<u>RIPEC COMMENTS</u>

Shifting Property Values in Rhode Island

In January 2000, RIPEC published a report entitled *Property Taxes 2000: Next Steps*, which updated information related to Rhode Island's property tax characteristics and trends, summarized recent administrative reforms and outlined a series of recommendations for the next steps in property tax reform. The report documented Rhode Island's dependence on the property tax relative to most states across the country.

The following analysis focuses on Rhode Island's property value and how changes and shifts in value over time have affected different segments of the State's property base.

<u>Definitions and Principles:</u>
Taxpayers may confuse assessed value with full value of property. Assessed value is the value of the property that was established during the most recent revaluation conducted by the municipality. This value, which was based on market value at the time of the revaluation, is used to calculate one's property tax liability. Full value is an estimated value of the same property assuming that the property was sold in the marketplace today. Therefore, as time goes on, property may become more or less valuable than it was when the revaluation was conducted. However, the property tax liability for that property is still based on the most recent revaluation. The values are updated when the municipality updates all property through a revaluation.

Revaluation is necessary because the values of the property within localities change over time. Therefore, the more time between revaluation, the greater the potential for inequities among types and classes of property. More frequent revaluation results in greater equity within and among jurisdictions. Uniform assessments due to more frequent revaluation ensures that assessed values reflect the current market.

The frequency of real property revaluation is set by statewide legislation. Until recently, Rhode Island had a ten-year revaluation cycle. However, legislation enacted in 1997 advanced the ten-year cycle by one year, requiring a revaluation every nine years. In addition, in order to maintain assessments that reflect market changes, Rhode Island communities are required to conduct two statistical updates during each nine-year cycle. Communities are required to conduct a statistical update in the third and sixth year after each revaluation.

Rhode Island Property Values

The following analysis focuses on the issues of changing property values and the impact these changes have on different segments of the property tax base and the relative burden each segment must bear given these changes.

First, because of the complex nature of the data collected for establishing both assessed value and full value, there is a two year delay between the certified tax base and the fiscal year. For example, the data used for establishing property tax rates in fiscal year 2000 is based on the certified tax base established as of December 31, 1998. This is one of the reasons why the property tax is somewhat slower to respond to economic changes than taxes that are based on more immediate transactions, such as income and sales taxes.

Second, the most reliable method available to analyze the State's property value base is full value. As noted above, there is a significant difference in assessed value and full value. Assessed values among communities differ because each community is at a different stage in its revaluation cycle. In other words, the assessed property values over time do not represent a true picture of what is happening to the property value base in the State. Therefore, to provide a common base among all 39 municipalities and to ensure that the true market value of property is compared, the following analysis uses estimated full value of property. The property value base in each year has been estimated to reflect the market value of the property in each given year.

Third, the Rhode Island Office of Municipal Affairs (Department of Administration) calculates the estimated full value of property in each community based on recent sales data, random real property appraisals and market conditions. Because the Office of Municipal Affairs has yet to calculate full value figures for fiscal year 1999 and fiscal year 2000, RIPEC estimated full value based on the most recent sales assessment ratios available and general market trends.

Fourth, the estimated full value of property also requires an adjustment for inflation to accurately reflect the true growth or decline that has occurred during the period analyzed. Therefore, the following tables and charts reflect all figures in December 1999 dollars. For example, the estimated full value of property statewide in 1990 was $58.4 billion. However, when this base is adjusted to reflect 1999 dollars, it requires increasing the value by 26.0 percent, resulting in an estimated full value of property of $73.5 million in fiscal year 1990 (in 1999 dollars).

<u>Summary of Data and Major Findings:</u>
As Table 1 shows, there have been two distinct periods of change in the State's property base. First, the 1980s evidenced significant growth in the Ocean State's property base. In fiscal year 1980, property value was estimated at $30.6 billion. Within a ten-year period, property wealth increased to $73.5 billion in value. This represented a $43.0 billion increase in property value – nearly 150 percent growth. It is estimated that property value in the State peaked in fiscal year 1991 (December 31, 1989) at $77.5 billion statewide.

Table 1
Local Property Value in Rhode Island
(FY 1970 - FY 2000)

Fiscal Year	Certified Full Value (2)	Change in Value	Adjusted Full Value (3)	Change in Value
1970	$5,954,097,829	-	$25,418,255,199	-
1980	15,406,520,302	-	30,558,687,674	-
1981	17,157,393,148	11.4%	30,898,003,506	1.1%
1982	19,284,983,167	12.4%	33,031,916,178	6.9%
1983	21,306,117,608	10.5%	35,482,069,125	7.4%
1984	22,557,664,741	5.9%	36,032,281,191	1.6%
1985	24,088,732,018	6.8%	37,274,376,499	3.4%
1986	26,226,873,474	8.9%	39,994,198,716	7.3%
1987	29,372,138,845	12.0%	42,848,167,855	7.1%
1988	37,235,387,492	26.8%	52,104,760,201	21.6%
1989	48,201,018,401	29.4%	64,549,452,986	23.9%
1990	58,367,757,602	21.1%	73,539,002,462	13.9%
1991	63,271,784,872	8.4%	77,454,979,734	5.3%
1992	63,939,332,733	1.1%	75,843,411,606	-2.1%
1993	61,111,531,669	-4.4%	70,548,796,340	-7.0%
1994	58,648,186,928	-4.0%	65,984,113,989	-6.5%
1995	56,609,728,052	-3.5%	61,950,268,434	-6.1%
1996	56,243,575,821	-0.6%	59,761,019,918	-3.5%
1997	56,263,370,147	0.0%	58,561,255,314	-2.0%
1998	56,465,184,556	0.4%	57,911,244,160	-1.1%
1999	57,465,568,427	1.8%	57,465,568,427	-0.8%
2000	59,389,947,392	3.3%	59,389,947,392	3.3%

1) Certified Full Value provided by RI Office of Municipal Affairs

2) FY 1999 and FY 2000 Full Value figures are RIPEC Estimates based on recent data.

3) Adjusted Full Value is a RIPEC calculation adjusting Certified Full Value by inflation (1999 dollars)

Source: Compiled by RIPEC based on Office of Municipal Affairs Data

Share of Pro

Second, since 1991 however, there has been a significant decline in full value of property in Rhode Island. Property value has declined from $77.5 billion in fiscal year 1991 to $59.4 billion in fiscal year 2000. This represents a decrease in value of nearly $18.1 billion, or 23.4 percent. Even if one examines the unadjusted figures in the table, the data clearly shows that that there has been stagnation in the State's property tax base.

There are a number of reasons why this occurred in Rhode Island. The late 1980s represented the peak of the real estate market. Unfortunately, the country experienced a recession in the early 1990s that had a significant impact on real estate.

The recession had a particularly strong impact in New England, and especially Rhode Island. Second, coupled with this recession in Rhode Island was the failure of many of Rhode Island's credit unions.

Chart 1
Estimated Full Value of Property in Rhode Island
(1999 Dollars)

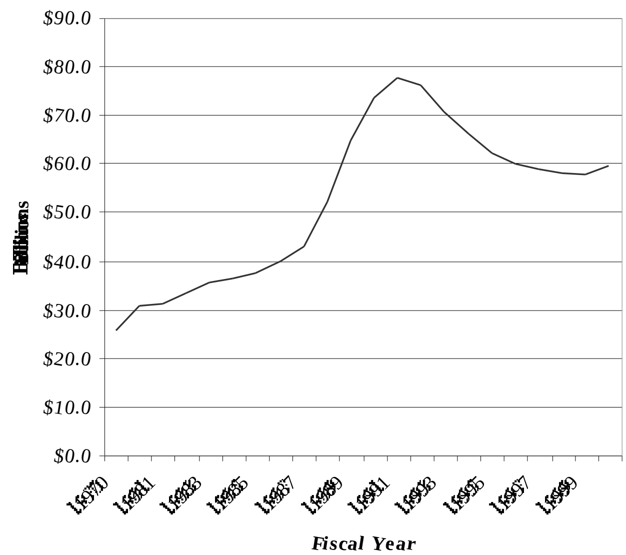


Chart 1 displays the statewide full value growth trend over the past thirty years. The late 1990s began to show signs of stabilization and growth in property value statewide. In fiscal year 2000, it is estimated that the property base in the State will show growth for the first time since fiscal year 1991. Recall that there is a two-year lag between fiscal year and the property value data used. Therefore, fiscal year 2000 actually represents growth in the State's property base in 1998. Given the continued growth in the nation and state's economy, it is likely that fiscal years 2001 through 2003 will also reflect additional growth in the State's property base. Since it is unclear how long the current prosperity will continue, estimating beyond fiscal year 2003 is difficult.

<u>Property Value Shifts Among Rhode Island Communities:</u>

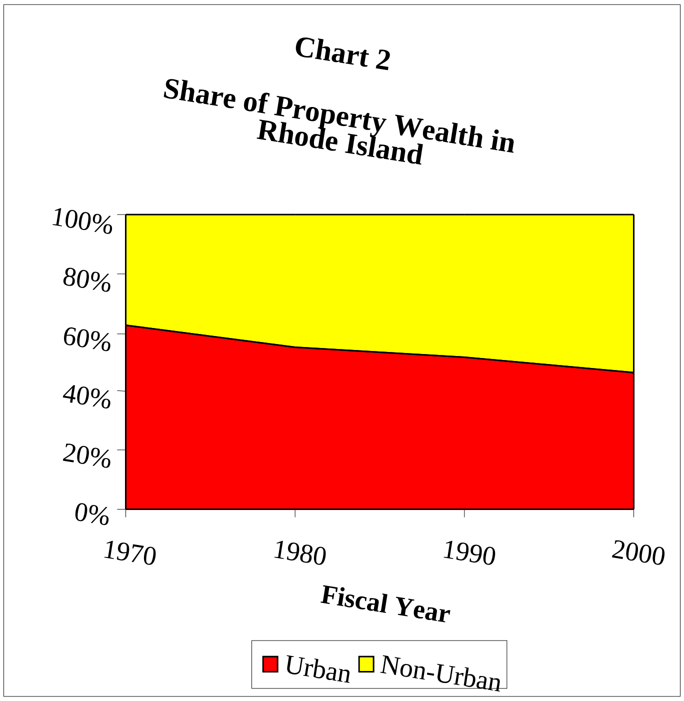
Statewide property tax value trends do not reflect the experience in all Rhode Island's cities and towns, therefore it is important to understand where the changes have occurred within the State. For purposes of this analysis, RIPEC has divided the State into two groups – urban and non-urban. The ten communities considered urban were identified in a January 1998 report – *Strengthening Cities – An Urban Strategy for Rhode Island*. This report used a series of indicators to identify those communities that were urban in the Ocean State and outline the challenges those communities faced.

Table 2

Rhode Island Urban Communities

Central Falls	*Pawtucket*
Cranston	*Providence*
East Providence	*Warwick*
Newport	*West Warwick*
North Providence	*Woonsocket*

Data displayed in Chart 2 shows that the concentration in property value has shifted from the State's urban communities to the State's suburban and rural communities (Following a similar pattern in population migration in the State). For example, in fiscal year 1970, nearly 63.0 percent of the State's property wealth was located in urban Rhode Island, with the 37.0 percent balance in non-urban communities. Over a ten-year period (1970-1980), the urban communities had their share of the State's property tax wealth decrease to approximately 55.0 percent. Non-urban communities gained in their share of property wealth to 45.0 percent.



While the entire State enjoyed considerable growth in property value from 1980 to 1990, the shift in where the State's property value continued. Urban communities had 51.5 percent of the State's property value in 1990 whereas non-urban communities had 48.5 percent of the State's value. In fiscal year 2000, urban communities now have approximately 46.5 percent while non-urban communities have 53.5 percent of the State's property wealth.

While the overall adjusted full value of property in the State declined by 19.2 percent from fiscal year 1990 to fiscal year 2000, urban communities experienced a 27.2 percent decline in adjusted full value while non-urban communities experienced a 10.8 percent decline. In other words, while the adjusted full value in urban communities declined by nearly $10.3 billion, non-urban property value declined by $3.8 billion during the same period. Therefore, while both urban and non-urban communities experienced declines in the overall tax-base, the rate of decline in the urban communities resulted in a shift in the concentration of property wealth in the State.

<u>Property Values by Class of Property:</u>
Table 3 displays the estimated share of property value for each major class of property – residential, commercial, industrial, utilities and rail, motor vehicles). In fiscal year 1970, residential property represented approximately 56.0 percent of the State's total property value. However, the residential property share of total property wealth has increased to approximately 70.5 percent in fiscal year 2000. During a thirty-year period, residential property wealth as a percent of total property wealth in the State increased from about half to nearly three-fourths of all property wealth.

Table 3

Share of Total Value by Class of Property

(FY 1970 - FY 2000)

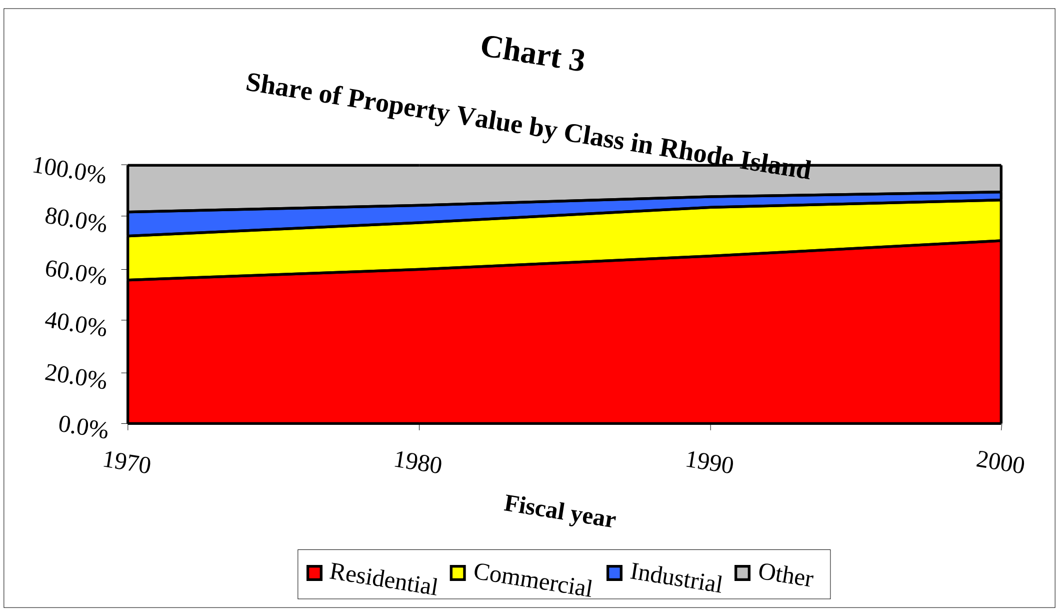
Fiscal Year	Residential	Commercial	Industrial	Utility Rail	Motor Vehicle	Misc	Total
1970	56.04%	16.86%	9.59%	5.50%	10.15%	1.86%	100.00%
1975	57.17%	18.24%	8.05%	4.93%	10.65%	0.96%	100.00%
1980	59.90%	18.00%	6.50%	4.00%	10.70%	0.90%	100.00%
1985	66.00%	16.80%	5.00%	2.80%	8.60%	0.80%	100.00%
1990	65.20%	18.50%	4.60%	2.10%	9.00%	0.60%	100.00%
1995	68.71%	17.14%	3.83%	2.12%	7.60%	0.60%	100.00%
2000	70.54%	16.21%	3.15%	1.97%	7.62%	0.51%	100.00%

Note: FY 2000 Data estimated by RIPEC.

Source: Compiled by RIPEC based on Office of Municipal Affairs Data (Annual Equalization Study).

Commercial property as a percent of total property has remained relatively stable. However, the share of property wealth considered industrial has declined. For example, industrial property represented about 10.0 percent of the total property value in Rhode Island in fiscal year 1970. This has declined to 3.0 percent in fiscal year 2000. Today's industrial property as a percent of statewide property wealth is a third of what it was in fiscal year 1970.

When one converts the percentages displayed in Chart 3 to estimated property values by class, additional trends can be observed. For example, of the $59.4 billion in full value in FY 2000, $42.0 billion is residential (70.5 percent), $9.6 billion is commercial (16.2 percent), $1.9 billion is industrial (3.1 percent) and the $5.9 billion balance is in other classes of property. Over the past decade, there was an $18.1 billion decline in property value - nearly $8.3 billion (46.0 percent) was in residential property, $6.7 billion (37.0 percent) in commercial and industrial property, and the $3.1 billion (17.0 percent) balance was in utility and rail, motor vehicles and other property.



As a result of the shifts in values over time, the reliance on different classes of property also shifts. Many communities have begun to employ property tax classification systems to minimize the impact these shifts have on the homeowner. In Rhode Island, a classification system taxes different classes of property at different tax rates. Some Rhode Island communities also include homestead exemption provisions that have a very similar effect on shifting the property tax burden away from residential property to other classes of property.

RIPEC Comments

As noted earlier, Rhode Island communities are now required to conduct a full revaluation every nine years, and conduct two statistical updates during each nine-year cycle. Communities are required to conduct a statistical update in the third and sixth year after each revaluation. The shift in values between classes of property and the fluctuations in value within a class of property demonstrate that frequent revaluations are important to maintaining a fairly administered property tax system in the Ocean State.

While the new revaluation cycle is in place, it is critical to ensure that all communities comply with the law. This will impact both the equity of property taxation within and among jurisdictions, the accuracy of various state aid distribution formulas and the overall efficiency and effectiveness of property tax administration. RIPEC recommends that the General Assembly consider (on a go-forward basis) a process by which the State would conduct (through contracted services) either the revaluation or the statistical update should a municipality intend to delay its revaluation or update.

Since each municipality has to pay for the entire cost of a revaluation, the State should bill the municipality for all related costs. Because of the cost-sharing arrangement for the statistical updates, the State should only bill the municipality for the local portion of the costs associated with the statistical update. Should the municipality fail to reimburse the State for the related costs, the State should have the authority to reduce the community’s non-school state aid by the amount owed.

With the range of changes occurring in the State's property tax structure, there is a need to clarify both the process and administration of these complicated taxing systems. There has been growth in the use of classification systems, homestead exemptions, personal exemptions and other programs that directly affect the administration of the property tax. The complexity of the property tax makes it increasingly difficult to ensure that the property tax system is effectively and fairly administered.

For example, while classification systems are often designed to provide property tax relief to different classes of property, they do not prevent shifts within classes of property after revaluation. Should one class of property be significantly favored in one jurisdiction but not in another, there may be a tendency for that class of property to be drawn into the more favorable jurisdiction at the expense of the other.

The State does not have any standards regarding a classification plan that a community may choose to adopt. In order to avoid further balkanization of the property tax structure in Rhode Island, public officials need to develop and implement classification parameters and standards to guide local officials in developing property taxation systems.

The Governor introduced a proposal in his FY 2001 Budget request to establish parameters for future classification plans in the State as each municipality completes its next revaluation. The Governor's proposal defines four classes of property, establishes a range in which effective tax rates can deviate from each other, and requires tax changes to be proportional to all rates. First, the Governor's proposal designates that there are no more than four classes of property (residential, commercial/industrial, tangible and motor vehicles). Second, the Governor's proposal requires that the effective tax rate applicable to any class of property cannot exceed the rate applicable to any other class of property by more than 50.0 percent. Third, should a community adjust its tax rate for any reason, the same percentage change has to be applied to the tax rates for all other classes of property.

The Governor should be commended for drawing attention to the property tax classification issue in the State. While the proposal will require some further analysis to understand the impact it will have on Rhode Island communities, it does serve as the much needed catalyst for policymakers to address this critical issue of property tax administration.