maryland rate and weighing them by their respective assessable bases.

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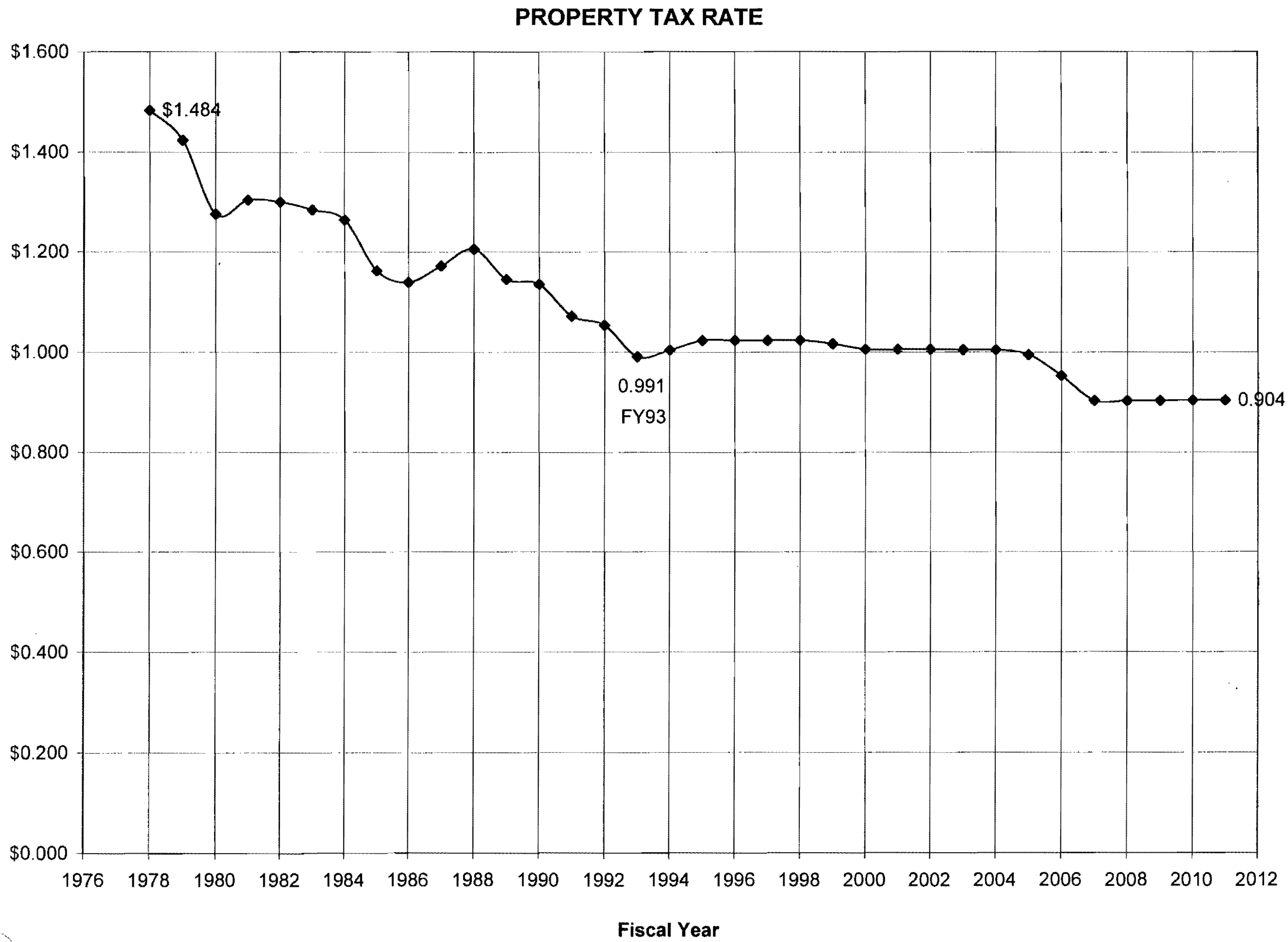
PROPERTY TAX RATE
$1.600
$1.400
$1.200
$1.000
$0.800
$0.600
$0.400
$0.200
$0.000
$1.484
0.991
FY93
0.904
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
Fiscal Year

PROPERTY TAXES SINCE SAG PROCESS STARTED
Tax in $million, Base in $billion, rate as % of Base

Income tax offset credit per household = ITOC

A	B	C	F	G	H	I	J	K
	Tax		Property Tax		Needed	Budget -	Council set	ITOC
FY	Budgeted	% Change	Current Rates	Charter limit	7/9 votes?	Charter Lim	rates at	per HH
92	$683.9		$700.0	$684.0	No	($0.1)	CL	
93	705.5	3.2%	744.2	705.6	No	(0.1)	CL	
94	730.0	3.5%	729.3	730.1	No	(0.0)	CL	
95	747.6	2.4%	733.7	751.2	No	(3.6)	< CL	
96	756.2	1.2%	756.0	764.5	No	(8.3)	CR, but <CL	
97	770.7	1.9%	770.7	775.7	No	(5.0)	CR, but <CL	
98	785.7	1.9%	785.7	806.6	No	(20.9)	CR, but <CL	
99	788.2	0.3%	811.6	811.2	No	(23.0)	< CL	$50
00	804.4	2.1%	807.0	804.6	No	(0.2)	CL	
01	819.5	1.9%	819.5	825.1	No	(5.6)	CR, but <CL	
02	870.7	6.2%	870.7	875.7	No	(5.0)	CR, but <CL	
03	911.9	4.7%	911.9	907.6	Yes	4.3	CR	
04	977.6	7.2%	977.6	948.4	Yes	29.2	CR	
05	1,069.0	9.3%	1,079.7	1,031.7	Yes	37.3	1¢ < CR	
06	1,105.2	3.4%	1,191.0	1,105.2	No	0.0	CL	116
07	1,154.0	4.4%	1,276.6	1,154.0	No	0.0	CL	221
08	1,207.5	4.6%	1,356.6	1,207.5	No	0.0	CL	613
09	1,364.9	13.0%	1,507.3	1,247.5	Yes	117.4	$118m>CL	579
10	1,440.9	5.6%	1,607.7	1,440.9	No	0.0	CL	690
11	1,450.1	0.6%	1,618.7	1,450.1	No	0.0	CL	692
12	1,462.2	0.8%	1,558.3	1,462.2	No	0.0	CL	692

FY12 is CE recommended

# years exceeded Charter limit	yes	4
# years did not exceed Charter limit	no	17

9 affirmative votes are required to set rates if the amount of tax will exceed the amount specified in §305 of the Charter (7 affirmative votes before FY10).

13

	A	B	C	D	E	F	G	H	I	J	K
1	PROPERTY TAX SCENARIOS FOR FY12 AT THE CHARTER LIMIT										
2	ITOC = Income Tax Offset Credit										
3	TV = Taxable Value										
4			Reduce				Incr rate				
5	Options provided by Finance		ITOC				CE				
6		FY11	Option 1	Option A	Option B	Option C	Option 2				
7	Property tax rate	0.904	0.904	0.914	0.924	0.934	0.946				
8	ITOC	(692)	(407)	(476)	(543)	(610)	(692)				
9	Change rate from FY11	0	0.000	0.010	0.020	0.030	0.042				
10	Change credit from FY11	0	285	216	149	82	0				
11											
12			Reduce				Incr rate	These columns compare each option to			
13	ALL DATA BELOW ARE FY12		ITOC				CE	the CE's option, which is Option 2			
14			Option 1	Option A	Option B	Option C	Option 2				
15	Type property	TV	Tax	Tax	Tax	Tax	Tax	1 - 2	A - 2	B - 2	C - 2
16	Residential	100,000	497	438	381	324	254	(243)	(184)	(127)	(70)
17	Residential median TV	390,000	3,119	3,089	3,061	3,033	2,997	(121)	(91)	(63)	(35)
18	Residential	678,571	5,727	5,726	5,727	5,728	5,727	0	1	0	(1)
19	Residential	1,000,000	8,633	8,664	8,697	8,730	8,768	135	104	71	38
20											
21	Rental apartment	100,000	904	914	924	934	946	42	32	22	12
22	Non residential	10,000,000	90,400	91,400	92,400	93,400	94,600	4,200	3,200	2,200	1,200
23											
24	**Data below are in $millions**										
25	Total property tax		1,458.9	1,459.5	1,460.4	1,461.3	1,462.1				
26	Change from CE option 2		(3.1)	(2.6)	(1.7)	(0.7)	0.0				

6

May 3, 2011

MEMORANDUM

TO: Councilmembers

FROM: Councilmember Phil Andrews

SUBJECT: The County Executive's Proposal to Raise the Property Tax Rate

Although County Executive Leggett has proposed staying within the Charter Limit in his budget, he has recommended raising the property tax rate by approximately 4.5%. A far better alternative is available: Keep property tax rates the same and reduce the FY 12 income tax offset credit from $692 to $395. The Council would thereby provide homeowners with a substantial tax credit without raising the property tax rate.

While the County Council has increased many taxes in recent years, the Council has not raised the property tax rate for many years. There are several good reasons why the Council should reject the CE's proposal to increase the property tax rate.

For the past two decades the Council has appropriately strived to reduce reliance on property tax revenues vis-à-vis other taxes, because property taxes are more regressive than many other taxes. During the middle of the last decade, the County received about the same amount of revenue from the local income tax as from property taxes, the first time this had occurred. This resulted, in part, from Council decisions in 2003 to increase the income tax rate to the legal maximum, and from decisions in 2004-06 to decrease the property tax rate. These decisions helped make the County's tax structure and tax burden more progressive.

About 24,000 households in the County face a 10% increase in the taxable value of their home for FY 12, even though the assessed value of almost all homes in Montgomery County decreased substantially in the past three years. These homeowners would likely find it particularly hard to understand a Council decision to increase the property tax rate. Moreover, all homeowners would reasonably view a Council decision to increase the property tax rate as a multi-year increase, since the Council has not increased property tax rates in nearly two decades and will not have reduced rates for five years after this year's budget. Apartment owners will pass along increased property taxes to renters, who in many cases already face large increases in rent because of the tight rental market.

In addition to these arguments against raising the property tax rate, less than three years ago, voters approved a ballot measure that makes it significantly harder for the Council to exceed the Charter Limit on property tax revenues. A Council decision to increase the property tax rate in the wake of that action by voters and during hard economic times would be ill-advised.