

The Future of HOST:

DeKalb's Homestead Option Sales Tax

A **White Paper**
Project of

ProActive DeKalb

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Executive Summary

In 1997, DeKalb County voters approved a major change in the way county government was financed when they approved the Homestead Option Sales Tax. Essentially, they agreed to shift a significant portion of the cost of government from residential property taxes to a sales tax. This was a step into the unknown. No other county in Georgia – and few in the United States – depends as heavily as DeKalb on sales taxes for financing local government. (Rockdale County has since become the second to enact a HOST tax.)

Six and a half years later, we know a lot more about HOST. Some of what we know is reassuring. We know, for instance, that even with sales tax revenues way down as they were in 2002, there is no danger that essential county services will be not be delivered because of HOST. We know that HOST remains popular with homeowners who prefer paying taxes a few pennies at a time rather than twice a year in property taxes. Finally, we're seeing signs that one of HOST's objectives – encouraging middle-class homeowners to remain in DeKalb – is being met.

But we're also coming to realize there are some unanticipated – and troubling – consequences of HOST. The most important:

- HOST has not produced nearly as much sales tax revenue as its advocates thought it would. As a result, it has provided less property tax relief than promised and far less money for capital improvements (police

precincts, emergency response equipment, libraries, road improvements, sidewalks, recreation centers and the like).

- It has made DeKalb's tax base far more volatile. Sales tax revenues rise and fall faster and further than more traditional local taxes, like property taxes. In slow economic times, like now, it makes it hard to improve local government services that most people consider important: more police protection, better fire protection, road repairs, synchronized traffic signals and so on. Result: During periods like this, DeKalb stands still while its neighbor counties steadily improve these essential services.
- It is "double-taxing" some people in DeKalb County. Apartment dwellers and business owners get no benefit from HOST because HOST's tax relief has gone only to homeowners. As a result, renters and business owners continue paying the same amount of property taxes (or, in many cases, higher taxes) as before HOST was passed but now pay a sales tax as well.
- It is aggravating a major long-term problem, which is that DeKalb does not have a large retail or commercial tax base. Why is that a problem? Because businesses tend to pay higher taxes and demand fewer services than residents. A county like DeKalb with many homes and few businesses has a much harder time affording government services.

DeKalb lacks a large retail or commercial tax base. That's a problem because, in general, businesses pay far more in taxes than residences do.

How could we make HOST work better? Here are some possible strategies:

- Work harder on economic development. One way of making HOST work better is to increase the tax base that isn't affected by HOST, including industrial, office and retail properties. Important to this will be attracting more retail to the county, since that is what generates the sales tax that the county now depends on.
- Accept the fact that HOST was oversold by some of its advocates. It is possible that HOST will never again provide near-total tax relief for homeowners, but as many officials point out, it still provides the most generous homestead exemption of any metro area county.
- Make sure that an appropriate amount of HOST's revenues go to capital improvements. If DeKalb doesn't keep up with road building, sidewalks and other capital projects, two bad things will happen. First, DeKalb

About This Paper

This is the first in a series of "white papers" or background reports on issues facing DeKalb County by ProActive DeKalb, a non-partisan citizens' group that studies, writes about and hosts forums on issues of importance to all citizens of DeKalb County. This paper is intended to inform DeKalb's citizens and leaders about HOST and its long-term effect on the county. It may be followed by forums or other public discussions. For more information, please visit our web site, www.proactivedekalb.com.

won't be able to attract the businesses that are crucial to making HOST work over the long haul. Second, falling behind in infrastructure improvements will seriously diminish the quality of life of residents and the county's appeal for businesses. Result: DeKalb will end up losing the things HOST was aiming for, more middle-class families in our community and a better environment for businesses.

How DeKalb's Finances Work

DeKalb County government is a big enterprise with nearly \$445 million in annual revenues, which pay for police and fire protection, roads and sewers, parks and recreation and a multitude of other services. A little less than half of the county's revenues go to the general fund (to pay for services most people associate with the county); the rest goes to various special funds, such as the fire fund, hospital fund, a water and sewer fund, a special "green-space" fund, debt service and so on.

County revenues come from a number of sources. The five biggest in 2002 were:

Property taxes	\$208 million
Excise taxes (including the HOST sales tax)	\$114 million
Fines and forfeitures	\$21 million
Licenses and permits	\$19 million
Intergovernmental revenue (usually grants or payments from the state and federal governments)	\$17 million

As you can see, even after HOST, property taxes produce the largest share (nearly 47 percent) of revenues for DeKalb County. How can that be? Four reasons:

- As in most jurisdictions, the majority of property taxes are paid by businesses, not homeowners. That's because office buildings, factories, apartment buildings and stores are generally valued higher than homes and do not receive a homeowner's exemption. DeKalb has less commercial development than other big Metro Atlanta counties, but even so, its businesses pay most of the property taxes.
- Property taxes are also collected on things people don't normally think of as "property." Example: automobiles. When you renew your car tag every year, you pay a tax based on the value of the car. That tax is part of the county's property taxes.
- Some county property taxes were being paid by homeowners even when HOST was providing what some called a "100 percent exemption." For example, by state law, HOST cannot be used to exempt property taxes used to repay county bonds. (And aside from county taxes, homeowners pay school taxes, state property taxes, a street light assessment and sanitation assessments in their property taxes. If they live in a city, they pay municipal property taxes as well.)
- Beginning in 2002, the county began collecting a portion of homeowner property taxes that had been exempted under HOST for three years. In 2002 homeowners received a homestead exemption (funded by HOST

and a state subsidy) of about 87 percent of the property taxes that can be exempted (not including school taxes, repayment of county bonds, state taxes, etc.).

So what effect has HOST had on county finances? It has shifted a substantial amount of taxes from property to retail sales. Before HOST took effect, DeKalb had no general sales tax, although it did collect “excise taxes” on hotel room rentals, alcoholic drinks sales and insurance premium payments. Before HOST, these taxes accounted for about 7.5 percent of county revenues. With HOST, excise taxes (now joined by the 1 percent sales tax) swelled to nearly 26 percent of revenues. Property taxes, meanwhile, declined from about \$207 million a year in 1998 to \$155 million the following year (a decline of about 25 percent). Since then, property taxes have risen steadily, as business properties increased in value, people bought new cars and (in 2002) the county began collecting again some residential property taxes.

HOST was a compromise between those who wanted property tax relief and those who felt the county should spend more on capital projects.

History of HOST

DeKalb’s HOST took shape in 1996 when two groups that had disagreed in the past started talking with one another. One group was business leaders and county officials, including then-CEO Liane Levetan, who were concerned that the county was falling far behind in major infrastructure improvements. These officials had pushed in 1995 for a temporary (three-year) 1 percent sales tax to build roads and sidewalks and renovate county buildings, similar to the taxes Gwinnett and Cobb county voters had approved, but DeKalb’s voters turned it down. (The voters had also defeated sales tax proposals in 1986 and 1989.)

The other group was made up of opponents of the temporary sales tax, led by then-State Rep. Bart Ladd. This group was interested in a sales tax only if it made possible major reductions in homeowner property taxes. Why the interest in cutting property taxes? One reason, as an early supporter of HOST, Commissioner Judy Yates, recalls, was the fear that DeKalb was losing its middle-class residents. A property tax cut would be particularly important to middle-class homeowners, she said.

What the groups came up with was a compromise: a permanent 1 percent sales tax whose proceeds would be dedicated by law to property tax exemptions and capital improvements. When the two camps – county officials and HOST supporters – took this version to the polls in March 1997, voters passed it by a large margin.

What HOST Says – and What Was Said About HOST

The Homestead Option Sales Tax is governed by a complicated – but very specific – law. It says that the county must set aside for property tax relief an

amount equal to *at least 80 percent* of the amount raised by the HOST tax *the previous year*. (Example: If the 1 percent HOST tax raised \$50 million one year, the county must grant property tax relief equal to \$40 million the following year.) DeKalb commissioners can grant more than 80 percent (and have done so), but the law requires that only 80 percent of the previous year's HOST revenues be used for property tax relief. What's done with the remaining money? Whatever isn't given in tax relief must be spent on county capital improvements (roads construction and repairs, buildings, parks, etc.).

It's important to note that the law does *not* require that all homeowner property taxes be eliminated. So where did the idea come from that HOST was supposed to write off 100 percent of homeowner property taxes? It came from those who were promoting the tax referendum. A few weeks before the 1997 referendum, Rep. Ladd wrote a letter to the *Atlanta Journal-Constitution* urging voters to approve the measure. In the letter, he wrote:

“On March 18, DeKalb residents will be the first in Georgia to have the opportunity to vote for a new way of funding county government operations. Although its workings are somewhat technical, the basic premise of the Homestead Option Sales Tax (HOST) is to do this: remove all county property taxes from your home and replace it with a 1 percent sales tax. It's that simple.”

County officials went even further. In a brochure printed shortly after the 1997 referendum, the county foresaw not only a near-total exemption for homeowners but, beginning in 1999, \$18 million in capital improvements a year and \$12 million in property tax reductions for businesses and apartment owners.

A Glossary of Terms Used in This Paper

Capital improvement – In DeKalb County, a capital improvement (or capital project) is any expenditure of \$25,000 or greater with a useful life of five years or more. Under this definition, a capital improvement could be major items, such as streets, sidewalks, traffic signals, courtrooms, police precincts, libraries, medical response equipment – or something less obvious like computers for a county department.

Homestead exemption – A residential property tax exemption applied to a primary residence. Since 1998, DeKalb County homeowners have enjoyed homestead exemptions ranging from 100 percent to 76 percent.

HOST (Homestead Option Sales Tax) – A 1 percent sales tax approved by DeKalb voters in 1997. HOST was created to replace residential property taxes as the primary funding source for county operations, thereby greatly reducing DeKalb homeowners' property tax bills. By law, the county must grant property tax relief equal to at least 80 percent of what HOST brought in the year before. The remainder – up to 20 percent – must be spent on capital improvements.

What Went Wrong With HOST Calculations

As we know now, HOST never produced enough revenues to do all that its advocates foresaw. How could so many people have been so wrong? There were two basic flaws in the calculations about HOST.

First, advocates overestimated the amount of revenue the 1 percent sales tax would produce in DeKalb. The county brochure estimated that HOST would produce \$92 million in sales tax revenues in its first full year. If that had been true, then HOST would have been a success – providing some money for new roads, libraries, traffic signals, sidewalks and the like and more than enough remaining money for homestead exemptions, with money left over to give business owners and apartment owners a generous property tax break.

In 2002, the county received \$82 million in HOST revenues but granted \$86 million in tax relief, dipping into other funds to pay for it.

In fact, HOST never came close to producing that much money. In 1999, the sales tax generated less than \$76 million. In 2000, it topped out at less than \$88 million. In 2002, with the economy lagging, it generated slightly more than \$82 million; it's expected to generate about the same amount in 2003. Obviously, it's harder to pay for property tax relief when the county is \$16 million short in revenues.

But that is only one problem with the way HOST has worked – and the lesser problem at that. The other thing advocates hadn't counted on was that the number of houses and their value would skyrocket in DeKalb, caused in part by HOST itself. Why is that a problem? Because the amount of money needed to write off homeowner property taxes skyrocketed along with housing values.

If housing hadn't increased so much in number and value from 1999 to 2002, the county would have squeaked through the current financial downturn without asking homeowners to pay any additional property taxes. It would have had much less money for capital improvements, and businesses would have gotten no tax relief, but homeowners would have gotten the near-total exemption that advocates promised in 1997.

But, in fact, the amount needed for homeowner tax relief was growing – and growing fast. The County Commission's response was to go ahead with eliminating all homeowner property taxes it legally could and finance fewer capital improvements than planned. So, in 1999, the county collected \$82 million in HOST taxes and granted \$70 million in homeowner tax relief – using 85 percent of the HOST money. In 2000 the HOST tax produced 7 percent more money, \$88 million, but the amount needed for 100 percent homeowner tax relief had risen nearly twice as fast, to \$79 million. Again, the Commission decided to

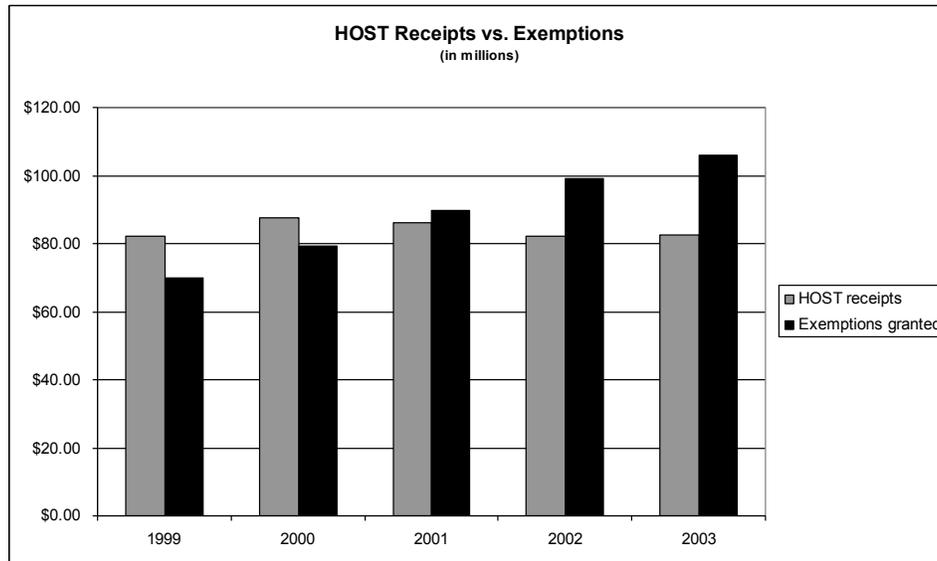
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give the most generous tax relief it could. That left only 10 percent of HOST's receipts for capital projects.

The next year, 2001, was worse. HOST's receipts had declined in the national economic downturn, to \$86 million, but the residential construction boom was continuing. The amount needed by then for complete homeowner tax relief was \$90 million – more than HOST was providing. Again, the Commission voted to give the maximum exemption allowable by law, using funds from other accounts to make up for the shortfall.

In 2002, with HOST revenues slipping even further, the Commission decided to give less than the maximum amount of homeowner property tax relief. This was a difficult decision but, it seems clear, an unavoidable one. In 2002, the county received \$82 million in HOST revenues – a 7 percent decline in two years' time. Even so, it granted \$99 million in tax relief, again dipping into other funds to pay for it. This year, the county is expecting HOST to generate about the same amount as last year but has committed itself to pay out nearly \$106 million in tax relief, again dipping into other sources.

The chart below shows how the property tax exemptions overtook the HOST receipts in the past five years.



How did HOST's advocates make such miscalculations? In 1997, when HOST was being voted on, they looked at what MARTA was collecting in DeKalb County with its 1 percent sales tax and, logically enough, assumed that a 1 percent HOST tax would yield as much as MARTA's tax. But later that year, the state Department of Revenue announced that it had been too generous with MARTA over the years, crediting sales tax receipts to MARTA that actually weren't collected in Fulton or DeKalb.

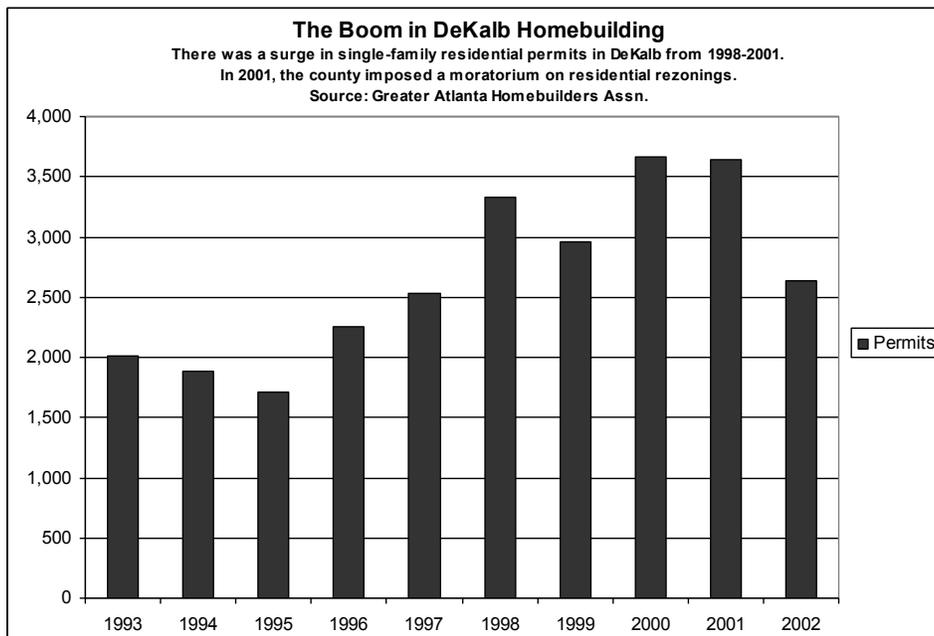
MARTA officials were furious, and so were DeKalb officials. DeKalb sued the state, but eventually settled – and accepted much lower HOST revenues than it had anticipated.

But as we said earlier, the revenue shortfall – damaging as it was – was the lesser problem. No one had counted on HOST and other factors dramatically escalating the number and value of houses in DeKalb – and pushing the amount needed for tax relief beyond the county's ability to pay for it.

What HOST Did for Housing

One of HOST's goals, an early advocate said, was to keep middle-class families in the county. If so, it appears to have worked – perhaps too well. DeKalb was already a heavily residential county in the early 1990s, and before HOST was passed, single-family homes were being added at a faster pace in DeKalb than elsewhere in the 20-county metro area. HOST – perhaps aided by other factors, such as suburban traffic congestion – made DeKalb an even more desirable place for housing.

From 1994 to 1997, housing starts in DeKalb County grew each year by an average of 7 percent; a little better than twice as fast as in the metro area as a whole. But from 1998 to 2001, after HOST took effect, residential construction boomed. DeKalb's average annual increase in housing starts over that period was 11 percent, more than five times as fast as the metro area.



The result was a dramatic increase in the number of households covered by HOST. In 1999, there were 124,000 homes that qualified for homeowner tax

credits. By 2002, there were 140,000, a 13 percent growth in homeowner-occupied housing in three years' time.

In many respects, DeKalb's popularity as a place to live is a positive thing. Most DeKalb residents want their county to be desirable. And the fact that the pace in DeKalb picked up after 1997 compared to the metro area indicates that HOST did what its advocates wanted – it made DeKalb more appealing to middle-class homeowners.

But this residential boom has come with a price – or, to be more exact, two prices. First, as we said earlier, expansion in housing and housing values makes it much harder to pay for homestead exemptions. Second, the increase in housing escalates the cost of county services, from police and fire services to roads, sidewalks and parks. Put them together and you have the makings of the budget crisis DeKalb experienced in early 2002.

The good news: HOST made DeKalb a more desirable place to live. The bad news: The sudden increase in the number and value of homes led to a budget crisis.

The county's reaction to the residential boom has been to slow residential rezoning approvals and redouble its economic development efforts. In March 2001, the county commission declared a moratorium on residential rezonings that lasted for a year. Ostensibly, this was to review the county's building inspections and fee structures (there were many complaints, particularly from South DeKalb, about shoddy construction), but it had the effect of shutting off some but not all residential construction. (It didn't, for instance, affect construction in places that were already zoned for residential.)

And even after the moratorium was lifted, in March 2002, the commission found ways of limiting residential construction by considering only a few rezoning applications at a time. (The commission hears rezoning requests only six times a year. Under its new rules, it will consider no more than 20 rezonings at a time and no more than half of those may be residential.) The effect was to slow the pace of residential rezonings – and, eventually, construction – in DeKalb County.

Residential vs. Commercial

While it was applying the brakes to residential growth, the county was pumping the accelerator of economic development by increasing the size and professionalism of DeKalb's Office of Economic Development. Why is bringing more businesses to DeKalb so important? Because businesses pay far more in taxes than they receive in county services, while homeowners tend to get more in services than they pay in county taxes. Put another way, businesses subsidize homeowners. Places with more businesses, then, have an easier time financing government services than places that are overwhelmingly residential.

A recent University of Georgia study shows how important it is to a county to have a strong business base. The average homeowner, the UGA study found,

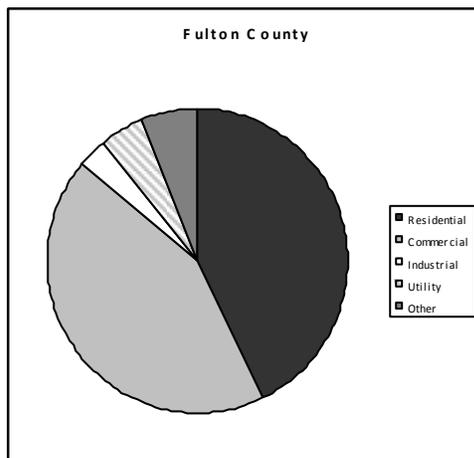
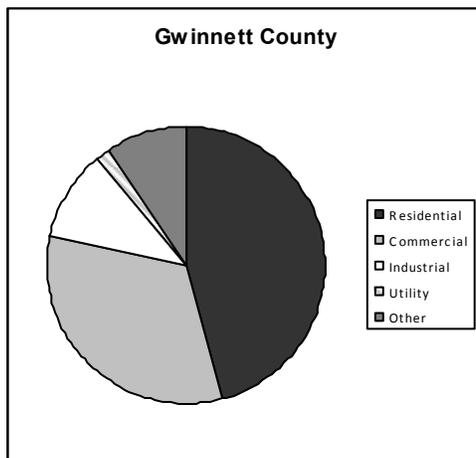
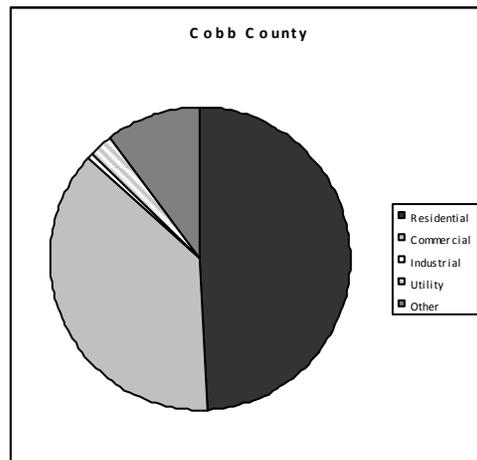
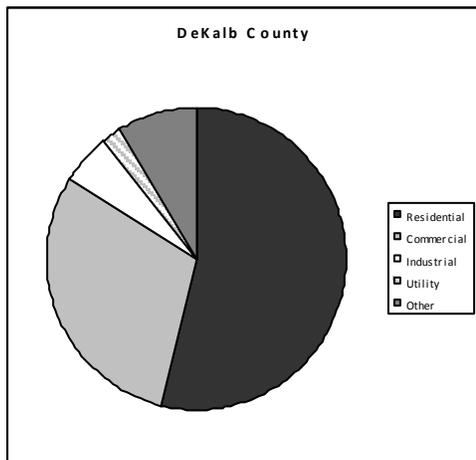
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pays 87 cents in taxes for every dollar he or she receives in services (police protection, library services, public schools, road maintenance and so on). The average office or factory, by contrast, pays \$3.45 in taxes for every dollar of services it receives.

DeKalb has businesses, of course, but not as many for its size as most developed metro counties. The best way to see the gap is in the property tax bases of the counties. Most local government finance officials say that, for government to be affordable, residential property should make up no more than half of a county's property tax base – and the ideal tax base is 45 percent residential or less.

In DeKalb, residential property makes up 54 percent of the county's property tax base (the total amount of land value before homestead exemptions), according to the state Department of Revenue. Compare that to other developed metro counties: Cobb County, for instance, where residential property makes up 49 percent of the tax base; Gwinnett, 46 percent; and Fulton, 43 percent.

In the charts below, you can see the differences in tax bases among the counties. Residential property is black, "other" property (including automobiles, agricultural and special uses) is in dark gray. Commercial uses (offices and stores) are in light gray, industrial is white and utilities are the striped portions.



The other three counties did not get so many businesses by accident. Unlike DeKalb, they have maintained focused economic development programs for years. If DeKalb is to build the non-residential part of its tax base – with the aim of making government more affordable and helping HOST to succeed – it must be as deliberate and sustained in its efforts as Gwinnett, Fulton and Cobb have been.

The Future of HOST

In early 2002, there was a long and sometimes angry debate over DeKalb County's budget because it reduced the homestead exemption from what had been granted in earlier years. Some homeowners saw this reduction as a breach of promise. But it's clear from our study – looking at how HOST revenues were overestimated, how sharply sales tax revenues have declined since 2000 and, most importantly, how HOST itself has spurred housing growth and value – that the County Commission was simply facing reality.

**We need to accept that
HOST will not now – and
perhaps never again –
provide a near-total property
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But what should DeKalb County do now?

First, we should acknowledge that HOST has met some of its goals, at least in the short term. It has made DeKalb a more desirable place for homeowners, and it is much preferred by voters over the property tax as a way of financing government.

But we should also acknowledge HOST's problems and deal with them forthrightly. The greatest problem, as we've said, is that it exposes DeKalb's long-term weakness in economic development. The best way of dealing with that problem is to build the county's non-residential tax base through economic development.

This won't be easy because HOST "double-taxes" businesses – extracting a sales tax but offering none of the property tax benefits that go to homeowners. This means elected officials and business leaders must be especially diligent and focused in its economic development efforts and, occasionally and strategically, willing to offer other inducements to bring important new business developments to DeKalb.

In the short-term, we need to accept that HOST will not now – and perhaps never again – provide a near-total property tax exemption for homeowners. It will, however, provide a very generous exemption. County finance officials estimate that in 2003, even with a smaller exemption, HOST is saving the owner of a \$150,000 house \$441.36 in county property taxes.

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We also should accept the need to spend an appropriate amount on capital projects. Why are capital improvements so important? Because they add to the quality of life of a place, the environment for businesses and the efficiency of its government. Middle-class families might move to DeKalb but they won't stay here if their children are forced to walk to school in the streets because there is no money for sidewalks, or they are fearful for their safety because the county cannot afford enough police or they are irritated constantly by antiquated traffic signals that are out of synch. And businesses will not move here if the roads are so clogged with traffic that employees cannot get to work or if the streets are so dirty shoppers avoid them. Plus, obviously, things wear out or are made obsolete.

In the short-term, then, HOST succeeded in making DeKalb a desirable place for middle-class families, but also succeeded in creating problems of its own. DeKalb's future depends not only on addressing the problems created by HOST but also in building public trust, improving public education and focusing on economic development.