Illinois’ Response to Rising Residential Property Values: An Assessment
Growth Cap in Cook County

Richard F. Dye
Institute of Government and Public Affairs, University of Illinois, Chicago, Illinois 60607
and
Department of Economics, Lake Forest College, Lake Forest, Illinois 60045

Daniel P. McMillen
Institute of Government and Public Affairs
and
Department of Economics, University of Illinois, Chicago, Illinois 60607

David F. Merriman
Institute of Government and Public Affairs, University of Illinois, Chicago, Illinois 60607
and
School of Business Administration, Loyola University, Chicago, Illinois 60611

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Abstract - A recent policy change caps the annual percentage increase in the assessed value of owner–occupied homes in Cook County, Illinois. Assuming that total revenue would remain constant, the result is relief for some financed by higher taxes on others. We estimate these tax burden shifts using data on all individual parcels and individual units of government in the county. We examine other aspects of the policy. In particular, we look at some of the difficulties in using changes in aggregate tax shares for residential versus non–residential property over time to justify or analyze a policy like this.

CONTEXT

Between 1996 and 2005, house prices nationwide increased by 45 percent after adjusting for inflation (Baker, 2005). This created more than $5 trillion in housing wealth, which led to greatly expanded property tax bases nationwide. For many localities this has been a mixed blessing.

One might think that local government leaders would welcome the run–up in residential values because it increased the wealth of residents and simultaneously provided an opportunity to increase property tax revenue while cutting the property tax rate. The rapid increase in the tax base should have been particularly welcome because it occurred during the period when state government budgets and intergovernmental aid were quite constrained due to dramatic falls in sales and income tax revenues after the recession of 2001.

However, like any sudden change, rapid residential appreciation disrupted the status quo. Residential real estate generally appreciated faster than commercial or industrial properties and some residential properties appreciated more rapidly than others. This meant that the increase in residential values was accompanied by a potential shift in relative tax burdens. Furthermore, it was argued that rapid appreciation threatened to alter the character of some low– and moderate–income neighborhoods in at least two ways. First, in–movers were disproportionately higher income than existing households because low– and moderate–income households could no longer afford these neighborhoods. Secondly, some
low- and moderate-income households had such tight liquidity constraints that increased property tax liabilities resulting from rapid appreciation presented a cash flow problem that could not be offset by the large capital gains. Local governments nationwide were pressured to enact policies that would preserve the status quo and protect vulnerable households.

How did these policy changes alter the vertical and horizontal equity, efficiency and administrative simplicity of the property tax? Did these policy changes remedy the problems they were designed to solve and did they create new problems? Are better alternatives available? We cannot give definitive answers to these questions, but we present one case study that we believe sheds some light on these issues and highlights their importance.

THE RATIONALE FOR POLICY CHANGE IN ILLINOIS

The state of Illinois responded to these pressures by enacting, in July 2004, a new state law allowing county boards to impose a cap on annual increases in residential property tax assessments. The cap takes the form of an expanded homestead exemption for owner-occupants. The law was sought by the Cook County Assessor and was designed to reduce the burden of large tax increases caused by rapid appreciation in home prices. The Cook County Board immediately implemented the cap and it was effective for tax year 2003.1

The law is now up for renewal and we, under the auspices of the Institute of Government and Public Affairs of the University of Illinois, were asked by the Illinois Department of Revenue to prepare a report on some of the effects of the cap (Dye, McMillen, and Merriman, 2006). In this paper, we briefly describe the findings of our report and examine the arguments for implementing or extending the cap.

Property in Cook County is reassessed on a three-year cycle: the City of Chicago was reassessed in tax year 2003; the North suburbs were reassessed in tax year 2004; the South suburbs were reassessed for tax year 2005; and the cycle starts again in Chicago in tax year 2006. Cook County also “classifies” the property tax base, with different assessment-to-sales ratios for different types of property specified in county ordinance.

The primary argument made for the cap stressed the increases in home prices and the burdens or cash flow problems from big one-year increases in tax bills. The increases can be substantial and sudden. Since Cook County assesses on a triennial cycle, three years of property appreciation show up in a single reassessment. The Cook County Assessor’s Office (2005) reports that, absent the cap, from tax year 2002 to 2003 residential property tax assessments in the City of Chicago: had a citywide median increase of 35 percent; increased more than 70 percent in a number of neighborhoods; and increased more than 150 percent for many individual parcels. The illiquid nature of property wealth along with increases of this magnitude raised the specter—familiar to property tax limitation debates—of

1 In Illinois, a tax year is the as-of year for property value assessments, but the taxes are billed and collected in the following calendar year. For example, tax year 2003 represents assessments as of January 1, 2003 and levies, the amount of property tax income sought by local government agencies, as of December 2003. The first installment of Cook County 2003 tax bills is billed in January 2004 and due on March 1, 2004. Because there is not sufficient time to compile all the information needed to finalize tax rates, the first installment is an estimate based on prior year amounts. The County Clerk is given the assessment and levy information and calculates tax extensions, the aggregate amount that goes on tax bills after various rules and limitations are applied, and the corresponding tax rates. The second installment of Cook County 2003 tax bills are billed in September 2004 and due on November 1, 2004. All of the change from the prior year shows up in this second installment, which is why a law passed in the summer of 2004 could be implemented in time to impact 2003 tax bills.
long–time, lower–income, especially elderly residents driven from their homes by taxes. The idea was that the tax cap would “smooth” year–to–year changes in tax bills and soften the impact.

A second argument for the limitation involved a comparison of the aggregate shares of the tax base or burden borne by residential compared to non–residential properties. Over the last seven years, the aggregate share of Cook County taxes paid by residential property has increased, while the share paid by commercial property owners has decreased (Cook County Assessor’s Office, 2005).2

THE CAP

The new law had some statewide and permanent features as well as the temporary and county–option assessment cap, which only Cook County adopted. Statewide, the general homestead exemption was set at $4,500 in tax year 2003 and then increased to $5,000 in 2004 and thereafter. The senior citizen homestead exemption was also increased permanently and in all counties.

Under the portion of the new law that only Cook County adopted: eligible homeowners who experience increases in assessed value of less than seven percent get the general homestead exemption of $5,000 ($4,500 in 2003); homeowners who experience property appreciation greater than seven percent receive an expanded homestead exemption that effectively caps assessment increases at seven percent; and the maximum value of the expanded homestead exemption is $20,000. The assessment cap law is due to sunset over the next three years, starting with the Chicago reassessment triad in tax year 2006, and the legislature is considering whether to extend it in its present form, revise it, or allow it to end. An initial attempt to extend the law was defeated in the Illinois House in the spring of 2006, but the bill will be reintroduced in the next session.

THE BASIC RESULT IS A SHIFT IN TAX BURDENS

If local government spending remains constant, a change in property tax policy that reduces the payments of one group will raise the payments of other groups. The expanded homestead exemption will result in a shift in tax burdens, rather than an overall decline in tax burdens. There are some restrictions on how much a local property taxing unit of government in Illinois can increase tax rates, but generally the tax rates will go up in order to maintain total tax collections and the level of government services.3 The reduction in taxes for eligible homeowners is paid for by a comparative increase in taxes for other taxpayers—owners of commercial and industrial properties and vacant land; owners, or perhaps renters, of apartment buildings. Also, homeowners with less than seven percent appreciation, though counted as “eligible” for the program, experience higher rates but do not receive an expanded exemption.

Moreover, the across–the–board increase in tax rates will also affect recipient households, so the benefit from the expanded homestead exemption will be partially offset by paying higher rates on the remaining taxable property value. There will even be some recipient homeowners who are net losers, with an expanded exemption above the minimum but not high enough to offset the increase in rates. For example, in a bedroom community where the average increase in property val-

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2 A third argument pointed to the decline in the real value of the Homestead Exemption over time.
3 It would be more precise, but less compact, to say “tax rates are higher than they would be in the absence of the cap” instead of “tax rates go up.” Over time, Illinois tax rates have been generally going down. With the assessment cap in Cook County, they have gone done less than they otherwise would have.
ues is 30 percent, an individual homeowner with property appreciation of only 20 percent will have their assessment capped at seven percent, but will see tax rates go up by a more–than–offsetting amount to pay for the relatively more generous value of the assessment cap to their neighbors. For a second example to make the same point, suppose an individual property experiences appreciation of ten percent. If the appreciation allowed for tax purposes is capped at seven percent, that is a tax base reduction of three percent. But if tax rates go up by four percent, the property owner will receive a tax bill that is one percent higher than it would have been.

The impact on each individual property taxpayer in the county depends on a complicated set of factors: eligibility for the cap; eligibility for other assessment limitations; location of the property in the county and, thus, in the triennial reassessment cycle; location of the property in terms of the specific constellation of jurisdictions (municipality, school districts, special districts) to which property taxes are paid; own–property appreciation rate relative to the seven percent floor; own–property appreciation level relative to the $20,000 maximum exemption; own–property appreciation rate relative to the appreciation rate for other eligible properties; and the share of ineligible property in the tax base. The biggest benefit of the cap, compared to the case where there is no cap, will accrue to eligible properties that appreciate rapidly and are in areas where ineligible properties are a large share of the tax base. The large ineligible share means the revenue–neutral increase in tax rates is relatively small. The biggest burden of the cap will accrue to ineligible property owners with a low share of the tax base in an area where eligible properties are appreciating rapidly.

HOW WE ESTIMATE THE TAX SHIFT

We measure the impact of the seven percent assessment cap law by calculating property tax bills with the expanded homestead exemption in place compared to a revenue–neutral alternative policy where all homeowners get a flat $5,000 ($4,500 in 2003) exemption. Just as the benefits and burdens of the expanded homestead exemption vary across types of property, they vary geographically due to both different property mixes and different appreciation rates in different local areas. The benefits and burdens of the assessment cap also vary over time due to the triennial assessment cycle and temporally differential appreciation rates.

The Cook County Assessor’s Office provided us with parcel–level data on assessments, other exemptions, and property class for 1.7 million parcels in each year. The Cook County Clerk’s office provided us with jurisdiction–level data on levies, aggregate assessments, and tax rate calculations for over 850 local taxing districts. We use these two data sets to estimate the property tax payment due on each Cook County parcel with and without the expanded homestead exemption for tax years 2003 and 2004. The Illinois Department of Revenue provided us with over ten years worth of home sales data for Cook County, which we use to project property value appreciation for tax years 2005 to 2008. With this we extend our calculation of the difference in tax burdens with and without the expanded exemption past the years we observe. (For a more detailed description of the data and method, see the appendices to Dye, McMillen, and Merriman (2006)).

Eligible homeowners whose assessments would otherwise increase by more than seven percent benefit from the cap, some of them significantly. Taxpayers who do not qualify—owners of commercial or industrial property, apartment buildings, senior citizen homeowners who qualify for a different program that freezes assessments (as well as homeowners with appreciation below the seven percent floor)—experience an increase in tax
Illinois’ Response to Rising Residential Property Values

burdens from higher tax rates. As noted, even some of the recipient homeowners will lose more from the increase in tax rates than they gain from the cap on their assessments. In our report for the Illinois Department of Revenue (Dye, McMillen, and Merriman, 2006), we examine the average benefits and burdens for eligible and ineligible taxpayers broken down by year, reassessment–year triad, community area within the City of Chicago or municipality in the suburbs, area income levels, and house value levels.

THE OVERALL RESULTS

In the report, we break down the tax shift from the assessment cap in many ways (enough to cover 123 pages of tables), but the overall results are summarized in the following single table, which presents the average benefits or burdens at the reassessment–year triad level. (The bolded cells in the table highlight the year in which the cap started in each of the three areas.) In tax year 2003 when the assessment cap was first in effect in Chicago, eligible homeowners saved an average of 14.2 percent on their tax bill—compared to what it would have been without the expanded exemption. That was the average—those with the highest rates of appreciation saved much more and those with the lowest rates of appreciation actually came out behind. Seventy–five percent of eligible Chicago homeowners benefited from the assessment cap in 2003 (see Table 3.2 in Dye, McMillen, and Merriman (2006)). While a majority of Chicago homeowners benefited from the assessment cap in 2003, all non–homeowner Chicago property taxpayers—the ineligible parcels in Table 1—were subjected to higher rates that cost them, on average, 4.1 percent more in taxes. In that same year, because Cook County government tax rates went up countywide to compensate for the decrease in the tax base in the Chicago portion of the county, tax burdens for all taxpayers—both eligible homeowners and ineligible non–homeowners—in the North and South suburbs went up by a fraction of a percent. Reading across the first row of the table, we see that the value of the expanded exemption was worth less to Chicago homeowners over time, mainly because their assessments can increase by another seven percent in 2004 and another seven percent in 2005.

In 2004, the North suburban triad was reassessed and Table 1 shows our estimate that eligible homeowners there saw tax bills that were, on average, 9.1 percent lower than they otherwise would have been. Again, that benefit to some came with an increased burden to others—a 6.6 percent higher tax bill for commercial property owners and other ineligibles in the North suburbs and a slightly larger

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<td><strong>AVERAGE CHANGE IN TAX PAYMENT HAD THE EXPANDED HOMEOWNERS EXEMPTION NOT BEEN ENACTED (FOR ELIGIBLE AND INELIGIBLE PARCELS BY REASSESSMENT YEAR TRIAD)</strong></td>
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<td>Cook County Triad</td>
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<td><strong>Eligible parcels (average for homeowners who qualify):</strong></td>
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<td>North Suburbs</td>
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**Ineligible parcels (other residential, commercial and industrial property, and apartment buildings):**

| | 2003 | 2004 | 2005 |
| Chicago | -4.1% | -4.2% | -3.3% |
| North Suburbs | -0.3% | -6.6% | -5.3% |
| South Suburbs | -0.2% | -0.4% | -5.8% |

Source: Table 3.1 in Dye, McMillen, and Merriman (2006).
county government portion of the tax bill for all those in the South suburbs. In tax year 2005 when the South suburbs were reassessed, eligible homeowners got an average 6.4 percent benefit and all other property owners there saw a 5.8 percent burden from higher tax rates. Note that the South suburbs had to wait longer to get the expanded exemption and, partly because their home values were not appreciating as rapidly as in other areas of the county, it was worth relatively less to them when they finally qualified.

Although we did not have data on the income of households and, therefore, were not able to analyze the impact of the cap by income class, we did cross tabulate the benefits of the cap with real estate values, which may have a strong correlation with income. On average, eligible parcels in Chicago got a property tax cut of about 14 percent. In the relatively rich, and fast–growing, North suburbs, the benefits were a smaller proportion of tax payments but larger dollar amounts per parcel. In the relatively poor, and slow–growing, South suburbs, proportional and dollar value benefits were much smaller. In all three areas we found that, among eligible households, the effect of the cap was fairly neutral with respect to the house value in most of the value distribution, but declined in the top two deciles (mostly because of the effect of the $20,000 ceiling on the expanded exemption). We also had median income data at the municipal and Chicago neighborhood level, but did not find a systematic relationship between the policy and the vertical distribution of income.

FRAMING THE COMPARISON

In studying the effects of the seven percent cap, we emphasize a single comparison—a within–year, revenue–neutral comparison of what property taxes would be with the assessment cap and what property taxes would be without the cap. This is pretty direct and, we argue, the single most appropriate measure for starting a ceterus paribus evaluation of the cap. When the Cook County Assessor’s Office (2005), an advocate for and the original author of the proposal, analyzes the effects of the cap, they emphasize two different comparisons: (1) trends in the aggregate shares of residential versus non–residential property; and (2) year–to–year changes in tax bills.

For example, in Table 1 we frame the first–year impact on Chicago homeowners as an average “benefit” of 14.2 percent. The Assessor’s Office would frame the same comparison as a “decrease in the burden” of higher taxes. They would emphasize how much taxes would otherwise increase and that the increase is partly due to a declining share of non–residential property. They would note that, compared to the prior year, eligible homeowners’ tax bills still go up, tax rates generally go down, and the non–residential share of the total burden still goes down. While such comparisons might provide some useful context for understanding the rationale for the policy, they introduce additional sources of variation that are not due to the assessment cap per se.

1. With respect to the comparison of aggregate shares of residential versus non–residential properties, there is nothing in Illinois tax law or, as we read it, principles of tax policy concerning aggregate tax shares by class. The economic principles of equity and efficiency (not to mention administrative simplicity) suggest that property should be assessed uniformly with respect to its market value. If different classes of property are to be treated differently, it should be an explicit legislative decision. Cook County does have authority under the state Constitution and an ordinance that specifies higher assessment–to–sales ratios for
Illinois' Response to Rising Residential Property Values

non–residential property, but these assessment fractions do not depend on aggregate burden shares.4 There are three separate reasons why the aggregate share of residential assessed values might change.

(a) There may be new construction or conversions that increase the numbers of residential versus non–residential properties. This was in fact the case in Chicago, which has been experiencing a significant number of conversions of commercial properties to residential condominiums. In their analysis of the seven percent cap, The Civic Federation (2005) documents an increase of 7.4 percent in the number of residential units between 2000 and 2003 and a 1.4 percent decrease in the number of non–residential parcels over the same period. A change in aggregate value shares due to conversions, new construction, or differential rates of improvement does not justify a policy that reduces per–unit residential assessments.

(b) A second reason the ratio of aggregate residential versus non–residential assessed values could change is assessment practices regarding assessment–to–sales ratios for different classes. Under Cook County Ordinance, the assessment–to–sales value ratio for commercial property (“Class 5a”) is 38 percent and the ratio for residential property (“Class 2, structures with six or fewer housing units”) is 16 percent. The de jure ratio of the ratios is 2.375–to–one (38/16). According to Illinois Department of Revenue assessment–to–sales ratio studies—an imperfect, but the official, measure—there has been a decrease in the de facto ratio of the ratios from 3.1–to–1 commercial/residential in 1996 (Swain, Calia, Davis, Turano and Vaselopolos, 1999) to 2.3–to–1 commercial/residential in 2003 (Illinois Department of Revenue, 2005).

A full examination of the reasons for the decline is beyond the scope of this paper, but one almost certain contributor was a 1996 change in Illinois law that gave Cook County property owners access to an additional forum for challenging assessments, the state Property Tax Appeals Board. A subsequent pattern of appeals was favorable to commercial property owners and appears to have been followed by conforming changes in assessment practice. Another possible explanation is a systematic divergence in the trends in the sales prices of commercial properties and the variables used to estimate the value of commercial properties employing the income–capitalization method. In Cook County, residential property is assessed by the comparable–sales method and commercial property is assessed by the income–capitalization method. For whatever reasons, commercial assessments declined over the last decade, both relative to the sales value and relative to residential assessments.

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4 At least two states do include aggregate shares in the calculation of classified property tax assessment fractions or rates: New York State (2006) and Massachusetts (Youngman and Malme, 2005). Illinois does not.
The fact of that decline is offered in support of the argument that “relief” for residential property owners is justified. It seems to us, however, that the case for residential relief depends on the particular reasons for the decline. If, for example, the decline is due to a change in assessment practice (perhaps driven by successful appeals) that has moved the *de facto* ratio of the ratios in the direction of the *de jure* ratio of the ratios, the case for reversing that change requires trading off the principle of uniformity—that all properties should be assessed at the same fraction of true value or legally classified value. If, on the other hand, the change is due to a systematic decline in income levels relative to sales values for commercial properties, then a stronger case could be made for favoring residential property as a class. Of course, it would be preferable to find the changes in the capitalization rate or other variables in the income formula that maintain the relationship of assessment–to–sales over time.

(c) A third potential reason for change in the aggregate shares is that there may be a greater rate of price increase for residential versus non–residential properties. The Assessor’s (2005) report extensively documents the increase in residential house prices in Cook County and also presents evidence of flat or declining commercial values or rents. This may explain some of the political pressure to “do something” to soften the impact on property taxes for those who experience the greatest appreciation. It involves, however, a new criterion and one that must be traded off against the principle of uniformity and other criteria. The principle of uniformity says that two homes with a market value of $400,000 should be taxed the same. The seven percent assessment cap gives the owner who went from $300,000 last year to $400,000 this year a lower tax bill than the resident of a different neighborhood who went from $390,000 to $400,000 this year.

2. Attention to year–to–year changes is invited by the “smoothing” argument for assessment caps. Unfortunately, measurement of year–to–year changes introduces additional sources of variation that are not attributable to the policy itself. All of our analysis is of within–year, revenue–neutral differences in taxes with and without the expanded exemption. Our estimates of the “benefit” to eligible homeowners can also be interpreted as how much higher taxes would have been without the assessment cap. What our estimates do not show, and what advocates of the policy would like to point to, is how much higher taxes were for recipients *compared to the prior year* even after the assessment cap.

The Civic Federation’s (2005) estimates of the property taxes paid in the city of Chicago with and without the seven percent cap are presented for property class aggregates. Residential (Class 2) property tax payments increased by 10.1 percent from tax year 2002 to 2003 but, they estimate, would have increased by 16.8 percent had the cap not been in place. Property taxes paid by all other classes combined increased by 2.4 percent with
the cap, but would have decreased by 2.0 percent had the cap not been in place in 2003. The Civic Federation presents their results in a very objective way and does not draw conclusions, but it is easy for an advocate of the cap to look at these results and note that residential taxes still went up a lot, and by a lot more than did non-residential taxes. We have already noted, however, some of the problems with drawing easy conclusions from comparisons of aggregate class shares and across years.

WHAT TO MAKE OF THE COOK COUNTY EXPERIENCE

Earlier we posed a number of questions about property tax policies designed to cope with rapidly appreciating residential values. If we evaluate Cook County’s policies with respect to these questions, we find that the assessment cap certainly reduced the horizontal equity of the property tax system. A full analysis of the effect of the cap on vertical equity is beyond the scope of our research, and such analysis would have to determine the incidence of the tax increase on owners versus residents of rental housing units. Among eligible parcels, the effect of the law varied based on a large number of sometimes apparently arbitrary factors that are unrelated to income or wealth. Because of this, it is hard to believe that the law had any consistent effect on vertical equity. To the extent that the cap reduces the property tax payments for residents of rapidly growing areas, it may discourage mobility, since the expanded exemption is lost when real estate is sold, and, thus, may decrease the efficiency of the residential real estate market, though the effect, thus far at least, is probably small. The law certainly increases the administrative complexity, of an already complex property tax system.

Did the cap remedy the problems it was designed to solve? Did it create new problems? The debate about the law has been so tangled and confused that it is often difficult to determine what “problems” the law was designed to remedy. Certainly, the law mitigated the shock of rapidly rising assessments for some homeowners and probably reduced popular protest against the property tax system. It may be too early to tell what, if any, new problems have been created by the cap. Down the road, a system that allows significant deviations from uniformity is sure to breed hostility and disrespect. Illinois politicians and journalists sometimes refer to the assessment cap as “the seven percent solution.” Ironically, this is reminiscent of a line from a Sherlock Holmes story referring to cocaine use. Special tax provisions have an addictive quality, in that they create distortions and inequities, which create a case for other special provisions, which begs for even more.

Are there better alternatives available? If the major problem is that rising assessments sometimes displace vulnerable households with limited liquidity, it seems that more targeted programs could accomplish the goal with less violation of fundamental tax principles. Whether a legally and politically viable alternative could be constructed is a question that goes beyond our research and our professional expertise.

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5 Our own estimates of taxes paid in the hypothetical case of the cap not being in place (Dye, McMillen, and Merriman, 2006) are based on parcel level data, while the Civic Federation’s (2005) estimates are derived from aggregate data and a different methodology. It is reassuring that our estimates for total residential and non-residential 2003 property taxes for the hypothetical “without cap” case are very similar to theirs.

6 “It is cocaine,” [Holmes] said, “a seven-percent solution. Would you care to try it?” The Sign of Four, Sir Arthur Conan Doyle.
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