

THE
COMMUNITY
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LETTER

NEWS & VIEWS FOR SOUTH CAROLINA'S
GRASSROOTS LEADERS



Cities Depend More on Local Revenues; Public Safety Top Expenditure Category

General revenues and expenditures do not include utility enterprise funds. Information on growth of income and expenditures has been adjusted for inflation.

See the table on page 4 for per capita general revenues and expenditures for the profile cities.

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Since 1983-84, South Carolina's cities on average have been forced to depend more heavily on own-source revenues such as property taxes, licenses, permits, service charges, and local sales taxes, as federal dollars to cities declined sharply.

An analysis of ten years of data reported to the S.C. Budget & Control Board reveals that in 1992-93, own-source revenues provided 81.3% of municipal general revenues statewide. This compares to 69.9% in 1983-84, according to researchers at the Strom Thurmond Institute. During the same period the federal share fell from 23.0% to 6.1%.

Property taxes are the larg-

est single revenue source for cities and were 47.2% of own-source general revenues and 38.4% of total revenues in 1992-93. In 1983-84, the former was 48.2% and the latter 33.7%, a significantly lower share of total revenues.

On the spending side, researchers found that public safety is the largest component of city spending (39.1% in 1992-93) with average per capita spending of \$170.79, nearly twice that of per capita spending on government administration, the second highest city spending category. Per capita revenues and expenditures generally increase as population increases.

To compare cities of different sizes, researchers grouped cities into six size classes by 1990 population, and a 1992-93 fiscal profile was developed for each size class based on average revenues and expenditures (see tables to left, p. 4).

Fictional Tinytown has much lower per capita property taxes, partly because there are

some cities in this size class that levy no millage and partly because Tinytown has a more limited tax base per capita. However, the cities in this size group also provide fewer services, spend less per capita than larger cities, and spend a larger share on administration.

Smallville relies much more heavily on property taxes than Tinytown (39% of revenues rather than 25%) and collects much more property tax per capita. Public safety is the biggest spending area, followed by administration. This pattern holds for all six profile cities. Smallville and Metropolis had the two highest growth rates in solid waste spending between 1988-89 and 1992-93: 27% in Smallville and 32% in Metropolis.

Middletown comes closest to being the "average" South Carolina city. Its per capita finances are close to the state average. Grandville collects less revenue and spends less

*Continued p.4*

| Profile City | Size Class    | No. of Cities | Total Est. 1993 Pop. | % Pop. |
|--------------|---------------|---------------|----------------------|--------|
| Tinytown     | <1,000        | 129           | 55,422               | 4.1    |
| Smallville   | 1,001-5,000   | 87            | 229,438              | 17.0   |
| Middletown   | 5,001-10,000  | 24            | 186,909              | 13.8   |
| Grandville   | 10,001-20,000 | 15            | 194,647              | 14.4   |
| Central City | 20,001-40,000 | 9             | 239,041              | 17.7   |
| Metropolis   | >40,000       | 7             | 445,512              | 33.0   |
| All Cities   |               | 271           | 1,350,969            |        |

ECONOMIC BRIEF NO. 18

## Property Value & Tax Changes

*The market value of any property is determined by its annual rental value and the costs associated with owning or using it.*

Any time tax rules change, some people gain and some people lose. As the General Assembly considers property tax relief proposals, this fact has received little attention.

Economic theory tells us that a reduction in the property tax will increase the market value of property, and an increase in the property tax generally reduces

Cutting the property tax reduces the costs of owning and using a property and so increases the net rental value. An increase in net rental value in future years increases the selling price of that property right now, because it comes with a lower tax burden than it did before. The value of that onetime jump in property values accrues to the owners of real property at the time property taxes are eliminated or reduced. But those who might be thinking about buying residential property in the future will find the price tag on houses has increased.

Eleven studies of real world situations\* indicate that this capitalization process isn't just imagined by economists. It really happens. However, the studies differ in their conclusions about how much of the tax change is reflected in the market price. In some cases it's 100 percent of the tax change; other studies show as little as 50 percent.

All eleven studies, however, concluded that a substantial part of property taxes is capitalized into property values. That is, a change in taxes becomes part of the value of the property.

Based on these studies, it is reasonable to expect that if property taxes were cut in half in South Carolina, the market value of a \$100,000 owner-occupied house would increase by about four to five thousand dollars. If property taxes were elim-

inated all together, the increase would be on the order of ten thousand dollars.

Similar kinds of increases in market values would be seen for other types of property benefiting from tax changes. The existing owners of property reap all the benefits or bear all of the burden, in perpetuity, resulting from changes in rates.

Does this mean that eliminating property taxes in South Carolina will make it harder for first-time house buyers to make a purchase? It almost certainly means they will pay more for a house. The down payment will have to be larger; and because a mortgage is also likely to be larger, monthly payments will be higher. Much of what they would have paid in taxes will now be allocated to these higher costs. They will get some relief from lower annual taxes on the house, but this relief may or may not offset higher mortgage payments.

Yet if eliminating property taxes is likely to be adverse to interests of first-time home buyers, elimination will almost certainly benefit real estate brokers, who will realize larger commissions from selling higher priced property. Lenders should also benefit from interest on larger mortgages. Of course, sellers who own property when the property tax is eliminated will realize substantial windfall gains.

John Yinger, Howard S. Bloom, Axel Borsch-Supan, and Helen F. Ladd, *Property Taxes and House Values*, Boston, Academic Press, pp. 16-36.

### **... sellers who own property when the property tax is eliminated will realize substantial windfall gains**

property values unless the higher taxes are dedicated to things that enhance property values, like sidewalks and street lights. This change in property values is called *capitalization*.

The market value of any property is determined by its annual rental value and the costs associated with owning or using it. Even if a property isn't rented now, it may be rented in the future. It also has rental value to the current owner who gets to use it without actually paying rent.

A property's rental value can be viewed as a stream of future payments just like buying a bond or putting money in a certificate of deposit creates a stream of interest payments. Since payments in the future are worth less than today's, they are discounted. So the value of property is the sum of those discounted future payments.

***In furtherance of Clemson University's land-grant mission, the Community & Economic Development Program at Clemson provides access for community leaders in South Carolina to expertise in all branches of knowledge on the University campus.***

## Business Considers Impacts of Tax Reform

In all the debate over tax reform in South Carolina, the focus has been on property tax relief for home owners. But, while households have been busy calculating tax savings, business firms and economic developers have been thinking about how tax reform might affect businesses.

Business firms also pay property taxes, sales taxes, and corporate income taxes or individual income taxes on income from partnerships and proprietorships. So, the business community clearly has an interest in how the burden may be redistributed.

Tax reform hits firms differently, especially if firms differ in the amount of taxable property relative to sales or in the amounts of purchases subject to sales tax. A reform that has little effect on a manufacturer may be devastating to a distribution firm and result in a net gain to a tourism complex.

Tax reform may affect business firms differently depending on location. The property tax rate for school purposes can be as low as 100 mills in Anderson District 1 or as high as 276 in Hampton County's South 2 District. The county tax rate ranges from 44.5 mills in York County to 147 in Hampton County.

Tax reform that reduces tax

differences between counties or school districts may make it easier for counties like Jasper—where the mill rate is high because the county has so little industry—to attract new firms. Such reform would reduce some of the appeal of the I-85 counties where the tax burden is shared with a lot of other firms.

New firms pay more sales taxes than established firms because of the purchase of construction materials and other start-up costs subject to the sales tax. Established firms usually find the property tax to be their biggest tax liability. A shift from the property tax to the sales tax would increase the total tax burden on all firms, but especially on new firms.

How tax reform affects the business community depends on the direction the legislature chooses. All proposed changes will ease taxes on home owners. So obviously the share paid by business firms will increase.

If property tax relief for home owners is financed with new sales taxes, businesses will pay more dollars as well as a larger share. If property tax relief is funded out of state revenue growth and cuts in state agency budgets, the business community will pay

the same amount of dollars but a larger share in exchange for fewer public services. Cuts in appropriations for road repairs, technical education, maintenance of tourism facilities, local governments' infrastructure grants, and higher education will have an impact on most business firms.

Studies suggest that in making location decisions, firms typically choose several sites based on factors like transportation, location of markets, and the local labor force. Then, tax rates become one of the factors in choosing among similar sites. Tax rates may determine on which side of a county or school district line to locate.

For over 30 years South Carolina has invested heavily in its economic development program. Key components of the program are the existing tax structure, the highway system, investment in water and sewer systems, the public schools, quality higher education, and the technical colleges' special schools programs.

Tax reform, whether paid for out of higher taxes or paid for out of cuts in public programs and services, needs to consider impacts on the business community and the state's ability to successfully recruit new firms.

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**Businesses in South Carolina pay about 35 to 40 percent of the property tax, sales tax, and income tax. They pay a smaller share of the income tax, a larger share of the property tax, and about the same share of sales tax as firms in other states. New firms get relief from city and county taxes for five years, but do not receive school tax relief.**

**The assessment rate for manufacturing and utility property is 10.5 percent as compared to 4 percent for owner-occupied residential property and 6 percent for commercial and rental property.**

## Revenues and Expenditures of S.C. Cities . . . —From p.1

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on services than the cities just above and below on the size spectrum. On a per capita basis, only Tinytown collects less revenue and spends less. However, Grandville includes two limited service municipalities whose finances somewhat distort the group averages. Most of the electric cities in South Carolina are in the Middletown and Grandville size classes, so transfer of surplus utility revenues to the general fund is more significant in these two size groups than elsewhere.

Central City has the highest dependence on property

taxes—41% of general revenue, almost \$200 per capita. This group makes limited use of local option sales taxes and utility transfers. Combined with a larger per capita tax base than smaller cities and the highest population growth of any profile city, the property tax has had to shoulder the burden of paying for growing service demands.

Both revenues and spending in Metropolis are much higher, total and per capita, than in the other five profile cities. The seven cities in the Metropolis size class are able to generate more revenue per

capita from licenses and permits and receive more state aid per capita than smaller cities. They offer more diversity in services, and in 1992-93 they spent more per capita than smaller cities in every category but transportation.

More detailed municipal financial profiles, based on this research, soon will be available in the Municipal Association of South Carolina's report "The Fiscal State of South Carolina Municipalities." This will help cities to evaluate how they compare to cities in their size class.

**Per Capita General Revenues & Expenditures, S.C. Profile Municipalities, 1992-1993**

|              | Revenues (\$) |             |       | Expenditures (\$) |             |          |            | Total |
|--------------|---------------|-------------|-------|-------------------|-------------|----------|------------|-------|
|              | Own-Source    | Intergovtl. | Total | Admin.            | Pub. Safety | Environ. | Recreation |       |
| Tinytown     | 191           | 68          | 259   | 80                | 81          | 24       | 6          | 216   |
| Smallville   | 266           | 76          | 342   | 70                | 135         | 48       | 20         | 313   |
| Middletown   | 340           | 69          | 409   | 94                | 186         | 65       | 31         | 440   |
| Grandville   | 227           | 75          | 302   | 50                | 122         | 44       | 24         | 282   |
| Central City | 393           | 90          | 483   | 89                | 182         | 64       | 83         | 480   |
| Metropolis   | 466           | 92          | 557   | 105               | 206         | 68       | 83         | 561   |
| All Cities   | 358           | 83          | 441   | 86                | 171         | 59       | 54         | 436   |

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