



Tax reform clause may be discouraging buyers

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For the South Carolina real estate industry, the chickens are coming home to roost.

Almost two years ago, state lawmakers hastily passed a massive property tax reform bill — its provisions first sketched out on the back of a box of takeout chicken — that dramatically cut the amount of money property owners owe in taxes each year.

The law was widely praised at the time, but business leaders soon realized it had the unintended consequence of discouraging real estate sales. That's because, in most cases, a sale now causes a large increase in the new owner's annual tax bill.

Real estate groups are calling that provision a deal breaker for both home and commercial property sales, which already are hampered by a national market slowdown. Industry representatives are calling for relief, saying the state risks losing its business-friendly reputation.

It's unclear, though, if any help will come.

"It's been a deal breaker," said David Lockwood, senior vice president of Colliers Keenan of Columbia. "(Buyers are) not thinking twice about it, and a lot of sellers are saying, 'We can't sell,' because it's lowering their values so much."

The property tax reform bill passed with only two days left in the 2006 lawmaking session. The move came during a heated election year when voters demanded that something be done about their spiking property tax bills, caused partly by rapidly rising real estate values across the state.

Lawmakers admit the measure was passed hastily. Rep. Bill Cotty, R-Columbia, who drafted most of the bill, scrawled out its provisions on the back of a takeout box from Bernie's Broasted Chicken, a popular restaurant in downtown Columbia.

One of the bill's goals was to protect longtime property owners from paying taxes on the appreciated value of their homes. It created a 15 percent cap on reassessments, meaning a property owner's

assessment couldn't rise more than that during each five-year reassessment period.

To keep the capped assessment rate from reducing tax revenue too much, they created a provision called "point of sale" reassessment. That means that when a property sells, it is reassessed at the sale price almost immediately. The increase shows up on the following year's tax bill.

Business leaders didn't object when the measure passed. Real estate groups were busy trying to manage an unprecedented real estate boom, and most lawmakers were heavily focused on lowering tax bills for voters in their districts.

"There was such a groundswell of support for property tax reform, it was hard for a legislator to get in the way and ask what the long-term effects are going to be," said Otis Rawl, vice president of public policy for the South Carolina Chamber of Commerce.

But the bill's consequences are becoming clear as county reassessment offices start sifting through last year's sales to figure out the new assessments. Charleston County Deputy Assessor Bobby Cale estimates that the prices of properties were about 45 percent higher than the appraised value in late 2003, when his office last gathered assessment data.

What that means is, on average, properties sold in 2007 will have a taxable value 45 percent higher than the previous owners paid.

As a result, the new system discourages the purchase of real estate, and not just for buyers who are new to South Carolina, said Nick Kremydas, president of the South Carolina Association of Realtors. Most people move every seven years, and most homes in South Carolina are sold to people who already live in the state, he noted.

"Fifteen or 20 years into the future of this, it would be a huge deterrent from moving out of a home because it might be more expensive to buy a smaller home," Kremydas said.

The exact economic impact of the new law is hard to calculate. Most evidence of its negative effect on business is anecdotal.

Commercial brokers point to specific deals that didn't go through because potential buyers balked at the tax bill. And at meetings in Horry and Georgetown counties with more than 300 Realtors, two-thirds of the attendees raised their hands when asked if they had lost a deal because of the new tax law, Kremydas said.

Commercial properties are affected more dramatically because that type of real estate usually is more expensive than residential.

Bob Nuttall Jr., who co-owns Anchor Commercial brokerage firm in Charleston, gave a hypothetical example of a 42,000-square-foot commercial building that sold for \$8.35 million, a reasonable rate in today's market.

If the previous appraised value was \$5.1 million, the property's taxable value rose about 63 percent. The new owners likely would see their annual tax bill jump from \$69,861 to \$114,380, a \$44,519 increase.

It isn't just property owners and real estate agencies that are affected. Most retail stores have leases that allow the tax increase to be passed on to them, meaning business owners likely would have to absorb the added cost, Nuttall said.

"They're going to have to increase their prices or you might see some of them fold," he said.

Apartment community owners have been hit the hardest by the new law, Lockwood said. Monthly rentals already are set at competitive market rates, making it hard to pass the costs on to tenants. The tax increase would have to come directly out of profits, making the communities a less attractive buy for investment groups, he said.

Business leaders haven't been shy about sharing their experiences with state lawmakers, who are starting to look at ways to tweak the property tax law.

Cotty, for example, is working on a bill that would eliminate the point-of-sale reassessment altogether. Property owners would still enjoy the 15 percent reassessment cap, and buyers would pay the same taxes as the previous owner until the next scheduled reassessment.

The change would restore property tax predictability that was lost under the new system and encourage buyers to commit, Cotty said.

Rep. Chip Limehouse, R-Charleston, said he would support Cotty's proposal because it would help pull the state's economy out of its current slowdown.

"If you had Cotty's proposed legislation in place, the real estate market would boom," he predicted.

It's unclear, though, how easily the proposal would pass.

Rep. Jim Merrill, R-Daniel Island, said he knows the current law needs tweaking, but he wants to see better evidence of its effect on residential and commercial sales.

"Most of the time that this has been in place, we've been in what looks like a recession," he said. "Most of the country is having a slowdown in sales as well, and they don't have the property tax bill there."

Also, Cotty's proposal doesn't address the millions of dollars that would be lost from county, city and school district revenue without the point-of-sale provision.

Charleston County Budget Director Mack Gile estimates the proposal would remove \$3 million a year from the county's general fund. Last year's revenue totaled about \$162 million.

"It's something that we would notice," he said.

But as lawmakers debate possible changes, Kremydas says the state's business-friendly reputation is dwindling.

"We can't afford to wait," he said. "We've seen hundreds and hundreds of millions of dollars in investment that have gone to Georgia and North Carolina. We're already behind other states in economic development, and if we don't address it this year, we're going to be paying for this for years to come."

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