# Long-Term Consequences: Why Attempts to Further Cap Property Taxes Would Cripple Michigan's Future

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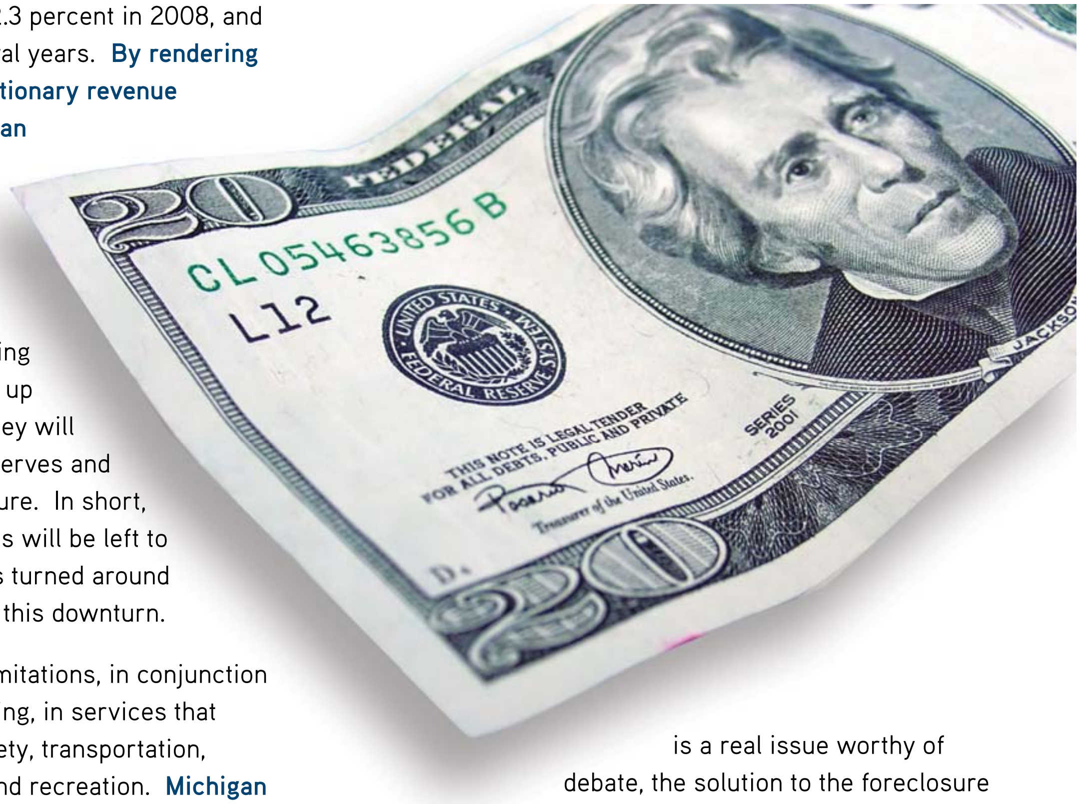
This year, many residents will have their property tax bills increase in spite of the declining real estate market. This reduction in their state equalized value (SEV) has some residents and policy makers calling for "reforms" to aid this seeming injustice. However, taking action on this issue without understanding the history of how we got here, and contemplating the consequences any action brings would be extremely shortsighted and detrimental to communities and residents across Michigan.

**Michigan already has one of the most restrictive property tax systems in the country** due to the combination of the Headlee Amendment and Proposal A. The former limits tax revenues collected by a community as a whole by requiring that tax rates be rolled back to limit revenue growth to inflation, while the latter limits growth on value for each parcel to 5 percent or the rate of inflation, whichever is less. This parcel cap is what creates taxable value, or the capped value. SEV, however, adjusts each year to reflect approximately half the market rate. The combination of these constitutional provisions greatly restricts a municipality's ability to raise critical revenue to provide essential services for residents.

Proposal A was passed 14 years ago and created the system we now use. Residents have either forgotten, or are too young to have known that they are the beneficiaries of a relative bargain on their property taxes. Instead of levying the applicable tax rate on the property's SEV, as was the case pre-Proposal A, taxes are levied on the property's taxable value which limits the growth in their tax bill significantly. Now, when their SEV is most likely decreasing, they may not understand they are not being taxed on SEV. They are being taxed on the capped or taxable value which, in most cases, is far below their SEV. This is why an individual's taxes can still be increasing in a declining market. As long as there is general inflation, taxable value can rise at that rate until it reaches the SEV level. When those two values are equal, the taxpayer's bill will decrease proportionately with any reductions in value. Homeowners with newly purchased homes, or homeowners who have not had significant increases in value are already starting to see real reductions in their property tax bills as their SEV and taxable values have equalized. In addition, because of the way these amendments collide in statute, some communities actually see property tax revenues grow at rates below inflation. This occurs because of how uncapped property is treated when calculating the allowable tax rate as required by the Headlee Amendment. The uncapping of sold property results in a tax rate reduction greater than would be expected otherwise, causing total tax collections to be less than inflation.

It is helpful to put this in the proper context using an individual example. Assume an individual has a home valued at $200,000, an SEV of $100,000, a taxable value of $75,000, a total local millage rate of 45 mills, and an inflation rate of 2.3 percent. Given this set of assumptions, the total increase in annual tax due to inflation is $77.65, or less than $6.50 per month. Few could argue that this increase is creating a significant impact on individual homeowners, and is certainly not a factor in the foreclosure crisis. When aggregated across a community however, it can be devastating.

The long-term impact for communities is frequently missed during this debate over the current housing market downturn. When the state's economy makes a comeback and income taxes, sales taxes, and business taxes rise again to levels above inflation, allowing the state to build reserve funds, property taxes will still be capped as they were during the last economic upswing. The rate of inflation used for




Michigan property taxes were only 2.3 percent in 2008, and has been very low for the past several years. **By rendering communities unable to capture inflationary revenue growth we will, over time, result in an absolute inability to maintain services.** If local communities are not allowed to capture inflationary growth during years that home values are flat, they will not have the means to: continue paying for services at the same level; catch up with the current economic rise as they will be limited to inflation or; to build reserves and adequately plan and build for the future. In short, local communities and their residents will be left to struggle for years after the state has turned around and legislators have forgotten about this downturn.

We have seen the effects of these limitations, in conjunction with severely reduced revenue sharing, in services that residents rely upon most: public safety, transportation, economic development, and parks and recreation. **Michigan local communities have lost more than 1,800 police officers and 2,400 firefighters off the streets since 2001** according to the Michigan Commission on Law Enforcement Standards and State Fire Marshal's Office.

The end result runs counter to research that shows place matters in the attraction and retention of people and jobs. For instance, a 2006 CEOs for Cities survey found two-thirds of college-educated 25-34 year olds look for a place to live first and then look for a job. Business owners have also identified community infrastructure as a top issue; they not only look for safe communities, but for those providing a number of services and amenities including parks, libraries, green spaces, cultural venues, walkable downtowns, and transportation options.

Much of the public dismay about paying higher taxes while SEVs shrink is centered on Michigan's foreclosure crisis. **The foreclosure crisis is not the result of Michigan's property tax system.** Furthermore, the state's high number of foreclosures is sending home values spiraling downward exacerbating this difficult property tax situation. While this is a real issue worthy of debate, the solution to the foreclosure crisis is not to create a crisis for local government by further limiting their ability to fund critical services.

Many proposals surfacing recently in the form of actual legislation and informal dialogue would place greater restrictions on Michigan's local property tax cap system, postpone the cap being lifted, or eliminate the uncapping altogether. These attempts would only continue to harm local communities' ability to provide services that offer quality of life and that attract and retain employers and residents.

If we want to continue reducing property taxes in Michigan, we must understand the consequences of that action. Any discussion about limiting property taxes must only take place in conjunction with much larger tax reform that includes various alternative ways to fund essential local services. The continued erosion of local revenue is resulting in the inability of local leaders to maintain and advance the quality of life for their residents. **If Michigan's communities cannot provide essential local services, we will not be able to attract and retain talented workers or critical jobs here in Michigan.**

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