FROM	
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SUBJECT	City Council Bill #18-0221 Recordation and Transfer Taxes – Yield Tax

CITY of BALTIMORE

MEMO

TO

DATE: September 24, 2018

The Honorable President and
Members of the City Council
Room 400, City Hall

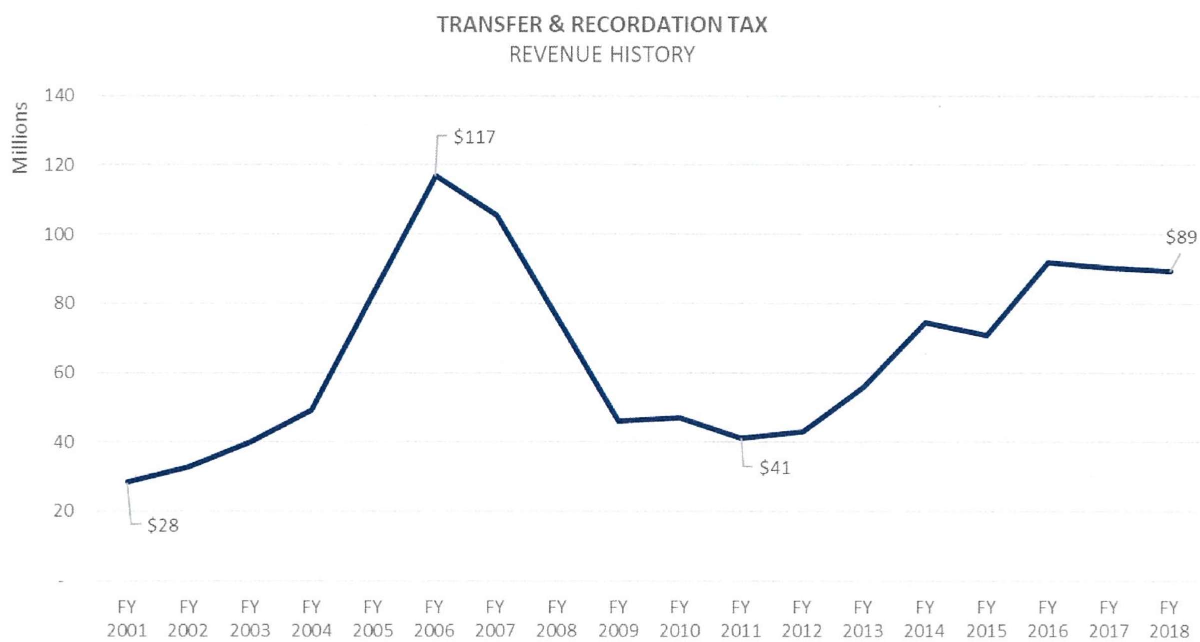
Attention: Ms. Natawna Austin

We are herein reporting on Council Bill 18-0221, which introduces an excise tax to be known as the Yield Tax to existing real property transactions that exceed $1 million. The Yield Tax would be applied in addition to the existing Transfer and Recordation taxes. Proceeds from the Yield Tax would be deposited into the Affordable Housing Trust Fund.

Background

In Fiscal 2019, the City's existing Transfer and Recordation taxes are budgeted to generate $76.7 million of General Fund revenue. The Transfer Tax rate is calculated as 1.5% of the value of a real property transfer. The Recordation Tax is calculated as $5 per $500 (equivalent of 1%) of the consideration value of a property transfer or refinancing transaction.

Transfer and Recordation tax receipts are a function of the activity in the commercial and residential housing market. As such, these sources are highly volatile over time and susceptible to changing economic conditions. To illustrate this volatility, the table below shows the City's actual historical receipts even as tax rates remained constant:



Fiscal Impact

CCB 18-0221 introduces a new excise tax known as the Yield Tax to property transactions exceeding $1 million. The Yield Tax rate is 0.6% for any consideration subject to the existing Transfer Tax and 0.15% for any transaction subject to the Recordation Tax. To determine the scope of this new tax and the revenue generated, BBMR compiled all transactions subject to the Recordation Tax over the last three fiscal years (Fiscal 2016 to Fiscal 2018).

BBMR estimates that the Yield Tax will generate $13 million annually, using the average of the last three years. Note that this assumes no change in market conditions, and no decline in demand for housing due to the new tax.

BBMR estimates that the Yield Tax will only affect 1.2% of real estate transactions. Fiscal 2017 data serves as a good illustrative example. In that year, of the 23,855 total transactions subject to the Recordation Tax, only 295 exceeded $1 million and would have been subject to the new yield taxes.

From a consumer's standpoint, this tax will add $7,500 to the closing costs on a $1 million real estate transaction. Currently, on a $1 million transaction a consumer would pay approximately 2.5% of the value in tax (1.5% Transfer Tax plus 1% Recordation), which equates to $25,000. The new surcharge would require an additional 0.75% (0.6% Transfer plus 0.15% Recordation), which equates to $7,500.

Implementation Considerations

The Bureau of Revenue Collections currently uses the real property application of the City's Mainframe for transfer tax and separate software for recordation tax. Modifying either system to handle a new yield tax is not considered cost-effective. Instead, the Bureau will work with BCIT to modify the cash slip application of the Mainframe. Modifications are needed to include a scan line to the cash slips and to record additional data so that reports can be created. The calculation of the yield tax would have to be performed manually. Based on present collections, the Bureau estimates that between 200 and 400 transfers each year would qualify for the tax. Customers who now submit separate checks for transfer and recordation taxes would have to submit a third check for the yield tax. The Bureau also would have to reconcile the receipts with the cash slip system at the end of each day and likely maintain a manual spreadsheet.

The Bureau will also need to notify the public of the new tax and procedures through an online alert and individual contacts with title companies.

Other Considerations

Tax Competitiveness

The burden placed on residents and businesses in the City is significant in comparison to both other local jurisdictions and major cities nationwide. The combined burden of state and local taxes for a family of three in Baltimore is in the top 20% of 51 cities surveyed for a recent *Tax Rates and Tax Burdens* report issued by the District of Columbia government. The following table illustrates the City has the highest property, transfer, and recordation tax rates of seven largest Maryland counties, and imposes the maximum possible local income tax rate under State law:

Jurisdiction	Property Tax	Income Tax	Transfer Tax	Transfer Tax >$1M*	Recordation Tax	Recordation Tax >$1M*
Baltimore City	**2.248**	**3.20%**	**1.5%**	**2.1%**	**1.00%**	**1.15%**
Anne Arundel County	0.923	2.50%	1.0%	1.0%	0.70%	0.70%
Baltimore County	1.100	2.83%	1.5%	1.5%	0.50%	0.50%
Harford County	1.042	3.06%	1.0%	1.0%	0.66%	0.66%
Howard County	1.190	3.20%	1.0%	1.0%	0.50%	0.50%
Montgomery County	0.999	3.20%	1.0%	1.0%	0.69%	0.69%
Prince George's County	1.374	3.20%	1.4%	1.4%	0.55%	0.55%

*Includes proposed yield taxes for transactions with consideration values greater than $1 million

Although the new yield tax would only be applied to a fraction of property transactions, even small increases to tax rates can be more harmful than in neighboring, wealthier jurisdictions.

Effect on General Fund Revenues

Given that City tax rates are already the highest in the State, any additional tax increase has the potential to reduce investment in Baltimore, which in turn could erode General Fund revenues. To further explore this issue, we researched peer-reviewed academic studies about the impacts of real estate transaction taxes on housing market prices and activity.

The results of the studies were mixed. One study, which looked at a transfer tax on sales over $1 million in New York and New Jersey, found evidence that transactions bunch below the new threshold, and produce strong incentives for buyers and sellers not to transact in the proximity of the threshold, which in turn led to lower sales activity. Another study, which looked at rate changes in Washington D.C., also found bunching below the new threshold, but no evidence of any change in the volume of housing sale activity in the market as a whole. Other studies in Australia, Canada, Finland, and France found lower property sales as a result of new transfer taxes. Differences in local economies and market conditions make it difficult to translate these findings to Baltimore.

Although CCB 18-0221 exempts most transactions due to the $1 million threshold, most of the City's General Fund Transfer and Recordation revenue comes from these high-value transactions. In Fiscal 2017, the top 1.2% of transactions (over $1 million) produced nearly 45% of the Transfer and Recordation revenue. In turn, even a small negative impact on housing transactions due to CCB 18-0221 could lead to lower General Fund revenue.

In looking at the Fiscal 2017 data, there were 295 high-value transactions subject to the Recordation Tax whose consideration value ranged from $1 million all the way the $142 million. If transactions were reduced by even 5% (about 15 transactions) due to the new yield taxes, General Fund revenues could be reduced by as much as $2 million per year.

Budget Flexibility

By dedicating the proceeds of a tax increase to a new function, CCB 18-0221 will limit the City's options and flexibility in the event of a future economic downturn.

In recent years, significant tax increases have only been used selectively in response to clear financial crises. For example, in Fiscal 2011, at the peak of the recession, the City increased rates for energy, income, hotel, and parking taxes. These tax increases, combined with significant expenditure reforms on civilian pension and health benefits among others, allowed the City to survive the economic downturn with only modest service impacts to City residents.

The City's revenues historically track closely with the health of the national economy. The United States has now entered its tenth consecutive year of expansion, the second longest since World War II, which increases the chances of a recession in the short to mid-term. In a future economic downturn, the City will have limited revenue options to choose from. The City is unlikely to pursue property tax rate increases due to the significant disparity between the City's rate and the rate in surrounding jurisdictions. The City's Income Tax is not an option since the rate of 3.2% is already capped by State law. And, the City's base Transfer and Recordation taxes along with the new yield taxes proposed in CCB 18-0221 will far exceed the highest rates in the State. Those three revenues alone make up nearly 70% of the City's Fiscal 2019 budget.

Conclusion

Given the concerns discussed above, Finance will coordinate an independent study to evaluate the impact of this legislation within two years of implementation.

cc: Henry Raymond
Karen Stokes