Ideas in Action

Florida TaxWatch
25th Anniversary 1979-2004
www.floridataxwatch.org

106 N. Bronough Street (32301-7723) ♦ P.O. Box 10209 (32302-2209) ♦ Tallahassee, FL♦ Phone: 850/222-5052 ♦ Fax: 850/222-7476

July 2007

Property Tax Reform:
Beware of Unintended Consequences

By

J. Antonio Villamil

J. Antonio Villamil is a former U.S. Undersecretary of Commerce for Economic Affairs, and served until December 2006 as Chairman of the Governor's Council of Economic Advisors of Florida. He is currently the CEO of The Washington Economics Group, Inc. based in Coral Gables.

Among statutorily enacted changes in the State Special Legislative Session just concluded, a so-called "cap" on the growth of property tax revenues collected by the 67 counties of Florida and over 400 municipalities was voted into law. Henceforth, local property tax revenues cannot exceed the growth of Florida's Personal Income per capita and the value of new construction in a given year. School district funding at the local level is excluded from the cap. The cap can also be overridden by a super-majority vote of the elected local commissions, or by unanimous vote if the cap is to be exceeded by a certain amount, or by public referendum if the cap is to be nullified for a given county or municipality.

The cap is only one of the many and complex changes brought about by the Special Session on property tax "reform." Other legislative mandates include a rollback to the property tax rate of 2006, and a further reduction in property tax revenues collected based on the fiscal spending of counties and municipalities in prior years. In addition, in late January 2008, voters will be asked to decide on whether to amend the State Constitution once again, to allow for super-sized homestead exceptions, among other changes. School funding is not exempted from the likely local revenue reductions if the voters approve the proposals, with Tallahassee "promising" to somehow make up the decline in local school revenues. Furthermore, current property owners under **Save our Homes (SOH)** could opt to stay in SOH or opt out of the system and move into the new super-sized exemptions.

Confused so far? So am I, and so are probably many economists as well as good number of policymakers and local elected officials. The changes, current and proposed, have brought a high degree of uncertainty to future public revenues at the local level for funding schools, fire and police protection, parks, infrastructure maintenance, economic development programs and others. All these are the types of expenditures that we economists' term "quality of life" or "amenities" – vital programs to attract, retain and expand high-wage jobs and the so-called creative class of knowledge workers to our counties and cities.

The mandates from Tallahassee have brought significant complexity and uncertainty to the property tax structure of Florida. In essence, they violate a principle of best practices of public finance, which is **simplicity and transparency** in the levy of taxes.

The Tallahassee mandates also violate other principles of best practices in taxation. The new system **is not equitable** to purchasers of second homes and renters, as only primary residences are included in the proposed super-sized exemptions. The proposed changes also provide little relief to income-producing (commercial) properties. These properties will continue to be taxed on the "highest and best use" principle as opposed to the "income" or "usage" method to determine taxable value. In fact, commercial properties could suffer much higher impact fees and other forms of fees in the future, as local governments look for alternative revenue sources to fund vital programs.

Finally, and perhaps most importantly, the Tallahassee-mandated cap will likely lead to severe problems over time in funding vital local programs for special needs populations in our many counties and municipalities, especially in large urban counties like Miami-Dade. This is due to the "one size fits all" approach for using a statewide **estimate**, called Florida Personal Income Per Capita (PI), as a key part of the "cap" for property tax revenue growth in all the myriad of counties and municipalities of Florida. As an economist and recent economic policymaker, I have a very serious problem with the cap approach -- the "cookie cutter" approach -- to such a large and highly diverse state.

- **First**, the cap takes away the **flexibility** of local elected officials and administrators, who are closer to the needs of their localities, to take advantage of opportunities and/or emergencies at the county and municipal levels – requiring cumbersome and politically charged procedures to override the Tallahassee-mandated cap.

- **Second**, tying the fortunes of local government property tax revenue growth to Florida Personal Income Per Capita (PI), an **estimate** subject to revisions, creates significant measurement problems. Personal income is **estimated** by the U.S. Bureau of Economic Analysis (BEA) for the nation. Then the BEA **estimates** personal income for the states, with about a year lag. All of these estimates are subject to "benchmark" revisions. Utilizing a per-capita measure is also methodologically troublesome, as state government **estimates** the resident population of Florida**,** subject to **revisions** once again. These revisions are large for a number of Florida's **counties** due to net migration flows, both domestic and internationally. In Miami-Dade, we have always undercounted the resident population due to volatile international immigration. Therefore, the PI mandate will likely **underfund** local needs year after year.

- **Third**, personal income (PI) is defined as the gross income accruing to households from all sources, including wages and salaries, and also includes passive income like investment returns on stocks and bonds, among other variables. Therefore, if the U.S. suffers a recession, or if the U.S. equity markets decline sharply, or when a hurricane hits the state (like Hurricane Katrina in Louisiana and Mississippi that wiped out properties, and therefore, the "rental income" contained in PI), PI tends to decline sharply. In conclusion, the PI cap is "pro-cyclical," accentuating economic downturns and fiscal emergencies at the time when local public needs are the greatest, due to negative events outside the control of local officials.

- **Fourth**, linking in part local property tax revenue growth to the growth in PI **is barely sufficient to cover the average increase in prices paid by local and state governments to produce public services**. This index for the U.S. was increasing at an over 5 percent annual rate in the first quarter of 2007, above Florida's average PI growth of around 4 percent. In essence, in terms of so-called "purchasing power," the **real** cuts to counties and municipal governments are quite significant when taking into account price changes for state and local government purchases.

- Finally, the "new construction" portion of the cap is less of an issue, since it is a county- and city-specific measure. However, there will likely be unintended consequences. For example, counties and cities may be tempted to relax the permitting of new construction so as to increase taxable revenue. This could impact growth management efforts. Furthermore, the "new construction" part of the cap may be also hurtful to dense urban counties and municipalities that are already close to being "built out."

As a member of the 2006 Property Tax Reform Committee, I argued for consideration of a number of more simple measures -- implementing a five-year moving average of property taxable values at the county and municipalities levels to smooth "peaks and valleys" in local revenues, for example. I also recommended that the current Tax and Budget Reform Commission of Florida be allowed more time to study the whole tax structure of the state, and come up with effective changes next year based on a **systems approach** to taxation, budgeting and best practices in fiscal governance.

###

For a copy of this report, please call:
(850) 222-5052
OR
Write to Florida TaxWatch at: P.O. Box 10209
Tallahassee, FL 32302
OR
Access and download the report at:
www.FloridaTaxWatch.org, where this *Ideas in Action* was initially released before being printed in hardcopy format.

106 N. Bronough Street
P.O. Box 10209
Tallahassee, FL 32302

NON-PROFIT ORG.

U.S. POSTAGE
PAID

TALLAHASSEE, FL
Permit No. 409