Comment on Jack Goodman's "Houses, Apartments, and the Incidence of Property Taxes"

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Abstract

The growing differential between tax rates for single-family dwellings and apartments is evidence of several accelerating trends. For single-family housing, the rate has declined over the past decade as the role of the property tax has diminished and other forms of revenue have become more significant. Moreover, new suburban residential developments have seen rapidly increasing use of privatization to supplant local government services and taxes. Apartments tend to be concentrated in older, more densely settled urban areas that continue to rely on the property tax, grow more slowly, and depend more on local governments for services. Fiscal zoning, reinforced by fiscal impact analysis and homeowners' economic self-interest, has militated against building apartments in growing areas.

Given policies that favor homeownership and foster single-family housing as an investment, market forces will likely work to close the tax rate gap by restricting locally financed services to those who cannot afford to pay for them.

Keywords: Rental housing; State and local governments; Tax issues

Introduction

On the basis of the 2001 Residential Finance Survey (RFS), a huge national sample, Goodman concludes that apartment properties pay median or average effective property tax rates (EPTRs) that are markedly higher than those paid by single-family homeowners and that the lower the value of the properties (and, by reasonable inference, the lower the income of the occupants), the greater the differential. Moreover, this differential in EPTRs between apartments and single-family properties appears to be a recent phenomenon, having grown from inconsequential in 1991 to quite significant in 2001.

As I will discuss, the results are interesting not so much as factoids, but because they are the proverbial tip of the iceberg and reflect a much larger and more complicated set of underlying national and regional trends. Are apart-

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ment owners and dwellers in effect being singled out for higher property taxes? Is this a matter of conscious policy or an accident caused by the recent meanderings of myriad local real estate markets? The answer is a little of both, and while there are large areas of uncertainty, it appears that the differential in local taxation is likely to continue to grow as local governance and its financing are recast in a changing society.

Whatever the causes, the policy importance of these issues is clear. In 2004, 68 percent of U.S. households owned their own home, while the remaining 32 percent were renters. In 1990, the share of renters was 34 percent (Himmelberg, Mayer, and Sinai 2005). In 1990, structures of four or more units represented 11.2 percent of the total net value of residential housing, but by 2001, this had dropped to only about 9.3 percent. During that interval, the value of residential units occupied by renters as opposed to owners declined from 33 percent of the net value of residential properties to 26 percent[1] (U.S. Department of Commerce, Bureau of Economic Analysis, various years). Clearly, over the past decade, the overall value of owner-occupied single-family housing grew faster than that of rental units, and the share of renter households declined. Moreover, that growth was fastest in the new suburbs on the outer fringes of urban areas.[2]

Data and method

The huge data set that Goodman uses appears to contain a lot of information. But lots of data dots do not guarantee that there is lots of information that helps to connect them. Depending on self-assessed property values and self-reported property taxes is worrisome, and confidentiality constraints mean that the collected data cannot be audited against tax records for the respective jurisdictions—a major limitation. It might be noted that questions about property taxes and self-evaluations of property could trigger plugging in assessed values instead of market values and that, among other things, assessed values tend to lag the market, especially when prices are rising.[3]

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[1] These values do not include the value of the land on which the structures are located.

[2] According to the Puentes and Warren (2006) study of "first" suburbs, the percentage of homeowners was 73 percent in newer suburbs, 68 percent in older suburbs, and 43 percent in primary cities. The population changes for the decade 1990 to 2000 were 22 percent, 11 percent, and 6 percent, respectively. In the 1990s, the growth was in the collar of new suburbs and was a national phenomenon.

[3] For example, footnote 4 of Goodman's article refers to the reported increases in housing and apartment prices for units purchased in the past four years. While respondents for single-family houses reported what could be inferred to be an annual rate of increase of 3 percent, respondents for apartment properties reported, on average, price increases of zero. Meanwhile,

Another issue, and one that is of increasing significance, consists of the property assessment and levying practices followed by various states and localities. As Goodman notes, these can have a substantial impact on tax bills, and my guess is that the various tax breaks that homeowners get (and apartment dwellers do not) have become more numerous. Again, these are often specific to localities, and state designations in the RFS are not fine enough to help uncover the impacts.[4]

Goodman dutifully acknowledges a number of other data problems, but, quibbles aside, the overall results appear to be pretty robust. Further, given the data limitations, Goodman does his best to extract as much blood from the admitted turnips that make up the database. Some of the specific values provided may be questionable,[5] but, overall, there appear to be differentials in EPTRs, they appear to be greater for lower-value properties, and they appear to have grown sharply over the past decade. Why has this occurred? Is it a matter of mean-spirited public policy that has been turned against apartment owners and dwellers (especially those in the lower brackets)? Or is it a byproduct of where development and housing price changes have taken place, reflecting essentially the results of a restless, dynamic economy?

Determining causality is made more difficult by the restrictions on the data, since they preclude getting the necessary details. Aside from knowing the states in several cases and being given broad-gauge descriptions of setting (urban, suburban, rural), there is simply not much to go on in dissecting the highly varied circumstances of the underlying observations. Even knowing the state is not much help. For example, comparable homes in the urban area of Bristow City, VA, cost half as much as they do in the city of Alexandria (VA), although the nominal and effective property tax rates are virtually identical. But the definitions of value per unit used in Goodman's analysis to distinguish between lower and higher values are uniform within a state, not to mention for the nation as a whole. The overriding problem is that real estate markets are parochial and the cost of housing (and living) varies widely even within a state.

national indexes were growing at 5 to 8 percent annually for the period. This snippet of evidence indicates that respondents were likely giving low estimates for property values, with apartment owners giving the lowest estimates of all. This is not surprising since responding to a government survey with information that could influence taxes makes people who see them as a cost of doing business hesitate.

[4] For instance, Cook County (IL) has a classified property tax system (that taxes multifamily properties at a higher rate), while the rest of Illinois does not.

[5] For example, Goodman's table A.3 shows the median EPTR on high-end apartments in Virginia to be 3.02 percent and the average rate to be 2.31 percent. The state, which has very good assessment and equalization practices and a uniform system of taxing properties, has no local units that even approach those rates.

The nation is rife with such anomalies and idiosyncratic situations that make direct comparisons of comparative tax burdens, especially based on a single tax, almost impossible, at least from the perspective of individual welfare.[6]

Local taxes in a changing economic landscape

Before considering what might be causing the recent divergence in tax rates between classes of property, it might be useful to set the scene. As far as unintended consequences are concerned, one of the more important may be that the property tax itself is sitting on a changing base. Because of the decline in industrial America, residential real estate properties of all types are now picking up more of the property tax load. Years ago, industrial, commercial, and agricultural properties were much more important in the property tax base than they are now. Their share has shrunk and homeowners' share has therefore increased.

In 1994, residential properties made up an estimated 69 percent of the national property tax base, up from 61 percent only a decade earlier (Petersen 1994). While I have seen no recent national estimates, local experience indicates that the trend has continued, since an increasing share of the nation's capital stock is devoted to housing—and single-family housing at that. Between 1990 and 2001, the current net value of residential housing structures (one to four units) rose by 93 percent,[7] while the net value of the total nonresidential stock of structures rose by 61 percent. In a postindustrial society, less value is locked up in the physical apparatus of production and more in the consumption of housing services (and in the expectation that the demand for them will continue to grow).

The large-scale de-industrialization of the economy has been most evident in older regions that earlier served as industrial centers. These same areas are likely to be where apartment dwelling has been more prevalent; this is a historical byproduct of an era when workers depended on public transportation and proximity to jobs. My surmise is that apartments are likely to be located in higher-tax local jurisdictions in large part because they are associated with higher-density development, which in turn is associated with higher government costs. Older areas inherited older local government political systems that featured longer lists of service deliveries and responsibility for infrastructure.

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[6] Taxes may be higher, but the menu of services can be longer and their quality better. Also, other taxes and charges in areas with higher property taxes may be lower—and vice versa.

[7] The widespread use of property tax exemptions as a means of retaining and attracting firms is also helping to erode the tax base. Again, this practice is most common where industry once prevailed and an effort is being made to attract jobs.

But the changing composition of the property base is only part of the answer. The other part is that property taxes reflect only some of the fiscal picture. Other local taxes and fees (governmental and nongovernmental) have come to play an increasing role in finance, especially in faster-growing areas. As noted, the past decade was one in which property values grew, and they grew much more rapidly in the case of single-family dwellings than they did for other units. This means that in all probability, apartment properties are disproportionately to be found in slow-growth urban areas and concentrated in urban cores. Further, there has likely been a curb on apartment building, especially in those faster-growing areas, since apartments (as opposed to condominiums) are more likely to be associated with lower-income and transient occupancy. The widespread use of fiscal impact analysis, a changing view of residential property ownership (as a form of investment), and a more exclusionary view of "community" are likely contributors. Before turning to those subjects, however, it might be useful to examine the changing role of the property tax itself.

How important is the property tax burden?

Goodman's results imply that property tax burdens are shifting to apartment dwellers and—by implication—to lower-income households. That may be, but examining the property tax burden requires placing it in the larger context of overall tax and charge burdens. In that context, property taxes as a source of local government revenues have been shrinking for a long time.

Table 1 illustrates that the property tax, while still the dominant tax source in the local government realm, has long been losing ground in the total local government revenue mix. The long-term drop in its importance to local own-source revenues shows the importance of fees and charges and, in the general revenues, the growing importance to local budgets of state transfers.[8] Thus, while the property tax viewed in isolation might be seen as promoting horizontal development and being more onerous on lower-income households that tend to live in apartments, the declining importance of the tax in the entire revenue mix suggests that this impact may be diminished.

It is important to note that as a percentage of the median value of single-family dwellings, the EPTR dropped from 1.03 percent to 0.9 percent between 1991 and 2001. The rub is that it remained constant for apartment dwellers (see Goodman's table 4). Again, my surmise is that rapid changes in national

[8] In the case of state transfers to local governments, the great bulk of growth has been in aid to public schools, which constitutes a preponderant share of all state transfer payments to localities.

Table 1. Local Property Taxes as a Percentage of Local Taxes, Own-Source Revenues, and General Revenues: 1967 to 2002

Fiscal Year	Percentage of Local Taxes	Percentage of Own-Source Revenues	Percentage of General Revenues
1967	86.6	66.2	43.2
1977	80.5	59.1	33.7
1988	74.1	46.9	29.3
2002	72.5	42.0	27.1

Source: Data from U.S. Bureau of the Census.

residential development patterns have both intensified the differentials in formal property tax burdens and made them overall less relevant in measuring these burdens as other forms of revenues and providers of government services have grown in importance.

Just what is a property tax?

The property tax is a charge against property for services, and since its level depends on the overall revenue regimes of the governments that are supplying services and the menu of services they provide, measuring it can be a problem. For example, the very low property tax rates in California reflect the constitutional limitation on rate and allowable growth in assessed values. So the traditional ad valorem property tax has essentially been transfigured into other forms of taxation based on measures other than values (the Mello Roos District is the prime example).[9] These fees and special taxes (and developer exactions that get built into housing values) replace the conventional property tax. They are also pretty much restricted to the single-family dwellings that have been constructed over the past 25 years. What Californians save in property taxes, they pay in other taxes and charges (and prices when they purchase a home). How does the more broadly defined property-related tax bill vary among property types? I have no idea, but if a high-income family living in a detached dwelling is more inclined to pay such taxes, then there is a displacement effect at that level. What historically has been and elsewhere is a public charge is becoming a private charge in many areas.

[9] Mello Roos Community Development Facility District legislation was enacted in 1983 in California after the passage of Proposition 13 in 1973 brought local government capital financing to a halt. Mello Roos provides a means of financing needed infrastructure by using almost any conceivable tax except for the ad valorem property tax. The special taxing district device has served as a model for other states to off-load facility costs from property taxes. See Petersen (2002).

This displacement phenomenon is most evident in the explosion of gated communities with their "homeowners' associations." These now involve about 18 percent of the population and are especially important in the most recent additions to the housing stock. In 1970, only 1 percent of the population lived in association-governed communities. But between 1980 and 2000, such developments represented fully half of all new housing built in the United States (Nelson 2005). They are increasing the most in the fastest-growing regions of the South and West and are clearly the wave of the future. The important aspect here is that the associations charge fees to supply services that have historically been supported by the property tax (security, sanitation, recreation, local streets) and are almost universally associated with single-family and condominium development. Therefore, as in the case of alternative sources of revenue, a displacement effect is at work. For a growing number of homeowners, association fees and charges are a substitute for property taxes. Casual observation places these fees at 1 to 2 percent of property value per year—roughly equal to the property tax. As de facto local governments themselves, associations are not coincidentally a major factor in holding down conventional government property taxes.[10] If the needed locational data were available, this displacement effect could be examined as well.

Should apartments pay higher rates?

As Goodman points out, his results have implications for the smart growth regional development and land use debate, not to mention future housing, environmental, and energy policies. If we, as a matter of policy (even if it is local) are taxing apartment dwellings more heavily (even inadvertently), we are in effect promoting space-extensive development and thwarting the aims of smart growth. We are not only handicapping growth policies; we are also discriminating against lower-income households in the bargain, shifting more of the tax burden onto them. But might it be the case that apartment dwellers tend to reside in higher-cost, more urbanized jurisdictions and that the supposed economies of compactness are offset by the costs of agglomeration? And what about the time-honored tradition of consumer choice and the efficiencies that flow from allowing the consumer to vote with a moving van?

Disentangling the costs versus benefits of higher-density development where apartments are more likely to be located is difficult. There have been comprehensive studies of the effects of the rate of growth and density on spend-

[10] The growth has been particularly spectacular in California and the Southwest, and associations are seen as a major political force ("secessionist utopias") that is decidedly antigovernment in its politics. See Micklethwait and Wooldridge (2004, 381).

ing at the local level and on taxes. For example, Ladd (1992) found that increasing population density initially lowered the costs of providing public services, but that overall there was a U-shaped relationship between spending and density. Once an area became substantially populated, higher density was typically associated with increased public sector spending (Ladd 1992). Other studies have found similar results, although there are no definitive answers.[11] The decidedly mixed results regarding the effects of increasing density on local costs seem at odds with the smart growth paradigm, which favors promoting more intensive use of already urbanized land for future growth. That paradigm envisages compact, transit-friendly clustered and mixed-use development at a variety of densities, ranging from rural to highly urban. But for already developed areas, the high-density die is largely cast, and the high costs of retrofitting regions to the new vision and the localized nature of land use decisions thwart attempts at change.

The effects of population growth and increasing densification are only one side of the coin: What happens when areas shrink? Then, an older urban core (with its disproportionate number of apartment dwellers) finds itself in prolonged decline while the surrounding suburbs are booming. This has been a long-term phenomenon in much of the country. Bradbury, Downs, and Small, for example, in examining the issue of city shrinkage 20 years ago, summed up the impact neatly:

> [T]otal costs for many local government services do not fall proportionally as a city's population declines. Thus, per capita costs for the remaining residents rise. In addition, if the local tax structure is progressive, out-migration of high- and middle-income people raises per capita taxes for all remaining residents. Furthermore, the cost of providing some city services varies inversely with residents' incomes. Hence, the departure of high- and middle-income households causes per capita service costs to rise, and taxes to rise even more. These changes are likely to create or increase a disparity between household tax burdens within the city and those in the surrounding suburbs. Higher tax disparities generate greater suburbanization of population. (1982, 205)

[11] For example, the American Farmland Trust (2002) analysis of a large number of jurisdictions indicates that increasing residential density increases costs. The Commonwealth of Virginia, Joint Legislative Audit and Review Commission (2002) found that population density in Virginia jurisdictions was highly correlated with increased per capita local expenditures on public safety, public works, and health and welfare. However, studies in Massachusetts found that higher-growth communities experienced lower rates of growth in per capita municipal spending (Nakosteen and Palma 2003). See Holzheimer (2005) for a review of the literature on the fiscal impact of various definitions of density.

Tax burdens may not be the only motivator, but this diagnosis continues to ring true: New growth has been focused in the outer fringes, away from the costs and concerns of the inner city and close-in suburbs.

Developer finance: exactions and contributions

The property tax used to have higher effective rates than it does now because it once paid the freight for most public infrastructure, among other things. At one time, most of the infrastructure related to property development was paid for by local taxes, which funded publicly owned capital facilities. As jurisdictions grew, the added infrastructure was paid for by increased indebtedness and services were financed through annual budgets. The increasing costs of development, compounded by the factors described earlier, led local governments to seek new ways to pay for the facilities and services previously supported by the property tax. One manifestation of this shift has been the increasing reliance on development exactions and contributions.[12]

Exactions are requirements placed on a land developer to pay for (or to provide) the public facilities required by new residents and businesses. Altshuler and Gomez-Ibanez noted the tidal growth in exactions a decade ago: "Since the mid-1970s there has been an exaction revolution....[T]he number of communities relying on exactions, the range of purposes for which they are considered appropriate, and the dollar magnitudes have expanded exponentially" (1993, 8).

Exactions represented an epochal shift in attitude toward land development. They shifted the burden of paying for new infrastructure from the local budget to the developers and new residents responsible for growth. In other words, those added costs borne by developers are capitalized in the form of housing prices.

However, exactions have their limitations. They usually require a clear nexus between the impact of new development and the required improvements. Thus, there has been a trend toward more flexible, negotiated development agreements where the nexus test is much less stringent. Negotiated agreements are now commonplace in the major developments where most new housing is built.[13] Many aspects of development, including infrastructure, facil-

[12] There is an array of financing devices that attempt to have development pay its own way and not burden the property tax. See Petersen (2002) for a description and analysis. To the degree that these are used, they relieve the property tax of its traditional role by substituting other funding mechanisms.

[13] The housing construction business has become increasingly corporatized and is dominated by large publicly held builders that assemble large tracts and build units to order. About 70 percent of all new housing is built by 7 percent of home building firms.

ities, and operating expenses, are covered by complex agreements under which developers provide both on- and off-site improvements or make contributions toward future improvements in return for approval of their plans. Since the proposed density of new development is usually beyond what is allowable, virtually everything is negotiable. Beyond the mitigation of direct impacts, development agreements may provide for annual payments for such public services as fire protection or libraries. Many of the improvements and contributions are never captured in the local government budget, nor do they appear on any public balance sheet.

Fiscal zoning and fiscal impact analysis

Hanging public price tags on land use decisions has had a far-reaching impact on new development. The development of multifamily apartments has no doubt been thwarted by the standard fiscal impact analysis applied by many jurisdictions when considering land use planning and rezoning. This is because apartments have a relatively low value per housing unit that makes them less desirable than higher-value single-family dwellings and commercial development. It is not uncommon to find noneducation costs per household in multifamily housing to be about the same as those for higher-value single-family units, but much less local revenue can be collected from multifamily housing because property values (and associated household incomes) are lower.[14] Thus, the fiscal zoning imperative moves jurisdictions in the direction of restricting the supply of new apartments in rapidly growing suburban areas.[15] Also, localities may themselves provide inducements for fiscally desirable development by offering value-capture financing techniques that extend de facto taxing and fee powers to developers to help them cover the costs of new development.[16]

[14] Where the locality is highly dependent on the property tax, the fiscal impact hierarchy tends to run from industrial and commercial as being the most beneficial (the services they consume cost less than the revenues they generate) down to residential (with the opposite result). From the local government's perspective, multifamily residential is typically calculated as the most costly form of land use. See, for example, Burchell and Listokin (1985).

[15] Although apartments usually generate fewer school children per housing unit, those children are more likely to attend public schools. Furthermore, state transfers (which are peculiarly important in public education finance) tend to reduce the impact of school spending on many local budgets. For noneducation services, for which those general units of government are responsible, the fiscal costs of lower-value residential development are probably more pronounced.

[16] See Petersen (2002). Developments with positive fiscal benefits are often targeted for assistance.

Conclusion

This discussion has attempted to place in context, explain to some degree, and signal the significance of Goodman's results. It could be that the results simply register the inchoate stirrings of a vast number of local real estate markets and that after a while, tax burdens for apartment properties and single-family dwellings will snap back toward equality. But I do not think so. Rather, I believe that the trends Goodman has uncovered are important and sustained and that if the data were up to it, the causes could be measured. A new perspective on local government and how it is to be financed is surfacing. The property tax—at least as collected by traditional government—will continue to wane as new self-contained and self-financing communities are formed. Older cities and regions will continue to finance services in traditional ways, but the generally more affluent, economically homogeneous, and politically powerful newcomers in growing areas will parse down the menu of publicly provided services and their associated tax burdens. With huge investments in their housing stock, the newcomers will seek to preserve those values and elected politicians devoted to their cause. This may result in decreasing the level and quality of local services for those unable to acquire them privately.

There seems to be little reason to think that the movement toward more private provision of government services via associations, fiscally based land use decisions, use of alternative revenue sources, and more de facto exclusionary rezoning will abate in the future. These policies, which are congruent with free consumer choice in the market economy, will likely continue to militate against urban agglomerations that feature a full range of housing opportunities over the income range. A byproduct will be that lower-income housing, including apartments with lower unit values, will pay an increasing share of local service costs because the opportunities to cross-subsidize among land uses at the local level are disappearing. Not surprisingly, this will lead to higher local tax rates in slower-growing, more densely settled older areas that retain the traditional pattern of government service delivery. Over time, the adjustment process will force down tax rates (and services) until they are consistent with the local population's ability to pay. Tiebout would approve the process, if not necessarily the outcome.[17]

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[17] See Teibout (1956) for the classic explanation of the dynamics of intergovernment fiscal competition.

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