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GREATER BOSTON REAL ESTATE BOARD

Memorandum: June 2024

To: Gabriela Coletta Zapata, Chair of the Government Operations Committee
From: Greg Vasil, CEO, The Greater Boston Real Estate Board
Re: Proposed commercial property tax increase

CC: Mayor Michelle Wu
Boston City Council

I write today in an effort to ensure you have all relevant data as you consider Mayor Wu's proposal to radically alter the Boston tax scheme in a manner which we believe could greatly impact the future of Boston's commercial real estate market and threaten the city's fiscal stability and future vibrancy.

To better understand the city's ability to raise tax rates on commercial properties, we developed this memo with support from the Center for State Policy Analysis at Tufts University.

The bottom line is:

- Temporarily increasing the city's ability to tax commercial businesses would have a sharp, negative effect on the commercial sector, exacerbating challenges across the industry and putting further downward pressure on prices.

- This proposal would also create a very unstable situation for residents, whose tax rate would drop substantially for one year and then climb 40 percent over the next 4 years.

- Residential property tax rates in Boston are relatively low compared to nearby cities and towns. A series of gradual increases in these rates could be less disruptive than the down-and-up impact of the current plan.

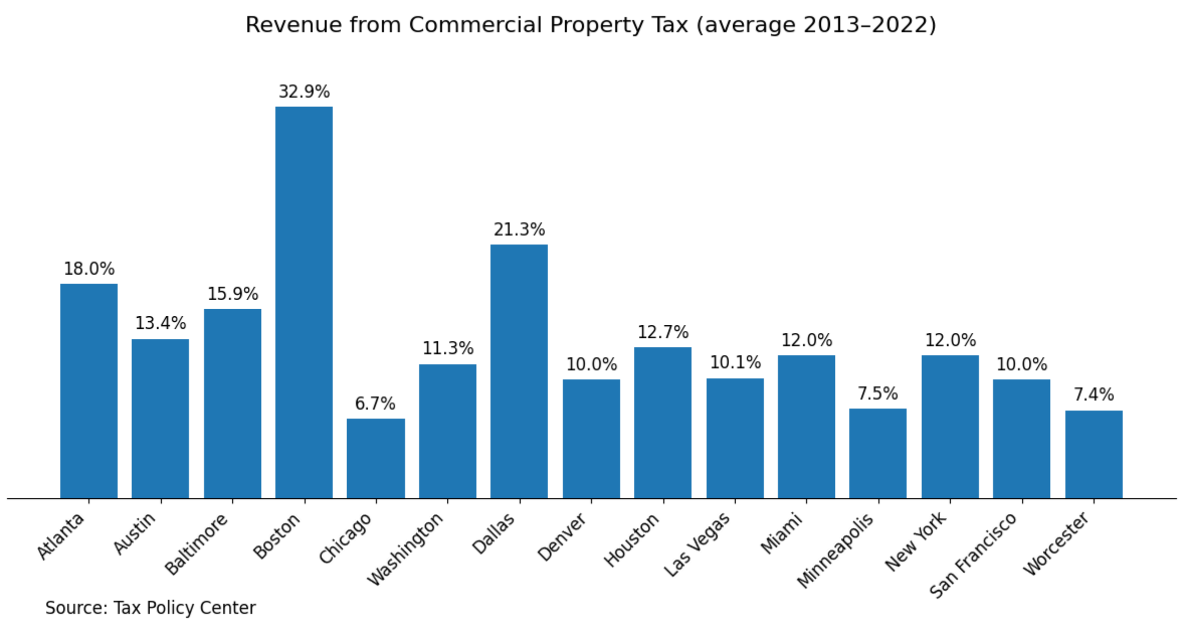
What follows is a fuller discussion of our findings, including background on the stresses warping the commercial real estate industry in Boston and more detail about the likely impact of the current proposal.

BACKGROUND

Over 30 percent of all tax revenue in Boston comes from commercial property taxes. That's higher than any other major city in the country, and it makes Boston especially vulnerable to the current decline in the value of office buildings.

As a widely-reported analysis found, within the next five years Boston could face an annual budget shortfall of $400 million to $500 million, or about 10 percent of the total city budget. This once-unimaginable shift is due, the report found, to a number of factors that have been heavily reported, including the rise in hybrid work and elevated interest rates. Prevailing estimates suggest Boston's downtown office buildings have fallen by as much as 25 percent in value.

Given that these trends will persist for the long-term, Boston has no choice but to explore serious policy solutions to address the budget shortfall.



SHIFTING RESIDENTIAL RATES

While Boston officials have been hesitant to pursue increased residential property tax rates, increasing rates in a gradual way could help the city address its fiscal challenges.

Boston's current residential tax rates are relatively low, well below what you find in some other large cities, including Springfield, Worcester, Brockton, and New Bedford.

In its recent assessment of Boston's fiscal standing, the rating agency Moody's made deliberate mention of this fact, noting that Boston had "a relatively affordable tax burden when compared to residential tax rates across the state and nation." This is one reason the agency maintains its confidence in the city's fiscal future, namely because it sees that the city has room to safely increase residential rates.

Residential Property Tax Rate, per $1000	
Cambridge	5.92
Lynn	10.53
Boston	10.90
Quincy	11.27
Fall River	11.49
Lowell	11.91
New Bedford	12.00
Brockton	12.02
Worcester	13.75
Springfield	16.06

Source: Division of Local Services

The argument for higher residential rates is strengthened by the recent run-up in home prices. One of the core principles of effective taxation is to target thriving individuals and industries that have the capacity to absorb the additional cost of new taxes. And while escalating home prices have created a stark affordability problem for those hoping to buy homes, they've been a wealth windfall for current homeowners.

FUTURE OF TAX RATES

Rather than reconsider the state of residential property tax rates, Boston officials are seriously debating a temporary increase in the tax rate on commercial buildings—a way to maintain revenue without adversely affecting home-owners. State approval is required for this approach, as it would violate current limits on the allowable gap between commercial and residential rates.

Boston took this path once before, in the early 2000s, when the city needed some flexibility to manage its recovery from the dot-com recession. But today's challenge is wholly different. In 2004, the city faced a temporary downturn, which required a temporary solution. In 2024, Boston needs to adjust to the new and durable reality of lower office values due to hybrid and remote work.

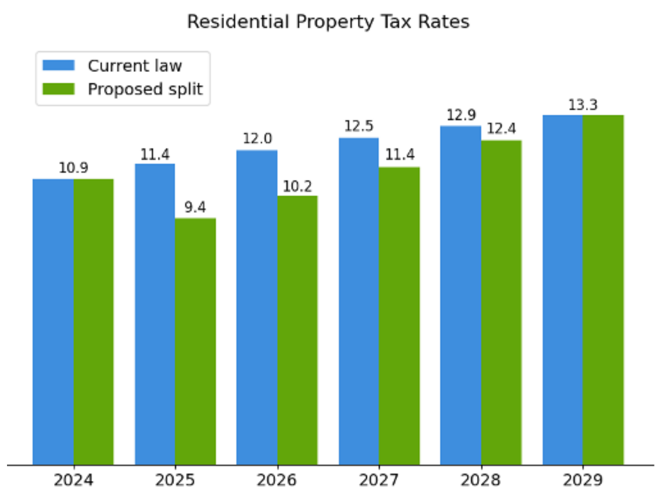
The city's current proposal would dramatically expand the gap between commercial and residential tax rates for one year, then unwind the change in years two through five. Our analysis suggests this would lead to:

1) A sharp increase in commercial property tax rates, from 25.3 to 29.2 in year one, putting additional strain on an industry in distress (all property tax rates are per $1000).

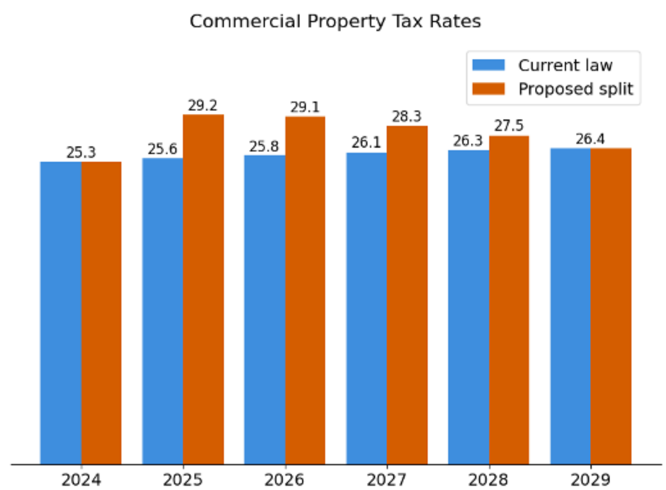
2) A large and immediate tax cut for residential properties in year one, with the rate dropping from 10.9 to 9.4.

3) A series of significant increases in the residential tax rates in years two through five, reaching 13.3 in 2029. This amounts to a 40 percent increase over four years.

4) An endgame where, beginning in 2029 but continuing indefinitely into the future, tax rates in Boston will be permanently higher for both residential and commercial properties, with no plan for the long-term fallout in terms of property prices.



Source: cSPA calculations



Source: cSPA calculations

The limits of Proposition 2 ½ and the rules governing the gap between commercial and residential tax rates significantly limit the city's freedom to adjust or alter these expected rates. Its main lever is the ability to reduce total tax collections.

IMPACT ON COMMERCIAL SECTOR

Boston's proposal to temporarily increase the rate on commercial properties would not only put further pressure on commercial real estate prices but could trigger some additional side-effects that increase tax challenges and raise the risk of bankruptcies.

Thinking chiefly about year one of any increase, the city has argued that the effect of a tax hike for commercial properties would not be so dramatic, and that many buildings would actually pay fewer dollars under this higher rate.

If some building owners do owe less in taxes, that is only because the value of their property has fallen substantially. And falling value is generally a reflection of reduced profitability, which suggests a limited cushion to absorb higher tax rates. The tax rate, not the dollar amount, is the accurate and accepted way to measure the new tax burden.

Because the city's proposal is temporary, and the tax rate on commercial building will glide back towards the current rate by year five, the long-term harm will be somewhat limited. But given the fragility of the commercial real estate sector as a whole, the city must remain vigilant about cascading risks.

CONCLUSION
Boston's future is at risk. Despite decades of competent governance, it was hit with a global pandemic and economic shock that irreversibly fractured its budgetary system.

In the past, when Boston's financial footing has been unsure, commercial property owners have helped the city navigate the trouble. But right now, they are not well-positioned to bear such a disproportionate burden of city spending. Vacancy rates are high and rising; property values are down and still falling.

The current proposal to temporarily increase commercial tax rates doesn't resolve the city's financial challenges. Not only does it phase out relatively quickly, it creates several shocks that could further destabilize the tax system, including a sudden increase in commercial rates in the first year and a dramatic rise in residential rates from years two through five.

Boston needs a long-term plan to support its operations, keep businesses and residents happy, and generally thrive in a world where office buildings are less valuable and less able to support the financial needs of city government. Higher residential rates could be a core part of that package, and need to be at least explored by City Hall.

METHODOLOGICAL NOTES
Our projection of future rates depends on assumptions shared between this memo and the report issued in May, including a 25 percent real decline in office values, $100 million in annual tax collections from new growth, continuing strength in other property areas (residential, industrial, etc.), and the city's commitment to collecting the maximum amount of revenue allowed under Proposition 2 ½.