# Municipal Property Tax Caps in Chicago

## A Preliminary Policy Brief

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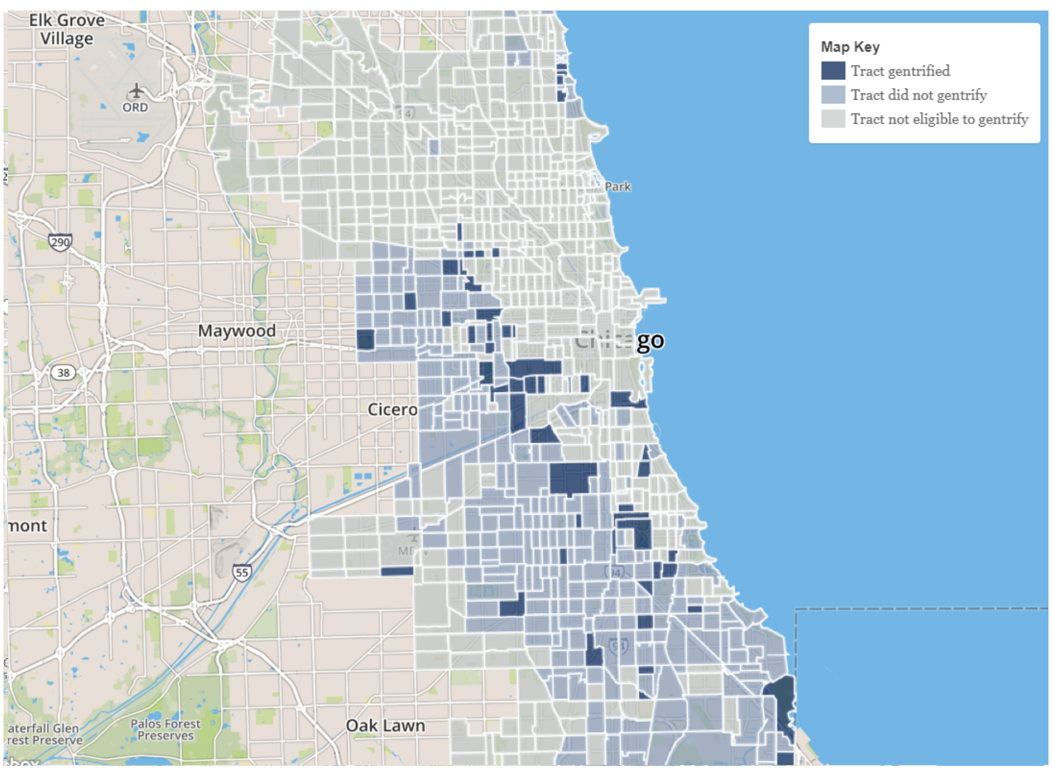
# I. OVERVIEW

A local property tax cap may be a viable method to protect low-income communities from rising home values. In the Chicago area, both low-income homeowners and small businesses face an affordability crisis, and in certain neighborhoods, increasing property values, changes in the cost of living, and social network disruption collectively amount to gentrification (Nyden et al. 2006, 19-20). While neighborhoods are classically assumed to face a tradeoff between economic development and decreased affordability, there may be room for innovative policy solutions to encourage development without displacing current residents. This brief provides initial insights on how a property tax cap may serve as one tool to mitigate gentrification. We outline potential benefits, consequences, and specifications of the implementation of a property tax cap. While further research is required to assess the impact of such a policy, this brief can guide initial conversations for local policymakers.

# II. EBB EXPANSION STRATEGY RECOMMENDATION

Here we define gentrification as the displacement of an area's current residents and businesses due to increasing local property values. Typically, gentrification occurs in historically disadvantaged communities in urban areas, affecting low-income and minority individuals, families, and businesses. Figure 1 visualizes gentrification's geographical reach in the city of Chicago, by U.S. Census tract. 17% of eligible tracts became gentrified over the past ten years, and several neighborhoods witnessed increases in median home values between 150%-250% (Governing 2018). Tracts are considered "eligible" if their household income and home values are in the lowest 40% of the city, and "gentrified" if income and home value increases are in highest 30%. (Governing 2018).

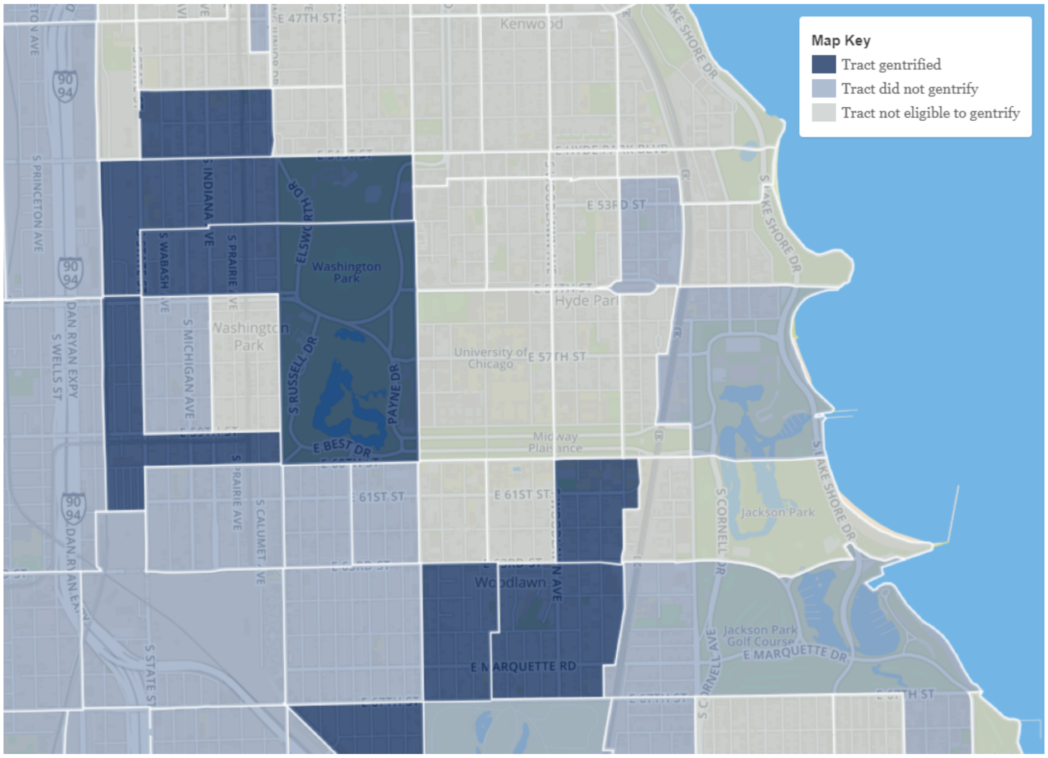
**Figure 1. Gentrification in Chicago**




Graphic from "Chicago Gentrification Map: 2000 Census - Present." Note: "data shown correspond to current tract boundaries, which may have changed from prior Census years" (Governing 2018).

The immediate area surrounding the University of Chicago has undergone especially concentrated gentrification. Three tracts in Woodlawn and four tracts in Washington Park are considered to be have been gentrified between 2000 and 2010, with an average of 50% increase in median home value.

**Figure 2. Gentrification Near the University of Chicago**




Graphic from "Chicago Gentrification Map: 2000 Census - Present." (Governing 2018).

## III. BENEFITS AND COSTS OF A PROPERTY TAX CAP

At their most basic function, property tax caps serve to reduce the financial burden of property ownership. They provide direct financial relief, offer ways to aid specific population subgroups, and enable solutions through relatively simple legislation. Property tax caps are a particularly useful policy tool to combat gentrification, as they can help existing low-income residents and owners continue to afford annual payments as surrounding property values increase. If successful, they can even allow low-income residents to benefit from local economic growth, job creation, and neighborhood development from which they would otherwise be priced out. However, property tax caps have historically created adverse consequences, including:

- substantial revenue loss for municipalities,
- cuts to local public services,
- intergenerational transfer cost spikes, and
- limited efficacy in relieving gentrification effects.

What explains the gap between theory and practice? We review prior issues with property tax caps, using California, Indiana, and Massachusetts as case studies.

**Municipal revenue loss** and its consequent **cuts to public services** are the most significant negative impacts of property tax caps. After Massachusetts passed a tax cap in its 1980 Proposition 2½, several communities laid off municipal employees, closed libraries, or froze government wages (CBPP 2008). California's decline in statewide public school ranking has often been attributed to the 1978 passage of Proposition 13 (McCombs et al. 2005). One study examining Indiana's 2010 constitutional amendment found that the cap it created affected some county revenues substantially while leaving others unchanged. In counties with the greatest revenue loss, local school systems often suffered the worst cuts (Faulk 2013).

Property tax cap laws that fail to stipulate for **intergenerational transfers** can also exacerbate displacement issues. In a neighborhood with a property tax cap and upward price pressure, a beneficiary inheriting property can face sudden and substantial increases in taxes, as the property's taxes are reassessed to market value with a new owner. California's Proposition 13 allows family members to transfer property without any reassessment (such a mechanism is sometimes called a "Homestead exemption") , but no other tax cap law has addressed this issue (International Property Tax Institute 2018, 3).

And finally, property tax caps may be **ineffective at their goal** of combating gentrification; in fact, this has historically been the norm. While in theory the caps protect low-income property owners, California's Proposition 13, Indiana's Constitutional amendment, and Massachusetts's Proposition 2½ applied statewide flat caps *across all property value levels*. As a result, owners of more valuable property save more in property taxes than owners of less valuable property. The burden of the lost tax revenue (and its resultant cuts to public services), however, falls upon the entire population, possibly even having harsher effects on lower-income citizens, as they depend more on public services than the wealthy. By this logic, a property tax cap placed on all properties may hurt the poor more than it helps them, although this conclusion is impossible to defend without a model or data. Moreover, flat caps can work to shift tax burdens to properties with slow or negative value changes (ITEP 2011), so rigid caps can adversely affect low-income families in other, non-gentrifying neighborhoods with constant lower property values.

# IV. PROPERTY TAX CAP MODELS

**Table 1. Type of property tax cap used in three state case studies**

| State, Measure | Type | Funding |
|---|---|---|
| California, Proposition 13[1] | Freeze (1976 levels), Rate cap (1%), Assessment cap (2%) | Traditional tax, State redistribution |
| Indiana, Constitutional Amendment[2] | Rate cap (1% Homesteads, 2% Residential and Agriculture, 3% Personal Property) | Local Option Income Tax (LOIT) |
| Massachusetts, Proposition 2 ½[3] | Rate cap (2.5%) | Traditional tax |

[1]Cal. Const. art. XIII A. http://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=CONS&division=&title=&part=&chapter=&article=XIII%20A
[2]S.J.R. 1, Sess. of 2010 (Ind. 2010), http://www.in.gov/legislative/bills/2010/RES/SJ0001.3.html
[3]Mass. Gen. L. c. 59, § 21C https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter59/Section21C

While challenges have plagued prior property tax caps, there are several alternative cap models that could easily circumvent these issues. Consider three proposed types of caps (CBPP 2008):

- **Rate caps**, a percentage restriction on the property tax rate;
- **Assessment caps**, a percentage restriction on the annual increase in the assessed value of a property; and
- **Total levy caps**, a percentage restriction on the revenue a municipality can collect;

as well as three proposed funding models:

- **Traditional**, offering no reimbursement;
- **Local Option Income Tax (LOIT)**, providing state subsidies to municipalities to offset revenue loss; and
- **"Circuit-breaker"**, providing state subsidies to individuals directly, as long as their property tax exceeds a certain portion of their income.

Many of these specific policies have never been tested, or have been combined into compound policies in a way that canceled the benefits they might afford if implemented alone. As shown in Table 1, each of the three states we examined used a Rate cap, either alone or in combination with other provisions. In general, Rate caps can create a significant revenue impact, as they limit taxable value directly across all levels of property values. In California, for instance, municipalities suffered substantial losses which led to service cuts, as discussed previously. Under Proposition 13, the State controls property tax revenue disbursement (LAO 1996), partially as a way to curtail revenue loss. Though this control aimed to aid municipalities with a disproportionately large volume of services (Los Angeles, for example), the redistribution was not enough to compensate for overall service cuts. With the exception of Indiana, nostate policy has stipulated any funding reimbursement for local governments. A Total levy cap can create possibly even greater fiscal woes than those of a Rate cap, since it directly restricts the financial autonomy of municipalities.

While the historical record of property tax caps is not promising, we predict that Assessment caps could ease the burden of rising property values on residents without resulting in severe fiscal challenges. Consider that where Rate caps decrease current revenues by immediately reducing property taxes, Assessment caps only alter future revenues, slowing the growth of property taxes but not actually decreasing them in the short term. Consequently, Assessment caps cause much less need to cut present services than do Rate caps. An Assessment cap could also specifically target gentrification effects while not losing revenue from non-gentrifying communities; it could be constructed to only restrict value changes on homes that are valued below a certain dollar amount, or even on homes owned by homeowners below a certain income percentile. Such a policy could protect at-risk homeowners from being displacement, but avoid significant revenue decreases for the city.

Further research will be required to assess and quantify the potential impacts of a Property Tax Assessment Cap. Additionally, legal mechanisms will need to be proposed to ensure intergenerational transfers do not impose financial burdens, likely taking the form of a traditional Homestead exemption. However, by using the correct model and funding structure, a property tax cap may be a very effective policy tool to combat gentrification. Proper design can easily solve challenges tax caps have created in the past, while ensuring their intended benefits protect the people and places that need it.

## V. CONCLUSION

While property tax caps have potential as a powerful combatant of gentrification, they have historically resulted in significant municipal revenue losses and service cuts. However, we theorize that an Assessment cap, limiting the proportion by which a property's taxable value can increase year-to-year, could limit budget cuts while also strategically easing the tax burden on those homeowners most at risk of gentrification. Research on the expected financial impact of a property tax cap, the legal constraints surrounding legislation and implementation, and possible proposals on how to supplement revenue loss will be needed to more confidently propose a specific policy.

For questions or comments on this brief or our other work, please contact policy@pauldouglasinstitute.org.

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