

PUBLIC HEARING

**REDUCING THE REAL PROPERTY TAX BURDEN
FOR CLASS 1 OWNER-OCCUPIED PROPERTIES
AND RELATED LEGISLATION**

Before the
**Committee on Finance and Revenue
Council of the District of Columbia**

The Honorable Jack Evans, Chairman

**January 13, 2004, 11:00 a.m.
Room 412**



**Testimony of
Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia**

Good morning, Chairman Evans and members of the Committee on Finance and Revenue. My name is Natwar M. Gandhi, and I am the Chief Financial Officer of the Government of the District of Columbia. With me today are Dr. Julia Friedman, chief economist and deputy chief financial officer for the Office of Revenue Analysis (ORA), and Dr. Henry Riley, director of the Real Property Tax Administration in the Office of Tax and Revenue (OTR).

I am here to testify on matters related to the taxation of residential real property.

These are:

- Bill 15-188, the “Homestead Exemption Amendment Act of 2003,” which would increase the homestead exemption from \$30,000 to \$100,000;
- Bill 15-303, the ”Comprehensive District Homeowner Property Tax Relief Act of 2004,” which would cap the annual growth in real property tax liability for homesteads at 10% and phase in \$5,000 increases in the homestead exemption between FY 2004 and FY 2008; and,
- Bill 15-619, the “Residential Real Property Tax Deferral Recapture Act of 2003,” which would defer annual real property tax liability increases in excess of 10% to the subsequent fiscal year.

I will also discuss the revenue impact of reducing rates for homestead properties.

The Tax Parity Act of 1999

Four years ago, the District made great strides in improving the taxation of real property in the Tax Parity Act of 1999. With that Act, the number of real property classes went from five to just two – residential and other. Tax rates were reduced

on three categories of property uses – commercial, rental residential, and vacant property. While the homestead exemption of \$30,000 was retained for owner-occupied housing, the tax rates on rental and owner residential were collapsed into the single rate of 96 cents per \$100 assessed value that previously applied only to homesteads. Under Tax Parity, the treatment of real property taxes conforms to the recommendations the Tax Revision Commission made in 1998. It also improves the ability of the District to compete for property owners’ attention in the region.

The Tax Parity Act also improved the District’s ability to administer the real property tax within a limited budget. Many important administrative improvements were subsequently made when the Council and Mayor approved Tax Clarity Acts 1 and 2. The administrative burden on the Office of Tax and Revenue increases sharply with the number of tax classes, because assessors must determine not only market value but also who occupies the property and what use the occupant makes of the property. The International Association of Assessing Officers (IAAO) recommends simplified tax systems that are easily understood by citizens and allow for simplified administration.

After Tax Parity

Since 1999, D.C. real property values and assessments have increased substantially. On average, residential property values increased by 34% between 1999 and 2003. Over the same period, real property tax receipts increased by 38%, from \$ 597.6 million to \$ 822.9 million. In FY 2003, real property tax was the second largest single component of the District’s tax base, contributing 25% of all local source revenue as compared to 21% in FY 1999.

A significant factor has been the phase-out of the triennial assessment process. With triennial, any increase in real property value is phased-in over three years. As triennial ends, a property is reassessed for the first time in three years, and the increase is applied all at once. Tri-group 1 was phased-out in FY 2002, Tri-group 2 in FY 2003, and Tri-group 3 is completed this year, FY 2004. Going forward, all properties will be reassessed annually. In our rapidly growing market, this can lead to particularly large jumps in tax liabilities.

In addition to triennial, the favorable market in the Washington Metropolitan Area and low interest rates have produced steadily rising property values. The burden of commuting and the successful turn-around of the D.C. government helped attract owners who would not have previously considered living in the District. Also, with the District's limited land area and height limitations, growth in demand inevitably means growth in property values.

Generally Accepted Criteria for Assessing Tax Laws

In the aftermath of recent increases in tax burdens on residential properties in D.C., taxpayers are looking for tax relief and legislators are looking for options to achieve relief. Analysts generally agree that "better" taxes:

- generate a significant amount of revenue , so that the absolute number of taxes is limited;
- interfere as little as possible with economic activity (it being argued that no tax has zero interference);
- meet generally acknowledged standards of fairness, to include imposing no excessive hardship on those least able to pay;
- can be effectively administered at reasonable cost;

- are simple to understand, so that taxpayers know what is being asked of them; and,
- where appropriate, also achieve other desired public purposes (e.g., to encourage homeownership).

When judged by these criteria, the various real property tax proposals reveal comparative strengths and weaknesses, as summarized in the attached table. All give relief to homesteads in the short run.

- Bill 15-188 and Bill 15-303 expand the homestead exemption, benefiting all homesteaders by the same dollar amount. Each \$1,000 of additional exemption reduces each tax bill by \$9.60, at a revenue cost to the District of about \$832,000. The annual revenue costs remain virtually unchanged in FY 2004-2008. Bill 15-188 increases the exemption to \$100,000, at a revenue cost of \$58.2 million in FY 2004 and \$232.8 million for the FY 2004-2007 period. While building on the current homestead exemption, increases to the exemption amount will exacerbate the known administrative challenges of determining exactly who lives in each piece of property. Fourteen states offer homestead credit programs, according to a March 2003 report by the American Association of Retired Persons (AARP).¹
- Bill 15-303 also includes a 10% cap on the annual increase in the tax liability of individual homestead properties, which benefits all homesteaders. Homesteads in Tri-group 3 will get the largest relative benefit in FY 2004, and those in Tri-group 1 will get the smallest. Over time, this bias should go away.

¹ State Programs and Practices for Reducing Residential Property Taxes, David Baer, Public Policy Institute, AARP, #2003-01, March 2003.

Also over time, the revenue cost of the cap should fall as assessments increase more moderately, as we forecast lower assessment growth in later years.

Higher caps have the same basic effects, although fewer owners benefit under higher caps. Bill 15-303 has a revenue cost of \$27.9 million in FY 2004 and \$113.1 million in FY 2004-2007, including both the 10% cap and expansion of the homestead exemption by \$5,000 in FY 2004, FY 2006, and FY 2008.

Twenty-two states have limits on property taxes, according to AARP.

- Bill 15-619, which provides for a deferral of tax, would result in a revenue loss of \$23.7 million in FY 2004 and \$24.9 million in FY 2005. Over the FY 2004-2007 period, a total of \$74.6 million would be deferred. Because of the possibility that deferred taxes may not be collected, I do not believe it would be prudent to reflect these deferrals as receivables in future years. Two key points to keep in mind here are that deferral does not provide relief in future years and it poses extreme administrative burdens, because each taxpayer account requires special management and monitoring.

- A tax rate reduction for homestead property, not proposed in any of the bills before you, would create a new tax class that permanently reduces revenues — even when assessments are growing moderately or not at all — and permanently increases the cost and complexity of administration. This would reverse the simplification of the tax regime that was enacted several years ago under Tax Parity and recommended by the Tax Revision Commission. Each one cent reduction in the rate per \$100 of assessed value (e.g., from \$0.96 to \$0.95) has a revenue cost of about \$3.2 million in FY 2004.

Other Considerations

In my responsibility as the CFO, I am concerned with the District's financial viability, not only in the short term but also in the long-term — day-to-day, year-to-year, and over several years. Over the last year, the Mayor and the Council have taken several significant steps to strengthen the District's revenue stream and to enhance its long-term financial viability. However, the recent GAO report, by confirming the District's structural imbalance of \$470 million to \$1.143 billion annually, makes it clear that we must guard our tax base closely. Currently, the real property tax rivals the individual income tax for the largest source of tax revenue to the District, at \$823 million versus \$929 million. The type of tax relief offered today can have significant implications for future revenues, as already indicated above. That is why I applaud the Mayor and the Council for considering each proposal very carefully.

On a technical note, any policy change that affects Tax Year 2004 and requires any significant additional programming of the real property tax system must be in place by January 26 in order to meet the March 1 statutory deadline for the mailing of property tax bills. Any postponement of this mailing complicates the billing process and impacts cash flow to the District. And I want to clarify any misunderstanding about the relationship between the real property tax and the current upward revision to the FY 2004-2005 revenue estimates, by \$98 million and \$107 million, respectively. These increases are strongly rooted in the growth in deed tax revenue, showing the strong current market in real property. They are not increases in expected collections of the real property tax – although that will be affected in later years of the planning period.

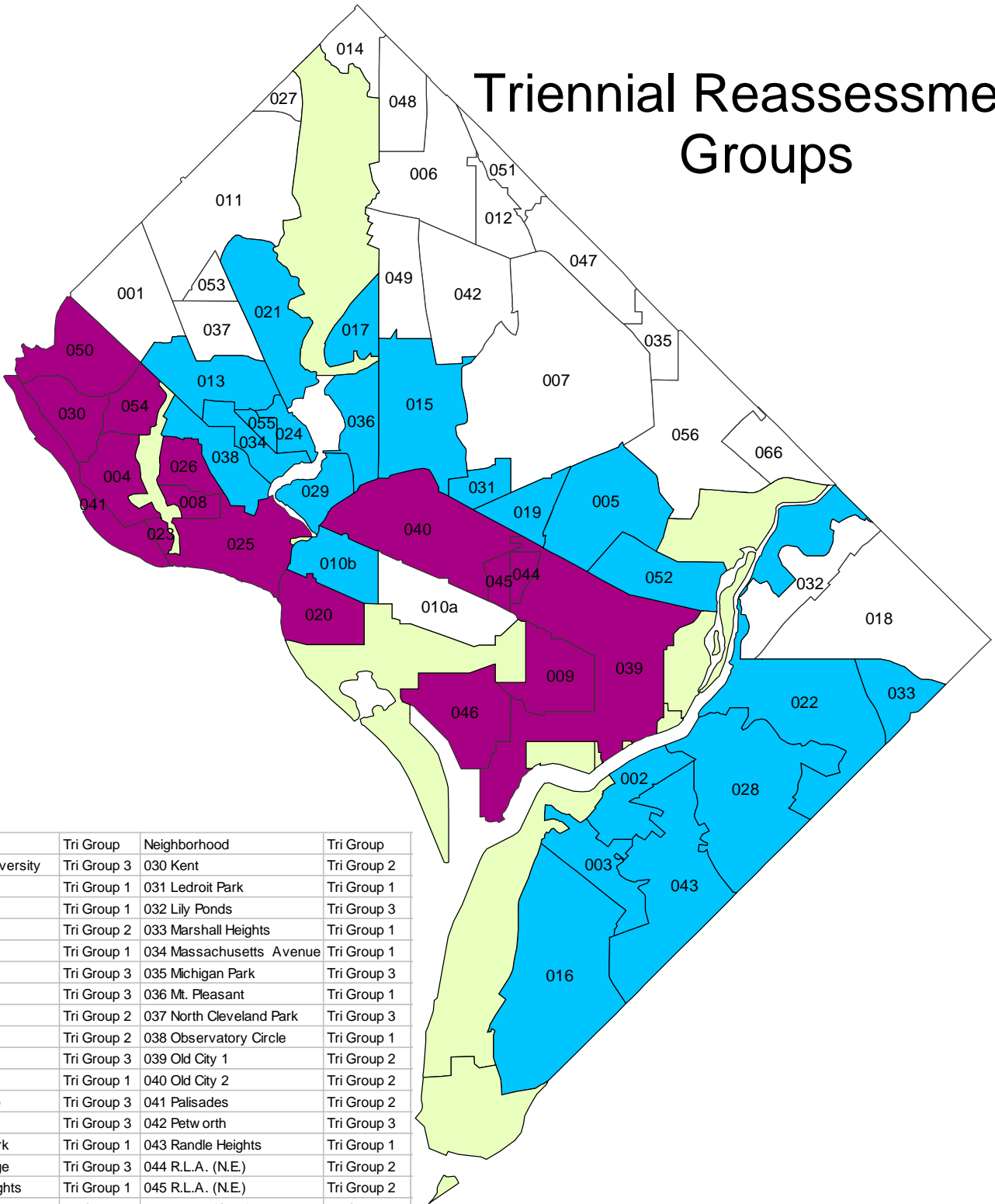
Attached to my testimony is a table that compares the three bills under discussion by several of the evaluative criteria generally used to assess tax proposals. The table also displays the option of reducing the tax rate on homestead properties. Also attached is a map from the Real Property Assessment Division showing selected data related to these issues.

I appreciate the opportunity to testify on these critical issues. My colleagues and I will be pleased to respond to any questions you or the members may have.

PROPERTY TAX RELIEF PROPOSALS

PROPOSAL	REVENUE IMPACT	ECONOMIC IMPACT	ADMINISTRATIVE IMPACT
Proposal to Increase Homestead Exemption			
Bill 15-188, "Homestead Exemption Act of 2003" – increases exemption from \$30,000 to \$100,000.	FY 2004 – \$58.2M FY 2005 – \$58.2M FY 2006 – \$58.2M FY 2007 – \$58.2M Total FY 2004-07 = \$232.8	Incentive for homeownership. All current owners get same \$ drop in tax. Lower valued property gets biggest % drop.	Increases needed for verification of homestead exemption claims.
Proposal to Cap Annual Growth in Tax Liability			
Bill 15-303, "Comprehensive District Homeowner Property Tax Relief Act of 2004" – imposes a 10% cap on assessment growth; phases in an increase in homestead deduction from \$30K to \$35K in FY 04, to \$40K in FY 06, to \$45K in FY 08.	FY 2004 – \$27.9M FY 2005 – \$32.5M FY 2006 – \$30.1M FY 2007 – \$22.6M Total FY 2004-07 = \$113.1M	Incentive to retain ownership. Virtually all current owners benefit, with largest % in first year to Tri-group 3 and smallest to Tri-group 1.	Increases needed for verification of homestead exemption claims.
Proposal to Defer Increases above 110% in FY 2004			
Bill 15-619, "Residential Real Property Tax Deferral Capture Act of 2003" – defers taxes on assessment growth above 10%.	FY 2004 – \$23.7M FY 2005 – \$24.9M FY 2006 – \$17.7M FY 2007 – \$8.3M Total FY 2004-07 = \$74.6M	Incentive only in the first year.	Administratively very costly and difficult.
Proposal to Reduce Tax Rate on Homestead Property			
Reduce tax rate on homestead property – 1 cent reduction in real property tax rate on residential property.	FY 2004 – \$3.2M FY 2005 – \$4.1M FY 2006 – \$4.6M FY 2007 – \$5.0M Total FY 2004-07 = \$16.9M	D.C. even more competitive with suburbs. All homestead owners benefit, with greater \$ and % to higher valued property.	Administratively very costly and difficult.

Triennial Reassessment Groups



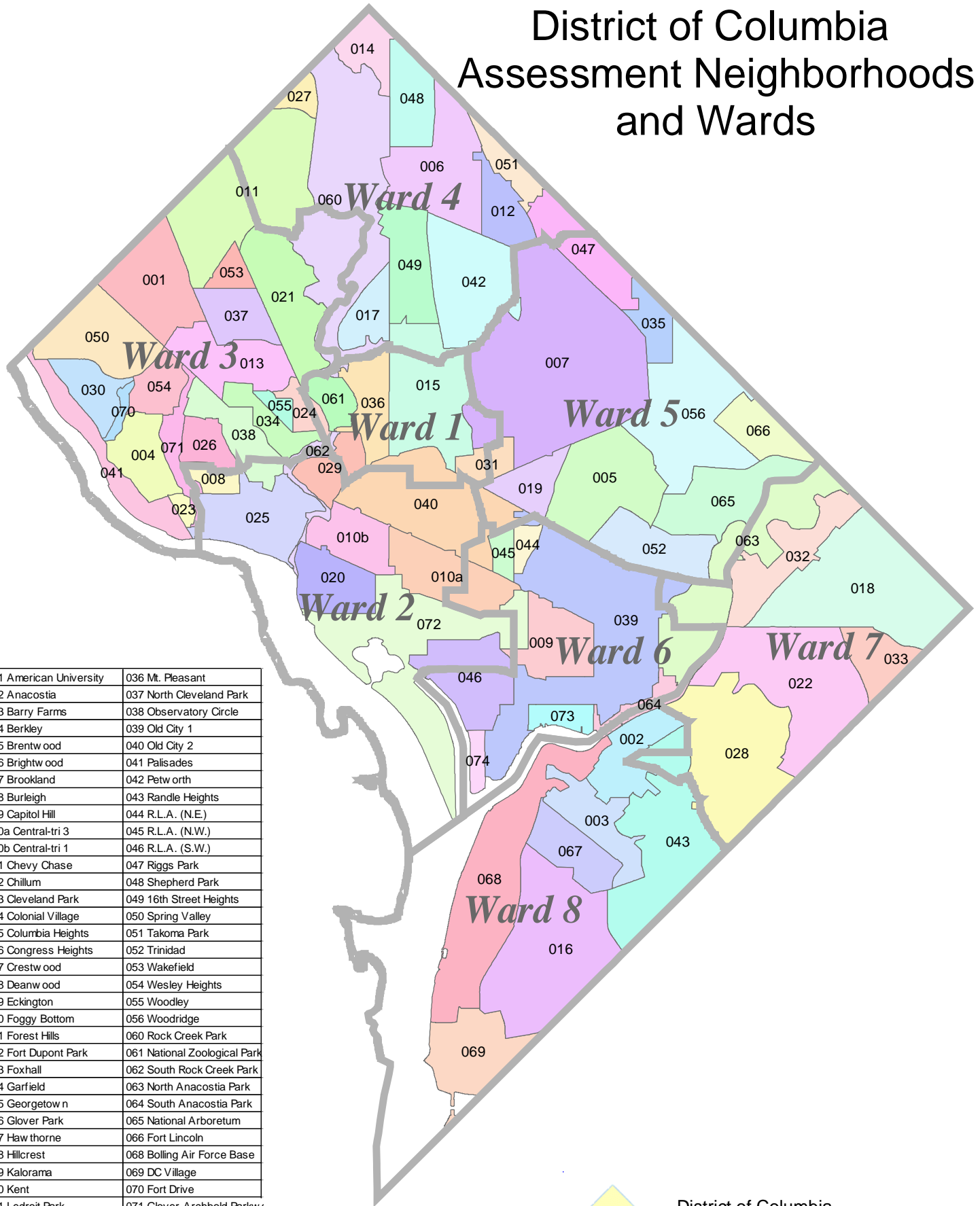
Neighborhood	Tri Group	Neighborhood	Tri Group
001 American University	Tri Group 3	030 Kent	Tri Group 2
002 Anacostia	Tri Group 1	031 Ledroit Park	Tri Group 1
003 Barry Farms	Tri Group 1	032 Lily Ponds	Tri Group 3
004 Berkley	Tri Group 2	033 Marshall Heights	Tri Group 1
005 Brentwood	Tri Group 1	034 Massachusetts Avenue	Tri Group 1
006 Brightwood	Tri Group 3	035 Michigan Park	Tri Group 3
007 Brookland	Tri Group 3	036 Mt. Pleasant	Tri Group 1
008 Burleigh	Tri Group 2	037 North Cleveland Park	Tri Group 3
009 Capitol Hill	Tri Group 2	038 Observatory Circle	Tri Group 1
010a Central-tri 3	Tri Group 3	039 Old City 1	Tri Group 2
010b Central-tri 1	Tri Group 1	040 Old City 2	Tri Group 2
011 Chevy Chase	Tri Group 3	041 Palisades	Tri Group 2
012 Chillum	Tri Group 3	042 Petworth	Tri Group 3
013 Cleveland Park	Tri Group 1	043 Randle Heights	Tri Group 1
014 Colonial Village	Tri Group 3	044 R.L.A. (N.E.)	Tri Group 2
015 Columbia Heights	Tri Group 1	045 R.L.A. (N.E.)	Tri Group 2
016 Congress Heights	Tri Group 1	046 R.L.A. (S.W.)	Tri Group 2
017 Crestwood	Tri Group 1	047 Riggs Park	Tri Group 3
018 Deanwood	Tri Group 3	048 Shepherd Park	Tri Group 3
019 Eckington	Tri Group 1	049 16th Street Heights	Tri Group 3
020 Foggy Bottom	Tri Group 2	050 Spring Valley	Tri Group 2
021 Forest Hills	Tri Group 1	051 Takoma Park	Tri Group 3
022 Fort Dupont Park	Tri Group 1	052 Trinidad	Tri Group 1
023 Foxhall	Tri Group 2	053 Wakefield	Tri Group 3
024 Garfield	Tri Group 1	054 Wesley Heights	Tri Group 2
025 Georgetown	Tri Group 2	055 Woodley	Tri Group 1
026 Glover Park	Tri Group 2	056 Woodbridge	Tri Group 3
027 Hawthorne	Tri Group 3	066 Fort Lincoln	Tri Group 3
028 Hillcrest	Tri Group 1		
029 Kalorama	Tri Group 1		

	Last Reassessment Tax Year	Proposed Reassessment Tax Year
Triennial Group 1	2003	2004
	Valuation Date 01/01/02	Valuation Date 01/01/03
Triennial Group 2	2003	2004
	Valuation Date 01/01/02	Valuation Date 01/01/03
Triennial Group 3	2001	2004
	Valuation Date 01/01/00	Valuation Date 01/01/03



District of Columbia
Real Property Assessment Division

District of Columbia Assessment Neighborhoods and Wards



001 American University	036 Mt. Pleasant
002 Anacostia	037 North Cleveland Park
003 Barry Farms	038 Observatory Circle
004 Berkley	039 Old City 1
005 Brentwood	040 Old City 2
006 Brightwood	041 Palisades
007 Brookland	042 Petworth
008 Burleigh	043 Randle Heights
009 Capitol Hill	044 R.L.A. (N.E.)
010a Central-tri 3	045 R.L.A. (N.W.)
010b Central-tri 1	046 R.L.A. (S.W.)
011 Chevy Chase	047 Riggs Park
012 Chillum	048 Shepherd Park
013 Cleveland Park	049 16th Street Heights
014 Colonial Village	050 Spring Valley
015 Columbia Heights	051 Takoma Park
016 Congress Heights	052 Trinidad
017 Crestwood	053 Wakefield
018 Deanwood	054 Wesley Heights
019 Eckington	055 Woodley
020 Foggy Bottom	056 Woodridge
021 Forest Hills	060 Rock Creek Park
022 Fort Dupont Park	061 National Zoological Park
023 Foxhall	062 South Rock Creek Park
024 Garfield	063 North Anacostia Park
025 Georgetown	064 South Anacostia Park
026 Glover Park	065 National Arboretum
027 Hawthorne	066 Fort Lincoln
028 Hillcrest	068 Bolling Air Force Base
029 Kalorama	069 DC Village
030 Kent	070 Fort Drive
031 Ledroit Park	071 Glover-Archbold Park
032 Lily Ponds	072 Mall
033 Marshall Heights	073 Washington Navy Yard
034 Massachusetts Avenue	074 Ft. McNair
035 Michigan Park	



District of Columbia
Office of Tax and Revenue
Real Property Assessment Division

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