Taxation in New Orleans

BGR Presentation to the Tax Fairness Commission

February 3, 2011

The following is a presentation delivered by Janet Howard, BGR President & CEO, before the Tax Fairness Commission, City of New Orleans, on February 3, 2011.

GOOD MORNING. First I'd like to thank you for taking on this important challenge and for the opportunity to speak to you today.

BGR has been examining fiscal issues and the City's tax structure since the organization's founding. We issued our first reports calling for tax reform in the 1930s. In the 1960s, BGR managed and co-sponsored with the City a study identifying the factors undermining City finance, known as the Matteson report. Since then, we've repeatedly taken on two issues that go to the very heart of the words "tax fairness." One is the pervasive underassessment and unevenness – and therefore the unfairness – of local assessments. The other is the excessive exemption of private property from taxation. We've created a special page on our website, www.bgr.org, that provides an easily accessible compendium of our reports on taxation and assessments since 1996.

But, over the years, rarely have the opportunities for reform been as ripe as they are today. The recent consolidation of the assessors' offices has opened the way for fair assessments citywide. The very existence of the Tax Fairness Commission reflects the extraordinary opportunities before us.

Before launching into specifics, I'd like to say a few words about taxes and tax systems. Generally speaking, an effective and fair tax is one that establishes a clear link between the benefits received and taxes paid, without ignoring a taxpayer's ability to pay. Because of the inherently contradictory nature of these principles, and philosophical differences as to what constitutes fairness in the social arena, there is no such thing as a perfect tax.

Local government needs a broad-based system that is balanced, with a mix of types of taxes. This increases stability in the revenue base and helps to increase efficiency and equity.

As you know, the Louisiana Constitution limits the types of taxes that local governments can impose. Income taxes, for example, are off limits. Today, I'll focus on the two local taxes that affect residents the most: sales and property taxes. After that, I'll finish with a discussion of assessments.

SALES TAX

The sales tax rate in Orleans Parish is 9%. Of that, 4% goes to the State, 2.5% to the City's general fund, 1.5% to the School Board and another 1% to the Regional Transit Authority. The City's 2.5% sales tax is projected to generate $135.9 million in 2011.

Like all taxes, the sales tax has advantages and disadvantages.

- To begin with, the impact of the sales tax is less noticeable than the property tax because it is collected in small amounts throughout the year.
- The sales tax can be easily exported to nonresidents, making it particularly attractive for tourist destinations, such as New Orleans.
- It is simple and applied in an even-handed manner. It is directly correlated to actual purchase prices, rather

Area Sales Tax Rates

St. Tammany Parish (City of Mandeville)	9.25%
Orleans Parish	9
St. Bernard Parish	9
Jefferson Parish (Metairie)	8.75
Plaquemines Parish	8

Source: Louisiana Association of Tax Administrators.

than estimates of value.

- Sales taxes capture taxes from a broader base than property taxes, such as nonprofits and homestead-exempt citizens.

The main shortcoming of a sales tax is that it is regressive, meaning that it affects low-income residents more heavily than others. That's because they spend a greater proportion of their income on necessary purchases subject to the sales tax.

In addition, sales tax collections are directly correlated with consumer confidence and the vagaries of the business cycle — a problem when the economy slows down.

Based on the existing collection rate, raising the sales tax rate by ¼ percent would yield around $13.6 million in additional revenue. However, any decision to increase the tax would have to be considered in the regional context. Here there's a competitiveness issue. New Orleans' sales tax rate already hovers near the top in the region. It is higher than in neighboring Jefferson Parish, the region's retail hub. A significant increase could drive more retail dollars out to surrounding parishes, or to the internet. (Higher property taxes, of course, have a similar effect, because they increase the cost of doing business.)

Any increase in the sales tax rate would require approvals from both the State Legislature and local voters.

PROPERTY TAXES

Now, let's take a look at property tax exemptions.

Currently, taxpayers in New Orleans pay about 148 mills of property tax on a citywide basis. Of that millage, 69 mills go to the City and the Board of Liquidation, mainly for City operating expenses and debt. In 2011, property taxes are expected to generate $384.6 million for all local government entities in Orleans Parish, and $182.1 million for the City alone.

As it stands, New Orleans' tax rate is high compared to most surrounding jurisdictions. While it remains below those in Mandeville and Slidell, it stands nearly 50% higher than the rates in Metairie and Chalmette.

Since 1966, when the Matteson report identified nonprofit exemptions and the homestead exemption as major impediments to a healthy financial picture, the underlying fiscal structure has not significantly improved. In fact, constitutional changes have exacerbated the problems. In the 1970s and early 1980s, the State increased the level of the homestead exemption. The 1974 constitution muddied the legal waters limiting nonprofit exemptions and expanded the realm of eligible properties. A State program designed to compensate local jurisdictions for losses under the homestead exemption did not keep pace with inflation, making compensation just a fraction of what it once was.

Current Millage Rates

St. Tammany Parish (City of Slidell)	176.12
St. Tammany Parish (City of Mandeville)	158.58
Orleans Parish (East Bank)	147.58
Jefferson Parish (Metairie)	102.70
St. Bernard Parish (Upper)*	102.39
Plaquemines Parish	62.53

* Upper St. Bernard refers to Wards 1 through 5A, which consists of Arabi, Chalmette, Meraux and portions of Violet.

Source: Parish assessors' offices.

THE REAL ESTATE PROPERTY TAX BASE: 1996 VS. 2011

	Assessed Value			Share of Total Assessed Value	
	1996	2011	% Change	1996	2011
All Real Property	$2,544,000,000	$3,926,460,810	54.3%		
Taxable Property	$902,068,224	$2,220,301,170	146.1%	**35.46%**	**56.55%**
Exempt Property	$1,641,931,776	$1,706,159,640	3.9%	**64.54%**	**43.45%**

Source: BGR calculations; Orleans Parish Real Property Tax Roll, 2011.

When BGR analyzed New Orleans' property tax base 15 years ago, it found that about two-thirds of the real estate tax base was exempt from taxation. In dollar terms, $1.7 billion of the total assessed value of $2.5 billion was not taxed. BGR calculated that if all exemptions on private property were eliminated, the tax rate could be cut in half – or revenue could be nearly doubled, from $142.8 million to $265.8 million.

Since BGR released that report, taxable property valuations have gone up. However, the basic structural problems remain. So let's look at property tax exemptions in more detail, beginning with the homestead exemption.

Currently, the total assessed value of property in Orleans Parish is $3.9 billion. Of that amount, $1.7 billion – or 44% of the total – is off the tax roll. The largest portion of tax-exempt property, more than half, is owned by government entities. Most of the balance is evenly split between property shielded by the homestead exemption and the nonprofit exemption. Currently, each of these exemption protects approximately 10% of the city's property value from taxation.

THE NONPROFIT EXEMPTION: MORE LAND, LESS VALUE

	Assessed Value			Share of Total Assessed Value	
	1996	2011	% Change	1996	2011
Nonprofit Exemption	$476,600,000	$384,490,030	-19%	18.73%	9.79%

Number of Tax Records		
1996	2011	% Change
3,028	4,869	+61%

Source: BGR calculations; Orleans Parish Real Property Tax Roll, 2011.

The percentage of assessed value currently off the tax rolls is significantly lower than the two-thirds that was off the rolls in 1996. This would, if based on good numbers, indicate a move in the right direction. Unfortunately, however, the numbers suffer from severe data limitations. To begin with, the assessors do not keep assessments up to date. Indeed, while the total assessed value of property has risen by 56% since 1996, the assessed value of all exempt property has remained virtually unchanged. In the case of the nonprofit exemption, the value has actually *declined* by 20%, even as the number of records for nonprofits has increased by 61% (see table on previous page).

In addition, the tax-exempt rolls contain obvious errors. For example, the portion of Tulane's campus between St. Charles Avenue and Freret Street has a land value of $58 million. The adjacent and larger parcel, owned by Loyola University, inexplicably has a land value of $0.

The bottom line is that policy makers and the public lack good information on the value of exempt properties, other than homestead-exempt property. This will seriously hamper your ability to calculate the price tag for exemptions, to perform a cost-benefit analysis of exemptions and to quantify the impact of proposed reforms.

EXEMPTIONS

Before moving on to individual exemptions, I'd like to talk briefly about the concept of exemptions. Tax exemptions are basically indirect subsidies for certain property owners. Although they occur off the books and are seldom accounted for in budgets, they have real consequences for both government bodies and non-exempt taxpayers.

They affect homeowners, renters and businesses. Ironically, in a community that is constantly fretting over economic development, the impact of these tax transfers falls most heavily on businesses. That's because commercial improvements are assessed at a 50% higher rate than residences.

BGR has taken the position that tax subsidies should be analyzed with the same stringency as any direct subsidy.

Government Exemption

As noted previously, the largest segment of tax-exempt property is government owned. It includes federal buildings, City holdings, State properties, public hospitals, the port's property, public schools and universities, parks and preserves. The assessed value of this category of tax-exempt property has actually grown over the last 15 years. In addition, the number of government-owned parcels has more than doubled, mainly as a result of State buyouts of flood-damaged properties after Katrina.

Homestead Exemption

Now let's turn to the homestead exemption. As you know, the Louisiana Constitution exempts up to $7,500 of assessed value, insulating the first $75,000 of a home's value from property taxes. However, the homestead exemption doesn't apply to municipal taxes levied by any of the roughly 200 municipalities in Louisiana.

Any, that is, except one: New Orleans.

In New Orleans, properties valued at less than $75,000 pay a small portion of the millages – those dedicated to police and fire protection. These are currently set at 10.47 mils. A homestead valued at $75,000 received a $79 tax bill this year.

According to the assessors' records, more than 53,939 homeowners take the homestead exemption. Approximately one-fifth of them have homes valued by the assessors at no more than $75,000. This is a decline from the pre-storm situation, when half of all homesteads fell into that category. Due to an anomaly in the law governing disaster-impacted homes, the number of fully exempt homes could tick upward next year.

This year the homestead exemption shielded $384 million of assessed value ($3.84 billion fair market value) from most taxation. The absolute value of the exemption has declined significantly post-Katrina: It fell by approximately $80 million post-Katrina as a result of a 27% decline in the number of homesteads. However, it still represents approximately 10% of the assessed value in the parish.

How does the homestead exemption affect government revenues and millage rates? If the exemption were eliminated and millage rates maintained at current levels, tax recipient bodies would see a $37.1 million increase in their revenues. The City of New Orleans' share of the increase would be $11.8 million. If the exemption were eliminated and the millage rolled back to a revenue-neutral level, taxes in Orleans Parish could be reduced by approximately 21 mills.

Eliminating the homestead exemption would affect taxpayers differently, depending on whether they now enjoy the exemption and whether the millages were reduced or held steady. A couple of examples help to illustrate the point.

If the homestead exemption were eliminated and millage rates maintained at current levels, the owner of a house valued above $75,000 would pay an additional $1,030 in property taxes. If the homestead exemption were eliminated and the millage reduced to a revenue-neutral level, the additional tax for a property valued at $75,000 would be $950 rather than $1,030. Taxpayers with non-exempt properties, including rental properties, would see their tax bills reduced.

BGR has consistently recommended elimination of the homestead exemption. Concerns about low-income residents can be addressed through a needs-based exemption, known as a circuit-breaker.

Assessment Freezes

The constitution provides assessment freezes for homeowners over the age of 65, as well as for disabled homeowners and members of the military (and their families) killed in action, missing in action or a prisoner of war. The assessments for these homesteads are frozen at the current level for the rest of their lives, assuming they meet certain income requirements. It is currently $64,400.

Roughly one-fifth of all homesteads are benefiting from a freeze. A little less than half of the assessments are frozen below the homestead threshold, meaning they pay next to nothing in taxes. In some cases, the impact of the freeze is compounded by historic underassessment.

While the freeze helps some on fixed incomes, it also results in an intergenerational transfer of taxes. Young people struggling with the expenses of their stage of life, like the expenses of raising children, pick up the tab.

Now, keep in mind the Baby Boom generation is reaching retirement age beginning this year. As the many homeowners who make up this demographic bulge begins to take advantage of the freeze, its negative impact on the tax base could increase.

Nonprofit Exemptions

In addition to the homestead exemption and freezes, the constitution exempts property owned by a wide array of nonprofit entities. The constitution exempts property owned by:

- Nonprofits "organized and operated exclusively for religious, dedicated places of burial, charitable, health, welfare, fraternal, or educational purposes …"
- Labor unions.
- Lodges or clubs "organized for charitable and fraternal purposes."
- Nonprofit corporations "devoted to promoting trade, travel, and commerce."
- Nonprofit trade, business, industry or professional societies or associations.

THE ESTIMATED IMPACT OF EXEMPTIONS ON REVENUE AND TAXES

	2011 Property Tax Revenue	Additional Revenue If… Eliminate Homestead	Eliminate Nonprofit	Eliminate Both
All Local Taxing Bodies (Incl. City)	$384,616,670	$37,117,769	$40,856,927	$77,974,696
City Only	$182,102,053	$11,849,765	$15,608,181	$27,457,946

	2011 Millage Rate	Rolled-Back Millage Rate If… Eliminate Homestead	Eliminate Nonprofit	Eliminate Both
All Local Taxing Bodies (Incl. City)	147.58	128.68	125.35	112.92
City Only	69.15	62.01	60.87	55.33

Source: BGR calculations; Orleans Parish Real Property Tax Roll, 2011.

The only limitation on these exemptions is that the property cannot be used for a commercial purpose that is unrelated to the exempt purposes of the nonprofit entity.

The Constitution also allows an exemption in some cases where the nonprofit does not own the property. It exempts property leased for no more than one dollar per year to a nonprofit for housing for the homeless and "property used for cultural, Mardi Gras carnival, or civic activities and not operated for profit to the owners." It also contains a special exemption for Tulane exempting up to $5 million of property that would not qualify for other exemptions.

As noted above, a tax exemption is in reality a subsidy, and there should be an identifiable quid pro quo for granting it. The framework for exemptions should be based on a clear articulation of the types of services or benefits that the government considers worthy of its indirect financial support. These services could be narrowly defined as services that the government would have to provide if the nonprofit community did not. They could be more broadly defined to include services and amenities that the government considers important to the quality of life in the community. In any case, exemptions should not be granted merely on the basis of nonprofit status.

According to the tax rolls, the nonprofit exemption shields $385 million of the city's assessed value – or 10% – from taxation. As noted above, various factors suggest that the number may be seriously understated. However, for illustrative purposes, let's look at the impact of the exemption on governments and other taxpayers using those numbers.

If all nonprofit property were taxed, the revenue increase to tax-recipient bodies would be $41 million. The City's share would be $15.6 million. Alternatively, millage rates could be reduced by 15%, to 125 mills, without reducing local government revenues. The tax bills for the city's residents could be reduced by approximately $220 for every $100,000 of taxable property, and business owners' taxes could be reduced by approximately $330 for every $100,000 of property value.

The above numbers cover all nonprofit properties included on the tax rolls. In presenting the numbers in this fashion, BGR is not implying that *all* nonprofit property should be added to the tax rolls. Rather, it is making the point that these exemptions have a price tag, both for the other taxpayers and the City. Given the significant cost, this area deserves careful scrutiny and dispassionate analysis of the costs and benefits.

The nonprofit exemption in Louisiana in general, and in New Orleans in particular, suffers from a number of problems:

- The exemption provisions are too broad.
- They are also too vague. Qualifying exempt purposes are not clearly defined.
- The exemption does not require that the property actually be used for the exempt purpose. Property taxes apply only if a property is used by a nonprofit for a commercial purpose that is unrelated to the exempt purpose. (By the way, this was not always the case in Louisiana. The problem was introduced by the 1974 Constitution, which modified a more stringent limitation in the prior constitution).
- The exemption is not well administered, allowing ineligible property to receive the exemption.

In other words, the approach to nonprofit exemptions is extremely slack. This is of particular concern in a city like New Orleans, which serves as a hub of nonprofit activity in the region.

How does Louisiana compare to other states? When we last researched the issue, all states had cemetery, religious, educational and charitable purpose exemptions for nonprofits. This was not the case for some of the other exemptions – fraternal, trade organizations, etc. The scope of the exemptions was in some cases very strictly defined, and in other cases left wide open to interpretation. For example, the definition of religious purpose varies considerably. While some states exempt property used for religious organizations for a range of diverse purposes, others define religious purposes narrowly, limiting the exemption to property used for public worship. Operating definitions of what's charitable also vary widely.

The area of nonprofit exemptions is too complex to deal with in any detail at this meeting, but I'll give you a general summary of BGR's recommendations. These include an overhaul of the State constitution and statutes to narrow eligibility by, among other things, defining in detail the public services that a nonprofit should provide in exchange for the benefit of an exemption. The revisions should also tie the eligibility for exemption to the use of a property, rather than simply to the legal status of the organization.

BGR has recommended giving local jurisdictions the option of limiting the universe of nonprofit exemptions.

It has also recommended that both assessors and the Louisiana Tax Commission provide tighter administration of exemptions.

In addition to tightening exemptions, the Tax Fairness Commission might want to evaluate a number of alternative revenue-raising measures relating to nonprofits. These include:

1. Taxing nonprofits at a reduced rate.
2. A State reimbursement program.
3. Voluntary payments in lieu of taxes.
4. Parcel-based service charges.

We are not aware of any state that takes the first tack. A couple of states have programs to reimburse local governments for revenues lost due to the nonprofit exemption. Voluntary PILOTs and parcel-based service charges would not require action by the State Legislature. We will provide a detailed analysis of these options in a report that we hope to release in the near future.

As noted above, analysis of the nonprofit exemption is impeded by the assessors' failure to reassess such property and by obvious errors on the tax roll. In addition, use exemption codes do not match the tax exemption. Nearly half of all nonprofit exemptions granted in New Orleans – for entities ranging from charities to nonprofit hospitals to float warehouses – are all combined under one code, designated "All Other." This illogical coding system further impedes analysis of the impact of specific exemption categories.

ECONOMIC DEVELOPMENT SUBSIDIES

Industrial tax exemptions and reduced payments in lieu of taxes, or PILOTs, take still more property value off the rolls. The PILOTs we're talking about here are quite different, by the way, from PILOTs associated with nonprofits. The nonprofit PILOTs bring in revenue from entities that don't owe taxes. The PILOTs I'm talking about are development-related subsidies that reduce tax liabilities for years. In a PILOT, the assessed value of a property is effectively frozen, usually at its pre-development level, for a period of time.

Since Katrina, requests for reduced PILOTs have increased dramatically, and 17 have been awarded. This brings the total of approved PILOTs to 25. Many of these are for large-scale developments, such as the Saulet Apartments, the redevelopment of the Hyatt hotel, and the Benson Tower project. Some have received substantial government subsidies from other sources. BGR attempted to estimate their impact on the City's revenues and taxpayers but abandoned the project due to lack of reliable information on the value of properties that benefit from the exemption.

ASSESSMENTS

For decades, BGR has considered improved assessments critical to the health and fairness of the city's tax base. Past BGR reports have found that the practice of "sales-chasing" is endemic among New Orleans assessors. This approach reassesses properties as they sell at their sale price, while leaving surrounding properties at older valuations.

On the eve of Katrina, sales chasing was alive and well. Studies by the Times-Picayune and the Louisiana Tax Commission found underassessments of 41% and 25%, respectively. As a result of its findings, the Tax Commission took the extraordinary step of ordering a reassessment in New Orleans.

Underassessments can affect revenue and the millage rate. This was clearly demonstrated by the 2008 reassessment when a significant increase in assessed values led to a serious cutback in millage rates. The citywide rate fell from 175 to 129 mills. The potential revenue impact is demonstrated by the City's 7.74 roll forward, which is expected to bring in $20 million.

Right now, we don't know what the 2012 reassessments will show. But based on past history, this is an area that requires vigilance from anyone trying to create a fair and sustainable tax system.

This brings me full circle to the issue of fairness – because improving assessments isn't just a tax base issue, it's a fairness issue. If you haven't visited nolaassessor.com and scanned the parcel maps, I suggest you do so. You can find $300,000 houses assessed correctly at $300,000 – but also at $150,000. And you can find $600,000 houses assessed at $300,000. And you'll find this all within a one-block radius.

Think about what that means. The owner of the house properly valued at $300,000 and the owner of the $600,000 house are paying the same amount of taxes, but at wildly different effective rates. Leaving aside the impact of the homestead exemption for a moment, the first taxpayer's effective rate is 150, but the rate for the more expensive, underassessed house is half of that. The owner of the $300,000 house assessed at $150,000 is also paying at the half rate.

This is grossly inequitable.

Fortunately, modern technology – accompanied by recent investments in fresh appraisals by the assessor's office – opens up the possibility of fairness on a citywide basis. It opens the way for valuation of government and nonprofit-owned property, so that we can quantify the true impact of the exemptions. And it opens the way for a stronger tax base through more accurate assessments. It's all within grasp.

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BGR

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