is due from the seller of the unit at the time of occupancy. I assume that this tax would not show up on the closing statement at time of sale.

FINANCIAL EFFECTS OF TAX

Building Costs

It can be assumed that increased building costs resulting from the excise tax will be shared among four parties:

1. **The federal government.** This tax will be deductible for federal income tax purposes. Therefore, 33% of the tax (assuming the highest marginal rate) will be passed on to the federal government by the developer.

2. **The landowner.** In strict economic terms, land prices are established on the basis of the value of the land to the developer. The developer's profit is constrained by the costs of development and the market constraint on the ability to pass through development costs. Assuming that all costs of the excise tax cannot be passed on to the consumer, the price that the developer will be willing to pay for the land will decrease.

3. **The developer.** New building prices are constrained by market forces including disposable income, inflation, competition, and real estate market conditions. It can be assumed that these forces will prevent the developer from passing all excise tax costs on to the consumer.

4. **The consumer.** Some costs of the new excise tax will be borne by the consumer in the form of higher prices.

Ancillary Effects. It can also be assumed that the effect of the excise tax will be reflected in the price of existing dwellings and commercial structures. If the prices of new construction increase, the purchase of existing structures becomes more attractive, thus increasing demand and price for existing structures. Over a relatively short time, the entire real estate market will reflect the increase in value associated with the existence of the excise tax. Interesting enough, in an aggressive tax assessment environment such as the one that now exists in Oregon, property taxes will also be affected by the increase in property values associated with the excise tax.

METRO

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Memorandum

DATE: December 24, 1991

TO: Jennifer Sims, Director of Finance and Management Information

FROM: Christopher Scherer, Financial Planning Manager

RE: EXCISE TAX ON NEW CONSTRUCTION

You asked me to review materials from the Metropolitan Washington Council of Governments related to the imposition of an excise tax on new construction. The results of my review are below.

OVERVIEW

Montgomery County has proposed to impose an excise tax on new residential and commercial construction. The tax would be calculated on the basis of square footage constructed in the following amounts:

Single-family residential	$3.75
Multi-family residential	$3.00
Warehouse, manufacturing, research and development, and nonprofit office	$2.40
Other non-residential (office, retail)	$4.00
Nonprofit care-giving facilities, private schools	$1.00

Exemptions include:

1. The first 1,200 square feet.
2. Basements with ceilings below 7 feet 6 inches (the legal limit for conversion to living space)
3. Carports
4. Buildings used for religious activities
5. Moderately priced dwelling units (as defined by law)
6. Productivity housing units (as defined by law)
7. Rent- and price-controlled housing units

The receipts of this excise tax are intended to pay for infrastructure improvements required to accommodate the growth resulting from new construction. The excise tax

Potential Tax Receipts

In the materials I reviewed, it is estimated that $13 million per year will be collected through the imposition of the excise tax in Montgomery County. A very rough estimate for the Portland area shows that there may be higher potential for earnings in the Metropolitan Service District. The Metropolitan Portland Real Estate Report for 1990 shows that building permits for 8,315 single unit dwellings were issued in the tri-county region. Assuming that the average new dwelling built in 1990 was 2,000 square feet, the resulting excise tax per dwelling would be $3,000 (2,000 square feet - 1,200 square feet X $3.75). This amount multiplied times 8,315 equals $24,945,000. The addition of multi-family units and commercial construction leads me to believe that the potential exists for a great deal of revenue under the Montgomery County pricing structure and formula.

ISSUES TO CONSIDER

Housing Affordability

By exempting the first 1,200 square feet of construction from the calculation, Montgomery County has somewhat ameliorated the effects of this tax on the price of single-family homes. In particular, smaller homes that may fall into the lower priced and more affordable categories, could escape the bulk of the tax. However, increasing land costs stimulate builders to construct larger homes to ensure adequate cost recovery. The majority of new houses on the market these days are over 1,200 square feet. Although it can be reasonably assumed that the landowners and the developers would bear some of the costs, this tax will effect the housing affordability. Even if the price reflects only half the tax on a 2,000 square foot home ($1,500), certain buyers will be priced out of the new home market. As previously stated, this price increase in real property will soon be reflected in existing homes as well as new construction and result in a generally less-affordable housing market. The effects of the new tax on existing home values will result in wind-fall profits for home owners and governments receiving property taxes.

Cost of Administration

Montgomery County estimates that administering this program would cost $350,000 in the first year and $100,000 in each year thereafter. I have no basis on which to evaluate this estimate, but believe that it is probably quite low, especially for the years after the first year. A Metro staff of two accountants, a supervisor, and a secretary would cost approximately $275,000 per year without counting occupancy and other support.

Opposition

It can be reasonably assumed that a tax of this sort would be considered anti-growth. The information I reviewed indicates that this is the case in Montgomery County. The County Council has ameliorated the effects of the opposition on this basis by phasing the program in over time, under the assumption that the slump in the housing market will eventually subside, and specifically earmarking the receipts for infrastructure improvements that will ultimately effect the County's growth climate. However, I believe business opposition to this measure cannot be underestimated. Clearly opposition will occur from the development community, home builders' associations, the construction community (potentially including the rank and file workers), and the realtors' associations.

Opposition to such a tax would be very likely to emanate from the Metro's suburban regions. These regions are currently benefiting from the bulk of the growth and would oppose measures that would slow growth. Obviously, fund distribution formulas that guarantee a sharing of receipts with the suburban districts are critical to acceptance.

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Please let me know if you require further analysis.