CHAPTER 3
PROPOSITION 2½ MODULE
TOPICS AND OBJECTIVES

A. TOPICS

1. Definition and calculation of the annual levy limit.
2. Definition and calculation of new growth.
3. Definition and calculation of the levy ceiling.
4. Types of Proposition 2½ ballot questions and how they affect levy limit.
5. Calculation of the maximum allowable levy.
7. Procedures for a Proposition 2½ election.

B. OBJECTIVES

1. Participants will understand how a levy limit is determined under Proposition 2½.
2. Participants will understand the differences between an override and exclusion.
3. Participants will be able to compute the amount of property tax revenue their communities will have available for the annual budget.

CHAPTER 3
PROPOSITION 2½ MODULE

1.0 OVERVIEW AND DEFINITIONS

1.1 Introduction

Proposition 2½ is a voter initiative law that limits the property tax levy of cities and towns enacted in the 1980 state election.[1] It took effect in fiscal year 1982.

1.2 Definitions

1.2.1 Levy

The property tax levy is the revenue a community raises through real and personal property taxes each fiscal year when it sets its tax rate. The property tax levy is usually the largest source of revenue cities and towns have to fund their annual budgets.

1.2.2 Levy Limit

The levy limit is the maximum dollar amount a city or town can levy in a given fiscal year. It defines the maximum amount of property tax revenue a community will ordinarily have to support its annual budget and is the primary limitation established by Proposition 2½.

1.2.3 Levy Ceiling

The levy ceiling is the maximum amount the levy limit may be in a given fiscal year. It is a constraint on the size of the annual levy limit and is a secondary limitation established by Proposition 2½.

1.3 Application of Proposition 2½ Limits

- The property tax levy cannot exceed the levy limit for the fiscal year.
- The levy limit cannot exceed the levy ceiling for the fiscal year.

1.4 Department of Revenue's Role

The Department of Revenue (DOR) determines the annual levy limit and ceiling for each city or town and ensures the tax levy fixed by the setting of the tax rate complies with Proposition 2½.[2]

2.0 ANNUAL LEVY LIMIT

2.1 Definition

The levy limit is the maximum dollar amount a city or town can ordinarily levy in any given fiscal year.[3]

2.2 Calculation

2.2.1 Levy Limit Base

The levy limit for any given fiscal year is based on the previous year's levy limit and therefore, is an historic figure**.** The prior year's limit, not the actual levy, is the base for calculating the levy limit.

2.2.2 Annual Increases

The previous year's levy limit increases annually by two factors:

- Automatic 2.5 percent.
- New growth.

2.2.3 Preliminary Levy Limit

The formula for calculating the preliminary levy limit for any given fiscal year is the prior year's levy limit, plus 2.5 percent of that limit, plus new growth.

Annual Levy Limit Formula

Prior FY Levy Limit
+
[.025 x Prior FY Levy Limit] + New Growth

This subtotal is then compared to the levy ceiling to determine the final levy limit for the fiscal year. See Section 4.3 below.

3.0 NEW GROWTH FACTOR

3.1 Definition

New growth is a dollar increase in the annual levy limit that reflects additions to the community's tax base since last fiscal year. Proposition 2½ annually increases the levy limit so that cities and towns can raise additional taxes to meet service demands due to new development.

3.2 Calculation

The formula for calculating the new growth factor for any given fiscal year is the previous year's tax rate multiplied by allowable increases in the current year's assessed valuations of real estate parcels and personal property items over the prior year's assessed valuations.[4]

New Growth Factor Formula

Prior FY Tax Rate
X
[Current FY Assessed Valuation – Prior FY Assessed Valuation of Parcel/Item]

3.2.1 Allowable Valuation Increases

Valuation increases included in the formula come from three categories of growth in a community's tax base.

3.2.1.1 Construction Activity

The first category includes properties that have increased in assessed valuation since last fiscal year because of development and other construction activity on the site. Most of a community's new growth usually comes from this category.

Examples

Parcel A was assessed as a vacant house lot for $50,000 last year. A new house was built on Parcel A and this year it is assessed for $250,000, an increase of $200,000. The $200,000 in added value to the community's tax base due to the construction activity is included in the calculation of the new growth factor.

Parcel B is a single-family home that was assessed for $200,000 last year. An addition was built to the house and this year, Parcel B will be assessed for $225,000, an increase of $25,000. The $25,000 in added value to the community's tax base due to the construction activity is included in the calculation of the new growth factor.

3.2.1.2 Previously Exempt Real/New Personal Property

The second category includes property not taxable the previous year, such as exempt real property returned to the tax roll and new taxable personal property.

Examples

Parcel C was owned by a private college and was exempt from taxation last year. The college sold the parcel to a developer and it is returning to the tax roll this year with an assessed valuation of $100,000. The $100,000 in added value to the community's tax base is included in the calculation of the new growth factor.

Business D relocated to the community since last year. It owns taxable personal property that is assessed for the first time this year with an assessed value of $20,000. The $20,000 in added value to the community's tax base is included in the calculation of the new growth factor.

3.2.1.3 Subdivisions/Condominium Conversions

The third category includes real property that is subdivided or converted to condominiums and taxed as separate parcels for the first time.

<u>Example</u>

<u>Parcel E</u> is 20-acre site of vacant land that was assessed as a single parcel for $1,000,000 last year. Since then, a subdivision plan has been approved for the site. The plan creates 10, 2-acre house lots that will be assessed as 10 separate parcels this year. The total valuation of the 10 lots is $1,100,000, a $100,000 net increase in the assessed valuation of the community. The $100,000 in added value to the community's tax base due to the subdivision and taxation of the land as separate parcels is included in the calculation of the new growth factor.

3.2.2 <u>Excluded Valuation Increases/Decreases</u>

3.2.2.1 <u>Revaluation Increases</u>

The increased assessed valuation of property due to higher market value is not included in the new growth formula. To be included, the increase in assessed valuation has to result from a change in the physical condition, taxable status or taxable unit of a property.

<u>Example</u>

<u>Parcel F</u> is a single-family house that was valued at $300,000 last year. No construction activity took place on the site, but the parcel will be assessed for $350,000 this year due to a revaluation. The additional $50,000 in assessed valuation is not included in the new growth formula, even though it increases the total valuation of the community's tax base.

3.2.2.2 <u>Valuation Losses</u>

The new growth factor is not adjusted by decreases in the tax base due to fire, demolition or other valuation losses.

3.3 <u>Annual Reporting</u>

The new growth factor is calculated after the assessors have set all assessed values for the year and can compare them to the prior year's assessed values. The assessors report new growth to the DOR on Form LA-13, “Tax Base Levy Growth,” as part of the tax rate setting process.

4.0 ANNUAL LEVY CEILING

4.1 <u>Definition</u>

The levy ceiling is the maximum dollar amount the levy limit may be in any given fiscal year.

4.2 Calculation

The formula for calculating the levy ceiling in any given fiscal year is the total assessed valuation of the community's taxable real and personal property for the fiscal year multiplied by 2.5 percent.[5]

Annual Levy Ceiling Formula
Total Assessed Valuation X .025

4.3 Final Levy Limit Determination

The final step in determining the new levy limit is to compare the subtotal that results from increasing the prior year's levy limit by the annual 2.5 percent and new growth factors to the year's levy ceiling. The new levy limit is the lesser of the subtotal or ceiling.

4.3.1 Subtotal Below Levy Ceiling

The subtotal is the new levy limit if it is below, or at most equal to, the levy ceiling. The subtotal ordinarily is less than the levy ceiling and therefore, is the levy limit in almost all cases.

Example

Last year's levy limit was $100 million. That $100 million base is first increased by 2.5%, which equals $2.5 million. The new growth factor is then added, which for illustration purposes is $2.5 million. Adding the $100 million prior year levy limit base + $2.5 million automatic 2.5% increase + $2.5 million new growth factor arrives at a subtotal of $105 million.

The assessed valuation of the community this year is $10 billion. Multiplying that amount by 2.5% equals a levy ceiling of $250 million. The subtotal of $105 million is below the levy ceiling and therefore, the community's levy limit is $105 million for this year.

4.3.1 Subtotal Above Levy Ceiling

The levy ceiling is the new levy limit if the subtotal exceeds the levy ceiling. The total assessed valuation of a community's tax base and therefore, the levy ceiling generally increases over time at a higher rate than the annual levy limit as properties are added to or removed from the tax roll and revalued to reflect current market at least once every three years. This is almost always more than sufficient to accommodate the annual 2.5 percent and new growth increases.

Example

Again, the assessed valuation of the community this year is $10 billion. Multiplying that amount by 2.5% equals a levy ceiling of $250 million. If the subtotal is $265 million, the community's levy limit is $250 million for this year.

5.0 BALLOT QUESTION TYPES

5.1 Overview

A city or town may levy above its annual levy limit or levy ceiling with the approval of voters in a regular or special municipal election or state biennial election.

5.2 Types

5.2.1 Higher Levy

There are two types of Proposition 2½ ballot questions that allow a community to levy above the levy limit or ceiling. They are used for different purposes and have different impacts on the amount a community can levy in the year voted and future years. They are:

- Levy limit override.
- Exclusion.

5.2.2 Lower Levy

The Proposition 2½ ballot question that requires a community to reduce its annual levy limit is the underride.

6.0 LEVY LIMIT OVERRIDE

6.1 Definition

A levy limit override is a dollar increase in the levy limit approved by the voters.[6]

6.2 Features

6.2.1 Municipal Purposes

A levy limit override can be used to generate additional monies for any municipal expenditure. It is generally intended and usually used to raise extra funds for annual operating and other recurring costs.

6.2.2 Permanent Increase

A levy limit override creates a permanent increase in the levy limit base. The impact is to increase the amount a community can levy for the fiscal year voted, and in future years.[7]

Example

The levy limit for this year is $100 million. Voters approve an override of $1 million. The community can now levy $101 million dollars this year. In addition, the base for calculating next year's levy limit becomes $101 million, rather than $100 million.

6.2.3 Override Limit

A levy limit override cannot increase the levy limit beyond the levy ceiling. The annual levy limit as increased by an override must still fit within the levy ceiling.

7.0 LEVY LIMIT UNDERRIDE

7.1 Definition

A levy limit underride is a dollar decrease in the levy limit approved by the voters.[8]

7.2 Permanent Decrease

A levy limit underride creates a permanent decrease in the levy limit base. The impact is to decrease the amount a community can levy for the fiscal year voted, and in future years.

Example
The levy limit for this year is $100 million. Voters approve an underride of $1 million. The community can now only levy $99 million dollars this year. In addition, the base for calculating next year's levy limit becomes $99 million, rather than $100 million.

8.0 EXCLUSION

8.1 Definition

An exclusion is an amount the community can levy in addition to its levy limit approved by the voters to finance a capital expenditure.

8.2 Features

8.2.1 Capital Purposes

An exclusion can be used to generate additional monies for capital purposes only. Capital purposes are those for which a community can legally borrow money under Massachusetts law. A community may generally borrow only to construct or acquire its public infrastructure or other physical assets. For example, it may borrow to:

- Construct or renovate public buildings, such as schools.
- Construct public works, such as a new sewer treatment plant.
- Purchase land for public buildings, open space, conservation or other public purposes.
- Purchase equipment used to provide municipal services, such as police cruisers, fire trucks and computers.

8.2.2 Temporary Increase

An exclusion increases the maximum amount the community can levy for a temporary period of time. It does not become part of the levy limit and therefore, does not increase the base for calculating future years' limits.

A community may present one of two types of exclusions to voters depending on how it finances the capital project or item:

- Debt exclusion.
- Capital exclusion.

8.2.2.1 Debt Exclusion

A debt exclusion is used to obtain voter approval to increase the levy to pay for capital projects financed by borrowing.[9] Major capital items, such as the construction of a new school or installation of a sewer system, are usually financed by borrowing and repaying that loan over a fixed number of years.

Approval of a single debt exclusion question creates a temporary increase in the amount the community can levy in order to cover its annual debt service costs on the borrowing. Each year while the debt is being repaid, the amount of that year's debt service payment is added to the levy limit to determine how much the community can levy. Once the debt is retired, the exclusion ends.

Example

A community borrows to build a new water treatment facility. The debt will be repaid over 20 years with level debt service payments of $1 million. Voters approve a debt exclusion for the borrowing. The community can levy $1 million above its levy limit in each of the next 20 fiscal years in order to cover its annual debt service appropriation. In the first year the exclusion applies, the levy limit is $100 million. Due to the exclusion, the community can now levy $101 million in that year.

However, the $1 million exclusion is not added to the levy limit base used to calculate the second year's limit. In the second year, the new levy limit will be calculated using $100 million as a base. Once again, the community can levy $1 million above that new limit. Again, the $1 million exclusion is not added to the levy limit base used to calculate the third year's limit. This continues each year until the debt is repaid.

8.2.2.2 Capital Exclusion

A capital outlay expenditure exclusion (or capital expenditure or capital exclusion) is used to obtain voter approval to increase the levy to pay for capital projects financed by sources other than borrowing.[10]

Purchases of equipment, such as computers and vehicles with a shorter useful life, or other smaller projects are often funded within the budget.

Approval of a capital exclusion creates a temporary increase in the amount the community can levy to fund a budgeted capital project. The amount budgeted for the project or purpose is added to the levy limit to determine how much the community can levy in the fiscal year the item is budgeted. The exclusion lasts only for that one year.

Example

A community appropriates $100,000 from the tax levy to buy a new ambulance. Voters approve a capital exclusion for the purchase. The community can levy $100,000 above its levy limit this year in order to cover that appropriation. If the levy limit is $100 million, for example, the community can levy $100,100,000 this year. However, the $100,000 exclusion is not added to the levy limit base used to calculate the next year's limit and does not apply to next or any future year.

8.2.3 Exclusion Limit

An exclusion allows a community to levy both above the community's levy limit and its levy ceiling. An exclusion is the only way a community's levy can exceed the levy ceiling. Exclusions do not become part of the levy limit and therefore, are not constrained by the levy ceiling.[11]

8.3 Exclusion Calculation

A debt or capital exclusion is reduced by any state or federal reimbursement given to the community for the capital project.

A debt exclusion is computed using the true interest cost with premiums received at time of sale of notes or bonds offset against the stated interest cost or used to pay project costs and reduce the amount borrowed.[12]

9.0 OVERRIDE AND EXCLUSION COMPARISON

9.1 Purposes

- An override may be used to raise the levy to cover spending for any purpose.
- An exclusion may be used to raise the levy to cover capital spending only.

9.2 Duration

- An override permanently increases the levy limit and permits an increase in the levy of the year voted and the levies of future years.

- An exclusion temporarily increases the amount the community may levy.
  - A debt exclusion lasts for the life of the related borrowing.
  - A capital exclusion lasts one year.

9.3 Limits

- An override cannot increase the levy limit above the levy ceiling.
- An exclusion can result in a levy above the levy ceiling. There are no limits on the number or dollar amount of exclusions that may apply in any year.

10.0 MAXIMUM ALLOWABLE LEVY CALCULATION

Step 1	**Determine Current Year Levy Limit**
	• Use prior year's levy limit as base.
	  • Increase prior year's limit by 2.5%.
	  • Add new growth.
	• Compare subtotal to levy ceiling.
	  • If less, subtotal is current year's levy limit.
	  • If more, ceiling is current year's levy limit.

Step 2	**Adjust Levy Limit by Approved Permanent Ballot Question**
	• Subtract underride from levy limit determined by Step 1.
	• Add override to levy limit determined by Step 1.
	  • Compare subtotal to levy ceiling.
	    • If less, subtotal is current year's levy limit.
	    • If more, ceiling is current year's levy limit.

Step 3	**Add Approved Temporary Ballot Question** • Add excluded debt service for each debt exclusion to levy limit. • Add excluded appropriation for each capital exclusion to levy limit. • Total may exceed levy ceiling.
Step 4	**Maximum Allowable Levy** • Total is maximum amount of property tax revenue available to support current year's budget. • Tax rate must be set within that amount.

11.0 EXCESS LEVY CAPACITY

11.1 Definition

Excess levy capacity is the difference between the community's actual levy and its levy limit. In years where an exclusion applies, it is the difference between the actual levy and the maximum allowable levy.

<u>**Example**</u>
A community has a levy limit of $100 million. The community chooses through its budget decisions to actually levy only $98 million for the year. It has $2 million of excess levy capacity. That tax revenue is gone forever. The community can never levy an additional amount on taxpayers to recover that $2 million of revenue.

11.2 Future Year Impact

A community can have excess levy capacity in one year and in the following year, levy up to the full amount of its new levy limit, or maximum allowable levy if exclusions apply. It can levy up to that amount no matter how much the levy increases over last year's levy.

<u>**Example**</u>
A community had a levy limit of $100 million last year and actually levied $98 million. This year's limit is $105 million based on a $2.5 million automatic increase and another $2.5 million increase due to new growth. The community can increase its levy all the way from $98 million to $105 million, thereby using the $2 million in excess capacity it saved the previous year.

12.0 ELECTION PROCEDURE

12.1 Election Decision

The decision to place a Proposition 2½ ballot question before the voters is made in a town by the selectboard and in a city, by the city council, with the mayor's approval if the charter or other law requires it.[13]

12.1.1 Voting Quantum

- A majority vote of the selectboard or council is required to place an override or underride question on the ballot.
- A 2/3 vote is needed to place an exclusion question before the voters.

12.1.2 Alternative Procedure

A local initiative procedure may be used only to place an underride question on the ballot. A community must have a local initiative procedure in its charter for this alternative to apply.

12.2 Question Form

The form of each type of question is set out in the law and must be used to be properly presented. Override and exclusion questions state the purpose for which the additional dollars are being sought. Overrides, underrides and capital expenditure exclusions specify a dollar amount.

12.3 Election Scheduling

12.3.1 Municipal Elections

Questions may be placed on any municipal election ballot.[14] This includes regular elections held annually in towns and biennially in cities, as well as special elections called specifically to consider the questions.

12.3.1 State Elections

Questions may be placed on the November state biennial ballot.[15] These questions must be certified by the municipal clerk to the Secretary of State by the first Wednesday in the August before the election.

12.4 Question Approval

A question is approved if a majority of the persons who vote on that question vote "Yes."

13.0 REPORTING REQUIREMENTS

13.1 Override and Exclusion Votes

If a municipality has voted a new override/underride or debt/capital exclusion, the vote must be uploaded by the city or town clerk into the Gateway system ahead of submission of the tax rate recap form. Instructions for this process can be found on the DLS website, *Submitting Proposition 2 ½ Votes using DLS Gateway*. Additional assistance with this process is available at dlsgateway@dor.state.ma.us. Not uploading this documentation can delay the setting of the municipality's tax rate

13.2 Debt Exclusions

All voted debt exclusions must be reflected in the levy limit in any year a debt service payment is due, whether or not that levy capacity is needed to balance the budget within the limits of proposition 2 1/2. Therefore, all voted debt exclusions must be shown on the DE-1 so that the correct maximum allowable levy is shown on the levy limit form and the actual excess capacity can be calculated.

[1] G.L. c. 59, § 21C.
[2] G.L. c. 59, § 21D.
[3] G.L. c. 59, § 21C(f).
[4] G.L. c. 59, § 21C(f).
[5] G.L. c. 59, § 21C(b).
[6] G.L. c. 59, § 21C(g).
[7] G.L. c. 59, § 21C(f).

[8] G.L. c. 59, § 21C(h).
[9] G.L. c. 59, § 21C(k).
[10] G.L. c. 59, § 21C(i½).
[11] G.L. c. 59, § 21C(l).
[12] G.L. c. 44, § 20.
[13] G.L. c. 59, § 21C(a).
[14] G.L. c. 59, § 21C(i).
[15] G.L. c. 59, § 21C(i).

PROPOSITION 2½
ADDITIONAL RESOURCES

The following are additional resources on Proposition 2 ½ produced by DLS that are available on our website: https://www.mass.gov/orgs/division-of-local-services.

- ***DLSLAW Library*** – A searchable data base of current DLS Informational Guideline Releases (IGRs), Local Finance Opinions (LFOs) and Bulletins that is accessed by clicking the "Search DLSLAW Library" link appearing under "Public Reports and Databases" on the DLS Gateway login page.

- ***Levy Limits: A Primer on Proposition 2 ½*** - Explains the fundamental features of Proposition 2½: how the levy limit and ceiling are determined, new growth works and overrides, underrides and exclusions differ.

- ***Proposition 2 ½ Ballot Questions: Requirements and Procedures*** – Explains Proposition 2½ ballot question procedures, such as question form and presentation, sequencing of the election and related appropriations and contingent appropriations.

- ***Guidelines for Determining Annual Levy Limit Increase for Tax Base Growth*** – Annual Informational Guideline Release (IGR) that details calculation and reporting of new growth factor.

- ***IGR 2022-1, Premiums and Surplus Proceeds for Proposition 2 ½ Excluded Debt*** – Explains to local officials the adjustments made to a Proposition 2½ debt exclusion when premiums are received in connection with the sale of the bonds or notes for the excluded borrowing and when surplus loan proceeds remain after the project or purpose of the borrowing is completed.

- ***Submitting Proposition 2 ½ Votes Using DLS Gateway*** – If a municipality has voted a new override/underride or debt/capital exclusion, the vote must be uploaded by the city or town clerk into the Gateway system ahead of the submission of the tax rate recap form. This document provides instructions for that process. Additional assistance with this process is available at dlsgateway@dor.state.ma.us. Not uploading this documentation can delay the setting of the municipality's tax rate.