

Real Estate Taxes and Municipal Budgets

*How New Development Funds Essential
Services in Massachusetts Cities & Towns*



HOUSING
FORWARD MA



The construction of new homes in cities and towns across Massachusetts is essential for many reasons: meeting the growing and changing housing needs of our communities, moderating housing prices to a level that is more affordable across income levels, promoting equitable access to areas of opportunity, and creating more sustainable and climate-resilient communities.

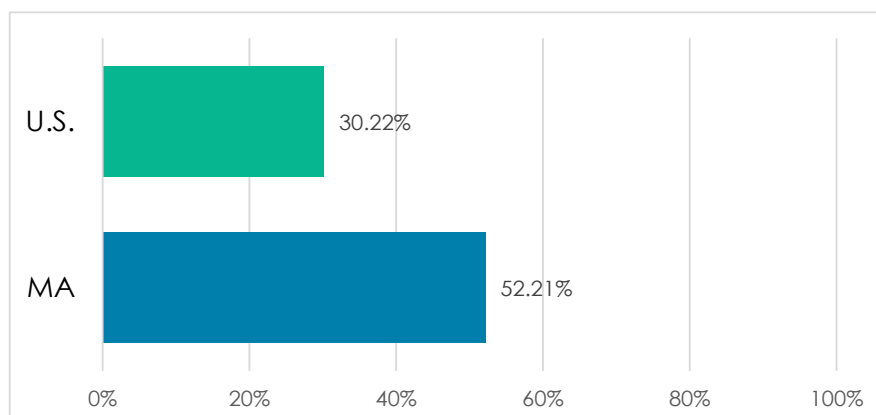
Yet, in addition to all of these benefits, there is one essential aspect to development that is not often discussed: **the critical role that new growth plays in ensuring that cities and towns have the financial resources that they need to provide the fundamental city services that we all rely on**, such as schools, fire departments, local libraries, and trash collection.

LIMITED POWERS & REVENUE SOURCES

Massachusetts state law places significant limits on how cities and towns can generate revenue. A study by [The Boston Foundation](#) compares Boston's legal powers with six peer cities across the country and concludes that **the state law limits on Boston's ability to raise revenue are far more onerous than any of its peer cities**. While the study focused on Boston, these limited powers apply to all cities and towns across the Commonwealth.

Strict state law limitations on taxing, borrowing, and spending leave Massachusetts municipalities with few options to ensure full funding of critical city services. For example, Boston only has access to four types of taxes while [other cities have from 3-7 times](#) that number. This results in an unusual dependence on property taxes for all Massachusetts cities and towns to fund their budgets. For example, Boston is [more than twice as reliant on property tax](#) as comparable cities in other states and, as noted in [a 2019 report](#) by then-Boston City Councilor Michelle Wu, "without reforms to diversify municipal revenue streams, slowing the pace of development could impact Boston's budget stability." Further, in addition to restricting the majority of city revenues to property taxes, state law also restricts how much each municipality can raise through property taxes.

Property Tax as a Percentage of All Local General Revenue



Source: Lincoln Institute of Land Policy, [2021 State by State Property Tax at a Glance Visualization Tool](#)

PROPOSITION 2 1/2 AND NEW GROWTH

Proposition 2¹/₂ is the state law that went into effect in 1982 and limits the total amount of revenue a Massachusetts municipality can raise through property taxes. Given the restrictions on other sources of revenue, Proposition 2¹/₂ effectively determines a city or town's annual budget.

Each year, the state government calculates a levy limit, or the maximum dollar amount a city or town may bring in through property taxes. [Only two factors may increase a municipality's levy limit](#): an automatic increase of 2.5% from the prior year's levy limit, and a calculation called the New Growth Factor.

$$\text{Levy Limit} = \text{Prior year's Levy Limit} \times 2.5\% + \text{New Growth Factor}$$

New Growth Factor

Properties that qualify to be included in the New Growth Factor fall into three categories:

1. Properties that increase in assessed value due to construction activity on the site
2. Formerly tax-exempt property that is returned to the tax rolls
3. Valuation increases as a result of subdividing a property or condo conversion

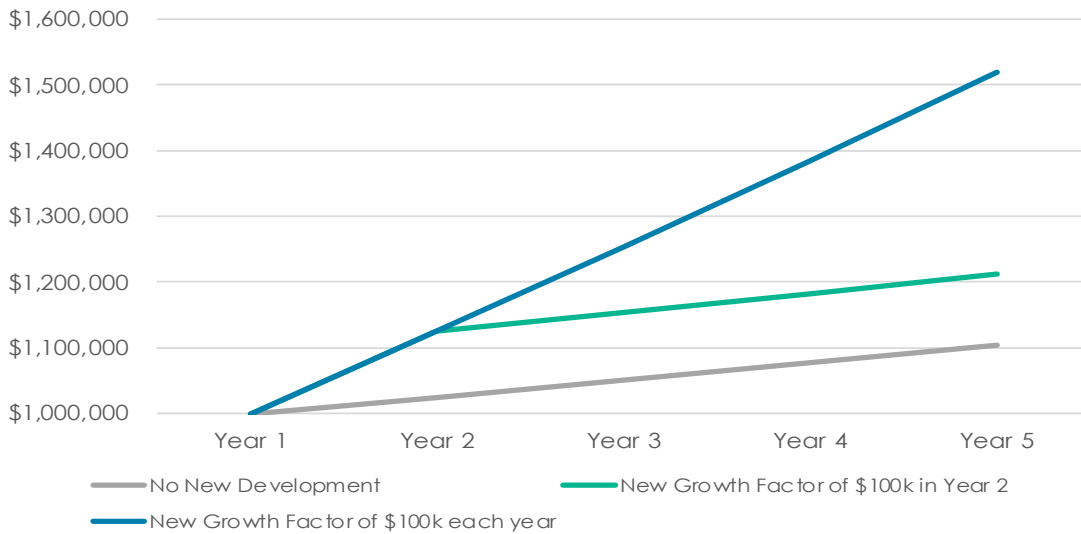
The [New Growth Factor is calculated](#) by multiplying the increase in assessed value of all qualified properties by the previous year's tax rate.

$$\text{New Growth Factor} = \text{Increase in Assessed Value of Qualified Properties} \times \text{Previous Year's Tax Rate}$$

In addition to the budget boost new development provides in its first year through the New Growth Factor, it is then [added to the tax base](#) eligible for the automatic annual 2.5% increase.

Notably, the annual levy limit calculation does not take population increases or fluctuations in the cost of city services into consideration. New growth is the only factor taken into account to lift caps on budget limits for cities and towns by more than 2.5%, outside of voter approval at a referendum election.

**MA Municipal Property Tax Levy Limit Growth Rate Comparison:
With and Without New Growth Factor**



LIMITATIONS IN ACTION

The passage of Proposition 2½ made local governments heavily dependent on state aid to fill budget gaps imposed by the levy limit. However, non-education state aid is not allocated as-of-right, and [tends to fluctuate](#) based on politics, shifting state-level economic priorities, and economic cycles. This can be [particularly problematic in an economic downturn](#) when state aid usually declines but the need for local services does not, and municipalities do not have the power to adjust property taxes to meet local needs. It also [exacerbates inequities](#) in access to quality services, because wealthier communities are more likely to organize and vote to override their levy limit, whereas other communities generally do not have that option.

These limitations were most recently made clear in Boston during the Great Recession of 2007-2009. The global economic downturn resulted in a more than [\\$90 million decline](#) in state aid from Fiscal Year 2009 to Fiscal Year 2010, and a [further \\$24 million decline](#) in Fiscal Year 2011. With few options available to raise revenue to cover the budget shortfalls this created, then-Mayor Thomas Menino made headlines for the hard choices he had to make to balance the city’s budget. [This included](#) significant layoffs in Fiscal Year 2011, including many school custodians and other staff; the launch of a comprehensive process for closing and consolidating schools; and the proposed closure of four branches

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of the Boston Public Library and the elimination of up to 77 library staff positions. While public pressure at the time forced both the city and the state to find other revenue sources to keep the libraries open, the city continued to face a difficult budgeting process with little power to find new revenue. And, without new development, the budget gaps would have been far worse: even during the recession, the New Growth Factor by itself contributed an increase in the levy limit of \$25 million in Fiscal Year 2010 and \$30 million in Fiscal Year 2011.



Massachusetts cities and towns are limited by state law in the revenue sources available to them, resulting in an unusual dependence on property taxes to fund municipal services. On top of that, the state further controls exactly how much a city or town is allowed to raise through property taxes each year under a law called Proposition 2 $\frac{1}{2}$. These limits are set without taking into account net changes in population, fluctuations in state aid, or changes in the actual cost of city services. The only two factors that can increase the maximum amount a city is allowed to bring in through property taxes are: a set annual 2.5% increase, and new development. Under the current law, continued growth is essential to the fiscal well-being of municipalities across the Commonwealth.

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