

Local Property Tax Yields and Burdens: Into the Great Recession and Beyond

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Introduction

The American public holds the real property tax in low regard as a means of financing local government, much in contrast to the view of many tax scholars who see the tax as being particularly appropriate for local use. As Kitchen (2013, p. 2) writes, among public finance scholars, "...it is generally agreed that the property tax meets the criteria for a good local tax better than the alternatives of personal income or consumption based taxes." The tax base is immobile, revenue is generally predictable and stable, and its visible burden is unlikely to be exported to those not receiving the local services financed by the tax. It thus can provide an appropriate contribution to the finance of local government services.

As previously noted, that is not the popular view of the tax. The tax always received a high rank for unfairness in the opinion surveys that the now-defunct U. S. Advisory Commission on Intergovernmental Relations conducted each year from 1972 through 1992 (ACIR) and in similar surveys more recently conducted by the Tax Foundation. Its 2007 survey reported the local property tax as the least fair of broad-based state and local taxes, with fully half of all respondents rating it as somewhat unfair or not at all fair (Chamberlain 2007). With such public attitudes, it is no surprise that many states have embarked on programs to reduce property tax burdens, either overall or for targeted sorts of properties – substitution of state revenues for the property tax in support of local services, provision of more tax options for local governments, limits on local property tax levy growth, statutory rate constraints of many varieties, specialized property assessment programs to mitigate increase of assessed value for parcels, rate classification schemes designed to reduce burdens on residential property, and other mechanisms designed to constrain use of the tax base. Through 2009, 47 states had adopted limitations on the property tax and, in fact, Georgia, Florida, and North Dakota had formal consideration of programs to totally eliminate the tax. (Mullins, 2010; Sokolow, 1998; Gravelle and Wallace, 2009). Other states likely would have developed elimination programs if they could have figured out a feasible mechanism that would not completely hamstring the ability of local governments to provide services. It is fair to say

that state lawmakers find programs to limit, constrain, control, or eliminate local property taxes an attractive political option.

The result of this aversion to the tax shows up in trends in the historic shares of local revenue from the tax. The property tax share of local government tax revenue was 0.877 in 1961; that share fell consistently through the years, reaching a low of 0.715 in 2001, although most of the decline had occurred by 1981, when the share reached 0.759. By 2007, on the cusp of the Great Recession, the share was 0.717, not much above the low point. The period of greatest decline was in the twenty years from 1961 to 1981; passage of California's Proposition 13 (in 1978) was toward the end of the great realignment away from the property tax, not at the beginning. Most of the forty year decline, indeed, occurred before the middle of the 1970s. Overall, states and localities have responded to the low public regard for the property tax by reducing local reliance on the source. Some of the decline in share reflects the constraints on property taxation previously noted, but some results from state assumption of local financing obligations (one example being state assumption of local school operating costs in Indiana), increased state transfer payments to localities, and provision of greater authority to levy non-property taxes to localities. All of these actions have contributed to the reduced property tax share of local government general revenue.

National Patterns of Local Property Taxation

The nearly two and a half decades since the end of the 1980s, after the greatest period of decline in property tax reliance, provide an interesting environment for a detailed examination of the property tax in local government finances. Although the period is mostly economic expansion, including the longest peacetime expansion in American history, it also includes three recessions, including the Great Recession of December 2007 through June 2009. Throughout the period, the property tax continued as an important revenue source of local governments, affording them a measure of autonomy and reliability not found with other local sources and certainly not from transfers from other levels of government.

Data from the Governments Division of the Census Bureau (U. S. Bureau of Census) show that in the twelve months ending in the first quarter of 2013, local governments collected \$464,616 million, the highest twelve month property tax yield in nominal terms in American history, surpassing the previous record of \$464,033 in the year ending in the third quarter 2010. The next largest tax source, the local general sales and gross receipts taxes, yielded \$51,155 million in the year ended in the first quarter of 2013, so the property tax remains dominant in the local tax portfolio by far, even with its general public unpopularity. While a few larger cities do raise more revenue from general sales or individual income taxes, they are notable mostly because they represent the exception.

Property tax reliance and the relative stability of the property tax saved localities from some of the fiscal shock governments felt in the Great Recession period. Figure 1 contrasts the tax yield dynamics of local income, general sales, and property taxes from the end of 1988 through the first quarter 2013 by reporting the twelve month yields ending at each quarter relative to their 1988: IV level. In fiscal year 2011, property tax collections were 6.5 times as large as general sales tax collections and 16.7 times as large as individual income tax collections, so measuring collections on this relative basis permits comparisons of the yields of considerably different size of yields. The figure shows that the yield path for each of the taxes has been generally upward, although income and general sales tax yields have shown considerable drops around each recession period (and sometimes even without a recession). The impacts were particularly dramatic during the Great Recession, as both individual income and general sales tax revenues fell considerably. General sales tax yields still have not returned to their pre-recession levels. However, property tax revenue shows no immediate decline with the Great Recession and, indeed, continues to grow through the formal end to the recession. Property tax yield did level out after the recession, although its level now is above its pre-recession peak. Given the importance of maintaining the services for which local governments have primary responsibility – public safety and primary and secondary education -- and their somewhat constrained ability to cover deficits by borrowing, local reliance on the more stable property tax is fiscally useful. Diversifying tax revenue sources beyond the property tax would have made local total tax revenues more sensitive to the recession declines.

More insights into the performance of the local property tax during the Great Recession appear in Figure 2, a figure that reports the annualized local property tax yield in real terms for each quarter from 1988:IV through 2013:I. Over the years, the inflation adjusted property tax yield has been increasing at a relentless pace. The initial reaction when the recession hit in 2007: IV was a very modest decline in revenue, followed by a steep yield increase, an increase dramatically greater than the historic growth path of revenue from the tax. This would suggest an adjustment upward of local property tax rates to recover revenues lost from other revenue sources that lacked the flexible rate adjustment potential of the property tax. The adjustment response is described in detail in Mikesell and Liu (2013). Shortly after the end of the recession, however, real property tax yield began to decline. By 2013: I, yield had returned to roughly the level it would have been if its growth since the start of the recession had followed its historic trend of around 3 percent: the yield at that point was 91.2 percent of its extrapolation from 2007: IV at its growth rate from 1988: IV to 2007: IV. This suggests that the property tax system has managed to return to its normal configuration through changes in property tax assessed values and rates after the Great Recession shock. In real terms, the recession shock was primarily a real increase in yield, continuing a pattern seen

in earlier recessions, although the extent of the increase was considerably more pronounced in the recent recession.

The distribution of taxes in the local tax portfolios reflects the tax patterns previously discussed. Figure 3 shows the considerable impact of the Great Recession on the local property tax share of total local tax collections. The recession period brought a considerable spike in property tax yield as a share of local tax revenue, from 75.6 percent in 2007: IV to 78.6 percent in 2009: II. Reliance continued to increase, reaching 80.6 percent in 2011: III, its highest level in the twenty-five years examined, until it began to decline back toward its historic average (average around 76 percent versus 77.5 percent in 2013: I). As noted earlier, while property tax yields were influenced by the recession, the impact was considerably less than felt by individual income and general sales tax yields. As yields from the other major local taxes recovered, the share of total tax revenue from the property tax declined again. The reliance patterns seen in the figure are a direct result of the differential recession impacts on these three major tax sources. It is noteworthy that, in the other two recessions that occurred in the period of analysis, the property tax share increased as well. The property tax represents a base for revenue stability in the face of economic recession. While the long term trend for property tax reliance has been downward, recessions of recent years have interrupted that trend and the Great Recession dramatically interrupted it. With the end to the recession, property tax reliance again began to decline, although it has not yet returned to its pre-Great Recession level and certainly not back to its level of the late 1980s.

Figure 4 traces the Great Recession impact to property tax burdens as a share of personal income. After the recession of the early 1990s, the secular path of the ratio of property tax to personal income had been downward until the recession of 2001. The ratio sharply increased with the 2001 recession and continued to increase until the start of the Great Recession, at which point the ratio increased dramatically, from roughly 0.032 to a peak of 0.0379 in 2009:IV, higher than at any time in the last quarter century. From that high, the ratio has fallen consistently to 0.0336 in 2013: I. That ratio is above all periods of the 21st century not influenced by the Great Recession and much above its level at the beginning of the century (around 0.027). An increase in the burden ratio appears in each of the three recessions covered by the data series. However, the decline in burden after the Great Recession is generally consistent with the pattern in the 1990-91 recession, but it is not like the pattern for the 2001 recession, in which burdens increased after its end. Overall, growth in personal income has not kept up with growth in property tax yields in the 21st century, even with the controls, constraints, and limits that state and local governments have placed on the tax. It is likely that, given the general hostility to property taxation in the nation, that the burden ratio will continue to fall in the next several years because it is considerably above its recent historic average.

Changes in Household Property Tax Burdens

Addition insights into how the property tax has changed can be gained by an investigation of individual household burden data. This analysis employs data on effective household property tax burden computed from the approximately 12 million household observations from the Public Use Micro Samples of the 2000 Census of Population and Housing and subsequent Annual Community Surveys done by the Bureau of Census from 2000 through 2011. The analytic focus here is on the relationship between the income of the household and the property tax bill paid by that household. While the property tax bill is not driven by household income, the bill generally must be paid from that income and, hence, this represents an important indicator of the economic burden that the property tax will make on households.

Because the property tax bill is based on a stock value (the assessed value of the property parcel) and household purchases are made on the basis of expected lifetime income status, the property tax burden relative to current annual income can be a difficult problem for households whose income has fallen below its typical value because of economic fluctuations, unemployment, or retirement. Indeed, the possible disconnect between the amount of the property tax bill and annual income of the owner of the property is a frequent concern of control and constraint laws. Furthermore, this investigation focuses on total property tax paid by the household. Concern about property tax burdens typically are about the total tax paid because the homeowner is not likely to be deeply concerned as to whether the tax being paid goes to a school district, a city, a county, or whatever. Furthermore, the homeowner is likely to think about the bill to be paid from its current income, not about the relationship between bill and value of the property parcel. Hence, the burden measure examined here has considerable policy significance.

Tables 1 and 2 provide a general overview of the distribution of burdens across household income deciles. Table 1 presents the average absolute dollar values of residential property tax burden by household income deciles in the years from 2000 to 2011 (plus 1990) in both current and constant dollars. The research here assumes that the household owning and occupying the residential property bears the economic burden of the property tax on that property. While other incidence assumptions are possible, this is the presumption that drives the political objections to the residential property tax and it is certainly a plausible assumption. Other elements of the property tax – the taxes on vacant land, agricultural property, commercial and industrial property, and personal property – are not part of the present examination.

Evidence in Table 1 shows expected patterns: payments rise as income is higher and payments in both current and constant dollars increase across the years. The burdens did not, however, all increase at the same pace. For instance, from 2000 to 2011, the increase for the bottom six deciles all exceeded 64 percent while the increase for the highest was 57 percent. While the increases may be entirely consistent with the laws applicable to property assessment and levy, such a pattern does nothing to convince the general public of the overall fairness of the tax.

Table 2 examines residential property tax burden as a percent of household income by income deciles and across the years. For all years, this burden measure is highest for the lowest income decile, likely the result of housing purchased on the basis of lifetime income prospects and not adjusted for transitory changes in income from cyclical unemployment or retirement. Across the other deciles, the property tax to income ratio falls as income is higher. The ratio usually increases with each year with deciles. However, the increase in the ratio is substantially greater for the lowest income decile. For the bottom end of the income distribution, regressivity of the tax has increased. With these data, it is not a surprise that the public is upset with property taxes: in spite of every political indication that the property tax is regarded as an unfair tax for support of local government, the effective burden of the tax as a percent of household income has increased and, although there has been an increase for all income groups, the increase has been greatest for the lowest decile and particularly after the official end of the Great Recession.

Conclusion

In spite of its unpopularity, the property tax remains the foundation for local government finance in the United States. Its stability provided many local governments a degree of fiscal security not provided those who had diversified their revenue portfolios to include more volatile individual income and general sales taxes. Governments appear to have responded to the Great Recession by increasing their property tax rates. Property tax burden relative to household income has increased over the years, with increases that are particularly great in the lowest decile.

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Figure 1. Local Property, Individual Income and General Sales Tax Yield Relative to 4th Qtr 1988, Annualized by Quarter

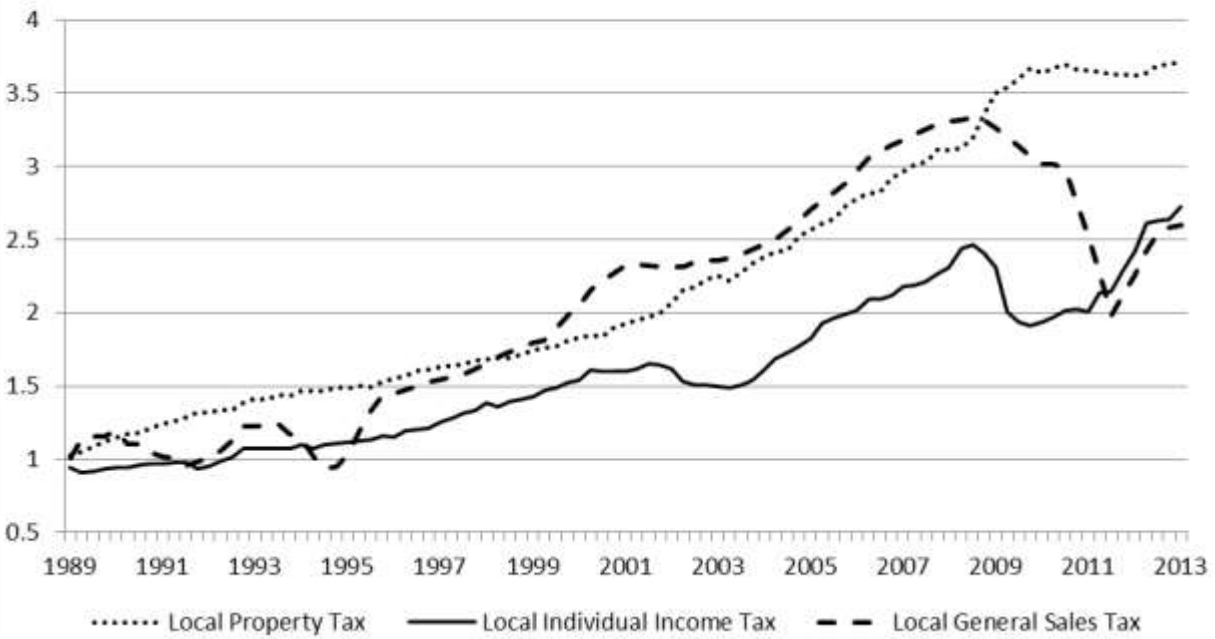


Figure 2. Real Local Property Tax Yield, Annualized by Quarter (1989-2013, 2009 dollars)

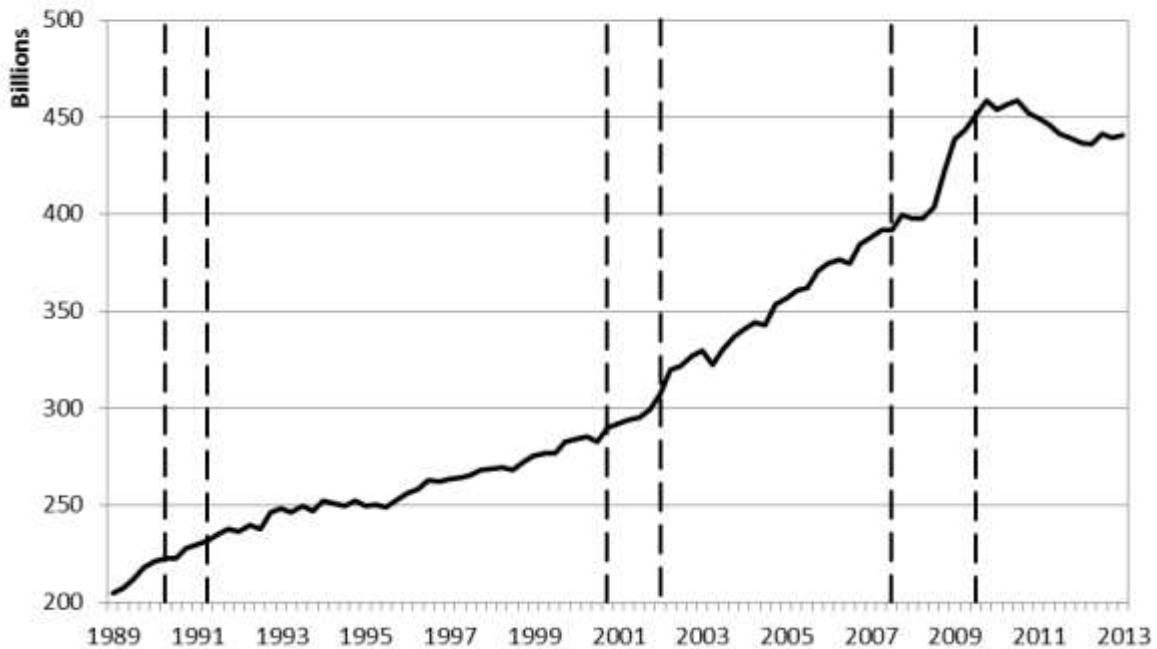


Figure 3. Local Property Tax Yield, as a Percent of Total Local Tax Revenue, Annualized by Quarter (1989-2013)

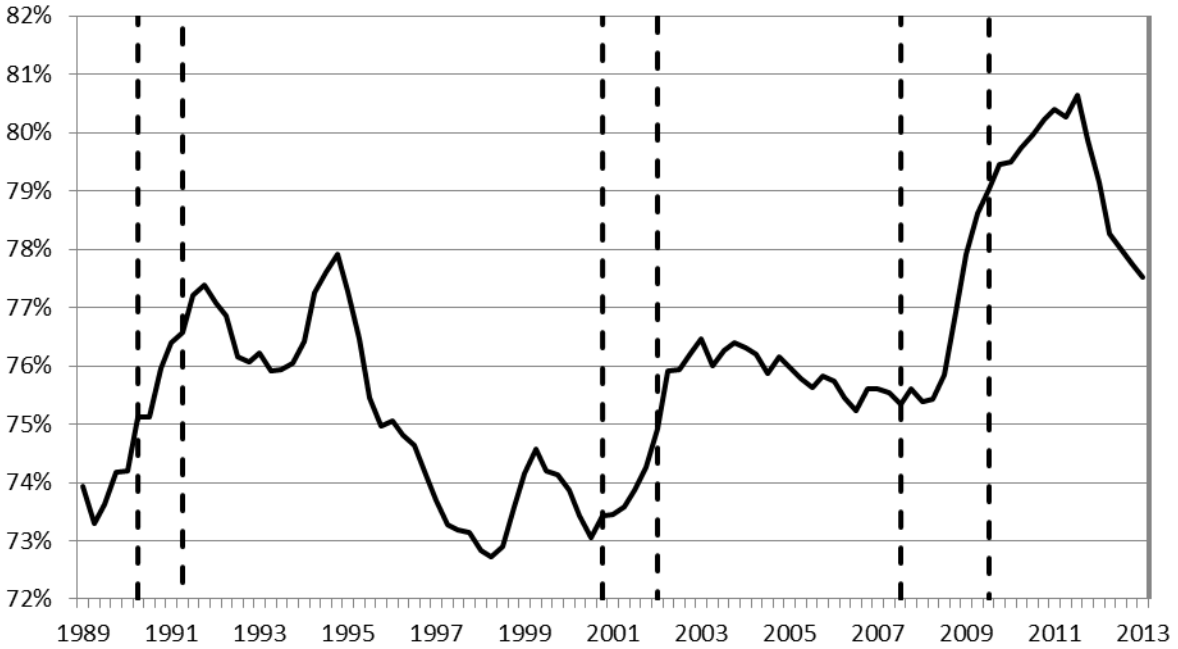


Figure 4. Local Property Tax as a Portion of Personal Income, Annualized by Quarter (1989-2013)



Table 1. Absolute Value of Residential Property Tax Burden by Income Deciles, 1990 & 2000 - 2011

CURRENT DOLLARS															
Decile	1990	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Ratio, 2011 to 1990	Ratio, 2011 to 2000
1	661	1066	1156	1224	1287	1374	1447	1533	1622	1649	1699	1752	1770	2.68	1.66
2	748	1163	1219	1287	1369	1456	1556	1673	1756	1808	1839	1909	1928	2.58	1.66
3	821	1264	1307	1385	1488	1575	1700	1812	1936	1983	2016	2079	2090	2.55	1.65
4	891	1360	1418	1501	1607	1711	1834	1965	2078	2148	2185	2197	2231	2.50	1.64
5	961	1449	1527	1623	1719	1862	1990	2124	2254	2324	2361	2389	2419	2.52	1.67
6	1039	1584	1640	1733	1853	1997	2154	2294	2408	2525	2534	2585	2596	2.50	1.64
7	1140	1728	1815	1929	2055	2209	2371	2540	2655	2744	2787	2810	2855	2.50	1.65
8	1272	1940	2052	2153	2329	2473	2667	2825	2995	3082	3102	3138	3160	2.48	1.63
9	1466	2280	2441	2553	2761	2869	3098	3316	3487	3572	3610	3648	3711	2.53	1.63
10	2027	3204	3479	3661	3832	4184	4449	4609	4819	4915	4947	4935	5015	2.47	1.57
CONSTANT 2009 DOLLARS															
1	988	1,301	1,380	1,439	1,483	1,541	1,573	1,617	1,667	1,662	1,699	1,731	1,715	1.74	1.32
2	1,119	1,420	1,455	1,513	1,578	1,634	1,691	1,764	1,804	1,822	1,839	1,887	1,868	1.67	1.32
3	1,228	1,543	1,560	1,629	1,716	1,767	1,848	1,911	1,989	1,999	2,016	2,054	2,025	1.65	1.31
4	1,332	1,661	1,693	1,765	1,853	1,920	1,993	2,072	2,135	2,165	2,185	2,170	2,162	1.62	1.30
5	1,438	1,769	1,823	1,908	1,981	2,089	2,163	2,240	2,316	2,342	2,361	2,360	2,344	1.63	1.32
6	1,555	1,935	1,957	2,038	2,136	2,241	2,341	2,419	2,474	2,544	2,534	2,554	2,515	1.62	1.30
7	1,705	2,110	2,167	2,268	2,369	2,478	2,578	2,679	2,728	2,765	2,787	2,777	2,767	1.62	1.31
8	1,903	2,369	2,449	2,531	2,684	2,775	2,899	2,980	3,077	3,106	3,102	3,101	3,062	1.61	1.29
9	2,193	2,784	2,914	3,001	3,183	3,218	3,368	3,497	3,582	3,600	3,610	3,604	3,596	1.64	1.29
10	3,033	3,912	4,153	4,304	4,417	4,694	4,836	4,861	4,951	4,953	4,947	4,876	4,859	1.60	1.24

Table 2. Residential Property Tax Burden as % Household Income by Deciles, 1990 & 2000 - 2011

Decile	1990	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1	11.78	14.69	15.68	16.44	17.20	17.98	18.85	19.12	18.76	19.23	19.54	19.82	20.64
2	4.68	5.28	5.34	5.53	5.84	6.07	6.29	6.44	6.43	6.43	6.64	7.03	7.10
3	3.52	4.00	4.00	4.14	4.42	4.56	4.77	4.86	4.93	4.91	5.06	5.32	5.33
4	2.97	3.35	3.37	3.50	3.70	3.86	3.99	4.09	4.13	4.14	4.26	4.35	4.41
5	2.63	2.92	2.97	3.09	3.22	3.40	3.53	3.60	3.65	3.64	3.74	3.83	3.86
6	2.40	2.67	2.67	2.75	2.90	3.05	3.17	3.24	3.24	3.28	3.33	3.44	3.42
7	2.24	2.44	2.48	2.57	2.69	2.82	2.92	3.00	2.99	3.00	3.06	3.11	3.12
8	2.12	2.27	2.33	2.39	2.53	2.62	2.72	2.77	2.79	2.78	2.81	2.86	2.83
9	1.98	2.09	2.19	2.24	2.36	2.38	2.48	2.56	2.56	2.54	2.57	2.61	2.60
10	1.68	1.62	1.80	1.87	1.94	1.97	2.00	2.04	2.01	1.98	2.03	2.06	2.04