The Resurgence of Property Taxes

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In this installment of State Fiscal Affairs, the authors discuss property taxes and their importance.

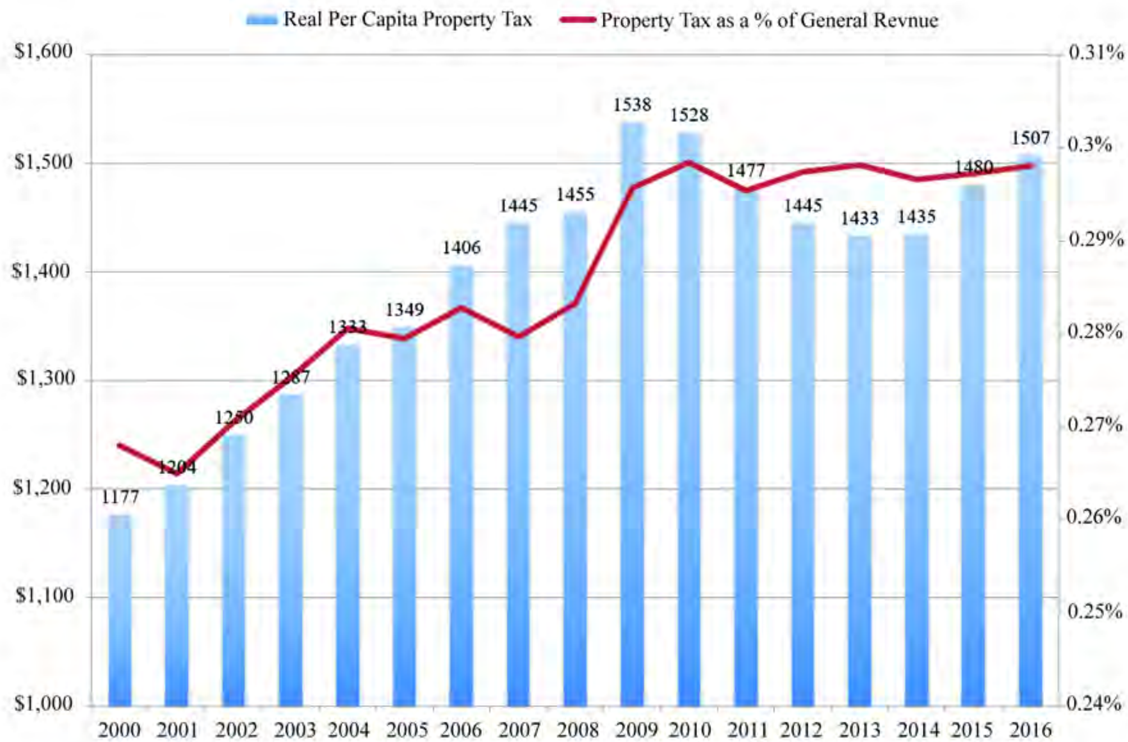
Often despised by taxpayers and criticized by public officials, the property tax is making a strong comeback. In fiscal 2016 (the most recently available data from the U.S. Census Bureau), property taxes provided nearly 30 percent of the aggregate general revenue for all types of local governments (counties, municipalities, townships, school districts, and special districts). This compares with 28 percent in 2007 before the Great Recession and less than 27 percent in 2000. In fact, one has to go back 40 years — to 1978 — to find a year when the property tax was substantially more important relatively, that is, provided a larger share of revenue than currently.

The magnitude of property tax revenue also has been increasing, in addition to its relative importance. Real property tax revenue per person increased substantially from 2000 through 2009, as shown in Figure 1, essentially growing faster than the combined effect of population and inflation. It declined for the next four years as declines in property values associated with the financial market crisis and the recession began to be reflected in taxable (or assessed) values. But since 2013, real property tax amounts per person have been increasing and by 2016 were nearly back to the peak levels of 2009-2010.

In a broader sense, since 2000 local governments have become more reliant on their own revenue sources, as taxes have been replacing intergovernmental aid, and rising property taxes have been a major factor in increasing local government taxes, generally. As shown in Figure 2, intergovernmental grants declined from 39.4 percent of revenue to 36.1 percent over this period. At the same time, local government taxes rose from providing 37.4 percent of revenue to 41.4 percent. As shown by the dotted line in the figure, much (although not all) of the increase in local tax revenue came from property tax increases. Thus, at the national level local governments have been replacing grants from the state and federal government with local property tax revenue.

To understand why property tax revenue is rising or falling, it is helpful to keep in mind the factors that influence property tax collections. Property tax revenue equals the rate of property taxation levied in the jurisdiction (measured as a percentage of the property tax base) multiplied by the real assessed value of the jurisdiction's property tax base. The property tax rate is the result of political and institutional forces as property tax rates require citizen approval in some states and there are state-imposed restrictions on rates in others.

Figure 1.
Magnitude of Local Government Property Tax



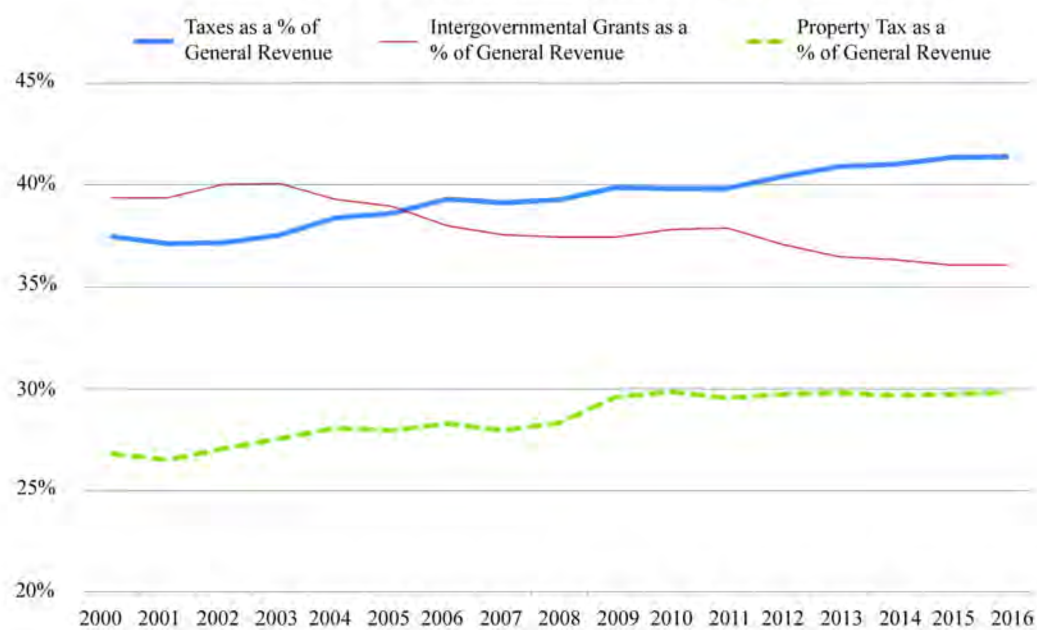
The assessed value of a jurisdiction's property is the result of market and institutional forces. Institutional forces include how the market value of property in a jurisdiction is translated into the assessed value, most importantly different assessment rules, especially whether current or acquisition-based assessment is used. Current assessment requires an assessor to value property at market value. Acquisition-based assessment values property at its market value when it is sold and restricts the growth in this value to a fixed percentage until the property changes ownership.[1] In addition, differences in market forces — different demand by both residents and business and constraints on supply — affect the market price of property.

These factors help explain why the situation in some states can be different from the national average trend shown in Figure 3. The cases for our two states illustrate this. In California, property taxes provided just 21.4 percent of general revenue for local governments in 2016, well less than the U.S. average of 29.8 percent. However, since 2000, property tax reliance increased substantially — from 16.9 percent — an increase in property tax share that is more than average. The increase in the property tax share was fueled by a large increase in the magnitude of property tax revenue. Real per capita property tax increased from $939 in 2000 to $1,495 in 2016. The increase of $556 is the 10th largest increase among the states (and the sixth largest increase in percentage terms).

Property tax revenue in California is limited by Proposition 13's requirement of acquisition-value assessment (with a 2 percent growth limit until resale) and a 1 percent maximum rate. On the other hand, the continued high demand for business and residential property in many areas of the state works to increase market values,

[1] For details on state-by-state institutional restrictions on property taxation as of 2017, see the Lincoln Institute of Land Policy's interactive table.

Figure 2.
Local Government Revenue Sources



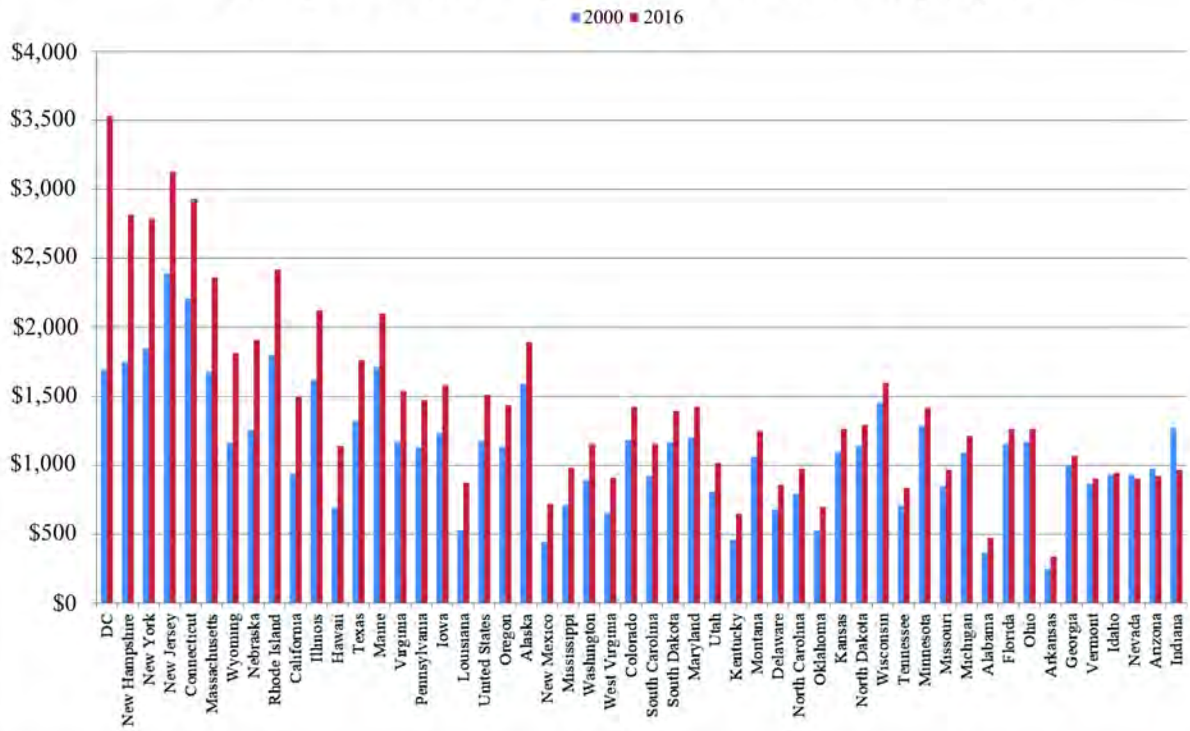
especially with high fees and regulations, restrictive building practices, environmental restrictions, and NIMBYs wishing to maintain high home values by limiting supply.

Michigan is a state where local property taxes are more important for local government than in California — providing 27.4 percent of general revenue, not including a state government property tax that is allocated to school districts. Since 2000, local property tax reliance increased slightly — up from 23.8 percent. Accordingly, the increase in the magnitude of property taxes was much smaller in Michigan than California. Real property tax per person increased modestly from $1,092 to $1,209. This $117 increase is 41st largest among the states and 40th in percentage terms. After Michigan's 1994 adoption of Proposal A, it also practices acquisition-value assessment, with a consumer price index or 5 percent maximum growth limit.

Part of the difference in the growth of property taxes between California and Michigan also reflects a difference in the property market. For example, in California, the median value of owner-occupied houses increased by 141 percent between 2000 and 2017. In contrast, in Michigan owner-occupied housing value increased by 32 percent in the same period. Michigan has not seen as substantial an increase in demand for property as California.

In three states — Indiana, Arizona, and Nevada — the real value of property tax revenue per person declined between 2000 and 2016, opposite from the national trend. Indiana experienced the most major change, with real per capita property tax revenue falling by $303 or nearly 24 percent. As a result, reliance on the property tax by local governments in Indiana decreased from more than 33 percent of general revenue in 2000 to 23 percent in 2016. The decline in property tax reliance was offset by increased reliance on user charges, state aid, and individual income taxes.

Figure 3.
Change in Real Per Capita Local Government Property Tax



Whether this resurgence of the property tax continues likely depends on two underlying conditions. The trend in property value would seem to be most important. If national economic growth continues and property values, on average, continue to grow, then evidence suggests that both the magnitude and relative fiscal importance of the property tax will also grow. In addition, local government property taxes are affected by the financial support provided by the federal and state governments to localities. It would seemingly require a substantial reversal of the declining trend in such support to bring about a corresponding decrease in local property taxes. Thus, until the next recession or housing market collapse, the resurgence of property taxes seems likely to continue. ■