To: Lexington Select Board
From: Joe Pato, Lexington Select Board Member
Date: 23 November 2021

ITEMS TO CONSIDER IN SETTING FY22 RESIDENTIAL RATE FACTOR

RECOMMENDATION

Do not reduce the **Residential Rate Factor (Factor)** from the current 1.75 rate.

- Reducing the Factor will impose a burden on residential taxpayers who have seen significant increases over the past 7 years.
- Providing this benefit to commercial[1] taxpayers will do little to help small businesses around town while imposing an appreciable burden on residential taxpayers.
- Any change to the Residential Factor should follow an analysis and policy recommendation.

RECENT HISTORY OF SETTING THE FACTOR

The last time the Board adjusted the Factor was in 2014 for FY15. At that time a DOR-mandated data re-validation coupled with rapidly increasing residential property values and stagnant commercial property values led to large increases in residential property taxes. The average increase in value for Single Family Dwellings was over 10%, but the range of change was quite wide, from -15% to over 35% for individual unimproved properties (i.e., those dwellings where the tax change was not related to permits and construction[2]). About 20% of unimproved residential properties, roughly 1800 dwellings, saw an increase of over 15% in value. That pattern of increasing residential property taxes and stagnant or decreasing commercial property taxes continued for several years.

Prior to 2014, changes in the Factor were a result of changes in state law[3] allowing communities to temporarily employ a factor greater than 1.75 (up to 2.0) in response to residential property values increasing rapidly during the housing bubble of the early millennium. This allowed Lexington to adopt a Factor of 1.8 in 2004 and 2005 and then reduce to 1.78 in 2006, 1.74 in 2007, and stabilize at 1.7 in 2008.

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[1] For simplicity I will use the word "commercial" to mean all commercial, industrial, and personal property taxes (aka CIP) onto which taxes are shifted from the residential sector when a split tax rate is in effect.

[2] Lexington FY 2015 Assessment Valuation Status Report to Summit II, 11/7/2014.

[3] [Session Law - Acts of 2004 Chapter 3 (malegislature.gov)](https://malegislature.gov/Laws/SessionLaws/Acts/2004/Chapter3)
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RATIONALE PRESENTED FOR LOWERING THE RESIDENTIAL RATE FACTOR

During the tax rate-setting hearing held on November 15, staff suggested that, given the greater increase in commercial property values this year relative to the increase in residential property values, the Select Board may want to consider reducing the residential rate factor.

Later in the hearing, a resident observed that "there are many more small businesses out there that are hurting and are close to considering closing than people realize, so anything we can do to relieve their tax burden in this particular year would be great."

ANALYSIS OF LOWERING THE RESIDENTIAL RATE FACTOR

As we consider lowering the Factor, we should examine how it affects our community; what does the change do to residential taxpayers and what benefits accrue in the commercial sector. We should consider whether using this tax shift tool is the best mechanism for assisting those in our community who have suffered financially because of the Covid-19 pandemic.

REDUCING THE FACTOR WILL IMPOSE A BURDEN ON RESIDENTIAL TAXPAYERS WHO HAVE SEEN SIGNIFICANT INCREASES OVER THE PAST 7 YEARS.

The average single-family home has seen significant property tax increases over the past 7 years. The cumulative increase in tax burden from FY14 (the last year before adopting the 1.75 Factor) and FY21 is 41%. This is an average increase of 5.1% per year[4]. For comparison, a 2.5% increase per year would have only yielded a 19% increase between FY14 and FY21.

Changing the Factor from 1.75 to 1.70 for FY22 would increase aggregate taxes on residential taxpayers by $1,390,921. On average, this is an increase of $138 for single household dwellings and increase of $107 for the residential miscellaneous category. Table 1 shows how many households exist in the two major residential categories and how much incremental tax the average household will pay if we retain the 1.75 Factor and the same for adopting the 1.70 Factor. The Savings/(Cost) column show how much less or (more) the average household would pay. The Total Savings / (Cost) column shows the total amount of tax paid by this property category. In Table 1, a change from the 1.75 to 1.70 Factor will result in increased costs for residential payers.

Residential Owners	Count	1.75 Factor	1.70 Factor	Savings / (Cost)	Total Savings / (Cost)
Single Household Dwelling	9058	213	351	(138)	(1,249,215.56)
Residential Miscellaneous	1320	250	357	(107)	(141,705.63)
	10378				**$ (1,390,921)**

Table 1- Increase in FY22 taxes over FY21 for Residential Properties

[4] See Exhibit C, Town of Lexington Fiscal Year 2022 Property Tax Classification Packet

For context, the projected FY22 effect[5] of the 2017 debt exclusion for the new Fire Station was an increase of $94 on the tax bill for the home of median value. Choosing to add a tax burden of this magnitude is one we typically analyze in detail.

PROVIDING THIS BENEFIT TO COMMERCIAL TAXPAYERS WILL DO LITTLE TO HELP SMALL BUSINESSES AROUND TOWN.

The relatively large increase in commercial property value for FY22 is “primarily attributable to the growth we have seen in values for lab / office space; this is a trend that is growing, it is not only in Lexington it is everywhere”[6] due to substantial increases in rents and demand for those spaces. Given that this increase in value is occurring everywhere, there is little likelihood that Lexington will be placed at a competitive disadvantage based in increased taxes for these properties. In addition, the large increase in personal property tax is due to the increase in the number of lab office companies, the addition of new equipment for these businesses, and in the deployment of new utility infrastructure.

The large increase in commercial property value is due to changes in demand for lab space and is not manifest in the small business properties of the Town-wide Retail and Office & Retail Condo property segments. Changing the Factor from 1.75 to 1.70 for FY22 would only decrease taxes on small business taxpayers by an aggregate of $146,839. Using the Factor as the mechanism to aid small businesses at the expense residential ratepayers is grossly inefficient. Small businesses would see a benefit that is only about a tenth of the increased taxes paid by residential ratepayers. Table 2 shows the relative changes in these two property segments and shows the relatively small number of properties in this category.

Small Retailers	Count	1.75 Factor	1.7 Factor	Savings / (Cost)	Total Savings / (Cost)
Town-wide Retail	71	590	-791	$ 1,381	$ 98,047
Office & Retail condo	240	-73	-276	$ 203	$ 48,792
Net to sector	**311**				**$ 146,839**

Table 2 - Decrease in FY22 taxes over FY21 for Small Business Properties

If the intent is to provide relief to small businesses, it would be much better to allocate ARPA funding or other funding to directly provide economic stimulus.

A CHANGE TO THE RESIDENTIAL FACTOR SHOULD FOLLOW AN ANALYSIS AND POLICY RECOMMENDATION

As noted above, increasing the Factor from 1.70 to 1.75 in FY15 was the consequence of significant changes in residential values. This process was deliberate and involved planning and public discussion. During the summer of 2014, the then-Town Manager came to me as chair of the Board of Selectmen and outlined anticipated challenges with FY15 residential valuation increases. We agreed on a plan of analysis and communication. Staff proceeded to conduct detailed analyses of the valuation changes and profiled the effect of different choices for the Factor. The Town reached out to the public during the fall so that property owners could see these new valuations and have an

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[5] Updated Analysis-Taxpayer Impact of Debt Exclusion Questions, Financial Summit 2, November 14, 2017

[6] Gregory A. Johnson, chair Lexington Board of Assessors, at timestamp [36:00] https://videoplayer.telvue.com/player/c0gKv9ZUF0uiidDafFfESDZA5EkkJp7L/playlists/8745/media/682164

opportunity to understand the basis for the changes. The Assessors also presented to Financial Summit II on November 7, 2014, where the issue was discussed. The Board received input from committees, including the Economic Advisory Committee, and then proceeded to adopt the 1.75 Factor at its rate setting meeting on December 1, 2014. Reaching consensus on raising the rate was the result of a process that took over four months of analysis and public discussion. Outreach did not end with rate setting; a public information session was held on December 9, 2014, at the Clarke Middle School so that the Board of Assessors could outline the effects of the valuation changes.

RECOMMENDATION RECAPPED

Do not reduce the **Residential Rate Factor (Factor)** from the current 1.75 rate.

Reducing the Factor will increase residential taxes by an appreciable amount while providing limited benefit to small businesses. The same amount of relief for these small businesses can be provided through ARPA funds or targeted economic stimulus in the budget without creating this additional burden on residential taxpayers.

Long-term plans to reduce the Factor should be the result of careful analysis and community consensus.