

# The Property Tax

## AND THE FORTUNES OF OLDER INDUSTRIAL CITIES

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**M**ost people are not particularly fond of paying taxes of any sort, but the discontent with one particular type of public levy, the local property tax, is gaining momentum across the country. Disgruntled homeowners are demanding that governors and mayors find alternative methods to raise revenue in order to relieve their own property tax burden.

Decades ago this discontent led to such tax limitation measures as Proposition 13 in California and Proposition 2½ in Massachusetts. More recently, this movement has been driven by sharply rising property tax levies in many cities and suburbs as a result of the extraordinary appreciation in property values over the past few years. The high visibility of the property tax, which in contrast to sales and income taxes is often paid annually in one or two large installments, makes this form of revenue generation an attractive target for taxpayer antipathy.

Still, the property tax has a number of important virtues. Foremost among these is its revenue stability. Whereas the revenues generated from income taxes and sales taxes tend to fluctuate, often wildly, as the economy cycles between growth and recession, real estate values (upon which municipalities levy property taxes) seldom decline as sharply. Widespread layoffs can eliminate residents' incomes, thus drying up the supply of income tax revenues and household consumption that fuels sales tax revenue. Meanwhile, except in the case of extreme circumstances in some communities, real property tends to maintain its value comparatively well over the normal business cycle. Thus, if property tax rates are held constant, the revenue stream from the property tax remains relatively healthy, even during economic recessions.

According to Lincoln Institute fellows Joan Youngman and Andrew Reschovsky (2007), the property tax is also among the fairest, most transpar-

ent, and most reliable of all mechanisms for raising municipal revenue. Those who bemoan yearly increases in their property tax bills, they argue, should realize that this tax's visibility is among its greatest strengths, for it motivates households to compare the taxes they pay with the benefits they receive, or move to communities where the mix of taxes and public spending priorities best mirrors their own preferences (see Tiebout 1956).

### The Local Property Tax and Uneven Economic Development

There is another reason to consider the efficacy of the local property tax, beyond the considerations of frustrated taxpayers, revenue stability, and political transparency. In recent research supported by the Lincoln Institute we found that, at least for the Commonwealth of Massachusetts, *overreliance* on property taxation can have potential harmful effects on older industrial cities. Disparities in property tax revenue due to growing gaps in assessed property values between wealthy and poor communities can lead to uneven development, where the rich communities become even richer and the poor even poorer.

In older industrial communities, the loss of business, industry, and residents over the course of several decades has led to a slow rise in assessed property values and in some cases absolute stagnation. This slow growth naturally compromises the ability of these communities to provide the municipal services necessary for attracting investment and sustaining an attractive living environment for residents.

Meanwhile, other communities' rapid growth and steadily increasing property values have had the opposite effect, allowing them to fund economic development efforts that support new business investment and residential development. Not surprisingly, over time the prospects for investment have diverged between these two groups of communities. The property tax was not responsible for stimulating



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Lawrence, Massachusetts

uneven development, but it now has the potential for exacerbating it. Without remedial intervention from the state, heavy reliance on the local property tax to fund local services ends up reinforcing these existing market trends.

In 2005, nearly 75 percent of locally generated revenue in cities and towns in Massachusetts came from property taxes. Only five other states, all in the Northeast, employed tax structures that focused as heavily on revenue from this one source. By contrast, Alabama's cities and towns generated only 18 percent of their local revenue from property taxes, balancing this revenue stream with sales taxes and service fees. These other sources of revenue are not necessarily better than the property tax—many are unstable sources of revenue and some lack transparency—but by relying so heavily on the property tax to fund municipal services, states like Massachusetts may very well be exacerbating the struggles of older industrial cities, even as they catalyze the growth of rapidly growing communities.

### Trends in Assessed Values and Property Taxes

To study this issue, we have followed trends in assessed values and property tax rates in two sets of Massachusetts municipalities. The first is comprised of 12 older industrial cities that experienced little employment growth and in most cases absolute job loss over the period from 1987 to 2004. The second group of 14 cities and towns experienced rapid employment growth over the same period. Many of these municipalities are directly adjacent to or close to the “deindustrializing” cities. This sample includes urban, suburban, and exurban communities located all across the state.

Between 1987 and 2004, the value of total assessed property in the affluent communities in our study grew between 2.5 and 3.5 times faster than

the value in the older industrial cities. In 1987, the City of Lawrence, which was once a hub of textile manufacturing, had just over \$13,000 in total (residential, commercial, and industrial) assessed property value per capita, compared to \$53,000 per capita in Andover, its rapidly growing next-door neighbor. By 2004 this already huge gap had widened spectacularly, with Lawrence's property values rising to about \$28,000 per capita while Andover's soared to nearly \$188,000, more than six times higher (see figure 1).

This is an extreme case, but the trend in diverging property values is unmistakable. By 2004 only one of the older industrial cities (Haverhill) had higher per-capita property values than all of the comparison communities, and in this case it was only \$1,000 higher than the lowest of the more affluent group.

These stark differences in property values have taken their toll on the public funding capacity of the poorer communities. To pay for schools, police and fire protection, infrastructure, and other municipal services for their relatively large and diverse populations, these older industrial cities have had to raise their tax rates, in many cases well above those in the more affluent municipalities. Indeed, as property values have risen and new construction has brought in new wealth, the more prosperous communities have had the luxury of lowering property tax rates, while still providing the same level of services.

In 1987, there were no large differences in the tax rates between these two sets of communities (if anything, the wealthier communities had *higher* tax rates on residential property). Over the next two decades, though, seven of the 12 older industrial cities increased their residential tax rates, compared to only one of the wealthier communities. It is likely, as well, that the older cities' higher tax rates have been capitalized into their assessed values, further reducing

property values and contributing to a vicious cycle of disinvestment—lower values lead to higher tax rates, which in turn discourage new investment and decrease property values even further.

**State Revenue Sharing to the Rescue**

If local services were funded strictly out of local revenue, the level of public spending in the older industrial cities would gradually fall further and further behind the level in the more affluent communities, reinforcing already existing uneven development. If left unchecked, this snowballing inequality might lead to an inescapable disadvantage that would forever condemn older industrial cities to decades of stagnation and decline.

Two key factors have mitigated this potential hazard, however, almost completely eliminating the differential in per-capita municipal spending between the two sets of communities. The first is the powerful redistributive impact of state-supplied aid to local communities. Youngman and Reschovsky (2007) note that state aid is unreliable and subject to the vicissitudes of the economy.

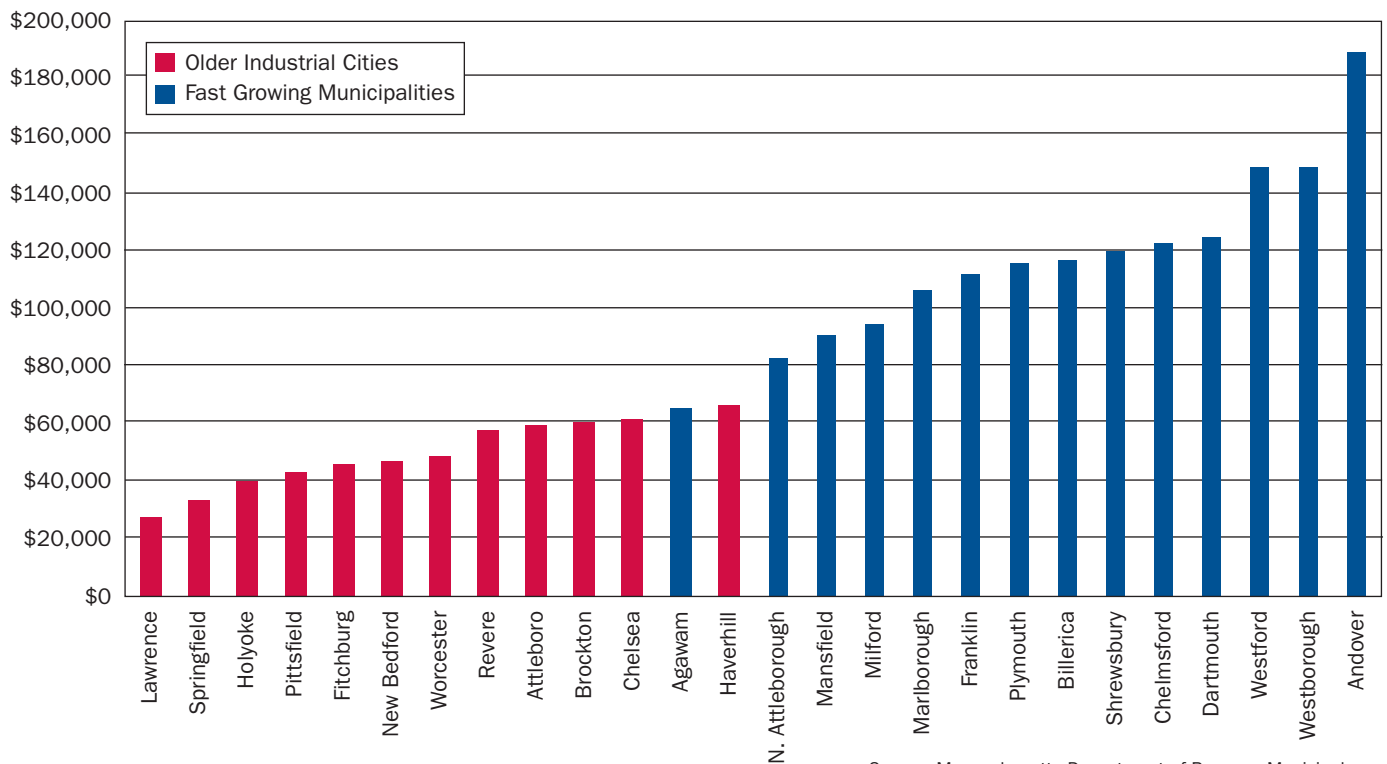
This is true, but Massachusetts has been careful in how it has distributed and, when necessary, cut state aid. By providing significantly more aid

to the communities with the least ability to raise municipal revenue from the local property tax, the state has systematically offset much of the per-capita differential in municipal spending on schools and other local services. To accomplish this feat, the state has had to provide a huge amount of resources in the older industrial cities while limiting support for the comparison municipalities.

In 2004 all 12 of the older industrial cities we studied were more reliant upon state aid for their fiscal health than the neediest of the 14 comparison communities (see figure 2). At the high end, 73 percent of local spending in Lawrence was financed with money from the state government. Even the most self-reliant of these older cities, the old mill city of Haverhill, used state aid to fund 39 percent of its budget. By comparison, the *most* dependent of the wealthier communities (Franklin) used state aid for only 37 percent of its total municipal spending. For Andover and Westborough, the state supplied less than 10 percent.

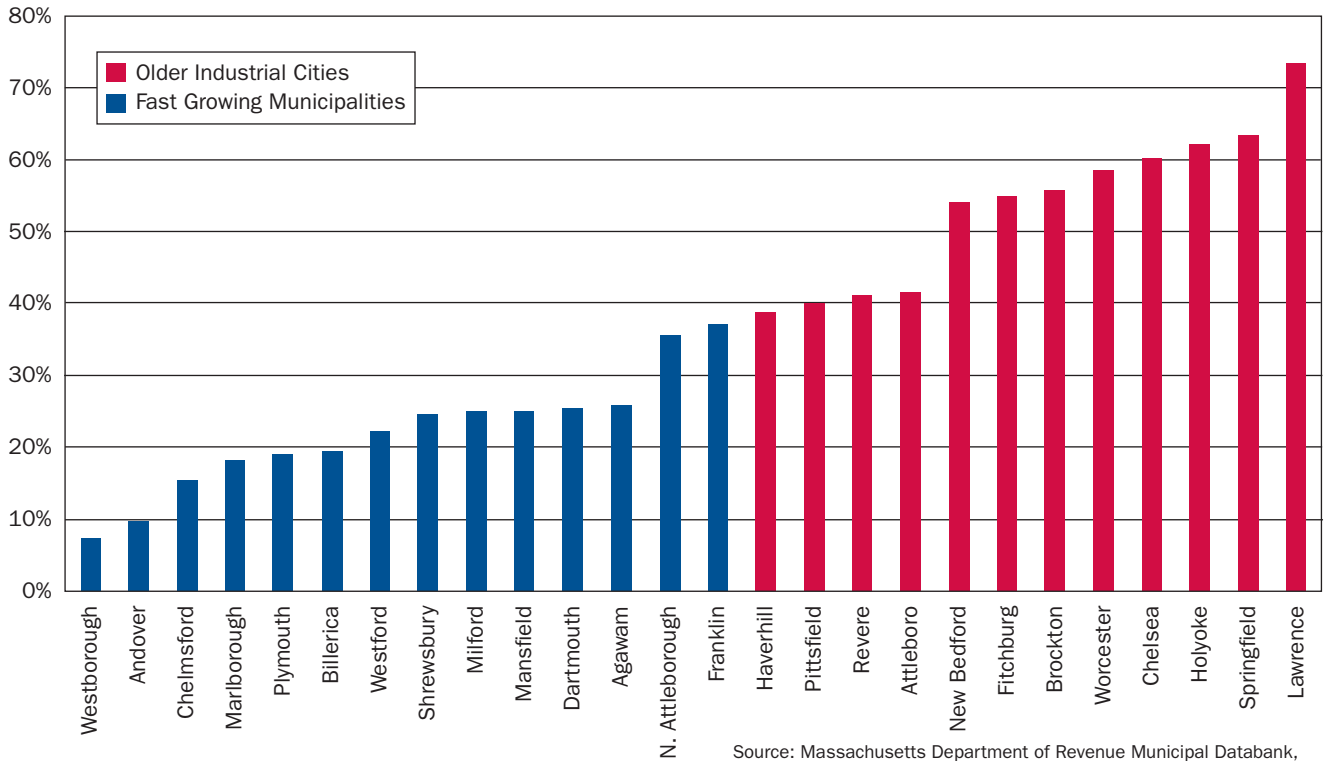
Reliance on state aid was most noticeable when it came to providing public education. In 2004, the majority of school spending in all 14 older industrial cities came from state-funded education aid, and three cities (Holyoke, Chelsea, and Springfield) had

**FIGURE 1**  
**Total Real Property Assessments per Capita, Selected Massachusetts Municipalities, 2004**



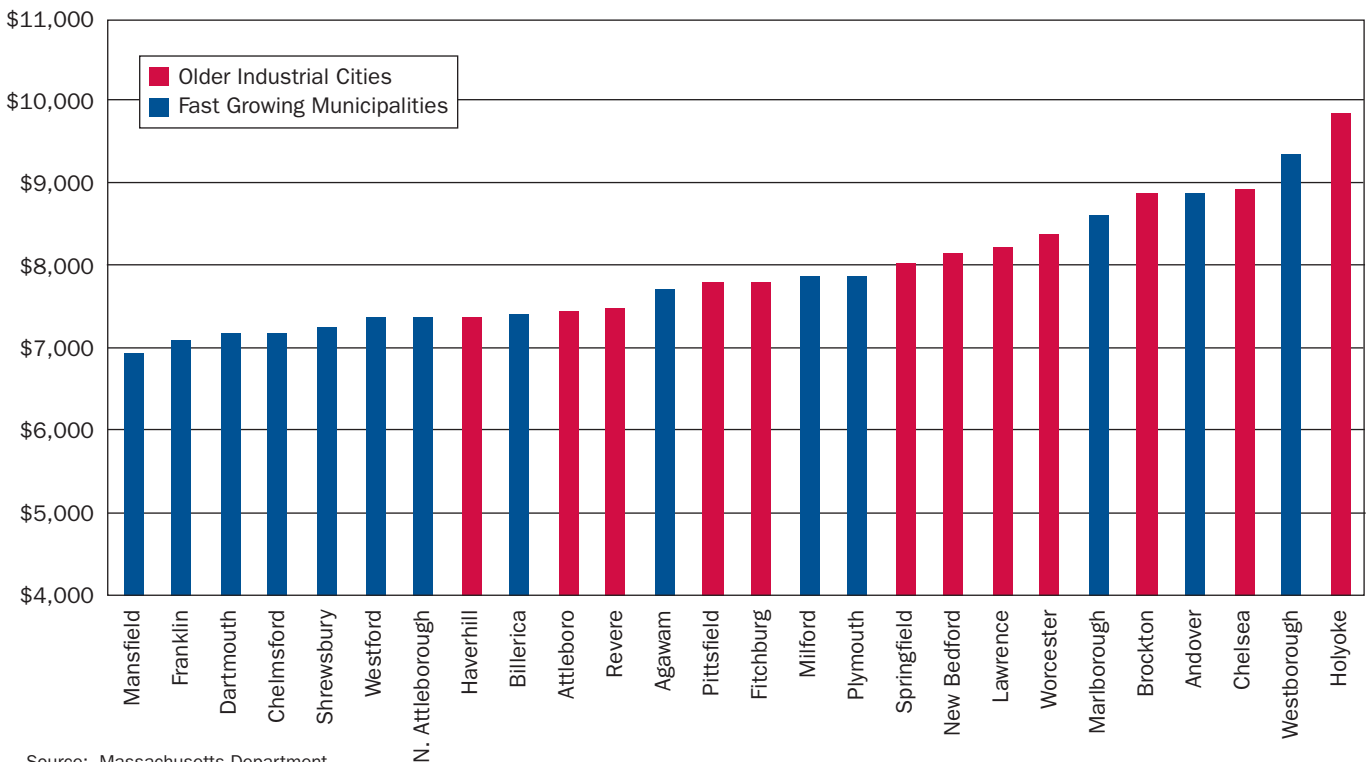
Source: Massachusetts Department of Revenue Municipal Databank, Fiscal Year 1981–1989 Assessed Values by Class; Fiscal Year 2000–2006 Assessed Values by Class; Population Data from U.S. Census Bureau.

**FIGURE 2**  
**Percent of Spending from State Aid, 2004**



Source: Massachusetts Department of Revenue Municipal Databank, Fiscal Year 2000–2005 School Versus Total Expenditures; Fiscal Year 2000–2007 Cherry Sheet Estimated Receipts by Program.

**FIGURE 3**  
**School Spending per Pupil including State Aid, FY2004**



Source: Massachusetts Department of Education, School Finance Statistical Comparisons, Fiscal Year 2004

100 percent of their school spending funded by the state. With the help of such generous state aid, nine of the 12 older industrial cities in this sample were located in the top half of per-pupil school expenditures in 2004 (see figure 3).

### The Peculiar Impact of Proposition 2½

Ironically, the second factor leading to more equal municipal spending has been Proposition 2½. This voter initiative, passed in 1980 and implemented in 1982, was the culmination of the anti-tax movement in Massachusetts. Proposition 2½ contains two important mechanisms for limiting the local property tax levy within individual cities and towns. The first, the levy ceiling, forbids a community from collecting more than 2.5 percent of its assessed property value in taxes, unless voters in the community approve an override in a referendum. This measure affects all cities and towns, but most acutely impacts the older industrial cities, which otherwise might raise property tax rates to make up for lagging property values.

The second key provision in Proposition 2½ has played a critical role in attenuating uneven development by limiting the amount of revenue wealthier communities can raise from appreciating property values. This measure, the levy limit, bars municipalities from increasing their total tax revenue on existing property by more than 2.5 percent each year, regardless of the appreciation in property values. The levy limit has little impact on older industrial cities where assessed values are hardly increasing, but it does affect more affluent communities where assessments are rising rapidly. Consequently, the actual gap in revenue generation between rich and poor cities is much smaller than it otherwise would be.

### The Combined Impact of State Aid and Proposition 2½

As an example of how these two factors—state aid and Proposition 2½—limit the disparity in total per-capita local spending, we can again consider the case of Andover and Lawrence, which border each other in the northeastern region of the state. Recall that Andover had more than \$180,000 of total assessed property per capita in 2004 compared with less than \$30,000 in Lawrence.

If there were no state aid and no property tax limitation, Andover could theoretically spend six times as much as Lawrence on local services per capita without charging a tax rate any higher than its older industrial neighbor. In fact, from local revenues alone, Andover spent about \$2,700 per capita

while Lawrence spent just under \$1,000. But with virtually its entire public school budget provided by the state, and with a generous allocation of state aid for the provision of other critical local services, Lawrence was able to spend \$2,600 per capita for local services in 2004.

Meanwhile, with minimal state aid and the constraints of the Proposition 2½ levy limit, Andover spent a total of \$3,200 per capita, just \$600 more than the total spent by Lawrence. Of course, even this diminished gap in spending can, and probably does, contribute to uneven development between the two adjacent communities, but the impact is muted by the state's generous redistribution policy and Proposition 2½.

### Is Equality Necessarily Equal? The Case of Public Safety

An improvement in distributional equity across communities is important, but is it enough? As evidenced by the data on municipal spending from local revenue sources and from state-funded local aid, Massachusetts has generally succeeded in its efforts to mitigate the impact of unequal property tax revenue between richer and poorer communities, especially with regard to K–12 schooling. Without the generosity of the state government, these cities would be forced to balance their budgets by cutting funds for teachers, textbooks, and school supplies, thereby placing more hurdles in the path to success for their school-aged children.

As older industrial cities struggle to provide services to poor, elderly, and foreign-born populations at rates far higher than those found in more prosperous cities and towns, and as they deal with the legacy of historical inequalities, leveling the playing field in other areas besides K–12 schooling requires a disproportionate response from the state.

Data on expenditures on police protection provide an illustrative example. It is true that the older industrial cities actually spend, on average, more per capita on police services than the rapidly growing municipalities. In 2004, for instance, Holyoke spent about 2.5 times as much on police protection as Shrewsbury, a town with a population just slightly smaller than Holyoke's. However, this fact obscures the reality of public safety in these two communities: Holyoke experienced 81 crimes per 1,000 residents in 2004, while Shrewsbury had 14. What is important for public safety has more to do with spending *per crime* than spending *per capita*. Thus, despite Holyoke's larger budget for police, the result is unequal public safety.

The most extreme example is the older industrial city of Springfield compared to the affluent community of Westford. In 2004 Westford had only 129 reported crimes, but spent an average of \$25,000 for each incident. By comparison, Springfield, with nearly 14,000 reported crimes, spent the equivalent of \$2,200 on each. If you were a rational criminal contemplating a crime, where would you plan your next heist? Westford might be more lucrative, but your chances of being caught are certainly higher there because the police have the resources to concentrate attention on your crime.

### Is Equality Enough?

#### The Case of Services and Amenities

Municipal budgets in cities with depressed property assessments can only achieve so much. Recognizing the need to prioritize, these cities have stretched their locally generated revenue and the aid donated by the state to give their residents the services they cannot live without: public schools, police and fire protection, water, sewer, and infrastructure. Yet, in struggling to meet these basic needs for their residents, they have been unable to fully invest in basic services and cultural and recreational amenities.

Each municipality is obligated, under the requirements of Chapter 70 of the Massachusetts General Laws, to meet a given “foundation” threshold of per-pupil school funding. Such obligations are not in place, though, for other important municipal amenities, such as the cost of planning, zoning, building inspections, and other services. Business enterprises demand that these services be provided effectively, efficiently, and with little delay if they are to consider investing in these communities.

Similarly, both homeowners and businesses seek out communities with cultural and recreational amenities. Of the 12 older industrial cities, nine are found in the bottom half of support for culture and recreation, including libraries, parks, and community celebrations—components that are essential for creating and sustaining an attractive environment in which to work and live. The affluent communities with rising property assessments are in a much better position to fund these public services, helping them attract investment and high-income households.

#### The Bottom Line: Unequal Property Values and Uneven Development

What does this all mean for development in Massachusetts and other states highly dependent on the property tax for local services? To the extent that

firms make decisions about where to expand operations or relocate new ones based on the quality of local services and the quality of life in each municipality, an initial inequality in assessed values can lead over time to a spiraling gap between older industrial cities and more affluent ones. The state can, and in the case of Massachusetts does, step in to try to rectify the massively different ability of local municipalities to provide local services. But even with a Herculean redistribution of resources through state local aid, older industrial cities are at a distinct disadvantage in competing for new investment and new jobs.

Our research suggests that while the property tax remains an important part of the local finance apparatus, it cannot, on its own, ensure the equitable provision of municipal services to rich and poor communities alike. The amenities available to residents and businesses should not be contingent upon the unique economic circumstances, positive or negative, that have affected the fortunes of the communities where they have decided to locate.

There is no simple remedy to this problem, but it suggests at least two things are needed to keep uneven development from becoming even more pronounced. First, the state government must continue to provide resources needed by poorer cities and towns to keep their communities viable and able to play a role in the overall economic development of state. Second, more study is needed to determine whether providing local communities with a more diverse set of fiscal tools, such as local income and sales taxes, would lead to more equity among local communities. **L**

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