Fiscal Note

BILL # HB 2315

TITLE: primary residence; property tax; exemption

SPONSOR: Jones

STATUS: As Introduced

PREPARED BY: Benjamin Newcomb

Description

HB 2315 and its companion bill, HCR 2017, would provide a property tax exemption for Class 3 primary residential property that is not encumbered by a mortgage or a deed of trust. Since HCR 2017 would amend the Arizona Constitution, it would require voter approval at the next general election in November 2024. Therefore, the enactment of HB 2315 is conditional upon the passage of HCR 2017. If HCR 2017 is approved, the proposal would become effective beginning in tax year (TY) 2025 which would first affect FY 2026.

Estimated Impact

We estimate the legislation would have a net General Fund cost of $221.8 million, beginning in FY 2026 prior to applying the state's Truth-in-Taxation (TNT) adjustments. The proposal would reduce Net Assessed Valuation (NAV), which would increase the state's Basic State Aid (BSA) cost for K-12 schools. At the same time, the bill would also reduce the cost of the Homeowner's Rebate (HOR) program, under which the state pays 50% of a homeowner's primary school district tax.

This $221.8 million net cost would be more than offset by savings under the automatic school tax rate adjustments provided under the state's TNT provisions. Once TNT savings are incorporated, the General Fund would realize a net savings of $(149.8) million, beginning in FY 2026.

The General Fund net savings under TNT would occur for the following reasons. First, the TNT calculation automatically increases the Qualifying Tax Rate (QTR) to offset the decrease in levies that would otherwise result from the NAV loss attributable to the proposal. This rate increase has the effect of eliminating the BSA General Fund cost increase related to existing property that would otherwise occur under the proposal.

Second, since the TNT calculation would result in a higher QTR under the proposal than under current law, there would be a shift in the property tax burden of taxpayers with qualifying residential properties to other property taxpayers, especially owners of non-residential property. As described in more detail in the *Analysis* section below, this tax shift has the effect of reducing the state cost for the HOR program.

The tax shift under the bill assumes that local governments respond to the NAV reduction by increasing their tax rates rather than lowering their spending.

Analysis

The bill would create a property tax exemption for any primary residence not subject to a mortgage or any other form of encumbrance. According to the Arizona Department of Revenue's 2022 Abstract of the Assessment Roll, the total NAV of Arizona Class 3 primary residential property is $33.8 billion, which we estimate will grow to $39.3 billion by TY 2025.

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According to the U.S. Census, approximately 36.5% of Arizona owner-occupied housing units are unencumbered by a mortgage. For our analysis, we assume unencumbered primary residential properties are distributed evenly across income groups and property values. Applying this percentage to our estimates of Class 3 NAV yields a reduction of $(14.3) billion in TY 2025, which would represent a (16.0)% reduction of the total statewide property tax base. We assume this reduction would primarily affect existing property.

Pre-TNT Impact – By reducing NAV by $(14.3) billion in TY 2025, the proposal would result in a direct BSA cost increase of $443.6 million, beginning in FY 2026. The $(14.3) billion Class 3 (primary residence) NAV reduction would also have the effect of reducing the cost of the HOR by an estimated $(221.8) million. The direct net impact on the 2 state programs is a cost increase of $221.8 million, beginning in FY 2026.

Post-TNT Impact - The NAV reduction under the proposal would have an impact on the state's TNT program. Under TNT, the QTR is adjusted each year to offset the statewide annual valuation change of existing property. This rate change occurs automatically unless the Legislature decides to forgo the TNT adjustment. Due to the $(14.3) billion NAV loss, the TNT adjustment would result in the estimated QTR being $0.62 higher in FY 2026 under the proposal than under current law. While the revenue from the higher QTR under TNT would not have any fiscal impact on existing property, it would generate BSA savings of $9.9 million due to higher FY 2026 property tax collections for new property compared to current law.

Under the HOR program, the state pays 50% of the QTR levied on Class 3 property. The remaining 50% is paid by the homeowner. Other classes of property do not receive the homeowner's rebate. After the application of TNT, the HOR General Fund savings decline from $(221.8) million pre-TNT to $(139.9) million.

The Arizona Constitution, Article 9, Section 18 provides that the total amount of taxes collected on Class 3 residential property for primary tax purposes cannot exceed 1% of the parcel's limited property value. To the extent the bill increases property taxes above the 1% cap, the estimated General Fund savings would be overstated.

Local Government Impact

Apart from the QTR shift described above, the proposal could also result in a tax shift of other primary as well as secondary taxes levied by local taxing jurisdictions, such as counties, community college districts, cities, and special taxing districts. The amount of such tax shifts would depend on the extent to which local taxing jurisdictions would raise their tax rates to make up from the loss of levies under the proposal. *Table 1* below shows the maximum potential shift of total (primary plus secondary) property taxes under the proposal.

The estimates included in *Table 1* assume that taxing jurisdictions would levy the same amount under the proposal as under current law. Under this assumption, taxpayers with unencumbered primary residences would have a total (primary plus secondary) tax reduction of $(1.35) billion in FY 2026.

Table 1

Maximum Potential Property Tax Shift
($ in Millions)

Property Class	Primary Tax Shift	Secondary Tax Shift	Total Tax Shift
Non-Class 3 – commercial and other	$662.0	$390.7	$1,052.8
Class 3 – primary residences with mortgage	256.3	193.6	450.0
Class 3 – primary residences without mortgage	(768.6)	(584.4)	(1,353.0)
General Fund	(149.8)	0.0	(149.8)
Total Net Change	**$0.0**	**$0.0**	**$0.0**

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The reduced HOR cost combined with the higher QTR levied on new construction under the bill would generate total General Fund savings of $(149.8) million. (This amount is the sum of HOR savings of $(139.9) million plus BSA savings of $(9.9) million from the higher QTR levied on new construction.)

This means that under the assumption that local taxing jurisdictions would set their rates in a manner that would "hold them harmless," the savings realized by taxpayers with unencumbered primary residences of $(1.35) billion and by the General Fund of $(149.8) million (for a total of $1.50 billion) would essentially be offset in the form of a tax shift of $1.05 billion to non-Class 3 property and $450.0 million to encumbered Class 3 property, (for a total of $(1.50) billion).

2/6/23