The Impact of Declining Residential Property Values at Reappraisal and Triennial Update

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Real property in Ohio is taxed based on the property's value as assessed by the county auditor. Under state law and Ohio Department of Taxation rules, real property in all counties is reappraised at 100 percent of market value every six years and updated the third year after each reappraisal. Reappraisal and update are tools to help ensure accurate taxation of real property. At reappraisal, a visual inspection is made of all property. At triennial update, sales ratios based on property transactions during the three preceding years are studied. Counties are divided into three groups and undergo reappraisal or update on a rotating basis. In 2011, the largest group of counties, 28, will undergo reappraisal and 13 will undergo update. In times of inflation, reappraisal and update regularly resulted in higher property values and moderately increased tax revenues; under current real estate conditions, values may have to be lowered.

The Mechanics of Update & Reappraisal

The Department of Taxation oversees the update and reappraisal process to ensure that taxable values[1] are properly reflective of market values. To compare values, we calculate sales ratios comparing assessed value and recent sale prices. We use these ratios as a benchmark of how closely the values listed for tax purposes may or may not be tracking the real estate market. The department uses sales ratios to analyze both reappraisal and update valuation changes.

Department of Taxation staff in the Division of Tax Equalization collects conveyance forms for each real estate transaction in each county in Ohio. Using information on the form, our examiners determine whether or not each sale was an "arm's length transaction" that would be useful as a measure of value; an "arm's length transaction" is a sale by a willing seller to a willing buyer with neither party under compulsion or duress to participate in the transaction, and with both parties fully aware of all the potential legal uses of the property. Excluded sales include transactions between family members, foreclosures, sheriff sales, and bank sales. This practice meets the standards of the International Association of Assessing Officers (IAAO) and Ohio law.

Qualifying sales for the three years prior to the update year are included in the study; sales from 2008, 2009, and 2010 are used for counties going through update in 2011. Changes in 2011 updates and reappraisals will impact 2012 tax revenues.

Sales ratios are calculated by dividing the appraised market value of the transferred properties by the sales prices paid for those properties. Appraised value by taxing district is reported to the Department by county auditors. Separate sales ratios are calculated for residential, agricultural, commercial, and industrial property. The resulting ratios show the value for tax purposes as a percent of sales price for each class of property. The lower the ratio, the greater

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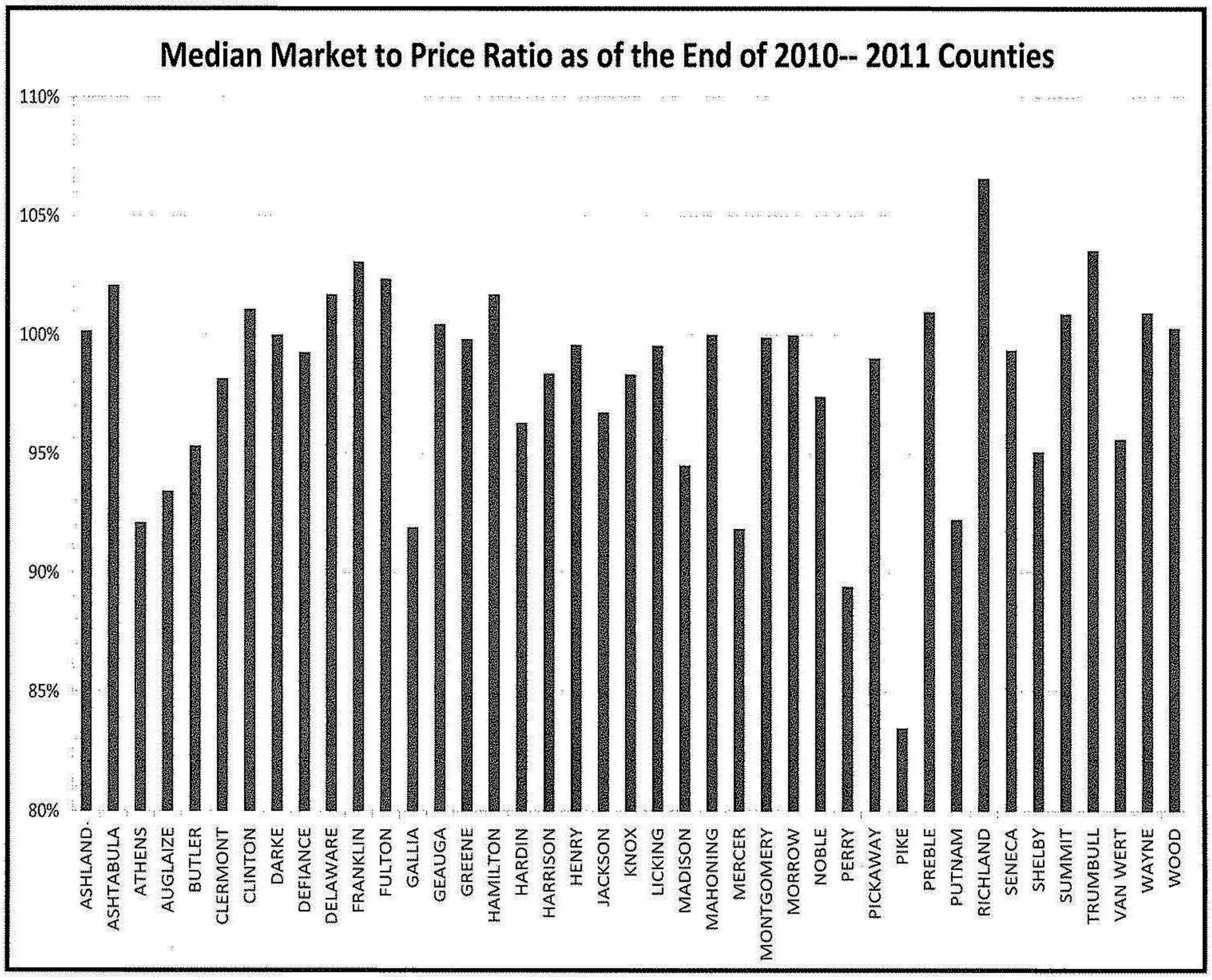
is the amount by which the sales price of the property exceeds its reappraised or updated value. Under guidelines established by the IAAO, the final ratios should be between 90 and 110 percent for taxable values to best reflect actual market conditions. Exhibit 1 displays the residential sales ratio for counties undergoing reappraisal in 2011.

Understanding Sales Ratios

Historically, when a county is coming up for reappraisal or triennial update, the value to price ratio has been in the low to mid-80 percent range, so the county must raise values to bring that ratio above 90 per-

[1]Forest land devoted exclusively to forestry or timber and qualifying commercial agricultural property is not taxed according to value.

Exhibit 1.



cent and into the acceptable range for the county auditor's value to reflect true market value. Under current real estate market conditions, in areas where the ratio is approaching or has exceeded 100 percent, values may have to be lowered. Exhibit 1 shows the sales ratio for residential property in 2011 update counties; the majority of counties will need to lower values to bring the ratio into a moderate position within the compliance range. A handful of counties, including Shelby and Auglaize, will need no adjustment. In 2011, Pike and Perry should experience an increase in assessed value to bring the sales ratio into compliance.

In counties where overall property values are declining, the decline in valuation will result in a reduction in property taxes charged and collected for the year following valuation or reappraisal. For example, Summit County will complete reappraisal in 2011; taxpayers in Summit County will pay taxes on the updated values in 2012. Should property values increase consistently in 2011, 2012, and 2013, revenue on such increased values would not be collected until 2015, after the 2014 update.

Residential property sales prices began reflecting a consistent recessionary trend beginning in 2007. Sales data from 2010 reflects that housing prices continue to decline. Furthermore, the number of qualifying residential sales has continued to decline, e.g., the quantity of sales decreased by 10 percent from 2009 to 2010. The decline in the volume of sales does not directly impact values, however it is a sign of a weakening real estate market. The majority of counties up for reappraisal in 2012 will see further reductions in residential value.

Counties undergo reappraisal and update on a rotating schedule. This makes it difficult to make broad comparisons across counties. In general, the counties most impacted in terms of residential property valuation loss are the large, urban counties with distressed economies, e.g., Lucas, Summit, Cuyahoga, and Mont-

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gomery counties. Counties that experienced significant and rapid growth in the early 2000's are now experiencing greater declines in value. Table 2 compares three very different counties: Montgomery, Pike, and Delaware. The median residential sale price in Montgomery County has increased in the past five years; however the number of annual sales has decreased by nearly 60 percent since 2005. Rural Pike County has also experienced a significant decline in the number of annual sales. Delaware County experienced significant residential growth early in the decade; the number of home sales in Delaware County has decreased, but not as drastically as in Montgomery and Pike Counties. Furthermore, the median sales price in Delaware County has not been dramatically reduced.

> ***"Updates and reappraisals play an important role for counties preparing budget and long term financial forecasts."***

Table 1. Comparing Median Sales Ratios

	Montgomery County			Pike County			Delaware County		
Year	Number of Sales	Median Sales Price	Median Appraised Market to Sales Price Ration	Number of Sales	Median Sales Price	Median Appraised Market to Sales Price Ration	Number of Sales	Median Sales Price	Median Appraised Market to Sales Price Ration
2005	7,137	$109,900	89.70%	187	$82,000	80.10%	2,077	$223,500	96.49%
2006	7,055	$112,900	89.09%	166	$82,000	80.06%	2,018	$227,000	95.22%
2007	5,414	$113,000	90.54%	140	$80,000	79.02%	2,000	$226,000	96.79%
2008	3,865	$119,000	93.28%	124	$85,000	90.39%	1,829	$234,900	98.08%
2009	3,412	$117,300	97.28%	117	$79,000	86.93%	1,776	$225,000	101.43%
2010	3,050	$121,700.00	99.90%	89	$85,000	83.47%	1,829	$235,000	101.71%

The Impact of Tax Reduction Factors

The impact of declining overall property values on tax revenue varies by type of property levy. Local governments may have an assortment of inside millage, and outside millage. Inside millage is millage levied under the statutory 10-mill limitation; such millage is enacted without a vote and is not subject to tax reduction factors.

Tax reduction factors impose a major restriction on the growth of tax levies. These factors restrict the growth in real property taxes due to valuation increases that occur after reappraisal or triennial update (reduction factors also restrict decreases in taxes due to valuation declines that may occur after reappraisal or triennial update). Tax reduction factors are calculated only on levies enacted outside of the 10-mill limitation. Each levy has two reduction factors, one for each classification of real property. Reduction factors do not apply to public utility personal property. Reduction factors are only calculated on 'carryover property' – property that is taxed in both the preceding and current year within the same property class. The tax rate that results after the calculation of reduction factors is the effective tax rate.

Reduction factors decrease the tax rate as taxable values increase and increase the tax rate as taxable values decrease; however, the effective rate cannot increase above the initial rate approved by voters. If property values decline in the first year, or the year after, a voted levy has been assessed at the rate authorized by voters, the tax rate cannot be adjusted upward which means the taxing authority will bear the full effect of the valuation decrease (i.e., the tax rate cannot be increased to mitigate the effects of the reduced tax base on revenues).

The extent to which tax reduction factors may mitigate the impact of valuation declines on a taxing authorityís real property tax revenue depends on the nature of its levies (whether the levy is even subject to reduction factors), and the relative size and vintage of those levies. These variables preclude us from making generalized statements about the degree by which tax reduction factors will play a part in moderating the current risks of declining property tax revenues. To illustrate the variables in play, Table 2 below shows the impact of declining values on a hypothetical (and great simplified) county.

In general, levies in place prior to 2006 have a gap between voted and effective rates which will offset about 7.5 percent of the valuation reduction. In Table 2, increases in

Table 2. Effect of Reappraisal & Update Value Decrease on Revenues

	Authorized Rate (mills)	2010 TRF	2010 Effective Rate (mills)	2010 Taxes Charged	2011 TRF	2011 Effective Rates (mills)	2011 Actual Taxes Charged	Revenue Change from 2010
Tax Rates: Example County								
Inside General Fund	3.9		3.9	35,100		3.9	31,200	-3,900
Voted:								
2009 Senior Citizens	3	0.1	2.7	24,300	0	3	24,000	-300
1983 MH & DD	2	0.4	1.2	10,800	0.325	1.35	10,800	0
1986 Library	1	0.2	0.8	7,200	0.1	0.9	7,200	0
Total	**9.9**	**0.7**	**8.6**	**77,400**	**0.425**	**9.15**	**73,200**	**-4,200**

*Carryover Value Calculation - 2011:	
2009 Total Taxable Value	9,000,000
2010 Valuation Change	
New Construction	0
Reappraisal	-1,000,000
2010 Total Taxable Value	8,000,000
2010 Carryover Value	8,000,000

effective rates protect the library and mental health & developmental disability levies from decreases in revenue following a decrease in residential valuation. Levies passed since 2006 have experienced little inflationary millage reduction since passage, effective rates are very close to voted rates and there is little room for increases. Even if reduction factors can be reduced to protect revenue from voted levies, a 5 percent decline in property values will typically result in a decline in tax revenue of approximately 1 percent.

Updates and reappraisals play an important role for counties preparing budget and long term financial forecasts. Going forward, local government officials should keep in mind the high likelihood of declining valuations and property tax revenue. **CCAO**

The analysis and interpretations contained in this document are those of the author. They do not represent official views of the Ohio Department of Taxation.