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# Research Report

December 2006



*Center for Local Government Studies*

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## **Controlling Escalating Property Taxation and Local Government Spending and Revenue**

Florida's property tax system is in crisis. Property tax levies are skyrocketing and the system places most of the burden for these increased taxes on only a portion of the taxpayers. The state's Save Our Homes constitutional amendment, while holding down taxes for many homeowners, has brought on a myriad of problems, shifting billions of dollars in taxes from some taxpayers to others each year, creating inequities in tax treatment, increasing housing costs for renters and new home buyers, and restricting the financial ability of some people to move to a different home.

Many local officials are ignoring a provision of the state's Truth in Millage law by enacting large tax increases and passing them off as "holding the line" or even, inappropriately, stating that they are cutting taxes.

Total property tax levies in Florida have more than doubled in the last nine years (FY 1997 – FY 2006), including growth of 42% in just three years. This is almost three times as fast as the combined growth in population and inflation, and doesn't even include the recently commenced local fiscal year, which is likely to have the largest increase in recent history. Florida's total property tax burden now stands at over \$25.7 billion (FY 2006).

Spending by local governments is also increasing rapidly, outpacing population and inflation growth, as well as Floridians' ability to pay. Hefty revenue hikes are not just limited to property taxes; other revenue sources, such as special assessments, impact fees, and charges for services (previously supported by taxes) are increasing in number and growing even faster.

Every year around the time taxpayers get their property tax notices and local governments hold budget hearings, Florida TaxWatch hears from taxpayers that are upset about some aspect of the property tax system. This year, the volume of calls and magnitude of taxpayers' anger reached a fever pitch. Taxpayers perceive a property tax system that is unfair, unaffordable, out of control, and getting worse.

Governor Jeb Bush established a Property Tax Reform Committee that has been holding meetings across the state. Florida TaxWatch had encouraged such a group. The Committee has also heard from many disgruntled taxpayers. It is planning to continue its work through 2007. Florida TaxWatch will work with the Committee, as well as the upcoming Florida Taxation and Budget Reform Commission, to try to bring some reasonableness back to property taxes and local government revenue and spending practices as a whole.

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*"Improving taxpayer value, citizen understanding and government accountability."*

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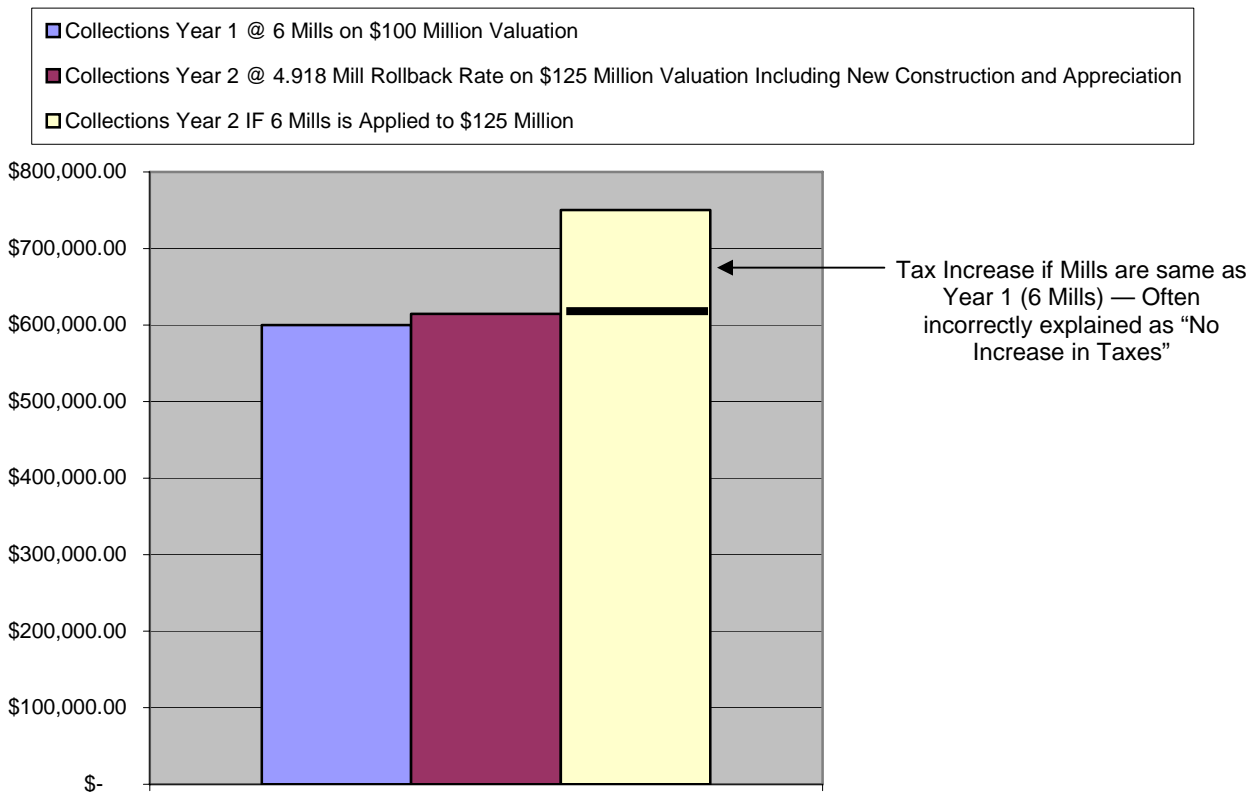
## It's All About the Millage Rates

In recent years, Florida's rapidly escalating property values have made it possible for cities, counties, and school districts to raise significant new revenues without increasing, and even slightly reducing, millage rates. Moreover, even small increases in tax rates can result in huge revenue boosts.

Many local governments have treated this as a windfall, when it is actually a significant tax increase.

Florida's Truth in Millage (TRIM) law recognizes that property values are a powerful revenue-producing tool and that skyrocketing values result in skyrocketing tax burdens if locally elected officials do not commensurably reduce the property tax rates. TRIM requires that taxing authorities calculate a "rolled-back millage rate". This is the millage rate that, when applied to the current year's assessed value, would raise the same amount of revenue as last year.

### How Keeping the Same Millage Level as the Previous Year Constitutes a Tax Increase as Defined by State TRIM Law



According to TRIM, any millage rate in excess of the rolled-back rate is considered *by law* to be a tax increase and is to be advertised as such. New construction, additions to existing structures, major rehabilitations, and annexations are excluded from the rolled-back rate calculation to allow for some growth revenue. Even if a taxing authority keeps the same millage rate, if the total

assessed value of the property on last year's tax roll is up, then it is considered, and should be presented as, a tax increase. [For more information on Truth in Millage, read "TRIM" and Property Taxes: A Primer, December 2006, accessible on the Florida TaxWatch website at [www.FloridaTaxWatch.com](http://www.FloridaTaxWatch.com).]

Even with Save Our Homes artificially holding down the taxable value of homestead property, the total taxable value of property in Florida has more than doubled since 2000, reaching more than \$1.6 trillion. These values increased by an extraordinary 25% in 2006 alone.

This remarkable growth has allowed local governments to often lower millage rates. In fact, the estimated average statewide millage rate of 19.54 mills for 2006 is the lowest since 1989.

This does not mean that local governments have been cutting property taxes. Florida property owners are experiencing the curious dichotomy of falling tax rates and rising taxes (again, because of ever-growing property values). However, many local governments have been deceptively portraying these millage reductions as tax cuts.

**Florida should look closely at the state's valuable TRIM law to ensure that it serves its intended purpose of making local governments truly accountable for increasing property taxes over the rolled-back rate. It should be required that the rolled-back rate be the starting point in local budget processes.**

### **Other Local Revenues Also Growing Rapidly**

Another remarkable aspect of local revenue has been that the growth in other revenue sources has been keeping pace with that of higher property value-fueled property taxes. It must be remembered that property taxes, while by far the largest local tax source, only provide 37.1% of city, county, and special district revenue (24.7%, when including enterprise funds). Property taxes, which are high profile, have received the attention, but virtually all local revenues have also been increasing far faster than population and inflation, as well as taxpayers' ability to pay.

Local data for these sources is only available through 2004. Florida TaxWatch examined the growth in revenues for cities, counties, and special districts for the ten-year period of 1994-2004. While total property tax revenue for these jurisdictions grew 94% over this period, total governmental revenue increased 108%. Cities led the way with 135% growth, but this is at least partially attributable to increased annexations.

<b>Growth in Total Revenues and Expenditures</b>		
<i>1994-2004</i>		
	Revenue	Expenditures
Counties	101%	103%
Cities	135%	124%
Special Districts*	118%	128%
Total	108%	109%

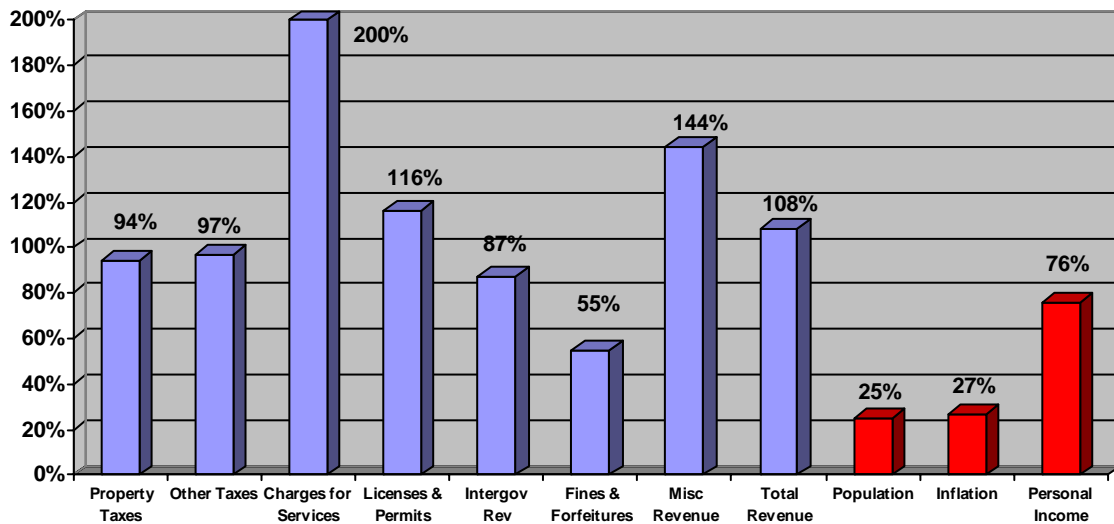
\* includes enterprise revenues

The 94% growth of property taxes over this period pales in comparison to the increase in charges for services (200%) and miscellaneous revenue (144%, which includes impact fees and special assessments). Interestingly, non-property taxes (sales, franchise, utility, and communications) grew slightly faster than property taxes (see chart below).

### Rapidly Rising Growth in Local Government Revenues

FY 1994 - FY 2004

Cities, Counties, and Special Districts



Source: Florida TaxWatch, using data from the Florida Legislative Committee on Intergovernmental Relations, December 2006

### Special Assessments and Impact Fees

Two other local levies that affect property owners, impact fees and special assessments, are skyrocketing. These are included in the “Miscellaneous Revenue” category in the above chart.

Special assessments, also known as non-ad valorem assessments, are a home rule revenue source that may be used by a local government to fund certain services, and construct and maintain capital facilities. To impose a special assessment, the property assessed must derive a special benefit from the improvement or service provided, and the assessment must be fairly and reasonably apportioned among the properties that receive the special benefit.

If a local government’s special assessment ordinance withstands these two legal requirements, the assessment is not considered a tax, which is levied for the general benefit of residents and property rather than for a specific benefit to persons and property. That distinction is becoming increasingly lost on many taxpayers, as more and more of these assessments are included with their tax bills.

While still a fairly small component of local governments' total revenues, special assessments are growing rapidly. From 1994-2004, special assessments levied by all Florida counties, cities, and special districts have almost tripled, increasing 171%. This is faster than population growth (25%), inflation (27%), and even growth in Florida's total personal income (76%). These assessments totaled \$848 million in 2004. While having the lowest dollar amount, cities have had the fastest increase, with non-ad valorem assessments growing eight-fold in ten years.

Impact fees are charges levied against new development to pay for needed infrastructure, such as roads and sewers. These fees (including cities, counties, special districts, and school districts) have grown almost five-fold in ten years (389%), increasing from \$219 million in 1994 to \$1.07 billion in 2004.

More and more jurisdictions are using impact fees. In 1994, 167 government entities reported impact fee revenues. This number grew to 258 in 2004. Those governments levied 283 different impact fees in 1994; there were 492 different ones in 2004.

Another revenue source increasingly relied on by local governments is charges for services, which increased 200% in ten years. In many instances, the charges are added costs for services, which were previously supported with taxes.

### **Profligate Revenue/Spending Practices are Commonplace: Spending is Growing Because Local Officials Cannot Resist Spending from Swollen Revenue Bases**

Not surprisingly, growth in local government expenditures over the same period is comparable to revenue growth. Total city, county, and special district governmental expenditures were up 109% from 1994 to 2004. Comprehensive local revenue and expenditure data is not available past 2004, but the growth in the three years since is likely even higher, since property taxes have had such huge growth.

A limited survey of some cities and counties by the Property Tax Reform Committee showed average budget growth of 38% from FY 2005 to FY 2007 (average annual growth of 11.3%). The survey was not statistically representative, but included approximately 20 cities and counties in each year. Florida TaxWatch has examined several local government budgets for FY 2007 and found even higher growth.

The lack of revenue/spending discipline is a local government-wide problem, and not just a property tax issue. Over the ten-year period studied, the growth in local government revenue of 108% far outstrips other measures of the economy, including population growth (25%), inflation (27%), and even growth in Florida's total personal income (76%). The growth in local government revenue is not sustainable and is exceeding the taxpayers' ability to pay.

At some point, if it has not already, this will have negative impacts on competitiveness, capital formation, healthy job growth, and tourism.

The latest data available from the U.S. Census Bureau (FY 2004) shows that Floridians' per capita local tax burden is the 16<sup>th</sup> highest in the nation. This is up from 21<sup>st</sup> in 2002. The

double-digit growth in property taxes in recent years will likely push Florida's ranking even higher.

## **Responsible Controls on Local Government Spending Are Critical**

Of course, the driving force behind escalating property taxes and other revenues are the spending decisions made by local government officials. Governments have sizable spending pressures on them and citizens often demand increased governmental services. But government spending must consider economic growth and the capacity of the taxpayers' ability to pay.

Local government revenues and expenditures are outpacing these factors and the cost of government in taking a larger piece of Floridians' income. The extraordinary growth in recent years may be resulting in governments adding or enhancing programs and services, "spending now while we've got the money," and creating budgets that may not be sustainable.

Many taxpayers are upset and some are predicting a "tax revolt". If taxing and spending continues unabated, this is a real possibility. If this should happen, limits on local governments may be imposed by the citizens through the constitutional initiative process. Such a limit could take an extreme and draconian form, making it very difficult for local governments to continue to provide even basic services.

Before this happens, **Florida needs to implement a reasonable, but meaningful, limit on local governments' revenues or expenditures.**

There are many ways to go about doing this. Decisions must be made on whether revenues or spending should be capped and how it will be limited. Should school districts be included?

Capping revenues would probably make more sense than limiting expenditures. Because of Florida constitutional prohibition against deficit spending, a revenue limit has the effect of capping spending. Also, expenditures can be harder to define and can have greater fluctuations.

A limit should probably only include governmental functions, and exclude enterprise funds. Special consideration should be given to the treatment of infrastructure funding. It would be unwise to unduly restrict the ability to provide needed schools, roads, and water projects. One approach is to only cap operating funds.

Since property taxes are the big issue now, one option would be to limit property tax levies. This could be done by mandating that local governments cannot adopt a millage rate in excess of the rolled-back rate. By capping tax rates instead of revenue actually collected, there is no need for provisions to handle revenue that may be collected over the cap. This would be a straightforward approach, but the rolled-back rate should be reconsidered. While the rolled-back rate does make some allowance for growth by excluding new construction, there is no allowance for inflation. Over the last ten years, the largest average growth allowed under the rolled-back rate was 3.5%. The definition of the rolled-back rate should be changed to allow for an inflation factor, or to use another measure, such as income growth.

Capping only one revenue source is not a complete solution, because it may result in governments compensating by increasing other taxes, special assessments, or fees. A more comprehensive revenue limit may be in order, or a separate limit on non-property tax revenues, in concert with a millage cap.

While a limit must have teeth, it also needs some flexibility to handle unforeseen circumstance and emergencies. A supermajority vote of the governing board to override is one approach. New voter-approved taxes could be exempt.

Florida TaxWatch will continue to examine the issues involved in limiting local government revenues or expenditures, and will work to develop a proposal that works for taxpayers and local governments.

## The Big Property Tax Issue: Save Our Homes

The biggest property tax issue, in addition to unsustainable growth, is the Save Our Homes amendment in the state constitution. The 1992 amendment (which took effect in 1995) limits the annual increase in the assessments of homestead property to 3%, or the increase in inflation, whichever is less. In recent years, it has been below 3%, often less than 2%. When a house is sold, it is reassessed at full, or just, value. This has resulted in shifting billions of dollars in taxes, creating numerous inequities, and leading to the “locked-in effect”, where people feel they cannot afford to move due to the significant tax increase they face.

<b>Save Our Homes Annual Increase</b>		
<b>Year</b>	<b>CPI Change</b>	<b>Cap</b>
2006	3.40%	3.00%
2005	3.30%	3.00%
2004	1.90%	1.90%
2003	2.40%	2.40%
2002	1.60%	1.60%
2001	3.40%	3.00%
2000	2.70%	2.70%
1999	1.60%	1.60%
1998	1.70%	1.70%
1997	3.30%	3.00%
1996	2.50%	2.50%
1995	2.70%	2.70%

Despite best intentions, Save Our Homes (SOH) is flawed and is not a tax limit, but a tax shift, as Florida TaxWatch has pointed out since 1992. Since it does not control millage rates, the effect has been a shifting of the tax burden to non-homestead property, affecting businesses, renters, and second homeowners, or anyone who owns property that is not homesteaded. Even though average millage rates have been falling, they are certainly much higher than they would be without the amendment. Property not subject to the limit bears the brunt.

Save Our Homes has removed \$404.4 billion in taxable value from the rolls in Florida in 2006. This is worth approximately \$7.7 billion in taxes, based on an estimated 2006 average statewide millage rate of 19.0. (The 2005 statewide millage rate was 19.54 and the 2006 rate will likely be slightly lower.)

The Save Our Homes differential is growing by leaps and bounds (see table below). It increased by 64.2% from 2005 to 2006, and has not had an annual increase of less than 34% since it took effect. Since 2000, SOH has removed over \$1 trillion in value from the tax rolls. This is worth approximately \$21 billion in property taxes.

<b>Growth in the Save Our Homes Differential</b>								
<b>(\$ in millions)</b>								
<b>Year</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>Total</b>
<b>Taxable Value</b>	\$27,815	\$47,679	\$80,364	\$117,891	\$165,144	\$246,221	\$404,380	\$1,089,494
<b>Ave. Millage Rate</b>	20.92	20.75	20.46	20.24	20.09	19.54	19.0*	
<b>Tax Dollars</b>	\$582	\$989	\$1,644	\$2,386	\$3,318	\$4,811	\$7,683	\$21,413
<b>Annual Increase</b>		71.41%	68.55%	46.70%	40.08%	49.09%	64.23%	
<b>Cum. Increase</b>		71.41%	188.92%	323.84%	493.72%	785.21%	1353.82%	

\*estimated

Source: Florida TaxWatch, using data from the Office of Economic and Demographic Research, December 2006

## **Make No Mistake: Save Our Homes Has Been a Tax Shift**

Claims have been made that SOH has not shifted taxes; that is, no one's taxes are higher than they would have been without SOH. The only way this could be true is if SOH has resulted in local governments having \$21 billion less to spend since 2000. The growth in property tax levies and local government spending since SOH suggests that this is certainly not the case.

It is more likely that SOH has done little to hold down property taxes in total. Many homeowners have undoubtedly saved money from Save Our Homes. However, the amount of property tax revenue that governments bring in is probably not much lower than it would have been without SOH. Local governments have simply compensated for SOH by keeping millage rates higher than they would have been otherwise.

Millage rates are surely much higher than they would have been without Save Our Homes. This means that those properties being assessed at full value are paying higher taxes than they would have, and those with reduced assessments are paying less.

If one assumes the same level of revenue, not all of the SOH differential has been shifted from homestead to non-homestead properties. Since millages rates are higher, some of that differential (in terms of tax dollars) is being paid by those with SOH protection, so tax savings may not be as high as some think.

For example, the Required Local Effort (RLE) millage rate levied by school districts is much higher than it would be without Save Our Homes. RLE is the millage school districts are required to levy to participate in the state's education funding program. With the reduction in taxable value from SOH, it takes a higher millage rate to raise the dollars the Legislature determines districts need to contribute.

To raise the same amount of money, the current RLE of 5.010 mills would be reduced to 3.997 mills (20.2%) without Save Our Homes.

## **Save Our Homes Removes Many Voices from Local Tax and Spend Decisions**

One aspect of Save Our Homes may have resulted in local governments actually taxing and spending more than they would have without it.

There is little doubt that SOH has limited one of the most effective methods of controlling local taxing and spending — disgruntled homeowners. Since rapidly growing property values have kept most millage rates from increasing, those under SOH protection have mostly seen property tax increases of less than 3%. These people are less likely to attend local budget hearings. Florida TaxWatch has heard from taxpayers all over the state that budget hearings have had very low public attendance in the years of SOH. This began to change last year, and especially this year, but the people attending the hearings tended to be business owners and non-residents, who likely do not carry the same political weight as resident homeowners/voters.

This year, the average increase in state **taxable** value was 25.1%. At this growth, if a local government voted to keep the same millage rate, that would be a 25.1% increase in taxes. If all taxpayers shared equally in that tax increase, it is likely more taxpayers would have demanded that their local officials roll back rates.

### **Taxes Shifted Among Homesteaders As Well**

Along with the shifting of billions of dollars in taxes from homestead property to non-homestead property, because some homeowners benefit more than others, it has also shifted taxes among homesteaders.

There is no real natural market to control property taxes, such as there are for other homeowner costs like principal, interest, and insurance. Because there is little control over millage rates or local revenue/spending, anything that reduces one group of taxpayers' taxable value will result in taxes being shifted to the taxpayers not enjoying the benefit. This includes Save Our Homes, the homestead exemption, classified use differentials, or any of a number of property tax exemptions.

**Because newly purchased homes are reassessed at full market value, SOH also shifts taxes to first-time homebuyers and people that move within Florida.** The faster a home's fair market value increases, the larger the savings will be. So, homes with rapidly increasing values shift taxes to those that rise slower.

Multi-county tax levies can also shift taxes. For example, a water management district's millage rate covers multiple counties. Homes in counties with higher SOH differentials shift taxes to those in counties with lower differentials.

### **Inequities Created by SOH Place Constitutionality in Question**

The amendment has also created inequities, such as two similar houses in the same area having vastly different tax bills. "Similarly situated" taxpayers should have similar tax liabilities, but this is not the case under SOH. The SOH savings on the same valued house can vary greatly. The longer a person has owned their homesteaded home, the greater the SOH savings. An analysis by the Florida Department of Revenue put all houses in Florida valued between \$200,000 and \$225,000 into deciles (ten equal sized groups) based on the size of their SOH differential. The 10% with the largest savings, on average, had 73.4% of their homes' value exempted, while the lowest ten percent had only 11.7% exempted.

The unequal taxation of similarly situated taxpayers opens the door for a legal challenge for violation of the state's equal protection clause. In Justice Ben Overton's dissenting opinion, during the Florida Supreme Court's pre-ballot review of SOH (Amendment 10), he states that although the question had not been raised, "I find that the application of amendment 10 may result in a serious equal protection violation. For example, two identical condominium units in the same building could be taxed at different amounts for identical public services because the amount of the tax would be calculated on the length of time the owners owned their respective units rather than on the true present value of their units." He raises the question of whether

Amendment 10, by implication, also amends Florida's equal protection clause without adequately notifying the voters. Two other Justices concurred.

### **Lack of Portability a Problem**

SOH has also resulted in people feeling "trapped in their homes". Many homeowners who want to move to another house feel they cannot due to the huge tax increases they would face when the new home is initially assessed at full value.

Earlier this year, the Legislature considered several bills to allow homeowners to make portable their tax savings and apply it to any newly purchased house, and wisely decided to hold off on attempting a fix. There is much sentiment to address this issue in the upcoming session. This "portability" issue is a real problem, but it must be remembered that any change to ameliorate the situation will likely exacerbate its main problem of shifting taxes. The Legislature should not act in haste. The Florida Property Tax Reform Committee is currently studying portability and the upcoming Taxation and Budget Reform Commission is sure to consider it as well.

A portability provision should be part of a comprehensive change to the state's property tax system.

### **SOH Impacts Affordable Housing**

Save Our Homes also has negative effects on affordable housing in Florida. Since SOH shifts taxes to non-homestead property, it is likely that landlords pass the increasing taxes on rental property to renters.

In addition, since the taxes on a newly purchased home are higher than they would be without SOH, the cost of home ownership is increased for first time homebuyers. According to a study by the Florida Office of Economic and Demographic Research, a \$150,000 home purchased in 2005 would pay \$204 per month in property taxes, compared to \$84 per month for one bought in 1999. That \$120 per month difference equates to the ability to purchase \$20,000 (13%) more home.

### **Change is Needed: Distortions and Inequities Will Continue to Increase**

SOH still enjoys significant (while possibly eroding) popularity, and due to its constitutional standing, any change to it will be difficult. However, the best approach would be replacing SOH with a system that protects and is fair to all taxpayers, and one that also has the effect of controlling local government spending.

## **Skyrocketing Property Taxes Renew Interest in Homestead Exemption**

In Florida's property tax debate, another issue is Florida's \$25,000 homestead exemption, which is being debated by the Florida Legislature, the Property Tax Reform Committee, and even gubernatorial candidates in the last election.

Some are calling for an increase to the basic homestead exemption, noting that it has not been increased since 1982. Below we examine the homestead exemption and its relative value today, while considering the effect the Save Our Homes amendment has had on homeowners' taxes.

### **History of the Homestead Exemption: Are Benefits Withering Away?**

Florida's homestead exemption was created in 1934 by a constitutional amendment, providing for a \$5,000 exemption designed to help homeowners keep their homes during the Great Depression. During the Depression, a \$5,000 exemption represented a huge benefit for most homeowners, and all but eliminated property taxes for many. The \$5,000 was deducted from a home's assessed value, before the tax (millage) rate was applied.

In 1980, the Florida Constitution was amended twice in reference to the homestead exemption. In March, the exemption for school taxes was increased to \$25,000, and then in October, the exemption for county, city, and special district levies was also raised to \$25,000, to be phased in over a three year period — \$15,000 in 1980, \$20,000 in 1981, and \$25,000 in 1982. The amendment also authorized the Legislature to provide ad valorem tax relief to renters. The constitution still allows for this, but the Legislature has only provided such relief in a very limited form (e.g., homes for the aged).

In 1986, the Legislature brought a proposed amendment to voters to substantially change the homestead exemption from \$25,000 to \$5,000, plus one-half of the assessed value over \$5,000, the total exemption not to exceed \$25,000. At the time, many counties had a significant number of homesteads that were valued at less than \$25,000, and were therefore totally exempted from taxation. The idea was that "everyone should pay something". The amendment was soundly defeated.

In 1998, an amendment was passed authorizing an additional local option homestead exemption of up to \$25,000 for low-income homeowners over 65 years of age. The exemption may be adopted by ordinance by cities and counties, and only applies to the levy of the jurisdiction passing the ordinance. The 1999 Legislature passed a law to allow this local option. The latest information from the Florida Department of Revenue shows that 158 cities and 53 counties offer the exemption, ranging from \$5,000 to \$25,000.

The homestead exemption received a lot of consideration during the 2006 Legislative Session. One bill—HJR 353—started out as a proposed constitutional amendment to increase the main homestead exemption to \$50,000. It went through several mutations, including one that would phase-in an increased homestead exemption, while limiting the maximum differential allowed under the Save Our Homes assessment limitation. The version that eventually passed increases the limit on the additional local option homestead exemption currently provided for low-income

seniors to \$50,000. The voters approved this amendment last November. Now, Florida’s low-income seniors may receive, depending on the county in which they live, a total of \$75,000 in homestead exemptions.

### Relative Value of the Homestead Exemption Is Decreasing Over Time

Florida’s homestead exemption has not been increased in almost 25 years. Because it is a set dollar amount, the relative value of that exemption decreases over time. Adjusting for inflation, the \$25,000 homestead exemption of 1982 is now worth only \$12,353.

*To keep pace with inflation:*

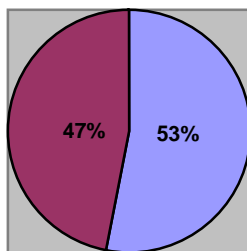
- *The original 1934 homestead exemption of \$5,000 would have to be \$72,873 today.*
- *The increased 1982 homestead exemption of \$25,000 would have to be \$50,596 today.*

***However, the combined effect of Save Our Homes and the homestead exemption in 2005 protects \$83,000 of the average homestead’s value from taxation. In 2006, the portion untaxed should exceed 50% of the home’s value.***

When the homestead exemption was increased to \$25,000 in 1982, it removed roughly half of the average home’s value from taxation. The average just value of a Florida single family home in 1982 was \$47,152. The homestead exemption was 53% of that amount. In 2005, the value of the average single-family home was \$210,795. This means the exemption now equals only 12% of the average home’s value (see charts below).

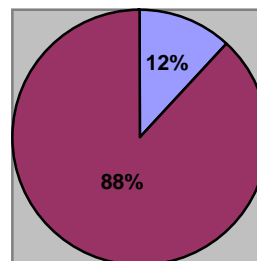
### Has the Benefit of Homestead Exemption Withered Away?

Percentage of 1982 Average Home Value of \$47,152 Exempt by Homestead Exemption



■ Exempt ■ Taxable

Percentage of 2005 Average Home Value of \$210,795 Exempt by Homestead Exemption



■ Exempt ■ Taxable

Source: Florida TaxWatch, using data from the Florida Department of Revenue, November 2006

In terms of actual tax savings to the homeowner, the homestead exemption is currently worth \$489 to the average homesteaded taxpayer, based on the average statewide millage rate (all jurisdictions) of 19.54 mills. This compares to \$408 in 1982, when the millage rate was 16.30 mills. Because property values have risen so rapidly, local governments have been able to raise significant new tax revenue without raising—and even lowering—millage rates. Therefore, the actual value of the tax break the homestead exemption affords has not risen dramatically. In fact, it has fallen in recent years as skyrocketing property values have led to decreased average millage rates. The savings from the homestead exemption peaked in 1997 at \$549 (21.97 mills), and it has fallen, along with millage rates, almost every year since.

### **Property Tax Savings from Save Our Homes Now Dwarfs the Homestead Exemption**

Although the homestead exemption has not been increased in years, the tax savings Florida law provides for homesteaders is growing rapidly. Florida's Save Our Homes assessment limitation has eliminated the need for increasing the homestead exemption for most taxpayers. In fact, for the average homestead property taxpayer, the \$25,000 protected from taxation by the homestead exemption is now dwarfed by Save Our Homes.

The average value of a Florida homestead property in 2005 was \$190,828. However, the average assessed value under Save Our Homes (SOH) was \$132,804. This means SOH protects more than \$58,000 (30%) of the average home's just value from taxation. When the homestead exemption is applied, the average homestead only pays taxes on 56% of the home's just value.

This is similar to the amount exempted in 1982, and with the big increase in the SOH differential expected in 2006, it is likely that the average home will have more than half of its value exempted.

The differential between the just and assessed values of homestead property is increasing rapidly as well. The differential was a little less than \$8,000 in 2000. The 2005 amount of \$58,000 was up from just under \$40,000 in 2004, and the total statewide SOH differential is expected to be 64% in 2006.

Overall, SOH removes \$404 billion in home value from taxation, compared to \$109 billion for the homestead exemption. And while the homestead exemption value is growing by about 2% a year, the SOH differential is growing by more than 40% a year. In fact, that differential has increased by more than 1,300% since 2000, rising from \$28 billion to \$404 billion.

### **Increasing the Homestead Exemption—By Itself—Does not Make Sense**

Increasing the homestead exemption, which has a lot of political and popular appeal, will certainly be considered. But it must be remembered that even though it has not been increased since 1982, the Save Our Homes amendment has more than made up for that, at least for most homeowners. Although it does have the benefit of providing a comparable benefit to all homesteaders, **as long as Save Our Homes exists, increasing the homestead exemption is not a tenable position.**

Since it has the same effect as SOH—reducing the taxable value of a homestead—increasing the homestead exemption exacerbates the big problem with SOH. It would increase the tax shift to non-homestead properties, affecting renters, businesses, second and vacation homeowners, and even homesteaders that also own non-homestead property.

When combined with changes in SOH, an increased homestead exemption could play an important role in a comprehensive reform of Florida’s property tax system. It can help taxpayers retain at least part of their accrued savings in the event that Save Our Homes is eliminated or modified. **But without more comprehensive changes and principled reforms, the Legislature should avoid the politically expedient move of proposing an increased homestead exemption.**

## **Conclusion and Recommendations: Florida's Property Tax System Must Be Reformed**

There is a property tax crisis in Florida. Local government spending has been rising largely unchecked, and property taxes and other revenues to fund that spending have been increasing as well. High property values have led to extraordinary property tax gains by local governments, even without increasing millage rates. The Save Our Homes amendment has kept taxes down for a large number of Floridians, so the growth in property taxes is unfairly being borne by the rest of the taxpayers. This has created a host of other problems, including unequal taxes on similar houses, people feeling they cannot afford to move, and an impact on affordable housing by increasing rents and increasing the tax liability on new homes.

The Florida Legislature is feeling a lot of pressure to “do something about property taxes”. The 2007 Session will surely consider measures such as allowing for Save Our Homes portability and increasing the homestead exemption. The Legislature should avoid attempting quick fixes, such as increasing the homestead exemption, that do not address the real problems and, in fact, would magnify those problems.

Save Our Homes still enjoys a high level of popularity and changing its constitutional provisions will be difficult. The constitutional issue of equal protection discussed earlier could result in a legal challenge to the amendment.

The Property Tax Reform Committee and the Taxation and Budget Reform Commission have the opportunity to develop truly deep, comprehensive reform, and the Legislature or TBRC can provide constitutional proposals to voters. This is an issue that requires research, deliberation, and thoughtful debate. The Committee and Commission are certainly appropriate arenas to tackle this complex issue. It will also take a good educational campaign to inform the voters, and a proposal that maintains most of the property tax protections homesteaders now enjoy, coupled with a system to limit property tax increases in the future.

To truly reform property taxes, Florida should:

- Repeal the Save Our Homes Amendment.
- Allow homeowners currently under SOH protection to keep the reduced assessment. The amount of the differential would not change. For example, if a home were assessed at \$60,000 below fair market value through Save Our Homes, future assessments would be at full market value minus \$60,000.
- Institute a revenue cap on local governments. This could be limited to property taxes by requiring that local governments adopt a redefined rolled-back rate (one that allows for more growth than the current definition). This would provide a direct property tax limitation for all property owners in Florida. Alternatively, or in conjunction with the above, a cap that limits all governmental revenue growth and, as a result, spending, to a measure such as population growth multiplied by inflation or growth in personal income could be used. The cap could be overridden by a supermajority vote of the governing body.

- Allow for one-time, statewide portability of a homeowner's assessment reduction. If someone moves within Florida, their new house's fair market assessment would be reduced by the same amount as their old house. However, the assessed value of the new home must equal or exceed that of the old home.

## **Other Property Tax Reform Issues**

The Property Tax Reform Committee is considering other property tax issues. Florida TaxWatch would like to offer these comments:

**Assessing business property based on current use.** The mandate to assess all property at fair market value, or "highest and best use", means that commercial property is taxed on what the property can sell for, not what the value of it is with the existing business. This has created unaffordable tax liabilities for many businesses, such as small hotels and apartments, and small businesses near the waterfront. Florida TaxWatch agrees that this is an important issue and supports efforts to remedy the situation.

**Assess property using a five-year moving average.** Annual assessments can result in big changes in assessed value, and therefore property taxes. Since there is a lag between market changes and assessments for property taxes, this can result in some real surprises for homeowners. A three or five-year moving average makes sense in that it would smooth out some of the fluctuations. However, this may not be the right time to institute this. Taxpayers have seen rapid increases in assessment in recent years, without the benefits of multi-year averages. Although there doesn't appear to be large-scale property value declines occurring now, they could come in the future. If such a decline in values takes place, assessments will decline at a lower rate with the multi-year average.

**Replace property taxes with another revenue source.** Basically, government can tax three things: wealth, income, and transactions/consumption. Florida currently relies on transaction taxes much more than the average state. Income, besides the corporate income tax, is not taxed to a great extent in Florida. Florida has a prohibition against a state property tax and with the recent (overdue) elimination of the state intangibles tax, local property taxes are the only major wealth tax in the state. About the only thing with a large enough tax base (under the current state constitution) to replace property taxes are sales taxes. It is currently estimated that a 1% increase in the current sales tax is worth \$3.72 billion. It would take almost an additional 7 cents in sales taxes to replace the \$25.7 billion in property tax levies in FY 2006. This would bring the total sales tax rate in the state to approximately 13% to 14.5%. It must be remembered that current levies (FY 2007) are probably closer to \$30 billion, so it would take another penny to replace that. Further, with such a high rate, there would certainly be some reduction in demand, meaning the additional 7 cents probably would not raise the \$25.7 billion. As former Federal Reserve Chairman Alan Greenspan said, "you get less of what you tax."

Florida already has one of the highest sales tax rates in the country. To more than double it does not make sense. It would create competitive problems, greatly increase taxes for anyone who doesn't currently pay property taxes, make Florida more expensive (and less desirable) for tourists, and create some major enforcement issues. With sales taxes that high, people will

search for ways to avoid them. Add the replacement sales tax to the current state rate, local options and local bed taxes, you could have rates of over 20%.

Also, sales taxes tend to be regressive, while property taxes are proportional.

Replacing part of the state's property taxes with sales taxes is also problematic. For example, you could use a 1% sales tax to mandate an average 2.4 mill decrease in property tax rates. (The actual reduction would have to be calculated for every jurisdiction.) It would then, in subsequent years, be difficult to assure that the sales tax savings is still reflected in the newly adopted rates.

One potential avenue for providing property tax relief through increased sales taxes is through the state's Required Local Effort for school funding.

This *Research Report* was written by Kurt R. Wenner, Senior Research Analyst, under the Direction of John Turcotte, Senior Vice President for Research.

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Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: in its first two decades alone, policymakers and government employees implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than \$6.2 billion -- approximately \$1,067 in added value for every Florida family, according to an independent assessment by Florida State University.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It is the only statewide organization devoted entirely to Florida taxing and spending issues. Its research and recommendations are reported on regularly by the statewide news media.

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