Real Estate Tax Calculation & Factors

Real estate taxes are becoming a bigger part of the housing affordability issue. Real estate taxes are also one of the misunderstood variables of the consumer marketplace.

Real estate taxes first and foremost are generated because the municipal government and other taxing agencies allowed under State law requires income to provide services to the constituents of that municipality. In this area that includes the City (Town or Village), County, Schools and Technical Colleges. No one of those entities controls what happens to the taxes levied against your home. They only control that portion of the tax they levy.

The amount of taxes levied against an individual property are a result of a series of formulas. Any assumption or misassumption made to any of the components of the formula can give a homeowner or buyer of a home a false read on what the final tax will be for that specific property.

Tax Levy: All the government agencies listed above prepare and approve a budget each year. That budget determines the revenues needed to operate for the year and the amount of taxes that need to be collected to allow that operation. It is offset by State contributions to the municipality. The increase or decrease in the tax levy determines the real increase or decrease in the overall taxes assessed against your property. The important thing to remember is that in all budgets there are things that are needed and things that are wanted and things that conceivably can be done better or with less cost.

Value placed on your home: Your levy is dependent on the value placed on your home by the Assessor. That value is based theoretically on what the property should sell for. And, here is where things start getting mixed up. The municipality is required to be fully reassessed every five years. In some cases that can be an estimate from the Assessor on every property or a complete reappraisal of each property by an outside firm. The five year reassessment is designed to equalize all property values to make sure nothing fell through the cracks and everyone is paying their fair share. At that time the “Estimated Fair Market Value” equals the “Assessed Value.” The “Assessed Value” is what you pay taxes on while the “Estimated Fair Market Value” is the indicated market value of the property. The difference between the two is what is known as the “Assessment Ratio.” The lower that number, the greater chance assessments are distributed unevenly.

If the municipality is not going through a general revaluation, the individual properties can be revalued for other reasons. That valuation is effective as of January 1st of each year and is dependent on what the property is actually worth. Items than can affect valuation include a sale (where a new value is indicated based on sales price), improvements to the property (generally looked at after a building permit is pulled) and construction of a new home.

Therefore, just because the taxes on a property look good in comparison now, does not mean the tax levy against that property will remain the same.

The total tax levied against a property is figured as follows:

> Total levy (budget) / Total Assessed Value = Tax Rate (Mill Rate [i.e. $/$1000 of Assessed Value])
>
> Tax Rate X Property Individual Assessed Value = Individual Property Tax Levy

There is another measure of tax levy known as the "Equalized Rate." This is the tax levy based upon the estimated fair market value of a property and is used mostly to compare taxes on a home worth "X" amount of dollars across different municipalities. It gets confusing because the formulas and assumptions to the formulas make the number more of an oddity rather than any meaningful measure.

Why do taxes increase? The simple reason is: Because any of the formula components increase. But, let's look at the concept of "increase."

General reassessments are more misunderstood than any other aspect of real estate taxation. If everyone's property value increases proportionately and the total tax levy remains the same, individual property taxes will remain the same because the tax rate goes down accordingly. The only time an increased valuation results in higher taxes is when the increase is proportionately higher than the tax base as a whole. (e.g. new construction.)

What will increase taxes without a doubt is if the full tax levy (budget) increases without a proportionate increase in the assessed valuation. The more that is spent means the more that needs to be collected. The more that needs to be paid.

Assessment Ratio: Many homeowners look at the property's assessment as a determination of value. The "Assessed Value" is really a creation of the State. It's simply a number on which to base taxes. The real indication of value on the tax role is the "Estimated Fair Market Value" and there are issues with the validity of that number. Theory says this is what you can sell the property for. But, there are factors to the number that may affect their validity. Prejudices from the Assessor, overly aggressive challenges by property owners, time and other changing factors can affect that number without it reflecting on the tax role. The assessment ratio is simply a measure of what the municipality is using for the base versus what they think the property is actually worth.