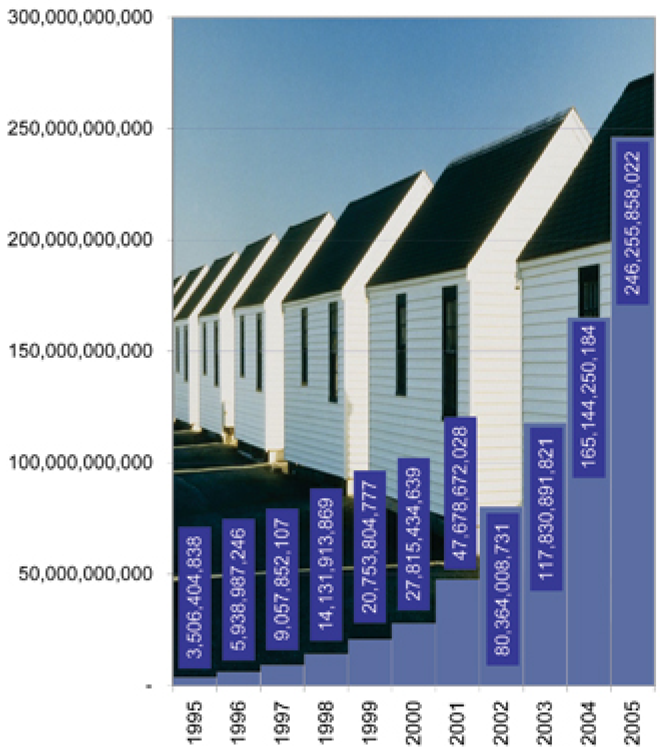
Florida TaxWatch

ECONOMIC COMMENTARY:

A monthly look at Florida's Economy

#14 September 2006

Property Differential Values of Capped Properties Under the Save Our Homes Amendment



Source: Florida Department of Revenue, Florida Property Valuations and Tax Data Book

Real Property Assessment Differential Value of Capped Parcels displaying the difference between the just value of residential properties with homestead exemption and the assessed value of the same properties which is capped by the Save Our Homes amendment. The cap limits increases in assessed value to the consumer price index or 3%, whichever is lower.

Unintended Consequences

"…there will eventually be dramatic differences in the assessed values of identically – valued homes." "…it is likely that the older, more affluent homeowner population – especially homeowners who live in areas that experience higher than average appreciation rates and those who do not move will benefit at the expense of the younger, less affluent renter population. In this sense it is regressive." "…property tax payments will be effectively shifted from homestead properties that have not been sold recently to properties recently sold and to non-homestead properties such as businesses and rental units." "Over time, the changes may work to limit (economic) growth, to slow down new construction, and to decrease sales in the real estate market."

These prophetic words were written in October, 1994 by Professor Dean H. Gatzlaff of Florida State University and published by Florida TaxWatch in its *Ideas in Action* series. Dr. Gatzlaff's article was entitled "The Save Our Homes Amendment Could Cause Some Problems." Little did many of us know that a constitutional amendment narrowly passed by 53.6% in 1992 with the intent of keeping residents from being taxed out of their homes would, by 2006, be a contributing source of tax inequity and a potential impact to the vibrancy of Florida's economy.

Amendment 10 to the Florida Constitution, commonly known as the "Save Our Homes" Amendment, was designed to limit the annual change in assessed property values for property tax purposes. It was a response to a period of rapidly rising property values and the associated hefty increases in property taxes. The idea was that by capping assessed values, property tax liabilities would also be constrained and residents would not face the chronic risks of sharply escalating property taxes.

Enacted in 1995 the cap applied only to all homestead owner-occupied properties. Business properties, rental units, and non-homestead exempt properties such as second homes were not covered by the Amendment. The cap was set at the lesser of either three percent or the previous year's rate of inflation as measured by the Consumer Price Index. Upon resale, properties that retained the homestead exemption were reassessed at market value.

According to Florida TaxWatch research, the Save Our Homes Amendment removed roughly 28 percent, or about $350 billion of residential real estate value from property taxes in 2005. Taxes on the shielded property were reduced by an estimated $6.8 billion.

Overall, however, while some property taxes have been capped, others have been sharply increased because of the shift created by Amendment 10. As Professor Gatzlaff predicted twelve years ago, taxes have been shifted from homesteaded properties to commercial, rental, and residential properties without the homestead exemption. Numerous cases abound of homes with nearly identical market values having significantly different assessed values on their property tax bills, simply because one house possesses the homestead exemption and protection of Amendment 10. These differing valuations are the most visible of the unintended consequences of Amendment 10 and, though serious, may not be the most significant ones.

On a very fundamental level, the tax treatment of individuals and businesses embedded in Amendment 10 fails the two basic economic principles of taxation. The first of these is known as the **benefit principle,** and simply states that taxes should be based on the benefits received from the public service. In theory, if an individual obtains no benefits from a public service and hence, does not use it, then they should not be taxed to finance its provision. User fees for services, such as public boat ramps, are an application of the benefit principle of taxation.

The concept behind the benefit principle is analogous to that in markets for privately provided goods and services. In the private sector individuals who place the highest subjective value (that is, receive the highest benefits) from a product will be willing to pay the most for it. To a greater degree than in private markets, however, individuals may be able to masquerade and understate the benefits they receive from some public services, for example national defense, and if enough taxpayers deliberately understate the benefits they receive, then the public service will not be adequately provided. This free-rider problem limits the use of taxes based on the benefit principle.

In this regard, it is difficult to see how those who have borne the tax incidence of Amendment 10 (second home owners, renters, those who have recently moved within a metropolitan area and owners of business properties) necessarily receive greater benefits from the public services they help finance than individuals who have homestead exemptions. Indeed, second home owners, as they reside in Florida for only part of the year, may actually obtain lower total benefits than full-year, homestead exempted residents, yet pay substantially higher property taxes.

Ability to pay is the second basic principle of taxation and, in its simplest form, states that taxes should be based on an individual's ability to pay for public services. The progressivity of the federal income tax system is derived from this principle. Clearly, all of those bearing higher taxes because of Amendment 10 do not necessarily possess a greater ability to pay. For the less affluent, such as renters and first-time home buyers who are not shielded by Amendment 10, tax increases may actually be regressive, as they pay a higher rate of tax on a lower income base. In contrast, more affluent home owners who have resided in the same homesteaded residence for an extended period may be paying lower tax rates at the margin and receiving implicit subsidies from the less affluent. Moreover, since property taxes are generally recognized to be capitalized in a home's price Amendment 10 may unwittingly be exacerbating the 'affordable housing' issue in Florida.

Regardless of whether the tax is benefit-based or ability-to-pay based, tax neutrality is viewed by many economists as a desirable feature of taxation. Neutral taxes are taxes that do not cause changes in behavior and the use of resources. Neutral taxes are thought to be the most economically efficient ones in part because they produce the least unintended consequences. Save Our Homes does not meet this criterion. Second home owners may relocate to other states; business owners may under-invest in commercial property; they either pass higher taxes along to consumers through higher prices or suffer higher costs in absorbing the higher taxes; local governments at their statutory maximum millage rates may seek other sources of tax revenues; subsidized home owners, on the other hand, may seek an expansion of local government services, realizing that others may bear a disproportionate share of the cost, while being less vocal about tax increases. All of these things appear to be occurring in Florida.

One of the ongoing challenges in democratic societies is that the political process has an inherent bias towards providing benefits to specific, identifiable voting groups, while spreading the costs over large numbers of diffuse, not easy to identify, and expensive to organize groups. The Save Our Homes Amendment may be such an example. Advocates of the Amendment argue that it has diminished the likelihood of people being taxed out of their homes but, given the unintended consequences, there may be more effective means of accomplishing this.

Taxing people out of their homes is certainly a valid reason for considering preventive measures, such as Save Our Homes. The critical issue may not be so much one of how to pay for local government as **how to control local government spending so that ever higher taxes are not necessary**. Save Our Homes may have been well intended in this regard but it has generated serious unintended consequences, and local government spending has yet to be constrained.

Florida's appealing climate and natural beauty have long been among its key competitive advantages. It has 'exported' these advantages to countless millions of people throughout the nation and the world. These advantages should not be threatened by well-intended, but unfair, taxes.

(Editor's Note: Florida TaxWatch is currently working with the Governor's Property Tax Reform Committee and will be preparing multi-faceted solutions for consideration by the constitutionally-created Taxation and Budget Reform Commission and the 2007 Legislature toward ensuring a fair and equitable property tax system in Florida.)

Coming Next Month: Florida's Affordable Housing Crunch

By Stephen O. Morrell, Ph.D., Florida TaxWatch Senior Research Fellow and Professor of Economics and Finance, Andreas School of Business, Barry University, Miami Shores.