

PRINCIPAL RESIDENCES: ALLOW LOCALS TO EXEMPT NEW CONSTRUCTION

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House Bill 4649 as passed by the House
Sponsor: Rep. John Pappageorge
Committee: Tax Policy
Second Analysis (4-7-04)

BRIEF SUMMARY: The bill would amend the General Property Tax Act to permit a local unit of government to exempt from property taxes new construction on eligible principal residences used as a living area.

FISCAL IMPACT: Because the exemption is subject to the approval of each individual local unit of government (of which there are approximately 1,800 in the state), there is no way to know how widely the exemption will be applied.

Data from the US Census of Housing and the Bureau of Economic Analysis suggest that approximately \$2 billion of new construction on additions of existing homestead (principal residence) property occurs in Michigan each year. Using a statewide average tax rate on homestead property of 32.35 mills, if all of this new construction was exempted, property tax revenue would be reduced by about \$30 million below what it would have been without the exemption.

Although the majority of the foregone revenue would occur at the local level, State Education Tax revenue would be reduced by approximately \$5.5 million if all of the new construction on additions qualified for the exemption. In practice, however, the potential revenue loss is likely to be smaller.

THE APPARENT PROBLEM:

Michigan land use patterns over the past several decades have become the subject of much debate and discussion. The importance of state land use patterns and policy were brought to the fore during the past year by the work of the Michigan Land Use Leadership Council. In its final report, the council notes that the state's population density is falling. In the early 1980's, the average density was 3.8 persons per acre. By the late 1990's the average density was 2.8 persons per acre. The report further notes that, on average, the state develops its land eight times faster than its population growth and that between 1970 and 2000, the number of households in the state increased by 43 percent while population only increased by 12 percent. Finally, in recognition of the possible consequences of seemingly unfettered sprawl, the report states, "[t]he state's development patterns...pervade every aspect of our lives, including the age of schools and school enrollment, the look of the environment, attractiveness to business and economic growth, and access to health care."

In addition, in a March 2003 report assessing the causes and consequences of land use changes in southeast Michigan, the Southeast Michigan Council of Governments (SEMCOG) notes that developed land in Metro Detroit increased 17 percent between 1990 and 2000. That rate was more than three times faster than the rate of population growth in the region over the same time period. The report also notes that housing density of new housing constructed between 1990 and 2000 is less than the density level in 1990. In 1990 the housing density in Metro Detroit was 2.84 housing units per acre. However, housing units constructed between 1990 and 2000 were constructed at a density of 1.26 housing units per acre. The density of recently built housing in Livingston and St. Clair counties was the lowest, at .74 and .84 units per acre (meaning that a single dwelling family would typically rest on a parcel of land that is more than one acre). The report notes that such low density development has resulted in an increase in the total acreage of developed land in the state. Finally, the report notes that the housing shift from older suburbs to outlying, more rural (but quickly developing) areas in the region has significant impact on the finances of local units of government. In particular, the report notes that as the shift in housing and business development occurs, older communities that have little undeveloped land or room to grow are likely to see financial declines as there is less taxable property.

The report of the Michigan Land Use Leadership Council briefly makes note of one important consequence of continued urban sprawl: its impact on schools. Continued urban sprawl (particularly in Metro Detroit) typically results in declining student populations in school districts in inner-ring suburbs. As families move from older, inner-ring suburbs to quickly developing areas further out, the inner-ring suburban schools typically see a decline in student population (along with a decline in funding), while the school districts in the developing areas have a rapidly increasing student population. This trend in student migration is hardly new. Decades ago (and still today) families left Detroit for Royal Oak, Ferndale, and the like. However, the difference today is that families are now leaving the inner-ring suburbs that their parents and grandparents migrated to 40 years ago, for newer and comparatively sparse locales in Livingston, Washtenaw, St. Clair, and Lapeer counties and in the few areas in Oakland, Wayne, and Macomb counties that remain relatively un-urbanized. In a May 2002 report, the Educational Policy Center at Michigan State University noted that total population of residents (not students) in the Chippewa Valley School District in Macomb County increased by nearly 50 percent between 1990 and 2000, and the resident population in the Howell Public Schools increased by more than 40 percent. Meanwhile, the resident populations of the Royal Oak and Taylor school districts dropped by eight percent and seven percent, respectively.

There are many consequences of this shift in student population. In late September 2002, the *Detroit News* ran an article that describes the situation quite well. The article notes that the migration of young families from inner-ring suburbs has “eroded the student populations in 25 established suburban districts, forcing many to close perfectly good school buildings and convert others for office or community use.” Perhaps most importantly, the article notes that, in some instances taxpayers continue to pay for shuttered or converted school buildings for several years. The article points to the

Ferndale schools as one of many examples throughout Metro Detroit. In 1995 voters approved a \$47.5 million bond proposal to renovate several schools. However, seven years later, four of the recently renovated schools were closed as student population declined. Taxpayers in the district will continue to pay off the bond until 2018. Meanwhile, other Metro Detroit school districts can't build or expand schools fast enough to meet the needs of rapidly increasing student populations. According to the *News* article, between 1991 and 2002 the Chippewa Valley Schools in Macomb County built three elementary schools and a new high school, and expanded two other schools. As a result of this imbalance, between 1991 and 2000, the number of school buildings in Metro Detroit increased by 13 percent, while its student population increased only six percent.

Legislation has been introduced designed to help mitigate urban sprawl and, by extension, the shifts in student enrollment, by creating an incentive for families to stay in their current homes rather than building in areas further out into suburbia.

THE CONTENT OF THE BILL:

The bill would amend the General Property Tax Act (MCL 211.7hh) to permit a local unit of government to exempt from property taxes new construction on eligible principal residences used as a living area. The exemption would require a resolution by the local unit's governing body, and the exemption would be effective on the December 31 immediately succeeding the adoption of the resolution. An exemption would remain in effect until property was transferred or for a period specified in the resolution (but not to exceed five years), whichever was sooner. The resolution granting the exemption could cover all or a portion of the local unit of government.

Prior to adopting the resolution, the clerk of the local unit of government would have to notify in writing the assessor of each local tax collecting unit in the unit of government and the legislative body of each taxing jurisdiction that levies ad valorem property taxes in the local unit of government. The clerk would also be required to file notice of a public hearing on the resolution between 20 and 40 days prior to the hearing. Adoption of the resolution would have to occur within 30 days after the public hearing and would be subject to applicable statutory and charter provision relating to the approval or disapproval by the chief officer of the local unit of government. Upon adoption, the resolution would have to be filed with the secretary of state.

For eligible principal residences that are less than 3,000 square feet in area, the exemption would be limited to new construction of a "living area" that is not more than 50 percent of the existing living area on that property. For eligible principal residences property that is 3,000 square feet or greater in area, the exemption would be limited to new construction on a "living area" that is not more than 25 percent of the existing living area.

The bill would import the definition of the term "new construction" from Section 34d of the property tax act, where it refers to "property not in existence on the immediately

preceding tax day and not replacement construction. New construction includes the physical addition of equipment or furnishings [except for normal maintenance].” The term “principal residence” would be defined as found in Section 7dd of the act, where it refers, generally speaking, to an owner-occupied principal residence. The term also applies to an owner’s unoccupied property adjoining or contiguous to a dwelling; a registered life care facility; property owned by a cooperative housing association and occupied by tenant stockholders; and a portion of a principal residence rented or leased to another person if the leased or rented portion is less than 50 percent of the total square footage of living space in the residence.

An “eligible principal residence” would mean a principal residence that is exempt from taxation of the school operating millage levied under the Revised School Code. The bill would define “living area” to mean an area of a principal residence property that is used by at least one person for domestic residential purposes and would include (though wouldn’t be limited to) a bedroom, kitchen, bathroom, living room, family room, den, or enclosed porch.

ARGUMENTS:

For:

This bill is intended to offer a practical approach to address two continuing and ever increasing problems in Michigan: seemingly unfettered urban sprawl and school enrollment patterns that change in congruence with continued urban sprawl. These dual issues are addressed by creating an incentive to families to expand existing homes rather than move into the developing suburban areas in the state, where the housing densities are not nearly as great as those in urban centers and older, inner-ring suburbs. Generally speaking, young families typically purchase “starter” homes that tend to be cheaper and smaller than homes in other areas. But, as the income and size of these families increase they tend to look toward newer developing areas with larger houses and larger plots of land. These are typically located in newer suburbs in fast developing counties. While a great many families may very well like the communities and school districts in which they live, they are nonetheless often constrained by the housing stock in the area. Some people believe the exemption will encourage families to choose to expand their homes and stay in the area, thereby slowing continued urban sprawl and declines in school enrollment.

Against:

There is some concern that the bill could reduce State Education Tax revenue without any input from the state. For instance, both the Neighborhood Enterprise Zone Act and the Plant Rehabilitation and Industrial Development Act (commonly known as P.A. 198) permit local governmental units to provide certain housing or industrial facilities with property tax abatements for up to 12 years. While the exemption in this bill is similar to provisions in those two acts, the bill lacks one important aspect found in the other acts. Both of those acts require approval of the state tax commission to grant “certificates” to property owners who, in turn, are exempt from general property taxes but pay a specific tax instead. This bill offers no major input from the state other than its presence at a

public hearing regarding the adoption of the resolution. At the very least, the bill should exclude the state education tax from the exemption.

Response:

Proponents say that the revenue impact of the bill can only be positive. If a family moves away when outgrows its home, no addition would be built and so no revenue from new construction would accrue. But if additions are constructed, additional revenue will be available to state and local government from the increased value after five years, or when the home is sold, whichever is sooner.

Against:

There is also some concern whether the bill would really create a meaningful incentive for families to stay in their homes and add on rather than move into larger homes. First, many of the homes in older, inner-ring suburbs are subject to certain lot restrictions, as a house's size is often limited based on the size of the parcel of land on which it sits. As much as a family wants to stay in the community and add on to their house, sheer space limitations may prevent that. A tax abatement will not help in that instance; it will only help with construction on houses with sufficient space to expand. These are not likely to be the houses of families that bill is targeting. Rather, it would merely provide a tax break to persons who would expand their homes anyway. Also, Proposal A already serves as a strong incentive for families to stay put, thanks to its limitations on year-to-year increases on a home's taxable value.

More importantly, it is not entirely clear as to why a local unit of government would want to grant the exemption. If anything, it would want to encourage frequent home sales, so that the taxable value of its housing stock more closely tracks the true market value, rather than an artificially low value that results from the assessment cap provisions of Proposal A.

Response:

Remember that the bill is permissive. It is up to the local unit to decide whether granting this exemption is advantageous. It is reasonable to assume that where it is advantageous for the community and its schools, it will be employed, and where it is not, it will not.

POSITIONS:

The Michigan Association of Homebuilders indicated that it supports the bill. (2-5-04)

The Department of Treasury indicated that it opposes the bill. (2-4-04)

The Michigan Municipal League indicated that it opposes the bill. (4-5-04)

The Michigan Assessors Association indicated that it opposes the bill. (2-4-04)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.