

Do People Leave when the Real-Estate Tax Is Increased?

Report FAC/FCA-112

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April 3, 2014

Introduction: The website HowMoneyWalks¹ shows that a net of \$6B (billion) in personal income is now lost annually because wealthier people left Fairfax County and poorer people entered. The work reported herein was performed to determine if the exodus was due to changes in the residential real-estate tax.

Summary: Past history suggests that, by increasing the real-estate tax 6.54%, the county will be causing families to leave the county. The county will be making the taxpayer pay almost 5% of his income in real-estate tax as compared to 3% not many years ago. The 5% will be the highest ever. IRS data implies that this increase will drive more people out of the county. Those that move are not the wealthy but those just under the Area Median Income (AMI), who are living on tight budgets. We can wonder if the tax separates adult children with families from their retired or elderly parents.

Past history also shows that increasing the real-estate tax results in more poor people coming into the county, people earning less than 60% of AMI, probably needing more government resources. The wealthy may currently be able to pay enough taxes to care for those entering the county; however, the increase keeps the county on the path of driving out the lower middle class and, eventually, driving out the wealthy so that only poor people will remain – with nobody to pay the welfare cost – shades of Detroit.

Because this year households are experiencing a 2.1% income increase, the county can reasonably impose a 2.1% tax increase. This increase corresponds to a tax rate of 1.059, which rate includes the stormwater fee. Keying the residential real-estate tax to the household income would be a good standard to use in the future. Without such a standard, the county's only restraint on tax increases is the threat that the Supervisors will not be re-elected.

The tax burden can be reduced if the County Executive's \$20M in savings is used and if the savings identified in two of our previous reports are implemented². Notice that these savings involve cuts in the increase, bringing the budget back toward FY2014 values, but still result in a budget larger than the FY2014 budget.

Discussion:

Background

Real-estate taxes increased 62% between 2001 and 2007 (Figure 1), part of the period covered by HowMoneyWalks. These years are those of the "housing bubble" caused by low mortgage rates and sub-prime mortgages. The data used by HowMoneyWalks was taken from the website of the IRS (Internal Revenue Service)³, which covers years from 1991 to 2009. We also obtained the IRS data, correcting an error in the data for the year 1994. (HowMoneyWalks did not correct the error.) HowMoneyWalks included data for 2010; however, the IRS has since removed the 2010 data to correct the errors in it. In light of the Census Bureau's faking unemployment data⁴, the IRS recall is worrisome, although faking migration data would seem to benefit nobody.

¹ <http://www.howmoneywalks.com/irs-tax-migration/>

² <http://www.fcta.org/Pubs/Reports/2014-03b-fac.pdf> and <http://www.fcta.org/Pubs/Reports/2014-03a-fac.pdf>

³ <http://www.irs.gov/uac/SOI-Tax-Stats-Migration-Data>

⁴ <http://nypost.com/2014/03/26/census-office-survey-scandal-grows-as-inflation-stats-faked/>

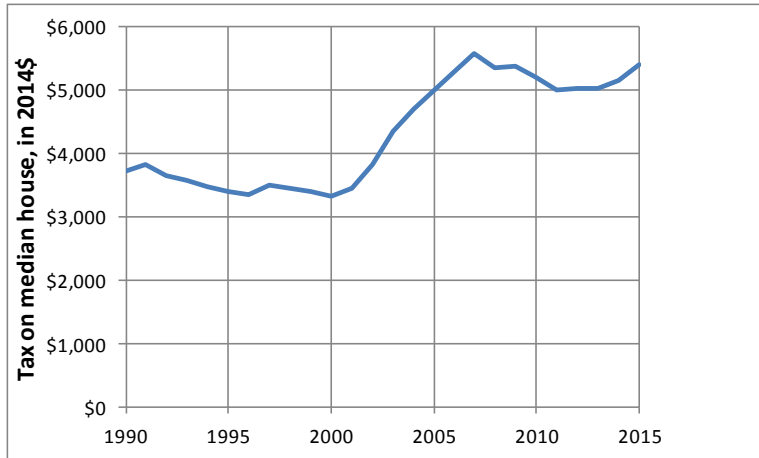


Figure 1: Real-Estate Tax Increased Substantially from 2001 to 2007

Over the years of rapidly increasing real-estate taxes, the migration out of the county exceeded the migration into the county by 5,000 households, far exceeding the net migration rates during the other years (Figure 2). The IRS data is based on the income-tax returns; however, the difference between the number of returns and the number of households in the county’s demographics data⁵ differs little (Figure 3). The net outflow of households amounts to less than 1.5% of the total number of households that remain in the county. In fact, the number of households in the county increased by approximately 1.5% annually from 1990 to 2010, presumably due to family growth because migration could not have accounted for the increase.

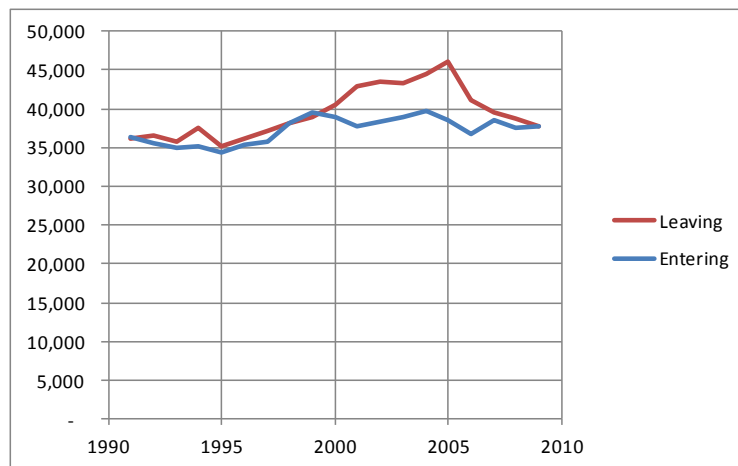


Figure 2: The Number of Taxpayers Leaving the County Exceeds the Number Entering

The IRS data also shows the financial impact of the exodus. The average AGI (Adjusted Gross Income) of those leaving was \$70,546 in 2005, the year of maximum exodus; of those entering, \$58,935. The average difference from 2000 to 2007 was \$8,963. Perhaps as important is the fact that the AGI of those entering is approximately equal to 60% of the AMI (Area Median Income); therefore, many of those entering are probably qualified for affordable housing and free- or reduced-price meals for their school children. Those leaving are not. In 2005, the net loss in the sum of all of the AGI’s (i.e., the total AGI) was 2.7% of the total AGI of those not migrating. In other years of high net migration out of the county, the percent was somewhat less (Figure 4).

⁵ http://www.fairfaxcounty.gov/demogrph/census_summaries/acs-1year/acs2012.pdf

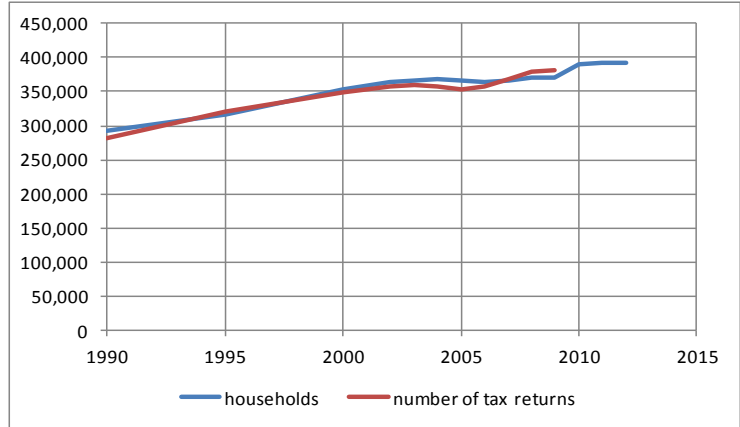


Figure 3: The Number of Tax Returns Nearly Equals the Number of Households

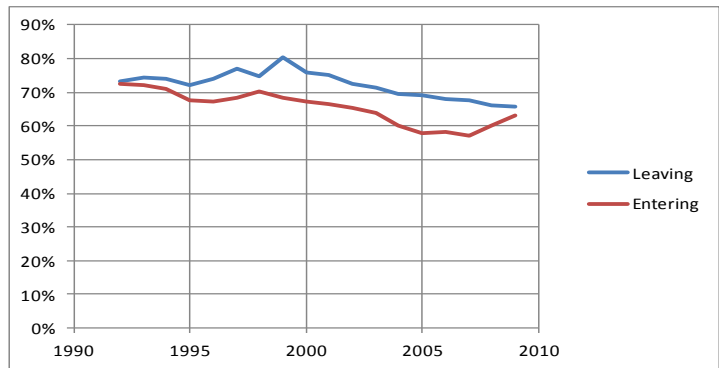


Figure 4: AGI of those Leaving and Entering as a Percent of AMI

That those leaving are at 70% of AMI implies that those somewhat below the AMI are the most affected by an increase in the tax; however, we cannot know for certain. We only know the average incomes of those going; however, the annual change in county population, computed from the ACS data⁵, implies that the people leaving are those somewhat below the AMI (Figure 5)⁶. (The income brackets shown in Figure 5 are: less than \$10,000; between \$10,000 and \$15,000; between \$15,000 and \$25,000; between \$25,000 and \$35,000; between \$35,000 and \$50,000; etc. The top bracket, plotted at \$250,000, consists of those earning more than \$200,000 per year. The data points are at the top of the income brackets.) The distribution in Figure 5 is affected not only by migration but also by salary changes for those not migrating; therefore, there is not a one-to-one correspondence with the migration data.

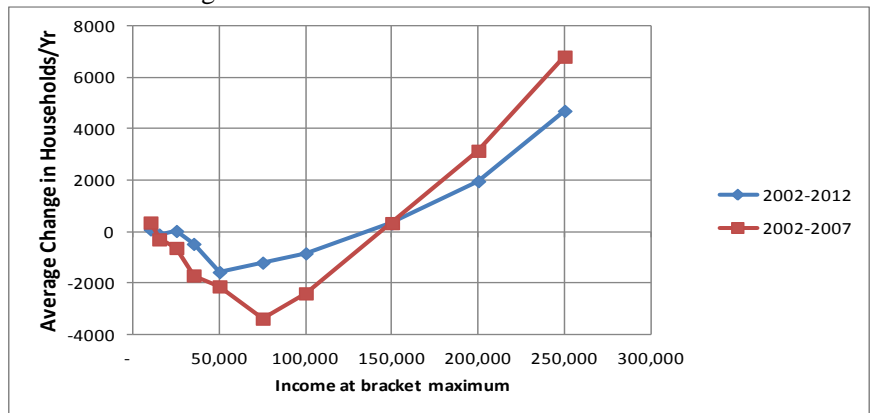


Figure 5: Average Annual Population Changes by Income Bracket

⁶ The AMI ranged from \$85,000 to \$110,000 from 2002 to 2012.

That those entering the county require more county services than those leaving can be inferred also from the county budget's Health and Welfare staffing, rising from 2011 employees in FY2001 to 2144 in FY2007 (1.1% per year) to 2488 in 2015 (1.9% per year), during which time the county population increased at a steady rate of only 0.8% per year⁷. (On a per capita basis, Health and Welfare funding has been nearly constant from FY2001 to FY2014.)

The AGI of those leaving the county is close to the retirement income of county workers who have 30 years of service; however, others are clearly involved. The American Community Survey⁸ shows that, in CY2012, 22% of the households with income receive their income from a retirement system, with the income averaging \$46,000. Therefore, retirees may be leaving the county as well.

From Figure 1 and Figure 2 we can see that there is a correlation between increasing taxes and increasing outflow of households from the county. The relationship is evident when we examine the net AGI outflow in any one year after a change in the real-estate tax (Figure 6). The R-squared for the linear fit is only 0.64, indicating that other factors are also involved (e.g., issuing subprime mortgages and offering low mortgage rates, people not moving until the next year), but the trend is obvious.

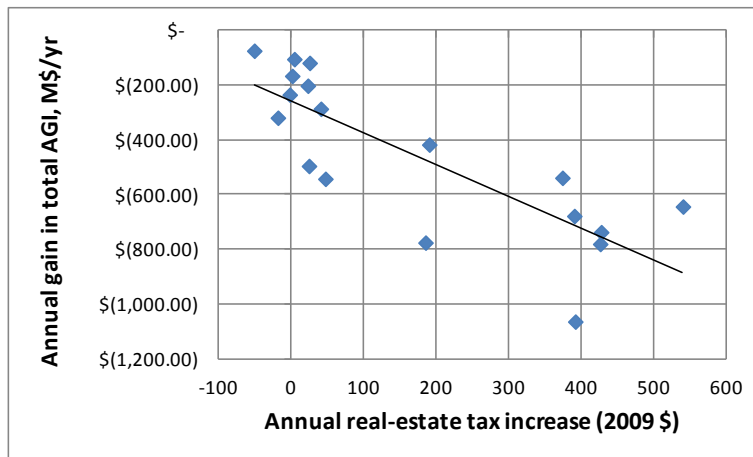


Figure 6: Correlation between Rate of Tax Increase and Rate of Net AGI Migration (R-squared = 0.64)

Impact on County Tax Revenue

We can estimate the impact of the loss of residential income on the county revenue. The cumulative effect of the loss of household income as shown in Figure 4 is a net loss of \$5.9B per year. The county website shows that the median home price is approximately \$442,000 (CY2013) and the median income is \$107,000 (CY2012), so the ratio of house price to income is 4.13. This ratio implies that the \$5.9B in income corresponds to real estate valued at \$24B. At a tax rate of \$1 per \$100 of assessed value, the loss in county revenue is \$244M (million) per year.

Because the county is considering a 6.54% increase in the real-estate tax⁹, or approximately \$350 (\$308 in FY2009 dollars), the exodus will cause a decrease in income of \$680M (\$600M in FY2009 dollars), which translates into a loss of \$28M in tax revenue. Multiplying the current residential tax revenue of approximately

⁷ Taken from the county budget documents: http://www.fairfaxcounty.gov/dmb/archives/budget_archives.htm.

⁸ http://www.fairfaxcounty.gov/demogrph/census_summaries/acs-1year/acs2012.pdf

⁹ The county executive's budget shows a 3.9% increase in real-estate taxes as compared to a 8.7% increase advertised by the BOS ($1.1275/1.105 \times 1.0654 = 1.087$).

\$2,200M by the planned 6.54% tax increase indicates that the increase in revenue will be \$114M – more than offsetting the exodus loss. Therefore, the increase will result in greater revenue.

We do not know if those entering will require more than \$114M in welfare payments. We do know that they are, on average, near the welfare income criterion and we do know that the total welfare budget is \$300M, so the increase should be well less than the \$114M.

Impact on Taxpayer

The county’s proposed tax increase for FY2015 imposes a significant tax burden on the householders. The tax burden on householders increased steadily during the housing bubble, but, as proposed, will be the highest ever, for the 35 years of data that we have gathered. The real-estate tax, as a percent of household income, will reach almost 5% (Figure 7). It was only 3% in 2001.

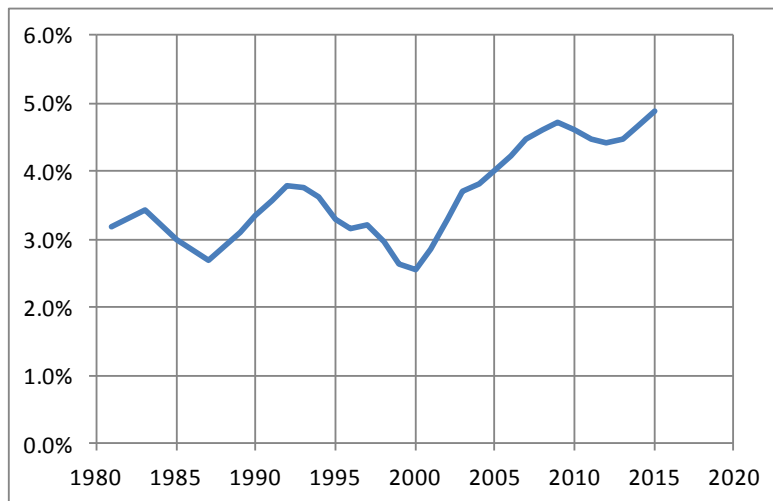


Figure 7: Real-Estate Tax as a Percent of Household Income

That the added tax is an added burden is also apparent when we realize that, in constant dollars, the taxpayer’s income has not increased for the past seven years (Figure 8). He has been able to keep up with inflation but no better.

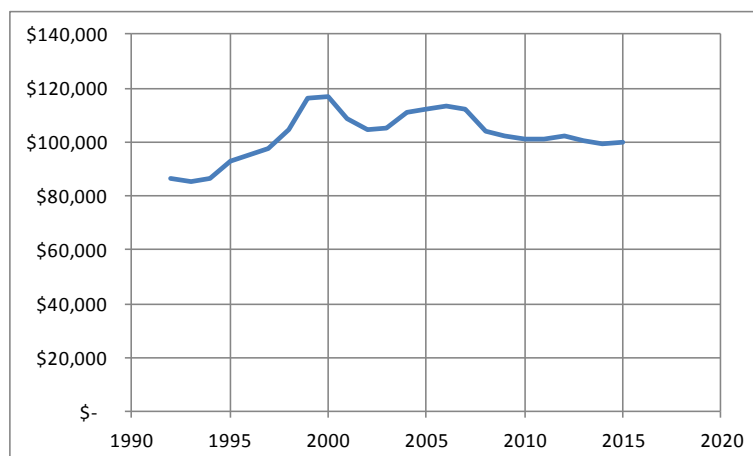


Figure 8: The AGI, in 2009\$, of Those Not Migrating Was Little Affected by the Migration

The county has long stated and keeps hoping that income from non-residential (commercial) properties will allow for lower residential taxes. History (Figure 9) shows that there is no correlation between commercial

development and residential taxes. In FY2015 in particular, commercial taxes have decreased, despite the continuing development. The county wants to offset this decrease by increasing residential taxes to an all-time high (as a percent of residential income).

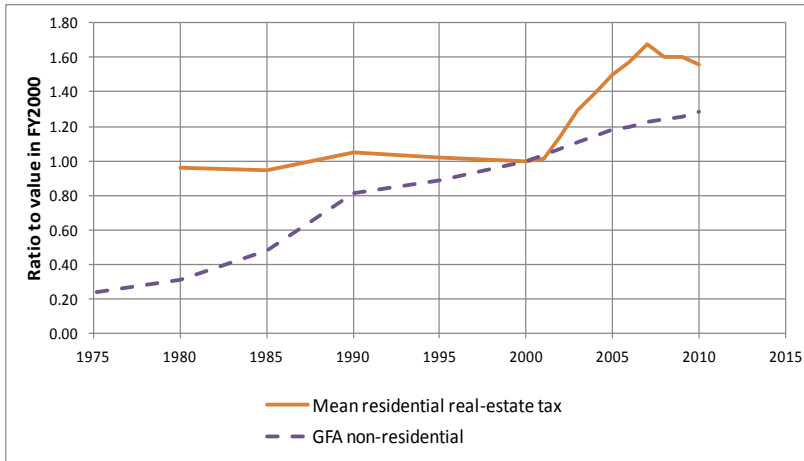


Figure 9: The Non-Residential Gross Floor Area Has No Effect on the Median Household Inflation-Corrected Real-Estate Tax

Appendix A: Adjusted Gross Income (AGI) or Area Median Income (AMI)

In our calculations, we have used the household AGI for non-migrating households as equal to the AMI, although the AGI is akin to the average household income. The American Community Survey (ACS) shows an average (mean) household income that is approximately 25% higher than the median, whereas the IRS data for the average income of those not migrating is close to the median (Figure 10); therefore, for years before 2010, the IRS income was used for the median. The IRS income was preferred so the comparisons would be made from one data source.

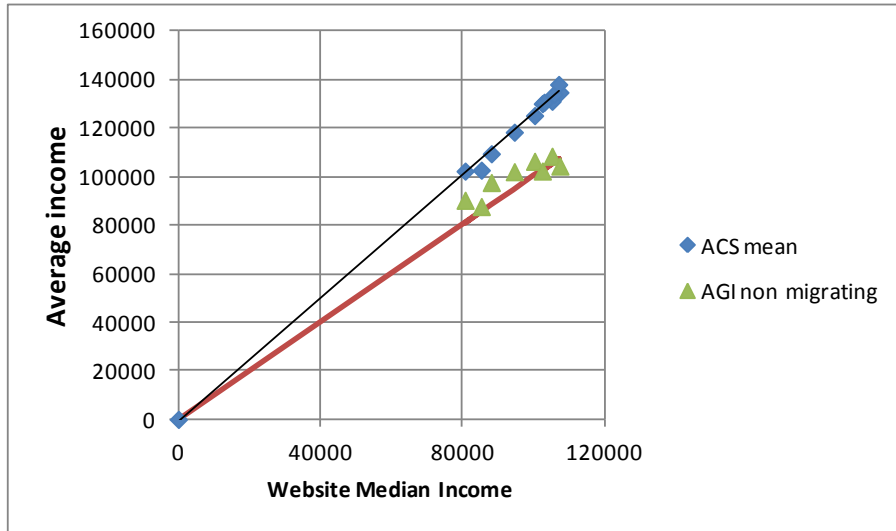


Figure 10: Comparison between Website Mean Income and IRS AGI