The Residential Exemption

Report by the Selectmen's Tax Exemption and Deferral Study Committee

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Introduction

This report discusses the Residential Exemption authorized by M. G. L. Ch.59, Sec. 5C. First, the mechanics of the exemption are explained. Those groups of taxpayers who will benefit and those who will lose from the exemption are identified. The experiences of cities and towns which have adopted the exemption are discussed. Finally, some of the pros and cons of adoption are summarized.

1. What is the Residential Exemption?

The Residential Exemption is a taxation option available to municipalities in Massachusetts that allows a shift in the burden of residential property tax from lower valued homes to higher valued homes and from homes that are a taxpayer's principal residence to homes, such as vacation homes or rental properties, that are not. The Residential Exemption has no impact on Commercial Industrial Property (CIP) taxes. Adoption is by the Board of Selectmen on an annual basis at the classification public hearing.

Currently eleven municipalities in Massachusetts have adopted the Residential Exemption: Boston, Brookline, Cambridge, Chelsea, Marlboro, Nantucket, Somerset, Somerville, Tisbury, Waltham and Watertown.

2. How does it work?

A. Finding the average residential value

In order to find the average residential value, the total value and the total number of Class One (Residential) parcels is determined. Class One parcels include all single family residences, multi- family houses, condominiums, apartment buildings, and residentially zoned vacant land. A single parcel can be as small as a side lot or as big as an entire apartment complex. As shown on the Lexington Assessor's LA-4 form, the total Class One value for Fiscal 2005 was $6,275,351,000 and the total number of Class One parcels was 10,570. Thus the average Class One parcel value was $593,695.

B. Determining the exemption amount.

The law allows an exemption of up to 20% of the average Class One parcel value. A 10% exemption, based on Fiscal 2005 values, would be $59,500; a 20% exemption would be $119,000.

C. Establishing the number of primary residences.

Only principal residences, as defined for income tax purposes, are eligible for the exemption. Thus apartment buildings, rental housing, vacant land, and non-principal residences are excluded. Of the 10,573 residential parcels in Lexington, the Assessor estimates that approximately 9,500 are principal residences.

The Assessor emphasizes that this is an extremely rough guess since there are no records available to indicate whether a Lexington homeowner owns a second residence out of state and whether the Lexington home or the second home is their primary residence. In addition, no records exist indicating whether a single family residence is currently a rental property.

D. Calculating the tax rate with exemption

With the adoption of a Residential Exemption, the tax rate for *all* residential properties goes up. In Fiscal 2005, the Class One total value was $6,275,351,000. The tax levy to be raised by Class One was $71,162,480. Therefore, the residential tax rate for FY 2005 was the quotient of (A) the number of residences and (B) the Class One total value, or $11.34 per thousand.

If a Residential Exemption of 10% had been in effect, the Class One total value would have been reduced by the product of (A) the number of principal residences and (B) 10% exemption of the average Class One property, or, 9500 x $59,369, which equals $564,005,500. Therefore, under a 10% Residential Exemption the FY 2005 residential tax rate would have been $71,162,480 divided by $5,711,345,450 or $12.45 per thousand, a tax rate increase of 9.79%.

A 20% Residential Exemption would have caused the tax rate to go up to $13.83 per thousand, an increase of 21.96%.

E. Determining the tax with the exemption

As shown above, at 10% in FY 2005 the Residential Exemption would have resulted in a new Class One rate of $12.45; a 20% exemption would have resulted in a new rate of $13.83. In order to determine the tax under the exemption it is necessary to subtract the exemption amount (at 10% = $59,500; at 20% = $119,000) from the eligible property's assessment and then multiply by the applicable tax rate.

For the purposes of this report, we will assume a 20% residential exemption creating a 21.96% tax rate increase, and round the number to 22%

The table in Exhibit A illustrates the tax effect in 2005 of a 20% exemption on various assessed values.

F. How the Residential Exemption appears on the tax bill

The exemption amount ($119,000 if it had been adopted in FY05) is listed on every homeowner's tax bill as a deduction from the assessment. On the State-required property tax bill form there is no indication that the tax rate is higher to compensate for the deduction. In towns that adopted the Residential Exemption in the 1980's, taxpayers who don't understand the exemption or don't remember the rate increase, often have the perception that they are benefiting from it, even if they are not.

3. Who benefits from the Residential Exemption?

A. How many residences will be affected and how much will the savings be?

Based on FY 2005 figures, anyone whose principal residence is assessed for less than $661,000* would receive a lower tax bill. According to the assessors there are approximately 6,400 Class One single family residences assessed at less than $661,000. Those which are principal residences would receive reductions of up to $900 with a 20% exemption; $450 with a 10% exemption. See Exhibit A for an analysis of the effect of a 20% exemption on different assessed values.

(* This $661,000 figure represents the average value of a <u>single family</u> residence in Lexington. This differs from the $593,695 figure used to calculate the Residential Exemption because that is the average of <u>all</u> Class One parcels and includes all vacant land, side lots and apartment complexes in addition to the single family residences)

B. Who comprises this group?

The main argument for adopting the Residential Exemption in Lexington is that it benefits taxpayers of relatively modest means. However, it can be assumed that principal residences valued under $661,000 contain at least three groups:

1) People of limited assets and lower incomes, including disabled people living on SSI and older citizens living on modest retirement or savings.

2) People who own a house that is appropriate to their income, affording them a comfortable lifestyle.

3) People of more ample means. The value of a home does not always correlate with wealth. Some quite wealthy people, certain elderly for example, may choose to live in smaller homes and condominiums.

Attempts have been made to correlate income with home value using census data. There is undoubtedly some value in this comparison, but income does not always correlate with wealth. People reporting low income may, in fact, have substantial assets such as stocks, municipal bonds or summer homes.

Census data showing low income elderly does not distinguish between those who live in subsidized elderly housing or accessory apartments and those who maintain their own home. The committee believes, however, that there is some correlation between income and home value and that adoption of the Residential Exemption would benefit many of our low-to-moderate income residents to varying extents.

4. Who pays?

There are four classes of properties in Lexington that would face increased costs if a residential exemption were adopted.

A. Homes with values above the average assessment

The approximately 4,100 homes valued above $661,000 would see tax increases if the residential exemption were adopted. This group can be assumed to comprise two broad categories of people.

1) People with wealth or increasing incomes that can afford expensive houses and for whom higher taxes are not a burden, although they may feel they are overtaxed.

2) Elderly who own large homes and may or may not be wealthy. In some cases this group is feeling pressure from higher real estate taxes.

See Exhibit A for an analysis of the distribution of tax increases among various assessed values.

B. Apartment owners/dwellers

Assessor records show that there are about 650 rental units in Lexington's eight apartment complexes. In addition there are an unknown number of other rental properties which could be single family homes or units in the 92 two-family and 14 three-family homes in town. Multi-family homes whose owner's primary residence is a unit in the building do receive the exemption for the entire property. Some renters are retired and on a fixed income.

Others are younger, moderate income residents, unable to afford a house or condo. Since apartment buildings and non-owner-occupied single, two-and three-family homes are excluded from the Residential Exemption, their owners would receive higher tax bills. Some or all of this tax increase may be passed on to tenants in the form of higher rent. (Publicly-owned apartments such as Greeley Village are not subject to property tax and would not be affected.)

Census figures indicate that about 15% of Lexington residents live in apartments, excluding public housing.

C. Vacant and Underused Residential Parcels

The Planning Board's 2002 Comprehensive Plan identified a number of vacant developable lots still left in town. At a 20% exemption, adopting the Residential Exemption would result in a property tax increase of 22% and thus increase incentives to develop this land.

D. Owners of Non-principal Residences

There are 10,570 Class One properties according to the Assessor. Of this total the Assessor estimates that there are about 9,500 that are the taxpayer's principal residence. The balance, about 1,000 properties (including vacant land) which are 10% of the Class One category, will get an increase of up to 22% if a 20% exemption is adopted.

E. Elderly persons who have transferred title of their homes to their children without properly worded trust documents.

Trusts must contain certain provisions in order for the home to be considered owner-occupied and therefore eligible for the residential exemption. Many trusts will be properly worded, however an unknown number of homes will be ineligible for the exemption because ownership was transferred under trust documents that were not properly worded or ownership was transferred without the protection of a trust at all.

5. How is the Residential Exemption implemented?

There are no state-mandated procedures for first-time implementation of the Residential Exemption. Each town is on its own when it comes to establishing who is entitled to the exemption. Some adopting towns sent out questionnaires initially requiring submission of evidence of legal residency. Others appeared to initially rely on town census data. But all towns we talked to have a continuing program to update their records. Many assessors cited the need for more manpower to administer the exemption.

The Town Assessor has identified a timing problem inherent in the adoption of the Residential Exemption. If the Selectmen adopt the Residential Exemption at a classification hearing in the fall or winter, it must be put into effect for the next fiscal year. Considering the amount of work necessary to determine who is entitled to the exemption, the Assessor believes that his department would have difficulty determining who qualifies in time to send out the next fiscal year tax bills. A solution to this timing problem might be for the Selectmen to state their intention to adopt the exemption a year before the intended implementation, thus giving the Assessor a year to get ready. However, in the following year a new Board of Selectmen might decline to adopt it.

6. The experience of other cities and towns with the Residential Exemption.

The committee interviewed the assessing officials of most of the cities and towns which have adopted the Residential Exemption. Currently eleven communities in Massachusetts use the Residential Exemption: Boston (30% by home rule petition), Brookline (20%), Cambridge (20%), Chelsea (20%), Marlborough (9%), Nantucket (20%), Somerset (10%), Somerville (30% by home rule petition), Tisbury (20%), Waltham (20%), and Watertown (20%). In Nantucket and Tisbury, there is a large second home population. Somerset is an anomaly in that there is only a small variation in residential values and therefore the Residential Exemption creates little shift in property taxes. In the other communities there are large apartment populations. All of these communities adopted the Residential Exemption in the early 1980's. No additional communities have adopted it in recent years. Weymouth gave it up in 1986 in response to complaints about higher tax bills.

7. The pros and cons of adopting the Residential Exemption.

A. Pros

1) Adoption of the Residential Exemption lessens the burden of the real estate tax on the lower valued homes in the community, which in many cases will be owned by persons of lower income and less wealth. This is a way to make the real estate tax more progressive.

2) Lower taxes on lower-valued houses may help some seniors stay in their homes.

3) A majority of property tax payers will experience some reduction in property tax.

B. Cons

1) The Residential Exemption provides a non-needs-tested benefit. Adoption of the Residential Exemption lessens the burden of the real estate tax on lower valued homes in the community. In many cases, these homes could be owned by persons of higher income and assets.

2) Taxpayers whose Lexington house is not their primary residence and some elderly homeowners who have transferred title to their children without creating specifically worded trusts will receive a tax increase of 22% if the 20% exemption is adopted.

3) Low-income seniors who live in homes with high assessed values will be negatively impacted by the exemption.

4) Rents could increase in Lexington as a result of adoption of the Residential Exemption. It is impossible to quantify the amount. Economic conditions would determine how much of the tax increase landlords can pass on to tenants.

5) Owners of Class One vacant land will see their taxes increase by 22%, if the 20% exemption is adopted. This could increase pressure to develop the land.

6) Since the Residential Exemption shifts the tax burden in the community from the lower-valued houses to the higher-valued houses, opposition can be expected from owners of higher-valued properties. The primary characteristic of almost all cities and towns that have adopted the Residential Exemption is that they have a substantial amount of rental housing or vacation property. In those cities and towns, it is readily acknowledged that adoption was a political decision. The exemption gave a break to the local homeowners by shifting some of the tax burden to rental properties, whose tenants tend to be unaware that property taxes affect them directly, or to absentee owners or summer residents who do not vote in the community. Lexington does not have large numbers of apartment buildings or a substantial number of seasonal homes, so a decision to adopt the Residential Exemption can be expected to be controversial. This controversial increase on higher valued houses could be intensified by overrides coming every two or three years, the Community Preservation Act surcharge (which already has a higher financial impact on higher income residents and higher valued houses), and the effect of possible CIP shifts.

7) Based on interviews with assessors in towns that have implemented the Residential Exemption, it is clear that adoption will require additional staff in the assessing department. The procedure for implementing the Residential Exemption requires determining whether a property is a principal residence either by sending out forms or by comparing voting and census records, and examining utility bills and other evidence. This must be done on an ongoing basis. Many residences, particularly many occupied by elderly residents, are owned in trust. The Assessor's office will be required to review complicated trust documents to determine whether properties can be considered owner-occupied.

8) The committee was initially concerned that the Residential Exemption might reduce the benefit of the Senior Tax Circuit Breaker Credit under the Massachusetts income tax law. This credit is available to certain low-income elderly whose real estate tax (including one-half of water and sewer charges) exceeds 10% of their income. It was thought that reducing the real estate tax might cause a partial loss of this credit. We calculated the credit based on several scenarios and it is concluded that any slight reduction in the income tax credit is more than offset by the substantial reduction in real estate taxes resulting from the residential exemption.

9) If the Residential Exemption were adopted, subsequently revoking it would cause a notable increase in property taxes for a majority of the taxpayers.

8. Other help available to seniors and moderate income taxpayers.

At present there are a number of statutory real estate tax exemptions available to Lexington taxpayers. These exemptions are based on income, assets, blindness, disability, age, or veteran status.

See Exhibit B for a description of the tax relief programs available to low income seniors.

9. Conclusion

The Residential Exemption, based on FY05 figures, would provide some relief to about 6,400 residences valued below $661,000. On the other hand, about 4,100 residences assessed above $661,000, and an unknown number of apartments, parcels of vacant land, and non-primary residences would see increases. Rental units would be at risk for rent increases. Tax increases for above-average valued properties are further increased by the 3% CPA surcharge from which properties owned by lower income residents are exempt.

The adoption of the Residential Exemption would require anticipatory work by the assessors and additional staffing to administer it after adoption. Its revocation in the future would certainly have political consequences.

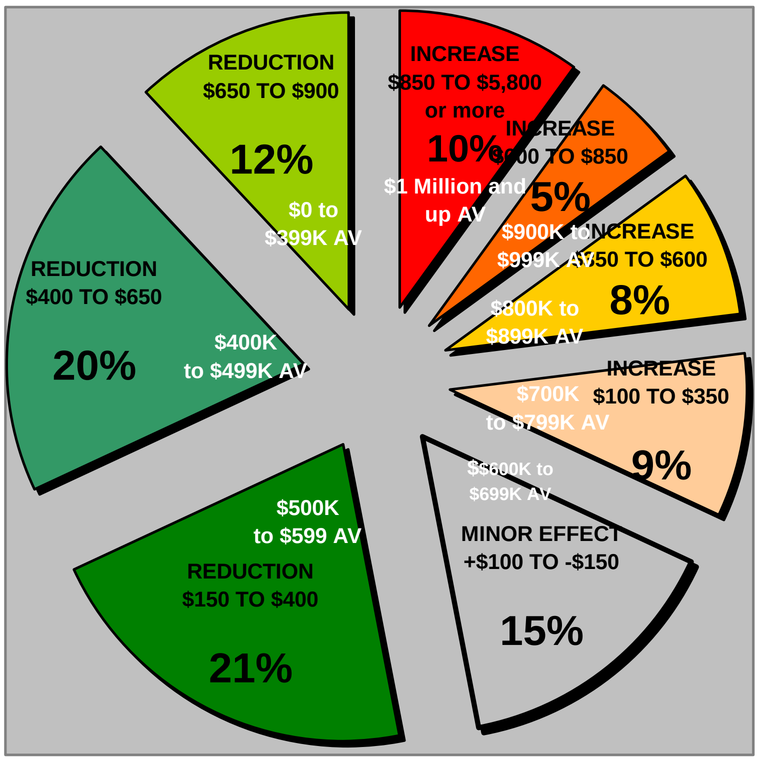
Finally, there are already a number of statutory measures on the books that give tax relief to low-income elderly taxpayers.

The committee has made its best effort to identify the advantages and disadvantages of adopting the Residential Exemption. The committee makes no recommendation to the Selectmen as to its adoption.

Exhibit A

Distribution of Tax Increases and Decreases

FY05 Data



These figures do not exclude the unknown number of homes that would not qualify for the Residential Exemption because they are not occupied by the owner as a primary residence or under a qualified trust.

Exhibit A

Property Impact Analysis
FY05 Data

Assessed Value	Current Tax	New Tax	$ Change	% Change
$300,000	$3,402	$2,503	-$899	-26%
400,000	4,536	3,886	-650	-14.32%
500,000	5,670	5,269	-401	-7.07%
600,000	6,805	6,652	-152	-2.23%
700,000	7,938	8,035	97	1.22%
800,000	9,072	9,418	346	3.82%
900,000	1,026	10,801	595	5.83%
1,000,000	11,340	12,184	844	7.44%
1,100,000	12,474	13,567	1,093	8.76%
1,250,000	14,175	15,642	1,467	10.35%
1,500,000	17,010	19,099	2,089	12.28%
1,750,000	19,845	22,557	2,712	13.66%
2,000,000	22,680	26,014	3,334	14.70%
2,500,000	28,350	32,929	4,579	16.15%
3,000,000	34,020	39,844	5,824	17.12%

Exhibit B

Property Tax Relief for Seniors Brochure
Town of Lexington Publication