taxanalysts states of mind

Talking Sense on Property Tax Relief

by Daphne A. Kenyon

In recent years, rising home values have led to increased assessed values and higher property taxes.[1] For example, a recent news article featured Bill Goodnight, a 66-year-old retired Idaho homeowner. His property taxes increased from $454 in 1989 to $3,005 in 2005 because of an increase in his home's assessed value from $59,500 to $225,000.[2] Those higher property taxes have spurred controversy and debate across the United States.

In response to voter pressure, legislatures across the country have debated and approved property tax relief measures. According to the National Taxpayers Union, an advocacy group, voters in 20 states are actively seeking property tax relief. One aggrieved homeowner in South Carolina has founded a group whose aim is to abolish property taxes on primary residences.[3]

This article is divided into three main sections. First, it addresses two major misconceptions regarding property tax burdens. The second section discusses property tax relief measures states should avoid. The third section proposes policy options that could offer property tax relief without pernicious side effects. Many commonly espoused property tax relief measures are severely flawed. Citizens, state and local policymakers, and nonprofits should work to channel property tax relief efforts toward the best, not the worst, options.

Major Misconceptions Regarding Property Tax Relief

In my experience, citizens and policymakers hold two mistaken beliefs about property tax relief that do much to impede good policymaking. One involves the burden of property taxes by income group; the other involves the financial well-being of seniors relative to other age groups.

Myth: Property taxes are regressive, so property tax relief helps those who are less well off.

Since the 1960s, economists' views regarding the distribution of property tax burdens have shifted nearly 180 degrees. In the 1960s, there was a consensus that property taxes were regressive. Today economists think of property taxes as having a considerable progressive element because of the "new view" of property taxes as a national tax on capital. That is, because higher income groups own a disproportionate amount of the nation's capital, they bear a disproportionate share of property taxes.[4]

Unfortunately, because analysis of the incidence of the property tax has become more complex since the 1960s, the changing consensus of economists is difficult to communicate to the public. Today's public finance texts typically include a lengthy discussion of property tax incidence divided into several sections depending on whether a tax change being analyzed is local, national, or considered together with a change in spending. Thus, instead of answering the question of whether property taxes are regressive with an unequivocal "yes" as they did 50 years ago, economists tend to answer, "sometimes yes, sometimes no; it depends on the context."

One economist who offers a clear answer about the incidence of property tax relief programs is John

[1]Although I have learned much about property taxes during my tenure as visiting fellow at the Lincoln Institute of Land Policy, the views here should not be taken as the views of the Lincoln Institute of Land Policy, its staff, or its directors. Many thanks to Peter Kachavos, Bethany Paquin, and Joan Youngman for their helpful comments on previous drafts.

[2]Lyman, Rick, "As Property Values Rise, Homeowners Feel Pinch," *The New York Times*, Feb. 19, 2006, p. 14.

[3]Gerena-Morales, Rafael, "Across U.S. Rising Property Taxes Spark Revolts," *The New York Times,* Feb. 1, 2006, p. B4.

[4]*See, e.g.*, Fisher, Ronald C., *State and Local Public Finance*, 2 ed., Irwin, Chicago, 1996: pp. 365-368, and Harvey S. Rosen, *Public Finance*, 7 ed., McGraw Hill/Irwin, Boston, 2005, pp. 522-529.

Table 1. Residential Property Ownership Rates, by Family Income, 1998

	Percent of Families Owning	
Family Income	Primary Residence	Other Residential Property
Less than $10,000	34.5	n.a.
$10,000 to $24,999	51.7	5.8
$25,000 to $49,999	68.2	11.4
$50,000 to $99,999	85.0	19.0
$100,000 and more	93.3	22.6

Source: U.S. Census Bureau[a]
[a]"Nonfinancial Assets Held by Families by Type of Asset, 1998," Table 676 in U.S. Census Bureau, *Statistical Abstract of the United States, 2002.*

Bowman, an emeritus professor at Virginia Commonwealth University. He argues property tax *relief* is generally regressive,[5] based on his observations that property owners are better off than nonowners and that state and local tax systems, which fund property tax relief, tend to be regressive. Table 1, which shows residential property ownership by family income, supports Bowman's argument, as does real-world experience with property tax relief programs, which are often skewed to wealthier taxpayers (more on that below). As the table shows, virtually all families with income in excess of $100,000 own homes, but only slightly more than one-third of families with incomes less than $10,000 do.

Myth: Seniors are more likely to need property tax relief than other age groups.

A casual observer of property tax relief policies would likely come away with the impression that senior citizens are more in need than citizens of any other age group. A recent review of property tax relief policies among the 50 states notes that relief programs for seniors, used by 39 states, are more common than any other single form of property tax relief.[6] One example is Colorado, which has amended its constitution to create a property tax exemption for all senior citizens, without regard to income.[7]

At one point, retired seniors on fixed incomes may have been the group most categorically in need of property tax relief — but no more. Consider the following statistics:

- In 2003 the poverty rate for those 65 years and over was 42 percent less than the poverty rate for children. Indeed, the poverty rate for seniors was less than the poverty rate for all age groups up to 34 years old.[8]
- Families whose family head is between 65 and 74 years old have the highest average net worth of families in any age group. The average net worth of those young seniors is over seven times that of families whose head is under 35 years of age.[9]

Thus, if one wanted to create a property tax relief policy targeted solely by age, it seems much better to allow property tax relief for all families with children than to allow relief for all seniors! But no single age group is categorically needy, and in the face of scarce resources it is much better to target property tax relief to those who truly cannot afford to pay their taxes than to property owners in a specific age group.

Property Tax Relief Options to Avoid

This section argues that policymakers should avoid three types of property tax relief measures:

[5]Bowman, John H., "Targeting Property Tax Relief," presentation made at Economic Perspectives on State and Local Taxes, Lincoln Institute of Land Policy, Cambridge, Mass., Oct. 17, 2005.

[6]Cico, David C., Stephen C. Robnett, Ellen W. Saltzman, and Holley H. Ulbrich, "Property Tax Relief Programs in the United States," The Jim Self Center on the Future, The Strom Thurmond Institute of Government & Public Affairs, Clemson University, Clemson, S.C., July 2004, pp. 6-7. According to this compilation, the number of states with property tax relief programs targeted to other groups is: general (27), disability (26), and veteran (13).

[7]The Colorado homestead exemption exempts 50 percent of the first $200,000 of property from property taxes for all those 65 years of age or older, who have lived in their home for at least 10 years. National Conference of State Legislatures, *A Guide to Property Taxes: Property Tax Relief*, Denver, November 2002, p. 10, and "Colorado Senior Property Tax Exemption" Available at http://www.co.adams.co.us/elected_officials/assessor/homestead.html, accessed Jan. 15, 2006. According to the Colorado Division of Property Taxation, the General Assembly did temporarily suspend funding for the homestead exemption in 2003. Funding for the exemption is scheduled to resume this year and will affect property tax bills beginning in 2007.

(Footnote continued in next column.)

[8]Table 696, "Persons Below Poverty Level by Selected Characteristics, 2003," U.S. Census Bureau, *Statistical Abstract of the United States, 2006.*

[9]Table 702, "Family Net Worth — Mean and Median Net Worth in Constant (2001) Dollars by Selected Family Characteristic: 1992 to 2001," U.S. Census Bureau, *Statistical Abstract of the United States: 2006*.

Table 2. Effective Tax Rates with a 5% Cap on Growth in Assessed Value[a]

Years	Market value of Property A (assuming 5% annual increase)	Market value of Property B (assuming 10% annual increase)	Taxable value of Properties A or B (with 5% cap on growth)	Tax (assuming a 1.5% tax rate)	Effective tax rate on Property A	Effective tax rate on Property B
0	$200,000	$200,000	$200,000	$3,000	1.50%	1.50%
1	$210,000	$220,000	$210,000	$3,150	1.50%	1.43%
5	$255,256	$322,102	$255,256	$3,829	1.50%	1.19%
10	$325,779	$518,748	$325,779	$4,887	1.50%	0.94%

[a]Modified from Powerpoint presentation of John Bowman, "Targeting Property Tax Relief." The market value of $200,000 and effective property tax rate of 1.5% were used to be reasonably representative of single-family homes in the U.S. According to the Minnesota Taxpayers Association's *50-State Property Tax Comparison Study* of January 2005, the average median sales price of single family homes for the largest city in each state was $195,515 and the average effective tax rate was 1.434 percent (p. 19).

untargeted relief, assessment caps, and property tax relief that stimulates higher property taxes.

Avoid untargeted property tax relief

The section above discussed untargeted relief to seniors. Other forms of untargeted relief include assessment caps and property tax relief available to all veterans. Income is the best gauge of need and should be the main determinant of eligibility for property tax relief. In an era when only the most generous states provide health insurance to children in families with incomes as high as 300 percent of the federal poverty line, it makes no sense to provide property tax relief to households whose income is 3,000 percent of the poverty line![10]

Avoid assessment caps

Assessment caps are a type of property tax break rapidly gaining in popularity. These caps limit property tax burdens by restricting growth in assessed values. As of 2002, assessment caps were enacted in 19 states,[11] and they are being actively considered in several others, for example, Alaska.[12] In attempting to stabilize property tax burdens, assessment limits greatly undermine the fairness of the property tax system.

Assessment limits undermine the fairness of the property tax system.

Take for instance, two owners of single-family homes assessed at $200,000, with a 1.5 percent effective tax rate. Assume further that one home is in a nice, but not extravagant neighborhood, experiencing annual increases in assessed value of 5 percent per year, while the second home is in a lakefront subdivision experiencing annual increases in assessed value of 10 percent per year. If growth in assessed values is capped at 5 percent, the home in the nice neighborhood obtains no benefit. Its effective tax rate (assuming no tax increases) remains constant at 1.5 percent. But the home in the lakefront subdivision is subject to a lower and lower tax rate over time. In five years time, the effective tax rate of the exclusive home falls to 1.19 percent; in 10 years, the rate falls to 0.94 percent. The table above illustrates that policy. Another way to look at the policy is that after 10 years, two very different houses are subject to the same tax burden. Both homeowners pay $4,887 in annual property taxes — one owning a home with a market value of $325,779, the other with a market value of $518,748. Thus, assessment caps provide the most benefit to those homeowners whose property values are increasing the most rapidly. What reasonable form of "tax relief" is targeted only to homeowners, and among homeowners, to those whose property values are increasing the fastest?

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[10]Vermont, which is one of the most generous states in health insurance coverage of children under the State Children's Health Insurance Program, covers children in families up to 300 percent of the federal poverty line. *See* State Coverage Initiatives, "Coverage Profile: Vermont," Available at http://www.statecoverage.net/profiles/vermont.htm#waivers. Many property tax relief programs available to seniors have no income limit.

[11]National Conference of State Legislatures, *A Guide to Property Taxes: Property Tax Relief*, Denver, Colorado, November 2002, p. 33.

[12]Tkacz, Bob, "Lawmaker Proposes Caps on Property Assessment Hikes, Appeal Fees," *State Tax Notes*, Feb. 6, 2006, p. 360, *2006 STT 19-10*, or *Doc 2006-1535*.

A new Web-based tool can make the effect of assessment caps transparent: http://www.Zillow.com.[13] The primary objective of that tool is to provide information on estimated market values of single family homes, but with a little work it can be used to check effective tax rates. By typing in a random address in Sunnyvale, Calif., I was able to find property taxes paid by the owner of a four-bedroom house and the property taxes paid by owners of five homes of comparable market values in the neighborhood. The range in property tax liabilities was 9 to 1. Although analysts have long known that California's Proposition 13 has created enormous disparities in effective tax rates, Zillow.com offers an opportunity to easily convince ordinary people of the effects of such policies. By typing in the street address of a friend or relative in California, one can enjoy the voyeuristic pleasure of obtaining an estimated market value of that person's house and also get a lesson in the real effects of assessment caps on property tax burdens.[14]

Avoid property tax relief that increases property tax burdens

Some state aid programs ostensibly meant to reduce property tax burdens can actually lead to higher property taxes! That appears to be the case with New York's school tax relief program (STAR) proposed for expansion.[15] Because STAR exempts a share of property taxes from taxation, it lowers the price of education to voters and encourages them to spend more. Economist John Yinger has estimated that STAR has boosted property tax rates by "about 20 percent in the average district, thereby eliminating about one-third of homeowners' original tax savings from the STAR exemptions and substantially boosting the property tax on all property other than single-family homes." The general lesson from that type of policy is to be on the lookout for behavioral responses to property tax relief programs, as there sometimes are unwanted unintended consequences, which in the case of STAR undermine the original intent of the program.

Property Tax Relief Measures Worth Expanding

This section describes two property tax relief measures worth expanding — one used in my hometown to directly stabilize property tax rates, and another modeled after home equity loans and reverse mortgages.

Adopt tools that directly stabilize property taxes

I live in a small town in New Hampshire whose voters must directly approve increases in property taxes for town or school district expenses. An important tool we use for stabilizing property taxes is to set aside a portion of the property tax revenue ($1.50 of the total combined town and school property tax rate) to pay for capital improvement projects. That set-aside, together with a capital improvement plan (CIP), appears to work well to stabilize the tax rate and even to keep taxes relatively low. Each year the CIP committee considers all capital requests, prioritizes those requests, and plans how each meritorious request can be fit within the $1.50 tax rate set aside over the next five years. Town departments postpone many projects because they don't fit within the following year's CIP budget. The advantages of that system are several: It tackles the problem of unstable property taxes head on rather than using a mechanism like a freeze on assessed values that would undercut the equity of the tax system or have unintended consequences. It also enforces a mindset focused on savings, and the idea that there is a limit on what will fit within the budget.

Perhaps other towns or states could take that property-tax-stabilizing tool as a model for other policies that directly work to stabilize property taxes, rather than undercut equity (such as assessment caps) or undercut the very goal they purport to achieve (such as New York's STAR school finance aid system).

Expand the use of property tax deferral programs

Let us return to the case of Bill Goodnight, the retired Idaho homeowner with an increased property tax burden cited at the beginning of this article. It is true no one wants to see his property taxes increase by 562 percent over a 16-year period (from $454 to $3,005), but it is also evident that Goodnight has reaped a large capital gain in the form of his property value (from $59,500 to $225,000).[16] If Goodnight were able to tap into that capital gain, he

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[13]"A New Web Site for Real-Estate Voyeurs," *The Wall Street Journal*, Feb. 8, 2006, p. D1.

[14]A study that many researchers may find of interest was done in February 2005 by the Minnesota Department of Revenue. Because property tax limits can shift property tax liability to other taxpayers, the Minnesota study found that use of assessment caps increased tax liability for 68 percent of homeowners even as it reduced tax liability for 32 percent of homeowners. Further, 27 percent of taxpayers whose assessed value was limited by the policy still paid higher taxes under the policy. Dan Salomone, commissioner, "Limited Market Value: A Study of Who Benefits and Who Pays," Minnesota Department of Revenue, Powerpoint slides, February 2005.

[15]This information is taken from "Stop STAR II!" a monthly column by Employee and Family Assistance Program Director John Yinger, Syracuse University Education Finance and Accountability Program, January 2006.

[16]The article gives information only on assessed values, not market values, but we can safely assume that the market

(Footnote continued on next page.)

would likely be able to pay his increased property tax liability. His property value has increased by $165,500 and his annual property tax liability has increased by $2,551. If Goodnight were able to draw down the increased home equity, he could afford to pay the increased tax burden under any reasonable assumptions regarding his longevity and future increases in property taxes and assessed value.

The private market has seen an enormous increase in the use of reverse mortgages, one avenue for tapping increased property values. For example, Home Equity Conversion Mortgages, which are federally insured, have increased from 157 loans in 1990 to 43,131 loans in 2005.[17] With a reverse mortgage, instead of the borrower making payments to the lender, the lender makes payments (or a single payment) to the borrower. Instead of building up equity and reducing debt, the borrower reduces equity and increases debt.

A recent *Wall Street Journal* article noted, "In a sign of how comfortable Americans are becoming with tapping their home equity, retirees are increasingly drawing on it to finance a more lavish lifestyle." According to that article, reverse mortgages are one of the fastest-growing products in the mortgage industry, and seniors have used reverse mortgages to finance a waterfront cottage, a jet ski, a Cessna 172 airplane, a diesel truck, and travel to Mexico, Paris, and Brazil.[18]

If home equity can be tapped to pay for a more lavish lifestyle, could it perhaps be used to pay increased property tax liability? That would allow retired homeowners to stay in the homes they love. In fact, 24 states do have property tax deferral programs.[19] As currently structured, those programs are fraught with problems, such as unrealistically low income limits. Furthermore, it appears that those programs are politically unpopular and rarely used. However, that policy option is being considered by several states.

value of Goodnight's home has increased considerably, prompting the increase in assessed value.

[17]Home equity conversion mortgages are insured by the Federal Housing Administration, a branch of the U.S. Department of Housing and Urban Development. They account for about 90 percent of all reverse mortgages issued in the United States. http://www.nrmlaonline.org/Resources/HomeEquity/ConversionMortgageHECM/YearbyYearProduction/tabid/494/Default.aspx.

[18]Greene, Kelly, "Living Large on a Mortgage of Last Resort," *The Wall Street Journal*, Apr. 26, 2005.

[19]NCSL, *A Guide to Property Taxes: Property Tax Relief*, Denver, November 2002, pp. 21-24.

One manner in which property tax deferrals should be restructured is to fund them at the state level. Of the 24 states that currently have property tax deferral programs, six states offer deferrals at the option of local governments. The details of many of those programs also should be reexamined. The District of Columbia's program with no age or income limit, which allows owners to apply for deferral if property taxes increase by 10 percent from the previous year, seems attractive. However, Arizona places stringent restrictions on its deferral program by limiting it to residents 70 years and older with income of $10,000 or less and with property valued at $150,000 or less.[20]

Once property tax deferral programs are restructured or expanded, it is important that they be advertised and eligible taxpayers be made aware of the option. If the private market were harnessed to sell property tax deferral programs, those programs would have a much better chance of growing in popularity. Within the last week, I received home equity loan applications in the mail and in the grocery store, and my town library hosted a session on reverse mortgages. If the same marketing vigor were used for property tax deferral programs, use of that sensible policy option could be considerably expanded.

Conclusion

Increases in property tax burdens are a contentious and visible issue, and are likely to continue as such for the foreseeable future. As state policymakers work to respond to citizen pressure, they should be wary of adopting property tax relief measures that may appear promising but have detrimental effects in the long run. Most importantly, policymakers should be aware of common misconceptions regarding property tax relief. Contrary to conventional wisdom, property taxes are not always regressive and seniors are not always the group most deserving of property tax relief. There are workable policy options for reducing tax burdens in an equitable manner. Those concerned with tax reform must learn to market those alternatives with some of the same vigor exhibited by tax revolt proponents. ✰

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[20]*Id.*, at p. 21.