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PROPERTY TAX RELIEF CONSIDERATIONS

By Ed Lazere

In response to concerns over rising property tax bills, the DC Council gave initial approval this month to a bill that would limit a homeowner's tax increase to 10 percent in any year. (This bill would lower a cap, set at 25 percent, that was enacted in 2001.) Alternate provisions, including one to lower the property tax rate and increase the homestead deduction, also were considered. A final vote on property tax relief legislation could occur as early as December 16 or in early January.

The effort to relieve growing property tax bills is understandable. Many homeowners have faced substantial assessment increases in recent years, as market values have risen and as the District shifted to a process of assessing properties annually. Nevertheless, there are serious issues raised by the 10 percent tax cap legislation:

- **Significant Revenue Losses that Could Require Program Cuts:** The cap would reduce property tax revenues $18 million in its first year and $70 million over four years. No plans have been identified to address this loss of revenue. It is worth noting that while property taxes have risen in recent years, other tax collections have fallen. Overall revenue growth in recent years has been slow and has created substantial budget shortfalls — including a $323 million gap in 2002 that forced budget cuts of nearly $200 million. The new cap could require further cuts or limit the ability to fund other initiatives.

- **Uneven Benefits:** A DCFPI analysis finds that over half of the benefits would go to homes worth $500,000 or more. While 60 percent of DC homes are worth $250,000 or less, owners of these homes would receive just 20 percent of the cap's benefits.

  Moreover, the tax cap effectively would set different tax rates for different homeowners. Owners of homes that have increased greatly in value would pay a lower tax relative to their home's value than homeowners in neighborhoods where market values are rising more slowly. New homeowners or those who make significant home improvements — who do not qualify for the cap in the year the home is bought or improved — would pay higher taxes than other homeowners.
- **Weakening of DC's tax system:** Tax systems need to be broad and flexible to ensure revenues are stable and grow in tandem with the economy. Setting a cap on property taxes for individual homeowners limits the growth in this revenue source and restricts the tax system in ways that could hurt the city's fiscal conditions in the future. As noted above, rising property tax collections in recent years have helped offset declines in other revenue sources. If a 10 percent

property tax cap had been in effect last year, the budget shortfall would have been even larger than $323 million.

As the DC Council completes legislation to provide property tax relief, the following issues should be considered.

Balance the need for tax relief with spending needs: Given budget cuts in recent years, and serious funding needs in the District — in areas such as education, health care, child care, and affordable housing — property tax relief should be limited in costs so that it does not prevent the District from making targeted investments in key program areas.

Consider alternatives to the cap that spread tax relief more broadly: Council member Phil Mendelson has proposed lowering the property tax rate and increasing the District's homestead deduction as an alternative to the tax cap. Both of these methods would ensure that homeowners throughout the District receive tax relief and would target more relief on homeowners in lower income neighborhoods than a tax cap.

Council Member Mendelson's initial proposal was to lower the property rate from 96 cents per $100 of assessed value to 86.5 cents and to raise the homestead deduction from $30,000 to $35,000. This was intended to have roughly the same cost as the 10 percent cap. Subsequent analysis suggests that the costs of this proposal would be substantially higher than the cap. Thus, a smaller reduction in the property tax rate may be appropriate.

Consider modifications to the cap to limit revenue losses: If a cap on property taxes is enacted, it may be appropriate to consider modifications such as the following:

- Converting the cap to a deferral: Under a proposal introduced by Council member Brazil, tax bills would be calculated under the existing 25 percent cap, but any tax increase above 10 percent would not have to be paid in that year. The unpaid amount would be deferred into future years. This proposal requires homeowners to pay the higher taxes associated with rising home values, but effectively spreads those payments over a number of years. A deferral also could be designed so that the deferred taxes are paid when a home is sold.

- Changing the size of the cap: The annual cap could be set at a different level, such as 20 percent or 15 percent. This would provide relief while helping to ensure that homes are not taxed below market values for numerous years.

- Making the 10 percent cap temporary: The cap could be limited to two years, for example, after which the 25 percent cap would be applied again.