City of Portland Issue Brief: Property Tax Compression and its Impact on General Fund Property Taxes

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Office of Management and Finance

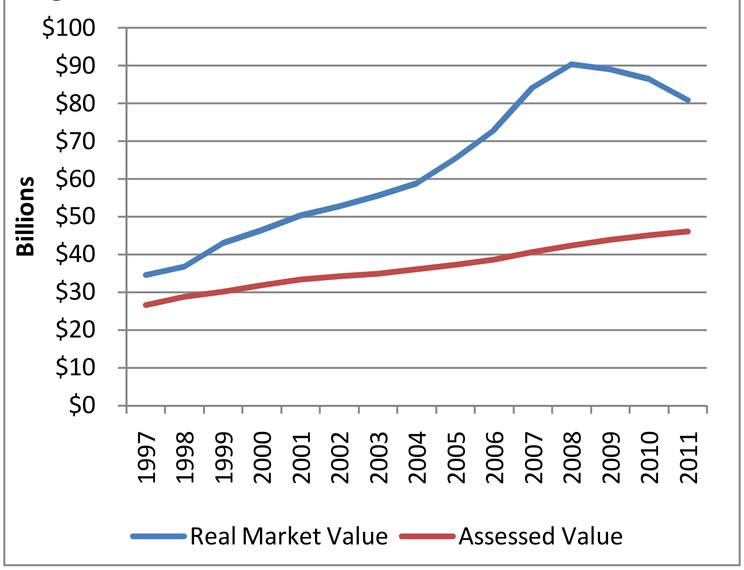
Issue: For the first time since Oregon voters passed two property tax limitation ballot measures in the 1990s real estate prices have dropped dramatically. This interaction has de-stabilized a historically growing revenue source for the City of Portland through what is known as property tax compression. This document describes how property tax compression occurs and why it is beginning to have a significant impact on the City's General Fund property tax collections.[1]

Background: Prior to the passages of Measures 5 and 50 in the 1990s, which put limits on the amount of tax each property could pay (Measure 5) and value upon which the tax would be assessed (Measure 50), property tax bills were calculated by multiplying the value of the home times the tax rates (expressed as $X of tax per $1,000 of value) from all of the jurisdictions in which the property resided. Now there are three components to a property tax bill that determine the amount of property taxes paid – real market value (RMV), assessed value (AV), and tax rates.

Real Market Value – This is essentially what people think of when describing the value of their house – that is, for what one might reasonably expect to sell the property. Measure 5 limits are applied to RMV. Under Measure 5, no property can be subject to a tax of more than $10/$1,000 of value for general government (e.g., county, city, water district, etc.) or $5/$1,000 of value for schools. Note that both limits are exclusive of voter-approved general obligation bonds.

Assessed Value – The assessed value is the taxable value of the property. The distinction between assessed value and real market value was needed following the adoption of Measure 50. A provision of Measure 50 "rolled back" taxable property values to 1995 levels (for FY 1997-98) and established that they could grow by no more than 3% per year. The result was a distinction between the RMV and AV for most property (particularly single family homes). During the housing boom over the following decade, a large "gap" was created between RMV and AV, as illustrated in the figure to the right.

Figure 1. RMV & AV Since Measure 50



Tax Rates – There are two types of tax rates that are pertinent to compressions discussions – permanent rates and local option levies. This distinction is important because local option levies, which are voter-approved five-year renewable levies, like the City's Children's Levy, get compressed first on tax bills that would be over the Measure 5 limits. As an example, the Children's Levy has roughly 40% of its taxes compressed away, while the General Fund "loses" only 5%.

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[1] Please note that for simplicity purposes most of this document will be narrowly focused on the impacts to the City of Portland, particularly its General Fund. Impacts to other jurisdictions or other types of governments, such as schools, can vary widely.

How Compression Occurs: There are at least two important factors related to compression impacts. First, compression occurs on a property-by-property basis, so analyses based on broader geographies (e.g., citywide) can sometimes be misleading. For example, it matters not just that RMVs decline, but specifically *where* these declines occur. Second, taxes are determined by the AV, but the limit is determined by RMV. The table below attempts to illustrate this concept using actual property assessments from tax year 2010. Again, the real market value is the amount you could sell the house for on January 1, 2010, and the assessed value is the 1995 value increased by 3% per year, adjusted for improvements (i.e., remodeling). For the properties below, the City would collect its full levy amount from Houses #1, #2, and #3 – though House #3 would see their local option levies compress somewhat. The City, along with governments also levying permanent rates would only see a portion of its levy amount from House #4. None of House #4's tax bill would go to local option levies because they would be fully compressed under this scenario.

Table 1. Actual RMV & AV of Selected Portland Homes (2010 Assessments)

	RMV	AV	AV/RMV Ratio	Extended Gen. Gov. Tax*	Measure 5 Limit	Local Option Levy Compression Loss	Permanent Levy Compression Loss	Total Compression Loss
House #1	$300,450	$115,430	38%	$1,616	$3,005	$0	$0	$0
House #2	$300,020	$164,080	55%	$2,297	$3,000	$0	$0	$0
House #3	$300,310	$218,800	73%	$3,063	$3,003	($60)	$0	($60)
House #4	$300,220	$251,130	84%	$3,516	$3,002	($377)	($137)	($514)

*Assumes total general government tax rate of $14/$1,000 of value, comprised of $1.50 of local option levies and $12.50 of permanent levies.

How Compression Impacts Tax Collection Growth: AV will grow by 3% annually for most properties because the vast majority of properties in Portland have an AV much lower than the RMV. Without compression, this would translate to a simple 3% increase in property taxes for the City. However, for a property that is in compression, taxes paid (and thus received by local governments) will not increase unless the property's RMV increases. Using the same four houses as in Table 1, Table 2 shows what would happen to their property taxes if each house saw an 8% decline in RMV in the following year. Note that even though AV went up by 3% on each property, total tax payments to the City[2] actually declined. While we do not expect actual collections to decline in the near future, the phenomenon shown in Table 2 will reduce growth in collections to something less than 3% for several years.

Table 2. Property Tax Compression Impact on Tax Growth (assumes AV +3%, RMV -8%)

	RMV	AV	AV/RMV Ratio	Impose Gen. Gov. Tax[2]	Measure 5 Limit	Amount to City "Last" Year (Table 1)[2]	Amount to City "This" Year	Percent Growth
House #1	$276,414	$118,893	43%	$1,665	$2,764	$528	$544	3.0%
House #2	$276,018	$169,002	61%	$2,366	$2,760	$751	$774	3.0%
House #3	$276,285	$225,364	82%	$3,155	$2,763	$1,001	$1,012	1.0%
House #4	$276,202	$258,664	94%	$3,621	$2,762	$1,099	$1,011	-8.0%
Total						***$3,380***	***$3,341***	***-1.2%***

For more information please contact: Josh Harwood, City Economist, 503-823-6954, Josh.Harwood@portlandoregon.gov

[2] Assumes current General Fund Levy of $4.577/$1,000 value, and total General Government Levies of $1.50/$1,000 for local option levies and $12.50/$1,000.