

THE PROPERTY TAX AND PLANNING

**Lincoln Institute of Land Policy
Workshop on
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The Nuts and Bolts of Development Finance**

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I. Introduction and Overview

The purpose of this paper is to explore how the property tax is collected in the U.S. and how the daily activities of planners affect this important revenue source for local governments. The property tax continues to provide the bulk of local tax revenues for all forms of local government, although its importance has diminished over time (Lucy and Fisher 2000:405) largely due to the growth of other local revenue sources and pressures to limit property tax growth. Through the early decades of the 20th century the property tax was used primarily by state governments, with only limited use by local governments such as cities, counties and school districts. By the end of the Great Depression state governments had moved almost entirely away from use of the property tax, while property taxes became the main tax collected by local governments (Bell and Bowman 1991:85-86). Among the various types of local governments, property taxes are of most importance to town governments and school districts (58% and 34% of total revenues respectively), with lesser relative importance for counties (24%) and municipalities (17%) (Huddleston 2005b:Table 3).

The property tax is almost constantly under scrutiny by taxpayers and local and state elected officials and is often the flash-point for heated public debate. The property tax is often faulted for its striking imperfections, which include (among other factors): a highly noticeable lump-sum payment versus a less obvious periodic payment; taxation of unrealized capital gains; not based on property owner's ability to pay, and perceived unfairness and lack of transparency in the property appraisal process (Bland 2005:93; Bell and Bowman 1991:87). The dissatisfaction with the property tax led to the well-known tax restraint initiatives in California (Proposition 13) and Massachusetts (Proposition 2 ½) and numerous lesser known efforts in other parts of the country. Given the importance of the property tax to school districts, it is not surprising that much public attention has been placed on reducing property tax increases associated with local education. In some states (Michigan, Minnesota and New Hampshire for example), state governments have assumed greater responsibility for funding public education

¹This paper has been commissioned by the Lincoln Institute of Land Policy. The author appreciates the helpful review by Richard L. Stauber, the property tax "legend" of Wisconsin. All other errors or omissions are solely the responsibility of the author.

and in the process have increased state governments' reliance on the property tax, with a corresponding decrease in local government use of the property tax (Bland 2005:77).

The property tax is not only an important source of local revenues, but it also serves as the platform for several of local governments' limited development incentive programs. Local governments, for example, use property tax abatements (or other relief measures) as their primary local economic development incentive (Lucy and Fisher 2000:408; Peters and Fisher 2003:116; Bowen, Winson-Geideman and Simons 2003:258). Perhaps more importantly, the basic property tax system serves as the structure upon which tax increment financing (TIF) normally is based. This popular local government financing tool basically diverts growth in property taxes from local governments that benefit from local development (such as school districts, counties, and so forth) to local governments that undertake and finance development projects (such as cities).²

The purpose of this paper is to discuss the mechanics of property tax administration in terms that can enable practicing planners to understand how their various activities affect the property tax. To accomplish this, the paper first discusses the basic features of the property tax system in a simple, one-government world. Here terms such as levy, tax base, tax rate and tax collections are defined. Following this, the paper turns to how the property tax works in reality, that is, in a world where multiple local governments all are sharing the same property tax base. Here concepts of tax administration districts, assessed versus equalized value, apportionment and so forth are defined and discussed. After the general discussions of the first two sections, the paper discusses major special features of the property tax system that need to be understood by planners. These features include how value is determined, time lags inherent in the property tax system, the role and implications of exemptions, property taxes and economic development, and property tax relief and control measures. The paper concludes by briefly exploring how the activities of planners interact with the property tax system.

²See Rachel Weber (2003:54-57) for a discussion of the "mechanics" of tax increment financing.

II. Basic Features of the Property Tax System: Simple World of One Government

In a world with just one local government wanting to raise revenues using the property tax, the basic workings of the property tax can be explained by the five equations shown below.

$$\text{Tax Levy}_j = \text{Spending}_j - \text{Aids}_j - \text{Other Revenues}_j \quad (1)$$

$$\text{Tax Base}_j = \sum \text{Parcel Value}_i \quad (2)$$

$$\text{Levy}_j / \text{Tax Base}_j = \text{Tax Rate}_j \quad (3)$$

$$\text{Tax Rate}_j * \text{Parcel Value}_i = \text{Property Tax Liability}_i \quad (4)$$

$$\sum \text{Property Tax Liability}_i = \text{Total Property Tax Revenue}_j \quad (5)$$

Each of the terms in the five basic equations above can be defined as follows.

Tax Levy_j *Levy* refers to the amount of property taxes an individual government **j** needs in the *upcoming* fiscal year to finance its operations and amortize its capital improvements. The levy is determined by first identifying total spending (Spending_j) for the upcoming year and then reducing this amount by federal and state aids (Aids_j) government **j** will receive in the upcoming year and the amount of other revenues (Other Revenues_j) such as user charges, fines, fees and so forth that are likely to be received. The property tax is often referred to as a *residual* tax; that is, the amount of property taxes to be collected is the amount needed to balance the local government budget after all other revenues have been used. Levies are normally determined and approved each fiscal year by the legislative body of the local government (e.g. city council, school board, etc.).

Parcel Value_i The value of an individual property parcel **i** (including both land and improvements) normally is established by local property *assessors* and

generally reflects some proportion of the amount that the parcel would be sold or purchased by free parties (i.e. willing buyers and sellers) in an “arm’s length transaction” (e.g. not family members) at the time of sale. See Section IV.A. for more detail on how land and improvements are normally assessed. The value of each parcel normally is established as of a specific day (e.g. January 1 of the current year) and is used to generate property taxes to be used in a future time period (e.g. January 1, 2005 property values are used to determine property taxes that will be collected in 2006). Property values can be contested by parties believing their assessed property values are too high (in comparison to similar properties) by following some fashion of review or appeal (e.g. Board of Tax Appraisal Appeals).

Tax Base_j

Tax Base refers to the total taxable land and improvements that are contained within the boundaries of government **j** and available for property taxation. Property values for all taxable property within a jurisdiction normally are recorded in a single place, often on what is called the *Assessment Roll*, or equivalent. The tax base of a local government simply reflects the summation of all taxable parcels within the government’s boundaries. All property is categorized as either *real property* or as *personal property*. Real property is comprised of land and improvements, where land is typically categorized into *classes* (of uses) such as residential, commercial, industrial, agricultural, forests, and so forth. Real property typically refers to physical structures such as buildings or parking facilities. Personal property refers to non-fixed assets such as machinery and equipment, inventories, patents, and so forth. Some land and improvements such as churches, government buildings and so forth typically are exempt from local property taxation.

Tax Rate_j

The *tax rate* for government **j** is the rate at which all taxable property within the jurisdiction will be taxed. The rate is simply determined by

dividing the levy to be collected by the total *assessed value* tax base of the jurisdiction. In uniform taxation states, this single rate is applied to all taxable properties within the jurisdiction. That is, for example, a dollar of residential property will pay the same tax as a dollar of commercial or industrial property. In non-uniform taxation states, different rates can be applied to different classes of property. The convention is to express property tax rates using either five or six decimal places (e.g. tax rate = 0.01254) or as mill rates. Mill rates refer to the dollars of property tax per \$1,000 of value.³ For example, a tax rate of 0.01254 can be expressed as \$12.54 mills, meaning \$12.54 of property tax per \$1,000 of value.

Property Tax Liability_i	The amount of property tax owed by the owner of a parcel i is the <i>property tax liability</i> of the parcel. This is determined for each taxable parcel by multiplying the <i>assessed</i> value of the parcel by the property tax rate (that has been determined using the <i>assessed</i> value of the tax base).
Total Property Tax Revenue_j	The total property taxes collected by a government j is simply the sum of property tax payments made by individual property owners i . This is the property tax revenue available in the upcoming year that can be used to balance the local government's budget. In any given year, total property tax revenues actually received by the local government will likely be less than the sum of individual parcel property tax liabilities due to failure of some property owners to pay their property taxes in a timely fashion. Property taxes not paid are often referred to as <i>delinquent</i> , and normally make the property subject to immediate interest penalties, and ultimately to seizure and sale by the government.

Property taxing jurisdictions overlap one another and, depending on their physical size and population, may contain hundreds, thousands, or millions of parcels. For purposes of illustration, however, Table 1 shows how property taxes are determined and collected in a simple

³The convention in some states is to refer to dollars of property taxes per \$100 of value.

world of just one local government, a single city which is comprised of just two taxable parcels whose values have been assessed as of January 1, 2004 at \$10 and \$30 million, producing a total tax base for the city of \$40 million. The city anticipates spending \$4 million in 2005. It also anticipates receiving \$1 million in federal and state aids in 2005 and \$2 million in various local revenues other than the property tax (e.g. user charges). To balance its budget the city will need to raise (*levy*) \$1 million in property taxes for 2005.

To accomplish this, the 2005 levy is divided by the tax base as measured January 1, 2004 to produce a property tax rate of 0.02500, or \$25 of property tax per \$1,000 of assessed value. Applying this rate to each of the properties in the city produces property tax liabilities of \$250,000 for Property A and \$750,000 for Property B. If both property owners pay their property tax liabilities in a timely fashion (i.e. no delinquencies), the city will collect just exactly the amount in property taxes that will be needed to keep the local budget balanced.

The illustration in Table 1 pertains to a world where only one local government is using the local property tax base to raise revenues. In reality, numerous local governments use all or part of the same tax base to raise revenues, each using the basic principles discussed in Section II. The sharing of the local tax base by multiple governments produces a more complex set of fiscal relationships that are described in Section III.

TABLE 1. Illustration of Property Tax Administration for a Single Local Government

<u>Tax Base: January 1, 2004</u>		<u>Anticipated Government Budget: January 1 - December, 2005</u>	
<u>Parcel</u>	<u>Assessed Value</u>	<u>Spending</u>	
Property A	\$10,000,000	General budget	\$3,000,000
Property B	\$30,000,000	Capital budget	\$1,000,000
Total Assessed Value:	\$40,000,000	Total anticipated spending:	\$4,000,000
		<u>Revenues</u>	
		Federal/state aids	\$1,000,000
		Other local revenues	\$2,000,000
		Property taxes needed (levy)	\$1,000,000
		Total anticipated revenues:	\$4,000,000

Tax Rate Determination

Property Tax Levy	\$1,000,000		
<i>divided by</i>			
Total Assessed Value (<i>tax base</i>)	\$40,000,000		
Property Tax Rate:	0.02500	<i>or</i>	\$25.00 (mills) per \$1,000 (value)

Determination of Property Tax Liabilities and Total Property Tax Revenues

<u>Parcel</u>	<u>Assessed Value</u>		<u>Tax Rate</u>	=	<u>Property Tax Liability</u>
Property A	\$10,000,000	(*)	0.02500	=	\$250,000
Property B	\$30,000,000	(*)	0.02500	=	\$750,000
Total Anticipated Property Tax Revenue:					\$1,000,000

III. Property Tax System when Multiple Local Governments Use the Same Tax Base

As suggested above, in reality numerous local governments use at least portions of the same tax base to raise property taxes for their various purposes. Some have referred to this as the *layer cake* of local government fiscal relationships. Figure 1 illustrates how the layer cake of local governments appears to an individual property owner. In this illustration, four different local governments, the county, a school district, a sewer district, and the city all tax the property of an individual property owner. The county's tax base is larger than any other local government, followed by the school district's tax base, then the sewer district's, and finally the smallest tax base being that of the city. The taxpayer will be paying property taxes to each of the local governments. From the taxpayer's point of view, she or he is interested in both the property taxes paid to each separate local government and the total amount of property taxes paid to all local governments.

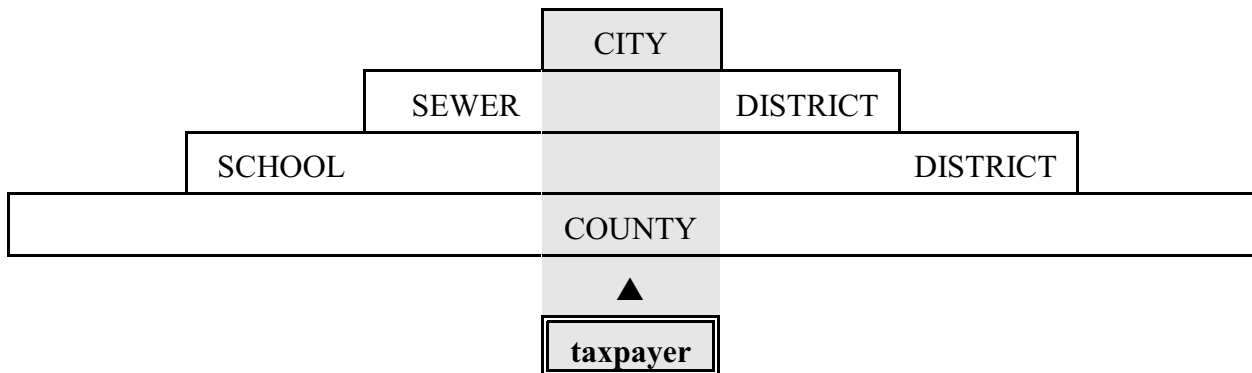


FIGURE 1. The “Layer Cake” of Local Governments from a Taxpayer’s Perspective

An important feature of the local government layer cake is that the tax base of some local governments crosses the boundaries of other local governments. For example, large school districts may serve residents in several adjacent cities and towns. The associated tax base of the school district may, thus, be composed of property values located in several different municipalities. Conversely, two taxpayers located in the same city would be taxed at the same rate for city services, but might face different tax rates for school purposes if the two properties are served by different school districts. In the layer cake of local governments, the property values contained in a single community may be used to raise property taxes for numerous local governments.

Another important feature of the layer cake is that it would be onerous to taxpayers to pay separate property taxes to each of the separate local governments using the property tax. In most situations, a single entity takes on the responsibility of collecting property taxes for all local governments. In some states, county governments take on the responsibility of collecting property taxes for all local governments; in other states municipal governments (e.g. cities and towns) take on this responsibility.⁴ Although the name of these special property tax administration entities varies from state-to-state, a general name that is used is *tax administration district* (TAD). In most cases, the tax administration district oversees assessment of property values, determines appropriate property tax rates, distributes property tax bills to property owners, collects property tax payments, and distributes collected property taxes to the appropriate government.

In comparison to property tax administration in the simple world of a single local government (as illustrated in Table 1), multiple governments using the same tax base encounter two additional challenges.

1. Comparable Property Assessments. The property tax levies of governments (such as counties or school districts) which overlap a number of smaller governments (such as towns and cities) will most often be allocated, or *apportioned*, among the tax base of the governments they overlap. For equity purposes, it is crucial that similar properties be valued similarly, without regard to value estimates made by individual local assessors. In concept, for example, a home that has a “true” market value of \$300,000 in one part of a county should pay the same county property tax as a second home in the county that also has a “true” market value of \$300,000, even though a local assessor has placed a fractional assessment of \$100,000 on the second home.
2. Method for Collecting Appropriate Levies. When a single local government serves as a tax administration district and will be collecting property taxes for other local governments in an area, it is critical that clear instructions are communicated to the tax administration district. For example, a county must have ways to communicate that it wants TAD #1 to collect \$2,000,000 in property taxes and TAD #2 to collect \$4,000,000.

⁴In a very few states (Maryland and Montana) the property tax system is directly administered by state government. In Texas, independent entities called Central Appraisal Districts (that have a scale equivalent to a county) administer much of the property tax system (Bland 2005:87).

A corresponding set of controls are needed to ensure that the various local governments receive (are apportioned) the proper amount of property taxes after they have been collected by the TAD.

Table 2 illustrates how the property tax is administered when numerous local governments share the same tax base and a higher level of government, such as the county, serves as the tax administration district. In this illustration, a TAD (Madison County) is composed entirely of two cities (Swellsville and Downersville) and therefore contains three general purpose governments (the county and two city governments).

The County acting as a TAD is responsible for establishing the *Assessment Roll* for all taxable properties in the County as shown in Step 2. The TAD has to take special care to ensure consistent valuation of property as discussed (Challenge 1) above. Each local government determines its needed property tax levy for Fiscal Year 2005 (as illustrated in Table 1). These levies are shown in Step 3. It is at this step that lower-level governments (such as the City of Swellsville) must communicate to the County TAD how much property tax it wants collected on its behalf. For example, the City of Downersville tells the County TAD to collect \$1,200,000 in property taxes for its purposes. This communication normally occurs through an official document called the *Statement of Apportionment* (or equivalent).

As shown in Step 4, the County TAD determines how much property tax is to be collected from various property owners in the County and establishes an appropriate property tax rate based on *assessed* property values. For example, the County TAD will need to tax property owners in the City of Swellsville \$7.11 per \$1,000 of assessed value for city purposes and \$4.44 per \$1,000 for county purposes. Property owners in the City of Downersville will be taxed at \$7.41 per \$1,000 of assessed value for city purposes and \$4.44 per \$1,000 for county purposes (the same as property owners in Swellsville).

The County TAD is now able to prepare property tax bills for individual property owners throughout the County. As shown in Step 5, Property A, with an assessed value of \$225,000,000 will be billed \$1,600,000 for city purposes and \$1,000,000 for county purposes. Property tax bills will be prepared and sent to all property owners in the County. As shown in Step 6, these property owners will, in turn, make a single payment for all property taxes owed to the County TAD. In the end and if all taxes have been paid (i.e. no delinquencies), the County

TABLE 2. Property Tax Administration with Multiple Governments under Uniform Taxation: County as Tax Administration District

1. Madison County is located in a uniform taxation state and is composed entirely of two cities, with three general purpose governments: Madison County, City of Swellsville and City of Downersville. Madison County is the property *tax administration district* (TAD) for all local governments.
2. Madison County as the TAD hires its own assessor, or contracts with local assessors to determine property values for all properties in the County as of January 1, 2004. The County TAD assesses at 90% of true market value. Below is the true market value of all properties and the *assessment roll* that is created by the TAD.

<u>Government</u>	<u>“True” (100%) Market Value January 1, 2004</u>	<u>ASSESSMENT ROLL Assessed (90% of “True”) Property Value January 1, 2004</u>
City of Swellsville	\$ 1,000,000,000	\$ 900,000,000
* Property A	\$ 250,000,000	\$ 225,000,000
* Property B	\$ 750,000,000	\$ 675,000,000
City of Downersville	\$ 180,000,000	\$ 162,000,000
* Property C	\$ 180,000,000	\$ 162,000,000
Madison County	\$ 1,180,000,000	\$ 1,062,000,000

NOTE: The TAD must ensure that assessments by all of the contracted assessors are comparable across the County.

3. Each general purpose government determines the amount of property taxes that will be needed (*levied*) for the 2005 fiscal year.

<u>Government</u>	<u>Fiscal Year 2005 Levy</u>
City of Swellsville	\$ 6,400,000
City of Downersville	\$ 1,200,000
Madison County	\$ 4,720,000

A *Statement of Apportionment* is sent by each general purpose government to the TAD. For example, the City of Swellsville’s Statement of Apportionment tells the TAD to collect \$6,400,000 in property taxes from all owners of taxable parcels within the city’s boundaries.

TABLE 2. Property Tax Administration with Multiple Governments under Uniform Taxation: County as Tax Administration District (continued)

4. The TAD *apportions* property tax levies based on total *assessed* value of each general purpose government and determines appropriate property tax *rates*. For example, the owners of property in Swellsville constitute 100% of the total tax base of the City of Swellsville and, thus, will be responsible for 100% of the City’s levy. The same property owners constitute 84.7% of the County’s tax base and will be responsible for 84.7% of the County’s levy.

<u>Government</u>	<u>Total Assessed Value (Tax Base)</u>	<u>Levy</u>	<u>APPORTIONED LEVIES</u>	
			<u>Swellsville Taxpayers</u>	<u>Downersville Taxpayers</u>
City of Swellsville	\$ 900,000,000	\$ 6,400,000	\$ 6,400,000	\$ 0
City of Downersville	\$ 162,000,000	\$ 1,200,000	\$ 0	\$ 1,200,000
Madison County	\$ 1,062,000,000	\$ 4,720,000	\$ 4,000,000	\$ 720,000

Property tax rates are determined by dividing *apportioned levies* by the *total assessed value* of each local government.

<u>Local Government Tax Rate</u>	<u>Swellsville Taxpayers</u>	<u>Downersville Taxpayers</u>
City of Swellsville	$\$ 6,400,000 \div \$ 900,000,000 = 0.00711$	
City of Downersville	$\$ 1,200,000 \div \$ 162,000,000 =$	0.00741
Madison County	$\$ 4,720,000 \div \$ 1,062,000,000 = 0.00444$	0.00444

5. TAD sends *property tax bills* to all property owners in County.

<u>Property A</u>	<u>Tax Rate</u>	<u>Assessed Value</u>	<u>Property Tax Liability</u>
City	0.00711 (*)	\$ 225,000,000	= \$ 1,600,000
County	0.00444 (*)	\$ 225,000,000	= \$ 1,000,000
<i>TOTAL TAX BILL</i>			<i>\$ 2,600,000</i>

<u>Property B</u>	<u>Tax Rate</u>	<u>Assessed Value</u>	<u>Property Tax Liability</u>
City	0.00711 (*)	\$ 675,000,000	= \$ 4,800,000
County	0.00444 (*)	\$ 675,000,000	= \$ 3,000,000
<i>TOTAL TAX BILL</i>			<i>\$ 7,800,000</i>

<u>Property C</u>	<u>Tax Rate</u>	<u>Value</u>	<u>Property Tax Liability</u>
City	0.00741 (*)	\$ 162,000,000	= \$ 1,200,000
County	0.00444 (*)	\$ 162,000,000	= \$ 720,000
<i>TOTAL TAX BILL</i>			<i>\$ 1,920,000</i>

TABLE 2. Property Tax Administration with Multiple Governments under Uniform Taxation: County as Tax Administration District (continued)

6. Property owners pay property taxes (no delinquencies) to TAD.

Property A	\$ 2,600,000
Property B	\$ 7,800,000
Property C	\$ 1,920,000
TOTAL PAYMENTS RECEIVED	\$ 12,320,000

7. TAD distributes collected property taxes to underlying governments according to Statements of Apportionment.

Payments received by TAD	\$ 12,320,000
<i>less</i>	
Payment to City of Swellsville	\$ 6,400,000
Payment to City of Downersville	\$ 1,200,000
Payment of Madison County	\$ 4,720,000
TAD fund balance	\$ 0

Payments received by each general purpose government exactly match their levies for Fiscal Year 2005.

TAD will receive \$12,320,000 in property tax payments. As shown in Step 7, the County TAD makes payments to the various general purpose governments according to the Statements of Apportionment and will have exactly enough revenue to make all payments. Each general purpose government will have received from the TAD just exactly the amount needed to balance its budget for the 2005 fiscal year.

Table 3 looks at the same governments as in Table 2, but with the two (lower-level) cities serving as tax administration districts instead of the county. The local assessor for the Swellsville TAD produces the assessment roll shown in Step 2 for Swellsville properties; the local Downersville TAD assessor produces the assessment roll for Downersville properties. It should be noted that even though the three properties shown in Table 2 and Table 3 are the same, the assessment rolls that are produced in Table 3 are all different than those in Table 2, because the two local assessors have valued property at different ratios of its true value. In the property tax system, different property assessors can arrive at different assessments of value,

TABLE 3. Property Tax Administration with Multiple Governments under Uniform Taxation: Cities as Tax Administration Districts

1. Madison County is located in a uniform taxation state and is composed entirely of two cities, with three general purpose governments: Madison County, City of Swellsville and City of Downersville [same as Table 2]. Both *cities* serve as the property *tax administration district* (TAD) for all local governments.
2. The assessor for the Swellsville TAD determines the assessed value of all property within Swellsville; the assessor for the Downersville TAD determines the assessed value of all property within Downersville. The *Assessment Roll* produced by each assessor is shown below.

Swellsville Assessment Roll		Downersville Assessment Roll	
Property A	\$ 200,000,000	Property C	\$ 200,000,000
Property B	\$ 600,000,000		
Total Assessed Value (Tax Base)	\$ 800,000,000	Total Assessed Value (Tax Base)	\$ 200,000,000

3. State Department of Revenue *equalizes* assessed property values for each TAD by determining *assessment ratios*. It determines that the assessment ratio for the Swellsville TAD is 0.80 and for the Downersville TAD is 1.11. This means that the assessor for the Swellsville TAD has been assessing property values 20% less than full market value and the assessor for the Downersville TAD has been assessing property values 11% above full market values (on average).

Tax Administration District	Assessed Value	Assessment Ratio	Equalized Value (100%)
Swellsville	\$ 800,000,000	0.80	\$ 1,000,000,000
Downersville	\$ 200,000,000	1.11	\$ 180,000,000
Madison County			\$ 1,180,000,000

4. Each general purpose government determines the amount of property taxes that will be needed (*levied*) for the 2005 fiscal year.

Government	Fiscal Year 2005 Levy
City of Swellsville	\$ 6,400,000
City of Downersville	\$ 1,200,000
Madison County	\$ 4,720,000

TABLE 3. Property Tax Administration with Multiple Governments under Uniform Taxation: Cities as Tax Administration Districts (continued)

5. Based on adopted property tax levies and the distribution of *equalized values* among the various TADs, each general purpose government sends a *Statement of Apportionment* to the respective TADs that specifies the amount of property taxes to be collected in their behalf. For example, 84.7% of the County’s *equalized* value lies within the Swellsville TAD. The County’s Statement of Apportionment will instruct the Swellsville TAD to collect 84.7% of the County’s adopted levy, or \$ 4,000,000, from taxpayers within the Swellsville TAD.

<u>Government</u>	<u>Total Equalized Value</u>	<u>Levy</u>	<u>APPORTIONED LEVIES</u>	
			<u>Swellsville TAD</u>	<u>Downersville TAD</u>
City of Swellsville	\$ 1,000,000,000	\$ 6,400,000	\$ 6,400,000	\$ 0
City of Downersville	\$ 180,000,000	\$ 1,200,000	\$ 0	\$ 1,200,000
Madison County	\$ 1,180,000,000	\$ 4,720,000	\$ 4,000,000	\$ 720,000

6. Each TAD determines appropriate property tax rate based on *assessed* property values of the TAD.

<u>Government</u>	<u>Total Assessed Value</u>	<u>Levy</u>	<u>Swellsville TAD</u>	<u>Downersville TAD</u>
			City of Swellsville	\$ 800,000,000
City of Downersville	\$ 200,000,000	\$ 1,200,000		0.00600
Madison County		\$ 4,720,000		
* <i>Swellsville portion</i>		\$ 4,000,000	0.00500	
* <i>Downersville portion</i>		\$ 720,000		0.00360

7. Each TAD sends *property tax bills* to all owners of property within their jurisdictions.

Swellsville TAD

<u>Property A</u>	<u>Tax Rate</u>	<u>Assessed Value</u>	<u>Property Tax</u>
City of Swellsville	0.00800	\$ 200,000,000	\$ 1,600,000
Madison County	0.00500	\$ 200,000,000	\$ 1,000,000
<i>TOTAL TAX BILL</i>			<i>\$ 2,600,000</i>

<u>Property B</u>	<u>Tax Rate</u>	<u>Assessed Value</u>	<u>Property Tax</u>
City of Swellsville	0.00800	\$ 600,000,000	\$ 4,800,000
Madison County	0.00500	\$ 600,000,000	\$ 3,000,000
<i>TOTAL TAX BILL</i>			<i>\$ 7,800,000</i>

TABLE 3. Property Tax Administration with Multiple Governments under Uniform Taxation: Cities as Tax Administration Districts (continued)

<u>Downersville TAD</u>			
Property C	Tax Rate	<i>Assessed</i> Value	Property Tax
City of Downersville	0.00600	\$ 200,000,000	\$ 1,200,000
Madison County	0.00360	\$ 200,000,000	\$ 720,000
TOTAL TAX BILL			\$ 1,920,000

8. Property owners pay property taxes (no delinquencies) to TAD.

Property A (paid to Swellsville TAD)	\$ 2,600,000
Property B (paid to Swellsville TAD)	\$ 7,800,000
Property C (paid to Downersville TAD)	\$ 1,920,000

Total Payments Received

Swellsville TAD	\$ 10,400,000
Downersville TAD	\$ 1,920,000

9. TADs distribute collected property taxes according to Statements of Apportionment.

Swellsville TAD

Payments received	\$ 10,400,000
<i>less</i>	
Payment to City of Swellsville	\$ 6,400,000
Payment of Madison County	\$ 4,000,000
TAD fund balance	\$ 0

Downersville TAD

Payments received	\$ 1,920,000
<i>less</i>	
Payment to City of Downersville	\$ 1,200,000
Payment of Madison County	\$ 720,000
TAD fund balance	\$ 0

TABLE 3. Property Tax Administration with Multiple Governments under Uniform Taxation: Cities as Tax Administration Districts (continued)

<u>Levy Reconciliation</u>		
City of Swellsville	Fiscal Year 2005 Levy:	\$ 6,400,000
	Payment from Swellsville TAD:	\$ 6,400,000
City of Downersville	Fiscal Year 2005 Levy:	\$ 1,200,000
	Payment from Downersville TAD:	\$ 1,200,000
Madison County	Fiscal Year 2005 Levy:	\$ 4,720,000
	Payment from Swellsville TAD:	\$ 4,000,000
	Payment from Downersville TAD:	\$ 720,000
	[combined payments from TADs]	[\$ 4,720,000]

even when “true” property values are known. Since different assessors are establishing the tax rolls that will ultimately be used to generate property taxes for Madison County government, it is important that the value of similar properties are made comparable across local TADs. Otherwise, owners in one TAD will be paying less than their fair share, while owners in the other TAD will be paying more than their fair share. The process of making properties comparable is shown in Step 3 of Table 3. The state Department of Revenue (or equivalent) looks at recent property sales data and determines that the assessor for the Swellsville TAD has been assessing properties at only 80 percent of their “true” market value, on average. The Department of Revenue also determines that the Downersville TAD assessor has been assessing about 11 percent above market value, on average. Using these *assessment ratios* for each TAD, the Department of Revenue produces its estimate of *equalized* or true market value for all properties in the County. The *equalized value* tax base of the Swellsville TAD is determined to be \$1,000,000,000 and the tax base of the Downersville TAD to be \$180,000,000. Equalized values are comparable across TADs and are ultimately used to *apportion* the property tax levies of higher-level governments.

The total property tax levies needed by the three general purpose governments for the 2005 fiscal year (shown in Step 4 of Table 3) are the same as those shown in Table 2. As shown in Step 5, *equalized* property values are used to allocate the County’s property tax levy among the two TADs for collection. The Swellsville TAD will need to collect \$4,000,000 in property

taxes for Madison County; the Downersville TAD \$720,000. These instructions are communicated using a *Statement of Apportionment* that is sent to each TAD.

The two TADs now know how much property tax is to be collected for each general purpose government and use their respective *assessed* value tax bases to determine the appropriate property tax rate. The Swellsville TAD, for example, will tax all property owners within its boundaries at \$8.00 per \$1,000 for city purposes and \$5.00 per \$1,000 for county purposes. Unlike the county tax rates shown in Table 2, the county tax rate shown in Table 3 is different between the Swellsville and Downersville TADs since local *assessed* values rather than the *equalized* values are used to determine tax rates. As in Table 2, the two TADs send out tax bills (Step 7) and collect property tax payments (Step 8) from all owners of property in the County. As shown in Step 9, the Swellsville TAD receives enough in property taxes to pay all of the necessary levy for the City of Swellsville and a portion of the necessary levy for Madison County. The Downersville TAD similarly receives enough in property taxes to pay the necessary levy for the City of Downersville and the remaining portion of the Madison County levy. All general purpose governments have the amount of property tax revenues needed to exactly balance their respective budgets for Fiscal Year 2005.

Both examples shown in Tables 2 and 3 have assumed that all tax liabilities are paid by property owners. In fact, a normal rate of collections is around 95%—i.e., approximately five percent delinquency each year (Bland 2005:91). Typically a process is specified by state statute as to how property can be removed from delinquency status. Properties that do not pay their obligated property taxes within a reasonable amount of time are often subject to auction, with proceeds used to pay at least a portion of the obligated property taxes. Although the reasons for property to become delinquent are many, it is not uncommon for property with improvements that are in disrepair or properties that are located in declining areas to become delinquent in their property tax payments. Conversely, property held for speculation or development may remain delinquent until it is sold or developed and the proceeds used to pay the back taxes.

The illustrations of property tax administration discussed in Sections II and III are general expressions of how the property tax is administered across the U.S. The process and specific nomenclature (such as Statement of Apportionment or appraised value versus assessed value) may vary from state-to-state, but the general concepts and steps are similar to those discussed above.

IV. Special Features of the Property Tax Administration System

In addition to the general patterns for property tax administration discussed above, it is important that planners understand several special features that affect how property taxes are collected or used. These features include: determining land and property values; time lags associated with land development; exemptions from local property taxation; property taxes and economic development; “use value” assessment of agricultural land; the role of property values and taxes in state equalization aid programs; property tax relief and property tax controls.

A. Determining Property Values.

Property typically is broken into two broad categories: *real* property and *personal* property. Real property refers to *land* and *improvements* on the land, such as houses, office buildings and parking structures. Personal property typically is broken into *tangible* personal property and *intangible* personal property. Tangible personal property includes physical assets such as business inventories, equipment, office furniture, and livestock. Intangible personal property includes non-physical assets such as stocks and bonds, financial resources, and patents. Real property continues to dominate most local tax bases, while tangible property is becoming increasingly tax exempt. In addition to these trends, the growing importance of intangible personal property (such as patents and intellectual property) has proven challenging for local assessors to value.

The two components of real property, both land and improvements, are generally valued at their *highest and best use*.⁵ Highest and best use is a somewhat abstract concept that simply means that real property is being used in a way that over a foreseeable amount of time will produce a prudent owner with the highest net return or profitability, in comparison to other possible uses. Generally the highest and best use of real property must preserve the utility or functionality of the property over time and is influenced by numerous factors, such as supply and demand, size of land, alternative economic uses that are consistent with adopted plans or regulations such as zoning.

Beyond the abstract concept of highest and best use, property assessors normally use three methods to establish the value of different types of real property (Bell and Bowman

⁵In some cases (discussed below), land used for agricultural (or other similar) purposes is not always valued at its highest and best use.

1991:95-97). They are: market data (comparable sales) approach; cost approach;⁶ and the income approach. In some cases (such as residential real property) a single approach such as market data is used; in more complex cases (such as unique industrial real property) multiple approaches such as cost and income may be used to determine property value. Below is a basic description of each of the approaches to determine the value of real property.

1. Market Data (Comparable Sales) Approach. In simple terms the market data approach establishes the value of real property by comparing any specific property to sales data for similar properties located in the general vicinity that have recently sold. This means, for example, that all three bedroom ranch style homes with double car garages in the same neighborhood or assessment district will be valued at roughly the same value as three bedroom ranch style homes with double garages that have actually sold in the past year. The general list of factors that are commonly considered in determining “comparability” include: condition, age, location, type of structure, number of bedrooms, number of bathrooms, type of garage, topography, transportation access, utility availability, and so forth. The market data approach is commonly used for homes and small apartment properties, small commercial properties, and agricultural properties.
2. Income Approach. The income approach to valuing real property assumes that the value of real property depends on the relative demand for a specific property, which in turn depends on the net return the property will make for its owner. For example, the value of a property that makes \$1,000,000 in net profits per year will have greater value than a property that makes \$100,000 in net profits each year.

While the income approach can require considerable data that is often complex in nature, the basic nature of the approach can be illustrated in two techniques that are commonly used. These approaches are: Gross Income Multipliers, and Present Value.

- a. *Gross Income Multipliers.* The simplest of income approach techniques is that of calculating Gross Income Multipliers for comparable properties. Under this

⁶Sometimes referred to as the depreciated replacement cost approach or summation approach.

approach, which can only (reliably) be used when a large volume of comparable sales occur, requires data on the sales price of properties (land and improvements, but excluding personal property) and gross annual income. For example, Table 4 shows data on four apartment complexes that were sold in a given year. Dividing the sales price for each property by its gross annual income produces the Gross Income Multiplier for each property. The average of the four properties that sold is 7.11. In effect, this ratio means that, on average, apartment complexes sell for 7.11 times the annual gross income of the respective properties. The average multiplier for the four properties that sold can be used to value a fifth property that has not been sold. If the fifth property has gross annual income of \$4,104,000, its approximate value for both land and improvements would be \$29,164,000 (\$4,104,000 times 7.11).

TABLE 4. Illustration of Gross Income Multiplier Approach to Determining Value of Real Property

Comparable Properties that Have Been Sold Recently

Property	Sales Price	Annual Income	Gross Income Multiplier
1	\$ 28,800,000	\$ 4,100,000	7.02
2	\$ 32,100,000	\$ 4,600,000	6.98
3	\$ 33,800,000	\$ 4,700,000	7.19
4	\$ 28,200,000	\$ 3,900,000	7.23
		Average:	7.11

Value Determination for Comparable Property that Has Not Been Sold

Property	Annual Income	Average Gross Income Multiplier	Estimated Value
5	\$4,104,000	7.11	\$ 29,164,000

- b. *Present Value.* A second technique that is also commonly used to estimate the value of real property is that of calculating the present value of the net profits associated with the use of real property. More specifically, the technique calculates the present value of net profits associated with the *improvements* placed upon a parcel of land. In comparison to the Gross Income Multiplier approach, the present value approach has its grounding in basic economic theory, which suggests that the value of real property should increase with an increase in the economic returns to the property.

Table 5 illustrates how the present value technique works. This example assumes that a 300 unit apartment is located on a parcel of land that is valued at \$13,480,000 (at its highest and best use). The question that is addressed by the assessor is: “What is the value of the improvement constructed on this land?”. As shown in Table 5, the apartments have a gross revenue potential of \$4,320,000 per year if fully occupied. Reducing this by \$216,000 per year to reflect possible vacancies that may occur, the effective gross revenue for the apartments is \$4,104,000 per year. If it costs \$2,800,000 to operate the apartments each year, this would produce an annual profit (before taxes) of \$1,304,000. If the owner of the apartments could earn eight percent each year on alternative investments (i.e. the discount rate), and the expected useful life for the apartments is 30 years, the present value of this stream of net profits would be approximately \$14,680,100. This is the value of the improvements placed upon the land. Thus, in total, the apartment property would be valued at \$28,160,100: \$13,480,000 for the land and \$14,680,100 for the improvements.

TABLE 5. Illustration of Present Value Approach to Determining Value of Real Property

<u>Value of Improvements</u>		
Gross annual revenue potential	\$ 4,320,000	
less vacancy adjustment (@ 95% occupancy)	\$ 216,000	
Effective gross annual revenue	\$ 4,104,000	
Annual operating costs	\$ 2,800,000	
Annual net profit (before taxes)	\$ 1,304,000	
Discount rate	8%	
Expected life in years	30	
Present value of improvements		\$ 14,680,100
Value of land		<u>\$ 13,480,000</u>
Total Value of All Real Property		\$ 28,160,100

The various income approaches to valuing real property are commonly used for multi-family residential properties, commercial and office properties, and other real property uses that involve significant income generation potential.

It is important that planners understand the dynamics that would cause property value to increase or decrease when the income approach is used. In general, rising local incomes will cause local retail sales to increase, leading to an increase in commercial property values. Conversely, stagnant local income or declining population will cause retail sales and commercial property values to decrease or to grow slower. Rising costs for inputs such as labor or energy can cause net profits to decrease, thus, slowing the growth in commercial or office values or even leading to declines. Increasing interest rates on borrowed funds increase the holding costs of land, leading to decreasing net profits unless local land markets allow increasing rents or land charges. To the extent that land owners use a “real” (adjusted for inflation) capitalization or discount rate, increasing interest cost could lead to increasing land prices and property values.

3. Cost Approach. The cost approach to valuing real property basically assumes that the full market value of improvements that are made upon a parcel of land cannot be greater than the costs of replacing the improvements. Thus, the cost approach to valuing improvements is to record the cost of improvements at the time of construction and then adjust these downward to reflect depreciation over time and (generally) upward to reflect increasing costs of replacement.

The cost approach is often applied to industrial or scientific uses of land and often involves complex assessment procedures that are beyond the expertise of local assessors. It is not uncommon for the assessment of industrial and scientific improvements to be conducted by highly trained specialists who are employed by state departments of revenue or their equivalent. The cost approach is not used to assess the value of land, since land is a non-depreciating asset.

B. Time Lags Associated with Land Development

A second important feature of the property tax system is the lag between the need for new spending and the availability of new property tax revenues when land development occurs. This lag largely results from the fact that most property tax systems use prior year property values to finance upcoming expenditures.

Figure 2 illustrates the case of new development in the State of Wisconsin. Assume a developer gets final approval in July 2005 to begin construction of a new shopping center starting in July 2006 and finishing construction in June 2007. The city will need to improve infrastructure in the area prior to the start of construction and is able to add needed spending to the property tax levy in December 2005, for collection in 2006. *The increased levy-financed spending is funded using the January 1, 2005 tax base—a tax base without the new shopping center value included.* The city makes necessary infrastructure improvement between January and June 2006, spending the funds that were levied for 2006. The shopping center is completed in June 2007 and receives the necessary occupancy permits. A portion of the shopping center is completed by January 1, 2007. The value of these improvements is added to the city's assessment roll at that time. The local assessor places the total value of the new shopping center on the city's assessment roll as of January 1, 2008. Thus, the owner of the shopping center makes a property tax payment for a portion of the development in 2008, but it is not until

January and July of 2009 that the completed value of the development is taxed. The time lag is created in this example due to the fact that the city was required to start spending in January 2006 and couldn't realize partial property tax revenues from new development until 2009 and full property tax revenues until 2009.

July 2005	Jan 2006 -June 2006	July 2006- June 2007	Jan 2008	Dec 2008	Jan 2009- July 2009
Developer gets city approval for new shopping center: start July 2006; finish June 2007 City levy for 2006 increased	City makes infrastructure improvements City spending occurs	Shopping center constructed Partial property value added to assessment roll January 1, 2007	Full property value added to assessment roll 1 st smaller property tax payment made	2009 property tax bills out	2009 "Full" property taxes paid

FIGURE 2. Time Lags Inherent in Property Tax System

The example illustrated in Figure 2 assumes that new city spending associated with the new shopping center will be financed only with property taxes. The use of impact fees or special assessments could in fact reduce the gap between development-induced spending and revenue impacts. It is also possible that new city spending could be financed using borrowed funds (debt) that could be repaid when the new shopping center begins paying property taxes in 2009. The main purpose of the example is to show that the need for new spending is separated from the generation of new revenues when the property tax is involved in financing new development.

C. Exemptions from Local Property Taxation

While most uses of land require expenditures by local governments, not all land or improvements are subject to the local property tax. The primary classes of use that are not subject to local property taxation are selective social organizations (such as churches), government and certain types of land that are placed in conservancy. These activities are generally thought to provide social benefits that merit exclusion from local taxation. It has also become common for specific classes of property to be declared exempt from local property taxation. Many states, for example, exempt for economic development purposes the value of

machinery and equipment used in manufacturing facilities from taxation. While these programs are often aimed at increasing employment and income levels within a region, it is clear that they are also intended to increase the property tax base of local governments. An almost equal number of states exempt many forms of personal property (such as inventories, automobiles, boats, and so forth) from local property taxation, due mainly to the difficulty in assessing these assets (they can be hidden or moved out of the TAD).

It is important for planners to understand two important features of property tax exemptions. First, most land uses affect local government spending, without regard to their exemption status. Secondly, exempting certain classes of property from local property taxation does not affect local government spending or the levy, it simply affects who pays the local property tax. Exemptions have the effect of raising the tax rate and shifting apportioned levies from one property owner to another.

D. Property Taxes and Economic Development

Local governments often perceive that businesses wishing to operate within their boundaries face negative cost differentials (in comparison to other places) due to higher than normal taxes, high labor or energy costs, high transportation costs (due to location), or some combination of such factors (Fisher 1996:619). One of the few economic development tools local governments have available to them is the provision of tax incentives to firms hoping to expand or locate within an area, or firms threatening to leave an area. Lucy and Fisher (2000: 408), in fact, claim that “tax incentives have become a mainstay of local economic development planning.”

Property tax incentives normally take the form of exemptions or abatement. In some states, property tax incentives are part of a larger local economic development program, such as enterprise zones or special districts (Peters and Fisher 2003). Exemptions typically remove entire classes of property from local property taxation. For example, most states in 2005 totally exempt machinery and equipment used in manufacturing from local property taxation—meaning that all manufacturing machinery and equipment is exempt from local property taxation in all years. The general purpose of these exemptions is to encourage investment in such assets. Abatements, on the other hand, do not permanently remove classes of property from local property taxation, but rather reduce or eliminate the amount of such taxation for a specified period of time. For example, in some states, firms undertaking new construction,

reconstruction, expansion of existing facilities or upgrading of production facilities can have investments exempt from local property taxation for a period up to 10 years. In other states, up to nine percent of the investment in multi-family land and improvements can be exempt from local property taxation for a period up to 20 years (National Association of Home Builders 1987:82).

Clearly the objective of tax incentive programs for local governments is to attract, expand or retain economic activities. Like tax exemptions for social organizations and government, the exemption or abatement of property taxes associated with economic activity increases property tax rates (above what they would be without the exemptions) and shifts the burden of paying for local services from one property owner to others. In addition, new or expanded economic activities can have significant impacts on local government spending and property tax levies, thus, increasing the amount others will need to pay. Of course, to the extent that property tax exemptions for economic development purposes increase the local tax base, the impact of exemptions upon property tax levies and tax rates may be mitigated.

E. “Use Value” Assessment of Agricultural Land

A common problem for farmers wanting to farm on land located close to expanding urban areas is the fact that the *highest and best use* of such land is often higher in residential or commercial uses than it is in agricultural uses. This leads to land value assessments that can become prohibitive in terms of the profitability of farming, because agricultural land is assessed and taxed at its development value instead of at its agricultural value . The holding costs of land for farmers exceeds the revenue they can fairly expect to receive as a farming enterprise.

An approach used by a growing number of states is to assess agricultural land at its *use value* in farming, rather than at its highest and best use (e.g. residential development). Under use value assessment, agricultural land is assessed at the amount that land would be sold in a free, arms-length exchange by parties wishing to use the land for agricultural purposes. Agricultural land that is more productive than other agricultural land is valued at a higher level than less productive agricultural land, but all agricultural land is generally valued at less than it would be in urban uses (such as residential development). This has the effect of lowering the holding cost of land for agricultural purposes and in concept slows the conversion of agricultural land into urban uses. It is important to note that not all planners believe that use value assessment of agricultural land is an effective way to curb urban sprawl (Lucy and Fisher 2000:410).

It is also important for planners to understand what happens within the property tax system when agricultural land is assessed at its use value rather than at its highest and best use, especially during the transition from one practice to the other. Like exemptions and abatements discussed earlier, use value assessment does not affect the overall level of spending or property tax levies by local governments, but rather affects the composition of the local property tax base. During and after the transition from assessment of agricultural at its highest and best use to assessment at its use in agriculture, agricultural lands pay a smaller share of all local government levies and non-agricultural properties pay a higher share, including a shift from farm lands to farm homes, barns, etc.. It is a difficult and hotly debated judgment as to which distribution of local property taxes is most equitable, but it is clear that the distribution is different. While most farmers would no doubt welcome the switch in assessment practices, the shift in apportioned levies to elderly residential households with fixed annual incomes might be considered by non-farmers as a negative impact.

F. Role of Property Values and Taxes in State Equalization Aid Programs

State governments distribute a significant amount of financial aid to local governments each year, often in the form of equalization aid.⁷ Such programs can take many specific forms, but generally fall within two broad categories: foundation aids, or power equalization aids.⁸ A detailed discussion of equalizing aids is beyond the scope of the current paper, but a general version of a power equalizing aid program is illustrated below.

A power equalizing aid program generally rewards local spending or tax effort and penalizes increases in tax base. Equation 6 contains the basic formula used in a power equalization aid program.

$$AID_j = [1 - \{EQ\ VALUE_j / (POP_j * GTD\ VALUE) \}] * SPENDING_j \tag{6}$$

where

AID_j The state equalization aid received by community **j**.

⁷See Huddleston (2005b) for a discussion of state equalization aid programs.

⁸See Ladd and Yinger (1993) for a general description of both types of equalizing aid programs.

EQ VALUE_j	The <i>equalized</i> property value (tax base) of community j .
POP_j	The population of community j .
GTD VALUE	The property value per capita that the state government guarantees will be available for each resident of community j .
SPENDING_j	The annual total spending (or revenue effort) of community j .

As shown above (Equation 6), the state equalization aid a community would receive *increases* as its *spending* increases and *decreases* as its *tax base* increases relative to the state guaranteed tax base—hence, the notion of rewards and penalties.

In the absence of state equalization aids, the computation of the impact of new development on local government property taxes is reasonably straight forward. Table 6 estimates the impact of new development on a city’s tax rate when the impact of the new development is *not* considered. A city has a tax rate of \$6 per \$1,000 of assessed value prior to a new development occurring. This is a result of \$14,000,000 in total city spending, a city levy of \$6,000,000 and an assessed value tax base of \$1,000,000,000. A proposed shopping center will add \$1,000,000 to city spending each year, which will be financed entirely with the property tax. The tax base of the city should increase by \$100,000,000 due to the new shopping center (population will remain unchanged). Ignoring for the moment the impact of the proposed new development on state equalizing aids and considering only the impacts of the development on total city spending, property tax levies and tax base, the new shopping center should cause the city’s property tax rate to increase to \$6.36 per \$1,000 of assessed value. This increase results because property tax levies are forced upward more than the tax base is increased due to the development.

TABLE 6. Impact of New Development on Property Tax Rates: Without Anticipating Changes to State Equalization Aids

<u>City Budget</u>	<u>Pre Development</u>	<u>New Development</u>	<u>Post Development</u>	<u>% Change</u>
Total spending	\$ 14,000,000	\$ 1,000,000	\$ 15,000,000	7.1%
<i>less</i>				
Equalizing aids	\$ 4,000,000		\$ 4,000,000	
Non-equalizing aids	\$ 2,000,000		\$ 2,000,000	
Other revenue	\$ 2,000,000		\$ 2,000,000	
Levy	\$ 6,000,000	\$ 1,000,000	\$ 7,000,000	16.7%
Assessed value	\$ 1,000,000,000	\$ 100,000,000	\$ 1,100,000,000	10.0%
Property tax rate	0.00600		0.00636	6.0%

But the impacts shown in Table 6 do not take into account the changes that may occur to state equalization aids because of the new development. As discussed above, state equalization aids attempt to reward increased spending and to penalize increased local tax base. Table 7 looks at the impacts of the same development, but also includes an analysis of the impacts that will occur in state equalization aids. State equalization aids will actually decrease for the city due to the new development. This results because the *tax base grows faster than city spending*. The “reward” for increased spending is out-weighted by the “penalty” for increased tax base, thus, producing a decrease in equalization aids. This *decrease* in state equalization *aids* leads to an *increase* in the property tax levy, which ultimately leads to the *higher property tax rate* for the city. The impact of equalization aids can be significant. In the example shown in Table 7 and assuming the new tax base of \$1,100,000,000 is given, 56% of the increase in the tax rate is due to the \$1,000,000 in new spending caused by the new development; 44% is due to the decrease in state equalization aids (- \$785,714). It is important, thus, that planners understand both the basic workings of the property tax system and other important local revenue sources, such as state equalization aids.

TABLE 7. Impact of New Development on Property Tax Rates: Including Changes to State Equalization Aids

<u>City Budget</u>	<u>Pre Development</u>	<u>New Development</u>	<u>Post Development</u>	<u>% Change</u>
Total spending	\$ 14,000,000	\$ 1,000,000	\$ 15,000,000	7.1%
<i>less</i>				
Equalizing aids	\$ 4,000,000		\$ 3,214,286	- 19.6%
Non-equalizing aids	\$ 2,000,000		\$ 2,000,000	
Other revenue	\$ 2,000,000		\$ 2,000,000	
Levy	\$ 6,000,000	\$ 1,000,000	\$ 7,785,714	29.8%
Assessed value	\$ 1,000,000,000	\$ 100,000,000	\$ 1,100,000,000	10.0%
Property tax rate	0.00600		0.00708	18.0%

State Equalization Aid Determination: Pre-Development

Total equalized value*		\$ 1,000,000,000
City population	14,000	
State guaranteed value per capita	\$ 100,000	
State guaranteed value		\$ 1,400,000,000
1 - (EQ VAL/POP*GTD VALUE)		0.28571
City spending		\$ 14,000,000
State equalization aid		\$ 4,000,000

State Equalization Aid Determination: Post-Development

Total equalized value*		\$ 1,100,000,000
City population	14,000	
State guaranteed value per capita	\$ 100,000	
State guaranteed value		\$ 1,400,000,000
1 - (EQ VAL/POP*GTD VALUE)		0.21429
City spending		\$ 15,000,000
State equalization aid		\$ 3,214,286

*Assessment ratio equals 1.0.

G. Property Tax Relief and Controls

State governments often employ fiscal tools that are intended to relieve property tax burdens for either selected classes of property or for all property owners. Programs such as circuit-breakers and homestead exemptions, for example, are primarily intended to ease property tax burdens on low-income or elderly families. These programs may allow deduction of local property taxes from state income tax liabilities or may exempt a portion of a property's assessed value for qualified families.⁹

Perhaps of more importance to planners are state efforts at controlling property tax increases. This can be done through a number of different mechanisms. Some states, for example, require voter approval before tax *rates* can be increased. Some states limit the aggregate tax rate that all local governments combined can use. Other states limit property tax *levies* to a fixed percentage of the tax base. As the tax base increases, property tax levies can increase accordingly. Yet another approach is to limit the amount that *assessments* of individual properties can increase from year-to-year. California, for example, limits assessment increases to two percent per year (in most circumstances). Texas follows a different approach by “freezing” school property taxes for taxpayers reaching the age of 65.¹⁰

The major point for planners is to understand that state controls on the property tax system can have significant impacts on the way property taxes are determined and used. For example, proposed developments involving residential development for the general public may have far different impacts on the property tax than similar residential development intended for elderly families. A thorough understanding of relevant property tax controls is crucial for the practicing planner.

V. The Property Tax and Planning

It is virtually impossible to describe the workings of the property tax system in every situation in which planners work. While the general concepts and practices apply in most situations, the details vary from place-to-place. Nevertheless, it is hopefully now possible to

⁹See Bland (2005:93-96) or Bell and Bowman (1991:105-109) for a more detailed discussion of various property tax relief programs.

¹⁰See Bland (2005:64-65 and 93-96) for additional information on various property tax relief programs.

reflect upon how the various activities planners undertake on a daily basis interact with the property tax system.

An earlier paper in this series (Huddleston 2005a) has established the link between seven activities planners undertake and the general local government budget. The seven planning activities are: land use planning and zoning; development approval; provision of public infrastructure; revitalization programs; housing and community services; natural resource development and protection; and economic development. These general connections can now be more specifically expressed for the property tax system.

The basic connections center around how the various planning activities affect five central elements of the property tax system. As shown in Figure 3, these elements are: (1) impacts on government spending; (2) impacts on intergovernmental aid; (3) impacts on other local revenues; (4) impacts on tax base, and (5) influence of state controls. Planning activities affect local government *spending*, while state and federal *aids*, and *other local revenues* off-set or reduce local government *levies*. Levy changes, combined with impacts that happen to the property *tax base* lead to impacts upon the property *tax rate* of local governments. All or any part of these impacts may be influenced by controls state government has put in place to control local property taxes or other features of local government finance..

Major Categories of Planning Activities	Elements of the Property Tax System
LAND USE PLANNING & ZONING	<i>impacts on government spending</i> <i>impacts on intergovernmental aid</i> <i>impacts on other local revenues</i> <i>impacts on tax base</i> <i>influence of state controls</i>
DEVELOPMENT APPROVAL	
PUBLIC INFRASTRUCTURE	
REVITALIZATION PROGRAMS	
HOUSING & COMMUNITY SERVICES	
NATURAL RESOURCES	
ECONOMIC DEVELOPMENT	

FIGURE 3. Intersections Between Planning Activities and the Property Tax System

A simple, but dramatic example may serve to illustrate the connections between planning activities and the property tax. Suppose a city's planning department approves a new regional shopping center for the edge of the city.

- * The new development will require a defined set of new city infrastructure (e.g. roads and sewers) and services (e.g. police and fire protection).
- * It is anticipated that \$1,400,000 will be needed in new city infrastructure and that annual spending for city services (including debt service, operation and maintenance of infrastructure, police salaries, etc.) will increase by \$800,000 per year.
- * It is anticipated that infrastructure expenditures will be financed using city-issued term bonds.
- * The new shopping center should add \$410,000,000 of assessed value to the tax base. This will be off-set, however, by a decrease in the assessed value of commercial properties in the downtown business district, since sales there are expected to decrease by 10 percent.
- * The increase in city spending and tax base should work together to produce increased state aids to the city, estimated to be \$102,000 per year.
- * Impact fees and sewer user charges can be used to pay for a portion of infrastructure costs, estimated at \$210,000.
- * All factors considered, it appears that the city's tax rate should increase from \$8.54 per \$1,000 of assessed value to \$9.96 per \$1,000.
- * Unfortunately, the state limits outstanding municipal debt to five percent of a city's equalized property value. The city is at its limit, thus, all new infrastructure costs (except those funded through impact fees and user charges) will need to be financed using the property tax. The impact of this adjustment is to increase the city property tax increase to \$11.24 per \$1,000 of assessed value.
- * The use of special assessment districts is considered as a method of financing new infrastructure, but it is too late in the planning process.
- * The Mayor and City Council are run out of town (i.e. voted out of office) at the next election and a new "no growth" coalition takes over City Hall.

As demonstrated by this example, the act of planning (in this case approving the new shopping center at the edge of the city) has dimensions that are mainline "planning" (e.g. sewer extensions), and dimensions that are "financial" (e.g. property tax rate impacts). A thorough

understanding of local government finance in general, and the workings of the property tax in particular are needed if planning is to produce and implement plans that are sustainable in the long-run.

Hopefully, planners who are fully aware of how the property tax system works in their local situation will be able to develop and implement plans, programs and planning regulations that will lead to fiscally sustainable development that will serve the communities for whom they plan long into the future. This paper, although basic in nature, has attempted to start or at least improve practicing planners' understanding in this important area.

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