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Serving local government and private enterprise

INFORMATION BULLETIN

January 6, 2009

EXECUTIVE SUMMARY

- Many Michigan taxpayers are about to face what many will feel is an absurd situation. Their property tax values will rise 4.4 percent even though real estate market conditions are falling badly.
- Most will want to blame the government. Instead they should be blaming voters and promoters or Michigan's 1994 state Constitution Amendment known as proposal A.
- **Here is why.** Prior to Proposal A, property taxes were based upon the value of comparable, real estate which had sold. Proposal A, requires real estate tax valuations to be disconnected from the real estate market and instead connected to the CPI (Consumer Price Index). Housing prices may fall, but the price of food, medicine and gasoline determines how much a property tax value will rise.
- Details of several laws which came into play follow: (1) the amount a property value used for calculating a property tax could increase each year was capped; (2) in order to create a legal method to cap taxes, laws were modified to create a new value for tax calculations, "Taxable Value;" (3) limiting the annual increase in Taxable Value did save taxpayers money each year, but (4) it created today's situation, property values are required to rise even though real estate market values were declining.
- In late October 2008, State Tax Commission officials issued orders for 2009. Assessors are required to increase the Taxable Value of all properties having a tentative 2009 State Equalized Value above the tentative 2009 Taxable Value by up to 4.4%. Properties where the State Equalized Value is higher than the tentative Taxable Value, but less than 4.4 percent higher, will receive increases which bring the Taxable Values up to the amount of the tentative State Equalized Value. All properties with a spread of greater than 4.4% between the SEV and Taxable Value will increase 4.4%. Properties with an SEV equal to the Taxable Value will not be increased. Properties where the SEV drops below the 2008 Taxable Value will have their 2009 Taxable Value drop to the new SEV. All changes are subject to appeal.
- What can be done? Property owners should verify the situation with their local assessor. If values are going down, owners should determine if the actual market value of their homes is low enough to justify an appeal. If so, they should attempt to get the SEV lowered.

Details follow ...

Expect some property taxes to increase 4.4 percent in 2009

As incredible as it seems with real estate values plummeting, many property owners will see their taxable value go up 4.4 percent in 2009. Facing higher taxes will be those with a State Equalized Value larger than their property's Taxable Value.

How come? Because back in 1994 voters said that's what has to happen.

Not every taxpayer will see this increase. Almost all taxpayers seem confused *about how their property taxes could go up when values are going down*. They also want to know **who is responsible**. This bulletin provides readers with an explanation of the process causing the increased burden. It also shares authoritative references and information sources for your use.

This bulletin focuses on two issues: (1) the reason there will be an increase in Taxable Value during declining market conditions; and (2) an explanation of who is responsible. These issues are related to five modifications in the law which occurred in the years 1993 and 1994. Those laws are summarized near the end of this document.

Issue 1. How can property taxes rise when property values are falling?

Property taxes are calculated by multiplying a property value by a millage rate. The looming tax increase is a result of increasing property values used in the calculation, not increasing millage rates. Property owners could see a change in property value and/or a changed millage rate.

This bulletin focuses on property values and projected property tax increases arising from a 1994 voter mandated change in the state's constitution known as Proposal A. Prior to proposal A (March 15, 1994), all property taxes were calculated by using a value known as the State Equalized Value (SEV). Following the implementation of Proposal A, the SEV was no longer used to calculate taxes. Instead, a new value, the "Taxable Value" was substituted for SEV. It was designed to cap annually increasing tax burdens resulting from real estate values rising more quickly than overall "cost of living" and wages.

Tax Base Change - CPI vs Market Changes

Influence on \$100,000 Tax Value

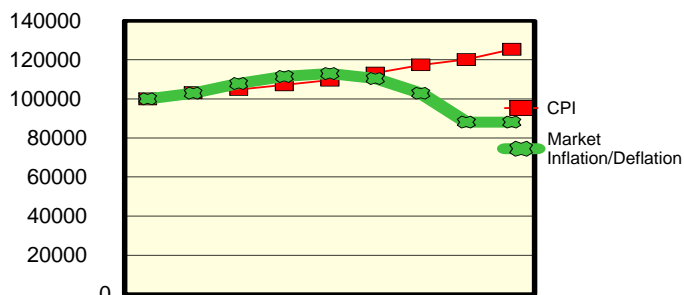


Chart by Michigan Property Consultants

CPI used by State v Actual Sales Data - Mich. Assn of Realtors

Whereas an SEV must represent 50 percent of a property's fair market value, "Taxable Value" was initially set equal to an SEV and then tied to inflation or CPI (Consumer Price Index).

The result is shown in the adjacent chart. It illustrates the difference in value changes for a property initially valued at \$100,000.

The thick line shows an annual increase in property value calculated using percentages derived from market data. The line tracks changes from the year 2000 through 2008.

Reports of annual sale prices of existing homes were used to estimate these price fluctuations. The line marked with little rectangles illustrates a \$100,000 property with annual changes capped by the Consumer Price Index. Capped prices (Taxable Values) did remain below market value in the early part of the decade. However, this chart shows market values have dropped while the capped value continues to rise. How come, you ask?

Well, the answer can be seen in a similar chart. Michigan's constitution still requires an SEV to change directly with changes in market value. In this chart, one can see that SEV is in fact declining.

The key to rising taxes lies in that "capped" value which is tied to the CPI. When the Taxable Value is less than the SEV, the law requires the Taxable Value to rise until it becomes equal to the SEV. The rise is limited ... to annual increases of no more than the annual rate of general inflation or 5 percent of the current Taxable Value, whichever is less. Proposal A requires the Taxable Value to rise by either 5 percent or the rate of inflation. Hence, there will be up to a 4.4 percent increase in the Taxable Values of any properties which have an SEV larger than the Taxable Value.

The one exception is that some properties have a "spread" or difference between the SEV and Taxable Value that is less than 4.4 percent. Those properties will only see their Taxable Value rise by an amount required to make it equal to the SEV.

Over the decade and a half since the approval of Proposal A, real estate market values have increased more rapidly than Taxable Values and in general, most property owners did save money each year. In places where property values rose a lot, taxpayers saved a bunch.

There are two fundamental concerns addressed in these manipulations. First, property tax burdens had become so heavy that Proposal A was enacted to lighten the load. The other, is the need in levying taxes to treat everyone the same. Taxation experts refer to these issues as principles of equity (doing what is only fair) and uniformity (making sure the rules apply to everyone). In Michigan's constitution, uniformity is created by making sure all property is valued in the same way, at 50 percent of market value (the State Equalized Value). Proposal A modified this concept by emphasizing what some people view as equity or fairness; making sure the property tax burden was not so high that people were taxed out of their homes. Thus, property taxes were capped. The result was to give certain taxpayers a "break" by creating a special exemption based on inflation.

Value difference: CPI & Statewide SEV
Influence on \$100,000 Tax Value

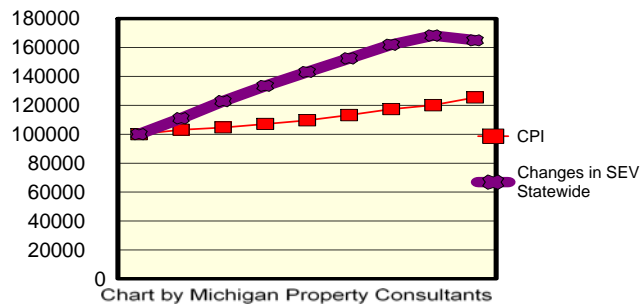


Chart by Michigan Property Consultants
CPI used by State v Actual Sales Data - Mich. Assn of Realtors

Thus, while historically, property taxes had been levied based upon the true cash or market value of a property, Proposal A created levies based upon the price of food, furniture and gasoline. In this declining market, the difference between those methods is becoming clear to many taxpayers.

The gap causing this unusual situation is closing. Michigan Department of Treasury figures illustrate that for 2008 the SEV of all real estate in Michigan is about 25 percent higher than the Taxable Value of corresponding real property. This spread between them was 29 percent in 2007, 30 percent in 2006 and 32 percent in 2005.

It should be cautioned that taxes are calculated by multiplying a millage rate times the Taxable Value. Should millage rates change, the property tax burden will change too. To properly determine the actual increase in taxes levied, the taxpayer should examine both changes in property value and changes in millage rates.

Issue 2. Who is responsible for the process?

Proposal A was adopted by more than a 2 to 1 margin. It was one of several important changes in property tax law during that time period. The motivation for change was a widespread reaction to Michigan's overall property tax burden. It was approximately 30 percent greater than the national average burden at the time of passage of Proposal A.

While taxpayers often want to blame government administrators, tax assessors and equalization directors for higher taxes, and as unpalatable as it may be to taxpayers, the reason Taxable Values will rise when property values are falling is because in 1994 voters required the process by approving Proposal A. It's the law.

Here is a summary of five laws in 1993 and 1994 which changed Michigan's property tax levying procedure.

- Public Act 145 of 1993 which eliminated the funding of Kindergarten and Intermediate school by the local property tax;
- Proposal A of 1994 which replaced the funding with a 2 percent increase in the state sales tax and provided a new "capped" value (Taxable Value) as the basis for levying the property tax in the state of Michigan. Based upon Proposal A, future increases in property taxes were to be limited to the rate of the U.S. CPI (inflation rate multiplier) or 5%; whichever was less.
- Public Act 312 of 1993 which permitted local school districts to levy not more than 18 mills or the levy they had made in 1993 whichever is less (exempted personal residences)
- Public Act 331 of 1993 created a new six mill state education tax on all property
- Public Act 136 of 1994 exempted qualified agricultural property from the 18 mills

More Information for Verification and further research

References and Sources:

For documentation of the order required by Proposal A to raise Taxable Values, see Michigan State Tax Commission Bulletin No. 6 of 2008

http://www.michigan.gov/documents/treasury/Bulletin_6_of_2008_Inflation_Rate_for_2009_254420_7.pdf

The inflation rate multiplier used to calculate 2009 Taxable Value increase may be found in Michigan Compiled Laws Section 211.34d . For the General Property Tax Act see:

[http://www.legislature.mi.gov/\(S\(hoatb345z5okwo55kd04kc45\)\)/mileg.aspx?page=getObject&objectName=mcl-211-34d](http://www.legislature.mi.gov/(S(hoatb345z5okwo55kd04kc45))/mileg.aspx?page=getObject&objectName=mcl-211-34d)

The inflation rate multiplier is derived from the U.S. Bureau of Labor Statistics CPI for All Urban Consumers. For federal definition of CPI go to <http://www.bls.gov/cpi/cpiovrw.htm>

A table illustrating items used to determine the CPI which adjust property taxes may be found at: <http://www.bls.gov/news.release/cpi.t01.htm> A relevant excerpt is: *“Indexes are available for two population groups: a CPI for All Urban Consumers (CPI-U) which covers approximately 87 percent of the total population and a CPI for Urban Wage Earners and Clerical Workers (CPI-W) which covers 32 percent of the population.”*

For a more complete description of the Michigan property tax structure go to:

<http://www.michiganpropertytax.com/2008taxpayersguide.pdf>

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Property Tax Administration Certificate No. R-1798