HB 258

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

House Bill 258 (Delegates Gilleland and Boschert)
Ways and Means

Property Tax Assessments - 4-Year Assessment Cycle

This bill changes the triennial assessment cycle for real property for property tax purposes to a four-year assessment cycle.

Fiscal Summary

State Effect: Special fund revenues would decrease by approximately $35.3 million in FY 2008. General fund expenditures would decrease by $74,000 annually beginning in FY 2008. The decrease in State special fund revenues could require either (1) an increase in the State property tax rate; or (2) a general fund appropriation, in order to cover debt service on the State's general obligation bonds. The impact in future years reflects assessable base changes resulting from the phase-in to a four-year assessment cycle.

($ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
SF Revenue	$0	($35.3)	($19.3)	($23.4)	($21.8)
GF Expenditure	0	(.1)	(.1)	(.1)	(.1)
Net Effect	$0	($35.2)	($19.2)	($23.4)	($21.8)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local revenues could decrease by approximately $221.6 million in FY 2008 and $82.5 million by FY 2011. Expenditures would not be affected.

Small Business Effect: Meaningful.

Analysis

Current Law: Real property is valued and assessed once every three years.

Background: The triennial assessment process was part of major property tax reform established in 1979. Under this process, assessors from the State Department of Assessments and Taxation (SDAT) physically inspect each property every three years. No adjustments are made in the interim, except in the case of (1) a zoning change; (2) a substantial change in property use; (3) extensive improvements to the property; or (4) a prior erroneous assessment. The assessor determines the current "full market value" of the property and any increase in value is phased in over a three-year period. Any decrease, however, is recognized immediately for assessment purposes.

Because only one-third of the properties in each county are reassessed in a given year, local governments can rely on prior years' growth in the other two-thirds of the base to reduce the full impact of any one-year decline in assessable base. Conversely, when market values are rising, assessed values lag behind the current market, resulting in a slower annual growth in the assessable base than the market may indicate. For example, consider a home that had been assessed for $100,000 and is increasing in value at $5,000 per year. The new assessment was $115,000. Under the triennial assessment process, the home's assessed value would phase in through three equal increments (year one $105,000; year two $110,000; year three $115,000).

If the market value of the property continues to increase by $5,000 per year, the difference between the market value and the assessed value for each year increases. For year one, the property owner will pay taxes on a $105,000 assessment although the home is now worth $120,000. For year two, the property tax bill will be based on an $110,000 assessment and the market value of the home is $125,000. Finally in year three, the assessment reaches the market value at the time of the last reassessment or $115,000 while the property's actual value is now $130,000. For each year, the property's assessment is below the current market value.

In summary, the triennial process and its three-year phase-in schedule provide some cushion for taxpayers during periods of dramatically increasing property values and for local governments during a downturn in the housing market.

State Revenues: Periodic reassessments are performed to ensure that property owners are taxed uniformly on the current market value of their property. Most states require that real property be reassessed at a frequency of one to five years. However, the frequency of reassessment is not the only consideration in achieving uniformity. A more important factor is how the reassessment is performed. Since the purpose of periodic reassessment is to fairly apportion the tax burdens imposed by governments among property owners, moving to a four-year assessment cycle should have no effect on State and local revenues in the long run. Over the long term, changes in State and local assessable bases under a four-year assessment cycle should be roughly equivalent to that under a three-year cycle. Although assessment increases would be spread over four years, the amount of inflationary increase to be phased in will be larger when reassessed. However, in the short term, there is expected to be a significant change in the assessable base under a four-year cycle compared to a three-year cycle, as shown in **Exhibit 1**. The transition to a four-year cycle results in assessment growth over periods of less than four years being phased-in over four years.

Exhibit 1
Estimated Loss in Assessable Base as a Result of Switching to a Four-year Assessment Cycle
($ in Thousands)

	FY 2008	FY 2009	FY 2010	FY 2011
Estimated Assessable Base – 3-Year Cycle	$594,699,295	$640,903,134	$692,499,742	$738,352,604
Estimated Assessable Base – 4-Year Cycle	565,324,811	622,421,599	671,861,099	720,011,460
Difference	**($29,374,484)**	**($18,481,536)**	**($20,638,643)**	**($18,341,145)**

Estimating the revenue loss from the lower assessable base is complicated by the Homestead Tax Credit Program. The program tends to smooth fluctuations in the assessable base of State and local governments by capping annual increases in taxable assessments of owner-occupied residential properties. For State property tax purposes the cap is 10%. Local governments can reduce the percentage to not less than zero for local property tax purposes. Base that is not taxed in times of rapid growth becomes taxable in times of slower growth (such as the mid- to late-1990s). The effect becomes more pronounced the lower the cap.

Local governments have been lowering assessment caps on owner-occupied properties in recent years to control for rapidly rising assessments. Data from SDAT indicates that as of July 1, 2005, approximately 65.4% of all taxable accounts are owner occupied and therefore potentially eligible for the homestead tax credit and that 61.8% of owner occupied properties are located in low cap (5% or lower homestead tax credit) counties. In 2005, 73.9% of owner-occupied properties received a State homestead tax credit, compared to 53% in 2004 and 40% in 2003. As the assessable base decreases initially, the amount of the homestead tax credit would decrease as well, thereby mitigating the revenue decrease associated with the conversion to a four-year assessment cycle.

Exhibit 2 shows the estimated State special fund revenue decrease resulting from the shift to a four-year assessment cycle, as well as effect of the homestead tax credit. The revenue decrease to State and local governments could be mitigated by an increase in property tax rates.

Exhibit 2
State and County Revenue Decrease Resulting from Shift to Four-year Assessment Cycle
($ in Thousands)

	FY 2008	FY 2009	FY 2010	FY 2011
State Special Fund Revenues	($38,774)	($24,396)	($27,243)	($24,210)
Homestead Tax Credit	3,521	5,093	3,808	2,379
Net State Effect	**($35,253)**	**($19,303)**	**($23,435)**	**($21,831)**
County Revenues	($310,894)	($200,600)	($218,100)	($195,237)
County Homestead Tax Credits	89,341	200,458	150,344	112,758
Net County Effect	**($221,553)**	**($142)**	**($67,757)**	**($82,479)**

Debt service payments on the State's general obligation bonds are paid from the Annuity Bond Fund. Revenue sources for the fund include State property taxes, premium from bond sales, and repayments from certain State agencies, subdivisions, and private organizations. General funds may be appropriated directly to the Annuity Bond Fund to make up any differences between the debt service payments and funds available from property taxes and other sources. The fiscal 2007 State budget allowance includes $656.2 million for the Annuity Bond Fund and assumes a $46.8 million ending fund balance that could be available in fiscal 2008. State general funds are not being appropriated to the Annuity Bond Fund in fiscal 2007.

To offset the reduction in State property tax revenues, general fund expenditures could increase in an amount equal to the decrease in the Annuity Bond Fund revenues or the State property tax rate would have to be increased in order to meet debt service payments. This assumes that the Annuity Bond Fund does not have an adequate fund balance to cover the reduction in State property tax revenues.

State Expenditures: The bill would require SDAT to: (1) reprogram its Computer Assisted Mass Appraisal Program; (2) program changes into the Annapolis Data Center; (3) design changes to the billing tape provided to the counties; (4) redesign the assessment notice; (5) realign properties in all 24 subdivisions into four assessment groups; (6) redesign brochures and forms; and (7) rewrite procedures to reflect a four-year assessment cycle instead of a three-year assessment cycle. SDAT indicates that these changes can be handled with existing budgeted resources.

Administrative Savings

Current law requires that each parcel of real property must receive an external physical inspection once every three years. For those properties that received an assessment in 2005, approximately 50% of properties did not receive an external physical inspection due to lack of staff. In spite of advances in automation, many aspects of an assessor's job are labor intensive when properly done. These job functions include: physical inspections, appeal hearings, new construction pick-up, and responding to taxpayer inquiries. By assessing fewer properties each year, the costs of mailing and producing assessment notices will fall. It is estimated that under a four-year assessment cycle, SDAT would reassess approximately 200,000 fewer properties each year. This would lead to approximately $74,000 in savings in the production and mailing of assessment notices annually.

Local Fiscal Effect: Local revenues would decrease during the initial conversion from a three-year to four-year cycle due to a loss of assessable base (as shown in Exhibit 1). However, once the conversion is made, the effect on local governments should be minimized.

In fiscal 2007, 15 of the 24 local jurisdictions have assessment caps below 10% as illustrated in **Exhibit 3**. In addition, several municipalities have also lowered assessment caps below 10%.

Exhibit 3
Counties with Assessment Caps Below 10% in Fiscal 2007

County	Cap	County	Cap	County	Cap
Anne Arundel	2%	Dorchester	5%	Prince George's	3%
Baltimore City	4%	Frederick	5%	Queen Anne's	5%
Baltimore	4%	Garrett	5%	St. Mary's	5%
Carroll	7%	Howard	5%	Talbot	0%
Cecil	8%	Kent	5%	Worcester	3%

Source: State Department of Assessments and Taxation

The estimated local revenue decrease resulting from the shift to a four-year assessment cycle and the effect of the homestead tax credit is shown in Exhibit 2.

Small Business Effect: In the short term, small businesses that own real property would incur smaller annual phase-in increases during a four-year assessment cycle compared to a three-year cycle. However, it is possible that over time, they would still have to pay the same amount of property taxes as under the three-year assessment cycle.

Additional Information

Prior Introductions: A similar bill (assessments conducted on a five-year cycle) was introduced as HB 320 in the 2005 session. It received an unfavorable report from the House Ways and Means Committee.

Cross File: None.

Information Source(s): State Department of Assessments and Taxation, Baltimore City, Howard County Montgomery County, Prince George's County, Department of Legislative Services

Fiscal Note History: First Reader - March 17, 2006
mam/hlb

Analysis by: Michael Sanelli

Direct Inquiries to:
(410) 946-5510
(301) 970-5510