Coates' Canons Blog: N.C. Housing Market Improves But Local Tax Bases Continue to Suffer

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Contradictions abound in recent news about the North Carolina real estate market.

First, the good news: home sales, home prices, and home construction starts are up.

The North Carolina Association of Realtors reports that home sales through the end of March rose 22% compared to a year ago. Prices also increased, up 7% from 2012. Inventory is tight, which is encouraging more new construction both nationally and locally: home construction across the country is at its highest pace in 5 years, while residential building permits issued in Mecklenburg County have increased more than 300% since 2011 in both number and dollar value.

Now, the bad news. Property tax bases in North Carolina communities are still suffering.

For decades, local governments in North Carolina reasonably expected increases of 20% to 35% in their tax bases after reappraisals. Those expectations evaporated following the Great Recession of 2008. Since then, numerous counties have suffered drops in their tax bases following reappraisals. This trend continues in 2013.

An informal survey of the counties that conducted reappraisals effective January 1, 2013 produced this list of estimated changes to county tax bases:

County	% Change in Tax Bases Following 2013 Reappraisals
Currituck	-35
Dare	-29
Burke	-9
Forsyth	-8
Wilkes	-7

Stokes	-4.5
Buncombe	-3
Columbus	+1.5
Stanly	+1.5
Caldwell	+5
Washington	+10

The two counties with the largest tax base losses are of course coastal counties with lots of high-end vacation homes. Currituck and Dare counties got huge bumps in their tax bases when they last reappraised their real property in 2005 and since then have maintained two of the lowest property taxes in the state. Currituck's rate has been $.32 for years while Dare's rate was $.26 immediately after its 2005 reappraisal and $.28 since 2010.

Not any longer. The two counties have yet to set their tax rates for 2013-2104, but they are sure to jump up closer to the statewide average of $.62. Consider the situation in neighboring Brunswick County, which increased its property tax rate by 80% following a 2011 reappraisal in which the county's real property tax base dropped by nearly a third.

In the past two years tax rates also increased subtantially in Carteret County ($.23 to $.30 in 2011) and New Hanover County ($.46 to $.55 in 2012). Nor is this phenomenon is limited to the coast. Up in the mountains, Henderson and Rutherford counties raised their tax rates by more than 10% after recent reappraisals.

As the list above proves, not every reappraisal since 2008 has resulted in a a lower tax base. Plenty of counties continue to experience modest tax base growth. But five years after the Great Recession it is now clear that local government officials can no longer depend on a substantial tax base increase following a reappraisal. And this state of affairs is not likely to change any time soon.

Despite some positive trends, North Carolina's real estate market has a ways to go before it regains the ground it lost in 2008. The average sale price of an existing home at market peak in 2007 was $223,000; that same figure year-to-date 2013 is $192,000. Based on these statistics, it seems certain that upcoming reappraisals will continue to produce negative or very flat tax base growth.

Ten counties are scheduled for reappraisals effective January 1, 2014, including three (Mitchell, Onslow, and Watauga counties) with high proportions of vacation homes that tend to rise and fall in value more dramatically than other types of real property. Onslow County might be able to escape the negative tax base trend, given the strong growth around Camp Lejuene and the county's recent reappraisal in 2010. But the other counties had best prepare for shrinking tax bases.

When a local government's tax base shrinks, its revenue neutral tax rate will be higher than its existing tax rate because it will require a higher tax rate to produce the same revenue next year on the new (lower) tax base as this year's tax rate did on this year's tax base. Local governments are required only to publish the revenue neutral tax rates, not adopt them for the coming year. But when its tax base shrinks, a local government usually has only two choices: reduce the amount of services it provides or raise its tax rate to make up for the lost tax base. (Click here for more details on the often confusing revenue neutral tax rate.)

Higher tax rates can cause political as well as economic problems for local governments, especially in jurisdictions with large amounts of high value vacation homes owned by non-residents. When the assessments of those vacation homes drop precipitously, the resulting tax rate increase has a much greater relative impact on owners of modest homes than it does on the owners of the expensive vacation homes. And the owners of the more modest homes tend to be residents and voters in the county, not folks from away.

Consider two hypothetical houses in Brunswick County, an oceanfront mansion owned by a rich lawyer from D.C. originally assessed at $3 million and a modest in-land bungalow owned by a local retiree originally assessed at $150,000. In 2010 the county tax rate was $.305, meaning the taxes on the mansion would have been $9,150 while taxes on the bungalow would have been $457.

After the 2011 reappraisal, assume that the mansion was assessed at $1,800,000 (a drop of 40%) while the bungalow assessment remained unchanged at $150,000 (not unusual for more modest homes in coastal communities). At the county's new tax rate of $.54, taxes on the mansion would be $9,720, while taxes on the bungalow would be $810.

The wealthy D.C. lawyer saw his property taxes increase only 6%, while the county resident who owns the bungalow saw his property taxes rise by 77%. How well do you think the county's voters will react to that change of affairs?

Sure, county officials can try to explain to their voters that for years the county was able to balance its budget mostly on the backs of those rich folks from away. But it's unlikely that explanation will do much to each the pain of a tax bill that grew by 77%.

Unless and until the North Carolina real estate market replicates its healthy annual growth of the mid-2000's, local government officials will continue to face trying property tax troubles.

Links

- canons.sog.unc.edu/wp-content/uploads/2013/04/house.jpg
- www.ncrealtors.org/market-statistics-about-ncar-menu/yearly-market-sales-statistics/320-market-sales-statistics-2013-totals/file.html
- censtats.census.gov/bldg/bldgprmt.shtml
- www.ncrealtors.org/market-statistics-about-ncar-menu/yearly-market-sales-statistics/336-market-sales-statistics-2007-totals/file.html
- canons.sog.unc.edu/?p=4857