



Working for Smarter Growth:
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Chasing Their Tails: Municipal “Ratables Chase” Doesn’t Necessarily Pay

By Tim Evans
Research Director

Conventional wisdom among municipal leaders says that the key to keeping property tax rates down is to discourage residential development – particularly housing likely to attract families with children – while courting large non-residential projects like office parks, shopping malls, or hotels. This practice is commonly referred to as the “ratables chase” – whereby towns chase after high-value taxable, or “ratable,” properties.

The motivating concern is that the property tax revenues generated by residential development are not going to cover the costs of extending infrastructure and government services to the new residents of the project, especially the costs of educating any new school children who move in. (Public education is by far the largest component of local government spending in New Jersey and nationwide.) Conversely, it is believed that commercial properties generate a lot of property tax revenue without a high level of demand for services and, most significantly, no demand for public education (kids don’t live in office buildings).

This argument is compelling not only at the conceptual level, but at the quantitative level as well. Consider that New Jersey spends more than \$16,000 per pupil on public education annually,¹

while even our highest-in-the-nation median real estate tax bill – which pays for other things besides schools – comes to “only” about \$6,300,² a fraction of what it would cost to educate even one child living in that house. This disparity does not necessarily represent conclusive proof that residential development doesn’t pay for itself, since funding for schools derives from a variety of sources, including state aid. But it does hint at why non-residential properties are so much more attractive to municipal leaders from a fiscal standpoint.

But does it play out this way in reality? Do municipalities with the highest concentrations of commercial properties also tend to have the lowest tax rates? It turns out this is actually a testable question.

Using data compiled by the *New Jersey Legislative District Data Book*, it is possible to compare a municipality’s equalized property tax rate (adjusted to reflect true market values)³ with the percent of the municipality’s total tax base that is comprised of non-residential property.⁴ If the assumption is correct – that pursuing non-residential development while discouraging residential is the key to low property taxes – we should see municipalities with higher non-

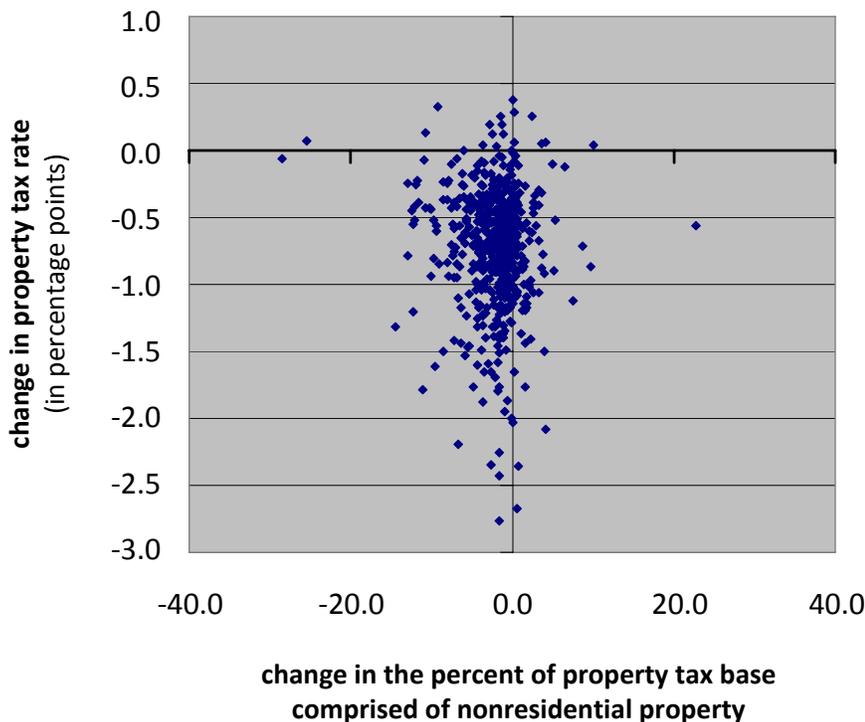
residential percentages also having lower property tax rates, and vice versa. More precisely, we will look first at longitudinal data – the *change* over time in the non-residential proportion of the tax base, compared to the *change* over time in the equalized property tax rate – to see whether it appears that pursuing this strategy over time actually tended to result in improvements in the tax rate.

Figure 1 shows the change in the municipal equalized property tax rate plotted against the change in the percent of the property tax base that is composed of non-residential property for all 566 New Jersey municipalities from 1998 to 2006. Surprisingly, there is no sign of the downward-sloping line that would occur if increasing the non-residential proportion of the tax base really were associated with decreasing the tax rate. The few municipalities that increased their non-residential share did generally see their tax rates go down, but not systematically any faster than their neighbors. What we *can* take away from this chart is that most municipalities saw their tax bases become more residential over this period (the changes in the non-residential percentages are mostly negative) while also seeing their tax rates decline (with a median change over all municipalities of -0.69 percentage points), counter to the conventional wisdom. Clearly, property tax rates can decrease for a variety of reasons, even when property tax bases are generally becoming more heavily residential, not less.

These data appear to contradict the notion that striving to increase the non-residential component of the municipal tax base will automatically lead to outperforming other municipalities in terms of keeping property taxes down. But what about municipalities that already have an abundance of non-residential property? Do they tend to have lower tax rates than other municipalities, as the conventional wisdom would suggest?

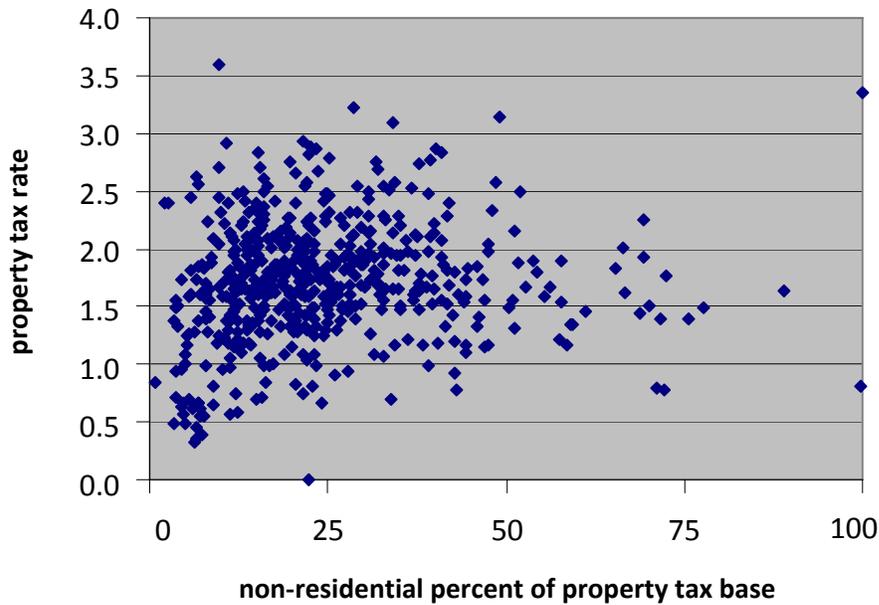
Figure 2 (page 3) plots 2006 equalized property tax rates against the 2006 percent of the municipal property tax base comprised of non-residential property. As with the trend data shown in Figure 1, the expected relationship fails to materialize: the data points do not appear to follow any sort of downward-sloping pattern that would indicate property taxes decreasing as the non-residential

Figure 1. Change in Property Tax Rate vs. Change in Non-Residential Percentage of Total Property Tax Base, 1998 to 2006



While most municipalities saw their property tax rates decline between 1998 and 2006, there is no evidence that they systematically declined any faster among municipalities that increased the non-residential proportion of their tax base over the same time period.

Figure 2. Equalized Property Tax Rate vs. Non-Residential Percentage of Total Property Tax Base, 2006



There is no clear indication that a high proportion of non-residential property in a municipality's tax base necessarily leads to a lower-than-average property tax rate. Conversely, plenty of municipalities illustrate that a low tax rate is possible even with very little commercial property.

All of this calls into question the wisdom of engaging in the ratables chase in the first place. On paper it would seem a canny fiscal strategy for a municipality to pursue high-revenue, low-service-cost retail, office and industrial development while trying to discourage family-friendly housing and the demand for public school expenditures that it generates. In practice, the evidence is at best inconclusive that such a strategy actually works.

Perhaps this is because some of the municipal leaders who are most successful at wooing non-residential development choose to spend the revenue on

percent of the tax base increases. Of special interest is a cluster of data points at the lower left of the chart, corresponding to municipalities with particularly low non-residential percentages but also particularly low tax rates, further confounding the conventional wisdom. Upon inspection, these turn out to be shore-area municipalities, whose tax bases are indeed predominantly residential, but consist largely of a unique type of residential property: vacation homes that are empty most of the year and therefore don't generate school children (or many other year-round expenses, for that matter). Hence the lower tax rates.

Still, even ignoring the anomaly of the shore towns, a tax base skewed heavily toward non-residential property does not appear to be a prerequisite for lower property tax rates, as there are plenty of towns with low tax rates that have heavily residential tax bases.

additional services and amenities rather than passing the savings along to residents in the form of lower taxes. Perhaps local governments are so diverse in the range of services they choose to spend money on that the variation among them is enough to swamp any small effect that the ratables chase might be having when the data are compared across all municipalities. Perhaps in the contest to attract commercial properties, the price of "winning" involves essentially giving away the store via extensive tax breaks, thereby neutralizing the fiscal advantage those properties are theoretically supposed to bestow.

Whatever the reason, any municipality that thinks the secret to beating its neighbors at the property tax game is to score the next office park or shopping mall should probably take a look at the data first. As far as the race for non-residential property goes, the conventional wisdom is simply not supported by the evidence.

Endnotes:

¹ U.S. Census Bureau, Public Education Finances, 2008.

² U.S. Census Bureau, American Community Survey, 2008.

³ The equalization process seeks to measure the relationship of locally assessed values to an ever-changing real estate market. By applying a weighting factor to the assessed values, based on recent market transactions, it helps to better reflect real-world values. Computing the tax levy as a fraction of this equalized property tax base then yields an estimate of the “true” property tax rate for the municipality – that is, an average property tax bill as a percent of what the property is actually worth, rather than the value at which it is nominally assessed. This allows for comparison of “true” tax rates across municipalities, a comparison that would otherwise be inhibited by differences in municipal reassessment schedules and practices.

⁴ A major limitation of this data is that corporately-owned rental housing complexes (as distinct from one- or two-family dwellings that are owned by individuals but are rented to tenants) are treated as commercial properties and are thereby included in this analysis as part of the non-residential property tax base. This is due to the fact that for tax purposes, apartment buildings are income-generating properties owned by businesses, just like any other commercial property, although from a fiscal perspective they are certainly not viewed the same by their host municipalities. Still, this is not a fatal flaw for this comparison. Municipalities having a disproportionate share of office or retail development will still rank near the top of the list in terms of the non-residential percent of their tax base, even if they have to share space with a few “false positives,” municipalities with an unusually high proportion of rental housing whose “clean” (i.e. non-school-child-generating) commercial tax bases are thus somewhat overstated by this statistic. As long as the false positives are distributed evenly over the full range of municipalities in terms of the residential/non-residential composition of the balance of the tax base (and a more in-depth analysis could check this assumption), they will tend to dampen but not entirely mask