Economic Impact Statement

Montgomery County, Maryland

Bill 17-23 Taxation – Recordation Tax Rates – Amendments

SUMMARY

The Office of Legislative Oversight (OLO) anticipates that enacting Bill 17-23 would have a small to moderate negative impact on economic conditions in the County in terms of the Council's priority indicators. By increasing the recordation tax, the Bill would increase the total cost of transactions for property transfers. In the residential sector (the focus of this analysis), certain buyers, sellers, and homeowners refinancing their homes would pay higher closing costs than they otherwise would in the absence of the policy change, resulting in a one-time net increase in nondiscretionary expenses. Moreover, based on a review of the economic literature on the impacts of transfer taxes for residential properties and data on residential home sales in the County around the time the Council increased the recordation tax rate in September 2016, OLO believes there is a moderate likelihood the Bill would result in a short-term reduction in the volume of home sales in the County.

BACKGROUND AND PURPOSE OF BILL 17-23

A recordation tax is an excise tax imposed by certain states, including Maryland, as compensation for registering the purchase or sale of property as a public record.[1] The tax applies to the principal amount of debt secured by a mortgage or deed of trust when a house or building is being purchased. When a mortgage is refinanced, the tax applies to the amount of principal debt that is greater than the principal remaining on the original debt.[2]

Bill 17-23 proposes to increase the recordation tax rate levied under state law for certain transactions and allocates revenue received from the recordation tax for capital improvements and to the Montgomery Housing Initiative Fund (HIF). Specifically, the Bill proposes:

- Increasing the rate of the "school increment" from $2.37 to $3.79 for each $500 of the property's sale price.[3] The school increment funds can be used for any Montgomery County Public Schools capital project;
- Increasing the rate of the "Recordation Tax Premium" from $2.30 to $3.45 for each $500 on the property's sale price,[4] only if it is over $500,000. The proceeds are split equally – half is allocated to County Government capital projects and the other half is for rent assistance for low- and moderate-income households; and

[1] Maryland Tax – Property Code §§12-101 to 12 -118.

[2] Introduction Staff Report for Bill 17-23.

[3] Or, if refinancing, on the additional amount borrowed over the remaining principal.

[4] Or, if refinancing, if additional amount borrowed over the remaining principal is over $500,000.

- Adding a new premium rate of $1.15 for each $500 on the property's sale price,[5] only if it is over $1,000,000. The proceeds would be split equally – half would be allocated to County Government capital projects and the other half to rent assistance for low- and moderate-income households.[6]

Bill 17-23, Taxation – Recordation Tax Rates – Amendments, was introduced by the Council on March 21, 2023.

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

Per Section 2-81B of the Montgomery County Code, the purpose of this Economic Impact Statement is to assess, both, the impacts of Bill 17-23 on residents and private organizations in terms of the Council's priority economic indicators and whether the Bill would have a net positive or negative impact on overall economic conditions in the County.[7]

Scope Limitations: By increasing the recordation tax, Bill 17-23 would involve a transfer from certain residents to the County. Ultimately, the total annual economic impact of the Bill would depend on:

(a) the per year economic costs of the recordation tax increase; and

(b) the per year economic benefits of additional government expenditure.

OLO limits the scope of this analysis to the economic impacts of the recordation tax increase because it is unknown how County revenues would be used. While the Bill would earmark revenues from the tax increase for capital improvements and HIF, OLO cannot determine whether additional revenues would result in a net increase in funding for these areas due to the fungibility of money. [8]

Also, the Bill would increase the recordation tax for all property transactions (residential, commercial, industrial, etc.). Due to limited research on the economic impact of transfer taxes for non-residential building sales, OLO limits the scope to the economic impacts of increasing the recordation tax for residential home sales.

Information Sources: To do so, OLO performs a qualitative assessment based on the following sources of information:

- A 2018 report published by the UK Collaborative Centre for Housing Evidence (CaCHE) that reviews the peer-reviewed and "gray" literature[9] on the economic impacts of taxes on the transfer of residential property;[10] and

[5] Or, if refinancing, if additional amount borrowed over the remaining principal is over $1,000,000.
[6] Ibid.
[7] Montgomery County Code, Sec. 2-81B.
[8] The bulk of recordation tax is spent on new schools or school modernizations, technology modernizations in MCPS and College, transportation improvements, and affordable housing acquisitions and preservation. If the taxes are raised, it would most likely be used in one of those areas. See Project Funding Detail By Revenue Source, pages 38-52 to 38-56.
[9] Gray literature is literature published outside of journal articles or books. It includes reports by governments, think tanks, and other institutions, working papers, graduate dissertations, and more.
[10] Lenoel, et al, "International Evidence Review on Housing Taxation."

- Data on residential home sales in the County around the time the Council increased the recordation tax rate in September 2016 with the implementation of Expedited Bill 15-16, Recordation Tax – Rates – Allocations – Amendments.[11]

Assumptions: The primary assumption made in this analysis is that the increase in the total cost of residential home transactions would be shared by the seller and buyer at the time of sale.

VARIABLES

The primary variables that would affect the economic impacts of Bill 17-23 are the following:

- total cost of home transactions; and
- total volume of home sales.

IMPACTS

WORKFORCE ▪ TAXATION POLICY ▪ PROPERTY VALUES ▪ INCOMES ▪ OPERATING COSTS ▪ PRIVATE SECTOR CAPITAL INVESTMENT ▪ ECONOMIC DEVELOPMENT ▪ COMPETITIVENESS

Economics of Residential Transfer Taxes

The County's recordation tax is a one-time cost at the time of sale that adds to the total cost of transactions. Bill 17-23 would increase the recordation tax. As shown in **Table 1**, the recordation tax on a property that sells for $500,00 would increase by $1,420, from $4,450 (0.89% of the sales price) to $5,870 (1.17% of the sales price). For additional context, the table in the Appendix lists the current recordation tax rates in Maryland Counties per $1,000 in sales cost.

Would increasing the transfer tax rates alter the behavior of buyers and sellers? To answer this question, OLO reviewed the economics literature on the topic and data on residential home sales in the County around the time the Council increased the recordation tax rate in September 2016.[12]

Economics Research

The 2018 CaCHE report identified above reviewed studies on the economic impacts of taxes on the transfer of residential property conducted in the U.S., UK, Australia, France, Germany, Canada, and the Netherlands. In general, studies show transfer taxes have direct impacts on housing markets. Increasing transfer taxes has been found to reduce the number of transactions and house prices, while transfer tax "holidays" (i.e., temporary reductions or eliminations of a tax) have been found to increase transactions and house prices.

The CaCHE report also reviewed several studies on the indirect impacts of transfer taxes on labor markets. Two studies found that transaction costs reduced residential mobility in the Netherlands and the UK. Moreover, in a study of fourteen

[11] Expedited Bill 15-16.
[12] Expedited Bill 15-16.

European countries, transaction costs were found to be positively associated with unemployment, perhaps because reduced housing transactions may contribute to mismatches in the demand and supply for labor.

It is worth noting that U.S. studies have found mixed results. On the one hand, Benjamin et al. (1993) found that an increase in the Real Estate Transfer Tax in Philadelphia decreased residential sales prices in the city relative to properties outside and that this decrease was larger than the tax increase. Moreover, Berger et al. (2020) found that the temporary First-Time Homebuyer Credit between 2008 and 2010 increased the number of home sales by 490,000 units nationally.[13]

On the other hand, two U.S. studies did not find evidence for the direct impacts of transfer taxes on the housing market. In a study not reviewed in the CaCHE report, Slemrod et al. (2017) examined DC's 2003 increase in transfer tax rate from 2.3% to 3% for homes sold for $250,000 or more. While they found the policy change resulted in sales price manipulation to avoid the higher tax rate, there is no evidence for its effect on the volume (nor timing) of transactions. In addition, Chen (2017) found no significant difference in housing price volatility between states with and without transaction taxes.

Table 1. Recordation Tax Amounts

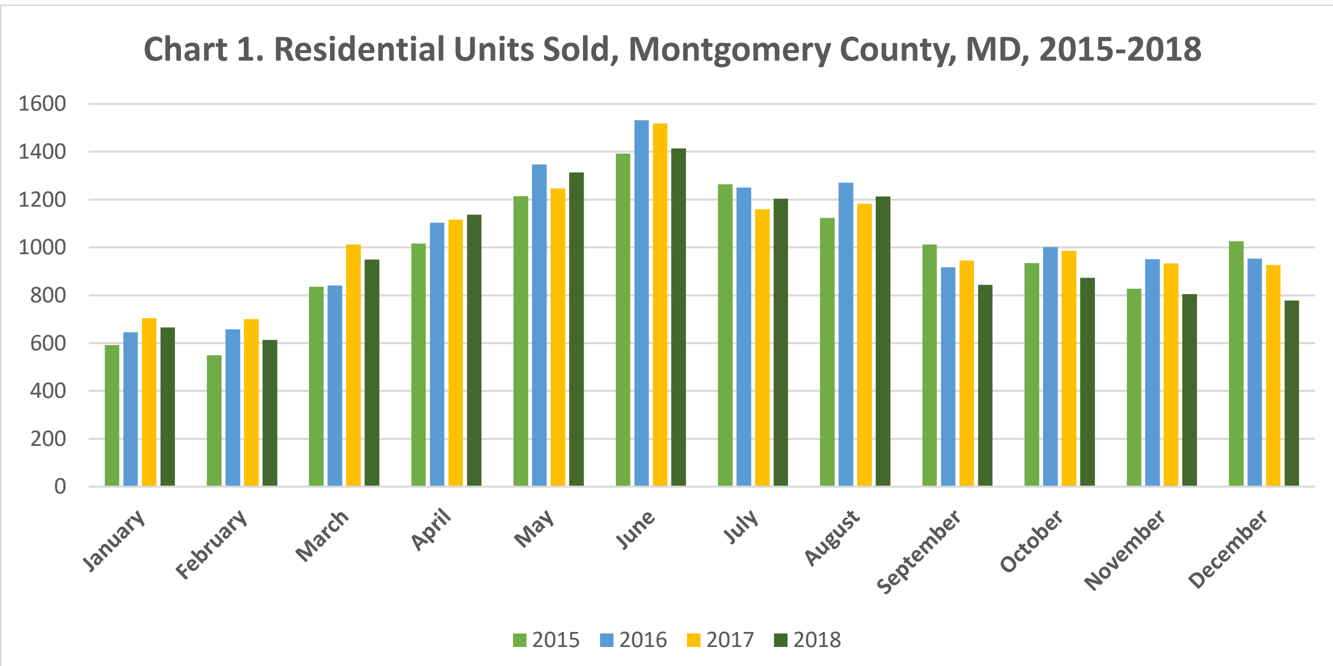
Home Price	Tax Due	Difference from Proposed MoCo Rates
$500,000		
Montgomery County		
Current Rates	$4,450	
Proposed MoCo Rates	*$5,870*	
Frederick County	$7,000	19%
Howard County	$2,500	(57%)
$750,000		
Montgomery County		
Current Rates	$7,825	
Proposed MoCo Rates	*$10,530*	
Frederick County	$10,500	0%
Howard County	3,750	(64%)
$1,000,500		
Montgomery County		
Current Rates	$11,207	
Proposed MoCo Rates	*$15,200*	
Frederick County	$14,007	(8%)
Howard County	$5,003	(67%)

[13] The CaCHE report included an earlier version of this study in their analysis.

Montgomery County

Figure 1 below show monthly home sales in the County from 2015-2018,[14] which covers the period when the Council changed the recordation tax rates in September 2016. While time and data limitations prevented OLO from performing a rigorous quantitative analysis, OLO notes that the year-over-year changes in monthly home sales do not suggest an obvious, long-term impact from the tax increase.

The data show a cyclical pattern in monthly sales with the number of home sales increasing in the spring and summer and decreasing in the fall and winter. If an increase in the recordation tax had a large impact on home sales, one would expect to see an increase in the number of homes sold prior to September 2016 as well as a reduction in the number of homes sold beginning in that month compared to sales in previous years. The data does show a sharp drop in homes sold in September 2016 compared to the previous month. However, following that time, monthly sales in 2016 do not appear systematically higher than the prior year home sales.



Source: Maryland Realtor

Based on the sources of information reviewed above, OLO concludes there is a low likelihood that Bill 17-23 would systematically lower the number of residential transactions over the mid- to long-term. However, OLO believes there is a moderate likelihood of the Bill resulting in a short-term reduction.

[14] For additional context, the three charts at the end of the memo show the same type of data – the number of monthly home sales from 2015-2018 – for Frederick County, MD, Howard County, MD, Fairfax County, VA, and Arlington, VA.

Residents

OLO anticipates that enacting Bill 17-23 would have a negative impact on certain residents in the County in terms of the economic indicators prioritized by the Council.

The Bill would primarily impact residential home buyers, sellers, and homeowners refinancing their homes. By increasing the total cost of residential home transactions, certain buyers and sellers would pay higher closing costs than they otherwise would in the absence of the change in the recordation tax. Holding all else equal, they would experience a one-time net increase in nondiscretionary expenses.

Certain buyers may compensate for the increase in the total transaction cost by lowering their price range, thereby purchasing an asset less valuable than they otherwise would absent the policy change. It is worth noting certain residents could incur indirect costs from lowering their price range given the competitiveness of the County's residential housing market (e.g., paying additional months of rent or mortgage due to timing constraints).

Moreover, as suggested by studies that have found higher transfer taxes reduce home sales, certain residents may respond to higher recordation taxes by remaining in their current residence and/or expanding their search to more affordable housing markets. If sufficient in magnitude, a net decrease in demand in the local housing market (even if temporary) could have mixed impacts on other buyers and sellers. For instance, certain sellers may accept lower offers than they otherwise would in the absence of the recordation tax increases, which would benefit certain buyers.

Finally, homeowners refinancing their homes would pay higher closing costs. Residents using their home equity to borrow money to cover nondiscretionary expenses (food, housing, debt, etc.) would be particularly impacted.

Beyond these potential impacts, OLO does not expect the Bill to affect residents in terms of the Council's other priority indicators.

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that enacting Bill 17-23 could have a negative impact on certain private organizations in the County in terms of the economic indicators prioritized by the Council. If the Bill reduces residential home transactions, certain real estate agents and realtors likely would experience net losses in revenues. Beyond this potential impact, OLO does not expect the Bill to affect private organizations in terms of the Council's other priority indicators.

Although this analysis does not examine the per year economic benefits of additional government expenditure, OLO believes it is worth noting the following: If an the increase in recordation tax goes towards new schools or school modernizations, technology modernizations in MCPS and College, transportation improvements, and affordable housing acquisitions and preservation, various private organizations in the construction industry would benefit from the Bill.

Net Impact

OLO anticipates that enacting Bill 17-23 would have an overall negative impact on economic conditions in the County in terms of the Council's priority economic indicators. By increasing the total cost of residential home transactions, certain buyers, sellers, and homeowners refinancing their homes would pay higher closing costs than they otherwise would in the absence of the increase in the recordation tax. As a result, these residents would experience a one-time net increase in nondiscretionary expenses. Moreover, based on a review of the economics literature on the impacts of transfer tax increases and data on residential home sales in the County around the time the Council increased the recordation tax rate in September 2016, OLO believes there is a moderate likelihood the Bill would result in a short-term reduction in the volume of home sales.

DISCUSSION ITEMS

Not applicable

WORKS CITED

Lenoel, Cyrille, Jeffrey Matsu, and Barry Naisbitt. International Evidence on Housing Taxation. UK Collaborative Centre for Housing Evidence. September 2018.

Montgomery County Code. Sec. 2-81B, Economic Impact Statements.

Montgomery County Council. Introduction Staff Report for Bill 17-23, Taxation – Recordation Tax Rates – Amendments. Introduced on March 21, 2023.

Slemrod, Joel, Caroline Weber, and Hui Shan. "The behavioral response to housing transfer taxes: Evidence from a notched change in D.C. policy." *Journal of Urban Economics*. Vol 100 (2017): 137-153.

CAVEATS

Two caveats to the economic analysis performed here should be noted. First, predicting the economic impacts of legislation is a challenging analytical endeavor due to data limitations, the multitude of causes of economic outcomes, economic shocks, uncertainty, and other factors. Second, the analysis performed here is intended to *inform* the legislative process, not determine whether the Council should enact legislation. Thus, any conclusion made in this statement does not represent OLO's endorsement of, or objection to, the Bill under consideration.

AUTHOR

Stephen Roblin (OLO) prepared this report, with contributions from Leslie Rubin (OLO).

APPENDIX

Table. Current Recordation Tax Rates for Maryland Counties[15]

	Recordation Tax Rate (per $1,000)
Allegheny County	$7.00
Anne Arundel County	$7.00
Baltimore City	$10.00
Baltimore County	$5.00
Calvert County	$10.00
Caroline County	$10.00
Carroll County	$10.00
Cecil County	$8.20
Charles County	$10.00
Dorchester County	$10.00
Frederick County	$14.00
Garrett County	$7.00
Harford County	$6.60
Howard County	$5.00
Kent County	$6.60
Montgomery County	**$8.90 on 1st $500K, $13.50 above $500K**
Prince George's County	$5.50
Queen Anne's County	$9.90
St. Mary's County	$8.00
Somerset County	$6.60
Talbot County	$12.00
Washington County	$7.60
Wicomico County	$7.00
Worcester County	$6.60

Source: Capitol Title

[15] Note that several jurisdictions, including Montgomery County, exempt certain portions of the sales cost from the tax, such as first-time buyers or if a property is the buyer's principal residence. Those exemptions are not included here.