

## Chapter 20: Property Taxes

On average each of us pays \$783 per year in property taxes.<sup>133</sup> Property taxes are assessed in all 50 states and account for 73% of local government revenue. Property taxes pay for vital services such as schools, local road construction and maintenance, police, fire, and other emergency services, libraries, water and sewer, and a host of other services provided primarily by local government.

An increase in new home construction can cause property taxes to increase for several reasons. When people migrate from cities and suburbs to rural areas they frequently bring with them an expectation of receiving the same level of public services to which they are accustomed. They new residents begin lobbying local government to increase emergency services response time, expand libraries, and so forth. To meet this demand local government may be forced to raise property tax rates.

There are marked differences in the amount of tax revenue generated and consumed by various land uses. Most studies divide land uses into three categories when analyzing these *fiscal* impacts: farm/forest/open space, commercial/industrial and residential land. Generally, the cost of government services provided to residential areas exceeds the amount of tax revenue paid by home- and rental unit- owners. Commercial and rural lands pay more in taxes than occupants consumed in services; so both uses are a net generators of revenue. A review of 70 cost of government services studies showed that for each dollar of tax revenue generated the three land use categories consumed the following amounts in government services: residential \$1.15, commercial/industrial \$0.29, and farm/forest/open space \$0.37.<sup>134</sup>

Jurisdictions where residential property taxes are lowest are generally those with a relatively large amount of commercial and industrial development within their boundaries. If the amount of new commercial/industrial development declines and new residential growth makes up an increasingly larger percentage of total building, then government may be forced to raise taxes to maintain services such as schools and police/fire protection at accustomed levels.

But an increase in commercial/industrial growth can also result in homeowners paying more in property taxes. A New Hampshire study showed that as commercial development increased relative to residential growth so did the amount of property tax paid by town residents.<sup>135</sup> The author

---

<sup>133</sup> Source: The Tax Foundation Special Report on State & Local Taxes available for download from <http://taxfoundation.org/sr106.pdf>

<sup>134</sup> The 70 studies were reviewed in *The Economic Costs of Development for Local Governments* available for download at: <http://www.forestry.uga.edu/warnell/pdf/cfb/EcCost.pdf>

<sup>135</sup> See *Commercial Development and Its Effect on the Tax Rate*, by Kurt Gotthardt, which is available for download from the New Hampshire Office of Energy & Planning Reference Library website at: <http://nh.gov/oep/resource/library/referencelibrary/o/openspace/>

theorized that as commercial development increases, house prices are driven up by the larger number of people competing for homes so they can live near their place of work. Since property tax bills are based upon the assessed value of a home, an increase in value raises the total amount of property taxes paid by the owner. While many homeowners might relish steadily increasing property value, the poor and those on fixed incomes may have more and more difficulty making ends meet as property taxes rise ever higher. Presumably, the impact of increasing housing demand could be prevented if new residential construction kept pace with commercial development.

### **IMPACT FEES**

As an area continues to grow local government is forced to repeatedly raise property taxes to provide the infrastructure (schools, roads, water-sewer, etc.) essential to growth. Continuing property tax increases become unpopular very quickly. Local elected officials must choose between the third rail of another property tax increase, foregoing infrastructure expansion, or cutting back on other services.

*Impact fees* emerged in the 1970s as an alternative to these three undesirable choices. An impact fee is set at the cost to expand infrastructure to accommodate each new home. For example, Prince George's County, MD charges developers \$7,000 for each new suburban home and \$12,000 per rural home. This about covers the cost of expanding schools to accommodate the new students added by each home.

As of 2002, 22 states had passed the enabling legislation required to institute impact fees.<sup>136</sup> However, impact fees have met with a fair amount of resistance. Usually the resistance comes from those who wish to sell their land for development and the development companies who wish to acquire more land.

Opponents argue that impact fees stifle economic growth and reduce the supply of affordable housing. But an analysis prepared by the Brookings Institution Center on Urban and Metropolitan Policy showed impact fees have either a neutral or positive effect upon economic growth, as measured by new jobs added.<sup>137</sup>

As stated previously, in the absence of impact fees local government may refrain from expanding the infrastructure required to accommodate new growth, especially if this means another property tax increase. Impact fees resolve this issue by providing a large portion of the additional funds

---

<sup>136</sup> See *Paying for Prosperity: Impact Fees and Job Growth*, The Brookings Institution, available for viewing at: <http://www.brookings.edu/es/urban/publications/nelsonimpactfees.htm>

<sup>137</sup> See *Paying for Prosperity: Impact Fees and Job Growth*, The Brookings Institution, available for viewing at: <http://www.brookings.edu/es/urban/publications/nelsonimpactfees.htm>

required to expand infrastructure without increasing property taxes. The Brookings Institution analysis examined economic development (job growth) in the 67 counties of Florida. The authors found that impact fees either had no effect on job growth or the counties with impact fees added more jobs during the study period (1993-1999) when compared with areas lacking impact fees.

With respect to the effect of impact fees on housing affordability, the Brookings Institution report cited research showing that impact fees tend to reduce the amount paid by development companies to purchase land and about half the fee gets passed on to the home buyer. Of course, this does increase the cost of a new home but by making more land available for development in a more reliable fashion impact fees may increase the supply of housing and lower areawide housing prices.

### **PROPERTY TAX & SPRAWL**

A number of researchers believe that the most widespread method of assessing taxes is in part responsible for sprawl. The problem stems from assessing land and buildings the same for property tax purposes. If land were taxed at a significantly higher rate than buildings, a strong incentive would exist to put as much density as possible on each acre. In urban areas the traditional approach to property taxes adds an unintended incentive to allow buildings to deteriorate. In other words, the more improvements one makes to an urban building, the higher the value of the building and the more taxes to be paid. Some localities have offset this effect by using a split-rate property tax in which buildings are assessed at a much lower rate than land. These localities have found that the split-rate tax acts as an incentive to compact infill development.<sup>138</sup>

---

<sup>138</sup> Further detail on the split-rate tax is available at the Sustainable USA Org website:  
<http://www.sustainableusa.org/>