

## WASHINGTON STATE TAX STRUCTURE STUDY

### Home Ownership - Findings

#### **The impact of taxes on the ability to purchase and retain a home**

- Taxes (sales and/or real estate excise) as a percent of the purchase price of a home range between 1.8% and 7.1% depending on whether the home is existing, spec- or custom-built.
- Development impact fees range from zero to about 2.7% of the purchase price of each home in a new housing development.
- Property taxes average about 1.3% of the market value.
- Property taxes do not play a large role in determining whether a prospective buyer can qualify for a home loan.
- About 70% of homeowners pay less than 4% of their income in property taxes; almost 50% pay less than 3%.
- Almost 6% of homeowners pay over 8% of their income in property taxes.

#### **The impact of taxes on the ability to purchase or retain a home by low-income persons**

- Mortgage interest and principal payments, rather than property taxes, determine the ability of below-median income households to qualify for home loans. The typical first-time home buyers in 16 counties are not able to afford the median-priced home.
- Property taxes can impact the ability of homeowners to retain their homes, especially in circumstances where home values rise and income remains fixed (retired) or drops dramatically (job loss, disability, etc.).
- Washington has two programs that provide property tax relief to disabled and senior citizens. One program, for persons 61 and over, provides substantial relief for households with incomes under \$30,000. The other, for persons 60 and over with household incomes under \$34,000, allows participants to be relieved of any remaining property tax for the rest of their lives.
- Some homeowners have high property taxes as a percent of income but do not qualify for either program, either because of age or income.

## Home Ownership

- 1) Do taxes impede the ability to purchase and retain a home?
- 2) Does our tax system make the purchase of a home difficult for low-income households?
- 3) Does our tax system cause difficulties for fixed-income homeowners to retain their homes?
- 4) Do impact and mitigation fees increase the cost of homes?

### Taxes and the Price of Homes

Tax liability on the purchase of a home differs depending on whether the home is a new house built on speculation (spec-built), a new custom-built house or a used house.

The basis for the tax applications is as follows.

#### Construction of a New Home by a Custom Builder

- The customer for whom the home will be constructed owns the land. The seller of the land pays real estate excise tax on the sales price.
- The customer is the consumer for purposes of the sales tax and is legally obligated to pay sales tax on the total contract/construction price (labor and materials) agreed upon between the customer and the custom builder (general contractor).
- Purchases of materials by the custom builder are wholesale sales because they are purchases for resale (incorporated into the building) to the property owner/customer/consumer.
- Any work on the project that is done by sub-contractors is also a wholesale sale if the work is contracted by and done for the general contractor. As such, the general contractor does not pay sales tax on these costs since the sales tax will be collected from the property owner/consumer as part of the overall project cost. If the property owner contracts directly with a sub-contractor sales tax is collected from the owner by the sub-contractor on the cost of the job.

#### Construction of a New Home by a Speculative Builder

- The spec builder owns the land. The seller of the land to the spec builder paid real estate excise tax on the sales price.
- The spec builder is the consumer for purposes of the sales tax because, at the time of the construction, there is no known buyer for the house. The sales tax is paid by the spec builder on purchases of all materials incorporated into the structure.
- As the consumer, the spec builder is obligated to pay sales tax on the costs charged by any sub-contractor engaged to perform some part of the building project.
- The home, once completed and permanently attached to the land, becomes real property. The subsequent sale of the home is subject to the real estate excise tax (sales price of the land and the structure) paid by the spec builder.

Sale of an Existing Residence

- Real estate excise tax is paid by the seller on the value of the real property conveyed. To the extent that personal property is included in the sales price, such as appliances, furniture, carpeting, drapes, etc) use tax should be reported by the purchaser. If the sale of the residence is by a business that is registered with the Department of Revenue, they should collect sales tax from the purchaser.

**Table 1**

<b>TAXES ON MEDIAN-PRICED HOME IN KING COUNTY (2001)</b>			
<b>Median Home Price=\$260,700</b>			
<b>Item</b>	<b>Sales Tax</b>	<b>REET</b>	<b>Total</b>
<b>Custom Built Home</b>			
Purchase of land (owner)	No	Yes	\$1,019
Purchase of construction materials	No	No	0
Cost of sub-contractors	No	No	0
Contract/construction price to owner	Yes	No	17,498
Total			\$18,517
Percent of median home price			7.1%
<b>Spec Home</b>			
Purchase of land by spec builder	No	Yes	\$1,019
Purchase of construction materials	Yes	No	5,122
Cost of sub-contractors	Yes	No	3,842
Sale of home and land to purchaser	No	Yes	4,640
Total			\$14,623
Percent of median home price			5.6%
<b>Existing Home</b>			
Sale of home and land to purchaser	No	Yes	\$4,640
Percent of median home price			1.8%

Builders of homes in a new housing development are sometimes required to pay impact fees to pay for additional infrastructure to service the community (e.g., roads, schools, and parks). Builders of homes that are not a part of a new development or purchasers of used homes do not pay impact fees. Some jurisdictions do not impose impact fees. As with sales tax, builders are able to pass a portion of impact fees onto purchasers depending on market conditions.

Table 2 shows the impact fees that builders pay on the median-priced spec-built homes in selected jurisdictions. Impact fees vary considerably by jurisdiction and can range from zero (where they are not imposed) to 2.7% of the purchase price.

**Table 2**

**Impact Fees Paid on Spec-Built Homes in Select Jurisdictions (CY 1998)**

<b>Unincorp. King County (outside RTA)</b>	
Median-Priced Single Family Residence	\$217,000
Parks (average)	2,000
School (average)	2,575
Streets and Roads (average)	1,301
King Total	\$5,876
Taxes as percent of purchase price	2.7%
<b>Redmond</b>	
Median-Priced Single Family Residence	\$217,000
Fire Protection	78
Parks	1,478
School	0
Streets and Roads	967
Redmond Total	\$2,523
Taxes as percent of purchase price	1.2%
<b>Tumwater, Thurston County</b>	
Median-Priced Single Family Residence	\$128,000
Parks	564
School	1,703
Streets and Roads	979
Tumwater Total	\$3,245
Taxes as percent of purchase price	2.5%
<b>Unincorp. Pierce County</b>	
Median-Priced Single Family Residence	\$137,800
Parks	0
School	985
Streets and Roads	0
Pierce Total	\$985
Taxes as percent of purchase price	0.7%

Note: Impact fees are from a 1998 Washington Association of Counties survey.

Both retail sales tax rates and real estate excise tax rates vary by jurisdiction. The table below shows the highest and lowest rates of each of the taxes.

	Lowest rate	Highest rate
Retail sales tax	7.0%	8.9%
Real estate excise tax	1.28%	2.78%

**Taxes and the Ability to Qualify for a Home Loan**

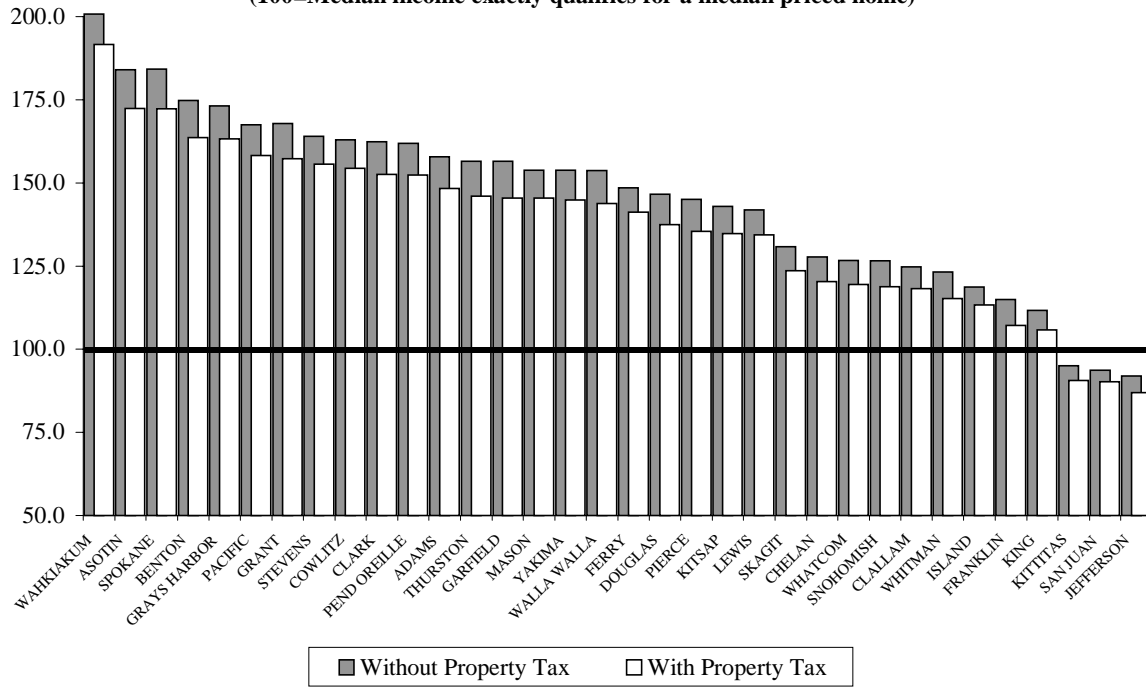
Property taxes play a role in the ability to qualify for a mortgage. The rule of thumb for making mortgage loans is that the mortgage payment plus property taxes on the home plus homeowner insurance should not exceed 28% of the purchaser's income. Property taxes constitute 4.6% of the median household income based on a median-priced home.

Charts 1 and 2 compare affordability indices across Washington counties. (The charts are based on data from the Washington State University Center for Real Estate Research and Office of Financial Management estimates of 2001 median household income.) Chart 1 shows an affordability index for all households. The index is equal to the income required to qualify for a home at the median price given the 28% rule, divided by median income.

An index higher than 100 indicates that median-income households have more income than is required to sustain a mortgage on the median-priced home. An index less than 100 indicates that the median-income family does not have enough income required to sustain a mortgage on the median-priced home. For example, the dark colored bar for Wahkiakum County in the chart below shows that the index for Wahkiakum is about 200. This means that the median-income family in Wahkiakum County has about twice (200%) the income needed to sustain a mortgage on the median-priced home. In Jefferson County, the median-income family does not have sufficient income to sustain a mortgage on the median-priced home. The median-income family in Jefferson County has only 87% of the income to sustain a mortgage on the median-priced home. Notice that in three Washington counties, median-income families are not able to qualify for median-priced homes.

The two bars on the chart represent the index with and without property taxes. The dark bar is the full index, which includes property tax in the calculation of the qualifying payment. The light bar in front is the index without property tax in the qualifying payment. By comparing the two bars, one can see the impact of property tax on affordability. The chart shows property tax is not a large driver in affordability. Also notice that generally, the less affordable a county's homes are, the smaller the role played by property taxes in affordability. Higher property values tend to have lower property tax rates. This is because jurisdictions that have a larger value base to tax are generally able to have lower property tax rates to pay for local needs.

**Chart 1**  
**Qualifying for a Single Family Home by County**  
 (100=Median income exactly qualifies for a median priced home)



**Chart 2**  
**First Time Home Buyer Qualifying for a Single Family Home by County**  
 (100=Median income exactly qualifies for a median priced home)

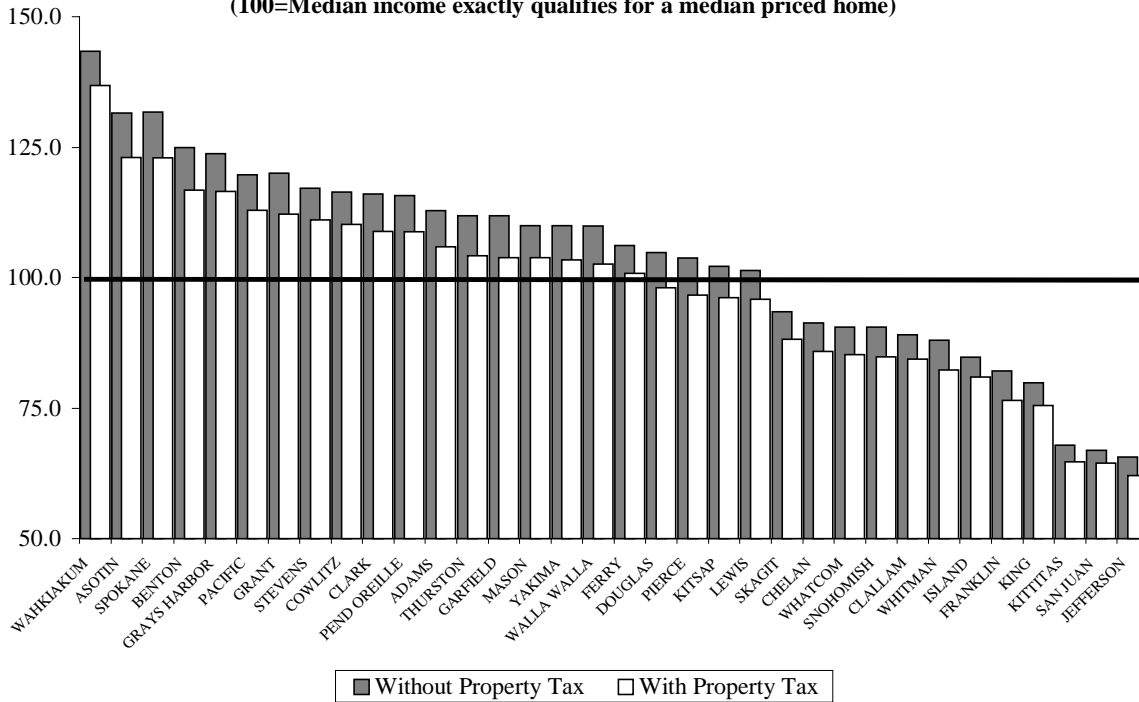


Chart 2 on the previous page shows the affordability index for *first time* homebuyers. This index compares median income for first time homebuyers with the qualifying income needed for a home priced at 85% of median price. The index also differs in that the qualifying income has assumptions about a lower down payment and a higher mortgage rate to include mortgage insurance. First time homebuyers are also assumed to have median incomes at 70% of county median income.

In sixteen counties first time homebuyers with median incomes are not able to qualify for median-priced homes. As in the chart for all homebuyers, this chart shows property tax is not a large driver in affordability and that property tax plays less of a role in the less affordable counties.

The affordability indices for the two charts are in Appendix 1.

### **Taxes and the Ability to Retain a Home**

Table 3 shows property tax rates in Washington counties. Property tax rates vary from 0.7% of a home's market value in San Juan County to 1.48% in Garfield County.

Washington State ranks 18th highest in terms of property taxes as a percent of personal income. Washington's property taxes were \$35.39 per \$1,000 of personal income in 1999. Motor vehicle excise tax (MVET), considered to be in-lieu of property tax, is included as in the Census data from which these calculations are derived. The MVET was eliminated by initiative effective in 2000. The U.S. average was \$32.52 in 1999. Appendix 2 compares property taxes per \$1,000 of personal income for all states.

Property taxes can impact a homeowner's ability to retain their home under some circumstances, including the following scenarios. Home values rise, but the homeowner's income is fixed. Market conditions cause a sharp increase in home values, greater than increases in salaries. The homeowner's salary decreases dramatically because of job loss, disability, divorce or other reasons.

Table 4 shows the distribution of property tax payments as a percentage of income by income categories. The table shows that almost 50% of homeowners pay less than 3% of their income in property taxes. About 70% of homeowners pay under 4% of their income in property taxes. Almost 6% of homeowners pay over 8% of their income in property taxes and almost 20% pay over 5% of their income.

Table 3

## Comparison of Effective Property Tax Rates\* for Taxes Due in 1994-2001

County	1994	1995	1996	1997	1998	1999	2000	2001
Adams	1.36 %	1.40 %	1.37 %	1.36 %	1.30 %	1.34 %	1.33 %	1.33 %
Asotin	1.34	1.24	1.15	1.17	1.19	1.22	1.29	1.31
Benton	1.32	1.62	1.24	1.33	1.38	1.36	1.32	1.31
Chelan	1.22	1.17	1.13	1.09	1.11	1.12	1.11	1.08
Clallam	0.97	1.05	1.06	1.10	1.13	1.12	1.09	1.07
Clark	1.30	1.34	1.34	1.36	1.28	1.31	1.29	1.27
Columbia	1.39	1.41	1.21	1.23	1.16	1.35	1.35	1.32
Cowlitz	1.10	1.08	1.05	1.10	1.06	1.11	1.05	1.11
Douglas	1.32	1.23	1.22	1.29	1.23	1.26	1.24	1.34
Ferry	0.93	1.04	0.99	1.07	1.00	1.04	1.06	1.03
Franklin	1.49	1.38	1.34	1.38	1.38	1.40	1.43	1.42
Garfield	1.53	1.31	1.30	1.37	1.59	1.53	1.49	1.48
Grant	1.26	1.23	1.16	1.27	1.29	1.26	1.19	1.25
Grays Harbor	1.26	1.26	1.22	1.17	1.14	1.25	1.21	1.23
Island	0.88	0.92	0.92	0.99	0.98	0.98	0.99	1.00
Jefferson	1.07	1.07	1.04	1.08	1.12	1.17	1.13	1.10
King	1.17	1.22	1.23	1.27	1.18	1.19	1.13	1.07
Kitsap	1.22	1.08	1.25	1.31	1.26	1.32	1.32	1.18
Kittitas	1.01	0.98	0.96	0.98	0.87	0.98	0.98	0.94
Klickitat	1.15	1.05	0.98	1.00	1.05	1.04	1.02	1.11
Lewis	1.13	1.08	1.04	1.06	1.08	1.13	1.13	1.13
Lincoln	1.43	1.36	1.33	1.34	1.28	1.21	1.28	1.33
Mason	1.06	1.01	1.00	1.04	1.04	1.13	1.11	1.15
Okanogan	1.29	1.17	1.14	1.12	1.07	1.05	1.09	1.12
Pacific	1.00	1.01	0.95	1.03	1.07	1.13	1.10	1.18
Pend Oreille	1.09	0.96	0.93	0.94	0.96	1.04	1.02	0.99
Pierce	1.42	1.43	1.38	1.44	1.47	1.40	1.46	1.43
San Juan	0.73	0.77	0.73	0.76	0.76	0.78	0.74	0.70
Skagit	1.04	1.13	1.15	1.20	1.21	1.23	1.18	1.18
Skamania	0.93	0.96	0.93	0.93	0.87	0.92	0.95	0.97
Snohomish	1.17	1.19	1.21	1.24	1.23	1.22	1.17	1.16
Spokane	1.32	1.34	1.33	1.37	1.30	1.32	1.31	1.32
Stevens	1.02	0.92	0.93	0.99	1.05	1.07	1.00	1.05
Thurston	1.38	1.25	1.29	1.36	1.38	1.36	1.36	1.38
Wahkiakum	1.00	0.98	0.93	0.93	0.90	0.96	0.91	0.89
Walla Walla	1.37	1.36	1.28	1.29	1.31	1.31	1.38	1.34
Whatcom	1.04	1.06	1.07	1.12	1.14	1.17	1.14	1.12
Whitman	1.32	1.24	1.20	1.28	1.26	1.29	1.33	1.31
Yakima	1.12	1.22	1.16	1.17	1.21	1.10	1.17	1.18
STATEWIDE	1.20 %	1.22 %	1.19 %	1.26 %	1.22 %	1.22 %	1.20 %	1.16 %

\*Effective property tax rates express taxes as a percent of current market value rather than current assessed value.

This rate is calculated by dividing the total amount of taxes due by the total full market value.



**Table 4**  
**Homeowner Property Tax Model Statistics**  
**Percent of Homeowners by Household Income and Tax as a Percent of Income**  
**Year 2002**

Income	Property Tax as a Percent of Income									Total
	less than 1%	1% to 2%	2% to 3%	3% to 4%	4% to 5%	5% to 6%	6% to 7%	7% to 8%	over 8%	
	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent
less than \$15,000	0.69%	0.33%	0.49%	0.27%	0.16%	0.12%	0.10%	0.15%	1.80%	4.11%
\$15,000 to \$25,000	1.23	0.85	0.79	0.99	0.36	0.51	0.54	0.28	0.85	6.39
\$25,000 to \$37,500	0.84	0.92	1.38	2.67	2.04	1.74	1.01	0.64	1.28	12.53
\$37,500 to \$50,000	0.52	0.94	2.16	3.12	2.36	1.98	0.82	0.23	0.70	12.83
\$50,000 to \$62,500	0.42	1.41	3.82	3.63	2.21	1.08	0.31	0.20	0.50	13.58
\$62,500 to \$75,000	0.12	1.58	3.72	3.12	1.34	0.98	0.28	0.12	0.12	11.39
\$75,000 to \$100,000	0.45	3.75	7.00	3.13	1.71	0.58	0.32	0.23	0.43	17.59
\$100,000 to \$150,000	0.32	3.97	5.06	2.07	0.59	0.68	0.15	0.11	0.05	13.00
over \$150,000	1.29	3.54	2.04	1.47	0.08	0.11	0.05			8.57
Total	5.88%	17.28%	26.46%	20.47%	10.88%	7.78%	3.57%	1.95%	5.74%	100.00%

Source: Washington State House of Representatives, Office of Program Research

The state of Washington has two programs to provide property tax relief for senior and disabled citizens. The first program provides varying levels of exemption for disabled homeowners and senior citizens (age 61 and over) with income under \$30,000. All senior and disabled citizens in the program are exempt from special property tax levies. Those with incomes under \$18,000 are additionally exempted from regular property tax levies on the greater of the first \$50,000 in assessed value or 60% of assessed value. Those with incomes between \$18,000 and \$24,000 are additionally exempt from regular property tax levies on the greater of the first \$40,000 in assessed value or 35% of assessed value (no greater than \$60,000 in assessed value).

In addition to the tax exemption, the assessed value of participants' property is frozen from the time that they enter the program.

The other program is a property tax deferral for senior and disabled citizens. All disabled homeowners and seniors (age 60 and over) with incomes under \$34,000 are eligible to defer their property taxes until the house is sold or until time of death. However, since most senior citizens that are eligible for the deferral are also eligible for the exemption, very few opt to take the deferral.

## Answers to Questions

### 1) Do taxes impede the ability to purchase and retain a home?

#### *Taxes and the price of homes*

For a sample of typical homes bought under different circumstances and in different counties taxes range from about 6% to 10% of the purchase price. Impact fees on homes in developments range from zero to about 2.7% of the purchase price.

#### *Taxes and the ability to qualify for a home loan*

Property taxes do not play a large role in affordability. Principal and interest on a mortgage have a much greater role in the ability of a household to afford a home. In fact, property taxes play a smaller role in affordability in less affordable counties compared to more affordable counties.

#### *Taxes and the ability to retain a home*

Almost 50% of homeowners pay less than 3% of their income in property taxes. About 70% of homeowners pay under 4% of their income in property taxes.

Almost 6% of homeowners pay over 8% of their income in property taxes. Almost 20% pay over 5% of their income. For homeowners in these latter two categories, taxes may affect the ability to retain a home.

Washington State has two property tax relief programs for senior and disabled citizens. Some homeowners that have high property taxes as a percentage of income do not qualify for the programs because of age or income.

### 2) Does our tax system make the purchase of a home difficult for low-income households?

Taxes play a small role, relative to payment of mortgage principal and interest, in the ability of below-median income households to qualify for home loans. However, taxes can be a significant component of the purchase price of a new home.

### 3) Does our tax system cause difficulties for fixed-income homeowners to retain their homes?

Washington State has two property tax relief programs for senior and disabled citizens. Some homeowners that have high property taxes as a percentage of income do not qualify for the programs because of age or income. Some of these homeowners may have fixed incomes.

**4) Do impact and mitigation fees increase the cost of homes?**

Spec-built homes in new housing developments can be subject to impact and mitigation fees. Spec-built homes represent an estimated 16% of all home purchases. Typical impact fees, as shown in our examples, range from about 0.7% to 2.7% of the price of a home. Not all jurisdictions impose impact fees.

## Appendix 1

## Qualifying for a Median-Priced Home

	All Single Family Home Buyers		First Time Single Family Home Buyers	
	Affordability Index	Affordability Without Property Tax	Affordability Index	Affordability Without Property Tax
ADAMS	148.3	157.8	105.9	112.8
ASOTIN	172.4	184.0	123.0	131.6
BENTON	163.6	174.8	116.8	124.9
CHELAN	120.3	127.7	85.9	91.3
CLALLAM	118.2	124.7	84.4	89.1
CLARK	152.5	162.3	108.9	116.0
COWLITZ	154.4	162.9	110.2	116.5
DOUGLAS	137.4	146.6	98.1	104.8
FERRY	141.2	148.5	100.8	106.1
FRANKLIN	107.2	114.9	76.5	82.1
GARFIELD	145.5	156.5	103.8	111.9
GRANT	157.2	167.9	112.2	120.0
GRAYS HARBOR	163.2	173.1	116.5	123.7
ISLAND	113.3	118.7	80.9	84.8
JEFFERSON	86.9	91.9	62.1	65.6
KING	105.8	111.7	75.5	79.8
KITSAP	134.7	143.0	96.1	102.2
KITTITAS	90.5	95.0	64.6	67.9
LEWIS	134.3	141.8	95.9	101.4
MASON	145.4	153.8	103.8	110.0
PACIFIC	158.2	167.5	112.9	119.7
PEND OREILLE	152.3	161.9	108.7	115.7
PIERCE	135.4	145.1	96.7	103.8
SAN JUAN	90.2	93.7	64.4	66.9
SKAGIT	123.5	130.8	88.2	93.5
SNOHOMISH	118.8	126.6	84.8	90.5
SPOKANE	172.2	184.2	123.0	131.7
STEVENS	155.6	163.9	111.1	117.2
THURSTON	146.0	156.5	104.2	111.9
WAHKIAKUM	191.7	200.7	136.8	143.4
WALLA WALLA	143.8	153.7	102.7	109.9
WHATCOM	119.5	126.7	85.3	90.5
WHITMAN	115.2	123.2	82.3	88.1
YAKIMA	144.9	153.8	103.4	109.9

Sources: Washington Center for Real Estate Research at WSU, Office of Financial Management  
Information is not available for Columbia, Klickitat, Lincoln, Okanogan and Skamania.

## Appendix 2

Property Taxes Per \$1,000 Personal Income  
Fiscal Years 1998-1999

	1998		1999	
	Amount	Rank	Amount	Rank
New Hampshire	\$56.53	2	\$57.24	1
Maine	58.83	1	52.70	2
Vermont	55.39	3	52.27	3
New Jersey	54.29	4	51.61	4
Montana	50.00	5	47.51	5
Rhode Island	47.29	6	46.45	6
Wyoming	46.02	7	43.68	7
Alaska	42.87	10	42.40	8
New York	44.20	8	42.30	9
Connecticut	43.13	9	42.22	10
Wisconsin	40.72	11	40.31	11
Illinois	39.11	12	38.97	12
Texas	36.94	14	36.97	13
Nebraska	39.03	13	36.49	14
Iowa	35.56	20	35.63	15
Massachusetts	36.43	18	35.58	16
South Dakota	35.21	21	35.49	17
WASHINGTON	36.59	17	35.39	18
Indiana	36.25	19	34.80	19
Florida	34.77	22	34.62	20
North Dakota	36.74	15	34.24	21
Michigan	33.98	23	33.47	22
Minnesota	36.68	16	31.98	23
Arizona	30.53	28	31.82	24
Ohio	31.29	26	31.75	25
Kansas	33.75	24	31.20	26
Idaho	30.27	29	30.23	27
Oregon	31.42	25	30.03	28
Virginia	30.76	27	29.92	29
Pennsylvania	29.45	30	29.42	30
Colorado	29.06	31	28.80	31
South Carolina	28.76	32	28.60	32
California	28.68	33	27.51	33
Georgia	27.21	36	27.17	34
Maryland	28.54	34	26.18	35
Arkansas	17.70	45	25.98	36
Utah	27.08	37	25.45	37
Mississippi	25.38	38	25.24	38
Nevada	23.38	39	24.26	39
Missouri	23.13	40	23.93	40
North Carolina	22.76	41	22.65	41
West Virginia	22.07	42	22.13	42
Tennessee	20.23	43	20.10	43
Kentucky	18.92	44	18.95	44
Hawaii	28.23	35	18.69	45
Oklahoma	16.46	48	16.70	46
Louisiana	16.65	46	16.61	47
New Mexico	16.43	49	16.01	48
Delaware	16.64	47	15.84	49
Alabama	11.87	50	12.38	50
U.S. Average	\$33.22		\$32.52	

\*Note: Calculations include MVET as a "in-lieu" property tax. This tax was repealed in 2000. If MVET had been repealed in 1999, Washington would have ranked 27<sup>th</sup> in terms of property tax per \$1000 of personal income and 21<sup>st</sup> in terms of per capita property tax.