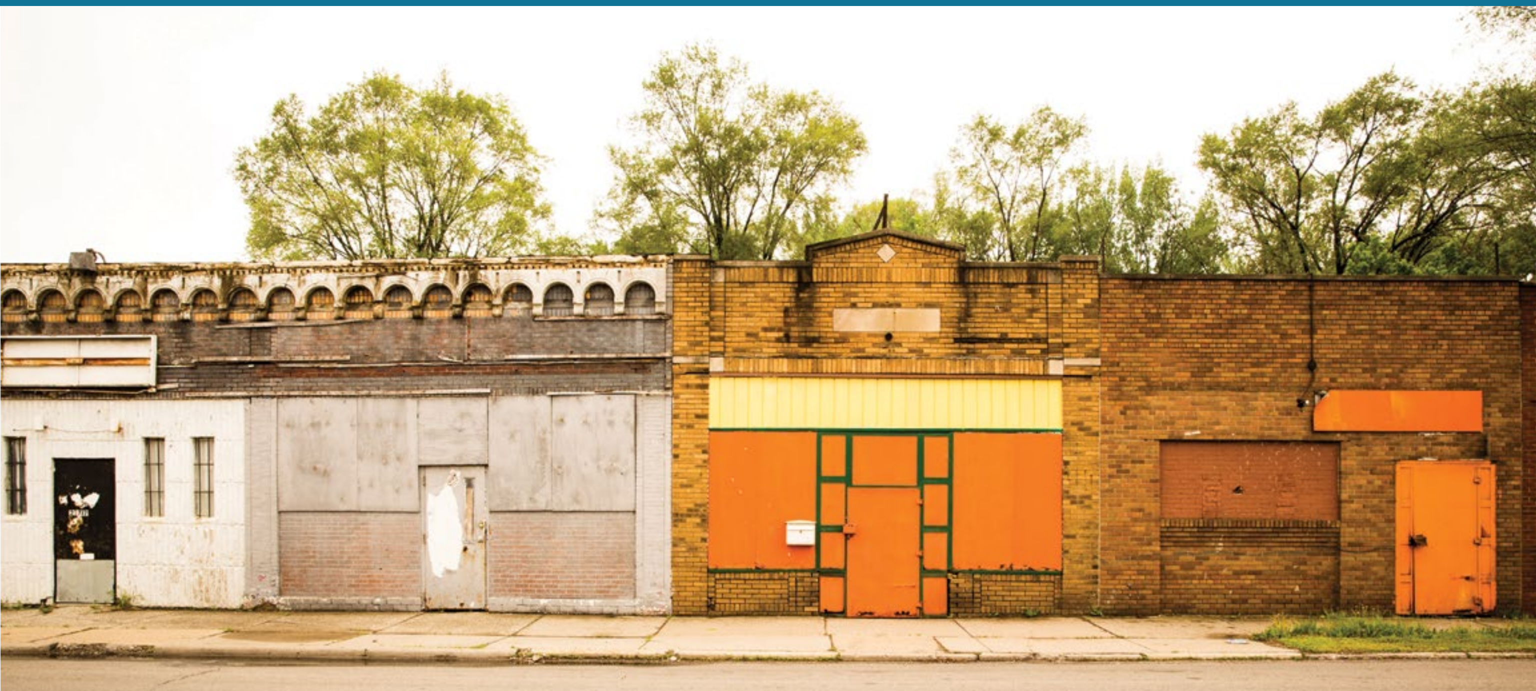
Detroit and the Property Tax

Strategies to Improve Equity and Enhance Revenue



POLICY FOCUS REPORT LINCOLN INSTITUTE OF LAND POLICY GARY SANDS AND MARK SKIDMORE

POLICY FOCUS REPORTS

The Policy Focus Report series is published by the Lincoln Institute of Land Policy to address timely public policy issues relating to land use, land markets, and property taxation. Each report is designed to bridge the gap between theory and practice by combining research findings, case studies, and contributions from scholars in a variety of academic disciplines, and from professional practitioners, local officials, and citizens in diverse communities.

ABOUT THIS REPORT

In December 2014, the City of Detroit emerged from bankruptcy with a plan that cut $7 billion from the city's $18 billion debt load. Although the causes of the bankruptcy were complex, a contributing factor was the ongoing decline in the revenue-generating capacity of the property tax. To the extent that most government entities rely heavily on property tax revenues, the story of Detroit's bankruptcy is relevant to other cities as well.

Detroit's projected property tax revenue for 2016 is just $90 million, compared to $240 million in 1995. Even so, property tax rates in Detroit are the highest rates in Michigan and among the highest in the country—suggesting that the system is broken. Problems include unfairly distributed tax burdens, inflated assessments, high rates of tax delinquency, and thousands of foreclosures that reduce the tax base and depress property values. The erosion of Detroit's property tax base is a symptom of changing social, economic, and cultural forces—challenges that have accumulated over more than six decades. This report suggests that property tax reform is not only necessary but can help recovery efforts.

The authors propose reforms in the context of the rapidly changing situation in Detroit in mid-2015. At the local level, they recommend improving assessments, refining the use of abatements, lowering tax rates, implementing a land-based tax, improving public services, and permanently removing excess land from the market. At the state level, they recommend eliminating the taxable-value cap, allowing the adoption of a land value tax by local municipalities, and regionalizing some public service functions.

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Front Cover: Astro Coffee in Corktown (top). Brightmoor (bottom). *Credit: David Lewinski Photography.*

Back Cover: Woodward Avenue. *Credit: Sean Marshall, Flickr/CC BY.*

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Executive Summary

The 2015 restoration of the Ransom Gillis House in Brush Park will be featured in an eight-part HGTV series celebrating Detroit. Of the neighborhood's roughly 300 homes built in the 19th century, only about 80 remain. *Credit: David Lewinski Photography.*

The City of Detroit, Michigan, spent 15 months in bankruptcy in 2013 and 2014. Although the causes were complex, and in some instances unique to Detroit, one contributing factor was the ongoing decline in the revenue-generating capacity of the property tax. To the extent that most government entities rely heavily on property tax revenues, the story of Detroit's bankruptcy is relevant to other cities. After years of deterioration and neglect, public services in Detroit are in need of maintenance, restoration, and improvement. In the short term, Detroit officials will have difficulty making urgently needed improvements without increasing the tax burden, which is already very high. This report, written in mid-2015, examines the effectiveness of current property tax programs and policies, problems in administration of the property tax, competitive factors, and alternative tax scenarios.

We consider distortions in Detroit's tax base—factors that make it significantly different from a tax base determined strictly by market valuations. We also consider the problem of tax delinquency and examine the growing inequity in Detroit's property tax system—inequity that is the result of tax exemptions and tax abatements, a high concentration of tax-exempt properties, lack of uniform assessing, and nonpayment of taxes, among other factors. We consider Detroit's growing volume of publicly owned properties, the impacts of this accumulation, and how it might be managed.

In our recommendations, we stress the need to improve equity, to improve Detroit's regional tax-service competitiveness, and to increase revenue-generating capacity. We offer six primary recommendations for reforms at the local level:

- **Continue improving assessments.** An analysis completed in 2015 suggests that assessments should be reduced by as much as 70 percent.
- **Improve targeting of abatements.** Detroit has granted abatements to approximately 3.5 percent of city properties. We challenge the notion that industrial property tax abatements, in particular, yield net-positive benefits to the communities that use them.
- **Reduce statutory tax rates.** Over time, a rate reduction could generate property value increases sufficient to offset the initial decline in revenue resulting from the rate reduction.
- **Implement a land-based special assessment tax.** We provide work showing that such a tax would cause significant changes in the tax burden across commercial, industrial, and residential properties, but would improve the efficiency of the property tax system.
- **Improve public services.** As of mid-2015, Detroit is making a concerted effort to improve and update public services. However, more improvements are necessary.
- **Permanently remove land from the market.** Detroit's excess of publicly owned properties inhibits private real estate transactions. Some of this land might serve the city well as parklands, industrial buffer zones, community gardens, and the like.

We also suggest the following property tax reform measures be enacted at the state level:

- **Eliminate the taxable-value cap.** The taxable-value cap, an aspect of Proposal A, limits the growth of the tax base as the real estate market recovers and is a major source of inequity between new buyers and longtime owners.
- **Institute a land value tax.** This would result in considerable shifting of the property tax burden among classes of property owners, but would encourage property development.
- **Regionalize some public service functions.** Transferring services to the state or a regional agency could improve Detroit's regional competitiveness. Possibilities include transportation, recreation, and cultural services.

The property tax environment is just one of several severe and complex problems facing Detroit and its residents. These challenges have accumulated over a period of more than six decades and will not be easily reversed. Although we are certain that reform of the property tax is necessary, we also recognize that property tax reform alone is not sufficient to guarantee a lasting recovery. Without a significant increase in employment opportunities, advances in the education and skill levels of residents, and improvements to public and private services, no amount of tinkering with the property tax system will be sufficient to make Detroit, once again, a vibrant and robust urban community.

CHAPTER 1

Introduction

Many of the buildings in Detroit's financial district were constructed during the city's period of rapid growth at the beginning of the 20th century. Shown from left to right are the Penobscot (1928), the Buhl (1925), the Guardian (1929), and One Detroit Center (1993).

In December 2014, the City of Detroit emerged from Chapter 9 bankruptcy, with Judge Steven Rhodes approving a plan to cut $7 billion from Detroit's estimated $18 billion debt load. The bankruptcy came to a close within 15 months, much less time than many experts had expected and certainly less time than needed in the bankruptcy filings of other large and complex local government bankruptcies such as in Vallejo or Stockton, California, both of which took more than two years. The quick resolution helped reduce the uncertainty introduced by the bankruptcy process.

The settlement imposed losses widely on Detroit's creditors. Unsecured loans, such as those insured by Syncora and Financial Guaranty Insurance, were awarded just 14 cents on the dollar. Though the recovery rate is low even for uninsured creditors, they were given the opportunity to participate in future real estate developments in some of the city's prime locations. Other bondholders received much higher recovery rates. Retired municipal workers agreed to a 4.5 percent reduction in monthly pension checks and will no longer receive cost-of-living increases. (These changes to pension benefits are perhaps the most significant precedent established by the Detroit bankruptcy case; previous municipal bankruptcy cases had treated pension benefits as inviolable.) The bankruptcy plan also set aside $1.7 billion for investment in public services over the next decade. The end result was a significant improvement in the city government's fiscal condition.

The bankruptcy provided a badly needed debt and fiscal reset. In an effort to avoid future financial problems, Detroit policy makers are now turning their attention to the larger socioeconomic issues confronting the city. Detroit needs to reverse the downward trend in population and employment that has persisted for more than six decades. Encouraging new development will require substantial improvements in public services. At least in the short term, Detroit officials will have difficulty making improvements without raising taxes, which are already considered to be excessive.

While the property tax is just one of the sources of Detroit's general fund revenues, it is among the most highly criticized, primarily because Detroit's property tax rate is the highest in Michigan. With a property tax delinquency rate of 54 percent at the end of 2014 and 62,000 tax foreclosures expected in 2015 alone, improving the administration of the property tax is critical. The statistics reviewed here suggest that there is something deeply wrong with the property tax as it is currently administered.

The manufacturing employment that was largely responsible for Detroit's growth in the first part of the 20th century became a major factor in the city's decline in the latter half. In 1970, there were 735,000 jobs in Detroit. By 2000, there were 390,000 fewer jobs in the city.

Although a budget surplus is expected in fiscal year 2015, Detroit's property tax environment continues to be riddled with challenges. While property values near the city center and midtown have experienced significant appreciation since the Great Recession, property values throughout most of the rest of the city remain below pre-Recession conditions. Detroit has embarked on a three-year citywide reassessment process and has recently lowered assessments in most neighborhoods. Nevertheless, tax payments continue to be based on inflated and inaccurate assessments. As a further exacerbation, about 80 percent of tax-foreclosed properties sold at auction are delinquent again within two years.

Background

At the beginning of the 20th century, Detroit was the fastest-growing major city in the United States. Rapid growth of the automobile industry helped bring more than one million new residents to the city between 1900 and 1930. As Detroit expanded its boundaries and population, much of today's built environment and public infrastructure was created. The automobile industry also helped create a prosperous working class, many of whom were able to afford to purchase their homes. By 1950, the majority of Detroit households (54 percent) were owner-occupants; single- and two-family homes dominate Detroit's housing stock.

The Packard Automotive Plant closed in 1958. Other businesses continued to operate on the premises through the early 2000s. *Credit: Albert Duce, Wikimedia/CC BY-SA.*

The story of the collapse of Detroit's housing market begins with the loss of employment opportunities that began half a century ago (Reese, Sands, and Skidmore 2014). The manufacturing employment that was largely responsible for Detroit's growth in the first part of the 20th century became a major factor in the city's decline in the latter half. In 1970, there were 735,000 jobs in Detroit. By 2000, there were 390,000 fewer jobs in the city. Many jobs were relocated to the suburbs, where employment increased from 1.2 million in 1970 to 2.3 million in 2000. Detroit's share of total metropolitan employment fell from 38 percent to 13 percent during this period. In 1950, almost 760,000 Detroit residents had jobs, divided between the city and its suburbs. Almost 28 percent of these jobs were in the motor vehicle manufacturing industry. Fifty years later, the number of Detroiters with jobs was just 331,000, a decline of over half.

The employment collapse brought about a decline in Detroit's population and households. From a peak population of 1.85 million in 1950, the number of Detroit residents fell to 951,000 in 2000. The number of households fell from a high of 515,000 in 1960 to an estimated 345,000 in 2000. The residential vacancy rate in Detroit in 2000 was just over 10 percent.

Detroit in the 21st Century

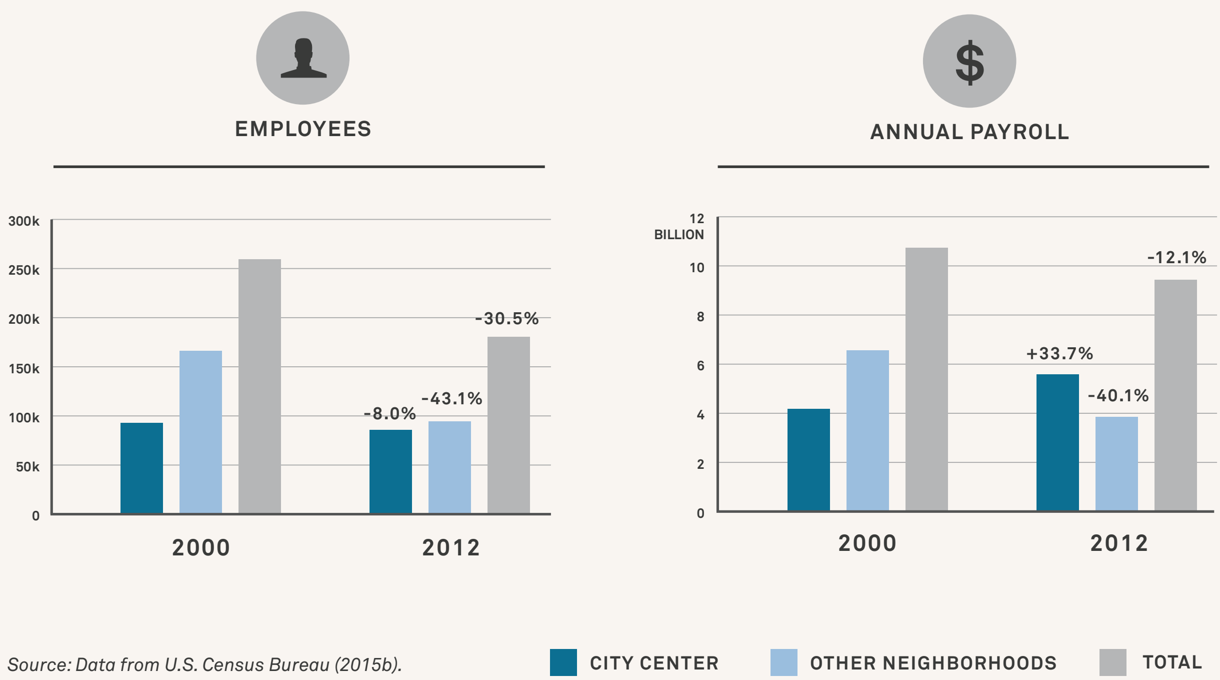
Between 2000 and 2012, Detroit's private-sector jobs declined by 30 percent, to 180,300. Job losses were particularly severe in the city's neighborhoods, where the number of jobs fell by over 70,000, or 43 percent (figure 1); city center employment, in contrast, declined by just 8 percent. The annual payroll of downtown workers actually rose by a third during this period, partially offsetting the substantial decline in annual payroll in the rest of the city. By 2012, the downtown core accounted for 48 percent of jobs and 61 percent of payrolls.

Since 1972, more than two-thirds of the businesses in Detroit have closed. Business losses have occurred in every industry, including manufacturing, retail trade, and personal and business services. Since 2000, the number of Detroiters with jobs has declined by more than 30 percent, doubling the city's unemployment rate from 13.8 percent to 28.5 percent.

Current estimates put Detroit's population at 689,000. Many of these residents have limited education and skills; the proportion of Detroiters with a bachelor's degree is just 12.7 percent, less than half the national average. The share of Detroiters with a disability, 19.5 percent, is significantly above the national average of 12.1 percent. Given these disparities, it is not surprising that Detroit residents find it increasingly difficult to qualify for the dwindling number of jobs that are available. Between 2000 and 2013, median household income in Detroit declined by more than 11 percent in current dollars, equivalent to a decline of 34 percent when adjusted for inflation. In 2013, poverty rates in the city were well above both the corresponding values in 2000 and the current national average (U.S. Census Bureau 2015a).

Since 2000, Detroit has issued permits for the construction of 9,500 residential units, mostly multifamily housing. During the same period, Detroit demolished more than 37,400 housing units, resulting in a net loss of 27,900 units. Despite the reduction in the housing stock, the city's residential vacancy rate has tripled, reaching 29.3 percent, as the number of occupied

Figure 1
Employees and Annual Payroll in Detroit, 2000 and 2012



Source: Data from U.S. Census Bureau (2015b).

Detroit has demolished more than 37,400 housing units since 2000. *Credit: © Alex S. MacLean/*The New York Times.

housing units has fallen by 80,000, a decline of more than 27 percent (Data Driven Detroit 2015).

Virtually every metropolitan area in the United States experienced significant housing market declines from 2008 to 2009 (Blinder 2013). While Detroit was no exception, the causes and consequences of its housing crash are distinct. For metropolitan areas such as Phoenix or Las Vegas, the fall in prices resulted from the bursting of a speculative price bubble. In metropolitan areas such as Charlotte, North Carolina, the housing price index declined less and has recovered more rapidly. Most areas have seen a significant price recovery in recent years. By 2014, average home prices nationwide had recovered almost two-thirds of their post-2007 losses (figure 2). Charlotte's home price index, for example, had regained more than 70 percent of its losses. Detroit, on the other hand, had regained just half of its losses and continues to have the lowest home price index among the 20 metropolitan areas included in the Case-Shiller Home Price Index (CoreLogic 2015).

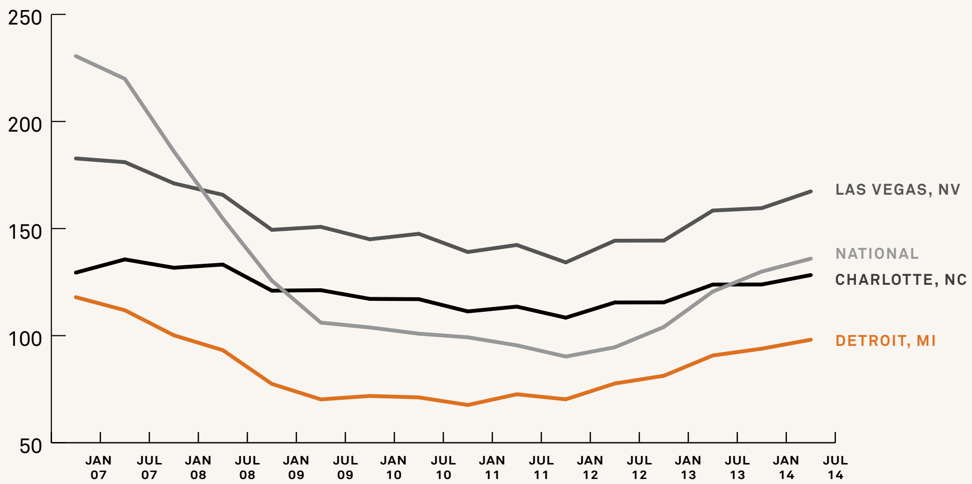
Detroit's housing collapse is the result of fundamental structural weakness in the city's housing market. The decline in employment in Detroit caused a reduction in population and incomes that has pushed housing prices down. As a result of the exceptional falloff in population and income, the recovery in home prices has proceeded more slowly in Detroit than in other metropolitan areas.

Figure 3 illustrates housing price trends in Detroit's core area and in the balance of the city from 2006 (just prior to the Great Recession) to 2014. In all four sections of the city, home prices dropped steeply between 2006 and 2009. Prices in the midtown-downtown core area continued to decline until 2011, when a sharp recovery began. By 2014, core area home sales prices were less than 1 percent below the 2006 average. In Detroit's neighborhoods, average sales prices reached their low point in 2009. Since then, prices have recovered, but at a much slower pace than in the core area; average sales prices in 2014 were just 22 percent to 36 percent of the corresponding 2006 averages.

Detroit, like other American cities, was plagued by a large number of mortgage foreclosures in this period. From 2009 to 2010, foreclosure sales depressed prices, crowding out most market sales. Beginning in 2008, foreclosure sales prices have been at least 22 percent lower than market sales prices. Because foreclosure rates were also high in Detroit's suburbs, prices declined there as well, allowing many Detroit residents to afford a house in the suburbs, further weakening the Detroit market.

Figure 2

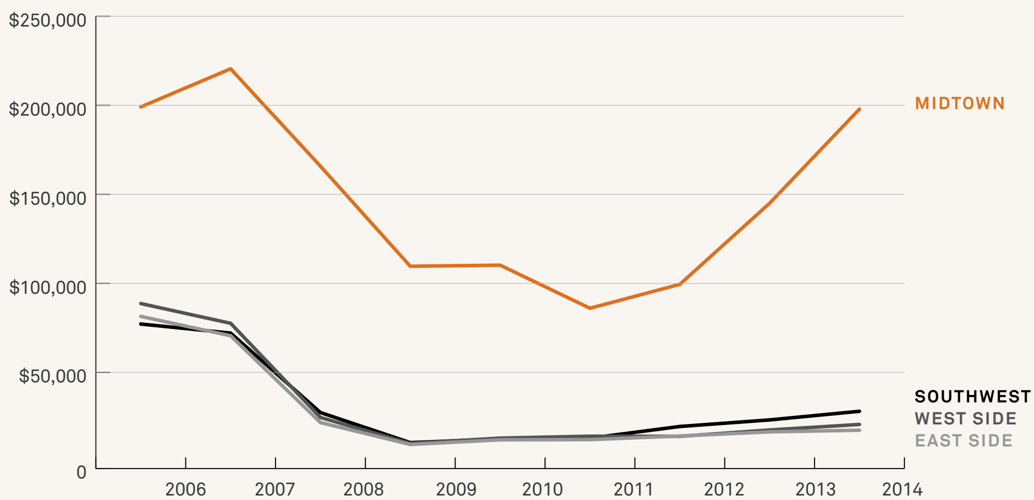
Metropolitan Home Price Index, 2007–2014



Source: Data from CoreLogic (2015).

Figure 3

City of Detroit Residential Sales Price Trends, 2006–2014



Source: Data from RealtyTrac Data Solutions (2015).

Currently, Detroit is experiencing a second wave of foreclosures, this time for unpaid property taxes. Over half of Detroit taxpayers are delinquent in their property tax payments (MacDonald and Wilkenson 2013). As many as 62,000 properties could be included in foreclosure auctions in 2015; the actual number may be considerably less because the volume exceeds the capacity to process all of the potential auction sales (Laitner 2014).

In Michigan, there are two important differences between mortgage foreclosures and tax foreclosures. Whereas the mortgage foreclosure process is relatively short, usually lasting about six months, it typically takes approximately three years to complete a tax foreclosure. Moreover, in mortgage foreclosures, property tax payments typically continue to be made, while tax-foreclosed properties generate no revenue to the city until they are returned to private ownership.

As property values dwindle, Detroit city government, public schools, and other government entities that rely on the property tax experience sharp reductions in their revenues. And local businesses have fewer customers. In this way, the quality of life in the city declines as public services deteriorate and basic commercial services disappear.

The physical evidence of housing abandonment in Detroit is striking. According to data from Data Driven Detroit (2015), roughly 80,000, or 23 percent, of the city's housing units are now vacant, as are 36 percent of commercial parcels and 22 percent of industrial properties. About 20 square miles of the city's land area is now vacant.

The collapsing housing market has had significant impacts on city services; the litany of service reductions is lengthy (Detroit Office of the Emergency Manager 2013). In a municipality where one-quarter

Some vacant lots have become so overgrown with vegetation that traveling along the sidewalk is no longer possible. *Credit: University of Michigan School of Natural Resources & Environment, Flickr/CC BY.*

The Brewster-Wheeler Recreation Center, where boxer Joe Lewis trained as a teenager, closed in 2006 and was once slated for demolition. In April 2015, city officials announced a redevelopment plan that will include a restaurant, event space, and offices. *Credit: Sam Beebe, Flickr/CC BY.*

of households do not have a car, bus service has been reduced by almost 22 percent. The number of city recreation centers has been reduced from 30 to 17; public swimming pools have been cut from 18 to 10; and half of Detroit's parks are closed. Water, sewage, and other public infrastructure—which was developed prior to 1950 for two million residents in an area of over 139 square miles—now serves a population of under 700,000 in the same space. A key challenge is how to maintain old infrastructure, much of which is now serving largely vacant areas, without the necessary tax revenues.

The widespread vacancies and abandonment have a perverse effect on the neighborhoods. Longtime residents see their property values decline and receive poor-quality public services for their property tax dollars. They feel threatened by the growing number of vacant and vandalized structures in their neighborhoods. Households that are able to maintain their properties and pay their taxes may choose instead to abandon the properties if they cannot sell them (Raleigh and Galster 2014). The process of neighborhood decline thus accelerates.

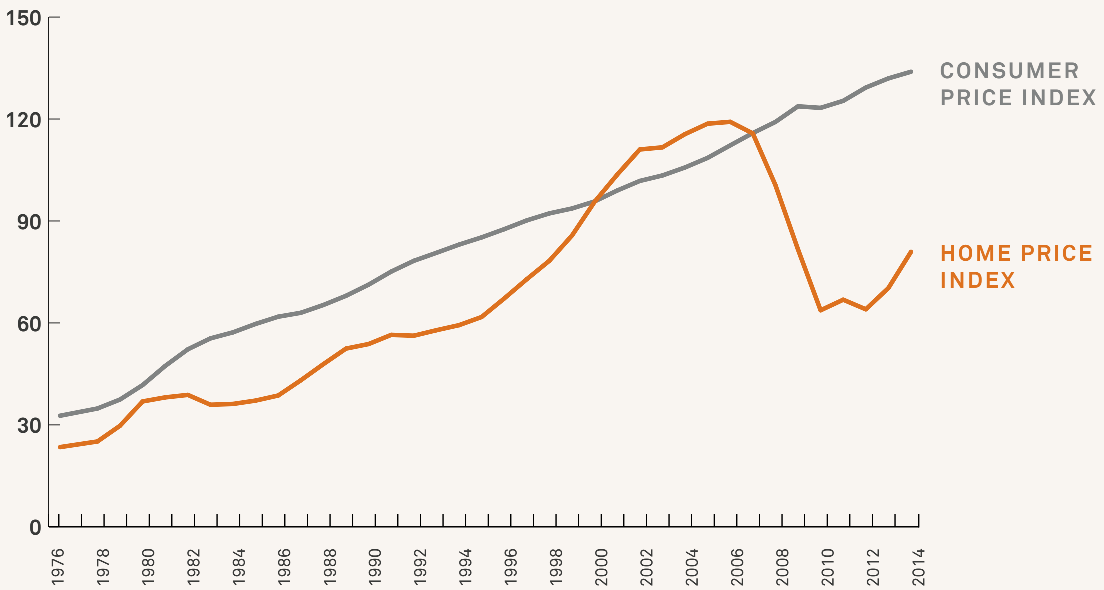
As property values dwindle, Detroit city government, public schools, and other government entities that rely on the property tax experience sharp reductions in their revenues. And local businesses have fewer customers. In this way, the quality of life in the city declines as public services deteriorate and basic commercial services disappear. Unless this cycle of declining employment, population, and income can be broken, Detroit's fiscal health can be expected to continue to deteriorate. In the near term, there seems little prospect for stabilization, let alone recovery.

For years, particularly during the late 1990s and early 2000s, flexible lending standards and policies that kept interest rates low buoyed the Detroit housing market, despite continuing population losses. As shown in figure 4, from 1976 through 1996, Detroit home prices rose with the rate of inflation as measured by the Consumer Price Index. Then, from the late 1990s through 2001, home prices rose more rapidly than the general price level. Beginning in 2005, home prices reversed; the home price index declined dramatically, losing more than half its value by 2009. Today, home prices are recovering and rising more rapidly than the general price level—a somewhat anomalous situation, given that the population is still declining. This trend can be explained, in part, by the renaissance that is occurring in the midtown-downtown core area of Detroit. The data also suggest that the national policy of record-low interest rates is overriding local market conditions in determining the trajectory of home prices.

The true decline in home prices during the depths of the Recession may actually be greater than the data presented here indicate. A large percentage of home sales were distressed in nature and were likely excluded from the Case-Shiller sample that is the basis for these home price indexes. In an evaluation of property value assessment practices in Detroit, Hodge et al. (2015b) show that by 2009 the average sales price of nonforeclosed properties had fallen by as much as 80 percent.

Figure 4

Detroit Home Price Index versus U.S. Consumer Price Index, 1976–2013



Note: The Detroit home price index shown here represents 13 of 30 zip code areas within Detroit.

Source: Data from CoreLogic (2015) and U.S. Bureau of Labor Statistics (2015).

CHAPTER 2

Statewide Property Tax Policies

Homes such as this one, which is located in one of Detroit's Homestead Neighborhood Enterprise Zones, may be eligible for tax reductions. *Credit: Gary Sands.*

Taxes on real and personal property are an important source of revenue for local governments throughout the United States. Before 1994, when Michigan approved Proposal A as a mechanism to constrain property tax revenue, property taxes typically accounted for about 41 percent of state and local tax revenues—well above the national average of about 30 percent. After Proposal A, property taxes have accounted for about 38 percent of Michigan revenues, a share that is closer to the national average, which remains around 30 percent. Michigan's property taxes are also above the national average when measured on a per-capita basis, but the difference in property tax reliance between Michigan and the U.S. average has lessened as a result of Proposal A.

It should be noted that Michigan also provides an income-based circuit breaker. The circuit breaker, known as the homestead property tax credit, operates as a refundable credit in the state's income tax. If the homestead property tax credit is netted out, the burden of the property tax is reduced. The homestead credit is more generous to senior citizens than to others; if we combine the homestead credit with Michigan's favorable treatment of pension income (it is generally not taxed), elderly Michigan residents have a negative effective rate of income taxation. While our focus here is the property tax, we conduct additional analysis to determine whether taking into account the homestead property tax credit makes a difference to our core findings. As described later, our findings and conclusions are consistent across these considerations.

In Michigan, local governments derive, on average, about 40 percent of their general fund revenue from the property tax; for local school districts, the proportion is even higher, about 80 percent. Local taxing entities in Michigan must operate within an overall framework set by the state constitution and statutes. For example, Michigan limits property tax rates for municipalities to 20 mills, with one mill equal to 0.1 percent of the property value. In addition to the municipal tax levy, a number of overlapping jurisdictions (including state government, county governments, school districts, and other special districts) also levy millages.

Proposal A

Proposal A dramatically altered education finance in Michigan when it was passed in 1994. Prior to Proposal A, property taxation in Michigan had two key characteristics. First, public schools were financed almost exclusively through local property taxes. Since there was wide variation among school districts in the value of taxable property per student, there were significant differences among school districts in expenditure per student. Second, the overall level of property taxation was well above the national average (U.S. Census Bureau 2015c). These features were the source of considerable dissatisfaction among voters, and they led to a long series of reform measures (Feldman, Courant, and Drake 2003).

Property taxes in Michigan are based on the state-equalized value (SEV) of a property. Every year, the assessor in each jurisdiction determines the market value of each property as of December 31 of the previous year. The assessed value is set at 50 percent of this market value. Assessed values are then reviewed at the county and state levels. State officials may adjust (equalize) the estimated values by class (residential, industrial, etc.) to establish the SEV.

In a key change, Proposal A introduced a cap on taxable-value increases. The cap limits the growth of property value for tax purposes to the lesser of the general rate of inflation (as measured by the national Consumer Price Index) or 5 percent, regardless of the actual increase in the SEV. Because the inflation rate since 1994 has remained below 5 percent, the 5 percent limit has never been applied. But with the cap in place, over time, the taxable value (TV) of a property could fall well below its SEV.

Proposal A includes a "pop-up" provision specifying that the taxable value of a property is to be returned to the current market-based SEV when the property is sold. The provision is applicable even in the case of a property transfer that does not involve an explicit sale of the property. For example, when property ownership is transferred from one family member to another, the benefits of the lower taxable value cannot be transferred to the new owner. The pop-up provision has had a notable impact in areas with significant increases in property values; the effective property tax rates facing longtime property owners have decreased relative to those of more recent purchasers of property.

Along with the taxable-value cap, Proposal A introduced a distinction between homestead property and nonhomestead property. Homestead property, Box 1

Statutory versus Effective Tax Rate

When talking about the property tax, it is helpful to define the terms *statutory tax rate* and *effective tax rate,* particularly as they are calculated in Michigan.

Statutory Rate

The statutory rate is the tax imposed by law. It is usually expressed as a percentage. In Michigan, the millage rates defined by statute are applied to the taxable value of a property, with one mill equal to 0.1 percent of the taxable value. For example, if the millage rate is 20 mills—or 2 percent—and the taxable value of a property is $200,000, then the tax payment for this property would be $4,000.

Effective Rate

In Michigan, the effective rate is calculated by dividing the tax payment—the statutory rate applied to the taxable value, or $4,000 in the example above—by the state-equalized value. If the property in our example has a state-equalized value of $250,000, then the effective tax rate would be $4,000 divided by $250,000, or 1.6 percent of the state-equalized value.

When taxable-value growth lags behind growth in state-equalized value (due to the assessment growth cap), the effective rate falls, whereas the statutory rate is constant (unless changed by referenda).

defined as the homeowner's principal residence, was granted a homestead exemption—an upper limit on the statutory property tax millage rate that local school districts could use for public school operating expenses. The effect of the homestead exemption was to reduce average statutory millage rates by about one-third. The exemption also effectively equalized statutory property tax millage rates for local school operating expenses on homestead properties across the state. However, although disparities in overall statutory millage rates across jurisdictions were reduced, they were not eliminated. There continue to be substantial differences in millage rates between homestead and nonhomestead properties, as well as differences in the millage rates for school capital expenditures, municipal governments, county governments, and other special districts.

To take the place of local property taxes in funding school operating expenses, a 6-mill state education tax was introduced along with increased sales taxes and cigarette taxes. Severe restrictions were placed on the ability of local jurisdictions to increase property taxes on their own. Thus, the financing of operating expenses for K–12 public education became much more centralized than it had previously been. Also, the revised funding formulas generated more equal per-student funding for operating expenses, although considerable gaps remain between the highest- and lowest-spending districts. Per-pupil spending increased substantially in many of the poorest districts, as increased state aid outweighed the reduction in property tax revenues. Spending increases were more modest, or even nill, for more affluent districts. In the area of school capital expenses, local school districts still must rely on their own property taxes. As a result, funding disparities for school capital expenses are much larger than those for operating expenses (Arsen and Plank 2003; Papke 2008).

Headlee Amendment

Proposal A was not the first mechanism for constraining property tax revenues in Michigan. Prior to Proposal A, property tax revenues were already limited by the

The historic Book-Cadillac building in downtown Detroit, vacant since 1986, was renovated and reopened as a Westin Hotel in 2008. It is located in a Renaissance Zone that expires in 2017. *Credit: Sean Marshall, Flickr/CC BY.*

Headlee Amendment, which was passed in 1978. While Proposal A limits statutory millage rates and imposes a limit on the growth in taxable values, the Headlee Amendment puts a direct limitation on property tax revenues. Property tax revenue growth is restricted to the rate of inflation, with an adjustment for new construction. Any jurisdiction with potential revenue increases exceeding the Headlee limit is required to reduce property tax rates in order to bring revenues into line with the revenue growth restriction. Prior to the introduction of the taxable-value cap, rapidly rising property values resulted in numerous Headlee rollbacks. After Proposal A, however, rollbacks have been greatly reduced, both in number and in magnitude.

Before Proposal A, the Headlee Amendment provided a mechanism for limiting property tax rates in a uniform manner across all properties in a jurisdiction. Proposal A's taxable-value cap also limits effective property tax rates, but unlike the Headlee Amendment, it does not treat all properties in a jurisdiction uniformly. The effect of Proposal A has been to reduce effective tax rates for existing homeowners, but not for new home buyers.

The Michigan Department of Treasury (2014) provides annual estimates of tax expenditures (i.e., tax revenue lost as a result of exemptions or subsidies) for all major sources of tax revenue. In fiscal year 2014, the estimated revenue loss from the taxable-value cap was $890 million, down from $3.4 billion in 2008. The homestead exemption produced an estimated revenue loss of $3.07 billion in 2014. These two property tax expenditures are estimated to make up more than 54 percent of the total tax expenditures associated with the property tax. The tax expenditure associated with the taxable-value cap is sufficiently large that, if it had been removed and total property tax revenues were held constant, the statewide average statutory tax rate could have been reduced by about 10 percent in 2012 and 20 percent in 2008.

Tax Abatements

For Detroit and other Michigan jurisdictions, Proposal A and the Headlee Amendment are externally imposed restrictions on their ability to raise revenue through the property tax. Municipalities can do little to alter the effects of these—just as they can do little to alter the effects of declining property values. But Michigan municipalities do have the ability to selectively reduce property tax burdens through state-sanctioned tax abatement programs. Michigan's three primary tax abatement programs—Renaissance Zones, Neighborhood Enterprise Zones, and Industrial Facilities Tax abatements—are widely used.

RENAISSANCE ZONES

The most generous property tax breaks are provided by a variety of Renaissance Zone programs that eliminate all property taxes (except debt retirement millages) for 12 years, followed by a three-year phase-in to full tax rate. These reductions apply to personal property as well as to land and improvements. Unlike other abatement programs, the benefits of the Renaissance Zone designation do not require new investment; simply being a property owner within a zone is sufficient to qualify for the tax break.

NEIGHBORHOOD ENTERPRISE ZONES

The Neighborhood Enterprise Zone (NEZ) program offers two types of property tax reductions in economically distressed communities: the NEZ New and Rehabilitated (NEZ-NR) and Homestead NEZ (NEZ-H) abatements.

NEZ-NR reductions apply to investments made for the construction of new residential units for owner occupancy and investments for the substantial rehabilitation of existing residential property. The land value of qualifying properties is taxed at the full rate. The applicable property tax rate on the improvements is equal to one-half of the average tax rate for all local jurisdictions in Michigan. This average, calculated by the Michigan Department of Treasury, has been just under 40 mills in recent years, resulting in an NEZ tax rate on improvements of slightly less than 20 mills. The taxes collected are apportioned among taxing jurisdictions according to their relative shares of the statutory tax rates. The state of Michigan reimburses some of the overlying taxing jurisdictions for some of their lost revenue. Tax savings for properties receiving NEZ-NR benefits vary, depending on the prevailing tax rates in each jurisdiction.

The NEZ-H program provides a limited reduction in property taxes for homeowners who purchased a home in a designated zone subsequent to 1994 and who have made qualifying improvements of at least $500. The NEZ-H is designed to provide a measure of property tax relief to current property owners, rather than to induce major new investments. Properties that qualify receive a 50 percent reduction in city and county operating mills applied to the value of the structures; the land value is taxed at the full rate.

INDUSTRIAL FACILITIES TAX ABATEMENTS

The Industrial Facilities Tax abatement program applies to both construction of new facilities and rehabilitation of existing facilities. A complicated formula is employed to calculate the property tax relief. In all instances, the value of the land is taxed at the full millage rate. Qualified improvements, to both real (structures) and personal (equipment) property, are taxed at half the prevailing rate. For rehabilitation projects, the value of the existing industrial property is frozen and the value of the improvements is not subject to property taxes for the period of the exemption. As a result, there is no way to generalize the amount of savings for rehabilitation projects. Because the valuation of the existing facility is frozen for up to 12 years, additional savings are realized on any incremental increases in property value. In recent years, declining property values have diminished these tax savings; they are typically substantially less than savings on the total value of the investment.

Detroit has made extensive use of the three abatement programs. While they can be effective in encouraging investments in the city, they also result in distortions to Detroit's property tax base and constrain the range of policy actions Detroit officials may consider when administering the property tax. We turn next to consideration of tax base distortions in Detroit and the erosion of Detroit's tax base over time.

CHAPTER 3

Tax Base Distortions in Detroit

DeRoy Auditorium, on the Wayne State University campus, is located on one of many tax-exempt properties close to the center of Detroit. *Credit: Andrew Jameson, Wikimedia/CC BY-SA.*

Tax base distortions in Detroit are the result of ongoing economic forces, policy, and the interaction between these two factors. Here we consider policies that distort the tax base and cause it to be significantly different from a tax base tied closely to market valuation of property.

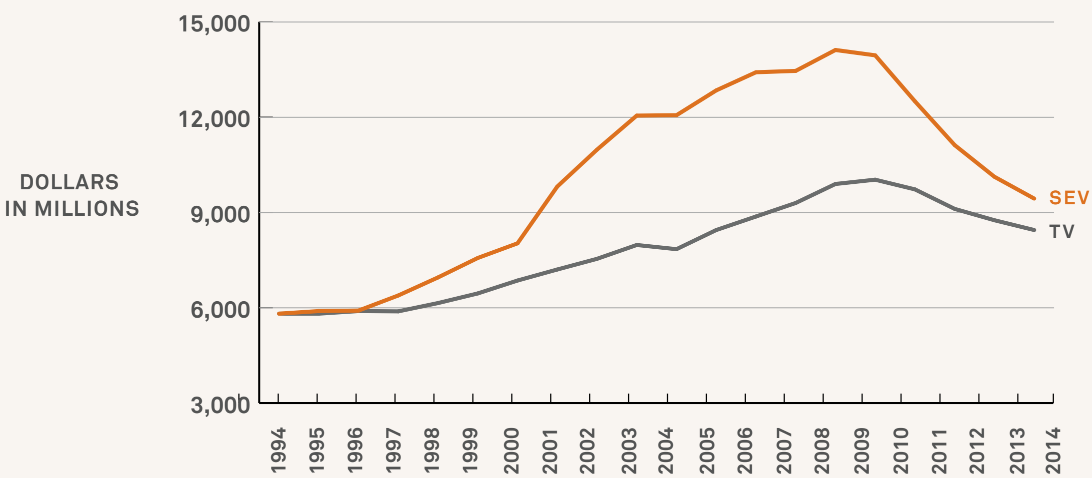
Limitations on Growth in Assessments

The Michigan constitution requires all real and personal property to be assessed annually to determine its current market value. The property tax base of Michigan jurisdictions is derived from these market values. As noted in the previous chapter, a property's assessed value is calculated at 50 percent of market value; the assessed value is used to set the state-equalized value (SEV); and then the taxable value (TV) is calculated by capping growth in the SEV to the lower of either 5 percent or a national measure of inflation. During the housing boom, both housing prices and SEVs increased substantially and Detroit experienced a growing differential between SEVs and TVs. By 2007, statutory tax rates could have been reduced by 42 percent—and would still have generated the same amount of revenue—if tax payments had been based on SEVs rather than TVs (City of Detroit 2015). Between 2003 and 2008, the use of TVs instead of SEVs as a basis of the property tax cost Detroit some $633 million in residential property tax revenue, an average of $105 million each year.

In the wake of the Great Recession, SEVs have dropped significantly across the state and in Detroit, narrowing the gap between SEVs and TVs. Between 2009 and 2014, the taxable-value cap reduced Detroit's revenues from residential property taxes by about $214 million, about $36 million annually. By 2012, aggregate residential TV in Detroit was 88 percent of SEV. Since then, the difference between SEV and TV has stabilized. These trends are illustrated in figure 5.

Figure 5

Aggregate Residential State-Equalized Values (SEV) versus Taxable Values (TV) for Detroit, 1994–2014



Source: Data from City of Detroit (2015a).

The taxable-value cap and its associated pop-up provision have introduced significant differences across properties in effective tax rates. A property's taxable value must be reset to its SEV (which reflects market prices) upon sale or transfer of the property. Thus, during periods of rapidly rising home prices, longtime property owners benefit from much lower taxable values than do more recent purchasers of property. Within neighborhoods, effective tax rates vary considerably across properties, depending on the rate of increase in SEVs and length of ownership. Figure 6 shows the wide range of effective tax rates for parcels in the Evergreen neighborhood of Detroit.

In an analysis of Detroit home sales data, Hodge, Sands, and Skidmore (2014) use quantile regression techniques to evaluate the distribution of effective tax rates resulting from imposition of the taxable-value cap and pop-up provision. They find significant inequities. As shown in figure 7, as of 2010, longtime homeowners (those who purchased their homes in 1994 or earlier) had significantly lower effective tax rates than those who had purchased their properties in 2001 or 2008. Further, there is a much wider distribution of effective tax rates for longtime property owners than for more recent purchasers of property.

Tax-Exempt Property

Detroit is home to a substantial number of parcels of land that are exempt from local property taxes. These

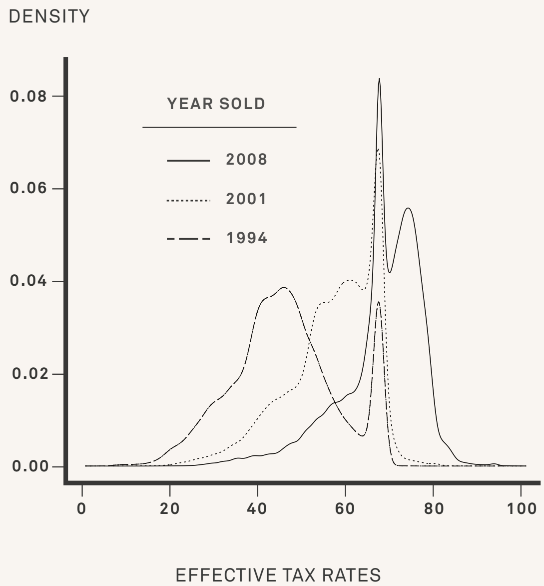
Figure 6

Effective Tax Rates at Parcel Level for Taxable Properties in Detroit's Evergreen Neighborhood, 2010

Source: Sands and Skidmore (2014).

Figure 7

Effect of Assessment Growth Cap on Estimated Effective Tax Rate Densities, 2010



Source: Hodge et al. (2015b). Reprinted by permission of SAGE Publications.

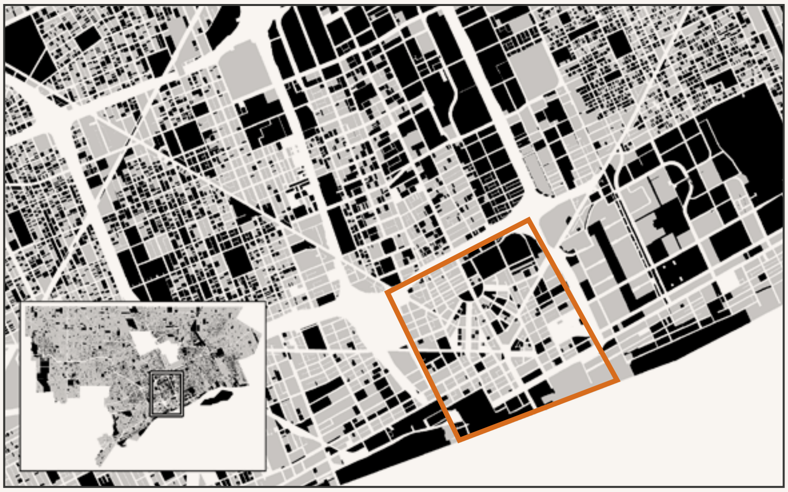
Figure 8
Taxable and Nontaxable Properties in Central Detroit, 2010

DOWNTOWN DETROIT

TAXABLE

NONTAXABLE

Source: Sands and Skidmore (2014).



include not only public streets and municipal buildings, but also property owned by schools, colleges and universities, hospitals, religious and charitable institutions, and other nonprofit entities. The relative importance of tax-exempt properties depends on the unit of measurement. For example, public entities and religious institutions own a comparable number of parcels in Detroit: about 4,000 each. Because the government properties are larger, on average, they occupy almost 14 percent of the city's area, compared with just 2 percent for the religious institutions. But if the metric used is reported land value, government-owned land has an aggregate value about 17 times that of religious organizations.

Most of the larger tax-exempt areas are parks and other public property, although cemeteries and hospitals also account for a sizable share of tax-exempt properties. Figure 8 shows a concentration of nontaxable property close to the city center of Detroit. While most of the central business district pays property taxes, the area just to its north—which includes the medical center, cultural center, educational institutions, affordable housing developments, and tax-foreclosed properties—generates a much lower volume of taxes.

City officials have also granted exemptions and tax abatements to certain property owners in return for qualified investments that are intended to stimulate economic development. The efficacy of tax exemptions and tax abatements in this regard is a topic of continual debate (Kang, Reese, and Skidmore 2015; Reese and Sands 2012; Sands and Reese 2006). However, it is clear that abatements and exemptions narrow the tax base, as fewer properties contribute to the total tax effort. With fewer properties contributing, either the burden on those continuing to pay must be increased, or services must be reduced. Moreover, as will be discussed later in the chapter, these tax privileges inevitably create horizontal inequities, with similar properties receiving widely different tax bills.

Detroit grants property tax exemptions to affordable housing that has been built under a variety of federal housing assistance programs. The exemption is partially offset by a payment in lieu of taxes (PILOT), which is typically set at 4 percent of contract rents. Because of the variety of formulas used to determine rents in subsidized housing, the resulting tax loss cannot be easily estimated.

Detroit also loses property tax revenue when normally taxable property reverts to public ownership, typically because of a failure to pay property taxes. The city is plagued with these tax-foreclosed properties, and, as noted in chapter 1, many new foreclosures are expected in 2015. Many of the least desirable of these properties

In September 2015, this tax-foreclosed industrial building on Mt. Elliott Street was offered at auction by Wayne County. The owner has been delinquent since 1988. *Credit: © 2015 Google.*

will remain in the hands of a land bank (a public or community-owned agency created to acquire and manage abandoned and foreclosed property) or other public entity. Detroit also owns more than 1,300 properties acquired as part of various economic development initiatives. This inventory includes unsold parcels in 1970s urban renewal projects, incomplete land assemblies for industrial parks, and other properties acquired through similar initiatives. Because these properties were acquired for specific purposes, they are often larger and have higher land values than other properties in Detroit's inventory. In one of every five Detroit census tracts, more than 40 percent of the aggregate reported land value is not taxable. Many of these tracts are located near the city center and along the riverfront. Most of the parcels with a high share of their aggregate land value subject to property tax (85 percent or more) are located on the periphery.

Parcels that are partially or totally exempt from property taxes represent almost 20 percent of Detroit's land area and just over 11 percent of total assessed land value. Importantly, the number of publicly held parcels—making up about one quarter of Detroit's land area—is increasing. Growing tax delinquency and the increasing number of publicly held parcels go hand in hand; one-third to one-half of the tax-foreclosed properties offered at auction are not purchased, and title is thus transferred to a land bank, the city, or some other public entity. While some of these parcels have the potential of being returned to the tax rolls, the current state of the property market in Detroit, as well as the size of the current inventory (more than 60,000 parcels), suggests that this will require time. Given the accumulation of publicly held parcels, Detroit might do well to consider which properties could be returned to the tax-paying private sector in the future and which could be removed from the tax base for an extended period of time. Absent a reduction in the excess supply of parcels, land values could remain depressed for years into the future.

Assessment Practices

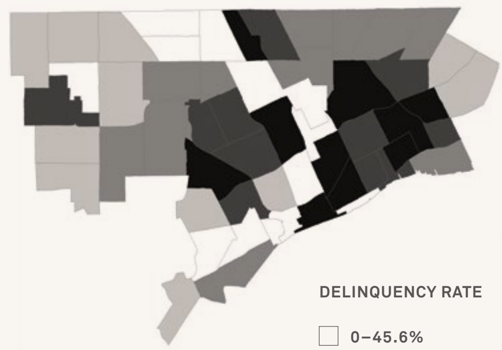
Assessed values of properties should, on average, be equal to actual sales prices; that is, the ratio of assessed value to sales price should be around one. In the case of Detroit, however, assessed values in 2010 were roughly five times sales prices, according to Hodge et al. (2015a). In their work, Hodge et al. make use of parcel-level data, traditional International Association of Assessing Officers measures, regression analysis, and quantile regression techniques to evaluate the degree of assessment inequity across Detroit property owners. They show that by all measures, assessment practices are vertically inequitable—that is, there is more variability of assessment ratios among lower-priced properties than among higher-priced properties. Assessment practices are shown, in addition, to generate significant horizontal inequity. Properties of similar value, and with similar household and neighborhood characteristics, face substantial differences in assessment ratios and tax payments.

In 2013, over-assessment of property in Detroit received considerable media attention (MacDonald 2013b, 2013c). This resulted in intervention by the state tax commission and corrective actions by the City of Detroit. Mayor Mike Duggan, newly elected, announced a multiyear, citywide reassessment of property and said that Detroit would soon be lowering assessments. In February 2015, citywide assessment reductions of 5 percent to 20 percent were announced (Helms 2015). While these reductions are a positive step in bringing Detroit's assessment practices in line with state law, the work of Hodge et al. suggests that assessments should come down much more than this. Once the citywide reassessment has been completed, assessments will likely have to be adjusted further to improve both horizontal and vertical equity.

Given the wide gulf between assessed values and sales prices, it is likely that Detroit will continue to see a large number of assessment appeals. In 2012, the Michigan Tax Tribunal heard 3,015 appeals of residential property assessments from Detroit property owners. Problems with assessment quality are exacerbated by outdated data processing systems and lack of sufficient personnel in both city and county governments. These shortcomings are responsible for processing errors, including sending bills to the wrong address and failing to return properties to the tax rolls when they are sold by the city (MacDonald 2013b).

Figure 9

Property Tax Delinquency Rates in Detroit by Neighborhood, 2010



Source: Alm et al. (2013).

Tax Delinquency

As shown in figure 9, tax delinquency is pervasive across Detroit, but some areas, such as the southeast quadrant, have particularly high delinquency rates. By mid-2015, Detroit's rate of tax delinquency had improved to about 30 percent, down from 54 percent in late 2014. Still, as noted in chapter 1, a new wave of tax foreclosures is expected in 2015.

The property tax foreclosure process in Michigan is complex and lengthy. Delinquent property taxes are first subject to late charges. After one year of delinquency, the property is forfeited to the county and subject to even higher monthly interest charges. For the first two years, the owner may redeem the property at any time by paying all outstanding taxes and fees. After this two-year period, the county treasurer (Wayne County for Detroit properties) initiates foreclosure proceedings. The judicial process extinguishes the rights of all parties with ownership interests, including the former property owner, banks, and mortgage companies. The property remains subject to liens filed by government agencies in relation to the Environmental Protection Act, as well as any recorded or visible easements (Michigan Department of Treasury 2010). The county treasurer then holds a public auction of these foreclosed properties. At the auction, properties may be purchased for a minimum bid that equals the unpaid property taxes plus interest and penalties, with the proceeds distributed proportionately to the taxing jurisdictions. If the property is not sold at the first auction, a second auction is held, with the minimum bid reduced to $500. Property not sold at either auction may be transferred to a city or state public body, transferred to a state or local land bank, or held for a subsequent auction. Wayne County offered 13,500 properties at auction in 2011 and 21,350 properties in 2012 (Anglebrandt 2013). In both years, fewer than half of these properties were actually sold.

A number of factors can disrupt the foreclosure process. Generally, if the property is involved in a lawsuit or a bankruptcy, the foreclosure action is delayed until these issues are resolved. In addition, because so many properties have entered the foreclosure process, the county treasurer and the circuit court lack the personnel to pursue every foreclosure action. Facing a growing backlog of tax-delinquent properties (about 200,000 as of mid-2015), Wayne County has typically not pursued foreclosure on properties for which less than $1,600 in taxes and penalties is owed (MacDonald 2013a). In 2015, however, the county treasurer has been much more aggressive in pursuing delinquent owners and negotiating payment agreements. These actions have substantially reduced the number of properties going to auction as well as the tax delinquency rate.

Even owners of higher-valued properties with limited equity may elect to ignore their tax bills, expecting that they will be able to repurchase the property for $500 when it is auctioned.

The collapsing real estate market and poor economic conditions combined with high tax rates, over-assessment, and the limited success of the foreclosure process, has resulted in increasing numbers of properties for which property taxes are not being paid. For owners of low-valued, low-tax properties, payment of property taxes has effectively been optional, since a foreclosure action was unlikely. Even owners of higher-valued properties with limited equity may elect to ignore their tax bills, expecting that they will be able to repurchase the property for $500 when it is auctioned. In addition, it seems likely that many purchasers of properties at auction are absentee owners who plan to reduce their operating expenses and increase their net rental income by never paying taxes. The tax delinquency decision process for Detroit property owners thus possesses, in effect, the elements of a standard tax evasion decision. Alm et al. (2013) find that various policy factors play a role in property tax delinquency. These factors include the degree of enforcement, homestead/nonhomestead status, taxable value, statutory tax rate, the assessment ratio, and police response times. Clearly, there is an important role for policy in addressing the complexities of the tax delinquency issue.

While Detroit's exceptionally high tax-delinquency rate is the result of broad regional and global economic forces, it is also a reflection of citizens' confidence in their government. Clearly, economic decline, falling property values, and the reduced ability of owners to pay taxes have resulted in higher rates of tax delinquency. However, some individuals—particularly those who own lower-valued properties—may ask themselves why they should pay their taxes at all. The combination of high statutory tax rates and over-assessment of property results in high tax bills, as well as very high effective tax rates. A case can be made that the City of Detroit is failing in its half of the social contract.

What should Detroit do now? Alm et al. (2013) suggest that city officials might reduce tax delinquency by taking steps including improving public safety services and targeting those property owners more likely to be tax delinquent (nonhomestead property owners). Stronger enforcement of delinquency provisions could also generate additional revenues. However, even full enforcement will not totally resolve delinquency problems. Most critically, property values must recover, both to provide increased incentive for owners of the lowest-valued properties to pay taxes and to improve the fiscal viability of the tax foreclosure process.

CHAPTER 4

Tax Abatements and Regional Competition

Detroit is part of a broader regional economy that is composed of 152 communities in the surrounding five counties. As the city strives to attract new homeowners and business activity, it is often in direct competition with these communities. However, Detroit is at a disadvantage because of high statutory property tax rates, low-quality public services, and insufficient revenue to upgrade those services. Property taxes in Detriot are higher than in most comparable cities. Michigan falls well above the national median in various measures of property tax burden, and Detroit's property tax rate is more than twice the statewide average.

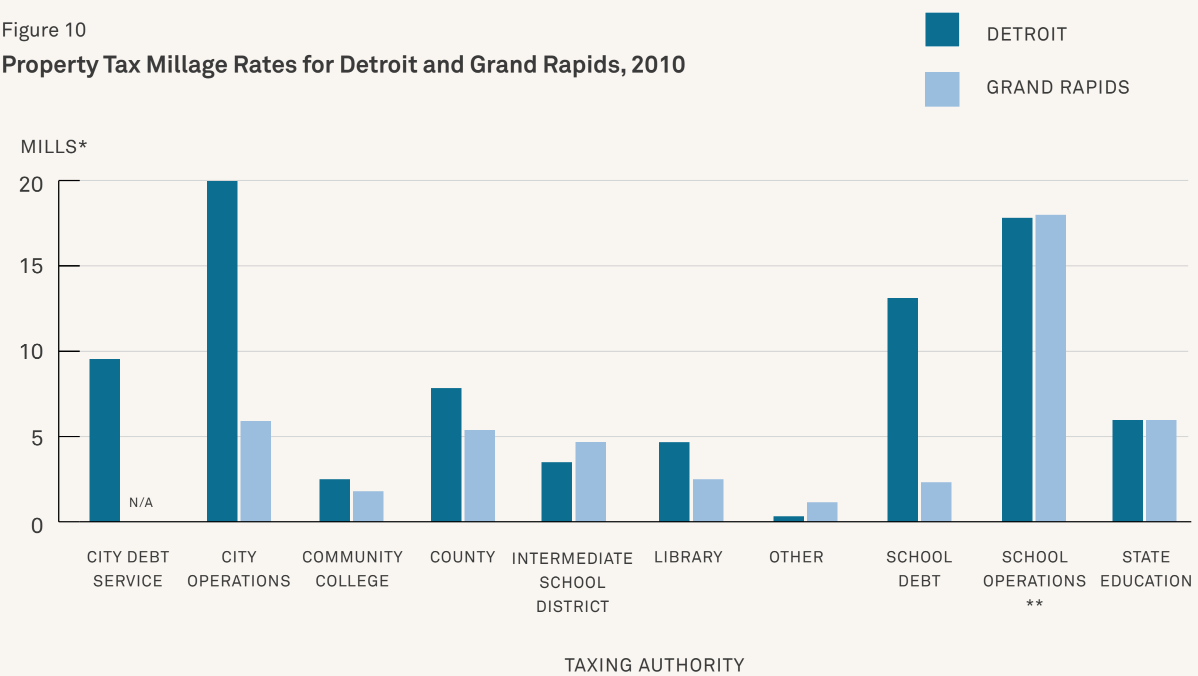
Renaissance Global Logistics, an inventory consolidation services company, chose to locate their headquarters in a Renaissance Zone on West Fort Street and remained there after the tax breaks ended. *Credit: Gary Sands.*

Relatively High Tax Rates

Homestead properties in Detroit are subject to one of the highest effective tax rates in the United States. A study by the Minnesota Center for Fiscal Excellence (MCFE and Lincoln Institute of Land Policy 2015: 25) estimates that the effective tax rate on homestead properties in Detroit was 3.325 percent, the highest among the 50 largest cities in the United States and more than double the national average of 1.561 percent. The rates used in the study include the tax savings available to owner-occupants of residential properties, but do not include other forms of property tax relief available to qualified households. However, when it comes to the actual dollar amount of taxes paid, Detroit's low property values cancel out its higher tax rate, resulting in a payment of $2,167 for the median-valued home, well below the average of $3,474 for the 50 largest U.S. cities (MCFE and Lincoln Institute of Land Policy 2015: 27).

Figure 10 shows a breakdown of fiscal year 2010 statutory tax levies for Detroit and Grand Rapids, Michigan's second-largest city. In almost every instance, Detroit's rates are higher. Detroit levies a total of 29.5 mills for city operations and city debt service; in Grand Rapids, this levy is 5.9 mills. In Detroit, state and city public school taxes amount to 19.1 mills for homestead properties and 36.9 mills for other properties; the comparable figures for Grand Rapids are 8.3 mills and 26.3 mills. Based on the millage rates in figure 10, the tax bills of Detroit homeowners would be more than double those of Grand Rapids homeowners for properties with identical values.

Figure 10
Property Tax Millage Rates for Detroit and Grand Rapids, 2010



* One mill equals one one-thousandth or 0.1% of the property value.
** Values are for nonhomestead properties only; all other values are the same for both homestead and nonhomestead properties.

Source: Data from City of Detroit (2015b); City of Grand Rapids.

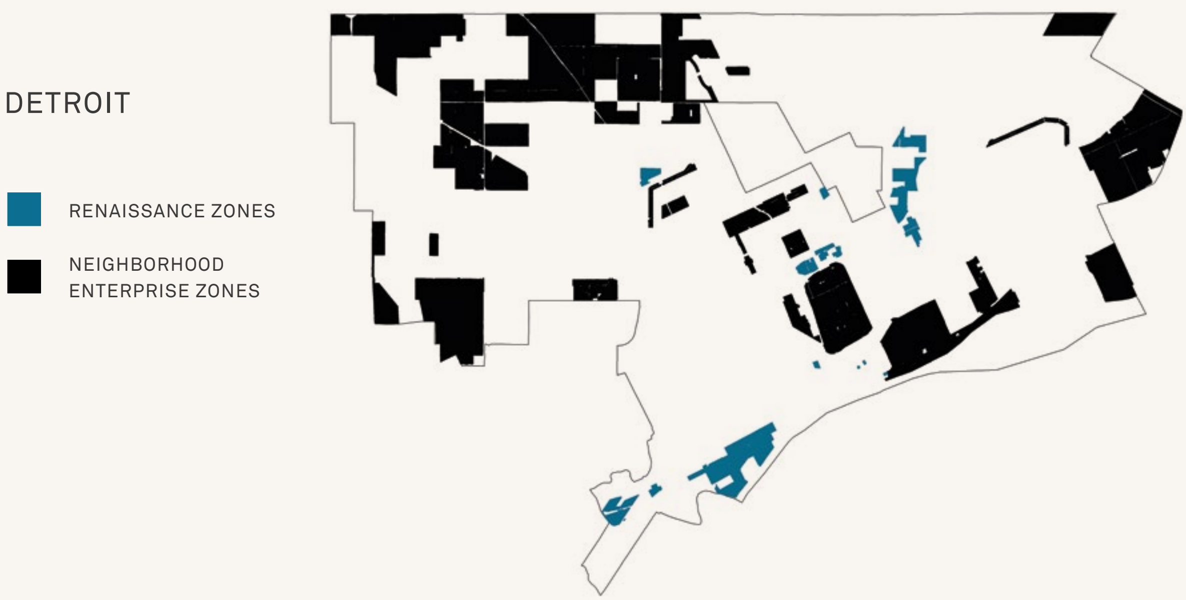
Use of Abatements to Reduce Tax Burden

To reduce the tax burden on individual properties and encourage investment, Detroit has granted tax abatements to some 11,400 of its roughly 330,000 privately owned taxable properties, even though these abatements represent a substantial loss of property tax revenue for the city. Many of the abatements result from Detroit's use of the three previously mentioned state programs: Renaissance Zones (RZ), Neighborhood Enterprise Zones (NEZ), and the Industrial Facilities Tax (IFT) program.

Detroit's Renaissance Zone areas include 10 subzones covering 1,434 acres (about 2.25 square miles). For a typical RZ property, the effective tax rate for state and city public school taxes is about 24 mills, compared with 42.6 mills for nonqualifying properties. As previously noted, no new investment is needed; simply being a property owner in an RZ is sufficient to qualify for a property tax reduction of 64 percent to 72 percent.

The NEZ New and Rehabilitated (NEZ-NR) program applies to new homes that are owner occupied and to substantial rehabilitation of existing residential properties. In fiscal year 2013, approximately 3,366 Detroit properties, with improvements valued at $92.7 million, qualified for the NEZ-NR program. Land value is taxed at the full rate, but improvements have been taxed at about 20 mills. On new construction, 20 mills is an effective tax reduction of more than two-thirds. For residential property in Detroit, land value represents,

Figure 11
Detroit Renaissance Zones and Neighborhood Enterprise Zones, 2010



Source: Data from City of Detroit Assessment Division.

on average, about 10 percent of state-equalized value (SEV); therefore, if 10 percent of the SEV of a new home in a Detroit NEZ is taxed at the full rate, the implicit overall tax rate for the property is about 25 mills.

The NEZ Homestead (NEZ-H) program provides limited tax relief to homeowners who purchased their home in a designated zone after 1994 and who have made improvements worth at least $500. For Detroiters who qualify, the tax reduction in this instance is about 13.3 mills, or 20 percent. The overall effective property tax rate is between 53 and 55 mills, depending on the relative value of the land and the real property improvements. Detroit has approximately 7,300 NEZ-H properties, with a total taxable value of $243 million. Figure 11 provides an overview of the areas within Detroit that qualify for the RZ and NEZ programs.

Finally, the IFT abatement program was designed to encourage industrial firms to make investments resulting in job creation and retention. Since the program was adopted in 1978, many local governments in Michigan have used it to reduce property taxes for eligible manufacturing firms in an effort to promote economic development. As noted previously, the value of the land is taxed at the full millage rate. Qualified improvements, including both real and personal property, are taxed at half the prevailing rate. The abatement lasts for a maximum of 12 years from the completion date of the facility. When the abatement expires, local governments can theoretically begin collecting more tax revenues as a result of new investments. But this is not always the case, as abatements are often renewed. On average, absent abatements, land represents about one-third of total industrial SEV in Detroit. When an IFT abatement is granted, real property other than land is taxed at an estimated rate of about 57 mills; personal property, which averages just over half the value of the associated real property, is taxed at an average rate of about 39 mills. Although Detroit has granted hundreds of IFT abatements, only 29 are currently active. The total taxable value for these properties is about $162 million.

Ineffectiveness of Tax Abatements

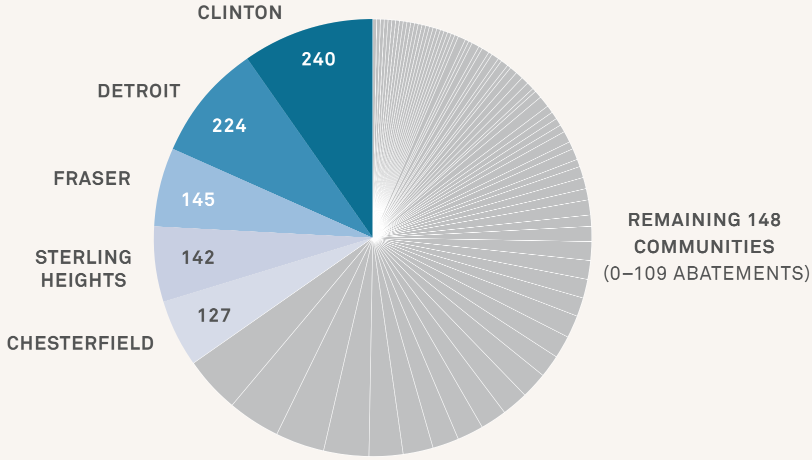
Despite ongoing debate regarding the effectiveness of tax abatements, communities across the state have used Michigan's IFT program to boost local economic development. Figure 12, which shows the number of abatements granted by communities in the five-county region, suggests that Detroit relies heavily on the IFT program. Figure 13 offers a different perspective; on a per-capita basis, Detroit uses industrial abatements considerably less than many of its suburban neighbors. The much wealthier suburban communities with lower millage rates appear to have utilized the IFT option more than Detroit, arguably the community with the greatest need to boost its competitiveness.

Using data for the same 152 communities surrounding Detroit, Kang, Reese, and Skidmore (2015) challenge the notion that industrial property tax abatements yield net-positive benefits to the communities that use them. They estimate the effects of industrial property tax abatements on growth in the value of industrial, residential, and commercial properties over the period from 1983 through 2002. They find that offering tax abatements yields statistically significant positive impacts on industrial property value growth; and the impact is larger in high-tax communities than in low-tax communities. However, while there are also positive spillover effects of industrial tax abatements on the growth of residential and commercial property values, the fiscal benefits to local governments that offer tax abatements are quite small compared with the costs of offering them, even when spillover benefits are considered.

Kang, Reese, and Skidmore draw several policy implications from their analysis. First, their findings directly support the arguments of Bartik (1994, 1991) and Wassmer (2009) that tax abatements may be more effective when used in communities with high property tax rates; absent the offering of abatements, industrial

Figure 12

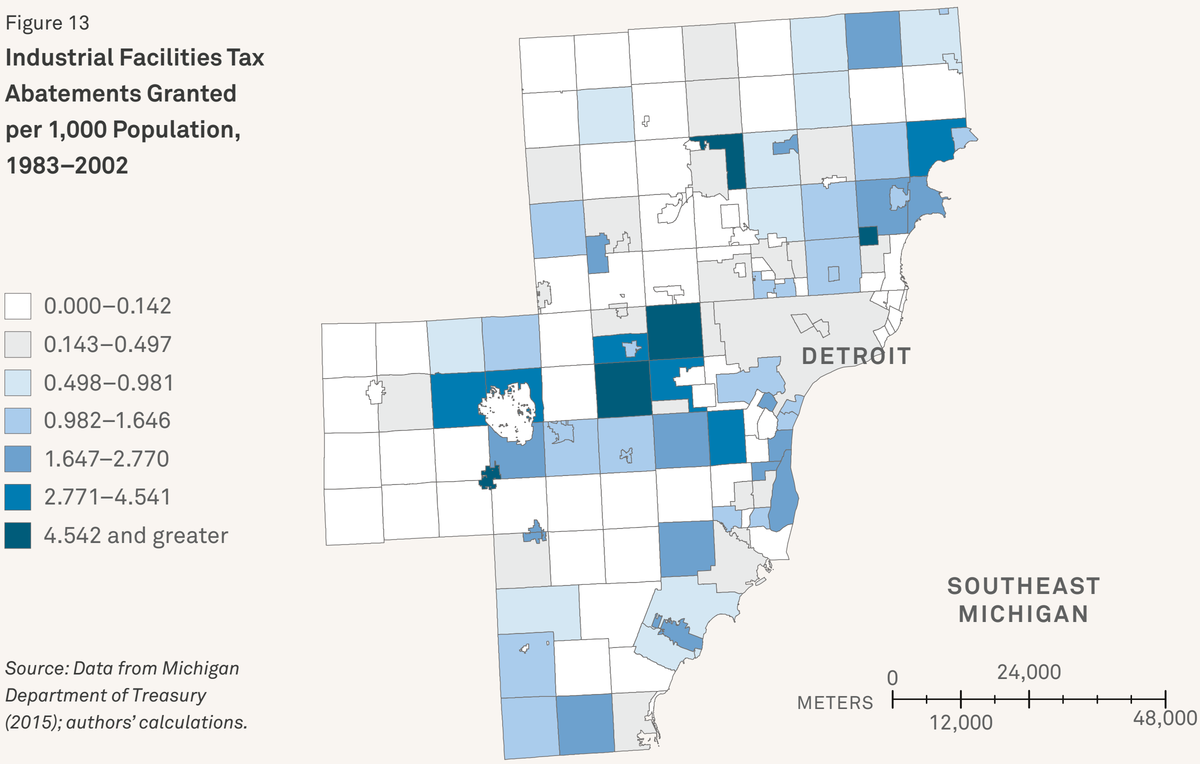
Industrial Facilities Tax Abatements Granted by Communities in Detroit's Five-County Region, 1983–2002



Source: Data from Michigan Department of Treasury (2015).

Figure 13

Industrial Facilities Tax Abatements Granted per 1,000 Population, 1983–2002



Source: Data from Michigan Department of Treasury (2015); authors' calculations.

firms appear to avoid such communities. In high-tax communities, therefore, tax abatements could be a useful tool to create a stronger, more competitive position that might, in turn, generate industrial property value growth in the context of regional competition.

The net fiscal costs of abatements found by Kang, Reese, and Skidmore may stem from a lack of targeting. In Michigan, almost every manufacturing firm is eligible for property tax abatements, and it is rare for localities to reject abatement requests (Reese and Sands 2012). In this context, firms that are likely to stay in a community without tax abatements still have a strong incentive to request and receive an abatement, thereby causing inefficiency. Kang, Reese, and Skidmore suggest that the efficiency of abatements could be improved by limiting the number granted, as well as placing restrictions on the types of industries and communities that are eligible. Improved targeting may reduce the forgone revenues of the abatements and help maximize their fiscal benefits. Overall, Kang, Reese, and Skidmore suggest that abatements would be more effective if used more judiciously and only in struggling, high-tax communities. Addressing this challenge would require state intervention to change the legislation that enables tax abatements.

Regional Competition in Southeast Michigan

If tax abatements are ineffective, how can an older industrial city like Detroit improve its competitive position in a regional economy? It is reasonable to ask, if Detroit's tax rate were to be reduced so as to bring the city in line with regional competitors, would the property value base grow, and if so by how much? This question can be considered by examining the effect of Proposal A on the 152 communities in the five-county region around Detroit. The adoption of Proposal A imposed substantial differential changes in property tax rates and school spending across all communities in Michigan. This major state-imposed intervention enables the examination of the tax rate–tax base relationship independently of local political decisions. Using data for all 152 communities from 1983 through 2002, Skidmore, Reese, and Kang (2012) suggest that both changes in tax rate and school spending have statistically significant effects on growth in property value. As part of their work, they also examine the effects of competitor-community policies on own-community tax base growth. How they define a competitor community is of note: they use migration flows as opposed to the more traditional methods based on contiguity or population. Again, they find significant effects from regional competition; changes in tax rates and school spending relative to competitors are also important to tax base growth. These conclusions are relevant to policy makers.

This work emphasizes that the link between property tax rates and property values is a regional phenomenon and that policy changes should be considered in the context of regional competition. In this context, cities facing extreme financial stress must carefully weigh the costs and benefits of changing property tax rates. If a high-tax jurisdiction such as Detroit were to reduce its tax rate, property values could still increase sufficiently over time to offset the losses due to the rate reduction, even once the effect of competitor-community tax policies are considered *(Ibid.).* However, their findings also suggest that a community can see negative property value growth if it fails to maintain a competitive tax-service package within the region. Similarly, communities stand to gain when competitors' tax rates increase. The communities surrounding Detroit seem to have benefited in this way—over time, Detroit's tax rates have increased more than the rates of competitor communities while the quality of public services in Detroit has declined. While this dynamic is not the only driver of Detroit's out-migration, the competition effects identified by Skidmore, Reese, and Kang illustrate the interconnectedness of metropolitan economic and fiscal health. Independent tax actions by individual municipalities have significant externalities (both positive and negative) on competitors.

Despite its inclusion in a Renaissance Zone, Tiger Stadium was demolished in 2008, leaving only the baseball diamond, pictured. Plans to redevelop the site were not announced until 2014, two years after the expiration of the site's tax-free status. *Credit: Dave Hogg, Flickr/CC BY.*

What are the implications for Detroit and other older industrial cities that are struggling with high tax rates? How can they generate growth in property values in the future? In the case of Detroit, the city's aggregate tax rate is exceptionally high relative to other communities in the region. Further, relative to most competitor communities, Detroit and its schools offer low amenities and benefits. Can Detroit generate growth in property values through its tax policies? The findings of Skidmore, Reese, and Kang *(Ibid.)* suggest that Detroit could, indeed, generate significant growth in property values by reducing tax rates, provided the city could simultaneously maintain or increase service levels. However, the taxable-value cap stands in the way of this. Detroit and other cities in Michigan are limited in their ability to fully realize increases in property values by the taxable-value cap. Moreover, it is possible that competitor communities would respond by lowering their own rates. It is also important to acknowledge that Detroit is a substantial outlier in the region; it may not be prudent to infer that Detroit's property tax base would respond to tax rate changes based on regional analysis. For these reasons, we are cautious when applying these findings to Detroit. However, the results are encouraging in that they suggest that the downward trajectory of Detroit's property values could be altered by a combination of tax rate reductions and additional outside funding to support the provision of public services.

CHAPTER 5

Alternative Tax Scenarios

Under a land-based tax, improvements to the buildings on a property are exempt from taxes. *Credit: Michigan Municipal League/mml.org.*

The discussion provided thus far is necessary background for understanding how a change in the property tax environment might alter the distribution of tax payments across parcels and land use types in Detroit. As discussed in previous sections, a significant portion of the city's potential tax base is not contributing to the tax effort. By redefining the tax base, it might be possible to generate additional tax revenue. We are particularly interested in understanding the implications of a shift from the property tax as it is currently administered to land-based taxation.

Land Area and Land Value Tax Options

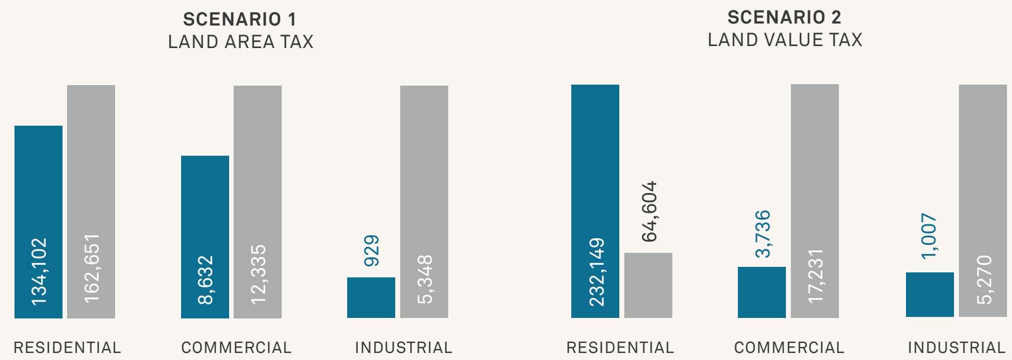
In figure 14, we present two scenarios that illustrate how a revenue-neutral, land-based tax might fully replace Detroit's current tax system. The first scenario considers tax payments where the sole basis of the tax is land area—the size of the parcel in square feet. This scenario is similar to a common-area maintenance fee used by many commercial properties with multiple tenants. The second scenario estimates tax payments based solely on land value. For ease of comparison, we assume a static, revenue-neutral change in all scenarios; that is, we do not consider how property values might change in response to a new tax regime, and we hold general fund property tax revenues constant. The comparisons are calculated by using Detroit's current city operations millage of 19.95 mills and debt service millage of 8.9157 mills, but not the millage for Detroit's overlying jurisdictions.

Figure 14 shows average tax payments for the land area tax scenario and the land value tax scenario; the existing tax environment is provided for comparison purposes. For each scenario, we calculate the number of parcels that would receive a tax reduction (winners) and a tax increase (losers).

The average tax payments in the current tax environment are $327 for residential properties, $1,812 for commercial properties, and $1,747 for industrial properties. These averages are skewed by a number of highly valued properties with correspondingly large tax payments. The median tax payments for residential, commercial, and industrial properties are $278, $242, and $294, respectively. Under the land area tax (scenario 1), average residential tax payments increase modestly in all property classes compared with the current situation and there are more losers than winners in all property classes. The average tax payment for commercial properties declines dramatically, from

Figure 14

Land-Based Tax Scenarios (Revenue Neutral)



	Scenario 1 Residential	Scenario 1 Commercial	Scenario 1 Industrial	Scenario 2 Residential	Scenario 2 Commercial	Scenario 2 Industrial
SCENARIO AVERAGE TAX:	$364	$807	$3,366	$156	$3,915	$2,826
EXISTING AVERAGE TAX:	$327	$1,812	$1,747	$327	$1,812	$1,747

Source: Data from City of Detroit (2015a); authors' calculations.

PARCELS WITH A TAX REDUCTION

PARCELS WITH A TAX INCREASE

$1,812 to $807, but there are more losers than winners in this group because, in the existing tax environment, tax payments for most commercial properties are small—the current median is only $242. Most industrial properties would also experience a tax increase, with the average payment almost doubling. Across all property types, the land area tax actually requires most property owners to pay more even though the proposed change is revenue neutral.

Box 2

Henry George and the Land-Based Tax

A land-based tax was advocated by Henry George in the 19th century. George (1886 [1879]) argued that the value of urban parcels is primarily a function of the accessibility their location provides and the infrastructure and other public investments that are available, rather than their current use or the value of private investments they may contain. The Georgist value of a vacant parcel of land is determined by the values of nearby parcels that have been developed; any improvements made to the parcel do not directly affect its own value, but could affect the values of surrounding properties. In this view, because land values are a result of community actions and not individual actions, the community should receive the benefit of higher land values. A land-based tax has the benefit of encouraging owners to develop their properties as intensively as possible, since the tax levy remains the same regardless of the development status of the properties. Development is encouraged because the cost of holding vacant land in high-value areas is high, and no additional tax is imposed as a result of developing the properties.

The land value tax (scenario 2), however, yields significant savings to residential property owners but imposes substantial tax increases on commercial and industrial properties. A vast majority of residential properties are winners, but the benefits come at the expense of commercial and industrial properties, which have land values that are considerably higher than residential land values. However, with a land value tax it is important to keep in mind that any future real or personal property investment is exempt from general city taxation. The exemption of such investments from taxation is one reason many economists favor the land value tax over the traditional property tax.

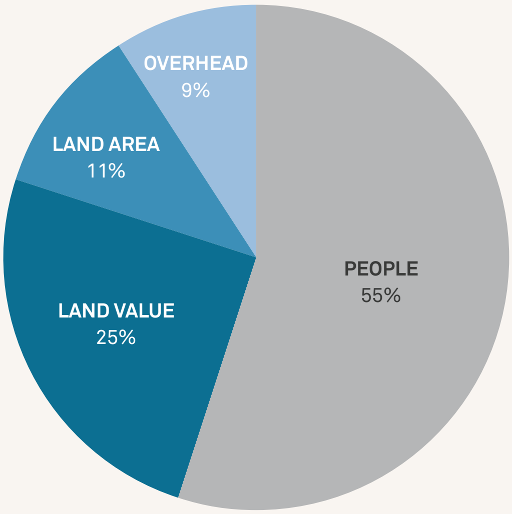
Special Assessment Option

We turn next to a scenario in which the city millage rate is partially reduced, with the lost revenues replaced by a land area tax. In Michigan, state law allows local governments to impose special assessments where the basis of a special assessment is defined by local authorities and could be land area or land value. We show how Detroit might use this law to implement a land-based tax to pay for a range of public services.

Creating a special assessment district (or districts) for specific services can make it possible to achieve a better match between tax payments and benefits received. Special assessments are commonly used to pay for capital improvements on services such as water and sewer systems. They have also been used to pay for ongoing services ranging from public safety to libraries to street lighting. Homeowner association assessments, common in many suburbs, are equivalent to a municipal special assessment in that they are used to provide for a variety of services that benefit the association, including maintenance of parks and common areas and snowplowing. In Michigan, a downtown development authority may levy a millage for operating and capital expenditures.

Figure 15

Breakdown of Services by Expenditure Category for Detroit's Fiscal Year 2010 Budget



Source: Data from Janet Anderson, personal communication.

Table 1

Municipal Services by Primary Focus of Service

POPULATION BASED	LAND BASED	
	VALUE	AREA
Health	Fire	Street Cleaning
Recreation	Police	Street Maintenance
Library	Environmental	Streetlights, Signals
Neighborhood Development		Trunk Lines
District Court		Vacant Lots
Bus Service		Environmental
Police		
Environmental		

Source: Sands and Skidmore (2012).

The basis for the special assessment can differ depending on the particular services provided. For example, front footage of a parcel may be appropriate for utility and sidewalk improvements, while property value may be more appropriate for public safety. Other criteria can also be used, as long as all properties in the district are assessed equitably. The tax assessment for the district is typically reviewed and adjusted as needed on an annual basis. In Detroit, numerous municipal services might be provided by a special assessment district, and a range of options might be used for establishing the basis for the assessment. The example we present here is illustrative only and should not be considered a recommendation or endorsement.

Many of the services provided by municipalities can be categorized into three broad groups: services to people, services to property, and general overhead. Figure 15 shows the breakout for these services in Detroit. Services to property may be related to the value of the property (such as fire and police services) or a function of the physical characteristics of the land parcel (such as street cleaning and street maintenance). Overhead includes activities that do not uniformly benefit all properties in the city, such as issuing permits, conducting inspections, finance, planning, and so on. While a special assessment might be used to fund any of these overhead activities, the assignment of appropriate costs and benefits to individual properties would be difficult.

Table 1 classifies services according to whether they focus on people or land—and futher breaks down land-based services into value-focused and area-focused services. At this level of aggregation, the

Table 2

Tax Burden with Special Assessment (Revenue Neutral)

	CURRENT AVERAGE PROPERTY TAX	AVERAGE NEW PROPERTY TAX	AVERAGE SPECIAL ASSESSMENT	AVERAGE TOTAL PAYMENT	NET CHANGE
RESIDENTIAL	$327	$189	$151	$340	+3.98%
COMMERCIAL	$1,812	$1,052	$335	$1,381	-23.8%
INDUSTRIAL	$1,747	$1,009	$1,452	$2,461	+40.9%

Source: Data from City of Detroit Assessment Division; authors' calculations.

assignment of categories is somewhat arbitrary. For example, police protection appears both as a service that benefits people and as a service that benefits property value. (According to crime reports for Detroit, about three-quarters of reported crimes violate property.) Similarly, environmental protection activities may fall into any one of the three categories, depending on the specific activity.

The example in table 2 uses a special assessment tax for area-based activities. In fiscal year 2010, the cost to Detroit for the area-based services for our proposed special assessment district was about $61.7 million, roughly 7 percent of total general fund expenditures. Detroit's property tax generated $146 million in fiscal year 2010. Reducing the property tax levy by $61.7 million would allow the city's operating millage to be lowered from approximately 19.95 mills to roughly 11.3 mills, a decrease of more than 43 percent. A special assessment tax rate of about 2.98 cents per square foot would be needed to generate the $61.7 million in lost revenue. For some services, such as street maintenance, the appropriate basis for assessment might be front footage rather than the area of a parcel.

The special assessment scenario has distributional consequences. As shown in table 2, average residential property owners—the majority of all landowners—would experience a modest increase in their total property tax bills. Their average bills would rise from $327 to $340. Owners of commercial property, which typically has a relatively higher value per square foot, would see a reduction of almost 23 percent in their total tax payments. Industrial parcels, with generally low values per square foot but relatively large square footage, would be subject to an increase of more than 40 percent. The majority of residential and industrial property owners would face higher tax bills.

Conclusions

In considering alternative tax scenarios, it is important to keep in mind the major attributes of Detroit's property tax environment. First, as has been shown, there are substantial inequities across classes of property and across parcels within the same property classes. Frequently, owners of similarly valued properties are subject to widely disparate tax burdens. Second, tax base erosion, arising from both policy choices and economic decline, has created a tax environment that is inadequate to meet Detroit's needs. Property taxes account for just over 7 percent of all city revenues and about 16 percent of general fund revenues. Despite a high tax rate (29.5078 mills for debt service and operations), numerous exemptions and preferential treatment significantly limit property tax revenues. Further, declining property values and tax foreclosures mean that property tax collections are falling more rapidly than most other major sources of general fund revenue.

Some inequities are beyond the city's direct control. For example, the largest source of inequity is the state-mandated cap on taxable-value increases. While the primary purpose of the taxable-value cap is to limit increases in the property tax burden for all taxpayers, the result has been to favor longtime property owners over more recent buyers. By rewarding owners who do not move, the taxable-value cap subjects recent entrants to the market to a greater effective tax rate. This inequity creates differentials in effective tax rates and distorts the local housing market by discouraging in-migration and mobility (Skidmore and Tosun 2011).

Another state-imposed source of tax rate differential is the principal-residence exemption (homestead provision) that is available to owner-occupants. Owner-occupied residential properties are exempt from the local school operating millage. The savings to homeowners is substantial, but the burden falls on all other local property owners. While the homestead exemption does not directly affect city tax revenues, it contributes substantially to overall tax rate differentials across classes of property.

The collapse of Detroit's housing market eroded the tax base. Tens of thousands of residential properties have reverted to the City of Detroit because of tax delinquency. While Detroit theoretically gains ownership of an asset, it is an asset that requires maintenance and does not generate tax revenue. Until these properties are returned to private ownership, the burden of funding public services falls to the remaining taxable property owners.

A special assessment based on land value could be used to fund public safety projects, such as the replacement of this out-of-service fire hydrant in 2014. *Credit: City of Detroit, Flickr/CC BY-ND.*

Detroit is home to numerous private and nonprofit tax-exempt properties, including churches, private schools, hospitals, and cemeteries. The cost of providing local government services to these entities must be borne by the city's taxable owners. As is often the case in struggling cities, Detroit has a higher-than-average concentration of such facilities. Although these properties provide important benefits, tax-paying residents may also pay higher taxes because of them.

With limited ability to increase revenue from other sources, it seems appropriate to consider significant modifications to Detroit's property tax environment. New policies should expand the tax base and should improve equity, transparency, and stability.

Finally, inequities arise when Detroit uses its discretionary authority to grant property tax exemptions to certain property owners. Property in designated Renaissance Zones, for example, is exempt from all property taxes except millage to repay bond indebtedness. Qualifying industrial and residential properties may be granted tax abatements that can sometimes exceed 70 percent, while the value of improvements to certain obsolete properties may be exempted entirely. Several thousand Detroit properties benefit from these programs. Not mentioned previously are tax-increment financing (TIF) districts, in which property is taxed at the full rate, but tax revenue growth is diverted from the general fund to TIF district activities. Each of these programs effectively shifts the tax burden from one set of properties to other properties.

With limited ability to increase revenue from other sources, it seems appropriate to consider significant modifications to Detroit's property tax environment. New policies should expand the tax base and should improve equity, transparency, and stability. While alternate definitions of the property tax base, such as land area or land value, are in some ways desirable, they can produce substantial shifts in the tax burdens for residential, commercial, and industrial properties. Increasing tax rates would generate more revenue—at least in the short run—with different implications for each class of property. However, Detroit property owners already pay a tax rate that is roughly twice the regional average. Thus, broadening the tax base seems a more prudent option for improving equity and efficiency, and potentially increasing revenue. Further, the evidence presented here suggests that broadening the base would reduce effective tax rates for many property owners while still generating new revenues. Special assessments have merit and deserve consideration. Importantly, special assessment laws provide an avenue by which city authorities could broaden the tax base, using one or more of several options for defining that base, including lineal street frontage, land area, land value, and state-equalized value. Moreover, the special assessment option is feasible in the current legal framework and has the potential to link taxes more closely with public service benefits.

Any changes in the definition of the tax base will inevitably result in higher taxes for some property owners. This reality suggests that there will be opposition to any proposed change. Regardless, the significant potential benefits of changing the property tax policy warrant that these alternatives should be seriously considered.

CHAPTER 6

Options for Reform

As described earlier in this report, problems with Detroit's property tax are multifaceted and complex. While some are unique to Detroit, municipalities around the country also share these problems to some degree. Thus, designing property tax reforms for Detroit may help identify best practices relevant to other cities as well.

Astro Coffee on Michigan Avenue is one of the many new businesses revitalizing Detroit's historic Corktown neighborhood. *Credit: David Lewinski Photography.*

Challenges to Property Tax Reform

Detroit's property tax regime is in need of reform. We believe policy makers must consider the following significant obstacles in order to make meaningful change.

- **Low and Declining Yields.** Over the past two decades, property tax revenues in Detroit have diminished absolutely and relative to other revenues. From a total of $240 million in 1995, Detroit's property tax revenue is projected to be just $90 million in fiscal year 2016. Since the 1970s, Detroit's survival has depended on the introduction of new taxes on income, utility users, and casino wagering. As of 2015, the property tax represents just 7 percent of Detroit's current budget.

- **High Tax Rates.** Notwithstanding low yields, Detroit citizens pay the highest property tax rates in Michigan as measured by both statutory and effective rates. It is widely recognized that high rates deter investment, particularly when surrounding suburban communities have significantly lower rates. Overlapping jurisdictions add substantially to property owners' tax burdens. In fact, if Detroiters paid no property taxes to the city at all, they would still face a property tax rate above the statewide average. In particular, property taxes levied by the Detroit Public Library (4.6 mills), by Detroit public schools for debt millage (13 mills), and by Wayne County (7.8 mills) represent a heavy burden over which Detroit has no direct control.

- **Constraints Imposed by State Laws.** Michigan state laws sometimes operate at cross-purposes and hamper attempts to address Detroit's property tax issues. For example, the Headlee Amendment and Proposal A prevent property tax revenues from increasing at more than the rate of inflation plus any new construction. In effect, revenues plummeted during the real estate crisis, but are not allowed to rise in the recovery.

- **Low Real Estate Values.** Although state policies and programs have played a role, no factor has had a greater impact on Detroit's low yield from the property tax than the plunge in real estate values. Since 2005, state-equalized values (SEVs) for residential properties in Detroit have declined by 60 percent.

- **High Tax Delinquency.** An increasing proportion of Detroiters are simply not paying their property tax bills. In 2014, 54 percent of Detroit taxpayers were delinquent. The reasons vary, from economic factors to a breakdown in the social contract: rising unemployment and decreasing incomes prevented some property owners from making timely payments, while others evaded payment to protest poor-quality services. In any case, the proportion of collected taxes has been significantly reduced.

- **Inequity.** One of the fundamental principles of public finance is fairness. Fairness says that similarly valued properties should be subject to the same tax burden. In Detroit, the property tax burden is often inequitable because of tax exemptions and tax abatements for certain property owners, taxable-value caps that apply in some situations, a high concentration of tax-exempt properties, property owners who cannot pay their property taxes or choose not to pay, and nonuniform assessment practices.

- **Assessment Inaccuracy.** Perhaps the greatest distortion in Detroit's property tax base is the poor quality of property assessments. This is most obvious in properties that have sold recently; the new SEV may be 10 times the sales price. But current market data suggest that SEVs for many properties that have not sold recently are also substantially overstated. One source of the distortions is reliance on land value appraisals dating back for several decades. In early 2015, Detroit reduced SEVs for many properties and continued a citywide reappraisal that is likely to result in more reductions. These efforts may result in a more accurate property tax base in three to four years; however, maintaining accuracy over time will be essential.

- **Public Ownership of Parcels.** About one-quarter of all real property parcels in Detroit are held by the Detroit Land Bank Authority and other public entities. Not only does this reduce the city's tax base and limit potential property tax revenues, but it also has a negative effect on the value of privately owned properties. The current pricing of privately owned properties recognizes the potential for this excess land to be made available to the market.

Key Considerations in Improving Property Tax Viability

Given Detroit's current challenges, implementing a completely new property tax regime does not appear to be a realistic possibility, and the most practical changes are likely to be those that are incremental. It is essential that policy makers consider gradual changes with the following overarching goals in mind.

- **Improve Equity.** Although Michigan's original property tax system had the elements of an equitable system, state and local public policies and poor administration have resulted in a distorted and inequitable system, especially in Detroit. Any changes that are made should, at least, move the system closer to its original, more equitable basis.

- **Improve Regional Tax-Service Competitiveness.** Detroit's relatively high property (and other) tax rates combined with Detroit's low quantity and quality of public services put the city at a competitive disadvantage in the region. Improving Detroit's tax-service package is necessary in order to strengthen the city's weak economic base.

- **Increase Revenue-Generating Capacity.** Any restructuring of the property tax system must make it possible for Detroit and overlying jurisdictions to generate sufficient revenues to meet their requirements. This does not mean returning property tax revenues to previous levels. Rather, Detroit must have the ability, relying on a range of sources, to raise the revenues needed to meet the city's needs. Shifting responsibility to state or regional entities may be an option for some funding/service needs.

Local Options for Property Tax Reform

Taking the challenges and concerns just outlined as a basis of understanding, we can consider specific reform options that might improve the property tax environment in Detroit. We first address options available to local authorities under the current statewide property tax policy regime.

IMPROVE ASSESSMENTS

Recent research by Hodge et al. (2015a) provides evidence that Detroit properties are substantially overassessed. Further, the analysis indicates significant vertical and horizontal inequity. In January 2015, city authorities reduced assessments 5 percent to 20 percent throughout Detroit while continuing with efforts to reassess all properties. This is an improvement, but housing price data discussed in chapter 1 and the Hodge et al. analysis suggest that some assessments should fall by as much as 70 percent.

ELIMINATE OR IMPROVE TARGETING OF ABATEMENTS

Detroit has granted tax abatements to an estimated 11,400 properties. An obvious inequity results from granting benefits to less than 3.5 percent of the properties in the city; other property owners must pay higher tax rates in order to make up for the forgone revenue. Conceptually, eliminating all abatements would make it possible to reduce property tax rates for the majority of property owners without reducing revenues. Eliminating abatements as they expire would be the least controversial strategy, although this measure would allow the impact of the abatements to continue for more than a decade. At a minimum, an effort should be made to improve the targeting of abatements.

Activists protested widespread residential water shutoffs in 2014. Detroit struggles to maintain and improve the system without raising rates. *Credit: Unitarian Universalist Service Committee.*

REDUCE STATUTORY TAX RATES

Detroit's aggregate tax rate is roughly double the regional average, with almost 24 mills dedicated to debt repayment. The work of Skidmore, Reese, and Kang (2012) suggests that a rate reduction could generate property value increases sufficient to offset the initial decline in revenue resulting from the rate reduction. Unfortunately, Proposal A prevents local governments from capturing these gains. In order for the rate reduction to work, state government would have to allow Detroit and overlying jurisdictions to capture the property value increases resulting from the rate reduction. Otherwise, the rate reduction would simply result in a revenue decline.

USE SPECIAL ASSESSMENT RULES TO IMPLEMENT A LAND-BASED TAX

It is possible under current statutes to implement a citywide, land-based special assessment tax. Although analysis suggests that such a tax would produce significant changes in the tax burden across commercial, industrial, and residential properties, it could improve the efficiency of the property tax system.

IMPROVE PUBLIC SERVICES

By objective measures, public services in Detroit are poor in quality and limited in number. For example, at the time of its bankruptcy, Detroit had the highest crime rate among large U.S. cities and police response time was about 47 minutes compared with the national average of 12 minutes. Roughly half of the city's streetlights were not operational. Over the years, Detroit has reduced bus service; in a city where 24 percent of households do not have a car, such a cut seems unconscionable (Reese, Sands, and Skidmore 2014). Improved public services will serve to retain and attract both businesses and residents. As of mid-2015, Detroit mayor Mike Duggan is making a concerted, systematic effort to improve and update public services.

PERMANENTLY REMOVE LAND FROM THE MARKET

As discussed in Skidmore (2014), Detroit has much excess land—a property overhang that depresses recovery in property values. We believe Detroit officials and other public officials should develop a strategy to categorize these properties into three groups: (1) those that should be kept available for eventual return to private tax-paying parties; (2) those best taken off the market for a decade or two with the option of returning them to the market should conditions change; and (3) those that should be permanently removed from the market. The 2012 Detroit Future City report calls for the reclamation of land for parks, forests, industrial buffers, greenways, retention ponds, community gardens, and even campgrounds (Austen 2014; Detroit Future City 2013).

State Options for Property Tax Reform

Because the Michigan constitution and statutes establish the framework for local property taxes, many corrective measures that might benefit Detroit's property tax environment can be achieved only through actions at the state level. The elimination or revision of the Headlee Amendment, for example, would require a change in the state constitution. Substantive changes at the state level seem difficult to accomplish in the current political environment.

It would be difficult to target changes to Detroit alone. The state could eliminate or phase out tax abatement programs, but this would likely require that the change be applied to all jurisdictions in the same way. While the total elimination of specific tax privileges is intellectually appealing, there would likely be considerable political push back. State-level changes that might ideally be considered include the following.

Lafayette Greens opened in 2011 on land once occupied by the Lafayette Building. The nonprofit Greening of Detroit has operated the community garden since 2014. *Credit: Ken Lund, Flickr/CC BY-SA.*

ELIMINATE THE TAXABLE-VALUE CAP

Eliminating the cap on taxable-value increases would significantly reduce the current levels of inequity in the property tax system. As a result of the bursting of the housing bubble, most jurisdictions have seen a substantial narrowing of the gap between state-equalized values and taxable values. However, the differential has begun to increase in jurisdictions where the housing market has begun to recover. Elimination of the taxable-value cap could be accomplished incrementally; when a qualifying transfer of property occurs, and the TV is reset to equal the SEV, the taxable-value cap could be permanently removed. All future increases in the SEV would be subject to taxation. An alternative approach would be to immediately reset the TV for all properties to the current SEV. In jurisdictions where there is a large gap between TVs and SEVs, the Headlee Amendment would mandate a lowering of property tax rates.

INSTITUTE A LAND VALUE TAX

As discussed previously, replacing the current real property tax with a pure land value tax would result

In 2013, management of Belle Isle Park, including the conservatory shown above, was transferred to the Michigan Department of Natural Resources under a 30-year lease. The agreement is estimated to save Detroit 4 to 6 million dollars a year in operating costs. *Credit: Elizabeth McMillan, Wikipedia/CC BY-SA.*

in a considerable shifting of the property tax burden among classes of property owners. An accurate and up-to-date appraisal of all land values is a prerequisite for such a change. Recent research by Hodge et al. (2015a) suggests that, at least for Detroit, this requirement is not met. It would not be necessary, however, to implement a land value tax in all jurisdictions at the same time, thus allowing for a phase-in of the new tax structure. Adoption of a land value tax system could also be made a local option.

REGIONALIZE SOME PUBLIC SERVICE FUNCTIONS

Detroit needs to improve public services, but tax levels in the city are already too high. Transferring some functions to the state or to a regional agency, along with the attendant property tax revenue, could significantly improve Detroit's competitiveness and the quality of services provided to residents. The state education tax provides a precedent for such a change. Potential targets for regionalization include transportation, recreation, and cultural services. A start has been made in regionalization of functions, but much more could be done.

Detroit's challenges have accumulated over more than six decades and will not easily be reversed; the erosion of the property tax base is a symptom of changing social, economic, and cultural forces. Policy makers at the state and local levels are now recognizing these structural changes and responding. We hope the analyses and observations in this report offer useful information in this regard. One need look no further than Detroit's high tax-delinquency rate for evidence that the social contract between property owners and the City of Detroit is broken and in need of restoration. This can be accomplished over time with a dedicated and ongoing effort to improve a broad range of policies as outlined in this report. Such improvements can help strengthen the socioeconomic fabric of the city and, in time, bring badly needed resources and jobs to Detroit.

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In 2004, the plaza where these fountains are located was donated by General Motors to the nonprofit Detroit Riverfront Conservancy. *Credit: Daniel Lobo, Flickr/CC BY.*

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Detroit and the Property Tax

Strategies to Improve Equity and Enhance Revenue

In December 2014, the City of Detroit emerged from bankruptcy with a plan that cut $7 billion from the city's $18 billion debt load. Although the causes of the bankruptcy were complex, a contributing factor was the ongoing decline in the revenue-generating capacity of the property tax. To the extent that most government entities rely heavily on property tax revenues, the story of Detroit's bankruptcy is relevant to other cities as well.

Detroit's projected property tax revenue for 2016 is just $90 million, compared to $240 million in 1995. Even so, property tax rates in Detroit are the highest rates in Michigan and among the highest in the country—suggesting that the system is broken. Problems include unfairly distributed tax burdens, inflated assessments, high rates of tax delinquency, and thousands of foreclosures that reduce the tax base and depress property values. The erosion of Detroit's property tax base is a symptom of changing social, economic, and cultural forces—challenges that have accumulated over more than six decades. This report suggests that property tax reform is not only necessary but can also help recovery efforts, and examines reforms in the context of the rapidly changing situation in Detroit in mid-2015.

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