Coates' Canons Blog: Are N.C. property tax assessments underwater?

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For two years now we've read story after story about the increasing number of homes that are mortgaged for far more than they are now worth. A recent report by the N.C. Department of Revenue suggests that for the first time a similar problem may be afflicting property tax assessments across the state. Last year, real property tax assessments exceeded market value in 31 of North Carolina's 100 counties. These figures suggest that many city and county tax bases are overvalued. What does this mean for local government finances in North Carolina?

It means that local governments can no longer count on comfortable increases in their tax bases when they revalue their real property every four or so years. Many counties and towns may actually experience shrinkage in their tax bases after revaluation, an unheard-of occurrence. It means that more local governments may increasingly fund their budget needs with other revenue sources such as the local option sales tax that may be more volatile and more regressive than the property taxes that have been the bedrock of local governments' revenue for decades. It means that more counties may choose to postpone revaluations for as long as possible in the hope that property values will recover, in the mean time leaving increasingly frustrated taxpayers with increasingly inaccurate assessments.

Let's take a closer look at the numbers producing such unusual consequences. Each spring, the N.C. Department of Revenue calculates an assessment-to-sales ratio ("ASR") for real property in each county. This ratio represents a comparison of property tax assessments with actual sales prices in that county from the preceding calendar year. If the ratio is less than one, then on average that county's property tax assessments were less than the properties' sales prices. In other words, the properties were undervalued for tax purposes. If the ratio is greater than one, then on average that county's property tax assessments exceeded the properties' sales prices. In other words, the properties were overvalued for tax purposes. If we can use mortage lingo in a tax context, these properties could be considered "underwater."

In normal economic times, a county's ASR will decrease in the years following a revaluation because market prices are increasing while tax assessments are constant. When a county revalues its tax base, a process that must occur at least every eight years, its ASR will bounce back close to one because it will raise its assessments (and increase its tax base) to reflect the general appreciation of its real property.

These are not normal economic times. According to the N.C. Association of Realtors, the average sales price of an existing home in North Carolina has fallen about 11% from its peak in 2007. The news is far worse in some areas of the state: the Outer Banks and parts of western N.C. have seen home prices drop 25% or more. Overall, N.C. housing prices today are about where they were in mid-2005.

As a result more and more counties are seeing their ASRs grow over time instead of shrink, as they always have before. Four counties now have ASRs over 1.10, meaning that the real property sold in those counties last year on average was assessed 10% or more above its true market value. Not surprisingly, all four counties are from the mountains or the coast, where prices have been most volatile. Cherokee County takes the dubious honor at the top with an ASR of 1.15. Another six counties have ASRs above 1.05.

All thirty-one counties with high ASRs are likely to suffer decreases in their tax bases if they revalue their property anytime soon. But even counties with "normal" ASRs could suffer that same fate in these uncertain economic times.

Consider Onslow County's experience with its revaluation this year. The county had last revalued its real property in 2006, near the peak of the market. Despite the fact that its ASR was well below one (.80) in 2009, Onslow County saw its real property value increase less than 3% after its 2010 revaluation, compared to a typical post-reval increase of 25% or more. Two of the county's municipalities, both beach towns, suffered shocking drops in their tax bases of more than *forty percent.*

Unless these two towns wish to dramatically decrease spending, obviously they will need to either raise their property tax rates or seek other revenue sources. With home prices at best stagnant across the state, many more local governments may be facing similar decisions in the near future.

Links

- www.ncrealtors.org/market-statistics-about-ncar-menu/yearly-market-sales-statistics/333-market-sales-statistics-2010-totals/file.html