PROPERTY TAX CAPS

By: Rute Pinho, Principal Analyst

ISSUE

Describe Massachusetts' Proposition 2 ½ and its effect on property taxes in the state.

Has a similar cap ever been proposed in Connecticut?

What are the arguments for and against property tax caps?

SUMMARY

Proposition 2 ½, approved by Massachusetts voters in 1980, limits the amount of property tax revenue municipalities can raise each year (Mass. Gen. Laws Chapter 59, § 21C). It does so by placing two constraints on the property taxes a municipality can raise. First, it caps the total property tax levy at no more than 2.5% of the municipality's total assessed value of all taxable real and personal property (i.e., levy ceiling). Second, it limits the annual growth in property tax revenue to no more than 2.5% over the prior year's levy, plus certain allowable increases such as new growth from property added to the tax rolls (i.e., levy limit). These limits are flexible in that they rise and fall as economic cycles cause a municipality's tax base to expand or contract. The attached 2007 OLR report provides more details about the mechanics of the law (*Adopting Proposition 2.5 Expenditure Limits*, 2007-R-0078).

Other provisions of Proposition 2 ½ allow for more flexibility. "Overrides" allow municipalities to annually increase or decrease the annual levy limit if the voters approve. "Exclusions" allow them to temporarily raise revenue above the levy ceiling to fund capital projects and other expenditures, again if the voters approve.

The flexibility built into Proposition 2 ½ explains why its effects on property taxes tend to vary with economic cycles. According to a 1997 study, Proposition 2 ½ significantly reduced property taxes in the cities and towns that were initially above its 2.5% levy ceiling and again in the early 1990s during a period of economic

recession. The study found that the law had little effect in the late 1980s and mid-1990s due in large part to Massachusetts' economic expansion during those years and ensuing increases in state aid to municipalities, which offset the impact of the tax cap.

A 2011 study found that although property tax revenue in Massachusetts grew on average 4.6% from FY 81 to FY 09, property tax revenue as a percentage of all local government revenue declined and property taxes grew more slowly in Massachusetts than they did for the average state over this period, suggesting that Proposition 2 ½ has had the effect of constraining property tax growth.

A 2001 study found that housing prices were likely to drop in municipalities with little or no capacity to increase spending for education and other services due to Proposition 2 ½'s revenue limits, thus reducing local tax bases.

The Connecticut General Assembly considered several proposals similar to Proposition 2 ½ in the past, including bills proposed by Governor Rell in 2007 and 2008 (HB 7431 (2007) and HB 5028 (2008)). In 2007, the legislature formed a 16-member Property Tax Cap Commission to study and evaluate how different methods to limit local property tax growth rates could affect taxpayers and municipalities. The commission did not ultimately issue a final report with recommendations.

The attached 2008 and 2009 OLR reports summarize the arguments for and against property tax caps (*Municipal Levy Limits*, 2009-R-0049, and *Pros and Cons of Various Tax Proposals*, 2008-R-0535).

EFFECT OF PROPOSITION 2 ½ ON MASSACHUSETTS PROPERTY TAXES

Research findings of Propositions 2 ½'s effects on property taxes vary depending on economic cycles, legislative changes, and a municipality's capacity to increase spending. A 1997 study estimated that the initial impact of Proposition 2 ½ was to reduce property taxes on average by 16% for those municipalities that exceeded its 2.5% levy ceiling when it was first imposed. According to the study's findings, 42% of Massachusetts communities, containing 73% of the state's population, were required to reduce property taxes. The remaining 58% of communities were already in compliance with the law and thus were not affected. Among the communities reducing taxes, the reductions amounted to an average $84 reduction per capita or a 16% average reduction as a share of 1981 taxes. ("Restraining the Leviathan: Property Tax Limitation in Massachusetts." *National Bureau of Economic Research*, August 1997).

In addition to this initial impact, the study found that the law significantly reduced local revenues during the recession of the early 1990s, but had little effect in the late 1980s and mid-1990s when Massachusetts' economy was expanding. During this recession, the state also cut local aid. Property tax revenue grew 6.7% annually from 1984 to 1990, largely due to a period of rapid economic growth in Massachusetts and an ensuing real estate boom, which allowed communities to increase their levy limits each year beyond the 2.5% cap to reflect the new growth in their tax bases. In addition, the state boom increased the state's coffers, allowing it to considerably increase its aid to municipalities and offset the impact of Proposition 2 ½ (pg. 10-14).

The study also noted that the 1980 legislative amendments to Proposition 2 ½ that allowed for voter overrides and exclusions increased the law's flexibility and, in doing so, allowed local revenue to grow much faster than the 2.5% limit. Overrides are permanent increases in taxing authority that can be enacted for any purpose. Exclusions are limited or temporary increases that can be used to raise additional funds for capital purposes, such as public works projects. The study found that new overrides and exclusions increased local revenue growth by about 0.1 percentage points per year in the late 1980s and 0.3 percentage points per year in the 1990s (pg. 9-10).

A 2011 study also identified the combined effects of Proposition 2 ½'s flexible components and economic cycle changes. It estimated that Massachusetts' statewide property tax revenue grew an average of 4.6% from FY 81 to FY 09, driven by high growth during the boom years. But the study also indicated that property taxes declined as a percentage of all local government revenues. Property taxes dropped from 58.9% of revenues in FY 81 to 51.0% in FY 83, dipped to 46% in FY 88, and subsequently remained in the 49% to 53% range from 1991 to 2009, with the exception of increases in FYs 90 to 92 and FY 03 when the state cut aid to municipalities. Moreover, on a per capita basis, property taxes grew more slowly in Massachusetts after the enactment Proposition 2 ½ than they did for the average state. From 1981 to 2007, the local property tax burden per capita in Massachusetts increased 27.5% (from $1,332 to $1,699, in 2007 dollars), compared to the average state property tax burden which increased 71.5% during the same time period (from $716 to $1,228) ("Property Tax Limitations and Local Fiscal Conditions: The Impact of Proposition 2 ½ in Massachusetts." *Regional Science and Urban Economics*, July 2011).

A 2001 study found that Proposition 2 ½'s limits triggered spending reductions in some municipalities that ultimately caused property values to decline and, concomitantly, stymied the growth of their tax bases. These effects were seen in municipalities spending at or near their levy limits, with little or no capacity to meet growing demand for better schools and other services. These unmet demands reduced housing prices (and their assessed values), as families looked for homes in other communities that still had the capacity to spend more on schools. "By constraining school spending, the [Proposition 2 ½] property tax limitation measure may have added a scarcity premium to the demand for housing in communities that were willing and able to raise their school spending" ("Property Tax Limits, Local Fiscal Behavior, and Property Values: Evidence from Massachusetts under Proposition 2 ½." *Journal of Public Economics*, 80 (2001), pp. 309).

PROPOSED PROPERTY TAX CAPS IN CONNECTICUT

In 2007, Governor Rell proposed a bill (HB 7431) that would have generally limited property tax increases to 3% over the prior fiscal year plus a portion of any new grand list growth, while allowing municipalities to exceed the limit under certain conditions. Under the proposal, starting in FY 09, municipalities could increase their property tax levies by up to 3% over the preceding fiscal year, plus any growth in their grand lists (other than motor vehicles) in excess of 1.5%, provided the growth was not the result of a revaluation. Starting in FY 10, the limit would be based on the maximum levy allowed in the prior year, rather than the actual levy. The bill would have allowed a municipality to exceed the annual levy limit by any additional amount approved by a two-thirds vote of its legislative body and a majority of its voters. It also allowed for other exceptions to the levy limit, including certain debt service costs and emergency expenditures. The bill was referred to the Finance, Revenue and Bonding Committee where it died without a public hearing.

Governor Rell proposed a similar bill in 2008 (HB 5028) that would have limited increases in municipal property tax levies to 4% in FY 09, 3.5% in FY 10, and 3% in FY 11 and after. The bill would have allowed a municipality to exceed the annual limit by any additional amount approved by a two-thirds vote of its legislative body and would have authorized 5% or 75 of the municipality's voters, whichever is greater, to petition for a referendum to reverse the legislative body's vote. It would have also allowed municipalities to opt-out of the levy limits for any two fiscal years, if the opt-out was approved by a two-thirds vote of the legislative body and by a majority of the municipality's voters. The 2008 proposal included an expanded list of exceptions to the levy limit, including certain employee health benefit, utility, pension, and debt service emergency costs; emergency expenditures; and the amount of certain decreases in state grants from the prior fiscal year. The bill received a public hearing on March 11, 2008, but the Finance Committee took no further action on it.

ADDITIONAL RESOURCES

An Overview of Proposition 2 ½. Massachusetts Municipal Association. November 10, 2008.

Levy Limits: A Primer on Proposition 2 ½. Massachusetts Department of Revenue. June 2007.

Massachusetts Taxpayer Foundation. *Municipal Financial Data, 45th edition*. December 2015.

RP:bs