Washington's Real Estate Excise Taxes (REET)

NAIOP has asked ECONorthwest, an economic consulting firm advising governments, business, and foundations, to provide perspective and commentary on the community and economic development impacts of land excise taxes related to proposals to expand these taxes in Washington. REET and other land transfer taxes are fairly inefficient forms of taxation and raise significant questions about the suitability of a property transaction tax as a robust policy instrument.

Graduated REET Proposal Increases State Rate by 134%

The current state 1.28% REET rate would be replaced with a tiered rate structure scaling with sale value. Properties under $500,000 would pay a 0.75% rate. Properties between $500,000 and $1.5 million would pay the current 1.28% rate. Properties between $1.5 and $7 million would pay a 2% rate. Properties above $7 million would pay a rate of 3%. There would still be the optional local rate for cities and counties of 0.5%, bringing the maximum rate to 3.5% in many places.[1]

REET Impacts Price, Number, and Timing of Transactions

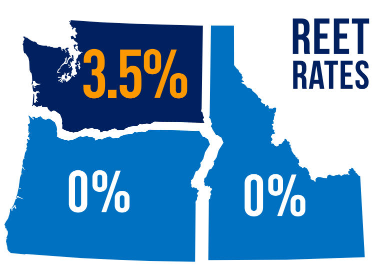
Buying commercial and residential real estate is a time-consuming and intricate process with large financial stakes. The transaction involves other costs like real estate brokerage commissions, inspection costs, legal fees, title insurance, mortgage application and insurance fees, and moving expenses. Excise taxes (or transfer taxes) increase the cost of buying or selling real property to account for tax payments. These taxes are fully capitalized into the value of land and are paid for by the owner of the property. These taxes cause large distortions to the price, volume, and timing of property transactions for residential and commercial uses.

REAL ESTATE EXCISE TAXES CAUSES SALES TO DECREASE

Two aspects of the REET proposal will cause sales and prices to decrease: The presences of graduated levels and the increase in the level of tax. In 2008, Toronto created a Land Transfer Tax. A subsequent study of the tax found that it reduced the volume of sales by 14%, on average.[2] A similar study in the New York region of the Real Property Transfer Tax found that a graduated rate structure tax itself reduced transaction volumes.[3]

REET Increases Place WA at an Economic Disadvantage

A good tax system should not place business and households located within the state at a competitive disadvantage relative to other states. A graduated REET would create excise tax rates as high 3.5%. Washington's neighboring states of Oregon and Idaho have no real estate excise taxes. The impact of these taxes will be felt strongest in neighboring metropolitan counties of Clark and Spokane. As a tax principle, the state tax system should not unduly burden businesses or households located, or considering locating, within the state of Washington relative to the tax systems of other states.



Washington State is increasingly a market for global capital investment in commercial real estate creating broad economic benefits. The proposed REET structure will decrease competitiveness of Washington commercial real estate industry compared to other similar situated US markets in West Coast (i.e. Portland, Bay Area, Los Angeles, Denver, Salt Lake City).

Washington Relies on Multifamily Housing

Growth Management directs development within urban places. Infill development of higher density housing is essential to achieving a range of community and environmental goals. Since 2010, the rate of housing unit growth in multi-family units has grown twice as fast as the rate of growth of single-family units.[4]

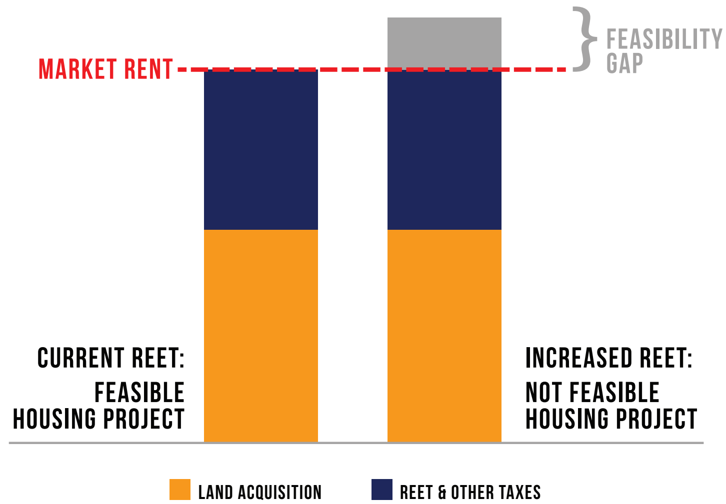
Yet, housing production has still not kept pace with population growth, incomes, and household formation. Land-use policies, fees, and taxes that make it difficult to build and reduce the productivity of urban land also create hidden costs on the existing supply while increasing overall prices. This, in turn, restricts the accessibility and affordability of land and housing in high-demand markets; creates barriers to economic opportunities; and contributes to economic displacement.

REET Impacts GMA Goals and Housing Affordability

Maintaining a healthy supply of new and moderate cost market-rate housing is critical for maintaining a future stock of affordable housing while meeting growth management goals. Taxes, fees, and other policies have an impact on a housing developer's ability to pay for the land - thus - their ability to build new housing units.

If inefficient taxes, fees, and policies drive down housing developers' ability to pay for property, the prospective site goes from being a housing development opportunity to maintaining the status quo of the existing use. All things being equal, adding additional tax burdens will incentivize local and global developers to prioritize other, lower cost markets for new projects versus Washington. The chart below shows how REET taxes can push a development project's cost above feasibility thresholds.

REET TAXES IMPACT HOUSING FEASIBILITY AND PRODUCTION



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REET Tax Expansion Creates Tax Equity Issues

A good tax system should distribute the tax burden across taxpayers in a manner that is consistent with the accepted norms of fairness. These norms typically define fairness according to the relationship between the amount of taxes paid to the benefits received by them from government programs. The proposed REET tax changes the burden of the tax for both 1) who pays the tax and 2) where the tax is paid.

Multifamily, Commercial, and Industrial Bear Tax Increases

The burden of the tax changes fall disproportionally on multifamily residential, commercial, industrial, agricultural, and natural resource uses. Based on a 2017 analysis of a similar legislative bill, single-family residential transactions under $250,000 will see their tax liability go down by $41 million. Meanwhile, multifamily, commercial, and industrial uses account for 80% of all new expected REET revenues.[5]

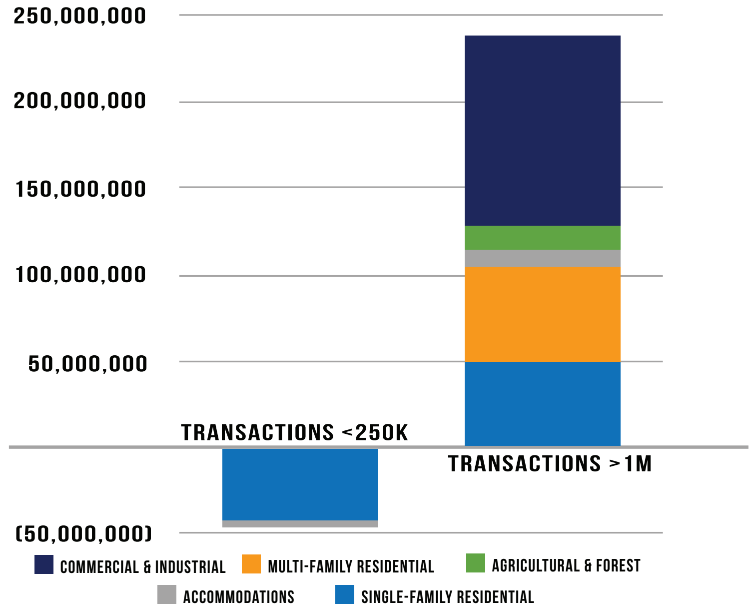
Pierce, Snohomish, and King Account for REET Tax Burden

The geographic burden of the REET tax will increasingly fall on a few areas of the state. In the fiscal year 2015, the counties of King, Pierce, and Snohomish accounted for 69% of the state's $726 million REET collections.[6] A move to a graduated REET structure is likely to accentuate the geographic burden of the tax further. For areas outside of the Puget Sound region, agricultural and resource lands are likely to bear a considerable burden of REET taxation.

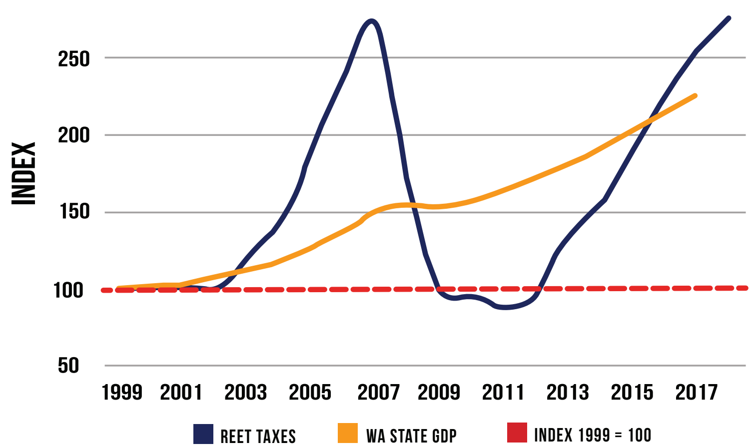
REET is a Volatile Tax Revenue Source

REET is an volatile revenue source and does not contribute to a stable tax system. Sound tax policy would avoid sources with large fluctuations each year. The more stable a mechanism, the more it can provide the revenue necessary to maintain public services notwithstanding variations in economic activity over the business cycle.[7] Historically, REET revenues have fluctuated wildly over time, it is not clear to what extent economic performance and tax elasticity have been factored into revenue estimates.

TAX BURDEN SHIFTS TO MULTIFAMILY, COMMERCIAL AND INDUSTRIAL



REET REVENUES SHOW BOOM-BUST PERFORMANCE



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1 HB 1921

2 Ben Dachos. The effects of land transfer taxes on real estate markets: evidence from a natural experiment in Toronto. Journal of Economic Geography (2011 pp 1-28)

3 Wojciech Kopczuk and David J. Munroe. Mansion Tax: The Effect of Transfer Taxes on the Residential Real Estate Market. (2014) Working Paper.

4 Washington State Office of Financial Management, Housing Unit Data for Single Family and Multifamily (2+ units) Housing Units, 2019.

5 Washington State Legislature. Bill Analysis for SHB 2186 (2017-2018). Excel file documenting net REET revenues by land use type.

6 Washington State OFM Forecasting and Research Division, State Expenditures and Revenues by County: Fiscal Year 2015. (September 2017)

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