

PROPERTY TAX RELIEF ISSUES

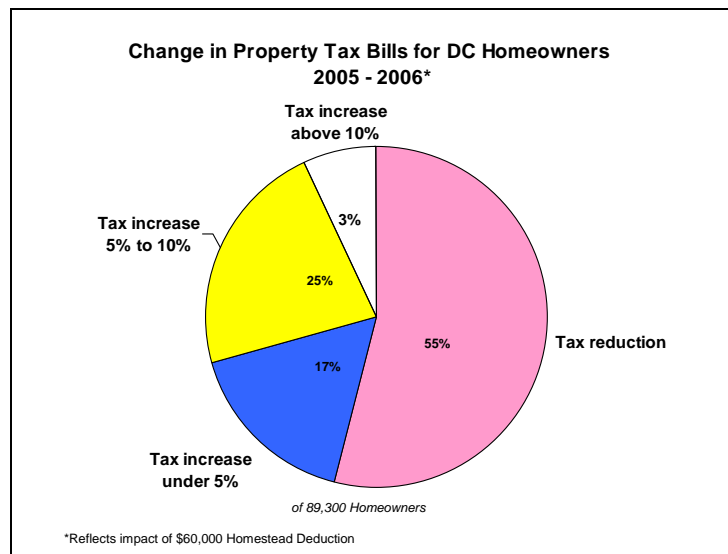
By Ed Lazere and Idara Nickelson

The District's strong real estate market has resulted in dramatic increases in property tax assessments for District homeowners in recent years. New assessments released in March 2005 show that most neighborhoods continue to face notable increases. District leaders have addressed the rising assessments by adopting a cap on annual property tax increases. The cap was set at a 25 percent rise in taxes in 2001 and was lowered to 12 percent in 2004. In addition to the cap, the Homestead Deduction was increased from \$30,000 to \$38,000.

These measures are providing substantial property tax relief. This year, DC homeowners will pay \$85 million less in taxes than they would in the absence of the cap. A DCFPI review of 150 homes that were sold recently found that the average taxable assessment — after the cap and the Homestead Deduction — was less than 60 percent of the average sales price. This suggests that homes generally are being taxed well below their full market values.

While most homeowners are benefiting from these measures, the continued surge in the city's home values has created demands for further property tax relief. Mayor Williams' proposed budget for FY 2006 would raise the Homestead Deduction to \$60,000. One proposal from the DC Council would lower the tax cap even further, to five percent per year. Another proposal would lower the property tax rate from 96 cents per \$100 of assessed value to 92 cents. A review of these proposals finds the following.

- The increase in the Homestead Deduction, which appears likely to be adopted by the DC Council, would reduce taxes by \$211 for each homeowner. While this would assist all homeowners, the relief would be greater as a share of income for low- and moderate-income families — those who are most likely to be burdened by rising property taxes.



- Some 55 percent of DC homeowners would pay less in property taxes in 200 than in 205 as a result of the larger Homestead Deduction. Another 17 percent would face a tax increase of less than five percent.
- Both the existing 12 percent cap and the proposed five percent cap provide far greater dollars of relief to owners of high-value homes than to owners of lower-value homes. Some 39 percent of the benefits of the five percent cap would go to homes assessed at \$750,000 or more. The cap also results in situations where homes with the same market value have different property tax liabilities.
- Three of four DC homeowners would receive greater assistance from the Homestead Deduction increase than from the five percent cap. The homeowners who benefit more from Homestead Deduction generally have homes assessed at \$500,000 or less. Of the owners who would benefit more from the cap, nearly half own homes assessed at \$750,000 or more.
- A rate reduction avoids the inequities of a cap and allows the District to keep pace with neighboring jurisdictions that are reducing their property tax rates. Nevertheless, the benefits of a rate reduction would be distributed similarly to those of a five percent cap — that is, with the largest share of benefits going to the highest value homes. Given the substantial relief offered by the higher Homestead Deduction, a rate reduction does not appear warranted at this time.

Finally, it is worth noting that none of the current or proposed measures provides relief to the 60 percent of DC households that rent, even though renters indirectly pay property taxes and also are facing substantial increases in their housing costs. The number of renter households with housing affordability problems rose by 5,400 between 2000 and 2003.

Given these factors, it would seem appropriate for proposals for additional property tax relief to target low-and moderate- income households and to include renters as well as homeowners. This could include.

- Increasing the Homestead Deduction to \$60,000, as proposed in the FY 2006 budget, or even an increase to a higher level.
- Updating and improving DC's tax credit for low-income owners and renters. The current Schedule H credit provides a maximum \$750 credit to households with income below \$20,000. Neither the credit amount or income limit have been changed since they were established in the late 1970s.
- Replacing the Schedule H credit. A credit proposed in legislation this year would cover homeowners and renters with incomes up to \$85,000 and would provide a maximum benefit of \$1,000. The revenue loss from this credit — which is based on a recommendation from the 1998 Tax Revision Commission — would be more than \$100 million. This is far higher than the costs of other property tax relief

proposals, which suggests that implementation would need to be phased in over several years.

The Homestead Deduction Provides Progressive Tax Relief; Proposed Increase Will Leave Taxes below 2005 Level for Majority of DC Homeowners

The Homestead Deduction is an amount that all homeowners are allowed to deduct from their home's assessed value before the property tax rate is applied. The deduction was set at \$30,000 from 1990 to 2004, when it was increased to \$38,000. In his FY 2006 budget, the Mayor proposed raising the Homestead Deduction to \$60,000.¹

This proposal, which would provide \$19 million in relief, would reduce taxes by \$211 for every homeowner. The Homestead Deduction provides broad property tax relief, but the relief is greatest as a percentage of a household's tax bill for owners of lower-value homes. For a home with a taxable assessment of \$200,000, for example, the additional homestead deduction would represent an 11 percent tax reduction. The relief totals 4.4 percent of the tax bill for a home with a taxable assessment of \$500,000

An analysis of the Mayor's proposed Homestead Deduction increases, which appears likely to be adopted by the DC Council, shows that it will result in significant tax relief for the vast majority of DC homeowners.

- Some 55 percent of DC homeowners will pay *less* in property taxes in 2006 than in 2005 as a result of the Homestead Deduction increase. For these households, the \$211 in new relief is greater than the tax increase they would otherwise face.
- Another 17 percent of DC homeowners will face a property tax increase of less than five percent. This means that the Homestead Deduction will provide a tax cut or a limited tax increase for nearly three of four DC homeowners.
- In 25 of DC's 56 neighborhoods (as defined by the city's property tax office), more than nine of 10 homeowners will experience a reduction in their tax bill or face an increase of less than five percent. (See Appendix Table I.)
- The neighborhoods in which most households would face a tax increase of more than five percent are those where home values are highest — such as American University Park, Chevy Chase, and Georgetown. In these neighborhoods, most homeowners will experience a tax increase between five percent and 10 percent.

¹ The mayor's budget also includes two other proposals. The first would "freeze" property tax increases — above this year's tax level — for homeowners with incomes under \$50,000. The deferred tax liability would be limited to 25 percent of the home's value and paid once the property is sold. The second would provide a 50 percent tax reduction to disabled homeowners with incomes under \$50,000. This is similar to the existing 50 percent property tax break for senior citizens under \$100,000 in income. Councilmember Evans has proposed a similar package of tax relief allowing older homeowners with incomes below \$100,000 to defer tax liability and a 50 percent tax reduction to disabled homeowners with incomes under \$100,000.

The Property Tax Cap Provides Substantial Tax Relief to Highest-Value Homes, Creates Inequities

Under current law, property tax increases are limited to 12 percent a year. This cap already provides significant benefits to homeowners facing large assessment increases. According to the DC Chief Financial Officer, the cap will reduce tax liabilities for DC homeowners by \$85 million this year. The proposal to limit tax increases to five percent per year would provide an additional \$16 million in tax relief.

The cap is a broad form of relief that benefits homeowners at all income levels. An analysis of the impact of the cap, however, shows that it provides substantial benefits to owners of DC's most valuable homes.

Table 1
Benefits of Property Tax Caps, By Home Value²

Assessed Value	Share of DC Homes	Share of Relief from Current 12 % cap	Share of Relief from Proposed 5%
Under \$250,000	33%	13%	10%
\$250,000 to \$500,000	35%	33%	24%
\$500,000 to \$750,000	18%	27%	26%
\$750,000 or More	13%	27%	39%
Total	100%	100%	100%

- Homes assessed at \$750,000 or more receive 27 percent of the benefits of the current cap, although they represent just 13 percent of DC homes. The 33 percent of homes assessed at \$250,000 or less receive just 13 percent of the benefits.
- The benefits of lowering the cap would be even more skewed toward owners of high-value homes. Some 39 percent of the benefits of the cap would go to owners of homes assessed at \$750,000 or more. Owners of homes worth \$1 million or more in the District — representing just six percent of all DC homes — would receive nearly 25 percent of the relief from the proposed reduction in the cap to five percent.

Homestead Increase More Advantageous for Most Households Than the Five Percent Cap

The benefits of the five percent cap can be contrasted with the benefits of the Homestead Deduction. A DCFPI analysis of the District's property assessment database shows that the benefit of the proposed increase in the Homestead Deduction would be greater than the benefit of the five percent cap for most households, particularly owners of lower-value homes.

² Does not include increase in homestead deduction to \$60,000.

- For homes with assessed values of \$250,000 to \$500,000, for example, the average benefit of the five percent cap would be \$98, or far less than the \$211 benefit from the increased Homestead Deduction.

**Table 2
Tax Relief Proposals, By Home Value³**

Assessed Value	Average Benefit from 5% Cap	Benefit of Homestead Deduction Increase
Under \$250,000	\$45	\$211
\$250,000 to \$500,000	\$98	\$211
\$500,000 to \$750,000	\$209	\$211
\$750,000 or More	\$425	\$211
Source: DCFPI analysis of DC property tax database		

- For homes assessed at \$750,000 or more, by contrast, the average benefit of the five percent cap is \$425, or higher than the benefit of the increase in the Homestead Deduction.
- As noted above, the Homestead Deduction increase would provide a tax cut or a tax increase of less than five percent for three-fourths of DC homeowners. The vast majority of these homes are assessed at \$500,000 or less.
- Of the homes that would benefit more from the five percent cap than the Homestead Deduction increase, nearly half are assessed at \$750,000 or more.

Other Concerns with the Five Percent Cap

In addition to the distribution of benefits, there are other aspects of the five percent cap that raise concerns. First, this proposal would set a fairly restrictive limit on the growth of one of the District’s major revenue sources. Constraining the growth of a major revenue source could make it hard to finance basic services over the long term. Flexibility with the property tax, one of the most stable major tax sources, is important because other tax sources can be highly volatile. Between 2002 and 2003, for example, the District’s income tax collections dropped \$240 million. Despite improvements in DC’s economy since then, income tax collections are projected to be nine percent lower in FY 2006 than FY 2002, after adjusting for inflation.

Second, the cap creates inequities by resulting in cases where homes with the same market value have different tax bills. Under a five percent cap, a home that increased in value from \$300,000 to \$400,000 over two years would pay 16 percent less in tax than a home that rises from \$350,000 to \$400,000 over the same period. Also, two identical homes sitting side by side could have very different tax burdens under a cap if the homes were bought just a few years apart, because homeowners do not get the cap in the first year they own their home.

³ The average benefit from the five percent cap represents the difference between the taxes homeowners would pay under the current 12 percent tax cap and what they would pay under the proposed five percent cap.

Property Tax Rate Cut

A common response to rising property assessments is a reduction in property tax rates. Some suburban jurisdictions in the Washington area have reduced their property tax rate in recent years and are considering further reductions this year. Fairfax County leaders, for example, are considering a 13-cent cut in their property tax rate — from \$1.13 to \$1.00 per \$100 of assessed value.

The District’s response to rising assessments has not included a reduction in the property tax rate — which is 96 cents per \$100 of assessed value for homeowners. One proposal raised this year would reduce the rate to 92 cents per \$100 of assessed value. A rate reduction has some advantages over a cap on annual increases.

- A rate reduction allows the District to demonstrate that it is maintaining tax rates that are similar to suburban rates. If tax relief is provided by a cap without a rate change, the District becomes open to charges that the property tax rate is higher than in the suburbs.
- A rate reduction does not result in inequities between taxes paid by owners of similarly valued homes. Instead, a rate reduction provides relief directly tied to each home’s value.

Nevertheless, because a rate cut would provide relief that is proportionate to each home’s taxable assessment, the benefits of a rate reduction would be greatest in dollar terms to owners of the most valuable homes. As shown in Table 3, over 40 percent of the benefits of a rate cut would go to owners of homes worth \$750,000 or more. This is very similar to the benefit distribution of a five percent cap. A rate reduction would be far less targeted on low- and moderate-income homeowners than an increase in the Homestead Deduction. Considering that the proposed Homestead Deduction increase would either reduce taxes or limit tax increases for most DC homeowners, it is not clear that a rate reduction is also warranted.

Assessed Value	Share of DC Homes	Share of Relief from Proposed Rate Cut
Under \$250,000	33%	10%
\$250,000 to \$500,000	35%	23%
\$500,000 to \$750,000	18%	25%
\$750,000 or More	13%	41%
Total	100%	100%

Renters Have Not Received Tax Relief

The strong real estate market that has contributed to property tax assessments also is having an effect on the 60 percent of DC households that rent their homes. Rising real estate values have led to substantial increases in rents and have made it harder for renters to transition to homeownership.

- Between 2001 and 2003, median advertised rents increased 23 percent for studio apartments, 60 percent for one-bedroom units, and 84 percent for two-bedroom units.⁴
- Between 2000 and 2003, the number of rental units with costs of \$500 or less fell by 5,000, or 15 percent. Meanwhile the number of apartments with monthly costs of \$1,000 or more increased by 7,000, or 25 percent.⁵
- Some 46 percent of renter household in DC now pay more than 30 percent of income for housing, or more than what is considered affordable under federal standards. The number of renter households with affordability problems rose 5,400 — from 55,800 to 61,300 — between 2000 and 2003.

The substantial property tax relief adopted in recent years has not provided assistance to renters, even though renters pay property taxes indirectly through their rent.

The District has one property tax relief mechanism that targets renters as well as homeowners — the Homeowner and Rental Property Tax Credit, known as the Schedule H credit — but it provides relatively modest relief and has not been adjusted for years. The maximum income eligibility level for the credit is \$20,000 and has not been adjusted since the credit was created in the late-1970s. The current maximum credit amount of \$750 has been unchanged since 1979. If the credit's features had received cost of living adjustments since then, the maximum credit now would be nearly \$2,100 and the income eligibility threshold would be \$55,000.

Expanding the Schedule H property tax credit to cover a wider range of low and moderate-income families is one step that can be taken to target aid on those most in need of property tax relief.

Future Tax Relief Should Consider Targeting Low- and Moderate Income Owners and Renters

As noted, property tax relief in the District has been provided primarily through the cap on annual tax increases. While this broad form of relief assists most homeowners, it provides substantial benefits to owners of high-value homes and does not target aid on low- and moderate-income families facing the greatest strain from property tax payments. Moreover, property tax relief has not included DC's renters.

⁴ *Housing in the Nation's Capital, 2004*, Fannie Mae Foundation, December 2004.

⁵ *Squeezed Out: The Worsening Shortage of Affordable Housing for Low-Income DC Households*, DCFPI January 2005. Reflects four-person household earning 50 percent or less of area median income or less than \$42,400.

If further property tax relief is considered, it would be appropriate to consider provisions that target low-and moderate- income households and include both renters and owners. This could include:

- An expansion of the Homestead Deduction to \$60,000 — as proposed in the Mayor’s budget — or higher. It appears likely at this time that the proposed increase to \$60,000 will be adopted by the DC Council.
- Modifications to the Schedule H credit to reflect inflation and other factors.

A bill introduced in the DC Council this year, the “Real Property Tax Relief Act of 2005” would, among other things replace the Schedule H credit with a new credit. The elements of the new credit, which is based on a recommendation from the District’s 1998 Tax Revision Commission, include the following. The new credit has the following features:

- The maximum credit amount would be \$1,000.
- Households up to \$85,000 in income would be eligible.
- The credit amount would be equal to a specified percentage of property taxes paid, with 15 percent of rent deemed to be a renter’s property tax payment.
- The percentage of property tax that can be offset by the credit would be higher for low-income households and would phase out as income rises. For the lowest-income households, 85 percent of taxes — up to \$1,000 — could be offset. (See Table 4 for phase-out details.)

Household income	Percent of Property Tax Relieved
Under \$5,001	85%
\$5,001 - \$10,000	80%
\$10,001 - \$15,000	75%
\$15,001 - \$20,000	70%
\$20,001 - \$25,000	65%
\$25,001 - \$30,000	60%
\$30,001 - \$35,000	55%
\$35,001 - \$40,000	45%
\$40,001 - \$45,000	40%
\$45,001 - \$50,000	35%
\$50,001 - \$55,000	30%
\$55,001 - \$60,000	30%
\$60,001 - \$65,000	25%
\$65,001 - \$70,000	20%
\$70,001 - \$75,000	15%
\$75,001 - \$80,000	10%
\$80,001 - \$85,000	5%

This credit would provide substantial relief to many low- and moderate-income households. For example:

- A renter with income of \$20,000 paying \$500 in rent currently qualifies for \$98 under Schedule H. The credit amount under the new proposal would be \$630.
- A homeowner with income of \$40,000 with a home assessed at \$150,000 would receive a tax break of \$484, or 45 percent of the full tax bill.
- A homeowner with income of \$60,000 and a home assessed at \$300,000 would qualify for a credit of \$755, or 30 percent of their full tax bill.

- It should be noted that the substantial relief provided by this credit would have a large cost in terms of lost revenue — over \$100 million per year. This is far larger than other existing proposals. The combined revenue loss from all other proposals, for comparison, is about \$50 million. The higher costs stems in large part from the fact that renters would receive relief, in addition to homeowners. This suggests that it may be difficult to implement the credit fully in the near term and that it might be necessary to phase it in over a number of years.

Appendix Table 1
Changes in Property Tax Bills for DC Homeowners, by neighborhood, 2005-2006
Following an Increase in the Homestead Deduction to \$60,000

Neighborhood	Tax reduction	Tax increase under 5%	Tax increase 5% to 10%	Tax increase above 10%
16th St. Heights	62.3%	28.6%	8.0%	1.1%
American Univ. Park	1.3%	13.5%	83.3%	2.0%
Anacostia	97.9%	0.2%	0.3%	1.5%
Barry Farms	97.5%	0.4%	0.0%	2.1%
Berkley	5.1%	9.2%	69.9%	15.8%
Bolling Afb & Naval Res	100.0%	0.0%	0.0%	0.0%
Brentwood	99.8%	0.0%	0.0%	0.2%
Brightwood	75.1%	22.6%	1.4%	1.0%
Brookland	91.1%	7.1%	0.2%	1.5%
Burleith	1.2%	18.9%	74.8%	5.1%
Capitol Hill	11.5%	31.9%	54.4%	2.3%
Central	46.0%	31.3%	20.3%	2.4%
Chevy Chase	5.3%	10.3%	83.2%	1.2%
Chillum	78.0%	20.0%	0.3%	1.7%
Cleveland Park	19.3%	24.8%	48.3%	7.6%
Colonial Village	0.0%	24.8%	74.5%	0.7%
Columbia Heights	71.1%	23.5%	2.9%	2.5%
Congress Heights	99.1%	0.3%	0.0%	0.6%
Crestwood	0.7%	1.8%	95.3%	2.2%
Deanwood	98.9%	0.1%	0.2%	0.8%
Eckington	71.6%	25.8%	1.1%	1.5%
Foggy Bottom	57.4%	15.3%	25.0%	2.3%
Forest Hills	32.8%	16.5%	41.5%	9.3%
Fort Dupont Park	98.5%	0.5%	0.2%	0.8%
Fort Lincoln	98.7%	0.8%	0.3%	0.3%
Foxhall	1.1%	14.5%	81.9%	2.5%
Garfield	17.2%	28.2%	51.7%	2.8%
Georgetown	11.7%	14.2%	61.9%	12.2%
Glover Park	39.0%	23.6%	34.6%	2.8%
Hawthorne	1.1%	12.9%	84.2%	1.8%
Hillcrest	76.5%	21.7%	0.8%	0.9%
Kalorama	25.0%	24.7%	40.2%	10.1%
Kent	1.1%	6.6%	81.3%	11.0%
Ledroit Park	59.7%	36.3%	2.4%	1.5%
Lily Ponds	98.4%	1.0%	0.1%	0.4%
Marshall Heights	99.3%	0.3%	0.2%	0.2%
Mass. Ave. Heights	3.4%	2.0%	32.4%	62.2%
Michigan Park	78.7%	20.3%	0.0%	1.0%
Mount Pleasant	18.9%	32.2%	46.4%	2.5%
N. Cleveland Park	3.3%	8.3%	86.0%	2.3%
Observatory Circle	26.8%	24.5%	43.8%	5.0%
Old City I	59.1%	28.0%	10.5%	2.4%
Old City II	49.3%	24.2%	23.0%	3.4%

Neighborhood	Tax reduction	Tax increase under 5%	Tax increase 5% to 10%	Tax increase above 10%
Palisades	11.8%	16.9%	68.0%	3.4%
Petworth	96.9%	1.5%	0.0%	1.6%
R.L.A. Sw	67.8%	18.8%	11.9%	1.6%
Randle Heights	97.6%	0.3%	0.1%	2.0%
Riggs Park	96.7%	2.7%	0.0%	0.6%
Shepherd Park	1.8%	70.1%	27.1%	0.9%
Spring Valley	0.3%	2.0%	68.4%	29.4%
Takoma	88.7%	10.3%	0.2%	0.8%
Trinidad	98.0%	0.1%	0.1%	1.8%
Wakefield	38.5%	19.6%	39.4%	2.4%
Wesley Heights	32.1%	18.8%	40.3%	8.8%
Woodley	7.6%	28.6%	60.0%	3.8%
Woodridge	95.1%	3.9%	0.1%	0.9%

APPENDIX 2

Property Values Continue to Rise Across City

Assessments under DC’s property tax continue to climb dramatically as a result of the city’s strong real estate market. Citywide, home assessments in 2005 are 20 percent higher than 2004 assessments. This year, even homes in the city’s eastern and southeastern neighborhoods — where growth home values has lagged city-wider trends — experienced significant growth in assessments.

- Neighborhoods primarily in the eastern and southern portions of the District — such as Anacostia, Barry Farms, Marshall Heights, and Trinidad — all experienced annual increases of 20 percent or more over last year’s assessment.

In prior years, assessment increases in these neighborhoods averaged less than 10 percent.

Appendix Table 2
2005 Average Assessment Increases and Home Value

Neighborhood	2005 Average Assessment Increase	2005 Average Home Value	Neighborhood	2005 Average Assessment Increase	2005 Average Home Value
16th St. Heights	16%	\$441,000	Glover Park	21%	\$460,000
Au Park	17%	\$704,000	Hawthorne	16%	\$677,000
Anacostia	22%	\$149,000	Hillcrest	19%	\$239,000
Barry Farms	18%	\$132,000	Kalorama	15%	\$759,000
Berkley	12%	\$1,064,000	Kent	13%	\$955,000
Bolling Afb/ Naval	7%	\$155,000	Ledroit Park	12%	\$325,000
Brentwood	18%	\$154,000	Lily Ponds	17%	\$153,000
Brightwood	17%	\$319,000	Marshall Hts	19%	\$123,000
Brookland	25%	\$264,000	Mass. Ave. Hts	15%	\$2,342,000
Burleith	17%	\$830,000	Michigan Pk	15%	\$289,000
Capitol Hill	16%	\$611,000	Mt. Pleasant	18%	\$578,000
Central	17%	\$419,000	N. Cleveland Pk	13%	\$694,000
Chevy Chase	12%	\$712,000	Observatory	16%	\$622,000
Chillum	23%	\$279,000	Old City I	26%	\$371,000
Cleveland Park	25%	\$716,000	Old City Ii	21%	\$460,000
Colonial Village	16%	\$725,000	Palisades	15%	\$716,000
Columbia Hts	29%	\$328,000	Petworth	29%	\$253,000
Congress Hts	14%	\$130,000	R.L.A. Sw	23%	\$327,000
Crestwood	22%	\$746,000	Randle Heights	12%	\$146,000
Deanwood	23%	\$138,000	Riggs Park	19%	\$210,000
Eckington	31%	\$312,000	Shepherd Park	22%	\$533,000
Foggy Bottom	14%	\$371,000	Spring Valley	22%	\$1,393,000
Forest Hills	14%	\$722,000	Takoma	12%	\$257,000
Ft. Dupont Park	19%	\$154,000	Trinidad	35%	\$159,000
Fort Lincoln	12%	\$179,000	Wakefield	11%	\$527,000
Foxhall	17%	\$677,000	Wesley Hts	13%	\$655,000
Garfield	15%	\$593,000	Woodley	7%	\$1,024,000
Georgetown	13%	\$1,010,000	Woodridge	27%	\$249,000

Source: DCPFI analysis of DC property assessment data.