International Property Tax Institute

PRESIDENT'S MESSAGE

April 2020

I must, inevitably, start this newsletter with reference to the unprecedented impact that the coronavirus is having on all our lives at present. I hope that everyone reading this has been able to stay safe and adjust as best they can to the very difficult environment we find ourselves in and the uncertainty of when the world will start to return to normality.

Like so many other organisations, IPTI has been directly affected by the travel and other restrictions that have, understandably and necessarily, been put in place. Planned meetings, workshops, conferences and other events have been reviewed and either postponed or, where possible, switched to online. A number of our smaller face-to-face events scheduled to take place over the next 6 months have had to be postponed. One of our larger events, the annual Mass Appraisal Valuation Symposium, planned for June in Calgary, has been postponed. It has been rescheduled for 23-24 November and we will send out more details about it when we are in a position to do so. At this stage, our annual Caribbean Conference, planned for 19-20 November in Trinidad is still due to go ahead.

IPTI is fortunate in having colleagues who can work from home so we are able to continue with our various online webinars and workshops planned to take place over the coming months. It seems likely that there will be an increasing use of "virtual" meetings and more online events going forward.

I should add that property taxes have featured very significantly among the many financial support packages that governments have put together quickly over the last few weeks to try and assist businesses and individuals to get through the devastating impact that the virus is having on our economies.

Property tax payments have been reduced, deferred or suspended in many jurisdictions around the world, although it is recognised that more direct and substantial measures are needed to deal with the crisis. In the UK, for example, a 12-month property tax "holiday" has been introduced for particular types of business properties along with financial support for residential property taxpayers.

Some jurisdictions, for example, Ontario in Canada, that were in the course of preparing for a revaluation (reassessment) of properties for property tax purposes have postponed the exercise. Property tax appeal systems around the world have been affected with the cancellation of hearings, etc. Governments, taxpayers and assessing agencies are all trying to find ways to deal with the problems we face.

Of course, the measures put in place to limit the spread of the virus are having an impact on property markets around the world. People buying, selling or renting properties have been affected and many transactions are now on hold. For similar reasons, the restrictions currently in place must be having a significant impact on property values. At this stage, it is impossible to estimate what the extent of that impact will be and what might be the longer-term consequences.

It is a very uncertain time for everyone, and we do not know how long it will last. Let us hope that the scientists can find a vaccine to fight the virus effectively and we can return to something like our previous lives soon. In the meantime, I hope you all manage to stay safe.

Moving on, just a few points to mention about recent IPTI webinars. I have been pleased that so many people, from around the world, have been able to participate in these events. We have delivered some interesting webinars on valuation issues such as the assessment valuation of airports, ports and railyards and, equally challenging, assessment valuations of wasting asset property types including mines, gravel pits and landfills. We also recently delivered another in our series concerning mass appraisal concepts. The latest of these looked at how multiple regression analysis is used in the mass appraisal process, focusing on model calibration. Topics included key regression statistics, additive, multiplicative and non-linear model calibration, and other options for model calibration. My thanks to our various speakers who have been able to make their presentations despite the present difficulties. I must also express my gratitude to our distinguished panel of international experts who have advised on the training material.

Looking ahead, although all our face-to-face events over the next few months have had to be postponed, we will still be running our online events. Full details of these can be found on our website: www.ipti.org.

I recently read an article entitled "Critics Argue The Property Tax Is Unfair - Do They Have A Point?". The author stated that, last month, an Idaho lawmaker called the property tax "inherently evil" and suggested the state repeal it and replace the foregone revenue with a higher sales tax. He described the property tax in feudal terms, saying it "dates back to the dark ages or the middle ages when the lords of the manor had to pay taxes to the Kings and the Queens otherwise they didn't get to keep their land."

The author went on to say that, in fact, property taxes date back to around 6,000 years BC. She also stated that it performs very well in respect of the criteria concerning sound taxation like efficiency, equity, and reliability. However, as an economist, she decided to take a look at the arguments against property taxes to see if they have any merit.

Her conclusion was that, although a good tax, the property tax has some troublesome features. These flaws are hardly deal-breakers in her view, but they do knock the property tax off its pedestal.

First, she asked, is the tax regressive or progressive? The goal of the property tax is to generate revenue for local governments to provide schools, roads, parks, police protection, etc. She said that, in the USA, it does that very well, generating about three-quarters of local taxes and half of all local government revenue, excluding state and federal aid. But, she stated, that's only one goal of tax policy. Another is equity, and this is where, in her view, the property tax gets tricky. The fairness of the property tax depends on what kind of tax you think it is.

Is it a tax on consumption (your cost of living in a house)? If so, the tax is regressive because housing costs take a bigger bite out of low-income household budgets. Especially if the property tax gets passed on to renters as well as burdening homeowners, we also need to consider what counts as income. Are students or seniors with low current earnings, but higher lifetime incomes, really “poor”?

Or is the property tax a tax on capital (your return to owning a house)? This kind of tax would be progressive on average (because capital owners tend to be wealthier), but places with higher-than-average property tax rates may see these higher taxes reflected in lower land prices or reduced wages and that would dampen progressivity.

What about the entry fee theory that says the property tax is the price of admission for living in a community and consuming all those services - like education and police protection - the local government provides? Progressivity is complicated here too. Low-income families with lots of kids consume more in government services (such as education) than they pay in taxes. Yet, a high-quality education system benefits many others besides students, including employers and, by increasing property values, higher-income homeowners.

The author also considered the importance of uncertainty and transparency. She said that the property tax may also expose homeowners to too much uncertainty. If a big box retail establishment closes in their area (or opens in a neighbouring one), homeowners may see tax bills rise as the local government tries to make up lost revenue caused by a reduction in the commercial tax base. To alleviate this concern (and avoid more drastic property tax limitations), she refers to taxing homeowners based on ranges or “bands” rather than specific levels of property value, an approach used in the UK.

She argues that greater transparency, including explanations of how property tax bills are calculated and how homeowners can apply for property tax relief, may also provide help improve the tax and increase its acceptability. She went on to say that, on the issue of transparency, some researchers have found significant inequities in property taxes due to delayed reappraisals and the greater chances of assessments being successfully appealed in fast appreciating, middle- and high-income neighborhoods compared to low-income ones.

Returning to where she started, the author says that the proposal to ban the property tax and hike the state sales tax rate to 11 percent to offset revenue losses would double down on regressivity. Sales taxes are regressive because low-income households spend a greater proportion of their budgets on consumption and on goods, which are taxed, rather than services, which are not. She says that we need to think realistically about how to pay for the government we want.

She concludes that property tax is a flawed, not evil tax. She said the property tax is a stable, adequate, and reliable revenue source, but it also raises equity and transparency concerns. A very interesting article and one that, in my view, contributes helpfully to the wider debate about property taxes.

I would also like to refer to a recent article written by David Wilkes, a Member of IPTI’s Board of Advisors, entitled “Opportunities to reduce property taxes for senior housing properties”. Although focussed on the position in the USA, David’s article may resonate with many jurisdictions around the world.

Senior housing, as an investment, he says, may now require its own form of life support. With developers adding more than double the number of units in 2018 as it did just four years before that, according to the National Investment Center for Senior Housing & Care, demand appears to be slowing down faster than its target residents. Despite the sobering market trend, managers and owners of senior care facilities may find in this challenging news an opportunity to reduce their property tax burden to offset declining net income and save a significant chunk of annual fixed operating costs.

Until recently, senior housing outpaced office, retail, hotels and apartments as one of the fastest-growing commercial real estate sectors, according to Green Street Advisors. Real estate developers have long been focused on accommodating the 72 million Americans born between 1946 and 1964, who are about to reach their mid-80s, the perfect move-in demographic for most facilities. However, occupancy among senior housing facilities fell in the third quarter of 2019 to 88%, down from previous highs.

David looks at five ways in which technology has impacted seniors' lifestyles, arguably for the better. Starting with "social contact", he refers to video chat as well as email and so many other services, which, while not a substitute for real human connection, are being embraced by the elderly – often being configured for them by tech-savvy grandkids.

He also refers to safety. Most surveys show that some 90% of seniors would prefer to stay in their own home, and various Personal Emergency Response System (PERS) devices are now available that allow the wearer to simply push a button for emergency attention. Beyond that, GPS tracking devices can monitor the location and send alerts for a loved one who may suffer from Alzheimer's disease or other dementias.

Next, he considers exercise and argues who needs to pay substantial sums for the recreational and exercise facilities at a senior facility when sports games are available to provide light physical activity to the elderly right in their own living room?

He also mentions medication management where the challenges posed by keeping track of one's medications have largely been solved by a variety of technologies to prevent life-threatening errors. His final, related, topic is healthcare information management where, he says, a variety of health tracking tools are now available to collect and keep current information such as medical history, physician contacts, medication schedules, and health conditions.

Venture capital and other firms will, he says, spend some $1 billion this year on "aging in place" technologies. The rise of technologies that help the elderly remain in their homes cuts against real estate bets that aging baby boomers will flee their isolation to enroll in senior housing developments. Moreover, with increasingly better health, the age at which people enter senior housing is rising, at around 85 years old today, compared to about 82 ten years ago.

The result is a looming glut of senior facilities units. And, while the word "looming" may sound speculative, the impact on valuation - for a variety of significant purposes, including property tax assessments - is very much real time, as in right now. The tax assessor's job is to estimate what a purchaser would pay as of a current taxable status date for the subject property, and that means they must consider market supply and demand factors in the industry that impact perceived risk.

The tax assessor's most challenging assignment when it comes to valuing such properties - in New York anyway - is to distill the real estate component from the overall going concern value: no easy task and one that is the subject of endless debate. Senior living facilities are, first and foremost, run as businesses that happen to occupy real estate. David concludes that with declining demand for the going concern business now comes a parallel drop in the value of the real estate that supports a senior living facility. Owners and operators should be especially keen to evaluate their property tax burden in view of the current market.

Of course, David's article was written before the coronavirus pandemic spread so rapidly across the globe which adds even more uncertainty to the problem he outlines.

Now, it's time for a quick look at what is making headlines concerning property taxes in selected jurisdictions and countries around the world.

In Thailand, the government recently overhauled property taxes and 2020 is the first year the new policies are in place. Until now, there was an outright exemption for residential use, so people didn't pay tax on their homes. The new Land and Structures Tax Act, passed in March 2019, introduces a 0.02% property tax on the official value of homes up to THB50 million (US$1.57 million), 0.03% for homes between THB50 million and THB75 million, 0.05% for those between THB75 million and THB100 million and 0.1% for homes valued at more than THB100 million. The official value is determined by the government and is "typically much lower" than the market value, a commentator said. However, next year, there will be a re-evaluation of property values. It is still possible to claim an exemption for some residential properties, but this is only applicable for the first property up to the value of THB50 million. There is also an additional tax for homes that have been empty or underutilized for more than three years. In the fourth year, the owner will be charged an extra 0.3%, and that rate will rise every three years until it reaches 3%.

In Australia, a commentator has said that land tax is a "headache". On just one piece of land, you could be paying up to $60,000 more in state land tax, depending on where you buy and the ownership structure. If you're a property investor considering a purchase, don't forget land tax. While its state-based revenue cousin stamp duty hogs the headlines and political attention, land tax - a far more economically efficient and arguably fairer measure - varies widely between states and territories. It's only one of the imposts property investors face - in addition to council rates, maintenance and interest costs - but the rules around land tax have been changing in various jurisdictions. He says, "The number of different acts you have to work through to find an answer is a little bit ridiculous. There are layers and layers of legislation. The complexity is not going away. If anything, it's getting more complex." Land tax anomalies mean an investor spending $2 million on a piece of land could pay as little as $11,975 in Victoria or as much as $72,000 in NSW depending on whether the land ownership is individual, trust-based or foreign-owned; this complexity hinders tax reform efforts to create a more efficient system. The ACT recently removed land tax on commercial properties and replaced it with what he calls a "very severe" variable charge, pointing out that while the top land tax rate of 1.1 per cent looks attractive at first glance, the territory's variable charge on commercial land can exceed 5 per cent. Unlike the large eastern states, South Australia, Tasmania and Western Australia don't impose an annual surcharge on foreign owners in the form of a land tax. But they have a higher stamp duty surcharge for foreign purchasers of land. The biggest change to land tax calculations comes in the way ownership is regarded, and this has been changing recently.

Historically, landowners have been able to reduce their overall land tax by separating land holdings into multiple entities and benefiting from the tax-free threshold multiple times. This is changing across a number of states, with SA changing the system bringing it into line with NSW and Victoria. This “loophole” regarding trust ownership of land is being tightened up across the country. Trusts have traditionally not been subject to such aggregation provisions, as determining who actually benefits from a trust can be difficult. NSW, Victoria, Queensland - and now SA - have established surcharge regimes for land held in trust that lower - or eliminate - the tax-free threshold for land held in trust and which make trustees subject to a higher land tax liability than an individual or company would pay on the same piece of land. Then there are considerations around foreign ownership. New reforms in NSW (where they have yet to pass parliament) and Victoria (where they took effect this month) will cause most family trusts to be treated as "foreign trusts" - and subject to an additional 8 per cent duty surcharge - unless they are irrevocably amended to exclude foreign beneficiaries. The new regimes also apply to the 2 per cent land tax surcharge levied to foreign owners of land in the two largest states, although with some variations.

In the UK, the Institute for Fiscal Studies (IFS) has published a paper entitled “Revaluation and reform: bringing council tax in England into the 21st century”. The IFS say that council tax bands in England are still based on property values in April 1991. Since then, the relative prices of different properties have changed significantly: for example, official estimates suggest the average price in London is now more than six times what it was in 1995, compared with barely three times in the North East. Moreover, the most valuable properties in 1991 (Band H) attract just three times as much tax as the least valuable properties (Band A), despite being worth at least eight times as much in 1991 and typically even more now, since prices have risen most in areas where they were already highest. Council tax is therefore both increasingly out of date and arbitrary, and highly regressive with respect to property values; it is ripe for reform. The IFS argue that reform could make council tax much more progressive. Revaluation and reform of council tax could help narrow household and geographical wealth inequalities via effects on property prices. Economic theory and empirical evidence suggest that changes in property taxes get largely or fully reflected in rents and property prices. This means that a proportional property tax would narrow the gap in property wealth between owners of high- and low-value properties and, if accompanied by redistribution of funding from central government, between areas with low and high property values. The report is detailed and contains many interesting recommendations.

And finally, an assessor in the USA shows that he has a sense of humour. He writes, “I hope all the property owners out there received my “love letters” last Valentine’s month. We commonly refer to these “love letters” as our Notice of Value (NOV). I can only assume, as a property owner, that you might not be thinking much about “love” when you receive these notices.” He went on to say, “However, I am proud to announce that last year we received less than one-fourth of 1 percent (.025%) of our properties in appeals. Our office takes your appeals quite seriously. We understand that we are bound to have an error rate, but an error rate this small is actually exciting in our field.” So, there you go, there is both “love” and “excitement” in the property tax world. Stay safe.

Paul Sanderson

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