The pros, cons, misnomers, and possible alternatives to assessment valuation caps

BY JUSTIN EIMERS

In recent years, property values have increased at rates not seen in modern times.

Much of this increase has been fueled by inflation, but regardless of the cause, some think that valuation caps are the answer to rising property values.

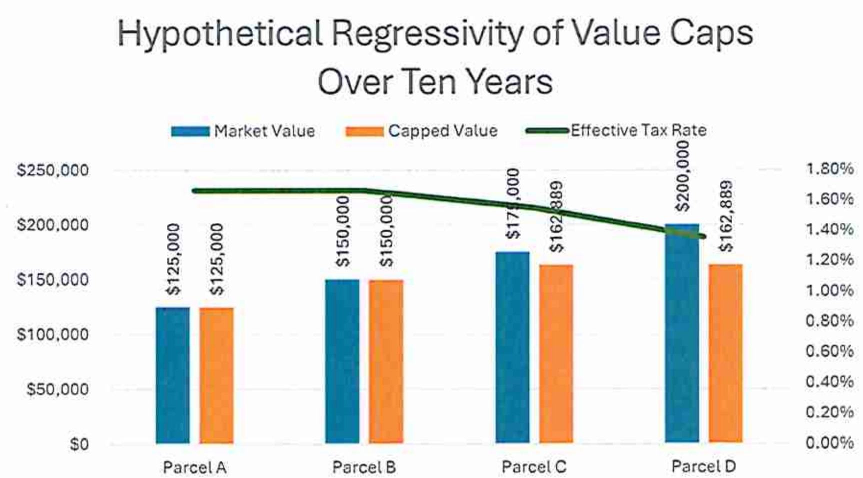
Pros of valuation caps

1) Valuation caps increase property tax bill stability on an individual basis for existing property owners.
2) In rate-driven systems and in budget-driven systems where property tax caps don't exist, valuation caps can reduce local government budgets because of a reduced assessed valuation base and potential requirements or pressure on local officials to keep or reduce mill levies, tax rates, or budgets, and this can be a pro if the goal is to constrain property taxes.

Cons of valuation caps

1) Valuation caps remove the equity component of the property tax system by allowing otherwise equal properties to be assessed at different values, causing unequal tax rates.
2) Valuation caps are regressive in nature, meaning that high-value properties typically receive a higher benefit from caps than lower value properties in the form of tax reductions. Properties in high-demand areas typically increase in value at a higher rate than properties in low-demand areas. Properties in high-demand areas also typically have higher values than properties in low-demand areas. So these high-demand properties in high-value areas will receive a larger benefit from a cap in valuations since low-demand properties by their nature are more likely to have market appreciation below a valuation cap. For this reason, valuation caps typically contribute to regressivity over time, creating equity issues by driving a larger wedge between the haves and the have-nots.
3) The examples at the bottom of the page and at the top of the next page look at the effects of a 5% cap over a 10-year period on a set of hypothetical properties in the same taxing jurisdiction with a budget of $10,000 that will be covered fully by the property taxes of the four properties below. Let's say these properties are in different neighborhoods and are different styles and as such appreciate at different rates. You can see in the example below that under a 5% cap the $125,000 property would pay an effective tax rate of 1.6648% while the $200,000 property would pay an effective tax rate of 1.3555%. A cap in this example creates a highly regressive tax system.
4) Valuation caps will be difficult to walk away from once valuation inequity becomes deep-seated.
5) In most valuation cap schemes, valuations reset when a property sells. Valuation caps create a lock-in effect that can limit individual mobility, which discourages individual and overall economic growth. Just as higher interest rates have discouraged property owners from selling their current house with a low interest rate and moving to a different house with a higher interest rate, the impacts of higher property tax rates will discourage property owners from selling their homes and moving to a different areas. Many people move to seek better economic opportunities, and the greater economy can benefit from their greater productivity, but if moving means a higher property tax bill, the financial incentive of moving to improve their economic situation can be eliminated.
6) Valuation caps hamper new

Parcel	2023 Value Base Year	2033 Value (Without a Cap)	2033 Value (5% Increase Cap)	2033 Tax (Without Cap)	2033 Tax (With 5% cap)	Difference in Taxes	Effective Tax Rate (2033 Cap Tax/2033 UnCap Value)
A	$100,000	$125,000	$125,000	$1,923	$2,081	+$158	1.6648%
B	$100,000	$150,000	$150,000	$2,308	$2,497	+$189	1.6647%
C	$100,000	$175,000	$162,889	$2,692	$2,711	+$19	1.5491%
D	$100,000	$200,000	$162,889	$3,077	$2,711	-$366	1.3555%
Total	$400,000	$650,000	$600,778	$10,000	$10,000	$0	



home construction and new home ownership by shifting property taxes from established homeowners to new homeowners. Transferable caps further impact new homeownership for the same reason. These policies have the effect of kicking the can down the road, forcing new buyers and younger generations to pick up the slack.

7) Values can continue to increase even in a down market in a capped system. A situation where values increase in a down market can be difficult for property owners to understand because it defies the actual market.

Misnomers of property valuation caps

1) Some believe that a valuation cap equals a tax cap. This is true only in a rate-driven tax system. Many jurisdictions are in a budget-driven system, so valuation caps don't necessarily cap property taxes. Local taxing entities in a budget-driven system can still increase budgets by increasing the mill-levy or tax rate and the taxes paid depending on local laws.

2) In many instances, the assessor is blamed for tax increases, when in fact property taxes are a result of the budgets passed by elected officials. If budgets were $0, property taxes would be $0. The assessor's job is to develop property values reflective of market value as a way to fairly and equally distribute the property tax load across the taxing entity according to the law. In some instances, the taxing entities choose not to reduce their mill-levies or tax rates, absorbing the increase in property values in the form of an increased budget at the same tax rate. The issue is not the values, but the increased budgets of the taxing entity. In other words, if the budgets stayed the same, the property taxes would stay the same on average. The issue of increasing property taxes is not a result of overall value increases but could reflect increased budgets.

3) Some believe that valuation caps will have little impact on valuation equity. While valuation caps could have a small impact on valuation equity in the short run, valuation cap equity issues are more obvious as time passes and the gap between true market value and the capped value increases.

4) Some believe valuation caps will simply remove the tax on the value above the cap. While this could be true in a rate-driven system, in a budget-driven system, property taxes are simply shifted to another group of taxpayers in the form of a higher tax rate. Valuation caps can shift the tax burden to lower valued properties or properties with lower appreciation rates.

5) Valuation caps create a system where property is more often valued below market, giving the false perception that individuals are paying less than their fair share when in fact they could be paying more than their fair share because the majority of properties could be valued under market value as well. Ascertaining what is fair is much more difficult and is hidden under the veil of a false capped market value. Valuation caps create a property tax system that deceives taxpayers into thinking they are paying less than their fair share when in fact there is a chance they are paying more than their fair share.

Alternatives to property valuation caps

1) **Homestead exemptions** typically exempt a fixed amount of value from each residential property. Homestead exemptions are progressive and help those least able to pay their property taxes. In some cases, states have these laws on the books, but it is possible that exemption amounts or income limits have not been kept up-to-date, making the exemp-

tion less effective than originally intended.

2) **Circuit breakers** are exemptions that are generally directed to low-income and elderly taxpayers. The main purpose of these programs is to help those residents who are least able to pay.

3) **Income tax credits** targeted at low-income property owners or renters help alleviate the challenges low-income residents face and are progressive.

4) **Tax deferrals** allow property tax payments to be made at a later date or when the property is sold. The property taxes are added to the property as a lien. When the property is sold, the taxes are settled out of the proceeds of the sale.

5) **Truth in taxation** policies that notify the property owner of the tax implication of value changes can make it clear to property owners that a value increase doesn't necessarily equal a tax increase, especially in budget-driven systems when budgets remain unchanged.

6) **Property tax caps** or budget increase limits that don't limit the property value but limit overall tax increases can help alleviate much of the public's angst regarding property value increases.

Conclusion

Assessments receive much of the blame for property tax increases, but it's increased budgets that are typically the cause.

Valuation caps can sound good on the surface, but they create unequal treatment of property owners that typically favors high-income earners at the expense of low-income property owners and create a false sense of equity.

If I have missed a pro, a con, a misnomer, or an alternative, please reach out to me at eimers@iaao.org.

▶ The opinions stated in this article do not necessarily represent the opinions of IAAO or its members.

JUSTIN EIMERS, AAS, is an assessment advisor at IAAO.