

**Case Study
Howard County
Transfer Tax**

BACKGROUND: TRANSFER TAXES AS A FUNDING SOURCE

Increasing pressure on municipal and education budgets in recent years has made real estate related taxes, generally the principal source of revenue for localities, a tempting source of supplemental income. Transfer taxes, levied either as a percentage of sales price or a flat fee per unit of value, are particularly tempting, as they are collected on the transaction, and unlike the annual property tax, seem to have no readily identifiable and stable group of taxpayers likely to object.

The tendency to impose or increase transfer taxes is particularly troublesome in Maryland, which already has some of the highest closing costs in the country. The state imposes a transfer tax of .50 percent; for first time homebuyers, the rate is reduced to .25 percent, which is paid by the seller. In FY 2004, state transfer tax revenue topped \$110 million, providing funding for certain specific state programs as well as the general fund.

At the local level, Maryland county governments with adopted home rule powers may impose a local transfer tax not greater than 0.50 percent. The remaining seventeen Maryland counties without home rule have a local transfer tax that ranges from as low as 0.50 percent to as much as 1.50 percent.

Transfer taxes and other fees have increasingly been seen as a way to meet the growing budgetary needs of local jurisdictions. As state support for new school construction dwindles, some counties have even approved impact fees of up to \$10,000 per house to fund growing education budgets. Howard County, the focus of this analysis, levies a transfer tax of 1 percent of consideration paid for real property with an additional \$5 per thousand-recording tax, which equals 0.50 percent.

THE ISSUE

As a suburb of Washington, DC and Baltimore, Howard County has experienced rapid growth since the 1950s. Between 1990 and 2000, Howard County population increased 32 percent. With the growing population, demand for housing has burgeoned. Prices have jumped so much that the average price has consistently been at or near the highest in the state.

In 2003, the Howard County Board of Education proposed a record \$86.3 million budget for school construction and renovation—over \$13 million more than the previous year. The County Executive supported the proposal, citing the need for new school construction as a result of the explosive county-wide population growth. Further, the increased financial need could not be met through the usual source, the state education department. In response to the county's request for \$86.3million, the state awarded a

mere \$3 million in funding. An alternative to state funding sources had to be found, it was argued, to keep pace with the increased capital budget requirements stemming from the growing school population.

THE PROPOSAL

To fund the shortfall, the County Executive proposed increasing the local transfer tax from 1 percent to 1.5 percent. Local officials predicted that the increase would raise about \$10 million a year in new revenue, which would be used to leverage \$200 million in bond financing for new schools as part of an ambitious construction plan.

The rationale for funding the schools system's proposed capital budget with a transfer tax increase was laid out in a presentation to the Howard County Association of REALTORS® (HCAR). An increase in the transfer tax, HCAR REALTORS® were told, was the only mechanism that had a direct connection with the source of school enrollment increases. This conclusion was based upon a study prepared by the county stating that the school board had determined that more than half of the increase in new Howard County students came from families purchasing existing homes rather than new construction.

Proponents of the increase claimed that it would provide the county with a longer-term, reliable source of school construction funds without affecting the county's substantial general debt of \$410 million. By dedicating the half percent transfer tax increase to pay for new borrowing, the county could avoid raising its general governmental debt level, which could potentially threaten its AAA bond rating. Under the plan, the county would borrow \$215 million over 8 years to pay for school construction and other municipal projects.

REALTOR® RESPONSE

Soon after an announcement that the county executive would ask state legislators to introduce a bill during the January legislative session to raise the Howard County transfer tax by 50 percent (permission from the state legislature is needed to raise the local transfer tax), the HCAR Board of Directors called an emergency meeting to discuss the proposed legislation and their position.

Howard is an affluent county where most residents, including REALTORS®, are proud of its reputation for academic excellence in its school system, and dedicated to maintaining it. At the same time, HCAR REALTORS® were very concerned about such a significant increase in the already substantial cost of purchasing a home in the County. They were skeptical about the need for such a sizeable increase in the school board's budget and about the claim that buyers of existing homes were principally responsible for growth in the school population.

REALTORS® were also doubtful about the wisdom of funding a budget gap with a tax that produced revenues that fluctuate with home sales. The County's revenue from transfer taxes varied widely in the previous 8 years, declining by almost 39 percent from 1993-1997, and rising by 55 percent from 1997-2001.

REALTORS® believed that if the school board's long term needs were as great as predicted, a broad based, stable funding source was critical. The HCAR board, doubting the assumptions underlying the proposal and the appropriateness of the transfer tax increase as a funding source, decided to oppose the increase.

Research and Information Analysis

A critical step in fighting the transfer tax increase, and a principal reason for the decision to oppose the proposal, was the research and analysis done by HCAR members. Howard REALTORS® suspected that the proposal was based on faulty estimates and analysis, but they knew they must verify their doubts before they could proceed.

A group of HCAR REALTORS® analyzed the projections included in the Board of Education's budget. The budget assumed that the majority of new students were from families purchasing existing homes rather than new construction sales. Given the pace of residential new construction in the county, the REALTORS® knew that this assumption was unlikely. The county's analysis had other flaws: it estimated future school enrollment projections based on the number of children born in Howard County hospitals, making no allowance for children born in surrounding counties whose parents resided in the county; and it failed to take into account families in rental properties whose children were enrolled in local schools. In the course of their research and analyzing the information they collected, the REALTORS® concluded that their initial doubts about the validity of the county's assumptions about the source for school growth, and even which school population was likely to grow, were correct.

THE PLAN

The HCAR Board of Directors designated itself as a committee of the whole to pursue its plan. The Board recognized that it had to form strategic partnerships to defeat the proposed transfer tax increase. Members contacted the Maryland Association of REALTORS® (MAR) for strategic advice, assistance in working with state legislators, and organizing a grassroots response to the proposal, if necessary. Although HCAR members have good relationships with their local legislators, they wanted advice in formulating strategy and in public education and media outreach. MAR provided them legislative staff support, provided funding for its outreach efforts, and helped HCAR with its request for funding from NAR's Issues Mobilization Fund. HCAR was required to match the funds it received through MAR. An HCAR spokesperson was appointed for communication on the state level. Other HCAR board members acted as liaisons to MAR and met with staff on a weekly basis.

FIRST PHASE

Armed with the results of its research, Howard REALTORS® met with the County Executive. Although local leaders remained firm in their support of the proposal, despite the REALTOR® analysis questioning its underlying assumptions, dissent was growing in the county, led by HCAR and other groups, and the issue was tabled early in the state's 2003 legislative session. The postponement was the direct result of the work of local REALTORS® and their local and state associations. Instead, the County Executive appointed a Task Force to study the education capital budget and alternatives to fund the projected increase in school construction. Due to HCAR's high profile on the issue, a Howard County REALTOR® was appointed to the County Executive's School Construction Capital Budget Task Force.

The Task Force analyzed the school board's proposed capital budget line by line, and REALTORS® following the process realized that the funding level, which was three times the normal amount, included more than just underwriting the cost of new school construction, as proponents contended. Some budget increases were the result of growth, others stemmed from changes in operations, such as a move to all day kindergartens throughout the county. Although the Task Force was charged simply with analyzing the budget and not making recommendations regarding the budget amount or current appropriations, it was again clear to HCAR that its original reservations about the proposal were valid.

SECOND PHASE

By the time the Task Force was finishing its work, in the summer of 2003, HCAR decided it would consider a legislative compromise. The REALTORS® proposed a .125 percent increase in the transfer tax, instead of the original .50 percent, coupled with a flat \$1,500 impact fee. The proposal effectively combined the concept of a broader based tax that included both sales of existing and new construction. The HCAR board had been adamant from the beginning that while it was not opposed to a tax increase to fund the education budget, the full costs should not be borne solely by buyers and sellers of existing homes.

The Task Force was not comprised solely of legislators, so although the HCAR Proposal had the support of two legislators, that was inadequate for it to be considered a serious alternative. However, the remaining 13 votes supported the original proposal for a 50 percent increase in the transfer tax, with no other changes to the funding sources. Without broad based support, HCAR abandoned its efforts to compromise and, once the Task Force concluded its meetings, turned its attention again to state elected officials.

At the conclusion of the Task Force, REALTORS® met individually with the entire Howard County legislative delegation. HCAR members and MAR legislative staff initiated meetings with state representatives, whose approval was required for any transfer tax increase. These meetings were critical for several reasons: they allowed REALTORS® to educate legislators using their analysis of the proposal; they gave

legislators information about the high level of the county's closing costs and housing prices; and they demonstrated REALTORS'® commitment to the county's needs and their expectations of their elected officials. The meetings opened some previously closed doors and changed some opinions. Equally important, they represented visible proof of the broad grassroots involvement of organized real estate in the county. Some officials admitted the possibility that an increase in the transfer tax might not be the easy solution it had been made to appear.

Media and Public Awareness

In the press, local REALTORS® were depicted as opponents of education. In a county that prides itself on the quality of its school system, this image was particularly harmful. Proponents of the original proposal presented this view of REALTORS® to the local parents-teachers association and the county Chamber of Commerce. With press support of the proposal, consumers found it logical to conclude that a transfer tax increase was the only way to fund the construction of new schools. Because transfer taxes apply only to home sales, and not to all property owners, the immediate constituency affected by the increase was not easily identifiable, and consumers tended to believe that the increase would not affect them.

To counter this perception, HCAR undertook a campaign to educate the public about what the increase would mean for homeownership and housing affordability. The ad campaign used numbers to emphasize the proposal's effect: that the transfer tax increase was permanent, and would increase closing costs for a \$250,000 home (the approximate median price in the County at that time) by \$1,250.

Member Education

HCAR's media campaign and education outreach extended to REALTORS® as well as the general public. The negative press received from some local media outlets had created friction within the HCAR membership, many of whom believed that the increase was necessary to preserve the quality of the county's education. Some members had even dropped their HCAR membership because of the board's opposition to the proposal.

HCAR undertook a comprehensive campaign to educate its members. The Board sent its messages through email blasts and speaking engagements. Board members spoke at local offices and Million Dollar Club meetings. Most REALTORS® were willing to give the HCAR board members an opportunity to speak, although the audiences frequently demonstrated stiff opposition to the message. Despite the initial resistance, HCAR's persistence paid off; eventually most members realized that the Board did not oppose better education, but instead believed that a broad based tax was the better solution. In so focusing their message, HCAR was able to emphasize the role of REALTORS® as the voice of homeownership in the community.

RESULTS

Before each legislative session, the Howard County Executive has the opportunity to draft new legislation. After the transfer tax bill was drafted, it was presented to the Howard County state Senate delegation for consideration and approval. Howard REALTORS® had had several meetings with each Senator and discussed their concerns in depth with them. The Senate delegation discussed the bill during its meetings, and held public hearings, during which REALTORS® testified as well as proponents of the increase. After several meetings, all three Senators decided to oppose the transfer tax bill. Without the support of the Senate delegation, the proposal to authorize the local transfer tax increase would not be considered in the full legislative session and thus would not pass.

EPILOGUE

After almost two years, HCAR and the local County Executive have been able to put aside their differences and start a dialogue. The REALTOR® position has been widely accepted as closer to the truth than the position presented in the original budget. Revised budget proposals have been very close to the numbers REALTORS® originally estimated. The negative image of REALTORS® as opponents of education has been reversed in the press; REALTORS® are now seen locally as advocates for homebuyers and home sellers on issues affecting homeownership.

Locally elected politicians, in the county and in the state legislature, recognize that working with REALTORS® is essential to develop workable solutions and address critical concerns.

Equally important, some members who resigned from the board have rejoined, and expressed their confidence in the board's judgment in handling the issue. Board members have learned that their involvement in community issues, while it may require at times substantial additional work, can have extraordinary benefits, both in creating a powerful political profile and in bringing volunteer members together as an effective team.

Lessons Learned

HCAR board members cite several important lessons from their experience:

1. Political relationships are essential, and must be developed before they are needed. HCAR REALTORS® had critical access to and credibility with their local and state representatives due to the extensive networking they had done over many years. They had supported real estate friendly candidates, attended fundraisers and met with legislators regularly on a variety of issues. The good relationship between REALTORS® and local legislators, which became the

lynchpin of their success, was many years in the making. REALTORS® also came to understand that while a decision may appear to be an easy quick fix at the state level, locally it can be difficult and unworkable.

2. Know your stuff. HCAR board members did extensive research and analysis of the complicated issues in the transfer tax proposal. In addition to examining the budget, they evaluated underlying assumptions and obtained and analyzed census data, school attendance figures and other relevant information to evaluate the proposal and identify its weaknesses. Their research also included anticipating arguments and developing cogent responses. All members who testified or spoke to officials on the issue were briefed extensively on the results of the research.
3. Stay on message. With complicated, technical issues, discussion can quickly be waylaid and the general focus of arguments forgotten. HCAR REALTORS® stayed on point, in their media messages, their testimony and their meetings with officials. They knew what they were going to say and what the issues were. Equally important, the HCAR message was factual, which required discipline in dealing with what often became an emotional issue.
4. Ask for help. HCAR believes that the financial and technical assistance it had from MAR was essential to its success. Their early involvement, at the request of HCAR, helped plan a strategy that guided their ultimately successful course.