CHAPTER 19

PROPERTY TAX FAIRNESS

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"Are property tax assessments even-handed?"

Did you know that the assessed value of some expensive homes in highly desirable Kahala *decreased* in 1992 by 18 percent while that of properties in many less desirable neighborhoods *increased* substantially—some by 30 or 40 percent? Or that identical side-by-side homes sometimes have significantly different assessed values? Do you find it odd that property taxes on Oahu homes have not increased nearly so much as has county spending? Believe it or not, there may be good explanations for these interesting facts.

First, all property in Hawaii—nonresidential as well as residential, improved as well as unimproved—is supposed to be assessed each year based on 100 percent of current market value. Rather than attempting to reappraise each property individually, the counties usually just adjust last year's assessed value, primarily on the basis of sales activity in each neighborhood. The fact that someone's assessed value went up, say, 30 percent suggests that a statistical analysis of recent sales in that neighborhood indicated an increase in market values by roughly that percentage. Overall, assessments in Kahala went up by 5 percent in

1992, but there were areas within Kahala that did indeed drop by 18 percent. The reason is simple: sales activity indicated that market values had actually gone down from the prior year by roughly that percentage.

Second, resident homeowners enjoy a $40,000 exemption in the calculation of property taxes. Additional exemptions are available for older homeowners. The total exemption increases to $60,000 at age 55, $80,000 at 60, $100,000 at 65 and $120,000 once the homeowner reaches 70. Exemptions bring down the net assessed value on which the tax itself is based. Consequently, property owners who use their property as a principal residence enjoy a reduction that is denied to investors. Investors sometime complain that this unfairly shifts more of the total tax burden to them, but not many people lose sleep over it. If government tried to shift the entire burden onto those same shoulders, however, there certainly would be a fairness problem.

Third, it may be that a particular house has been overvalued. Government appraisers are human and sometimes make mistakes. Perhaps an appeal would result in a reduction in the property's assessed value. I suggest that you not get your hopes up, however. Your chances of prevailing are not statistically high. Assessed values tend to "lag" the market by a year or two in any event. Consequently, your property can be overvalued by comparison to other people's properties, and yet be undervalued by comparison to its own current market value. The tax assessor's figure is presumed correct; the burden is on you to show otherwise. Finally, you must show that the assessor was off by more than 10 percent to get any relief. Not surprisingly, few people appeal, and three out of every four taxpayers who do, lose.

Fourth, residential property tax burdens in Hawaii are relatively low, and the trend is downward. Of course, this sounds great to residential property owners. But property tax "relief" that isn't matched by a reduction in county expenditures really just shifts more of the existing burden to others. In the case of Oahu, there certainly hasn't been an expenditure reduction, and the resulting shift of tax burden has been from residential owners to owners of business property.

Shift of burden on Oahu. From 1984 to 1991, the average annual increase in real property tax revenue from improved residential property was only 1.6 percent, but was 13.5 percent on commercial property and 18.1 percent on hotel/resort property. A 1991 study by the

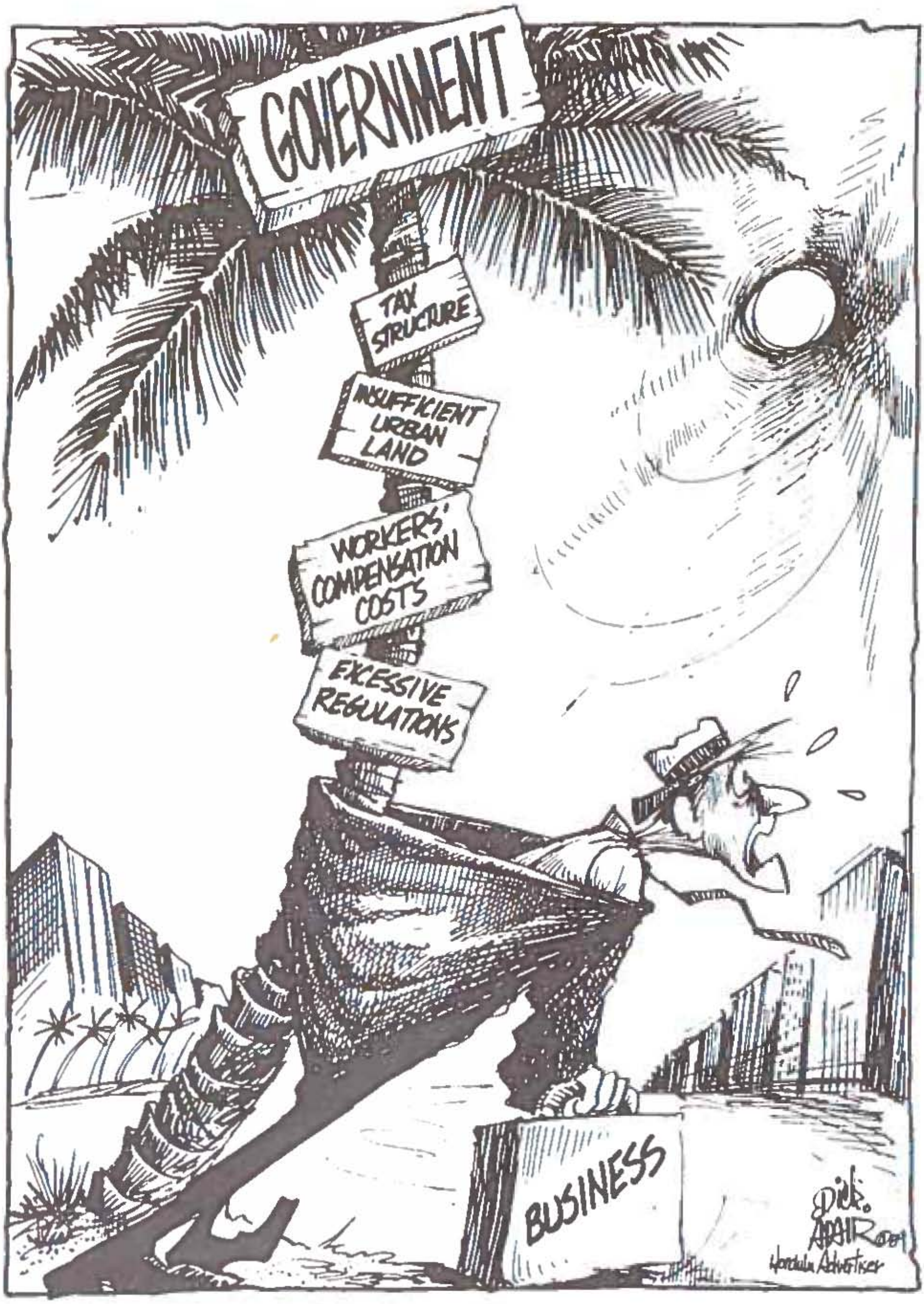
Honolulu Real Property Tax Advisory Committee showed the share of total property tax revenues raised from residential properties declined from 46.95 percent in fiscal 1987-88 to 31.74 percent in fiscal 1991-92. That's a whale of a shift.

This dramatic shift has been accomplished in one obvious and one less-than-obvious fashion. The first is through use of "differential tax rates"—separate classes of property taxed at different rates. The 1992 spread was extreme. The hotel/resort rate of $9.64 per $1,000 of assessed value was roughly triple the residential land rate of $3.25 and more than double the residential improvements rate of $4.09.

The less-than-obvious technique for shifting the property tax burden from residential property to business property has to do with valuation. A Honolulu rule directs county appraisers to determine the fair market value of improvements by market data and cost approaches. Consequently, Oahu appraisers ignore how much income a business property is generating, and refuse to consider the possibility that sales of comparable properties to foreign investors might have been for amounts above market value. Business property owners argue that the Honolulu assessment process is unfair because it ignores these important factors.

Several hotels were purchased in the late 1980s and early 1990s at prices far beyond values determined through use of traditional appraisal techniques. These purchases created an aberration within the marketplace and distorted valuations of adjacent and like properties. Commercial properties in downtown Honolulu had similar problems. For example, the 1989 purchase of the Merchandise Mart at Alakea and Hotel streets, at $1,200 per square foot, set a new standard for valuations downtown. Most commercial appraisers regarded that purchase as ill-considered, and yet the county assessor set values in 1990 and 1991 using that isolated sale to dramatically increase other downtown assessed values.

What it all means. Property tax assessments may be evenhanded with respect to property owners within each class, but they are not evenhanded between owners of residential property and owners of business property. This is precisely the sort of thing that gives Hawaii its reputation as a "Tax Hell" for businesses.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