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# *Empowering Cities and Towns to Tackle the Housing Shortage*

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# *Executive Summary*

Massachusetts needs new housing. Affordable housing, workforce housing, mid-market housing – we need it all. If our Commonwealth doesn't meet this housing crisis head-on, we might price out a generation of young people needed to fill critical jobs and help grow the Massachusetts economy.

The decisions made by cities and towns are pivotal in this effort. Local leaders oversee zoning rules, issue building permits, negotiate with developers, set tax rates, and welcome new residents and businesses into the community.

But new housing isn't always an easy sell, and while there are many ways to speed construction, not all efforts are equally effective.

Several Massachusetts cities and towns are petitioning the state Legislature for the right to impose new real estate transfer taxes, which would allow them to tax the sale of high value properties and dedicate the proceeds to affordable housing. Unfortunately, this approach is doubly fraught.

1. **Transfer taxes are highly inefficient, especially compared to established alternatives like the property tax.**
2. **There is no guarantee that the new tax revenue will actually be spent on housing, as we know from our prior analysis of poor compliance rates with the Community Preservation Act.**

*To highlight more effective alternatives and better understand the problems with transfer taxes, the Greater Boston Real Estate Board partnered with the Center for State Policy Analysis at Tufts University.*

# *Key Takeaways*

*Our analysis of existing research and the current landscape found that:*

**1**

Transfer taxes have substantial shortcomings. Even in the best of times, **cities would lose 35 to 45 cents for every $1 they expect to raise in new transfer taxes**, due to a combination of reduced property values and foregone sales.

**2**

**Transfer taxes inhibit property sales,** which is especially concerning now since the real estate market is frozen. And they disproportionately affect commercial real estate, a struggling sector in Massachusetts that is poorly positioned to absorb the cost of new taxes.

**3**

Often, what constrains affordable housing is not a lack of tax dollars but **excessive zoning restrictions and local legal challenges.** These impediments are amplified right now by high mortgage costs and a shortage of construction workers.

**4**

Where local revenue is needed, **the best alternatives generally involve targeted work-arounds for the limits of Proposition 2 ½.**

*What follows is a fuller discussion of these findings, including additional background on the known problems with the transfer tax, details on the strained condition of the real estate market, revenue challenges facing cities and towns, and the best available alternatives to help cities and towns expand affordable housing.*

# *The Trouble with Transfer Taxes*

The high cost of housing in Massachusetts is primarily a matter of will and only latterly due to a lack of tax revenue.

For decades, Massachusetts communities have made construction too onerous through a combination of excessive regulation, unworkable zoning, and protracted local legal challenges. The best path to housing abundance and real affordability in Massachusetts would be to dramatically shift the balance in favor of smoother development.

At the same time, it is also true that public dollars can make a difference. Taxpayer funding can be used to turn existing units into public housing, provide rental vouchers, convert commercial buildings to residential use, and help finance new construction.

*"Transfer taxes are, however, extremely inefficient, far less reliable than local property taxes. And they actually make it harder to buy and sell properties."*

In order to succeed, communities need to raise revenue in the fairest and most efficient way possible while ensuring that the proceeds generate sufficient housing affordability. Real estate transfer taxes fall short on both of these fronts.

The concept behind transfer taxes is straightforward. With permission from the Legislature and Governor, cities and towns across Massachusetts could introduce a new tax on high-value real estate transactions, with the threshold for "high value" set above $1 million or the median county home sale price.

Communities that adopt a transfer tax, with legislative approval, would then collect a share of the proceeds every time an expensive house, office, or apartment building is sold.

Transfer taxes are not an entirely novel idea. Massachusetts already has a tax that works this way, the deeds excise tax. In addition, many cities and states around the country have their own real estate transaction taxes.

Transfer taxes are, however, extremely inefficient, far less reliable than local property taxes. And they actually make it harder to buy and sell properties.

A report commissioned by the City of Boston, which itself is pursuing a transfer tax, found the same conclusion: "The professional literature analyzing the impact of transfer taxes finds that the taxes reduce the volume of sales and lower prices approximately equal to the level of the tax."

The Boston report says, in other words, that a new transfer tax of 1 percent would lower property values by that same 1 percent, while substantially reducing the number of sales. And these findings are likely optimistic because the literature the city references has tended to focus on thriving housing markets, not a struggling market like we see in Massachusetts.

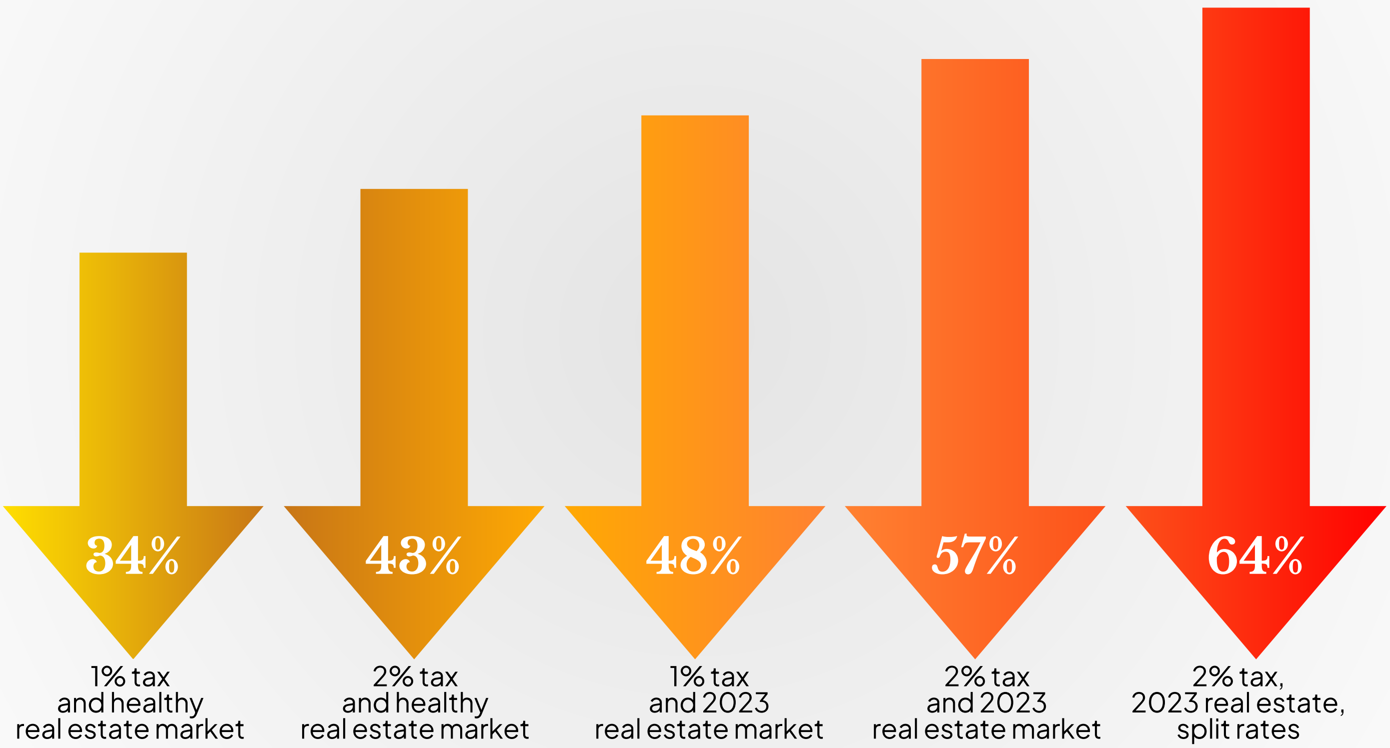
If, as the research suggests, a 1 percent transfer tax reduces prices by 1 percent, it is important for communities to balance any expected tax gains against potential expected losses. While municipalities could collect new transfer tax dollars when properties are sold, they would collect less in property taxes over time since transfer taxes push down property values.

Massachusetts communities should also expect that as cigarette taxes discourage cigarette purchases, transfer taxes will discourage real estate transactions, both residential and commercial. Los Angeles, for instance, has seen a dramatic decline in sales since its transfer tax took effect in 2023. Research suggests that sales decline by 7 percent or 8 percent for every 1 percentage point increase in the tax, which means the tax will generate less revenue than predicted.

Our research shows that, when times are good and buildings are selling, cities and towns that introduce a 1 percent transfer tax on high value properties will lose 34 cents for every $1 they expect to raise and, if communities opt for a 2 percent transfer tax, they'd lose 43 cents. The transfer tax shortfall is due to the combined impact of shrinking sales and lower property values.

## *Transfer taxes raise less money than expected*

Revenue shortfall from reduced sales and property taxes, compared to expected transfer tax collections




Source: cSPA calculations for tax on high value real estate transactions. Underlying data from the Warren Group.

The data shows that, when the real estate market is struggling, as it is right now, the transfer tax is even less efficient. A 2 percent transfer tax in place in 2023 would have produced offsetting losses of nearly 60 cents for every expected dollar.

The offsetting loss of tax dollars is just one of several problems with a transfer tax.

People sometimes overlook the fact that transfer taxes apply to commercial properties, as can be seen from the fact that it's occasionally referred to as a "mansion tax." Current proposals actually have a disproportionate effect on commercial properties because they're limited to high-value transactions and commercial properties are, on average, far more expensive than houses.

A high-value transfer tax would put additional pressure on the most distressed part of our current real estate industry and likely cause higher rents as the tax is passed on to tenants in multi-family buildings.

The transfer tax would also have a more direct effect on the regional economy, as any disincentive to sell property could keep owners from handing the keys to new organizations with more productive ideas.

Finally, there is deep uncertainty about whether the money raised through a transfer tax would actually be used to support new housing. Our recent study of a separate program, the Community Preservation Act, found many towns failing to spend even the minimum 10 percent of proceeds on housing.

The available research and data makes it clear: Not only does a transfer tax raise less money than anticipated, it performs worse in bad economic times, keeps buildings from being put to their best economic use, disproportionately affects the already-strained commercial sector, and can't guarantee effective spending.

# *Transfer Taxes in the Current Climate*

Taxes work best when they target healthy industries and thriving economic sectors, as that resilience provides a cushion to absorb tax increases.

But right now the statewide real estate sector is facing real and measurable distress, including falling wages in some key areas, job losses, and a general lack of opportunity affecting virtually every corner of the state.

Real estate agents in Massachusetts are earning 10 percent less than they were before the pandemic. In Boston, the drop-off is twice as big.

Businesses that lease out and manage residential properties, including apartment buildings, have been cutting jobs across the state. The number of workers in that industry fell 30 percent in Barnstable County and by more than 50 percent in Hampden, Franklin, and Bristol counties.

Wages across the real estate industry — from agents and building managers to developers and construction workers — have dropped roughly 20 percent in Berkshire and Worcester counties, and by more than 10 percent on Nantucket.

On the commercial property side of the economy, management companies in Worcester County have reduced their workforce by 20 percent and wages by 60 percent since 2019.

Available data shows the commercial sector struggling in every corner of the state. New office building construction is stalled because companies don't need space; high borrowing and insurance costs have reduced the profit margins on new apartment buildings; and stretch codes and other new regulations are adding costs to projects everywhere.

Overall, Massachusetts is not the picture of a healthy housing industry, the kind that could continue to power growth while absorbing new tax levies from cities and towns. Until interest rates fall, or offices are utilized again, new development will be difficult to catalyze.

## *Wages are falling across commercial real estate*

Change in real weekly wages, 2019–2023

| *Area* | *Multifamily Construction* | *Commercial Construction* | *Commercial Lessors* | *Commercial Property Managers* |
|---|---|---|---|---|
| Massachusetts | -7.6% | -7.8% | 1.4% | 0.0% |
| Barnstable County | 3.0% | N/A | -10.8% | -1.5% |
| Berkshire County | N/A | -6.1% | 12.4% | -26.3% |
| Bristol County | -34.1% | -3.1% | -0.7% | -9.3% |
| Essex County | 2.4% | -5.0% | -0.3% | -1.6% |
| Franklin County | N/A | N/A | -13.9% | N/A |
| Hampden County | N/A | -6.3% | -17.3% | 14.7% |
| Hampshire County | N/A | N/A | 6.7% | -34.4% |
| Middlesex County | -20.9% | -12.2% | 11.4% | 13.9% |
| Norfolk County | -0.1% | -4.2% | 8.3% | -0.4% |
| Plymouth County | -32.1% | -5.4% | -10.9% | -14.2% |
| Suffolk County | -0.9% | -7.3% | -2.3% | -2.9% |
| Worcester County | N/A | 1.0% | 9.4% | -60.7% |

Source: Quarterly Census of Employment and Wages, Bureau of Labor Statistics

# *The Fiscal Challenge for Cities and Towns*

With the real estate market flagging, and commercial properties facing generational stress, cities and towns are genuinely struggling to raise revenue for affordable housing and other key investments.

Massachusetts municipalities are bound by the limits of Proposition 2 ½, and those limits are not compatible with recent levels of inflation and wage growth.

How can towns keep up with road repairs when the cost of construction materials increases 12 percent (as it did in 2022) and their revenue rises by just 2.5 percent? How can communities attract teachers with the promise of 2.5 percent raises, when workers elsewhere are seeing 4 or 5 percent wage growth?

In the past, cities and towns with revenue needs could collect more property taxes than otherwise allowed by building more stuff.

New construction and major renovation don't count toward the 2.5 percent cap. Cities and towns hoping to make new investments can increase revenues by permitting new office buildings, retail spaces, apartment complexes, or big residential developments.

Commercial developments are especially prized by communities since they often pay a higher tax rate — and since offices don't dramatically increase demands on the city budget, whereas new apartment buildings generally mean more kids in local schools.

But this whole dynamic — where new construction gives towns the ability to circumvent Proposition 2 ½ — is now in jeopardy, thanks to the rise of remote work, higher interest rates, and the general downturn in the commercial real estate market.

Additionally, the way tax rates work in Massachusetts has left some cities and towns especially vulnerable.

Many municipalities levy a higher property tax on commercial properties, meaning overall tax collections fall at a more rapid rate when the commercial industry struggles.

## *Quick Facts on Proposition 2 ½*

*Introduced via a 1980 ballot initiative, proposition 2 ½ imposes two tight limits on Massachusetts cities and towns:*

1) Property taxes can't rise more than 2.5 percent in any given year (with an important exception for "new growth.")

2) Total property tax collections can't exceed 2.5 percent of the value of all taxable property

*Add in the fact that Massachusetts municipalities are not allowed to introduce local sales or income taxes, and these rules place tight limits on municipal revenue.*

### *Cities with higher commercial rates are more exposed to current downturn*

2024 municipal property tax rates

| *Municipality* | *Residential Rate* | *Commercial Rate* |
|---|---|---|
| *Holyoke* | *1.9* | *4.0* |
| *Pittsfield* | *1.8* | *4.0* |
| *Springfield* | *1.6* | *3.5* |
| *North Adams* | *1.7* | *3.6* |
| *Chicopee* | *1.5* | *3.2* |
| *Burlington* | *0.9* | *2.6* |
| *Worcester* | *1.4* | *3.0* |
| *Westfield* | *1.6* | *3.1* |
| *Ayer* | *1.2* | *2.7* |
| *West Springfield* | *1.5* | *3.0* |
| *Bedford* | *1.2* | *2.7* |
| *Wilmington* | *1.1* | *2.6* |
| *Boston* | *1.1* | *2.5* |
| *Seekonk* | *1.2* | *2.7* |
| *Avon* | *1.4* | *2.8* |

Source: Massachusetts Division of Local Services

# *There Are (Many) Better Options*

If the transfer tax were the only way for cities and towns to slip their fiscal straitjackets and fund investments in affordable housing, perhaps its weaknesses could be overlooked. But alternatives to support the creation of new affordable housing abound.

The most significant reason housing costs have skyrocketed across the state is because we've made it too costly and too cumbersome to build new housing. This can be addressed with better regulations.

The state has taken a vital step in this direction by passing the MBTA Communities Act, which requires many cities and towns in Greater Boston to loosen zoning restrictions.

*Other states are pursuing more aggressive reforms, some of which are bearing significant fruit. This includes:*

- **Setting core expectations for overall housing production or affordable production**, and imposing a builder's remedy on municipalities that fall short, as is happening in California. Under a builder's remedy, if communities fail to produce sufficient new housing, developers would be able to bypass local zoning rules. In Massachusetts parlance, a builder's remedy is akin to a beefed-up version of what we call 40b, with even less local recourse and even more scope for developer activity.
- **Allowing accessory dwelling units (ADUs) by right**, as included in the Governor's housing bond bill.
- **Setting clear expectations about local and legal review**, so developers know how long approval processes can take — and what recourse they have in case of delay.
- **Tracking and overseeing existing pots of money meant for affordable housing**, including funds in local housing trusts, which rarely report their activity, as well as revenue from the Community Preservation Act, which sometimes sits in municipal bank accounts.

The solutions detailed here don't require additional local funds and yet each could spur significant housing production and reduce housing costs.

*Additionally, there are ways to accelerate progress by helping towns raise new revenue for housing investments, including:*

- **Exempting affordable housing initiatives from Proposition 2 ½**, just as the state allows for new growth. To make this exemption especially appealing, the state could include a multiplier, allowing municipalities to exempt not just the tax value of new affordable housing but 5 times or 10 times that value. For maximum impact, the state could also exclude taxes on existing affordable housing from the other limit in Proposition 2 ½, where collections are compared to total assessed values. Lastly, there's no state compulsion here, just a new option towns can take or leave.
- **Allowing municipalities to introduce a new, CPA-like property tax surcharge for the express purpose of affordable housing**. Alternatively, the state could permit higher CPA surcharges — or offer a higher state match — when cities and towns commit 80 percent of the revenue to housing. In either case, better rules and oversight would be required to make this work; otherwise, we might exacerbate a key weakness of the CPA, where many cities and towns fail to properly invest their revenues.
- **Vastly expanding the number of state vouchers** is the surest, fastest way to ease the cost-burden for struggling residents — allowing developers to focus their energies on building for a broad market while ensuring that lower-income residents only pay what they can afford.
- **Pooling money at the state level** is often more effective than authorizing local spending. Scale means the state can amass much larger sums while ensuring more consistent priorities and better coordination across regions. With an infusion of new funds, existing entities like MassDevelopment could expand their role as catalysts for affordable construction.
- **Pursuing a new generation of public housing purchases and projects**, following the lead of innovative public agencies in places like Montgomery County, Maryland.

When it comes to solving the housing crisis in Massachusetts, the real challenge is not a lack of good ideas. What is needed is a durable commitment to funding and enforcing the best of them while avoiding less promising paths.

# *Conclusion*

Massachusetts seems poised to take bold steps toward a future of abundant, affordable housing.

But making up for decades of under-investments will require decades of thoughtful interventions. The state needs to borrow the best approaches, avoid counter-productive steps, and innovate.

Given the many proven options, real estate transfer taxes stand out as a particularly inefficient and risky tack, with a host of unintended consequences that will cost municipalities money, imperil the already-flagging commercial sector, and actually make it harder for people to buy and sell properties.

Where there is a real desire to build affordable housing, a lack of local tax revenue is rarely the key impediment. And even then, the best solutions generally involve state dollars or freedom from some limits of Proposition 2 ½.

*Empowering Cities and Towns to Tackle the Housing Shortage* was compiled in May 2024 by the Center for State Policy Analysis with assistance from the Greater Boston Real Estate Board.