PROPERTY TAX "101" – FY2008

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Introduction

This information about real estate taxation is designed to explain the process leading to a tax bill and attempts to dispel many of the common misconceptions associated with this often-misunderstood subject.

Slightly over half the money needed to fund Salem's City Government must be raised through property taxation. The remainder of the revenue comes from other sources such a State aid and local receipts.

Massachusetts's municipal law permits two types of local property taxation – real estate and personal property. Since it affects the greatest number of residents, most public attention is focused on the real estate tax.

Assessed Value & Tax Rate

Every year the Assessing Department adjusts all the City's taxable property according to a procedure outlined in Massachusetts General Law. The new "assessed value" is designed to reflect the property's "full and fair cash value" on the first day of January 2007. Once this is done, the assessors "add up" the total value of all the taxable property in the City.

The City's Finance Department provides the assessors with exactly how much revenue must be raised through property taxation. It is this revenue figure, divided into the total assessed value of the City's taxable property that determines the basic "equalized" tax rate per $1000 of assessed value. (Some communities use this "equalized" rate to tax all classes of property – Salem does not.)

Since Salem has opted to tax residential taxpayers at a different rate than commercial/industrial property owners, the equalized rate information is forwarded by the Mayor to City Council prior to an "annual "classification hearing" and with the agreement of both sides, it is decided how the tax burden will be apportioned. The two new rates, when applied to the new property values, produce the required total revenue amount and become the tax rates for that fiscal year.

Every three years, subject to the dictates of the Commissioner of Revenue, the City is required to undergo a "recertification" procedure. This is commonly known as a "reval year," – a shortened term for "revaluation year." In past years, it was at this time that property owners usually saw the greatest change in their property assessments. With the use of modern computerized mass appraisal systems, most communities, including Salem, now adjust their property assessments on a yearly basis. These assessments closely follow the fluctuations in the marketplace and reflect a property value on the 1st of January prior to the bill on which the new assessed value first appears.

How is Property Value Determined?

The average residential dwelling in Salem gets its new assessment each year from the Assessing Department's analysis of the property market. You could correctly say that the amount your "new neighbors" paid your "old neighbors" for the houses in your area provided the Assessors with the basis for your new assessment. The Assessors program the mass appraisal system with relevant sales information and it generates new values for similar property that did not sell.

Income producing property, such as multi-unit residences or commercial/industrial property is also valued by the mass appraisal system - but by a different methodology. Each year the Assessors request "income and expense" information from owners of "income" producing property and develop values based on property's income generated "return on investment". Sales and cost are also important aspects of valuing commercial/industrial property, but the greatest emphasis is associated with income.

What Makes a Tax Bill Go Up or Down?

Many factors can affect the total amount of your property tax bill and often many influences are at work at the same time. Historically, the yearly cost of running a City increases each year much in the same way the cost of maintaining a household increases each year. If nothing else changed, this increase would cause a tax bill to go up.

<u>These factors could also contribute to an increase</u>:

- Improvement to a property in the form of an addition, finished basement of attic or other alteration that would increase the property's market value.
- A disproportionate increase in the market value of a particular section of the City when compared to another section.
- The discovery by the assessors of incorrect property information such as an additional apartment unit, bathroom or finished basement that was not recorded on the previous assessment.
- In the case of income producing property, the increase of income versus the cost of doing business.

<u>These factors could contribute to a decrease</u>:

- A disproportionate decrease in the market value of a particular section of the City when compared to another section.
- The reduction in the value of the property as a result of an alteration made to the structure,
- The deterioration of the property as a result of neglect, disaster or accident.
- In the case of income producing property, either the loss of income or a change in the income expense ratio.
- Reduction of a form of revenue consuming municipal service(s).
- Other forms of budget reduction.

As you can see from the above, there are many dynamics to each tax bill. Any single factor, but usually a combination of factors, will influence the amount of your bill. Although an "average" tax bill can be statistically produced, very few bills would actually reflect the same amount as the statistical average.

What about Proposition 2 ½?

Simply stated, Proposition 2 ½ says that a community cannot collect any more than 2 ½ % more than the maximum amount it was legally allowed to collect through property taxation in the previous year. This refers to the "total" amount that the City collects from the community and not the "individual" amount it collects from a taxpayer.

What is "Growth" and why is it Important

"Growth," when referred to by municipal officials, means property eligible for taxation this year that did not exist last year. The reason why so much importance is attributable to the "growth figures" is that this infusion of this new-found revenue assists in defraying the impact of budget increases on the tax bill.

Large capital building projects normally contribute to the bulk of the growth figures, but the simple addition of a deck to the back of a house is also part of the calculation. The cumulative effect of growth on the City's economy can often reduce a tax bill by a couple of percent over what it would have been had this "growth" not occurred.

What was/is the "Power Plant" Agreement

Back in 1997, and as a result of the uncertainties surrounding the deregulation of the electricity generating industry, the City entered into a financial agreement with the operators of the power plant on Fort Avenue. Designed to allow both sides a degree of future financial planning, the agreement outlined a yearly schedule of payments in lieu of calculated tax assessments.

During Fiscal Years 1998-2001, the total remittance amount was $8.7 million a year. In FY2002, this amount was reduced to $7.7 million. In FY2003, to $6.7 million. And in FY2004 – FY2007 to $5.025 million. Although plans for a plant upgrade were noted in the agreement and procedures for changing the remittance amount addressed, the upgrade did not occur.

The impact the reduction of revenue had on tax bills was essentially the reverse effect of growth. It was a revenue contribution that was there in previous years that is not there in the ensuing tax year. Because State aid and local receipts are determinants in the amount to be raised from property taxation, the impact did not translate to a dollar for dollar increase, but like growth, translated to a percent or two on tax bills.

In December 2007, the City and Dominion Energy, the present owners of the plant, agreed to a one-year payment in lieu of taxes that would provide the City an additional remittance of $250,000 over last year's total. Negotiations to reach a longer term agreement are expected to continue during the coming months.

Summary

Although a community's tax rate or rates are often a measure of comparison by one city to another, your actual tax bill consists of not one but two parts – the tax rate and the property's value assessment. The better comparison would be to compare a similar home, in a like neighborhood and the "bottom line" of an actual tax bill.

Remember, the city's budget and what part of those funds come from property taxation, determine the amount property owners are asked to contribute in the form of their tax bills. The property assessment and tax rate are the mathematical way in which that sum is realized.

The City maintains a "state of the art" computerized mass appraisal system and periodically reviews, through various processes, all its taxable property. The resulting city-wide adjustments made to property data base assure taxpayers the most equitable distribution of the tax burden Salem tax assessors can provide.

Internet access to this information offers Salem's citizens and taxpayers a clear look at the statistical component of their property assessment and a way to track any discrepancies that might warrant correction now and into the future.