

Property Taxes - State and Local

Overview – Property taxes have been a part of state and local government revenues since 1889, and go all the way back to when Washington was a territory. Property taxes are assessed on all real property (land, real estate) and some forms of personal property (e.g. machinery, nonattached mobile homes, business and farm equipment, etc.). State property taxes are deposited into the General Fund and the Student Achievement Fund, while local property taxes are used for general government services such as public safety, libraries, and parks and provide local funding for schools.

Combined state and local property tax levies due in 2007 were more than \$7.7 billion. Over 1,700 entities have property tax authority in the state. County assessors are responsible for determining assessed value of most real and personal property, while county treasurers are responsible for collections. Following is a brief overview of the mechanics of Washington’s complex property tax structure.

Property Taxes – The Constitutional 1% Limit - In 1972 voters adopted a constitutional amendment capping regular property taxes (i.e. those that do not need voter approval) at 1 percent of fair market value. Since property tax rates are expressed as an amount per \$1,000 of assessed value, the 1 percent limit means property taxes can be no more than \$10/\$1,000 assessed value. Ports and public utility districts are exempt from this limit.

Voters can also approve property taxes higher than 1 percent, but only if 60 percent say yes (a minimum number of voters are required to validate the 60 percent threshold). In 2007, voters narrowly approved a constitutional amendment exempting school districts from the 60 percent threshold. Now school levies, even though they are in excess of the constitutional limit, can be approved by a simple majority of voters with no minimum turnout required.

Property Taxes – The Statutory 1% Limit - In 1974 voters approved a property tax levy limit of 6 percent (the 106 percent limit), excluding the value of new construction.

Recent initiatives and referenda have further limited the yearly growth rate of regular property taxes. In 1997 voters approved Referendum 47, which changed the way property tax limits are calculated. In 2001 voters approved a cap on annual regular property tax limits through Initiative 747.

Referendum 47 – Passed overwhelmingly by the voters in 1997, this measure changed the 106 percent limit enacted in 1974. R-47 limited yearly regular property tax increases to:

- For the state, the rate of inflation (as measured by the Implicit Price Deflator);
- For taxing districts with a population under 10,000 – 106 percent
- For taxing districts with a population over 10,000 – The lesser of:
 - Inflation; or
 - Upon finding of a “substantial need,” 106 percent of the highest levy in the most recent three-year period.

To increase property taxes by inflation, the governing board of the taxing district must pass a resolution with a *majority vote* of its membership. To declare a “substantial need,” the governing board of the taxing district must pass a resolution with a *supermajority vote* of its membership. If the board has four members or less, two-thirds of the members must vote to declare a “substantial need,” and in districts with four or more members, a majority of the board plus one can declare a “substantial need.”

The measure also made permanent a 4.7 percent reduction in the state property tax enacted in 1996, which is applied each year when the state calculates its property tax levy.

The third major provision of R-47 was a “value-averaging” cap for individual property assessments. Under this provision, property assessment increases would have been limited to a maximum 15 percent in any year. The goal was to prevent unusually large increases in property assessments and property taxes. However, the State Supreme Court unanimously struck down this provision of R-47, calling it unfair and unconstitutional. The Court reasoned that capping assessments would unfairly shift the property tax burden from fast growing areas with higher home values to slower growing communities with lower values. This in the Court’s view value averaging was unconstitutional because it did not tax property in a uniform manner. Thus, capping assessments is not possible without a constitutional amendment.

Initiative 722 – This measure limited the yearly growth of property tax levy increases to the lesser of 2 percent or inflation, unless voters approved a higher amount. The initiative also included an annual 2 percent limit on assessed value increases, eliminated “banked capacity” (discussed below), and repealed other tax and fee increases adopted in prior years.

This initiative never took effect because it was challenged in the courts. The measure was ultimately ruled unconstitutional by the state Supreme Court in September 2001.

Initiative 747 – This measure limits the yearly growth of property tax levy increases to the lesser of 1 percent or inflation. It is important to remember that this cap applies to property tax levies *as a whole* for a taxing district, not an individual’s property tax bill. The measure passed in 2001 with nearly 58 percent voter approval.

To increase property tax levies above 1 percent, a taxing district must submit a ballot proposition to the voters. Any increase above 1 percent applies for one year. In 2003 the Legislature gave counties and cities the authority to seek a 6-year “lid lift.” This allows counties and cities to increase property tax levies, with voter approval, above 1 percent for up to 6 years using a chosen growth factor such as the consumer price index. In 2007, this authority was extended to all taxing districts.

In June 2006, a King County Superior Court judge ruled that I-747 was unconstitutional. The initiative had been challenged by a coalition including Washington Citizen Action, the Welfare Rights Organization Coalition, 1000 Friends of Washington, and Whitman County.

The judge found that the initiative violated Article 2, Section 37 of the Washington State Constitution. That provision states that “no act shall ever be revised or amended by mere reference to its title, but the act revised or the section amended shall be set forth at full length.” I-747 was drafted to amend I-722, which placed a 2 percent limit on property tax increases. However, by the time I-747 was on the ballot, I-722 had been overturned and was therefore inoperative. Thus I-747 was actually amending prior law (R-47) but that prior law was not set forth in full.

The Attorney General filed a direct appeal of the Superior Court decision with the state Supreme Court. A stay of the decision was granted on August 18, 2006, and the 1 percent limit applied for taxes due in 2007.

On November 8, 2007, the state Supreme Court ruled I-747 unconstitutional on grounds that the bill did not properly set forth the provisions being amended in law. The Court reasoned that voters were misled because they were voting to reduce the annual limit from 6 to 1 percent instead of 2 to 1 percent.

After initially resisting calls by Republicans, the governor called a special session and on November 29, 2007, I-747 was reinstated retroactive to 2002.

Banked Capacity – The issue of “banked capacity” was heavily debated during the 2007 Special Session to reinstate I-747. Banked capacity is the difference between an actual property tax levy and the maximum authorized levy. For purposes of Initiative 747 and property tax levy limits, banked capacity represents the difference between the actual increase and the maximum authorized increase in a given year. This allows taxing districts to raise property taxes in future years without a vote of the people.

For example, the city of Federal Way’s 2007 levy increased by 0.71 percent instead of the maximum 1 percent allowed by law. The 0.29 percent difference becomes “banked” for 2008 and future years. The city could then use this to increase property taxes by more than 1 percent in 2008 or future years.

The court decision on I-747 created new “banked capacity” because almost all taxing districts increased their levies by the maximum 1 percent authorized by I-747, less than the rate of inflation and substantially less than the 6 percent allowed under the R-47 limits. The court-created banked capacity applied as follows:

- State property tax levy: Difference between 1 percent and inflation (about 8 percent)
- Taxing districts with population under 10,000: up to 30 percent
- Taxing districts with population over 10,000:
 - Difference between 1% and inflation (about 8 percent)
 - If passed “substantial need” resolution each of the last five years: up to 30 percent

The I-747 legislation eliminated the banked capacity created by the court decision. However, banked capacity accumulated prior to the passage of I-747, and if levies were increased by less than 1 percent from 2002-2007, remain in place.

The amount of banked capacity a taxing district can use is limited by the statutory maximum rate and reduced by any voter-approved levy lid lifts. A district can have a lot of banked capacity, but cannot use it if the district is at its rate maximum or has voter-approved lid lifts.

Major Exemptions - There are numerous exemptions or deferrals in statute for specific types of property. Two major exemptions from property taxes for seniors and for open space, however, merit particular attention.

The Senior Property Tax Exemption program is discussed in more detail in a separate paper. It provides lower-income seniors and disabled residents with substantial property tax relief.

Property owners with farm, timberland or open space can apply for a “current use assessment”, which values the property at its current use rather than its highest and best use. This allows owners of these lands to qualify for lower property taxes because the land is assessed as it is used rather than what it could be used for (e.g., homes, commercial centers).

To qualify for current use assessment, farm and agricultural land must be:

- 20 or more acres in agricultural use,
- 5 or more acres, but less than 20, with annual income from agricultural uses of \$200 or more per acre for three out of the last five years, or
- Less than 5 acres with annual income from agricultural use of \$1,500 or more for three out of the last five years.

To be eligible, timber land must be five or more acres (land only) and devoted primarily to the growth and harvest of forest crops. Open space land must be areas set aside to protect, preserve, enhance, promote, and retain such lands. Of the acreage reported for 2006 in the current use program, 98.2 percent is in the farm and agricultural land category.

In 2007, nearly 11.5 million acres of land were classified as current use, reducing property values by nearly 72 percent for tax purposes. This resulted in about \$10 million of property tax losses and \$98.3 million in shifts to other taxpayers.

State Property Taxes – The state levies its own property tax “for the support of common schools.” The maximum state property tax set in statute is \$3.60/\$1,000 assessed value (0.36 percent). However, the actual rate is based on each county’s locally assessed value adjusted by a ratio comparing the current assessed value with the current market value. (This ratio is termed the “equalized value.”) In 2007, the average state levy among the 39 counties was about \$2.01/\$1,000, and generated nearly \$1.7 billion. State property taxes typically account for 20-25 percent of a homeowner’s property tax bill.

Revenue from the state levy is deposited in the state General Fund with a portion then transferred to the Student Achievement Fund for distribution to school districts under I-728.

Local Property Taxes – In general, local regular property tax levies (county, city, fire district, library district, etc.) are limited to a total of \$5.90/\$1,000 Assessed Value (0.59 percent). Each taxing district is classified as a “senior” or “junior” taxing district. The senior taxing districts include the state, county, county road levy, and city or town. All other property tax jurisdictions are considered junior taxing districts. When the combined levies of the senior and junior taxing districts (except the state levy, conservation futures levy, affordable housing levy, and emergency medical services levy) exceed \$5.90/\$1,000 assessed value, then the levies of the *junior* taxing districts are prorated according to state law so that the combined regular levy of the local taxing districts do not exceed \$5.90/\$1,000.

Excess (Special) Levies – Any taxing district, including school districts, can ask voters to approve higher property taxes through an excess levy. Excess levies can be used for maintenance and operations or to issue bonds to fund capital improvement projects such as police stations, fire stations and schools. There are specific requirements outlined in the state constitution and state law governing elections on excess levies.

There are two ways to approve an excess levy:

- 1) A 60 percent “yes” vote and voter turnout equal to at least 40 percent of the number of voters who participated in the last preceding general election; or
- 2) If the turnout is less than 40 percent, then the number of “yes” votes must equal or exceed 60 percent of a number that represents 40 percent of the voters who participated in the preceding general election.

To pass an excess levy issuing long-term bonds, a taxing district must receive a 60 percent “yes” vote *and* turnout must be at least 40 percent of the number of voters that participated in the preceding general election.

Maintenance and operations levies are generally good for one year, while bond levies can be for as long as 20-25 years. The most common maintenance and operations levy is done by school districts while the most common type of bond levy done by local government is for public safety buildings and other city facilities. School district and fire district maintenance and operations levies are authorized for up to four years, while bond levies are good for up to six years.

The passage of EHJR 4204 in 2007 allows school districts to pass an excess levy with only a simple majority vote with no minimum turnout requirement.

Issues and Outlook – The recent housing boom has led to higher assessed values for tax purposes. These higher assessments generally lower the total property tax rate under the 1 percent statutory limit. It is important to remember that an increase in assessed value does not necessarily mean that property taxes will increase by that amount. For example, a recent analysis of 2007 property taxes statewide showed that on average, assessed values increased 15.8 percent, but overall property tax levies increased 7.1 percent.

Recent legislation on property taxes has focused on limiting assessed value increases. Some of the proposals include a “Prop 13” type of limit as in California where assessments are capped at a certain percentage each year. The property is then revalued upon change of ownership. While a cap like “Prop 13” would provide certainty in assessed value increases each year, it represents a major shift of property taxes from some owners to others, and also causes people to stay in larger homes longer because of the tax shield. There are also mechanical issues with implementing a cap like this in our property tax system. Other proposals to address assessed value increases include homestead exemptions, where a certain dollar amount or percentage of value is exempted, and value averaging or smoothing where increases are spread out over time.

Each of these proposals has benefits and drawbacks, including shifts of tax burden and equity issues on whether the exemption is limited to residential property or applies to all property. Regardless of the type of assessed value limit proposal, it will require a constitutional amendment of the uniformity provision for taxes on real property.