Homestead Exemptions: Some Considerations for Colorado

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Homestead Exemptions: Pros and Cons

**Cons**

- Expensive
- Insufficient relief for most heavily burdened households
- More cost-effective options:
  - **Circuit breakers** offset property taxes above a threshold percentage of income
  - **Deferrals** allow homeowners to defer payment of property taxes until home is sold or owner dies
- **Learn more:** [Property Tax Relief for Homeowners](2021)
Homestead Exemptions: Pros and Cons

Cons
× Expensive
× Insufficient relief for most heavily burdened households
• More cost-effective options: Circuit breakers and deferrals

Pros
✓ Make property tax distribution more progressive
  • Can offset assessment inequities with modest exemption
✓ Simple to administer
✓ High participation rate
✓ Universal benefit may be politically preferable
Outline

- Key features of homestead exemptions
  - Eligibility
  - Four approaches to provide relief
  - State- vs. local-funding

- Other considerations
Eligibility

• All owner-occupied primary residences (25 states)
  • Seniors only (8 states)

• Businesses, renters, 2\textsuperscript{nd} homes ineligible
  • Bear larger share of tax burden (Especially if state does not provide aid to offset local revenue loss)
Four Approaches for Relief

- **Exemption** or **credit** against property tax bill
- Fixed **dollar** amount or specified **percentage**

### # States (2018)

<table>
<thead>
<tr>
<th>Type</th>
<th># States</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ Exemption (e.g. $40,000)</td>
<td>16</td>
</tr>
<tr>
<td>% Exemption (e.g. 10%)</td>
<td>4</td>
</tr>
<tr>
<td>% Credit (e.g. 10%)</td>
<td>3</td>
</tr>
<tr>
<td>$ Credit (e.g. $400)</td>
<td>2</td>
</tr>
</tbody>
</table>

**Note:** Count is for broad-based exemptions and credits available for all primary residences, not narrower programs just for seniors, veterans, or disabled persons.

**Source:** Lincoln Institute of Land Policy. [Significant Features of the Property Tax](https://www.lincolninst.edu/publications/property-tax). Residential Property Tax Relief Programs: [Summary Table on Exemptions and Credits in 2018](https://www.lincolninst.edu/publications/property-tax).
Four Approaches for Relief

- **Exemption** or **credit** against property tax bill
- Fixed **dollar amount** or specified **percentage**

**Key Differences**

- **Progressivity**
  - Only flat dollar exemptions or credits make property tax distribution more progressive

- **Incentives for higher local taxes/spending**
  - Only flat dollar credits provide relief without creating an incentive for higher taxes/spending
  - With 3 other approaches, amount of relief increases when property tax rates rise, so homeowners don’t bear full cost of higher local taxes/spending at the margin
Local funding (12 states)
- Local gov’t offsets drop in property tax base by raising tax rates or cutting spending
- Higher tax rates reduce net tax relief for homeowners
- Large tax shift to ineligible taxpayers (Businesses, renters, and 2nd homes)

State funding (9 states)
- State aid to localities to offset drop in property tax revenues
- Offsets fiscal disparities between communities
- Reduces tax shift to businesses/renters and provides larger property tax savings for homeowners (Especially in communities that are poorer and/or largely residential)
- Incentive for local voters to support higher property tax rates since part of the cost covered by state gov’t (This is minimized with flat dollar credit – e.g. $400)

Shared funding (4 states)
- State could offset certain percentage of local revenue loss or reimburse localities fixed amount per homestead
Outline

• Key features of homestead exemptions
  • Eligibility
  • Four approaches to provide relief:
    • Exemption or credit against property tax bill
    • Fixed dollar amount or specified percentage
  • State vs. local funding

• Other considerations
Inflation adjustment

• Homestead exemptions normally NOT indexed to inflation
  → Over time, real value of relief diminishes
Vary Amount of Exemption Across State

• Set exemption amount equal to fixed percentage of median home value for county (or city, metro area)

• Otherwise, if amount of flat dollar exemption or credit is fixed across state
  → Tax savings and revenue loss relatively higher in areas w/lower property values

• Varying exemption amount more important with locally funded programs
Local Option vs. Statewide Program

• Local option programs (AK, HI, MA, PA)
• Local option to increase benefit on top of statewide program (AL, GA, IL, TX)

• Local option makes sense for locally funded programs
  • Impact of homestead exemptions varies:
    • Greater in communities with large business tax base, lots of 2nd homes, and/or large variations in home values
    • Limited in residential communities w/out much dispersion in home values
  • Especially important in Colorado given TABOR’s restrictions on raising mill rates
Exemption Against Specific Property Taxes

- Exemption against school property taxes only
  - AZ, MI, NY, SC, TX, WI

- Florida provides *smaller* exemption for school taxes ($25k) and *larger* exemption for all other levies ($50k)

- Exemption does not apply municipal taxes in Louisiana, or special assessments in New Mexico
Restrict Tax Shifts Across Property Classes

• **Boston**
  - 1\textsuperscript{st}: Allocate tax levy across City’s four property classes based on their full value \textit{without} any homestead exemptions
  - Then: Residential tax rate is calculated based on net residential value (i.e. Total value – Residential exemption)
  - Exemption creates more progressive property tax distribution among homeowners w/out shifting tax to non-residential classes

• **Colorado**
  - About the largest disparities in effective tax rates for residential vs. commercial property in the nation
    (Source: [50-State Property Tax Comparison Study](#))
  - Further tax shift to non-residential property could reduce economic growth
  - Consider whether a homestead exemption could shift the tax burden to renters
Income Ceilings and Maximum Property Value

**Income Ceilings**
- No state uses income ceilings for programs for all primary residences, but about half of states do for programs for seniors
- Verifying income typically requires annual application
  → Participation rate ↓ Administrative costs ↑

**Maximum Property Value**
- Avoids providing relief to high value homes
- But easy to administer and no burden on taxpayers (Unlike other approaches to means testing benefits)
- Could set statewide max property value for eligibility (IN), vary max property value by county (NE), or phase-out amount of exemption as assessed values rise (MN)
Minnesota's Homestead Market Value Exclusion

Exemption = 40% of first $76,000 in market value
(Peaks at $30,400 for $76k home)

Exemption reduced by 9% of home value above $76k
(Phases out completely at $413,800).
Residency Requirements

• General homestead exemptions: No states require home to have been owned & occupied for more than a year

• Senior homestead exemptions:
  • Colorado’s requirement is unusually long
    • To qualify, must have owned homestead for 10 years
  • MA is closest: Requires that seniors have *lived in* state for 10 years and owned *any* home in state for 5 years
  • A few other states require seniors to have…
    • *Lived in* state for more than a year: NH (3 yrs), UT (2 yrs)
    • *Owned* their home for more than a year: NJ (3 yrs), AZ (2 yrs)
Recap

• Homestead exemptions:
  × Untargeted – Expensive, inadequate relief for some taxpayers
  ✓ Progressive, simple, high participation rates, universal

• Four approaches to provide tax relief
  • Only flat dollar exemptions/credits make tax more progressive
  • Only flat dollar credits avoid incentivizing higher local taxes

• State vs. local funding
  • State funding reduces tax shift to businesses/renters and provides larger property tax savings for homeowners

• Other considerations
  • Adjust for inflation
  • Vary amount of exemption across state
  • Local option vs. statewide program
  • Exemption against all property taxes or specific property taxes
  • Restrict tax shifts across property classes
  • Income ceilings, max property value, phase out exemption
  • Residency requirements
Learn More:

• **Property Tax Relief for Homeowners** (64 pg.)

• **How Do States Spell Relief? A National Study of Homestead Exemptions and Property Tax Credits** (8 pg.)

• **Significant Features of the Property Tax**.
  • Residential Property Tax Relief Programs: **Summary Table on Exemptions and Credits in 2018**.