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Taxation of Residential vs. Non-Residential Property Is a Growing Problem

REAL ESTATE TODAY

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How real estate is taxed varies greatly from state to state. Here in Colorado, we are blessed with very low property taxes compared to many other states. According to USA Today, Colorado has the 7th lowest property tax rates in the country, although that is a statewide average. The median-value home in Colorado has a property tax bill of just over $2,000 per year, whereas the median-value home in New Jersey, the highest taxed state, has an average property tax bill of over $7,200. In suburban New Jersey, property tax bills over $20,000 per year are not uncommon because of the higher values, not just due to higher local tax rates.

In Colorado, property taxes are very much a local affair. Recently there was a hullabaloo over Metropolitan Tax Districts, in which mill levies can double the property tax in newer subdivisions. You can read my Dec. 26 column on that topic at **JimSmithColumns.com**.

This week, however, I'm going to address a different property tax problem that is getting worse every year and has little prospect of being solved politically.

The problem is the growing differential in property tax rates for residential vs. commercial and other non-residential real estate, such as vacant land. First you need to understand that property taxes are levied against the "**assessed**" value of real estate, which is a small percentage of its **actual** value. While the assessment rate for residential property — currently 7.15% — keeps going down, the assessment rate for non-residential property is fixed by the state constitution at 29%. That means that the property tax on residential real estate is 1/4 the property tax on non-residential real estate of the same value.

Rita and I own two pieces of real estate—our south Golden home and the Golden Real Estate office building. The county assessor values our home at twice the value of the office building, but the property tax for our home is one-half the property tax for the office building.

Vacant land is considered non-residential, so it, too, has an assessment rate of 29%. As I've written before, this puts enormous pressure on the owners of vacant land to develop it, which is upsetting if, like me, you value keeping vacant land undeveloped.

To understand how unfair the taxation of vacant land can be, consider a 20-acre parcel in Jefferson County that is currently listed for sale. The county's current valuation of the parcel for tax purposes is $275,554, so its assessed valuation is 29% of that, or $81,071. If the buyer of this land builds a high-end home on it, the valuation might increase, for argument's sake, to $700,000, but its assessed valuation would be only 7.15% of that value, or $50,050. Thus, the property tax bill would drop by nearly 40%, even though the value of the parcel has nearly tripled! The current owner is paying over $7,000 per year for his land to sit vacant.

As I'll explain below, the assessment rate for residential property keeps falling. Last year it was 7.2% and two years before that it was 7.96%. Prior to 1982, property of all types had an assessment rate of 30%, but the Gallagher Amendment changed the non-residential rate to 29% and the residential rate to 21%. Most significantly, the amendment also dictated that the residential assessment rate should be adjusted to retain that year's 45:55 ratio of residential to non-residential statewide property tax revenue in subsequent years.

As a result of that provision, since total residential valuations have grown much faster than non-residential valuations statewide, the 21% assessment rate of residential property has kept falling and will continue to fall. And this is likely never to change, since owners of residential property are the voters, and it's unlikely that homeowners would ever vote to increase their residential property taxes in order to soften the property tax burden of businesses.

Bottom line, residential real estate will continue to bear an ever smaller property tax burden compared to non-residential real estate, and owners of vacant land will feel more and more pressure to develop their vacant land or sell it to developers. The only alternative is to put livestock on the land or to farm it so they enjoy the even lower agricultural property tax rate, but the rules for qualifying for the agricultural rate are fairly strict and are aggressively audited, I would expect, since the cost to counties in lower tax revenue for agriculturally zoned property is pretty substantial.

As the Housing Crisis Deepens, Zoning Laws Are in the Crosshairs

In December 2018, Minneapolis made news when it abolished single-family zoning. That began a nationwide conversation about the use of zoning laws to restrict growth and density at a time when housing affordability was worsening and homelessness was increasing.

One of our broker associates, Chuck Brown, attended the National Association of Realtors convention last November in San Francisco. I had attended the same convention there several years ago. I hadn't noticed many homeless people on the streets back then, but Chuck reported that it was way out of control now, with the streets overcrowded with homeless people.

You, like me, have probably followed the coverage of homelessness in Denver, with that city passing an urban camping ban, which was ruled unconstitutional by a lower court but is still being enforced pending an appeal by the city. It could go all the way to the Supreme Court.

The conversation over zoning created by Minneapolis 13 months ago is growing louder. That's because the history of zoning is one of intentional discrimination. In researching this topic, I read a *Fast Company* posting on the history of zoning in San Francisco.. I'll put a link for that article on the posting of this article at **GoldenREblog.com**. After the 1906 earthquake, the Chinese population there was targeted by zoning changes designed to promote and protect white enclaves. This was long before there were federal laws making discrimination based on race or national origin illegal.

That *Fast Company* article included the following detail regarding the role of the mortgage industry: "In 1934, as part of President Roosevelt's New Deal, the Federal Housing Administration (FHA) was established to insure private mortgages. The FHA's underwriting handbook included guidelines that pushed cities to create racially segregated neighborhoods and encouraged banks to avoid areas with 'inharmonious racial groups,' essentially meaning any neighborhood that wasn't exclusively white."

Another New Deal program to help homeowners threatened with foreclosure to refinance their home with low-interest long-term mortgages, provided lenders with "safety maps" which used red shading for risky areas which were under "threat of infiltration of foreign-born, negro, or lower grade population." This is the origin of the term "redlining," and the practice wasn't outlawed until the Fair Housing Act of 1968.

Last week I attended a meeting of the Group Living Advisory Committee in Denver's municipal building, where they are discussing a zoning amendment which would dramatically increase the number of unrelated persons who can live in a single family home. You can expect this proposal to arise in suburban jurisdictions, too, even if they don't follow Minneapolis in getting rid of single-family zoning altogether.

I'll be reporting again as this conversation evolves. Don't shoot me. I'm just the messenger.

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