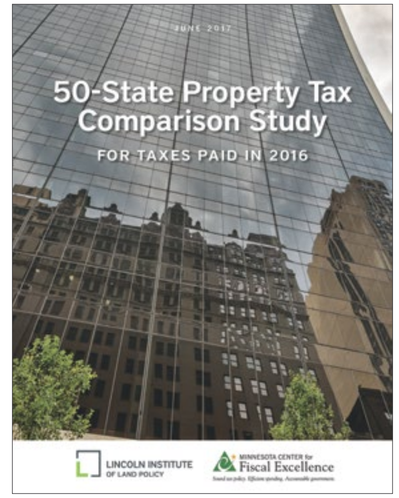
50-State Property Tax Comparison Study: For Taxes Paid in 2016

By the Lincoln Institute of Land Policy and the Minnesota Center for Fiscal Excellence



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FOR THE 12TH YEAR IN A ROW, New York City has the largest discrepancy of any U.S. city in property tax rates for multi-family rental apartment buildings compared to owner-occupied homes, according to the annual *50-State Property Tax Comparison Study,* by the Lincoln Institute of Land Policy and the Minnesota Center for Fiscal Excellence.

Because of assessment limits, valuation practices, and other factors, the result is that the effective tax rate on a typical owner-occupied home is just one-fifth of the rate paid by the owner of an apartment building. These costs are then passed along to renters.

The discrepancies in the New York City system emerge in a comprehensive analysis of the effective property tax rate—the tax payment as a percentage of market value—for residential, commercial, industrial, and apartment properties in more than 100 U.S. cities. The report underscores the importance of the property tax as a stable source of revenue for cities, and the challenges of fine-tuning property tax systems in widely varying U.S. market conditions.

Many cities with the highest property tax rates are struggling to make ends meet, dealing with a low tax base that requires higher tax rates to bring in enough revenue—and constrained by state laws that restrict their access to other revenue sources that would allow them to reduce their reliance on property taxes. Detroit, which has the highest effective tax rate on a median-valued home, has the lowest median home value of the cities covered in the report. In Bridgeport, which has the second highest rate on a median-valued home, the city relies more heavily on the property tax to fund local government than any of the other cities in the report because of state laws restricting their access to other broad-based taxes.

But in other places, high or low property tax rates are largely the result of other policy decisions made by local governments. Nowhere is that more true than in New York City, which has one of the nation's lowest tax rates on owner-occupied homes, but the highest tax rate on apartment buildings and the second-highest rate on commercial properties. There, a $1 million commercial property faces an effective tax rate that is 4.1 times higher than a median-valued home, while a $600,000 apartment building has an effective tax rate that is 5 times higher. Discrepancies in New York City are larger than in any other city in the report.

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The disparities in the New York City system, brought to light in many recent media reports, are the subject of ongoing research by the Lincoln Institute and the Regional Plan Association. That work will review the existing evidence, explore policy reforms that improve property tax efficiency and equity, and conduct empirical analysis to determine the impact of proposed reforms on different groups of taxpayers and on tax revenues.

As the largest source of revenue raised by local governments, a well-functioning property tax system is critical for promoting municipal fiscal health. *The 50-State Property Tax Comparison Study* includes data for 73 large U.S. cities and a rural municipality in each state, plus an analysis that explains why tax rates vary so widely. This context is important because high property tax rates usually reflect some combination of heavy property tax reliance, with low sales and income taxes; low home values that drive up the tax rate needed to raise enough revenue; or higher local government spending and better public services. In addition, some cities use property tax classification, which can result in considerably higher tax rates on business and apartment properties than on owner-occupied homes.

Property tax reliance is one of the main reasons why tax rates vary across cities. While some cities raise most of their revenue from property taxes, others rely more on alternative revenue sources. Cities with high local sales or income taxes do not need to raise as much revenue from the property tax, and thus have lower property tax rates on average. For example, the report shows that Bridgeport, Connecticut, has one of the highest effective tax rates on a median-valued home, while Birmingham, Alabama, has one of the lowest rates. In Bridgeport, however, city residents pay no local sales or income taxes, whereas Birmingham residents pay both sales and income taxes to local governments. Consequently, despite the fact that Bridgeport has much higher property taxes, total local taxes are higher in Birmingham ($2,560 versus $2,010 per capita).

Property values are the other crucial factor explaining differences in property tax rates. Cities with high property values can impose a lower tax rate and still raise at least as much property tax revenue as a city with low property values. The average property tax bill on a median-valued home for the large cities in this report is $2,871. Raising that amount in Detroit, which has the lowest median home values in the study, would require an effective tax rate more than 20 times higher than in San Francisco, which has the highest median home values.

There are also significant variations across cities in commercial property taxes, which include taxes on office buildings and similar properties. In 2016, the effective tax rate on a commercial property worth $1 million averaged 2.1 percent across the largest cities in each state. The highest rates were in Detroit, New York City, Chicago, Bridgeport, and Providence; all had effective tax rates that were at least three-quarters higher than the average for these cities. On the other hand, rates were less than half the average in Cheyenne, Seattle, Honolulu, Fargo, Billings (MT), and Virginia Beach.

There are wide variations across the country in property taxes on owner-occupied primary residences, otherwise known as homesteads. An analysis of the largest city in each state shows that the average effective tax rate on a median-valued homestead was 1.50 percent in 2016. On the high end, three cities have effective tax rates that are roughly 2.5 times higher than the average—Detroit, Bridgeport, and Aurora (IL). Conversely, six cities have tax rates that are less than half the study average—Honolulu, Boston, Denver, Cheyenne (WY), Birmingham (AL), and Washington DC.

Many cities have preferences built into their property tax systems that result in lower effective tax rates for certain classes of property; these features are usually designed to benefit homeowners. The "classification ratio" describes these preferences by comparing the effective tax rate on land and buildings for two types of property. For example, if a city has a 3.0 percent effective tax rate on commercial properties and a 1.5 percent effective tax rate on homestead properties, then the commercial-homestead classification ratio is 2.0 (3.0% divided by 1.5%).

An analysis of the largest cities in each state shows an average commercial-homestead classification ratio of 1.67, meaning that on average commercial properties experience an effective tax rate that is 67 percent higher than homesteads. Roughly a fourth of the cities have classification ratios above 2.0, meaning that commercial properties face an effective tax rate that is at least double that for homesteads.

Finally, the report also measures the impact of property tax assessment limits, which 19 states have adopted. Assessment limits typically restrict growth in the assessed value of individual parcels and then reset the taxable value of properties when they are sold, based on two factors: how long a homeowner has owned her home and appreciation of the home's market value relative to the allowable growth of its assessed value. As a result, assessment limits can lead to major differences in property tax bills between owners of nearly identical homes based on how long they have owned their home.

In Los Angeles, for example, the average home has been owned for 13 years, and the median home value is $542,100. Because of the state's assessment limit, someone who has owned a home for 13 years would pay 39 percent less in property taxes than the owner of a newly purchased home, even though both homes are worth $542,100.

ABOUT THE AUTHORS

The Minnesota Center for Fiscal Excellence was founded in 1926 to promote sound tax policy, efficient spending, and accountable government. As a nonprofit, nonpartisan group supported by membership dues, the center pursues its mission by educating and informing Minnesotans about sound fiscal policy; providing state and local policy makers with objective, nonpartisan research about the impacts of tax and spending policies; and advocating for the adoption of policies reflecting principles of fiscal excellence.