Special Report

BOSTON MUNICIPAL RESEARCH BUREAU

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Boston's Classification At Crossroads

The business tax ceiling should be reduced to 175% in FY08

Highlights

- FY07 marks the largest annual growth in business property values over the last 5 years, +$3.2B or 13.2%.
- New construction and condominium development continue to drive residential growth.
- This year's business tax rate is the lowest it has been since fiscal 1991.

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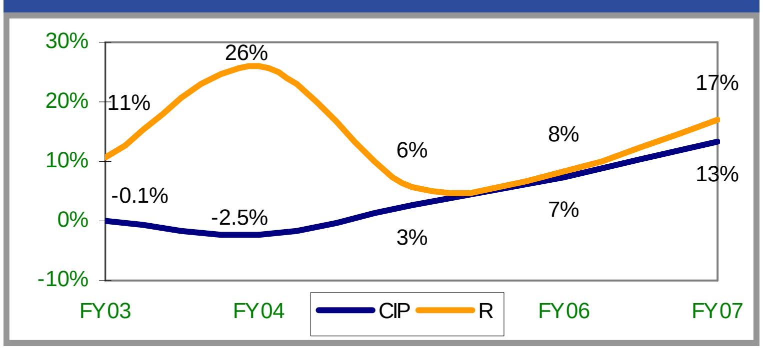
In this revaluation year, Boston's taxable property values in fiscal 2007 increased significantly by $11.8 billion or 15.8% over the prior year. The percentage growth of both residential and commercial property values basically doubled over the prior year's rise to 17% and 13%, respectively. Residential property growth continues to outpace the growth of business property while the two still trend close together. The value increases required cuts in the tax rates for both classes to insure that Boston's tax levy increase from existing property did not exceed 2.5%. Value and classification changes have combined to allow residential property to represent 68.5% of taxable value in Boston but pay 42.4% of the tax levy, its highest share to date. Business property represents 31.5% of the value but pays 57.6% of the levy.

Faced with significant increases in residential tax bills in fiscal 2004, compromise legislation was passed that increased the business tax ceiling share to 200% in 2004 with annual reductions planned to return to the original level in fiscal 2008. The classification compromise of 2004 should be honored and legislation that would make the business ceiling permanent at the original 175% should be enacted. To restore the original plan, language that prohibits the residential class from bearing a lower percentage of the levy than imposed in the prior year should also be eliminated in the same bill.

A closer look at Boston's property value trends reveals:

- The residential share of the tax levy grew by 3.5 percentage points to 42% in fiscal 2007 and the average single-family tax bill increased to $3,091, a jump of $338 or 12%.
- Over the last four years, overall taxable values have grown by 50%. Residential property values increased by 69%, while business values have risen by 22% during this period.
- New growth of $33.1 million is expected this year, a 16% increase due mainly to new condominiums and personal property growth.

Growth in Property Values FY03-FY07



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Values and Tax Rates FY06-FY07				
Values in Billions				
Class	FY06	FY07	Change	%
Residential	**$50.69**	**$59.29**	**$8.60**	**17.0%**
Condominiums	17.06	20.55	3.49	20.5%
Single Family	11.10	12.72	1.61	14.5%
Two/Three Family	14.55	16.72	2.17	14.9%
All Others	2.28	2.99	0.71	31.0%
Multi-Family	5.68	6.31	0.62	11.0%
Business	**$24.05**	**$27.22**	**$3.17**	**13.2%**
Commercial	19.46	22.32	2.86	14.7%
Industrial	1.26	1.39	0.13	10.0%
Personal	3.33	3.52	0.19	5.7%
Total Value	**$74.74**	**$86.52**	**$11.78**	**15.8%**
Residential Tax Rate	$11.12	$10.99	-$0.13	-1.2%
Business Tax Rate	$30.70	$26.87	-$3.83	-12.5%

** Numbers may not add due to rounding*

Property Tax Values

Boston's total taxable property value in fiscal 2007 is $86.5 billion, an increase of $11.8 billion or 15.8%. This year, residential property values grew by 17%, outpacing business property that increased by 13.2%. Last year, both values experienced a more balanced growth. Values for fiscal 2007 were set as of January 1, 2006 and reflect 2005 market conditions. That means that these residential values generally were not affected by the slow housing market in 2006.

Residential property is valued at $59.3 billion in fiscal 2007, a growth of $8.6 billion or 17% from fiscal 2006. The bulk of this growth is due to new construction, primarily condominium development. The remaining growth comes from the appreciation of existing properties.

Business property is valued at $27.2 billion, an increase of $3.2 billion or 13.2% over fiscal 2006. This is the largest growth in business values over the last five years. In fiscal 2003 and 2004, business values actually dropped by -0.1% and –2.5% respectively. The growth of commercial class A office tower values by 12.2% this year was a key factor in the increase of business value. This jump, as well as the overall growth in business property, are due to a healthier real estate market, sales of office towers, declining vacancy rates and increasing lease rates.

Personal property values rose this year by $188.1 million or 5.7%. This increase is due to wireless communication companies becoming taxable and NSTAR adding transmission lines and new substations. Specifically, a decision by the Appellate Tax Board in 2006 determined that wireless companies should not be classified as telecommunication companies and therefore are not entitled to a personal property exemption. This decision increased Boston's personal property tax levy by $4.7 million in fiscal 2007.

New growth in the tax levy jumped by $3.3 million or 11% compared to a rise of 7.3% last year. The larger increase is primarily due to the growth in personal property (as noted above) and new condominiums.

A review of taxable value of the City's 22 Wards shows that value appreciation and new construction have caused residential property values to grow by more than 100% in seven Wards since fiscal 2003. Housing prices in these Wards traditionally were more reasonable for first-time home buyers. These Wards still represent affordability for the City but now less so due to this recent value growth. Additionally, this same review shows that the total taxable value of the three downtown Wards (Ward 3-Boston Proper, Ward 4-Back

Select Value Growth FY03-FY07			
Figures in 000's			
Ward	Residential	Growth FY03-FY07	%
1	East Boston	$1,183,833	105%
6	South Boston, North	$1,196,368	107%
8	Roxbury, East & South	$368,645	112%
10	Roxbury	$622,597	107%
13	Dorchester, Savin Hill	$674,351	105%
14	Dorchester, West	$839,993	111%
15	Dorchester, North Central	$551,700	112%

Bay South and Ward 5-Beacon Hill/Back Bay) totals $39.7 billion or about 46% of the City's total taxable value, reflecting its office towers and high-end homes.

Boston is supporting legislation that would allow it to tax telecommunication property. The values of these properties are now determined by the Commonwealth and are exempt from local taxation. If this measure is approved, the City estimates that $15.4 million would be added to Boston's tax levy in fiscal 2008. Mayor Menino has pledged to use these funds to reduce the City's reliance on the property tax.

Property Tax Levy

The property tax levy is the City's largest revenue source, totaling $1.270 billion in fiscal 2007, an increase of $62.6 million or 5.2% from fiscal 2006. The breakdown of this increase is shown in the table below. Boston relies on the property tax for 56.6% of its fiscal 2007 operating revenues. Included in the gross levy is the overlay reserve for abatements and uncollected taxes of $46.6 million, which represents 4% of net property taxes. Boston continues to raise the maximum levy limit possible which cannot be increased further except by an override approved by the voters.

Tax Levy Growth FY06-FY07

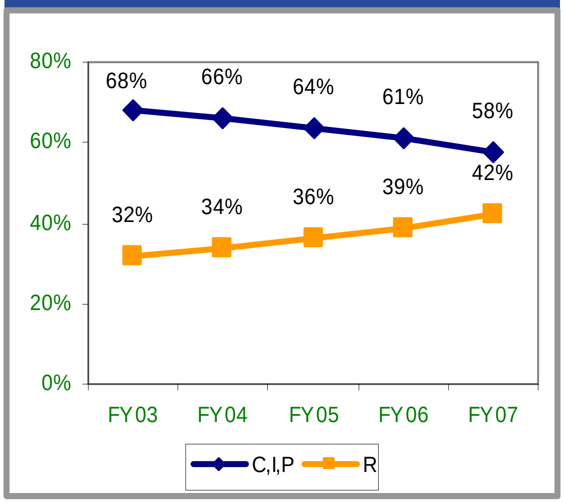
Figures in Millions

	FY06	FY07	Change	%
Prior Year Levy Limit	$1,149.2	$1,207.7	$58.5	5%
2 1/2% Levy Growth	$28.7	$30.2	$1.5	5%
New Growth	$29.8	$33.1	$3.3	11%
Total Levy Limit	**$1,207.7**	**$1,271.0**	**$63.3**	**5%**
Net Tax Levy	$1,167.3	$1,223.7	$56.3	5%
Gross Tax Levy	$1,207.6	$1,270.3	$62.7	5%

Business property continues to pay a disproportionate share of the tax levy under the City's application of classification. In fiscal 2007, business property represents 31.5% of taxable value yet pays 57.6% of the tax levy. Residential property represents 68.5% of the value but pays 42.4% of the levy. Business property pays a significant subsidy compared to what both classes would pay if taxed with a single tax rate. Nevertheless, for reasons explained below, the business share of the tax levy has decreased each year since fiscal 2003.

Since fiscal 1984, business and residential values followed a relatively similar trend and their share of the tax levy hovered at a 70%-30% split respectively. However, in fiscal 2003 this trend started to shift due to economic forces, particularly the high rate of residential property growth, the slowing of commercial property values, the reduction of telecommunication values and the city reaching the business ceiling of 175% in fiscal 2003. The result has been residential owners paying more of the tax bill. The percent of property taxes paid by residential owners increased from 32% in fiscal 2003 to 42.4% in fiscal 2007. The business share reduced accordingly and this year is 57.6% of the levy. As a consequence of the change in the tax levy shares from fiscal 2003 to fiscal 2007, approximately $133 million of taxes was shifted from business to residential property.

% of Levy Paid FY03-FY07

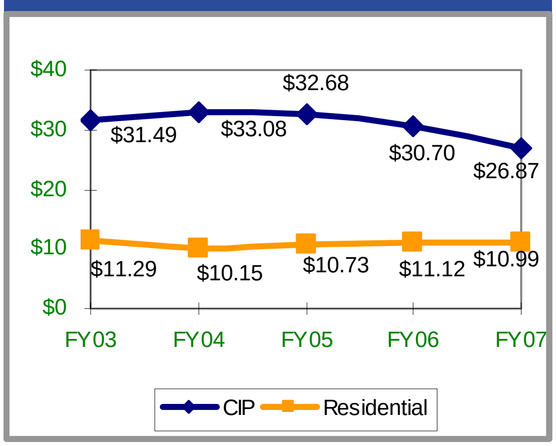


Property Tax Rates

The residential tax rate has remained relatively level while the business tax rate has declined over the past three years due to the divergence of values and shift in levy share among property classes. In fact, the business tax rate currently is the lowest it has been since 1991. The fiscal 2007 residential tax rate is $10.99, a drop of $0.13 or 1.2% from fiscal 2006, while the business tax rate is $26.87, a drop of $3.83 or 12.5%. The average tax bill for a single family home in Boston is $3,091 in fiscal 2007, an increase of $338 or 12%. Over the past five years, the property tax bill for the average single-family home increased by 78%.

Homeowners in Boston enjoy the significant benefits of classification as well as the 30% residential exemption for residential property used as a principal residence. In fiscal 2007, the residential exemption for eligible homeowners represented a tax cut of $1,525, an increase of $180 over fiscal 2006. The exemption represents a shift of $10.3 billion in value and $112.8 million in taxes from owner occupied properties to apartment buildings and other non-primary residences within the residential class.

Property Tax Rates FY03-FY07



Classification Compromise Challenged

Faced with very divergent residential and business property value trends that threatened to significantly increase residential tax bills in fiscal 2004 in Boston and several other communities, legislation was passed (Ch.3, Acts of 2004) to shift the business classification factor from 175% to 200% of its full value share in fiscal 2004. The law required the business ceiling to be reduced each year until it reached its original ceiling of 175% in fiscal 2008 and be further reduced to 170% in fiscal 2009. As scheduled, the business ceiling dropped to 183% in fiscal 2007, which with value changes contributed to a shift of $28.3 million from the business to the residential levy. The shift added $167 to the average single-family homeowner's tax bill.

The Governor's Municipal Partnership Act proposes to maintain the 183% business ceiling for two more fiscal years. This provision would negate the compromise agreement reached between city and state officials and business leaders in 2004 to ratchet down the business share from 200% to the original 175% in fiscal 2008. The 5% reduction in fiscal 2009 was not part of the compromise and was inserted in the 2004 legislation as it was enacted. So too was language that prohibits the residential class from bearing a lower percentage of the total tax levy than the percentage imposed in the prior year.

Recommendation and Conclusion

The classification compromise agreement should be honored and legislation (H3119) that would make the business ceiling permanent at the original 175% should be enacted. The legislation should delete language in the 2004 act that prohibits the residential class from bearing a lower percentage of the total tax levy than the percentage imposed in the prior year. This language would inhibit effective implementation of the compromise agreement. A deal is a deal and this commitment should be executed as planned to give confidence that future agreements between state officials and business leaders can be trusted and will be carried out as negotiated.

Too many unknown factors make it difficult to look ahead to December 2007 when the fiscal 2008 tax rates will be set. The valuations set as of January 1, 2007 should reflect a cooling of housing prices while commercial values will continue to increase. Any changes in the business levy ceiling and telecom valuations will also affect final values and tax rates.