BRIEFINGS

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Property Tax "Windfall" Really Just a Tax Increase; Local Governments Should Handle Rapidly Rising Property Values Openly and Prudently

Florida's surging real estate market is creating a tempting opportunity for its local governments. Rapidly escalating property values are making it possible for cities, counties and school districts to raise significant new revenues without increasing, and even slightly reducing, millage rates. Moreover, even small increases in tax rates can result in huge revenue boosts.

There has been much talk about what governments are going to do with this "windfall." First, it needs to be acknowledged that this is not really a windfall, but actually a significant tax increase.

Rolling back the property tax rates should be the first consideration. Florida's Truth in Millage (TRIM) law recognizes that property values are a powerful revenue-producing tool for local governments and that rapidly escalating values result in rapidly escalating tax burdens if the tax rate is not reduced. TRIM requires that taxing authorities calculate a "rolled back millage rate" which is the millage rate that, when applied to the current year's assessed value, would raise the same amount of revenue as last year.

According to TRIM, any millage rate in excess of the rolled-back rate is considered to be a tax increase and is to be advertised as such. New construction, additions to existing structures, major rehabilitations and annexations are excluded from the rolled back rate calculation to allow for some growth revenue. Even if a taxing authority keeps the same millage rate, if the total assessed value of the property on last year's tax roll is up, then it is considered a tax increase.

Example: A unit of local government generated $90 million in property taxes during 2004-05 with a millage rate of 6.0 mills on taxable value of $15 billion. In 2005-06 the taxable value of that same property (not including new construction and additions) increased 20% to $18 billion. The taxable value of new construction was $600 million. The rolled back rate would be 5.0 mills – the rate necessary to raise $90 million on the $18 billion. The rolled back rate would provide the local government with $3 million in additional property tax revenue ($600 million in new construction taxed at 5.0 mills). If the local government wants to adopt a millage rate higher than 5.0, that is a tax increase. Keeping last year's rate of 6 mills, while often portrayed as "holding the line on taxes," would actually be a major tax hike. Similarly, in this example a reduction to 5.5% mills is not a tax cut, but a $9 million (10%) tax increase.

(For a broader explanation of TRIM, see the May 2001 Florida TaxWatch Special Report *"TRIM and Property Taxes: A Primer.)*

Property Values Are Rising, So Is Revenue

TRIM notices began to be mailed to taxpayers last month and many people are seeing significant increases in the taxes proposed by their local governments. This is mostly due to the state's continued housing boom.

The state's last Ad Valorem Estimating Conference (March 2005) forecast that the total taxable value of property in Florida would grow by $142 billion in 2005, bringing the statewide tax roll to $1.257 trillion. This 12.7% growth marks the fifth year in a row that total taxable value has had double-digit annual growth.

This remarkable growth has allowed local governments to often lower millage rates. In fact, the estimated average statewide millage rate of 20.09 mills for 2005 is the lowest since 1989. (With certain exceptions for millage levies approved by the voters, the constitution limits county, municipal and school district levies to 10 mills each.)

This does not mean that local governments have been cutting property taxes. Florida property owners are experiencing the dichotomy of falling tax rates and rising taxes. Total property tax levies have increased 57% from 2000 to 2005, reaching $22.4 billion. This increase includes annual growth of more than $2 billion in each of the last two years.

This year is shaping up to be a record setter. Press reports on the arrival of TRIM notices have shown tax roll growth in excess of what was forecast, including 20% in Sarasota, 17% in Manatee, 17% in Hillsborough, 16% in Palm Beach and 15% in Pinellas.

Ill-Effects of "Save Our Homes" Magnified

The rapid growth in taxable values in Florida is even more remarkable when you consider the Save Our Homes provision in the state constitution. The 1992 amendment limits the annual increase in the assessments of homestead property to 3% or the increase in inflation, whichever is less. In recent years, it has been below 3%, often less than 2%. In 2005, the cap was 3%.

But as Florida TaxWatch pointed out in 1992, Save Our Homes is not a tax limit but a tax shift. Since it does not control millage rates, the effect has been a shifting of the tax burden to businesses, renters and second home owners. Even though average millage rates have been falling, they are certainly higher than they would be without the amendment. Property not subject to the limit bears the brunt.

Homeowners as a whole have undoubtedly saved money from Save Our Homes. But it is the high-priced homes with escalating values that profit the most. Others have not fared as well. People who want to move to another house also can face huge tax increases because the new home will be initially assessed at full value.

Rapidly appreciating home values magnify these effects. The amendment excluded $165 billion in property value from taxation in 2004, shifting the tax burden from Save Our Homes eligible property to non-eligible property. That total has more than tripled in three years.

Handling the "Windfall"

Using rising property values to lower tax rates should be the first consideration in handling the "windfall." There is no doubt that local governments are facing mounting spending pressures and the hurricanes have created costly problems for many counties. Statewide, new construction averages about 3.3% of total taxable value. While significant, this may not always be enough to fund growth demands. So going all the way back to the rolled back rate may not be feasible in many jurisdictions. But sharing the benefit of rapidly increasing property values with taxpayers is the right approach.

If local governments want to use this opportunity to significantly raise revenue, they should use it prudently and avoid instituting costly new programs or large expansions of existing programs that would create a recurring expense that may not be sustainable when property values slow. (*See August 2005 Florida TaxWatch* Economic Commentary *"Is There A Bubble in Your House?")*

Prudent use would best focus on growth management and the significant need for infrastructure. The 2005 Legislature made a commitment to local governments to help fund needed capital projects such as schools, roads and water. Using additional property tax revenues to enhance this effort makes sense and is defendable to the taxpayers.

Similarly, reducing taxpayers' debt burden by paying down long-term obligations produces long-term benefits.

We must stress the importance of responsible cost control and government productivity in any government's fiscal strategy. Major tax increases or unsound fiscal policy decisions by local government officials can serve to fuel anti-tax campaigns or ill-advised property tax-reactive constitutional amendments such as Save Our Homes, doubling the $25,000 Homestead Exemption, or Voter Approval of Taxes.

Instead of waiting for such measures (or worse) to be imposed on them, local governments need a responsible, workable spending limitation. Something that allows revenues to grow at a rate to account for inflation and growth—with a provision for a super-majority vote of the governing body to over-ride the limit--would go a long way in easing taxpayer fears and help stave off efforts to overly restrict the ability of local governments to meet the needs of their citizens.

Local governments need to be honest with taxpayers--if they need to raise taxes, call it what it is and work on convincing taxpayers of the need.

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