Coates' Canons Blog: Weak Housing Market Hits Property Taxes

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After showing signs of life in 2010, the North Carolina housing market has slumped again in 2011.

The N.C. Association of Realtors reports that existing home sales volume through July was down 7% from last year and down 22% from mid-2008 just before the national economy really hit the skids.

The average sale price of an existing N.C. home is $198,635, roughly where it was in mid-2005. That's down about 12% from peak prices in 2007.

While these declines are small potatoes compared to the dramatic drop-offs in cities like Las Vegas, the N.C. housing slump is severe enough to hurt local government property tax revenues. And because property taxes are the single largest source of general fund revenues for N.C. local governments, any drop in property tax revenues will have a major impact on local government budgets across the state.

A good starting point to see the effect of the housing slump on property taxes is the annual sales assessment ratio study compiled by the N.C. Department of Revenue. This analysis compares assessed tax values with actual sale prices for a sample of properties sold in the jurisdiction in the previous year. If the ratio is greater than one, then on average the tax values were greater than the sale prices. If the ratio is below one, then on average the tax values were less than the sale prices.

Under normal economic conditions, the sales assessment ratio drops over time because sale prices gradually rise while tax assessments remain stable in between countywide reappraisals. Only a handful of counties will have ratios greater than one in any given year, usually because they just conducted a reappraisal.

But these are not normal economic conditions, sadly, and the preliminary version of 2011 sales assessment ratio study shows why. Nearly *half* of the state's 100 counties have ratios above one. Ten counties have ratios over 1.10, meaning the sample properties were on average selling at least ten percent below their tax assessments. Cherokee County led the pack with a ratio of 1.31, meaning its sample properties were overvalued for tax purposes by nearly one-third.

When tax assessments are routinely hovering above market values, counties that conduct reappraisals can forget about the usual 25-40% post-reappraisal increase in their tax bases. Instead, some counties are seeing *decreases* in their tax bases. The counties of Henderson, Lincoln, Brunswick, and Carteret all saw their tax bases drop after their recent reappraisals.

A drop in the tax base means a county must either cut spending or raise its tax rate to balance its budget, of course. But it also redistributes the tax burden among county property owners.

For the most part, it is the more expensive homes that are suffering the largest declines in value. Vacation homes on the coast and in the mountains have been hit particularly hard. These are the same homes that saw the largest increase in values through 2008, which is one reason why coastal counties like Carteret were able to keep their tax rates among the lowest in the state for many years. But now, with vacation homes losing value faster than the more modest homes of permanent residents, counties are seeing their tax burdens shift from more wealthy non-resident vacation property owners to residents of more modest means. In other words, the tax burden is shifting from non-voters to voters, a fact which might be important in the next few local election cycles.

As local tax bases stop growing, so too do local property tax revenues. Historically, property tax revenues have grown even in bad economic times, especially when compared with more volatile sources of local government revenue. But the lasting effects of the Great Recession of 2008 may put an end to the property tax's slow and steady growth. Take a look at this chart, which illustrates N.C. county property tax and sales tax revenues, in billions of dollars. As expected, sales tax revenue dropped dramatically as a result of the recession. What was not expected was the near zero growth in property tax revenue last year.

Statewide property tax statistics for 2011 have not yet been released, but initial reports from several counties show this trend continuing. Wake County saw its property tax revenues grow by a mere .6% between fiscal 2009-10 and 2010-11. Why the stagnation? Fewer new homes are being built, fewer existing homes are being expanded, fewer new cars are being registered, and fewer businesses are investing in new equipment.

This is a troubling trend for N.C. local governments because of how much they depend on the property tax. Counties rely on property taxes for 45% of their budgets, up from 36% in 2007. Cities rely on them for 32% of their general fund revenue , up from 27% in 2007.

As other revenue sources drop even more precipitously, local governments will be placing more and more of a budgetary burden on the property tax. But stagnant tax bases mean that the only way the property tax can carry an inceased burden is through higher tax rates, a prospect that neither elected officals nor voters relish.

Links

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- www.nctreasurer.com/lgc/units/D_E.htm
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