Washington Research Council

Policy Brief

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Legislature Considers Property Tax Reforms

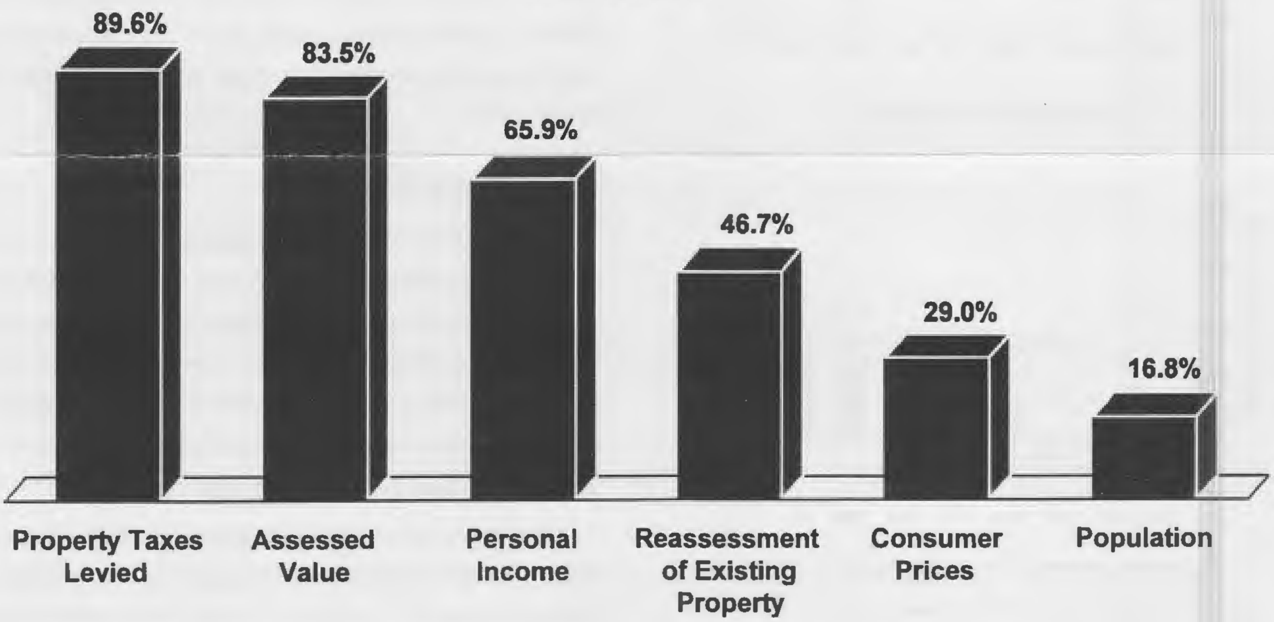
Between 1988 and 1995 total property taxes levied in Washington state increased by 86.9 percent, from $2.15 billion to $4.01 billion. Nearly all of the increase in property tax levies was associated with increases in the tax base. Between 1988 and 1995 the average tax rate for the state increased only slightly, from $13.35 per $1,000 of assessed value to $13.53. The assessed value of property in the state increased by 83.5 percent from $162.2 billion for taxes due in 1988 to $297.8 billion for 1995.[1]

Over the same 1988 to 1995 period, personal income for the state increased by 65.9 percent. Thus the rate of increase in property taxes has significantly exceeded the rate of increase in personal income and the relative burden of property taxation has risen.[2]

The aggregate assessed value of property may change either because new property is added to the lists (or old property subtracted) or because existing property is revalued. Revaluations account for 46.7 percent of the increase from 1988 to 1995. In contrast, the consumer price index increased by 29.0. The prices of taxable property have increased more rapidly than consumer prices in general and, again, the relative burden of property taxation has risen.

Between 1988 and 1995 the state population grew by an estimated 16.8 percent.

Property Taxes in Washington State Increased More Than Income
1988 to 1995



Sources: Department of Revenue, Office of the Forecast Council, and WRC calculations.

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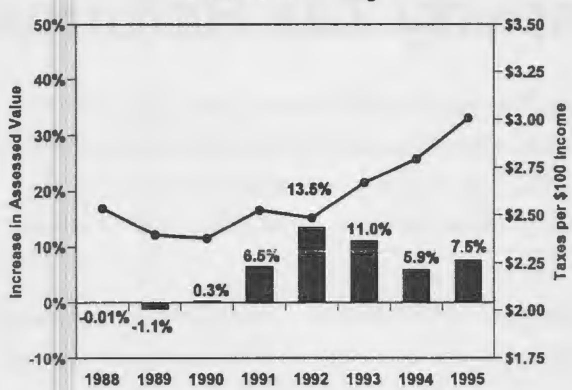
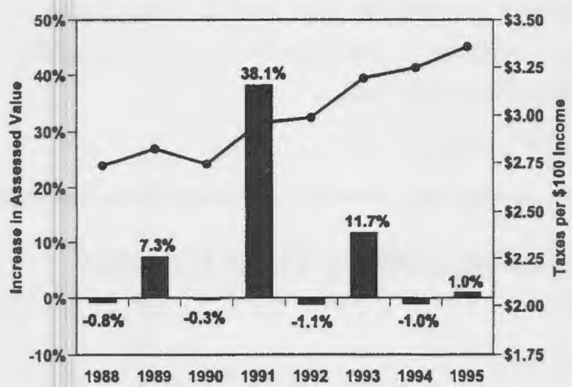
Increases in Assessed Value of Real Property and Total Property Taxes per $100 of Personal Income

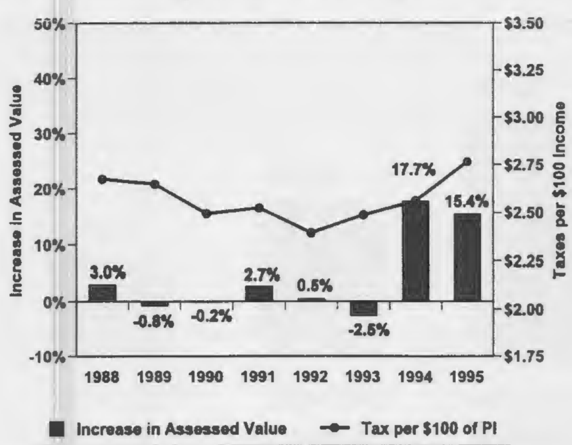
Clark County



King County



Spokane County



Sources: Office of Program Research, Department of Revenue, and Office of the Forecast Council.

Note: Assessment increases associated with the year that they affected tax payments.

Rick Peterson of the Office of Program Research has assembled data on property taxes by county for the House Property Tax Working Group.[3] The charts to the left show the pattern of revaluations in assessed values of real property in Clark, King, and Spokane counties over the period 1988-1995. Property values tend to move up unevenly. For example, over this period King County reassessed every other year. The late 1980s boom in the local real estate market is evident in the tremendous jump in values used to calculate taxes paid in 1991. Clark and Spokane counties experienced booms also, although later than and not as sharp as that in King County. The spikes in property values, however, do not translate into spikes in taxes for reasons that will be explained below. The charts also show for each county property taxes paid per $100 of personal income.

These rapid upward reassessments are an important source of public dissatisfaction with the property tax, but perhaps an even greater source is the unevenness across properties in the rates of increase. Population growth has been a major source of the increase in property values, and hence property taxes, as growth increases demand for a finite resource, land. Certain types of property, waterfront homes near Seattle, for example, are in limited supply, and their values have risen disproportionately. There are a number of longtime homeowners who have experienced tremendous capital gains on their residences but cannot comfortably pay their property taxes from their current incomes. Understandably, many do not view cashing in the capital gain to be an attractive option and petition their legislators for relief.

Property Tax Facts

The most recent data allowing comparison of property taxes between states are for 1992 state fiscal years and appear on the table found on the following page. These data show Washington's property taxes to be about average. Measured as taxes per $1,000 of personal income, Washington ranked 26th among the states and the District of Columbia. Alternatively, measured as taxes per capita, the state ranked 23rd.

Property taxes in Washington state are subject to two limits. The state constitution mandates that any property tax levies in excess of 1 percent of market value must be approved by a 60 percent majority in an election of the voters. In addition, there is a separate *6 percent* annual limit on increases in property tax. The first is referred to as the *1 percent limit*; the second, as the *106 percent limit*.

The 1 percent limit represents $10 for every $1,000 of property value. By state statute $3.60 is reserved for the state. The remaining $6.40 in taxing ability is apportioned among a variety of local districts, counties, cities, fire districts, and so forth, by a fairly complicated set of rules.

The state constitution exempts taxes by ports and public utility districts from the 1 percent limit.

The 106 percent limit restricts the total property tax revenue that any taxing district can raise; it does not restrict the taxes levied against a particular property. It applies to *regular* property taxes, that is, those that are not subject to the voter approval requirement of the state constitution. A district's total revenue in any year can be no higher than 106 percent of the greatest amount received in the preceding three years plus an increment related to the value on new construction and improvements to property within the district.

For 1995, the statewide average tax rates were $13.53 for each $1,000 of assessed value. This divides into $3.57 for the state levy, $5.34 in local regular levies, and $4.62 in voter approved local special levies. The state Department of Revenue estimates that for 1995 the ratio of the assessed value of property in the state to the fair market value is 90.1 percent.

Pending Legislation

A number of bills relating to property taxes have been introduced in the current session of the Legislature. Five are particularly notable. Republicans in the state House of Representatives announced on January 23 that they would support three property tax bills, HB 1957, HB 2213, and HB 2841. On the second day of the session the Senate passed ESB 6118. And the governor's supplemental budget included property tax reform.

HB 1957

This bill passed both the House and the Senate during the 1995 session but was vetoed by the governor. The

Washington Falls in Middle in FY92 Property Tax Collections

	Per $1,000 PI		Per Capita	
State	**Amount**	**Rank**	**Amount**	**Rank**
New Hampshire	$64.52	1	$1,349.15	2
Dist. of Col.	58.31	2	1,533.65	1
Wyoming	55.70	3	989.41	7
Vermont	54.07	4	955.92	8
New Jersey	51.75	5	1,272.79	3
New York	51.70	6	1,177.50	5
Alaska	51.43	7	1,071.21	6
Michigan	51.22	8	949.80	9
Oregon	49.68	9	862.74	12
Rhode Island	48.64	10	939.49	10
Maine	47.54	11	822.94	14
Connecticut	46.44	12	1,197.18	4
Wisconsin	46.20	13	819.48	15
Montana	46.07	14	705.75	22
Texas	42.65	15	731.03	18
Iowa	41.90	16	710.66	21
Illinois	41.53	17	847.69	13
Arizona	41.27	18	673.56	24
Minnesota	40.74	19	775.78	16
Nebraska	40.63	20	726.50	19
Kansas	40.18	21	725.53	20
Florida	39.08	22	737.59	17
Massachusetts	38.57	23	875.86	11
South Dakota	37.93	24	609.57	29
Colorado	35.12	25	673.28	25
Washington	**34.72**	**26**	**681.06**	**23**
North Dakota	34.18	27	531.55	34
Indiana	33.23	28	567.66	32
Virginia	32.83	29	649.66	28
California	32.67	30	667.84	26
Utah	32.01	31	460.33	37
Ohio	31.68	32	567.67	31
Georgia	31.26	33	542.13	33
Pennsylvania	31.24	34	607.92	30
South Carolina	29.46	35	450.73	38
Maryland	29.34	36	654.05	27
Idaho	29.08	37	446.10	39
Mississippi	27.24	38	357.01	42
Nevada	24.54	39	491.53	35
Hawaii	22.72	40	479.71	36
North Carolina	22.54	41	373.57	41
Missouri	22.32	42	401.61	40
Tennessee	21.36	43	347.87	43
West Virginia	20.11	44	293.43	46
Kentucky	19.38	45	296.83	45
Louisiana	18.48	46	276.21	47
Arkansas	18.23	47	260.91	48
Delaware	16.61	48	331.39	44
Oklahoma	15.72	49	242.45	49
New Mexico	15.03	50	217.46	50
Alabama	11.28	51	174.15	51
United States	**36.92**		**699.41**	

This table is reproduced from the WRC publication *How Washington Compares, 1994 edition*. The underlying data are collected by the Bureau of the Census. Cuts in the Bureau's budget and the two federal government showdowns have delayed release of fiscal 1993 state and local finance data and thereby have delayed the preparation of the 1995 edition of *How Washington Compares*. The Research Council hopes that the data will soon be available.

How the 106 limit works

Consider a simple district which has a tax rate of 0.5 percent and which encompasses just three vacant lots, each worth $1,000. The total annual tax revenue for the district would be $150; each owner would pay $50. Imagine that one year, call it year 1, the market value of one of the lots, lot A, doubles, while the values of the other two lots, B and C, are unchanged. The owner of lot B, however, constructs a house worth $1,000. At the beginning of Year 2 the district's assessor will revalue both A and B from $1,000 to $2,000. But since in any year the taxes paid on a property depend upon the previous year's assessment, taxes paid in year 2 will still be just $50 for each property. In year 3 the increased assessments would first affect taxes. Without the 106 percent limit, the annual taxes on both A and B would jump directly to $100 and the district's total revenue would be $250. With the 106 percent limit the increase is spread out over a number of years.

The year 3 taxes are limited to 106 percent of the Year 2 taxes, which works out to $159, plus the tax of 0.5 percent applied to the value of the new construction, an additional $50. Thus the 106 limit means that the district can collect only $209 in total revenue in year 3. To achieve revenue with a tax base of $5,000 requires a tax rate of 0.418 percent. Owners A and B each pays $83.60, while C pays $41.80.

The important thing to recognize is that the 106 percent limit applies to the total tax received by the district, not the tax paid by any one property owner. In this example, the taxes paid by A and B rose by 67.2 percent, while that paid by C fell by 16.4 percent.

The next year the taxes for each owner would be 6 percent higher, $88.62 for A and B, and $44.31 for C. Not until year 7 would taxes fully adjust to the increased assessments. Of course, in the real world property values are likely to change again well before the full adjustment is reached.

House voted to override the veto on the first day of the current session and it is now awaiting action in the Senate.

The 1995 Legislature passed and the governor signed legislation reducing the state levy for 1996 by 4.7 percent. The legislation specified, however, that this reduction would be ignored for the purpose of calculating allowed taxes in 1997 under the 106 limit. (For this reason the reduction was described as "temporary.") HB 1957 would make the reduction in the 1996 levy 5 percent rather than 4.7. More importantly, the reduction would be recognized in 1997 and future years in calculating the 106 limit. (Thus it is "permanent.")

HB 2841

This bill would modify the 106 limit mechanism, making the allowed increase the lesser of 6 percent or the increase in the consumer price index. This new limit would apply to both the state levy and to the regular local levy. Therefore the bill would reduce both state and local revenue.

HB 2213

There currently exists a property tax deferral program which allows senior or disabled homeowners with annual incomes less than $34,000 to defer a portion of their property taxes. The money would be repaid with interest when the property is eventually sold or transferred. HB 2213 would extend this program to all homeowners. Taxes in excess of 6 percent of disposable income could be deferred with an annual limit of $2,400.

In addition, HB 2213 would force county assessors to reassess annually. The bill would be required to provide more information, including a breakdown of taxes by district. Boards of equalization would be prevented from raising the assessment when hearing a taxpayer's appeal. And the annual tax bill, which is typically paid in two installments would be formally separated into two payments. Thus a taxpayer who is timely in making the first payment and then late in making the second will only be assessed late penalties on the missed payment rather than on the full bill.

ESB 6118

This bill passed the Senate on January 9th and is currently sitting in the House. Like HB 1957, ESB 6118 would permanently roll back the state property tax levy by 5 percent in 1996. In addition, the bill would create a property tax reduction fund. Following the end of each fiscal year revenues in excess of the Initiative 601 spending limit would be transferred to the property tax reduction fund. The governor's next budget must include a transfer of these funds to the general fund for the purpose of reducing the state property tax. The Legislature, however, would be free instead to transfer the money to the emergency reserve account. (Under current law, revenues in excess of the Initiative 601 limit are transferred to the emergency reserve account.)

The Governor's Proposal

Under Governor Lowry's proposal homeowners with adjusted gross incomes below $50,000 would be able to defer property taxes in excess of 5 percent of income.

Outlook

Over the last seven years, the relative burden of the property tax has increased. Providing even a modest amount of relief, however, would have a significant impact on the state surplus. The assessed valuation of property in the state for the tax year 1995 was $297.8 billion. With this base, a state tax cut worth $20 per year on a $100,000 home would reduce biennial state revenues by $119 million. Thus, in order to have a significant effect on the property tax burden in the near term, reform must involve either cuts in state spending or increases in other taxes, and neither of these seems likely in this session of the Legislature.

In the longer run, the Initiative 601 limits may restrain state spending sufficiently to allow tax reductions. But the property tax is only one of a number of taxes that would be a candidate for reduction. The full state tax system is sure to be examined very carefully over the next several years.

The future may also see a major restructuring of the relationship between federal and state governments. It appears likely that less money will be coming to the state than would be predicted by a simple extrapolation of past trends. At the same time, the elimination of federal mandates will give the state flexibility to reinvent a number of programs in ways that would both reduce cost and improve performance. The overall effect of the changes on the public's desire for general fund-state spending remains to be seen.

[1] Data on property taxes are drawn from various year's volumes of two annual publications of the Washington State Department of Revenue, *Property Tax Statistics* and *Tax Statistics*.

[2] Personal income, CPI, and Population data are from various issues of Office of the Forecast Council, *Washington Economic and Revenue Forecast*.

[3] Rick Peterson, "Local Regular Property Taxes, Growth from 1988 to 1995," Office of Program Research, January 7, 1996 and House Finance Committee Staff, "Overview of Washington's Property Tax System," Office of Program Research, September 13, 1995.