D.C. FISCAL POLICY INSTITUTE

TESTIMONY OF ED LAZERE, POLICY DIRECTOR,
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At the Public Roundtable on "The Real Property Tax Assessment Transition: Discontinuing the Triennial"
District of Columbia Committee on Finance and Revenue
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Mr. Chairman and members of the Committee, thank you for the opportunity to speak on this matter today. My name is Ed Lazere and I am the policy director of the D.C. Fiscal Policy Institute. DCFPI is a recently initiated project of the Center on Budget and Policy Priorities, a non-profit research organization that studies government programs and policies that have an impact on low- and moderate-income households. DCFPI focuses on tax, budgetary, and programmatic issues affecting low- and moderate-income District residents. It is supported through foundation grants.

Today I will discuss significant concerns I have about the District's continued use of a triennial assessment process under the real property tax in the District of Columbia. In particular, the triennial assessment process may be lowering property tax collections substantially, as much as $56 million next year. I urge the committee to consider options to address the potential revenue loss, including returning to an annual assessment process.

By way of background, the District relies heavily on property taxes to fund its services, as many state and local governments do. In the District, it is estimated that $574 million in real property taxes will be collected in fiscal year 2001, which equals 20 percent of D.C. tax revenue, and 18 percent of total own-source revenues.

The problem with the triennial assessment process stems in part from the way the property tax is administered in the District, which differs from the way property taxes are administered in many other jurisdictions. Outside of D.C., policymakers typically decide on the level of revenue they wish to raise from the property tax each year, and then the property tax rate is adjusted so that the revenue target can be met. For this reason, the property tax tends to be a very stable source of revenue. In the District, by contrast, the property tax rates are generally treated as fixed and do not change much, just as the sales tax rate generally does not change from year to year.

The District's history of keeping property tax rates stable is not necessarily a problem. Because the rates are not adjusted to keep total revenue collections stable, however, it is very important that property values are assessed accurately and are kept up to date. Unfortunately, while a triennial assessment process may help improve the accuracy of assessments, it leads to an under-assessment of the value of District properties, and thus a reduction in property tax revenues.

Consider the following example, which comes from a study conducted by John Bowman, chair of the Department of Economics at Virginia Commonwealth University, for the D.C. Tax Revision Commission. A home had an assessed value of $100,000 in 2000, and its market value is rising by five percent per year. If the property is assessed in 2001, its appraised value would be $105,000. Under the triennial assessment process, the home's assessed value for tax purposes would rise from $100,000 to $105,000 in equal increments over a three-year period. Yet during that period, the actual value of the home would continue rising. As a result of these factors, the home's assessed value would lag its actual value. By the third year, when the $105,000 assessment is fully phased in, the assessed value would equal just 90.7 percent of the actual value. This lag would not be erased when a new appraisal occurred, because once again the increase in appraised value would be phased in over three years, while the property's real value continued to rise.

Year	**Market Value**	**Assessed Value**	**Assessed Value as % of Market Value**
base	$100,000	NA	NA
1 (new appraisal)	$105,000	$101,667	96.8%
2	$110,250	$103,333	93.7%
3	$115,763	$105,000	90.7%
4 (new appraisal)	$121,551	$110,517	90.9%
5	$127,628	$116,034	90.9%
6	$134,010	$121,551	90.7%

The phasing in of new appraised market values over three years is intended to avoid major jumps in assessed value — and thus in taxes owed — that otherwise would occur if properties are appraised every three years instead of annually. But the phase-in feature has the downside of levying taxes on assessed values that are by definition lower than the property's actual market value in any period when market value are rising. The lag of assessed value relative to actual value would be larger than indicated here in periods when actual values are rising faster than five percent per year. It also should be noted that if market values decline over a period of several years, assessed values for tax purposes will exceed market value.

The process of appraising properties every three years and phasing-in new assessments also may create some impressions of unfairness in the property tax. When a home is purchased, it's assessed value for tax purposes would likely equal its market value as reflected in the purchase price. As noted above, once a property is held by an owner for more than a few years, the assessed value would be notably less than the market value. Thus, families newly buying a home in the District may feel they are paying an unfair share of the property tax relative to neighbors that have lived in the District for some time.

The Bowman study also modeled the effect of a triennial assessment process on assessed values of D.C. property by using data on actual changes in the assessed value of residential property in the city from 1986 through 1996, a period when the District was performing annual assessments. The total assessed value of residential property increased at an average rate of 5.7 percent per year during that period. The study found property assessed for tax purposes would have averaged 91 percent of actual values over a 10-year period if the city had used a triennial assessment process during that period. Assuming fixed property tax rates, this means that property tax revenues would have been reduced by nine percent relative to the taxes that would be collected under an annual assessment process.

In short, the triennial assessment process is likely to be reducing District property tax revenues substantially. Property tax revenues for 2002, the third year under the triennial assessment process, are projected to be $568 million (Mayor Williams 2001 budget proposal, p. V-11). It is reasonable to assume that the market value of property in D.C. will have increased at an annual rate of at least five percent between 1999 (the beginning of the triennial assessments) and 2002, which means that assessed values in 2002 will be at least nine percent lower than market values. If that is the case, property tax revenues in 2002 will be $56 million lower than they would have been if the District had not adopted the triennial assessment system.

Given the potential for these large revenue losses, the triennial assessment process should be reviewed carefully. There are at least three options for avoiding a substantial loss of revenue.

- The triennial assessment system could be maintained, but new appraisals could be effective in the first year rather than being phased in over three years. This would still create a lag, since any increases in assessed value after the first year would not be captured for two years. This could also create very large increases in assessments and taxed owed once every three years, which could generate substantial taxpayer anger over the property tax. It thus is not a highly desirable option.

- The Council and Mayor could agree to adjust the property tax rates on a periodic basis to reflect estimates of the under-assessments. This action would appear to many to be a tax increase, however, even though it would merely represent an effort to avoid revenue losses.

- The city could return to an annual assessment process. This is what the Tax Revision Commission recommended.

Clearly there are concerns about the ability of the District to conduct annual assessments, but it is worth pointing out that annual assessments can occur without a physical review of every property each year. If the city can develop a solid data base of the attributes of each property, it can generate estimated changes in property values each year without re-valuing each property individually. The potential revenue loss from the triennial assessment process is so large that the District could enhance funding to improve its real property data base to support annual assessments and still generate more net tax revenue (after administrative costs) than if it were to keep the existing triennial assessment process.

Thank you again for this opportunity.