North Carolina Cooperative Extension Service

NC STATE UNIVERSITY

COLLEGE OF AGRICULTURE & LIFE SCIENCES

NC State Economist

Agricultural and Resource Economics • May/June 2004

The Interesting Economics of Property Revaluations in North Carolina

M. L. Walden, *William Neal Reynolds Distinguished Professor and Extension Economist*

Sticker Shock

Once every seven years, and more frequently in some counties, homeowners and other real property (real estate) owners face a revaluation of their property. The purpose is to bring *assessed values* - the values on which the property tax is based - in line with *market values* - or the value of the property if sold.

These revaluations are important because property taxes are the single biggest source of locally generated revenue in North Carolina counties. Almost 70% of local government tax receipts are from the property tax. It is therefore important for the assessed property values to reflect the market, or economic, values of the property.

Yet property revaluations can create a kind of "sticker shock" for owners. For example, suppose a home's value is increasing a modest 4% annually. Over a seven year period, this results in a compounded increase of 32%. With no change in the property tax *rate*, the homeowner will experience a 32% increase in his property tax bill in one year!

Of course, property owners are generally happy to see their property values increase, because it represents an increase in their wealth. But property owners are equally not happy to see a double-digit or more rise in property taxes in one year.

The Usual Pattern

County commissioners understand the unhappiness created by large annual increases in property taxes, and so a usual pattern has emerged in North Carolina to cope with the challenges brought on by the infrequent property revaluations. During the year the property has been revalued, the property tax *rate* is reduced to moderate the increase in property tax payments. Then in subsequent years until the next revaluation, property tax rates are gradually increased in order that revenues will rise to meet normal rising public costs.

Figures 1, 2, and 3 illustrate the usual pattern. They are based on an analysis of assessed values, property tax rates, and property tax collections in North Carolina counties during 1988 to 1995.

Figure 1 shows the large increase in assessed values during revaluation years (year 0) and virtually no changes in the years thereafter. Figure 2 indicates the large reduction in the property tax rate during revaluation years and modest increases in other years. Figure 3 illustrates that, in revaluation years, property tax collections still rise significantly because the property tax rate is not reduced as much as assessments are increased. However, notice that the increase in property tax collections is less than half the increase in assessed values. In years following a revaluation, increases in property tax collections are much more modest.

A Better Way?

Property tax assessments and property tax rates display a pattern of balls bouncing in opposite directions. In years when real property is revalued and assessments rise, property tax rates decline. In years when real property assessments are relatively stable, property tax rates are pushed up. The pattern is then repeated beginning at the next revaluation. For local governments in North Carolina, this means a windfall of greater property tax revenues during revaluation years and moderate increases in revenues otherwise.

This pattern is not seen with other major taxes. For example, most households experience modest annual increases in their income, and their spending will likewise rise moderately. Consequently, income and sales tax revenues paid by households and received by governments will usually increase each year at rates comparable to the rise in income. This aids in predictability and planning for both households and governments.

Could the property tax system in North Carolina be structured to provide more consistency and regularity in revenues, therefore avoiding the "sticker shock" and fluctuations in property tax rates inherent in the current system?

An obvious way would be to more frequently revalue real property. For example, if real property was revalued annually, then typical increases in property values might result in property tax payments rising 4% or 5% annually. Property tax rates could be kept stable, and property owners would likely be more accepting of the payment increases due to their smaller size and their link to annual increases in property values. Local governments would also realize a more consistent increase in property tax collections each year.

The problem with this alternative approach is its cost of implementation. Full property revaluations are a major expense for counties. Most counties are unwilling to undertake this cost on an annual basis.

A second-best approach would be to continue full revaluations every seven years, for example, but to base revaluations in other years on a sample of revalued properties or on changes in some price index, like the Consumer Price Index. If the latter method were used, this would mean property values would rise 3% for the year if the Consumer Price Index rose 3% for that year.

The second-best raises two issues. First, when a full revaluation was done, procedures would have to be established to adjust owners' property values and past property tax bills if the assessed value from the full revaluation substantially deviated from the estimated assessed value based on the sample or index method. Second, property owners would have to be convinced the second-best approach was "fair" and reliable.

In Conclusion ….

The mainstay of local government revenues in North Carolina, the property tax, has peculiar problems not experienced with other major taxes in North Carolina. Due to the infrequent revaluing, for tax purposes, of real property, property tax collections display a pattern of rising substantially in revaluation years and rising much more modestly in other years. Correspondingly, property tax rates fall substantially in revaluation years and rise modestly in other years. This pattern creates confusion, misunderstanding, and an uneven flow of property tax collections to local governments.

However, there is no easy "fix." Annual revaluations are expensive. Revaluations based on samples or proxy price indices create issues of fairness and reliability.

In short, the current property tax system may have faults, but the faults may be fewer in number than for the alternatives. Nevertheless, a greater understanding of how and why the current property system works can aid acceptability and perhaps lead to improvements.

Figure 1. Change in Assessed Real Property Values

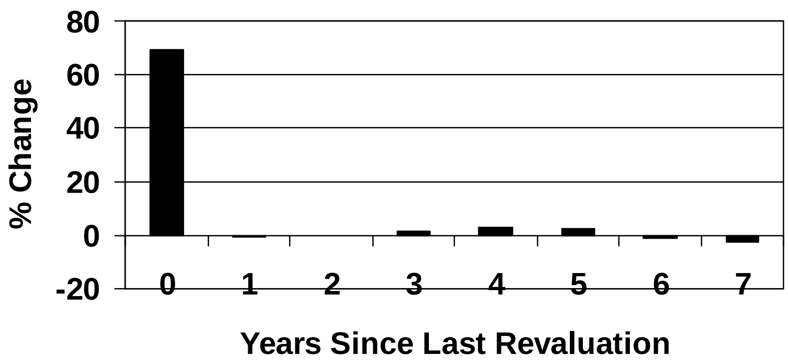


Figure 2. Change in Legislated Tax Rate

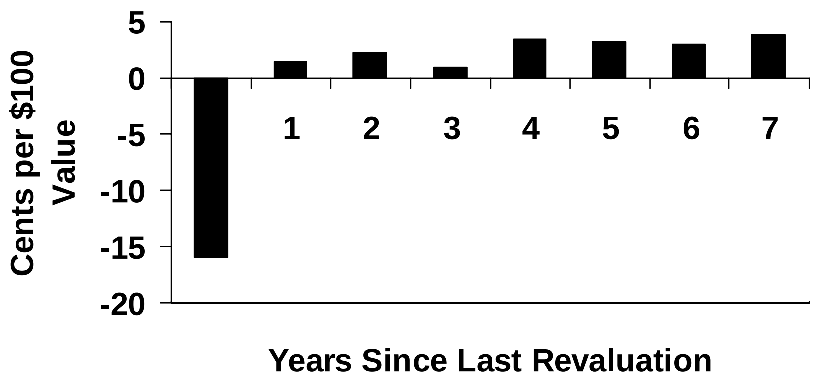
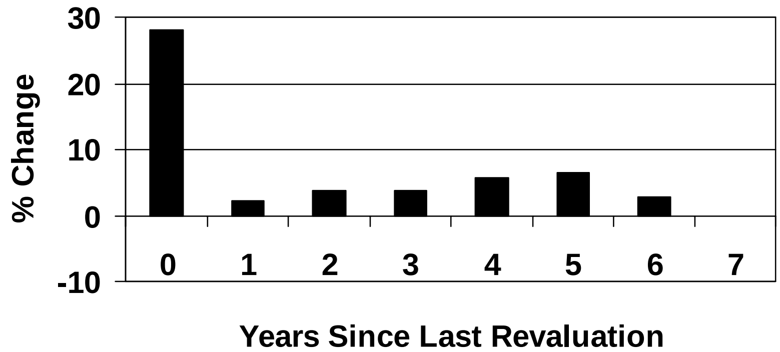


Figure 3. Change in Real Property Tax Collections



N.C. State Economist

Published bi-monthly by the Department of Agriculture and Resource Economics and the Cooperative Extension Service. Address correspondence to:

The Editor, N.C. State Economist
Box 8109, N.C. State University
Raleigh, NC 27695-8109
http://www.ag-econ.ncsu.edu/extension/economist.html

North Carolina Cooperative Extension Service
North Carolina State University
Agricultural and Resource Economics
Box 8109
Raleigh, North Carolina 27695-8109