BILL # SCR 1026 **TITLE:** property tax valuation rollback

SPONSOR: Gould **STATUS:** As Introduced

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FISCAL ANALYSIS

Description

If approved by voters in the 2008 general election, this resolution would roll back the valuation of real property in tax year (TY) 2010 to the full cash value (FCV) established in TY 2003. Additionally, SCR 1026 would replace the current formula for limiting valuation growth ("limited property value") by a new formula under which the limited value would be referred to as "uniform property value" (UPV).

Under the proposed formula, a parcel's UPV in TY 2010 would be the lesser of its FCV in TY 2003 or TY 2010. Beginning in TY 2011, a parcel's annual UPV increase would be limited to the difference between its FCV in the current and prior year multiplied by a discount factor represented by the ratio of UPV to FCV for all parcels in the county in the prior year. However, SCR 1026 would limit the annual increase under the aforementioned formula to the greater of 2% or the 2003 baseline value of new improvements.

For new parcels added to the tax rolls for the first time in TY 2010 or later and for parcels either added to the tax rolls or modified after TY 2003, the UPV would be determined based on the 2003 baseline value of comparable properties. Annual increases of the UPV would be limited to 2%.

Beginning in TY 2010, the resolution would require real property to be valued and taxed in the same calendar year. Under current law, the valuation and taxation of real property is on a 2-year cycle; a parcel's value is determined in one calendar year and taxed in the following calendar year.

Estimated Impact

Beginning in FY 2011, the state would pay a substantially higher proportion of K-12 formula costs than under current law because the K-12 Qualifying Tax Rate (QTR) that helps fund those costs would be applied to a greatly reduced local property tax base and, therefore, would generate less funding. Currently (for FY 2009) monies generated by the QTR fund approximately $2.0 billion of total K-12 formula costs, with the state backfilling the remaining $4.0 billion requirement. Even a relatively small percentage reduction in QTR revenues under the bill, therefore, could substantially increase state backfill costs.

The state impact of SCR 1026 will also depend on the Legislature's decision on truth-in-taxation (TNT). Under the TNT tax provisions, the QTR normally decreases automatically as an offset to rising property values. TNT appears to also permit automatic increases in the QTR to offset declining values. If this occurs, the tax rate increase would mitigate the cost impact, but not eliminate it.

If local taxing jurisdictions raise their tax rates in response to a reduced tax base, SCR 1026 could also result in higher costs for the state's 1% cap program. Under the Arizona Constitution, the state caps a homeowner's primary property tax bill to 1% of the parcel's limited value. Any amount in excess of 1% is paid by the state in the form of additional state aid to school districts. The lower property values will have the effect of qualifying more homeowners for this program.

While the state General Fund could incur substantial costs from SCR 1026, it is not feasible to determine those costs, at least in the normal two-week response time for a fiscal note. In addition, the magnitude of the cost will depend on subsequent decisions concerning TNT. If tax rates remain at the current levels, the SCR's General Fund impact would probably be measured in hundreds of millions. We will continue our efforts to refine our estimates after the publication of this note.

(Continued)

Analysis

Impact on Tax Base

The valuation rollback in TY 2010 coupled with the limitation in valuation growth in TY 2011 and later will result in a significant reduction of the property tax base relative to current law. However, valuation data reported in the Department of Revenue's (DOR) annual *State and County Abstract of the Assessment Roll* is not detailed enough to analyze the impact to the tax base. To obtain a sense of the order of magnitude, however, it may be instructive to note that the full cash value of real property has increased from a little more than $300 billion in TY 2003 to slightly less than $600 billion in TY 2007. It should be noted that some portion of this increase is attributable to new properties added to the tax rolls after TY 2003.

Under the Arizona Department of Education's Basic State Aid formula for school districts, a valuation loss reduces the local share of K-12 funding, which results in a commensurate increase in state aid. However, under the state's TNT provisions for equalization assistance, a reduction in property values would also result in a proportionate increase in the QTR so that the local share of the funding formula would remain unchanged. Note that if the Legislature decides to forego such rate increase, however, the entire cost of the valuation loss would be borne by the state.

There is, however, a limit to the offsetting increase of the QTR under TNT since Prop 301 caps the rate at $4.2530. Thus, for sufficiently large valuation reductions, the QTR would not be allowed to increase enough to prevent the local share of the funding formula from declining. Under such a scenario, the state share of K-12 funding would have to be increased. To provide some perspective, it is estimated that a 32% reduction in assessed valuation in FY 2009 would be enough for the QTR to reach the cap. Stated differently, notwithstanding TNT, any valuation reduction in excess of 32% in FY 2009 would result in additional Basic State Aid costs. For example, if property values declined by 35% in FY 2009, it is estimated that Basic State Aid would increase by $730 million if the Legislature decided not to allow the rate to increase and $104 million otherwise. Additionally, even if the Legislature decides to allow the tax rate to increase, the valuation reduction under SCR 1026 may still be large enough to cause the QTR to reach its cap, under which Basic State Aid costs could still increase by $100 million or more, as illustrated in the example above.

Impact on Tax Rates

Since SCR 1026 would have no impact on the 2% levy limit provision under the Arizona Constitution, counties, cities, and community college districts would be allowed to raise their tax rates in response to reduced valuations. This constitutional provision allows taxing entities to increase the annual levies by 2% plus tax revenues from new construction. Under a scenario of higher tax rates and lower property values, the state's cost for the 1% Cap program could increase significantly.

The Arizona Constitution limits combined primary property taxes to 1% of an owner-occupied residential parcel's limited value. For example, if a homeowner's parcel has a limited value of $200,000, their total primary tax bill would not be allowed to exceed $2,000. Thus, if this property owner faced a combined primary property tax rate of $9.90 per $100 net assessed valuation (NAV), their tax liability of $1,980 would remain within the 1% cap. (NAV is obtained by multiplying a parcel's limited value by its assessment ratio, which is 10% for residential property. Tax liability is derived by dividing a parcel's NAV by 100 and then multiplying the resulting number by the rate.)

Since SCR 1026 would not prevent taxing entities from levying the same amount as under current law, it is possible that the cost for the 1% cap program could increase. For example, if the value of the property used in the example above would decline by $60,000, or 30%, as a result of a valuation rollback, and taxing districts decided to levy the same amount as previously, the homeowner's tax bill would (in the absence of the cap) remain at $1,980, which is 1.41% ($1,980/$140,000) of the property's value. Under this scenario, the property owner would only be required to pay 1% of the property's value, or $1,400, whereas the state would have to pay the remaining amount ($580) to the school district where the parcel is located. The example above suggests that the valuation rollback under SCR 1026 could have the effect of shifting some of the residential property tax burden to the state.

Since neither the valuation loss nor the extent to which taxing jurisdictions will raise their tax rates is known, it is not possible at this point to determine the cost increase associated with the 1% cap program.

Local Government Impact

This bill may result in property tax losses for local governments.