Evaluating Assessment Limits

Homeowners understandably dislike unexpected increases in property taxes. Such increases have happened in the past most notably when property values grew rapidly, thereby raising property tax assessments that are normally based on market prices. Nineteen states and the District of Columbia have implemented limits on the growth of assessments with the objective of providing tax relief to homeowners.

Gregory K. Ingram

The Institute's recent policy focus report, *Property Tax Assessment Limits: Lessons from Thirty Years of Experience,* by Mark Haveman and Terri A. Sexton, concludes that assessment limits perform poorly in terms of their effectiveness, efficiency, and equity outcomes. Other approaches, such as circuit breakers that target tax relief to particular groups of households, perform better.

The logic of assessment limits is straightforward. The amount of property tax due is determined by multiplying a tax rate times a property's assessment. If assessed values track market prices, then higher property prices will increase assessments. If tax rates are not reduced to offset the overall rise in assessments, property tax bills will go up. An obvious solution is to limit the growth in assessments. However, such limits make the determination of local taxes less transparent to citizens and have produced surprising consequences.

Assessment limits normally set a uniform cap on the annual growth of assessments, but all property values do not rise at the same rate. The uniform cap redistributes the property tax burden—reducing the share paid by properties that are increasing rapidly in value, and raising the share paid by those growing slowly or not at all. This redistribution benefits high-income households when the prices of larger houses increase more than prices of smaller houses. In fact, the dollar benefit of assessment limits has been found to increase with household income.

In most states with assessment limits, the assessed value of a house is reset to its market value when it is sold. This also redistributes the property tax burden—reducing the share paid by long-term residents and raising the share paid by new residents—so that the tax payments of otherwise identical properties can differ many fold.

Typically a household loses its property tax advantage when it moves. The prospect of paying higher property taxes may impede household mobility and distort housing decisions, locking households into dwellings and locations that become suboptimal as household needs change. On balance, lower-income households relocate less frequently than high-income households, so they benefit from the lower tax payments but bear the costs of lower mobility.

Assessment limits also have impacts on local governments, which typically rely more than any other level of government on property tax revenues. Assessment limits have reduced the tax base of municipal governments by as much as half and have produced similar reductions in locally controlled revenues. This limitation on the revenues of local governments also constrains local control over spending because decreased local revenue is replaced by state aid payments that often come with restrictions. In lean times state aid payments may be reduced dramatically, leaving local governments with few options to replace state funds. The reduction in local control over spending also leads to less citizen involvement in local governments that now have less authority and influence over local spending.

What other instruments can help to control rising property tax bills? Truth-in-taxation procedures require municipalities to announce the constant-yield tax rate that would maintain revenues at the same amount as the previous year. Any increase above that rate is then seen transparently as an increase in the property tax rate.

If the objective is to reduce property tax burdens for low-income households or those in financial difficulty, circuit breakers—which reduce property taxes that exceed a given percentage of income—can be used to target relief to households whose bills are large relative to their incomes. This targeting increases the efficiency of property tax relief because high-income households normally would not qualify. Neither of these measures has the manifold unintended consequences produced by assessment limits.

A free copy of the complete report can be downloaded at *www.lincolninst.edu.*