Washington Research Council

POLICY brief

BRIEFLY

This November, voters will consider Initiative 747, which would limit property taxes. Its passage would mean a real reduction in property tax revenues for state and local government in coming years.

108 S. Washington St., Suite 406

Seattle WA 98104-3408

PH 206-467-7088

FX 206-467-6957

www.researchcouncil.org

PB 01-24 October 2, 2001

Initiative 747 Cuts Close to the Bone

Initiative 747 goes a step beyond the usual tax limitation measure, which generally ties tax increases to a measure of economic activity (e.g., growth in personal income) or to inflation. Instead, I-747 sets a low threshold – one percent – and says anything beyond that will require a vote of the people. With inflation currently running at about 2.7 percent, passage of I-747 would mean a real reduction in property tax revenues for state and local government in coming years.

The initiative follows on the heels of Initiative 722, which was struck down by the state Supreme Court September 20. That initiative would have limited growth in property tax revenues to two percent a year. In addition, it would have repealed a number of recent tax and fee increases adopted without voter approval. The court found that the initiative, which never took effect, violated the constitutional requirement limiting legislation to a single subject.

In drafting I-747, the sponsors of I-722 (and I-695, also found to violate the single-subject rule) seem to have learned the lesson. The initiative simply revises current law with respect to property taxes.

Overview

Initiative 747 simply amends current law on property tax limits, established by Referendum 47. The language of I-747 actually amends the law as amended by Initiative 722, but since that law was tossed out, the initiative amends the R-47 statute. And that law establishes the framework for the current discussion of limits on property tax growth.

It's important to understand what's meant when we say property tax increases are limited. I-747 would not limit tax rates or the taxes paid by an individual property owner. It would impose the same kind of limitation as is currently in force under Referendum 47. Specifically, that is a limit on the amount of property tax revenue that can be collected by state or local government from taxes levied on the valuation base prior to factoring in the value of new construction, improvements and increases in the assessed value of state-assessed property. The tax rate may increase or decrease to generate the revenue allowed under the limit, subject to other limitations, and the effect on individual properties will vary depending on changes in assessed valuation in the taxing jurisdiction.

Referendum 47, adopted by the voters in 1997, generally limits annual state and local property tax increases to the lesser of six percent or the rate of inflation. (Prior to passage of R-47, the limit was just six percent.) There are exceptions. Local property taxing districts with fewer than ten thousand residents are limited to six percent increases. Larger local governments are allowed to lift tax collections to as much as six percent if elected officials find a “substantial need” to exceed the inflation limit. Doing so requires a supermajority vote of the county or city council.

Initiative 747 drops the six percent to one percent. That is, the state government is limited to the lesser of one percent or the rate of inflation; jurisdictions with ten thousand or fewer residents are limited to one percent; and jurisdictions with more than ten thousand residents are limited to the lower of one percent or the rate of inflation. Local governments, large and small, can exceed the one percent limit only with the approval of a simple majority of the voters. Current law also provides for increases above the levy lid with voter approval.

The limit would not apply to voter-approved special levies.

Effect

If I-747 becomes law, many local governments will see property taxes grow much more slowly than would be permitted under current law. Although the initiative allows cities, counties, fire districts, ports, libraries, hospital districts, and so on to seek voter approval for increases above the limit, most would probably not do so. The administrative costs of the election and the difficulty in mounting an effective campaign will work against routine appeals for increases in the levy lid.

The state revenue department has prepared the best estimates of the impact of I-747. Their estimates might be considered a worst case scenario, in that it assumes that no jurisdiction receives voter approval to exceed the one percent limit. The department treats the difference between what would have been received under current law (using the percentage increase actually taken by the various jurisdictions in 2000) and what would be collected if I-747 passes as a loss.

State government would collect $34.4 million less than expected in the 2001-03 biennium if I-747 passes, $118 million in 2003-2005, and $227 million in the 2005-2007 biennium. For local governments, which rely much more heavily on property taxes, the capacity loss is greater (see table). Note also that local governments budget on an annual basis.

Initiative 747's Effect on Property Tax Revenues

	State Loss	Local Loss
FY02	($8,569,000)	($28,769,000)
FY03	($25,859,000)	($86,477,000)
FY04	($46,753,000)	($148,415,000)
FY05	($71,270,000)	($214,863,000)
FY06	($97,363,000)	($285,748,000)
FY07	($129,560,000)	($363,910,000)

Source: Office of Financial Management

By reducing allowable collections, the limit would hold down property taxes for property owners. Again, we rely on estimates provided to the state office of financial management by the department of revenue. For the owner of a $150,000 property, the difference between what would have been paid under current law and the tighter limit imposed by I-747 would be about $23 in calendar year 2002. By 2007, the savings would grow to $126.

Discussion

Initiative 747 represents a straightforward tightening of the property tax limit established by Referendum 47. It leaves the property tax system generally intact, and does not violate the state's constitutional requirement for uniform taxation of real property.

Clearly, the one percent limit is arbitrary. Initiative 722, one year ago, set the cap at two percent. The rate is cut in half in I-747, according to initiative sponsors, to penalize local officials for mounting the court challenge to I-722.

The current law approach, as put into place by Referendum 47, parallels the more customary use of a growth factor in setting tax and spending limits. For example, the state spending limit, Initiative 601, allowed for general fund budget growth equal to increases in population and inflation.

By holding increases at a level below the rate of inflation, measured by the implicit price deflator (IPD), the initiative would put pressure on local governments to reduce spending or replace the lost revenue with other taxes and fees. The most recent national data, for 1997, show Washington's property tax burden as 17th in the nation when measured as a share of personal income and 16th when measured on a per capita basis.

According to the Association of Washington Cities, property taxes provide about 25 percent of the average city's operating revenue. For some cities, property taxes provide as much as one-half of operating revenues. Cities with a lot of commercial activity can collect a relatively large share of their revenues from locally imposed sales taxes; other cities tap into the B&O tax base. (For some communities, of course, these revenues will drop as the economy slows.) For other cities, particularly those lacking a substantial business presence, the property tax can represent a major revenue source.

Counties do not collect B&O taxes, but do share in local sales tax revenues. Nearly 40 percent of county operating revenues come from property taxes. Special districts, like fire and library districts, generally rely to a greater extent on property tax revenues.

About one-third of all property taxes collected are the result of voter-approved levies, which would not be affected by the initiative.

Conclusion

Although I-747 avoids the constitutional pitfalls of I-722, several public policy concerns remain.

First, by adopting a limit below the rate of inflation, the initiative may lead local officials to pursue other revenue options (impact fees, B&O taxes) that will negatively impact the business climate. The arbitrary limit on property tax collections would have differential impacts on local government, affecting those communities without a diversified revenue base most directly. As well, with the state budget already experiencing the effects of the economic downturn, the loss of property tax growth would certainly increase the pressure in the next legislative session.

Second, cities and counties generally spend most of their budgets on infrastructure and public safety – streets, roads, sewers, police and fire services, courts and jails. As budgets tighten, the shortfall in infrastructure finance may well be exacerbated as constrained resources are channeled to important public safety functions.

Third, the initiative again raises the issue of the degree to which voters should give explicit approval to all tax increases. The tight I-747 cap would most likely result in more budget decisions being referred to the voters. Such direct democracy has in recent years weakened the legislative budget process, as popular proposals are presented out of context (e.g., raising teacher salaries, reducing class sizes), leaving the ramifications to be resolved by lawmakers with limited discretionary authority.

◆ ◆ ◆