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Ulbrich: Objections to point-of-sale defy economics

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Guest Columnist

The argument being put forth for a plan to tax newly sold property based on an artificially low value rather than the value at which it is sold relies mostly on equity, or fairness. But this equity argument for repealing point-of-sale reassessment shows a fundamental lack of understanding of the economics of the real estate market.

Consider a simple example. Suppose you own an apartment complex assessed at $2 million. The property is taxed based on 6 percent of the value, or $120,000. If the property tax rate is 250 mills (about the state average), the current tax bill is $30,000. Now, if you sell it for $2.8 million, the assessment will increase to $168,000 and taxes to $42,000. Furthermore, taxes will remain that high. Everyone involved in this debate agrees about these facts.

Here's where the disagreement starts.

Realtors argue that reassessment at point of sale means that deals don't happen. But for that to be true, it would mean that real estate prices do not adjust to reflect future property tax obligations. That's hard to believe.

Here's what really happens. A tax increase makes the property less valuable, so the buyer demands a lower price to compensate for the tax increase. The fair sale price would drop to, say, $2.5 million. The seller gets a smaller capital gain, and the buyer gets a lower purchase price to offset higher tax liability.

Where is the unfairness to the seller, or buyer? We have a 15 percent cap on the taxable value a property can increase every five years unless it's sold. As long as the owner doesn't sell, he pays taxes on less than the market value of the property. If the property is not sold, the assessed property value will go up to no more than $2.3 million at the next reassessment, and taxes will increase to a maximum of $34,500. The owner enjoys a deferral of the rest of the tax increase. Local government will never recoup those lost tax revenues. The obligation to pay for local government is shifted to other property in the form of either higher mill rates or reduced public services. Even if the owner sells the property at a lower price because of reassessment at point of sale, he still gets a capital gain, but only $500,000 instead of $800,000.

Proponents of the bill to let new buyers keep this artificially low assessment, H. 3272, also argue that since property that is sold will pay more taxes than a similar property that is not sold, reassessment at point of sale discourages sales of existing properties. But if the value of the property has increased by more than 15 percent over five years, eventually the owner will want to sell and reap that gain, even if it is reduced by reassessment.

If the owner doesn't sell, it doesn't affect anyone other than real estate agents, who see fewer transactions; no jobs are created or lost either way. But what about new construction? If construction costs are rising, a similar newly constructed apartment complex would be assessed at $2.8 million or more. So while the assessment cap may discourage sales of existing properties, the lack of reassessment to market value at point of sale could discourage new construction. Unlike turnover of existing properties, new construction creates jobs.

The problem is not reassessment at point of sale but the assessment cap itself, as other states with assessment caps have learned. Assessment caps create inequities in tax liabilities between property that is sold and reassessed at market value and property that is not sold. Assessment caps were promoted as a way to protect property owners from being forced to sell their property because of increased property taxes due to rapidly rising market value. But reassessment at market value just reduces the amount of capital gain when the owner does finally sell the property.

If we want to protect property owners from forced sales because of higher property taxes, we can follow the example of other states that offer income tax rebates for property taxes in excess of a certain percent of income. That policy targets those in need of relief while the rest of us pay our fair share of the cost of providing public services, based on the value of property we own.

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