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TO: The Honorable Detroit City Council

FROM: David Whitaker, Director
Legislative Policy Division Staff

DATE: October 3, 2023

RE: **REPORT SUMMARIZING THE LAND TAX EQUITY ACT**

Council President Mary Sheffield and Council Member Mary Waters requested that LPD provide City Council with a report summarizing the recently proposed Land Tax Equity Act.

LAND TAX EQUITY ACT SUMMARY

The Michigan Legislature has introduced a series of bills that, if passed, would be known as the Land Tax Equity Act (LTEA, HB 4966), which authorizes cities and local units of government to implement a land value tax (LVT). Although these bills speak about the ability of cities to implement a LVT generally, it has been amended to only apply to cities with a population of 500,000+ people.[1] In other words, the Land Tax Equity Act, should it pass, will only be applicable in Detroit.

Also, the legislature added a provision to the bill that would allow City Council to adopt a resolution to reverse the LVT in whole or in part after submitting the matter to voters if Council deems the LVT program unworkable.[2] If the voters approve a reduction of the LVT, the ad valorem tax may be reimposed at the level prior to the implementation of the LVT. We note that the bill is subject to further changes as it moves through the Michigan House and Senate.

A LVT is often referred to as a "split-rate" tax, meaning that it creates separate rates on the taxable value of properties, with a higher tax rate applied to land and a lower rate applied to structures and

[1] HB 4966, Section 2(i)
[2] HB 4966, Section 6(2)

improvements. In theory, implementing a LVT will discourage land speculation and the holding of vacant property and will increase development on those properties because the higher taxes will increase the cost of owning vacant land.

INITIATING A LAND VALUE TAX

Under the Land Tax Equity Act, implementation of an LVT begins with the written request of the chief executive officer of a city to the city's governing body. In Detroit's case, this would be a written request from the Mayor to City Council. The Mayor's request must include the following:

- The city's authorized ad valorem millage that may be eligible to be converted to an equivalent land tax and exempted from collection
- The year in which the LVT would commence
- If desired by the Mayor, the recommendation to adopt a system of credits allowed under the bill.

After receiving the written request, City Council may authorize a LVT by adopting a resolution consistent with the Mayor's request and provides for the following:

- The number of mills of the city's ad valorem millage that may be designated as eligible to be converted to the equivalent land tax rate
- The projected millage of the equivalent land tax rate that will be levied on land in the first year the LVT is imposed
- The first year in which the LVT would be imposed if approved by voters
- The phase-in period and percentages for equivalent land tax rate during the phase-in period
- If the Mayor recommends the adoption of a system of credits, the approval of the system of credits

City Council may adopt the resolution with a simple majority of members who are present. If City Council adopts a resolution consistent with the Mayor's recommendation, the city must submit the question of levying an LVT to voters at the first regular election date established under Michigan Election Law.[3]

IMPLEMENTING A LAND VALUE TAX AFTER VOTER APPROVAL

Upon authorization from the voters, the city may designate certain "qualified taxes" to be replaced by an equivalent land tax rate. Under the Land Tax Equity Act, qualified taxes are the rate of the ad valorem millage that the city levies for operating purposes, as allowed by the Home Rule City Act. The statute requires that the portion of qualified taxes to be converted to the equivalent land tax must be at least 50% of a city's authorized ad valorem millage. The Mayor may choose to either recommend immediate implementation of the LVT, or opt to "phase-in" the tax by incrementally shifting the taxes over a period of up to 3 years.[4]

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[3] The Mayor has publicly stated that he intends for the question to go to the voters during the February 2024 election. In order to get the question to the ballot for voter approval, the Michigan legislature and the City Council would have to vote to approve the question by **October 10, 2023**. Pursuant to the 2012 Detroit City Charter Section 12-103 the question "must be filed with the City Clerk not less than one hundred and forty (140) days before the election at which it is to be voted on." The proposed initiative will then be forwarded to the Election Commission for determination of whether the question can be lawfully placed on the ballot. Sec. 12-108, If there is no legal impediment, the question shall be placed on the ballot and approved by a majority of the votes cast in favor of the question. Sec. 12-108

[4] HB 4967, Sectioin 7yy

The LTEA states that the LVT must be assessed, levied, collected, and disbursed in the same manner as the ad valorem tax on real property under the General Property Tax Act[5] except as otherwise specified. Also, the LTEA provides that if revenue from the land value tax includes amounts that would have been tax increment revenues captured under a plan already approved by the city implementing the LVT, those tax increment revenues must be taken from the LVT consistent with the statutes governing tax increment revenues.[6]

Currently, the administration has stated that it plans to reduce the qualified ad valorem millage by 14 mills, meaning that homeowners will pay 53 mills instead of 67 mills if the LVT is approved by voters. This proposed reduction comports with the LTEA requirement that the operating millage converted to a LVT must be at least 50% of the city's operating millage, because the city's operating millage would be reduced from 20 mills to 6 mills. Concurrently, the administration will implement a LVT of 118 mills to make up for the reduction in the operating millage.

In order for the LVT to function as intended and to avoid revenue loss to the city, the increased land tax must be calculated to make up for the reduction in the ad valorem millage rate. The Office of the Chief Financial Officer (OCFO) calculated the LVT of 118 mills by finding the amount of revenue that would have been generated from the 14 mills levied on all Taxable Value in the city, then divided that number by the Taxable Value of Land in the city to arrive at 118 mills, which theoretically will be revenue neutral.

The House Fiscal Agency produced a legislative analysis of the LTEA. When discussing the potential fiscal impact of implementing an LVT, the analysis states that while it is ideal for the LVT to be revenue neutral, the ultimate outcome will depend on the scope and application of the LVT. Additionally, the analysis states that the fiscal impact is likely to change over time as property owners respond to the changes. In other words, there are too many variables involved to predict the ultimate outcome due to the permissive nature of the bill in allowing cities to craft and implement the LVT. The outcome will depend on the details of the Mayor's proposed LVT and the response by landowners.

Perhaps the most pressing concern with the implementation of the LVT is the capacity of the Assessor's Office given the myriad of new requirements that would accompany the implementation of an LVT in Detroit, and the increased importance of accurate assessments if an LVT is implemented. Over roughly the past 15 years, there have been widely publicized difficulties and complaints regarding inaccurate property assessments, and the city has acknowledged that many residents' properties were over-assessed. Numerous reviews, both from internal sources and from critics, have strongly suggested that the Assessor's office needs vast improvements, including staffing and increased budget allocations for technical services.

Due to the fact that the Assessor's Office is currently underfunded, the city must determine the amount of funding necessary to prepare the office to implement a LVT in 2025. It is likely that the Assessor's Office will require an increase in staff and the technological capacity to transition to the new system and process the additional data. LPD has asked the OCFO whether there is a current estimate of the amount of funding necessary to prepare the Assessor's Office and/or whether there is a plan to introduce a budget amendment to City Council. We are awaiting a response to this question.

PUBLIC STATEMENTS FROM THE ADMINISTRATION REGARDING THE LVT

[5] MCL 211.1 -211.155
[6] HB 4966, Section 8(6)

a. Tax Savings for Homeowners

The Mayor has most recently stated that Detroit homeowners will receive a 17% reduction in property taxes on average.[7] The administration provided LPD with data, broken down by neighborhood, which shows the expected tax changes for single-family homes with a Principal Residence Exemption under the proposed LVT. The data shows a reduction in taxes for every Detroit neighborhood, with a 16.1% reduction on average.

The administration's data is mostly in line with the public statements from the administration regarding a 17% tax reduction. Notably, homeowners will have to apply and qualify for the Principal Residence Exemption in accordance with the General Property Tax Act, which requires them to file an affidavit with the local tax collecting unit.[8]

The LTEA allows cities to adopt various credits to be applied against the LVT. The "homestead" credit provides that a parcel with a Principal Residence Exemption would be exempt from paying the ad valorem and specific taxes that would be levied on the taxable value of the homestead if the LVT were not levied.[9] Owners of eligible property must annually apply to the treasurer for certification of the amount of credit that may be applied against the LVT.[10]

b. Exemptions for Side Lots, Publicly Designated Properties, and Urban Farms

The Mayor has also stated that the LTEA will not increase taxes for homeowners who have purchased up to 4 side lots and would include exemptions for publicly designated properties and for individuals with parcels used for urban farming.

The LTEA includes up to 4 side lots as part of the "homestead" credit discussed above. Therefore, if a homeowner has a Principal Residence Exemption, they can include up to 4 side lots as part of their homestead so long as those parcels are under common ownership and the parcels are adjacent and contiguous. Although side lots would be taxed at a higher rate under the LVT, the expectation is that residents will still see a net savings due to the reduction in ad valorem taxes.

Applicants seeking exemptions for agricultural and publicly designated property must submit an affidavit to the assessor between January 1 and May 1 of the year in which the exemption would first apply. Exemption of agricultural property is limited to 15 acres and exemption of publicly designated property is limited to 5 acres. The properties must be properly designated for the intended use under the General Property Tax Act and the Natural Resources and Environmental Protection ACT (NREPA) and have all proper permits with the city. The assessor would review each exemption every 3 years after approval.

COMPANION BILLS

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[7] When the Mayor first announced the LVT at the Mackinaw Policy Conference, he stated that the LVT plan would likely cut taxes on buildings by 30%. LPD has asked the administration to explain why the expected reduction in taxes on buildings went from 30% to 17%, and we are awaiting a response. It is vital that both City Council and the voters have accurate information regarding the expected tax savings for residents prior to voting on the implementation of a LVT.

[8] MCL 211.7cc

[9] HB 4966, Section 9

[10] HB 4966, Section 10(3)

The LTEA includes companion bills which amend various other statutes to make complimentary changing allowing for the implementation of a LVT. These bills are tie-barred so that none of them can take effect unless they are all enacted.

a. House Bill 4967

Generally, this bill would amend the General Property Tax Act to allow for the exemption of ad valorem taxes that would not otherwise be exempt under the act if an LVT is properly authorized and approved by the voters. The bill provides for the additional requirements and procedures that the assessor and treasurer must undertake in order to effectuate the LVT.[11]

b. House Bill 4968

This bill would amend the Tax Reverted Clean Title Act to include LVTs in the calculation of eligible tax reverted property specific tax if the property is in a city that has adopted a LVT under the LTEA.

c. House Bill 4969

This bill would amend the Neighborhood Enterprise Zone Act (NEZA) to provide that a NEZ could not be levied on an otherwise eligible property if the property is located in a city with a LVT for any year in which the LVT is less than the NEZ tax. The bill would also prohibit the issuance of NEZ certificates for a homestead facility by a city after the date on which a LVT was approved by the voters.

d. House Bill 4970

This bill would simply amend Part 1 of the Income Tax Act to include the specific taxes levied under HB 4966 in the definition of property taxes.

THE LINCOLN INSTITUTE REPORT

As stated above, the theoretical benefit of implementing a LVT is that a higher tax on land will discourage speculative landholding of vacant land and encourage development, while shifting the tax burden from homeowners to individuals with vacant land. Therefore, the success of the LVT should be determined by the city's ability to remain revenue neutral while shifting the tax burden onto owners of vacant land, and the extent to which the tax increases development on vacant land.

The city commissioned a report from the Lincoln Institute of Land Policy, which was released in 2022 and is entitled *Split-Rate Property Taxation in Detroit: Findings and Recommendations*. The report analyzes the potential impact in Detroit of a 5:1 split-rate tax on business formation, property values, revenues, effects on homeowners, and rates of tax delinquency, foreclosure, and home ownership.

It should be noted that the report has not been peer-reviewed to attest for the methodology used in the study. Also, as the report points out, there is little-to-no comparative data from other cities as Pittsburgh is the only major American City to implement a split-rate tax. There is no city of comparable size to Detroit that currently uses a split-rate tax.

Additionally, the split-rate tax in Pittsburgh is fundamentally different from the type of tax suggested by the Lincoln Institute for Detroit. This is because Pittsburgh raised taxes across the board,

[11] HB 4967, Section 7(yy)

while the Lincoln Institute suggests that raising the tax on land should be accompanied by incentives to encourage development in order to achieve the desired outcome.

The results of the study estimate that there would be a modest increase in owner-occupied homes and a modest decrease in the tax delinquency and foreclosure rates if Detroit implemented an LVT (less than a 1% difference). The report estimates that the true cash value of residential and commercial properties will see an annual increase of 2.4% and 3.8% respectively.

The report also estimates that Detroit's general revenue would rise by 10.9% over a 5-year implementation period, while the debt levy would rise by 8.4%. However, it should be noted that the administration has worked with City Council to reduce the debt levy over a two-year period.

Notably, under the Recommendations portion of the report, it states that the potential benefits of a LVT will be attenuated if Detroit is the only city to adopt an LVT.