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Testimony of the Boston Municipal Research Bureau

Before the

Special Commission on Property Tax Classification

December 30, 2003

Regarding: Chapter 138 of the Acts of 2003

As President of the Boston Municipal Research Bureau, I am pleased to testify before the Special Commission on Property Tax Classification to present information and analysis related to classification in Boston in an effort to assist the Commission with its analysis of this issue and the legislative recommendations that it will present to the General Court on January 12, 2004. The Research Bureau is a non-profit, research organization that provides objective data and analysis on public policy issues facing the City of Boston. The Bureau first became involved with this issue of classification a year ago when we reported on the beginning of the shift in the tax burden in Boston in our annual tax rate report issued in January 2003.

By its nature, classification creates an arbitrary situation, within parameters, in which one class of property subsidizes the tax burden of another class of property. Rather than all property paying taxes based solely on 100% their assessed value, the tax burden is shifted so that one class pays taxes at a higher percentage of its full value share so that another class of property may benefit by paying at a lower percentage of its full value share. For Boston in fiscal 2003, classification resulted in business property representing 38.9% of all taxable value but paying 68.1% of the property tax levy. Conversely, residential property represented 61.1% of value but paid 31.9% of the levy last year. Traditionally, the tax levy has been split on a 70/30 basis between business and residential property. As a consequence of classification, Boston's business property in fiscal 2003 paid $302 million more in property taxes than it would if full classification were not in place.

The City of Boston has maximized tax benefits to the homeowner through full classification and the application of a 30% residential exemption. Classification and the residential exemption saved the single-family homeowner in fiscal 2003 an average of $2,745 and the three-family homeowner an average of $2,938 off their tax bills. Consequently, the average tax bill for a single-family homeowner in Boston was $1,972. That bill compares very favorable with the average single-family tax bill in surrounding communities such as Milton ($4,713), Quincy ($3,089), Brookline ($9,370) and even Somerville ($2,335). Part of this effort to favor homeowners in Boston stems from a policy decision to encourage retention of the middle class households in the city to support neighborhood stability.

Based on the preliminary values set by the City of Boston for fiscal 2004, it is clear that no change in the classification law would result in sharp increases in the residential tax bills in fiscal 2004. Overall increased residential values of 26.5% and decreased business values of 2.2% will combine to produce an increase in the average single-family tax bill of $816 or 41.4% and an increase in the average three-family tax bill of $1,292 or 56.6%. In certain areas of Boston, the average increase for a three-family property would be substantially greater. For example, in East Boston, Dorchester and Roxbury, the average three-family tax bill would increase by over 75%. Depending on their tax bracket, homeowners will be able to exempt a portion of their tax bill increases in their federal taxes. The public perception is that as residential bills increase, most business bills will decrease even if the business ceiling is increased. However, it is important to note that in moving the ceiling to 200%, a segment of business property, commercial office properties, that represents 48.9% of all business value in fiscal 2004, would receive tax cuts reflecting their decline in value. However, all other commercial, industrial and personal properties (51.1% of total business value) whose values remain level or increase would receive increases in their tax bills. By moving the business ceiling to 200%, the business tax rate in Boston is estimated to increase by $1.46 or 4.6%, to accommodate the commercial office value decline, which would result in tax bill increases for all business properties with level or increased values from last year. Business taxable value is estimated to decrease by 2.2% from last year, primarily due to an 8.3% reduction in commercial office value even with new growth included. Other commercial (+2.0%), industrial (+7.6%) and personal (+9.2%) values would increase in fiscal 2004. The combination of increased tax rate and increased value would produce noticeable tax bill increases for these properties.

Furthermore, the estimated tax bill decreases for commercial office properties are due to a weak office market and decrease in property valuation as a result of increasing costs and declining revenues. Various real estate studies have indicated that during the 1999-2003Q2 period, average asking rents have dropped by about 19% while building expenses have increased by over 28%. Often the actual negotiated rate is less than the asking rate and may include further tenant concessions affecting revenue. At the end of the third quarter of 2003, the vacancy rate for Boston was 13.8%.

Therefore, the Special Commission will need to determine the proper balance of mitigating the spike in residential property tax bills with creating greater tax hardships for business properties just as the local economy begins to improve. To that end the Bureau makes the following observations.

1. The preferable approach for addressing this issue would be to target relief to residential homeowners most affected rather than provide a blanket approach to all homeowners irrespective of income. We do recognize that whether a circuit breaker type of approach is used or a temporary increase in the residential exemption is considered, further study would be required to determine feasibility and understand any unintended consequences and administrative requirements.

2. If the Commission approves increasing the business ceiling under classification, the increase should be temporary and specified percentages should be established for each subsequent year until it is brought back to its fiscal 2003 level or for Boston to 175% by fiscal 2008. The Commission will need to consider the fact that commercial values could decline further in fiscal 2005 causing a second year of large residential tax bill increases before establishing the specified percentages.

3. Any temporary measure recommended should be consistent with the Commission's enabling legislation guidelines of bringing the residential and business split in the levy back to fiscal 2003 levels. Also, the concept of restoring the residential share of the levy to the fiscal 2003 level sooner than fiscal 2008 if the economy improves and commercial values rise sufficiently should be included in the proposed legislation.

4. The provision in the current classification law (Ch. 58, s. 1A) that stipulates that the residential share of the levy could not be reduced below its lowest percentage since classification was adopted by a community should not be changed.

5. Attempting to improve the existing small business exemption (Ch. 59, s. 5I) will be problematic this year because any resulting shift in tax burden will affect business properties already impacted.