To: Special Tax Commission
From: Tom Sgouros, Commissioner
Date: 11 December 2023
Re: Potential recommendations for Tax Commission

A fairly random collection of suggestions related to testimony we heard this fall as part of the special commission on taxation and revenue. Many of the recommendations that follow would require changes in state law, but making suggestions like that was a part of our original charge, at least as I understood it.

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Revaluation

Evidence was presented to describe two separate problems with current assessment practice. One analysis, from myself, suggests that many, if not most, of the abrupt changes in assessment frequently seen at revaluations are more attributable to side effects of the analysis technique used on the sales data than to real changes in the market.[1]

The second problem was outlined by analysis from the Center for Municipal Finance at the University of Chicago, which points out that properties at the less expensive end of the spectrum tend to sell for prices at or below their assessed values. Conversely, properties at the top end tend to sell for substantially more than their assessment.[2] The property tax already has a regressive flavor simply due to the fact that people's homes tend not to scale with their income. This makes it more so.

What can be done

There are a variety of statistical approaches to addressing these two problems:

- Cross-validation of the assessments. This is the technique of using an assessment conducted on some fraction of the sales data to try to predict the

[1] See https://sgouros.com/taxcommission for detail for an article and a presentation on the subject, as well as an electronic copy of this memo.

[2] See the link in the previous footnote for a report about Providence and a link to the national report on the subject.

prices of the remainder of sales. A well-done regression should offer predictions that match the sales prices, at least within a reasonable margin of error.

- Smoothing. There are a variety of possible techniques, ranging from simply using the previous assessed value as one of the data points in the assessment analysis to explicit smoothing, such as a moving average of previous assessment values, a technique in use for decades in New York City.[3] There are other techniques that are possible, too, and should be considered as a matter of fairness.
- Simple guard rails would also be appropriate, putting limits on how much an assessment can change from one year to the next (absent real improvements in the property). Such limits exist in at least 18 states and DC.[4]
- Separate revaluation of land and buildings. Land values vary more slowly than building values. All the lots on a block, for example, are probably comparable in value, while the houses might vary considerably. Separating the two in the analysis process might have a smoothing effect overall.

These might be implemented through a shadow revaluation, using the same data as the assessment company, but trying different techniques to test the potential impact of different reforms.

Tax assessment shortfall Data was presented to show that Providence, like most of the nation, tends to assess low end property at approximately the price that property can fetch on the market, while high-end property typically sells for substantially more than its assessment. This could be addressed with an assessment recovery tax, essentially an addition to the transfer tax, paid by the seller, related to the difference between the taxes paid at the assessed value and the sales price, and raising the new assessment to the sales price.

This could also address issues related to the assessment statistics. A known problem with smoothing assessment from one revaluation to the next is that some assessments might fail to catch up with a rising real estate market, leaving some houses assessed for less than they can get on the market. Indeed, this is the point of such smoothing. A tax on the difference between an assessment and the sales price could be thought of as a repayment to the city of the discount that had been in place. At the moment of sale, the seller has cash from the proceeds, so this is unlikely to be onerous.

A tax like this could also address the under-assessment of high-end properties, and could potentially have a significantly progressive incidence. If an owner wishes to avoid this tax, they can always appeal their assessment, to raise it. A tax like this has been proposed to address much worse assessment inequities in California, though it

[3] https://www.ibo.nyc.ny.us/iboreports/taxstability2102011.pdf

[4] https://cslf.gsu.edu/files/2014/06/property_tax_limitations.pdf

has not passed.[5]

Homestead exemption issues Several points of testimony to the commission were about the city's homestead exemption, that exempts a certain percentage of a property's value from taxation, essentially lowering the assessed value by 43% (the current value of the exemption). The problems outlined included these:

- A generous homestead exemption tends to shift the burden of supporting city services from homeowners, onto renters;
- A homeowner living in a multi-family property can often claim the exemption for the entire property;
- There is not audit capacity in the assessor's office to ensure that properties receiving the exemption are actually occupied by their owners.

Make exemption a dollar amount One relatively simple way to make the homestead exemption progressive, and meaningful for both single-family and multi-family properties is just to make it a flat dollar value instead of a percentage. To say, for example, that the first $100,000 of a property's value should not be taxed. For people who live in a property worth $250,000, this would be a 40% break on their taxes. For someone who lives in a $800,000 home, it would be only a 12.5% break. The dollar amount should be the subject of further discussion and financial modeling. In the presence of a more robust circuit breaker (see next item) a large homestead deduction makes sense, to discourage speculation and investor-owned single-family properties.

Expand circuit breaker The state income tax incorporates a property tax "circuit breaker" provision that offers a tax credit for elderly and disabled low-income residents (RIGL §44-33). The credit is small and not widely available, but it does cover both taxes and has a formula for imputing property taxes to rent, so it covers tenants as well as homeowners. As of 2020, fewer than 7,000 people take advantage of it statewide, at a cost of $2.4 million.[6] Expanding the circuit breaker to cover more people at higher incomes would go a long way to alleviate the regressive effect of property taxes in Providence.

Improve homestead exemption certification Testimony was presented to suggest that the certification required to grant a homestead exemption is not audited very effectively. More energetic auditing would entail substantial staff burden. Most certifications are apparently done electronically. The suggestion was made to combine an annual requirement with a substantial increase in the penalties for fraud, and to emblazon those penalties all over the certification web pages,

[5] https://www.betterinstitutions.com/blog/2015/07/prop-13-california-broken-property-tax-part-2

[6] The amount spent on the circuit breaker can be seen in the "Resident Personal Income Reports" at https://tax.ri.gov/guidance/reports/statistics-income

including popups to remind people of the penalties. Since the vast bulk of the certifications are done online, this would require little more than council action and some extra web designer expense.

Realty transfer tax RI already has a progressive realty transfer tax[7], the progressive part was passed in 2023, as part of the Speaker's housing package, and is intended to fund the Dept of Housing's production fund. The tax is $4.60 per thousand in value, with an additional $4.60 per thousand for the value in excess of $800k.

Underused property One issue that has come up repeatedly is about underutilized land, whether it be vacant buildings, surface parking lots downtown, or partially vacant buildings. These properties could be contributors to their neighborhoods, instead of blights. The state allows the city to levy a nonutilization tax (§44-5.1) but it is so onerous ($100/$1,000 in value) that it is not imposed very often.

The state could be requested to change the non-utilization tax to be "up to" $100/$1,000. A lower tax could be applied more often and would still serve as an inducement for owners of underutilized properties to develop or divest it.

If this represents a stick to persuade owners to develop, it is also feasible to offer carrots instead. A split rate, where land and improvements are taxed at substantially different rates, is one that has attracted attention. Pittsburgh established such a tax in the 1913, though it was repealed in 2001. A proposal to establish a split tax structure in Detroit (where the land tax rate would be five times the building rate) is under consideration in the Michigan statehouse.

Split-rate taxation is not necessarily a means to generate more revenue as much as it is to make the property tax more equitable and efficient. Economists often support split-rate land value taxation because it allows cities to generate the same amount of revenue while imposing a smaller tax on improvements, which encourages economic development and disincentivizes speculation of vacant land. Split-rate land value taxation is also a means to reduce the tax burden for homeowners, who often have more value tied up in their homes than the value of the site itself.

Though common in the rest of the world, in the US split rates have only been used in Pennsylvania. Because it is rare in the US, we do not have a record of the economic effects of establishing such a tax. But we do have a record of the economic effect of repeal. The Pittsburgh tax was repealed in 2001, largely due to political infighting and infrequent assessments. The city experienced a 19.5% reduction in private new construction, and property taxes increased for the majority of homeowners.

[7] RIGL §44-25

Municipal support The overarching story of Providence's financial constraints has to center the state's failure to support its capital city. Within living memory, Providence was among the richest municipalities in the state in terms of property value per citizen. The construction of the interstate highways and the subsidization of suburban infrastructure contributed to erode land values in Providence while enhancing them in the suburbs. By the 1990s, municipal land value had reached their current state, with the cities at the bottom of the scale. The end of Providence's glory days might seem long ago, but even so, the state continues to weaken the city, for example by continuing to move state offices out of town.

The commission frequently discussed the issue of non-profit tax exemptions from property taxation. The point is often made that non-profit institutions like Brown, RISD, JWU, RI Hospital, Miriam, the VA hospital, PPAC, and all the others, are tremendous engines of economic vitality in Rhode Island, not to mention the many other ways they enrich our state. This is obviously correct, but unfortunately for the city, the financial benefits of that vitality are felt in taxes the city does not collect. The income and sales taxes generated by the economic activity of Brown, RI Hospital, RISD, and all the rest accrue exclusively to state coffers, leaving the city handling the necessary services without even the property taxes to pay for them. The state currently reimburses the city for only a fraction of the foregone property tax income. To the budget of the city, the non-profit institutions are pure dead weight, while to the budget of the state they are a tremendous boon.

This divergence of interests between the city and state could be easily addressed by dedicating the income taxes collected at Providence's exempt institutions to the city. By themselves, the colleges and hospitals of Providence are responsible for well over a billion dollars in taxable wages and salaries. From their 990 forms, there are $480 million in salaries at Brown University alone,[8] and RI Hospital reports over $530 million in salaries and wages.[9] Miriam Hospital pays over $200 million.[10] This is hardly a comprehensive accounting, but there are more hospitals, universities, and other non-profits. All told, there is much more than a billion in taxable salaries and wages paid within the city of Providence by non-profit entities, probably around $1.5 billion. Conservatively estimating a 3% average state income tax rate, that would represent somewhere between $30-50 million per year in state income taxes. Having the income from these institutions support the city instead of flowing past it could relieve a lot of the antagonism that has marked the relations between the city and its institutions over the past many years.[11]

[8] https://projects.propublica.org/nonprofits/organizations/50258809

[9] https://projects.propublica.org/nonprofits/organizations/50258954

[10] https://projects.propublica.org/nonprofits/organizations/50258905

[11] As a perhaps not entirely incidental footnote, this would represent about 2% of the income taxes collected by the state in 2023, which currently run in the neighborhood of $1.9 billion per year.

Sales tax sharing Providence is a city of about 190,000 people. There are around 127 cities in America roughly that size, with populations between 150,000 and 380,000, roughly 80% to 200% the population of Providence. Of them, 54% are supported by a mix of taxes that include their own sales taxes as well as property taxes, and the vast bulk of the rest are supported by county sales taxes. That is 90% of these cities have a sales tax to lean on with the property tax. In other words, Rhode Island is among the very small minority of places in the country where a city is expected to make do on property taxes alone.

This is not completely true, of course, and Providence already has a local share of sales tax in the “meals and beverage” tax that adds a point to the sales tax on restaurant and bar sales in a municipality. But this is a very limited source and the city receives around $6.7 million from that tax each year,[12] collected and administered by the state. Des Moines, Iowa, is a city of roughly the same population as Providence. It receives one percentage point of the 7% sales tax there, which amounts to about $40 million per year.

Real estate speculation

In 2007, using data from the city assessor’s office, a study I conducted concluded that 5.5% of all real estate sales in Providence in the preceding years were “flips” where the property had been held for only a couple of years, or less.[13] Of those sales, only about one in nine had made any significant improvements to the property. The total number—5.5%—seems small, but it was very localized. In some neighborhoods, generally the ones along the edges of the more expensive areas, the proportion was much higher. In one plat, around Cranston Street and Potters Ave, more than 40% of the sales were flips and plats where a third or more of sales were flips were common.

People in the market for investment opportunities of this kind are competing with people in the market for housing, making it more expensive, and simply more difficult, to buy a house at an affordable price. And there is a lot of money involved. In 2007, $65 million per year was *earned* (sale price minus purchase price) on property held less than four years. The state of Vermont taxes such short-term sales at a significant rate, with various exceptions, including one for people who improve the house. A similar tax in Providence could earn as much as $10-20 million in a frothy market, though perhaps a better outcome would be if the tax discouraged this kind of profit-taking, and so did not raise much money, which is the case in Vermont.

I was unable to secure current sales data to update this study for current conditions, but the huge run-up in real estate prices certainly present the opportunity for these kinds of investors to make a buck at the expense of people who are just looking for housing. Given that even if the opportunities for flipping are fewer than in 2007, prices

[12] You can find these numbers in appendix D of the state budget executive summary document, e.g. https://omb.ri.gov/sites/g/files/xkgbur751/files/2023-01/Executive%20Summary_0.pdf.

[13] http://whatcheer.net/ripr/ripr23.pdf

have risen, so the dollar figures above might be the same, or greater. This tax has the potential to make a decent amount of money, at least in the short term *and* address affordability in the long term.

Hedge fund investors A change in the RE market since 2007 is the entry of big capital. Hedge funds now control over 5% of the single-family homes in the US, and are acquiring property fast enough that analysts at MetLife Investment Management predict that institutional investors will own 40% of the market by 2030.[14] Most of this activity is in the sunbelt states hit hardest by the foreclosure crisis, where the hedge funds were able to purchase millions of homes in 2009-2010, but it would be foolish to believe it is not happening here, too. A bill to restrict the entry of these funds into this market has been introduced to Congress, though its near-term prospects are dim.[15]

It is relatively easy to dismiss this threat by saying that banks earn a healthy margin from the single-family market, so why not hedge funds, but that overlooks the vital role of homeownership in the way wealth is built in American families. Homes are not only places to live, but ways that families build their assets, both within a generation and longer-term. A city of renters and not owners will be a poorer place in the future. It makes sense to develop tax policy that reserves the stock of single-family homes for owners, with a healthy homestead exemption and robust enforcement of its residency requirement.

Consumption taxes

The issue of consumption taxes was raised early in our deliberations. Here are some options from elsewhere around the country. The estimates here are strictly back-of-the-envelope work, but they can at least serve to show the order of magnitude and suggest that further inquiry might be appropriate.

Soda A Sugar-Sweetened Beverage (SSB) tax is an excise tax on drinks sweetened with sugar. Philadelphia established an SSB tax, explicitly for raising revenue for the city's universal pre-K program. A 1.5¢/oz. generated $70-80 million per year in revenue. Philadelphia's population is roughly eight times that of Providence, a similar tax might generate almost $10 million in yearly revenue.

Parking A report by the Parking Reform Network estimated that 24% of downtown Providence's area was devoted to parking.[16] My analysis using Google Earth defines the area of downtown as around 400 acres. There are about 100 parking spaces in an acre.[17] Using the 24% estimate gives us somewhere in the

[14] https://www.cnbc.com/2023/02/21/how-wall-street-bought-single-family-homes-and-put-them-up-for-rent.html

[15] https://nationalmortgageprofessional.com/news/democratic-legislation-aims-curb-hedge-fund-ownership-single-family-homes

[16] https://parkingreform.org/resources/parking-lot-map/

[17] This is a fairly conservative estimate. See, for example: https://utia.tennessee.edu/cpa/wp-content/uploads/sites/106/2020/10/CPA-222.pdf, where estimates range from 80–242 spaces per acre for self-park lots. Attended lots where cars are parked in can be quite a bit denser

neighborhood of 10,000 parking spaces in downtown Providence. Lots of the estimated parking area from the study is on-street parking, which wouldn't be relevant in this analysis, but there is no shortage of multi-level parking structures, either. Assuming these two cancel out and estimating 75% occupancy and $15-20 per day, that is somewhere around $20-25 million in sales per year. Applying the sales tax rate to parking fees would raise somewhere around $1.5 million, less administrative costs. Obviously this is a very rough estimate, but a conservative one, especially in the number of spaces per acre. A proper proposal should rely on a more rigorous survey.

Entertainment Making conservative guesses about attendance and average ticket prices in various venues (number of seats times number of nights times rough guesses of ticket prices in the various venues), it is not hard to come up with a figure of well over $20 million in ticket sales in Providence each year, between the Civic (Amica) Center, PPAC, Vets, Trinity, and other theatres and special events. For example, the AMP has 14,000 seats and around 10-15 events every month. 120 events a year times half the seats times $20 is over $16 million. PPAC has 3000 seats, but the tickets tend to be more expensive. Half the theatre capacity at ten events a month at $35 per ticket is over $6 million.[18] The other venues are smaller. Trinity Rep reports around $1.8 million in ticket sales in their FY22 financial report.[19]

A 7% rate on $20 miilion in ticket sales would therefore produce around $1.5 million, less whatever administrative costs are incurred. Again, this is meant to be a rough (but quite conservative) estimate and as above, a real proposal should rely on a more rigorous analysis.

[18] Their 2023 990 form shows over $21 million in program revenue, but only some of that is actual ticket sales.

[19] Find the Trinity Rep financial reports at https://www.trinityrep.com/about/financials/.