

Andrew Kleine

FROM	NAME & TITLE	Andrew Kleine, Chief
	AGENCY NAME & ADDRESS	Bureau of Budget and Management Research 432, City Hill (410-396-4941)
	SUBJECT	City Council Bill No.11-0668 and 11-0669 Property Tax Reduction/Homestead

CITY of
BALTIMORE
MEMO



TO

DATE:

June 10, 2011

Honorable President and
Members of the City Council
C/O Karen Randle
Room 409, City Hall

Please find attached a feasibility study in response to City Council Bill numbers 11-0668 Property Tax Reduction and 11-0669 Homestead Credit Modifications.

The Finance Department has performed extensive research and modeling of this proposal. The attached feasibility study details the impact of the proposal on future City finances. In the end, it was found that the proposal would create substantial financial hardships for the City in the long run. The Finance Department strongly opposes these bills.

CC: Edward Gallagher
Angela Gibson
William Voorhees

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Feasibility Study of
City Council Bill Numbers 11-0668 Property
Tax Limitation and 11-0669 Taxes-Homestead Credit Percentages

Baltimore City

Department of Finance

Bureau of the Budget and Management Research

June 10, 2011

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Executive Summary

The Department of Finance has analyzed City Council Bills 11-0668 and 11-0669 relating to property tax reduction for the City of Baltimore. CCB11-0668 proposes to reduce the property tax rate from \$2.268 per \$100 of assessed value to \$1.10 over a 4 year period beginning in Fiscal 2013. Each year the rate reduction must be at least 15 cents lower than the previous year. CCB11-0669 proposes to raise the Homestead Tax Credit cap from 4% to 6% in Fiscal 2013; to 8% in Fiscal 2014; and 10% in Fiscal 2015 through Fiscal 2019. In Fiscal 2020 the cap would revert to 4%. The difference in revenue between the Homestead Tax Credit cap at 4% and the cap at the new rates would be deposited into a property tax reduction fund and used to offset revenue shortfalls from the property tax reduction.

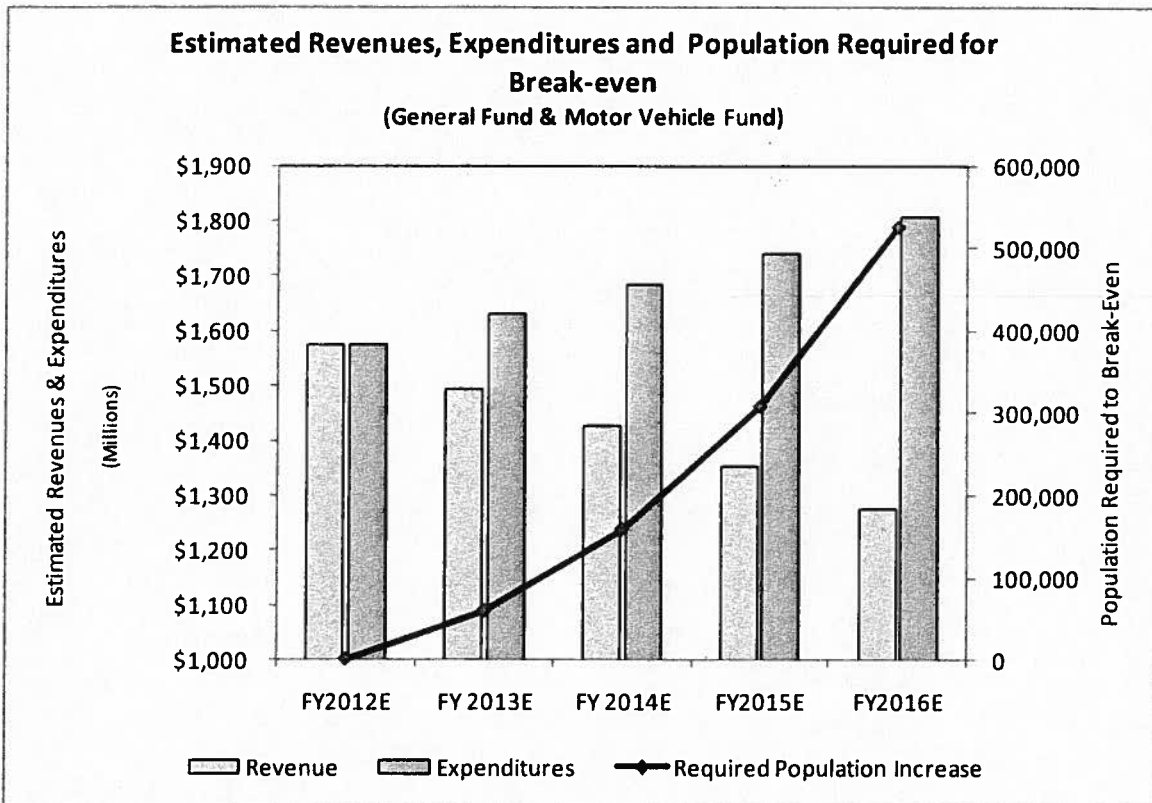
In analyzing the impact, the department started by estimating revenues and expenditures under current law to determine a baseline for Fiscal 2013 thru Fiscal 2016. Next the revenues were estimated under the proposed legislation finding that while other revenues were increasing, property tax revenues would fall from \$767 million in Fiscal 2013 to \$430 million in Fiscal 2016.

The provisions in CCB 11-0669, an increase in the Homestead Tax Credit cap, were estimated to increase revenues by \$1.3 million in Fiscal 2013 up to \$7.0 million in Fiscal 2016.

It was determined that reducing the property tax would increase property values resulting in some offset in taxes lost to lower rates. At \$1.10 property tax rate, it is estimated that a dollar in tax reduction will result in approximately \$0.077 in additional taxes due to higher property values. This was estimated to increase revenues by \$10 million in Fiscal 2013 increasing to \$29 million in Fiscal 2016. The graph below shows the total revenues under the proposed reduced property tax rate including the revenues from the Homestead Tax Credit cap offset and the anticipated increase in property values.

Expenditures were estimated for Fiscal 2013 at \$1,631 million increasing to \$1,808 in Fiscal 2016. The graph below also illustrates expenditure growth due to inflation and fixed costs growth, particularly in employee health care and pensions.

The annual revenues and expenses totals were netted to determine the City's estimated surplus or loss. It is estimated that under the new property tax rates, the City would experience a \$138 million deficit in Fiscal 2013 with the deficit increasing each year through Fiscal 2016 when it would reach \$532 million.



Because lower taxes would bring more residents to the City, the department next calculated the number of new residents that would be required for the City to break-even. In Fiscal 2013, it was estimated that each new household would generate an additional \$4,079 in annually recurring revenues. At the same time, an additional \$2,185 per household in additional expenditures would be incurred by the City. Utilizing the marginal contribution per household, it was estimated that 217,602 new households or approximately 526,597 additional persons would need to move into the City over the Fiscal 2012-2016 timeframe in order for the City to maintain balanced budgets.

Analysis

Baltimore's History of High Property Tax Rates

The history of high property tax rates in Baltimore City extends back 60 years to the mid 1950's. In short, the primary reason the rate is high is because of a persistent loss of population. In 1950, the census recorded a population of 950,000 residents. Today the City has 621,000 residents, a decline of 329,000 residents. The property tax rate is set on an annual basis by the Mayor and City Council, and is part of the annual budget process. To meet budgetary demands during the 1950's -1970's, the City raised the property tax rate as the population fell.^{1 2 3}

The exodus of residents from the City was not unique to Baltimore.⁴ It is well documented that from the late 1950's through the 1980's most major cities experienced an exodus from the central city to the suburbs. Much of this was driven by the affordability of automobiles and new highways that allowed residents to move to the suburbs where they could live in newer homes with individual green spaces, and with only a minimal increase in commute time down an interstate highway. Because the suburban homes were often built on vacant or agricultural land, the prices of the homes were cheaper than those found in the City.^{5 6} During the late sixties, the City also experienced the phenomena referred to as "white flight" as desegregation laws were passed and schools were integrated.

Over this same time span, the City was also faced with significant capital needs including a \$0.5 billion dollar contribution to the Fort McHenry Tunnel, downtown redevelopment, subway development, highway construction and water treatment plants. Increases in pensions and pay for employees also drove the rate upward over this time period

The chart below shows the history of the Baltimore City property tax rate. The rate climbed rapidly between 1950 and the mid 1970's, at which time it leveled off. In the mid 1990's, the City began a modest effort to lower the rate; however with the property tax being such a large part of the budget, large reductions were difficult without major budgetary cuts.

Property tax rates were reduced from \$2.308 per \$100 assessed value in 2006 to \$2.268 in 2008. To a great extent, this reduction was made possible by increased assessments during the housing boom. Since then, the City has experienced a major recession which resulted in a decline in the growth of City revenues. Still, the City has not increased

¹ "Tax up \$1.86 in 12 years", *Baltimore Sun*, June 25, 1968.

² Lukas, Anthony, "City Council agrees upon budget adding 31 cents to tax rate", *Baltimore Sun*, December 19, 1961.

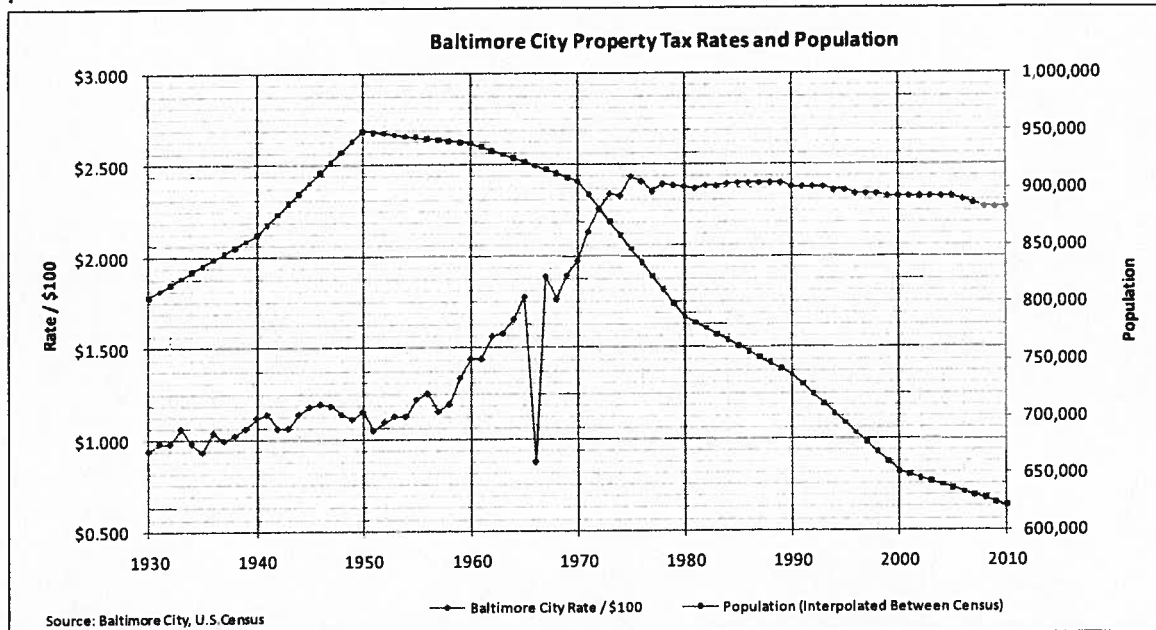
³ Whiteford, Charles, "50-cent city tax increase is forecast", *Baltimore Sun*, March 21, 1959.

⁴ "Shrinking cities", *Baltimore Sun*, December 20, 1980.

⁵ "City losing population to counties", *Baltimore Sun*, November 25, 1977.

⁶ Jones, Carleton, "Everyone went thataway!", *Baltimore Sun*, February 20, 1972.

property taxes during this time. While property tax rates have fallen to some degree over the past twenty years, they still remain high from decisions made 40 and 50 years ago.



From a budgetary perspective, the City faces many challenges that prevent significant cuts to the tax rates. Not the least of these challenges are the 80,000 jobs over and above those held by City residents that the City “exports” to surrounding counties. What this means to the City is that it must maintain police, fire, sanitation and transportation services to support the daily influx of 80,000 commuters into the City. At the same time, the City collects neither property tax nor income tax from those commuters. This is estimated to be over \$281 million in revenue or approximately 22% of the City’s current General Fund budget that the City would receive if those who worked in the City also lived in the City. If the City received both property tax and income tax for commuters, the tax rate would be roughly 85 cents lower per \$100 of assessed property value. Instead, the Citizens of Baltimore City pick up the tab for service provided to these commuters.

A second challenge to lowering the tax rate is the fact that approximately 28% of the City’s tax base is exempt from paying property taxes under State law, compared to 10% in other Maryland jurisdictions. While the City values its large universities and hospitals, it must also provide services for those institutions without the associated property tax revenues. And even though those facilities are utilized by many persons outside of the City, City residents must pick up that tab for those services also. The City loses approximately \$80 million in property taxes from exempt charitable organizations. Without these exemptions, the property tax would be about 24 cents lower.

Benefits of a Lower Property Tax

Currently the Baltimore City property tax is set at \$2.268 per \$100 of assessed value. The tax is more than double that of Baltimore County (\$1.10), Howard County (\$1.014), and Anne Arundel County (\$0.876). The average property tax rate of Maryland counties is \$0.93. The high rate has put the City at a competitive disadvantage among the counties vying for population growth and has limited the City's ability to grow economically.

Economic studies confirm that lowering the rate would result in several positive results for the City and its economy.

- A lower rate would make the City tax competitive with the surrounding counties, creating additional demand for housing in the City. A greater demand for housing would result in an increase in population. While it is clear that a lower rate would increase demand, it is unclear the degree that schools, crime and other factors constrain demand.
- An increase in population would result in increases in the General Fund tax bases including income, energy, telecommunication, transfer and recordation. As the tax bases increase, General Fund revenues will also increase. On the other hand, a larger population means added costs for core City services, such as sanitation, public safety, transportation, recreation, etc.
- A lower tax rate would reduce the cost of capital investment for business in the City. Lower capital costs would permit business in the City to be more competitive with businesses in surrounding jurisdictions.
- A lower rate would reduce interjurisdictional tax capitalization in the price of houses. Taxes are capitalized into the price of a property resulting in a lower value. For example, two identical homes, one in a high tax jurisdiction and one in a low tax jurisdiction will have different prices due to the tax. All else being equal, the house in the high tax jurisdiction will have a lower price than the house in the low tax district. Higher housing prices increase not only the City's tax base but also the wealth of its residents, providing them with greater financial leverage.

CCB 11-0668/9 Rate Reduction Methodology

City Council Bill 11-0668 sets a target property tax rate that is to be achieved over a four year period. The bill mandates that the rate must decline by at least \$0.15 each year; however, to achieve the target rate of \$1.10 in the four year period, the rate would need to decline by an average of \$0.292 per year. This analysis uses the straight-line rate of \$0.292 reduction for each year. To aid in recapturing some of the lost revenue, the Homestead Tax Credit cap is raised. **While this will offset some lost revenue, it is not anticipated that it will be enough to make-up for the shortfalls.**

The legislation defines property tax as “real property” only and excludes personal property from the legislation. However, this analysis includes personal property effects at the prescribed State mandated 2.5 times the real property tax rate. **Because the State law mandates that personal property be set at 2.5 times the real property tax rate, revenue from personal property tax is also reduced.**

Target Rate- The target rate for CCB 11-0668 is set at \$1.10. It is unclear why this rate was chosen, other than it is the same rate as that of Baltimore County. Arbitrarily setting a target rate to be equivalent to an adjacent county may not be appropriate. The minimum rate to achieve the desired results of an increase in housing demand in the City needs to be carefully considered. Economics would suggest that the City can bear a higher tax rate than surrounding counties and still generate substantial new housing demand. Easy access to sports, cultural, educational and health care facilities are a few factors that make a higher tax rate possible. Additionally, both the time and cost of commuting to work raise the desirability to live closer to a person’s place of employment.

Target Year – In CCB 11-0668, the target rate is to be achieved over a four year period. The target date appears to be arbitrary, with no supportive logic behind the four year period. First, it would be preferable to match the annual target dates of rate reduction with a plan for anticipated revenues and/or cuts in the City budget.

Second, a short target date creates unrealistic pressure to make up budget shortfalls that can only be achieved through substantial cuts to services. Matching revenue reductions caused by lower rates to new, specific revenue streams and budget cuts would provide a path to a successful reduction of the rate.

Finally, the City is on a three year assessment cycle with only one-third of the property being assessed each year and with the change in assessment phased-in over the following three years. In order for the rate reductions to fully impact the City’s revenues, the target year needs to extend more than four years into the future.

Homestead Exemption Reduction Reserve- CCB 11-0669 proposes to establish a nonlapsing fund for exclusive use in reducing property tax. The Homestead Tax Credit cap is raised from 4% to 6% in Fiscal 2013, 8% in Fiscal 2014 and 10% in Fiscal 2015. The minimum cap mandated by the State is 10%. The cap reverts to a 4% cap in Fiscal 2020.

Fiscal Impact

Assumptions

- Property tax rate declines on a straight-line basis of \$0.292 for four years in order to achieve the target rate.
- Tax de-capitalization is estimated to be \$7 of increased assessment value for every \$1 in tax reduction. Studies have shown this to be the effect in Northern California after Proposition 13. However, given the recessionary forces of the current housing market, it is unlikely that this rate would be attained.
- Housing prices are estimated at the current median price of \$150,000. This number is utilized for various tax estimates and for elasticities. Given recent price declines in the housing market, this number will be on the high side. The effect is to skew the analysis in favor of the tax reduction.
- This analysis assumes that economic benefits, such as de-capitalization of the rate from the property price, are available immediately. **In reality, these benefits would take multiple years to be fully realized.** Realization of increased prices are dependent on purchasers entering the market, bidding and closing on properties and lags in the three-year assessment cycle. All of these actions will delay realization of increased prices and associated tax revenues. This assumption will result in skewing the analysis towards a tax rate reduction.

Fiscal Benefits of CCB 11-00668/9

Two types of direct fiscal benefits accrue from CCB11-0668/9: de-capitalization of taxes and an increase in the Homestead Tax Credit cap. Additionally, a third indirect benefit is the expected increase in other City taxes resulting from additional residents.

De-capitalization of Tax Rates- The first benefit is the de-capitalization of taxes from the value of property. As taxes for a particular property increase, the relative value of the property decreases. The tax rate becomes capitalized into the selling price or full cash value of the property. As tax rates are lowered, the taxes are de-capitalized from the value of the property, raising the selling price of the property.

For example, assume two identical homes, one in a high tax district and one in a low tax district. Because homebuyers look at the total cost of purchasing a home, including sales price, interest and taxes, the house in the higher tax district must have a lower selling price in order to accommodate the higher taxes and make it attractive to purchasers (all else being equal). This is referred to as the capitalization of the taxes into the value of real property.

In Northern California after Proposition 13, it was found that property values increased \$7 for every \$1 in tax reduction.⁷ At the current tax rate of \$2.268 per \$100 of assessed value, this is equal to approximately sixteen cents for every dollar in tax reduction. In other words, for every dollar of property tax revenue lost by the City due to a tax rate reduction, sixteen cents is returned to the City in taxes on the increase in property assessments. As the rate drops, so does the return from de-capitalization. At a tax rate of \$1.10 this equates to approximately eight cents in de-capitalized taxes for every dollar in tax reduction.

For Fiscal 2013, it is estimated that a \$10.4 million dollar benefit would accrue to the City due to the de-capitalization of taxes from property values. This benefit increases to \$29.0 million in Fiscal 2016. Tax de-capitalization during a major housing recession is in uncharted waters. **Given the low demand for housing, it is unlikely that such a high rate will be achieved.**

Homestead Tax Credit Cap Increase-The second benefit is from the increase in the Homestead Tax Credit cap from four percent up to ten percent. As the tax cap increases, the difference between the four percent cap and the new cap (six percent in Fiscal 2013, eight percent in Fiscal 2014 and ten percent in Fiscal 2015 up to Fiscal 2020) will be placed into a non-lapsing fund for use in property tax reduction. The amount of the tax relief funding generated by the Homestead Tax Credit benefit begins at \$1.3 million in Fiscal 2013 and increases to \$7.0 million in Fiscal 2016.

The Homestead Tax Credit option produces only modest benefits due to lower property assessments. The City has experienced declines in assessments and is expecting the assessments to increase less than four percent for most of the period in question.

The three-year assessment cycle further moderates the revenue benefits of any property value increases that may be experienced during this time period. Properties in the City are re-assessed every three years and increases in assessments are phased in at the rate of one-third of the increase each of the three years until the full assessment is taxed at the end of the third year. On the other hand, if a property's value has declined, which is the current assessment trajectory, the full drop in property value is recognized in the first year of assessment. When a property is re-assessed, it takes three years before a higher assessment is realized, as opposed to only one year for a lower assessment.

Finally, it should be noted that an increase in the Homestead Tax Credit cap would result in owner occupied housing bearing a higher tax burden relative to business/rental property than under the current cap of four percent. This disproportionately mitigates the tax reduction benefit for homeowners.

Revenue Increases of Other Tax Bases- Under the basic premise that lower taxes will result in more people moving to the City, it is expected that additional tax revenues will

⁷ Rosen, Kenneth, (1982), "The impact of Proposition 13 on house prices in Northern California: A test of the interjurisdictional capitalization hypothesis", *Journal of Political Economy*, 90(11), 191-200.

be generated. These revenues are expressed in terms of revenue per household. The revenues include both recurring and non-recurring revenues. The recurring revenues include taxes such as additional property, income, energy and telecommunication taxes. Each additional household moving to the City will contribute an estimated \$4,079 in Fiscal 2013, falling to \$2,765 in Fiscal 2016. The decline is due to declining property tax rates.

It is expected that new City residents will also contribute an estimated \$3,750 per household in non-recurring revenues. Transfer and recordation taxes are considered non-recurring revenues. These non-recurring revenues will eventually diminish as any population growth from lower tax rates tails off.

Expenditure Increases - Of course these additional revenues must be offset by the additional costs associated with services to the increased population. These costs are estimated to start at \$2,185 per household. This amount represents the estimated marginal cost per household for public safety, health, recreation, schools, libraries, transportation, and sanitation paid from the City's General Fund and Motor Vehicle Fund. The marginal cost per household will be lower than the average cost.

Price Elasticity of Housing Demand

The primary premise underlying CCB 11-0668/9 is that a lower property tax rate will spur in-migration to the City resulting in a higher tax base and offsetting the cost of the tax reduction. Rather than attempting to determine the in-migration that would result from a lower property tax rate, this analysis quantifies the level of in-migration necessary in order to achieve a balanced budget.

In order to provide a benchmark for the expected in-migration, studies on the effect of prices on growth are examined. A fundamental of economics is that as prices fall, demand will increase. These effects are measured by the price elasticity of demand. Economists routinely look at elasticities to determine the impact of price on the demand for housing. Using the price elasticity of demand, the percentage change in demand can be determined given a one percent change in price. Studies have found that in the United States, for every 1% decrease in price of housing, demand will increase between 0.7% and 0.9 %.^{8 9}

Using these elasticities and the estimated drop in housing prices due to the property tax rate reduction, the increase in households due to lower property taxes can be estimated. Assuming that the City is currently at equilibrium with in-migration and out-migration, at a \$1.10 tax rate, the City would gain between 31,000 and 40,000 total new households after the \$1.10 property tax rate is reached, given all other factors are held constant. It

⁸ Maisel S.J., Burnham J.B., and Austin J.S. (1971) The demand for housing, *Review of Economics and Statistics*, Vol. 53, pp. 410-413.

⁹ Polinsky A. M. and Ellwood D.T. (1979) An empirical reconciliation of micro and group estimates of the demand for housing, *Review of Economics and Statistics*, vol. 61, pp. 199-205.

should be noted that the effects of the lower rate are not expected to be seen until a couple years after the rate has been lowered. In that the \$1.10 rate does not become effective until the fourth year, the full impact of the rate reduction would not be felt until 2017 or later. The process of a buyer deciding to enter the housing market and ultimately purchasing a house can take multiple years after a new price equilibrium is achieved.

The elasticities utilized here are based on national level analysis and are not specific to Baltimore City. The numbers also do not reflect the current housing market, which is not expected to improve much over the next several years. In such an environment, a lower elasticity than the one used here would be expected. Furthermore, the lower tax rates would be working against a long-term trend of population decline, which has continued over the last decade. If these trends persist, the gains in housing demand generated by a lower property tax rate would be reduced.

Determining the actual level at which in-migration will occur is a difficult task complicated by many socio-economic factors such as quality of schools, rate of crime, economic robustness of the housing industry, commuting cost, and services provided by the local government, to name a few.¹⁰ Given this difficulty, this study will instead focus on how many residents are required to achieve revenue and expenditure neutrality. It is left to the reader to determine if the required population gains can be achieved given the above elasticities.

Impact of Proposed Rate Reduction CCB11-0668/9

This analysis is based on the assumption that current service levels would need to be maintained for City residents during the new rate phase-in. This would include additional services that will be utilized by new residents that move to the City as a result of the reduced property tax rates.

In this analysis, projected current service level expenditures are calculated through Fiscal 2016 and netted from the forecasted revenues under the new rate structure. It should be noted that the shortfalls projected in this analysis reflect not only the loss of revenue from a lower tax rate, but also the City's existing structural deficit.

Forecasted revenues are based on projected property assessments through fiscal year 2016. Estimates for real property assessments are flat throughout this period based on the current declining assessments and the three-year assessment cycle. The projections for revenue are adjusted to reflect the new tax rates based on an annual straight-line decrease of the rate (\$0.292) until the target rate (\$1.10) is achieved in Fiscal 2016.

Likewise, because personal property tax rates are set by State law at 2.5 times the real property rate, they are adjusted to reflect the lower rates also. Because this law impacts

¹⁰ Tiebout, Charles, (1956), "A pure theory of local expenditures", *The Journal of Political Economy*, 64(5), 416-424.

all counties in the State, it would be unlikely that the State will enact changes to this part of the tax code. Additionally, given the time frame, the absolute earliest that the personal property tax rate could be changed by the State would be for Fiscal 2014.

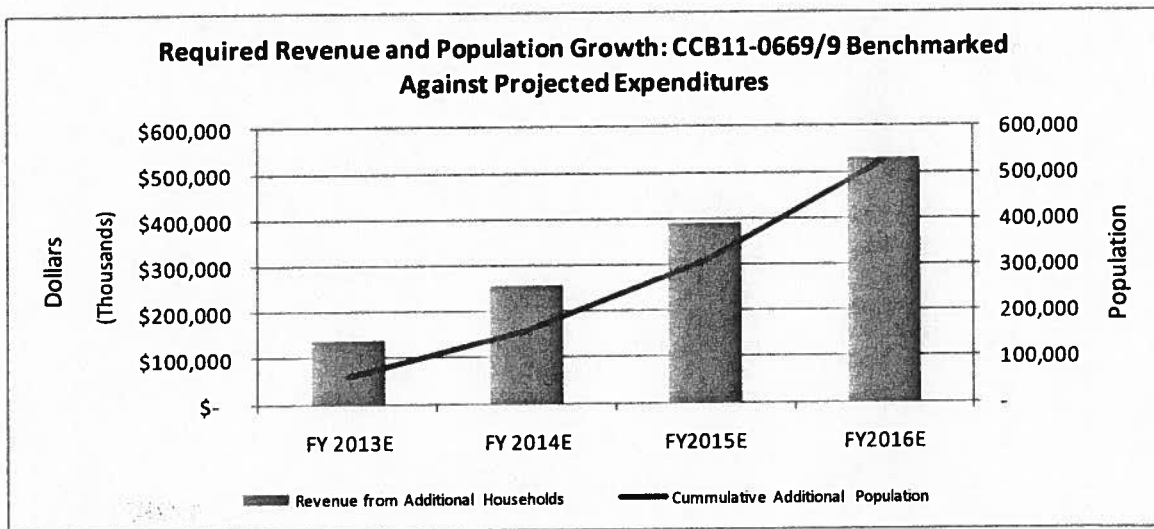
Required Revenue and Population Growth: CCB11-0668/9 Benchmarked Against Projected Expenditures					
	FY2012	FY 2013E	FY 2014E	FY2015E	FY2016E
Tax Rate	2.268	1.976	1.684	1.392	1.1
Rate Change		-29.20%	-29.20%	-29.20%	-29.20%
Taxes & Revenues with no population growth					
Net Real Property Tax Revenue	\$ 682,486,000	\$ 600,374,362	\$ 524,988,990	\$ 436,745,783	\$ 354,016,102
Other Property Tax Revenues	\$ 96,818,925	\$ 85,197,139	\$ 73,333,448	\$ 61,224,063	\$ 48,865,123
Non-Property Tax Revenues	\$ 793,859,249	\$ 795,803,939	\$ 804,395,672	\$ 820,967,567	\$ 836,178,568
Total Revenue	\$ 1,573,164,174	\$ 1,481,375,440	\$ 1,402,718,110	\$ 1,318,937,413	\$ 1,239,059,793
Benefits from Tax Reduction					
De-capitalization	0	\$ 10,380,174	\$ 19,756,218	\$ 26,998,989	\$ 28,999,347
Homestead Tax Credit Recapture	0	\$ 1,336,209	\$ 3,500,764	\$ 5,741,091	\$ 7,028,871
Total Benefits	0	\$ 11,716,384	\$ 23,256,981	\$ 32,740,080	\$ 36,028,218
Total Revenue and Reduction Benefits (without population growth)	\$ 1,573,164,174	\$ 1,493,091,823	\$ 1,425,975,091	\$ 1,351,677,493	\$ 1,275,088,011
Expenditures					
Expenditures	\$ (1,573,164,000)	\$ (1,630,705,000)	\$ (1,682,631,000)	\$ (1,740,681,770)	\$ (1,807,523,949)
Surplus/Deficit (without population growth)	\$ -	\$ (137,613,177)	\$ (256,655,909)	\$ (389,004,276)	\$ (532,435,939)
In-migration Required To Fill Revenue Gap					
Annual Additional Households	\$ -	24,380	41,101	61,902	90,218
Cumulative Number of Households	\$ -	24,380	65,481	127,383	217,602
Annual Population	\$ -	59,000	99,465	149,803	218,329
Cumulative Population	\$ -	59,000	158,465	308,268	526,597
Additional Revenue & Expenditures (from new households)					
Recurring Revenue	\$ -	\$ 99,448,606	\$ 238,424,019	\$ 408,021,108	\$ 601,689,707
Non-Recurring Revenue	\$ -	\$ 91,425,283	\$ 154,130,092	\$ 232,132,576	\$ 338,319,329
Recurring Expenditures	\$ -	\$ (53,260,713)	\$ (135,898,202)	\$ (251,149,408)	\$ (407,573,098)
Total	\$ -	\$ 137,613,177	\$ 256,655,909	\$ 389,004,276	\$ 532,435,939
Net Revenues (with Additional Households)	\$ 1,573,164,174	\$ 1,630,705,000	\$ 1,682,631,000	\$ 1,740,681,770	\$ 1,807,523,949

Revenues are assumed to be enhanced by an increase in property values due to the de-capitalization of the tax rate from current property values. The impact of de-capitalization of taxes will take several years before being fully realized. However,

because the exact timing is not known, it is assumed that the de-capitalization of taxes from property values will be realized contemporaneously with the rate reduction. This has the effect of skewing the analysis in favor of the tax reduction proposal. It results in \$10.4 million dollars in additional revenue during Fiscal 2013, escalating to \$29.0 million dollars in revenue in Fiscal 2016 and each year thereafter.

Revenues are also enhanced by provisions in CCB 11-0669 that require an increase of the Homestead Tax Credit cap from 4% to 10% over the four year period. It is estimated that this will increase revenues from \$1.3 million in Fiscal 2013 to \$7.0 million in Fiscal 2016.

These revenues are added to total revenues and then projected expenditures are subtracted to determine the surplus or deficit under the new property tax rates.



If the City adds no new households, the combined deficit in Fiscal 2013 would be over \$137.6 million escalating to \$532.4 million in Fiscal 2016. The graph above illustrates the required new revenue and the associated population growth that would be necessary for the City to break-even.

In order to fill those gaps and maintain service levels, the City would need to add 217,602 new households over the four year period, or approximately 526,597 new residents. This would require over an 80% increase in the City's current population of 621,000.

Other Simulations-Two other simulations were run to determine the impact of different expenditure policies. The first of the alternate simulations held spending to projected revenues at the current property tax rates, effectively eliminating the structural deficit from the analysis. This assumes that the structural deficit is handled through either service reductions or new revenue streams that are not included in this analysis. In this simulation, it was found that with no new households, the City would be facing a deficit

ranging from \$75.9 million in Fiscal 2013 to \$392.5 million in Fiscal 2016. In order to break-even under this scenario, the City would need to add 155,611 households over a four year period. This equates to a population increase of 376,579 persons over the same time period.

In the second alternate simulation, expenditures were held constant with Fiscal 2012 expenditure levels. This represents a budget that would be frozen at the Fiscal 2012 level and would result in extremely large budgetary cuts due to not only the structural deficit but also inflationary growth. In this simulation, if the City adds no additional households, it will face a revenue loss of \$82.0 million in Fiscal 2013, growing to a \$340.4 million loss in Fiscal 2016. In order for the City to break-even with Fiscal 2012 property tax revenues, it would need to add 137,920 households over a four year period. This equates to a population increase of 333,765 persons over the same time period.

Conclusion

The Department of Finance has simulated the financial position of the City under three separate expenditure scenarios. **Under each of the scenarios, the City would be faced with large deficits. Even though lower taxes would likely entice more residents to the City, the number of new residents required to break-even was found to be substantially higher than what could reasonably be expected.**

The analysis has also considered the target rate and target period of the proposed bill, raising questions as to why these numbers were chosen. Economics would suggest that given the close proximity to offices and cultural activities and the commuting costs associated with these activities, a property tax rate equivalent to surrounding counties is not necessary to make the City economically attractive to new residents. Further study needs to be done to find the appropriate tax rate that will make the City competitive with surrounding counties.

The length of the target rate phase-in period is also a concern. Rather than setting an arbitrary time frame for achieving the target rate, it would seem that new revenue streams (e.g., Video Lottery Terminals) and budget cuts (e.g., employee healthcare reform) should be included in the phase-in plan and ultimately dictate the length of time necessary to achieve the target rate. This will, of course, require a concentrated effort to find dedicated sources for reduction of the property tax rate.

Property tax rate reduction should be accomplished by developing a long-term financial plan which considers not only property tax reduction, but also the City's structural deficit, new revenue sources and additional efficiencies in the operating budget.

Revitalizing the City requires a delicate balance of simultaneously improving education, lowering crime and reducing property tax rates. While dramatically cutting the tax rate will improve the economics of living in the City, the lower revenues would do irreparable

harm to education and crime reduction, both of which are key components of making Baltimore City an attractive place to reside.

It has taken the City 50 years to get into this financial position; it is unreasonable to think that the City can get out of the financial situation in just a few years through the use of unproven tax policy.

Recommendation

The Finance Department strongly opposes this bill.