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F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 3/10/19

SPONSOR HTRC **LAST UPDATED** ____ **HB** 647/HTRCS

SHORT TITLE Limits On Valuation Of Certain Property **SB** ____

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
		Minimal impact because of rate-setting procedures			Recurring	State GO bond revenue
		Would increase substantially.			Recurring	State GO bond capacity
		Would probably increase, particularly if the new value were considered net new value and not valuation maintenance in yield control formula			Recurring	Municipal, County, School, Special District operating revenues
		Minimal impact because of rate-setting procedures			Recurring	Municipal, County, School, Special District GO revenues
		Would increase substantially.			Recurring	Municipal, County, School, Special District GO capacity
		Could be substantial – approaching 5 percent in some jurisdictions if the new valuations were considered valuation maintenance and not net new value in yield control formula.			Recurring	Tax decreases for owner occupants after first year of residency
		Could be substantial – approaching 50 percent in some jurisdictions.			Recurring	Tax increases for second homeowners or owners of rental properties

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total			Substantial as PTD would have to draft guidelines, rulings and, perhaps, regulations to deal with special cases.		Recurring	TRD/PTD operating
			Substantial as assessors would have to reclassify properties as owner occupied or not		Recurring	County Assessors

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Taxation and Revenue Committee substitute for House Bill 647 restricts the three percent per year property tax valuation cap of 7-36-21.2 NMSA 1978 to owner-occupants of residential property. The exact phrase is "… by the owner as the owner's principal place of residence." In addition, it sets a 10 percent property tax valuation cap in 7-36-21.2 NMSA 1978 for owners of residential property that is not occupied by the owner.

The provisions of the bill are applicable to the 2021 property tax year. If this is correct, valuations would be published in April of 2021. Yield control calculations would be performed by DFA/LGD in September 2021. Tax payments reflecting the changes would be due in November 2021 and March 2022, both payments affecting local receipts in FY2022.

FISCAL IMPLICATIONS

TRD provided some fiscal analysis of the original bill. LFC staff have updated the table to reflect the provisions of the HTRC substitute.

Estimated Revenue Impact*					**R or NR****	**Fund(s) Affected**
FY2021	**FY2022**	**FY2023**	**FY2024**	**FY2025**		
0	8,000	10,000	8,000	6,000	R	Counties & Municipalities
	400	500	320	300	R	State General Obligation Bond Fund

The Taxation and Revenue Department (TRD) polled some county assessors to estimate the value of property that was undervalued based on the 3 percent valuation increase cap in Section 7-36-21.2 NMSA 1978. This was scaled by the percentage of residential property that is not owner occupied. This result was then used as a sample for the whole state, scaling based on statewide residential property valuation, and an average residential millage rate applied.

LFC staff adjusted these data assuming that the average second home and rental residential housing would take about six to eight years to arrive at current and correct.

Note that property tax is handled differently than nearly all other tax programs in that it has yield control, which adjusts the tax rates downward (where possible) to control for increases in valuation. About 60 percent (weighted by value) of the residential property in the state still allows yield control. Assuming that those areas which are mill rate capped also will not be able to reduce their mill rate, this means only about 40 percent of revenue gains associated with higher valuations will actually be realized by the state and local governments. The gain is mostly

to county treasuries, with approximately 4.5 percent being experienced by the state General Obligation Bond fund, which is used to make debt service payments on State GOBs.

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LFC note: virtually all jurisdictions in the state have experienced yield-control reductions in residential operating rates. The "capped" amounts referred to here are primarily attributed to non-residential rates, and those rates are subject to separate yield control reductions..Also, a careful analysis of the effects of yield control for the period of 2010 through 2018 indicate that few jurisdictions are at .5 mill for the allowed residential property school operating. These are Vaughn in Guadalupe County, all jurisdictions in Sierra County, Encino in Torrance County and Zuni in McKinley County.

There would be no FY21 impact and the FY22 impact would be the full amount.

Apparently, the TRD analysis assumes that the yield control procedure will use any increase in values as valuation maintenance that will reduce the revenue gain to the local jurisdictions in favor of reducing operating (and debt) rates for all residential properties. That said, the $20 million annual impact estimated by TRD is a good order of magnitude estimate of the shifts that could either benefit advantaged taxpayers and, possibly, local jurisdiction operating revenues.

Calculating the impact for the 228 county, municipal and school district property tax jurisdictions is a difficult. We can, however, derive some general principles by analyzing data downloaded from the American Community Survey, 5-year 2012-2017 housing and population datasets. A sample of this profile is included at the end of this review. Statewide, the provisions of this bill would increase valuations for an estimated 24.2 percent of all residential properties. How much these property valuations would increase is quite difficult to determine, because it depends on how many years the property has been advantaged by the three percent cap. From the same dataset as in the table, the average property has been granted 16 years of valuation cap. The value of that cap, however, depends on the comparison of the 3 percent cap with the housing median price inflation from when the property was first granted the 3 percent cap. In the years from 2001 when the three percent cap first went into effect until 2010, when the "housing bubble" increased housing prices/values to all-time highs, statewide housing price inflation was about 74 percent. The lowest inflationary growth was experienced in Roosevelt Count at 2.6 percent for the entire period and the highest was in Santa Fe County with 287 percent increase. From 2010 to 2017 property tax years, statewide housing inflation was only 9.2 percent. For most counties, housing values have just recovered to the housing bubble levels. From these statistics, we can derive some approximate rules.

- All counties, and most sub-jurisdictions within counties, will have some proportion of residential properties that would not qualify for continuing with the 3 percent cap. This proportion averages 24 percent statewide, with a minimum of 2.1 percent in Rio Arriba County and 49.2 percent in Lincoln County (with its vast numbers of second homes). Santa Fe County would reclassify 23.7 percent of its residential properties – close to the statewide average.
- If properties have been owned for a long time on average, then the difference between capped value and uncapped value will be larger. Statewide, this average number of years is 16.0; the minimum is for Curry County at 13.8 years (apparently, there are a number of abandoned properties in the county) and the maximum is for Rio Arriba County, 22.3 years.

- For most jurisdictions, the primary impact of losing the three percent cap would fall on non-owner occupied rental properties. Many of these properties, particularly in Bernalillo County, are owned by out-of-state interests.
- These owners will probably testify that an increase in their operating costs would result in an increase in rents. This may or may not be true, since all markets are subject to supply and demand forces and the housing market is largely an efficient market. This increase in property taxes for some properties will not alter to any great extent the amount of personal income from which renters have the resources to pay rent. Ultimately, of course, the rental housing market may be somewhat displaced as some middle-income renters choose to buy houses and get a property tax cap. However, these new homeowners will experience a slight to significant increase in property taxes compared to the previous owners as the newly purchased property would be revalued to market. In efficient housing markets, this upward revaluation resulting in higher property taxes would cause housing prices to be lower by approximately the net present value of the increase. In less efficient markets, like perhaps the 22 rural counties that have lost population in the last seven years, this effect might be magnified and housing prices would be depressed even farther than would be warranted by the increase in property taxes.
- New Mexico has an unusually large percentage of our rental population paying more than 30 percent of their monthly income on rent. Statewide, this number is 42 percent, with a maximum of 58 percent in Doña Ana County and a minimum of seven percent in Harding County. To the extent that the provisions of this bill would increase rents, this 42 percent statistic issues a significant warning. We do not want to displace individuals and families and increase an already critical homelessness problem.

SIGNIFICANT ISSUES

Most of the significant impacts of this bill have been discussed above in the "Fiscal Implications" section. However, listed below are some additional, general understandings of the issue the provisions of this bill attempt to address.

Under the current law, county assessors may not raise the assessed value of residential properties more than three percent per year, no matter what the property's market value is (with some exceptions, such as when a property is sold). Residential properties include not just owner-occupied homes, but also rental units and second homes. HB 647 proposes to limit the 3 percent annual cap just to homes that are occupied by the owner as their principal residence. Therefore, investor-owned properties and second homes would be required to pay their fair share of taxes based on the market value of the property.

The bill intends to make the tax burden more equitable by ensuring that a greater share of properties are assessed at their actual market value. Owner-occupied properties would probably see their taxes go down (see technical issues, below) and investor-owned properties and second homes would almost certainly see their taxes go up, depending on how much of an under-assessment these properties currently enjoy.

Homeowners occupying a residence as a principal residence will probably see the total tax bill decrease (again, see technical issues, below). This is because of *yield control*. Yield control ensures that as values go up, rates come down to keep property tax revenues consistent and avoid a windfall to the taxing jurisdictions. The assessor still will not be able to raise valuation more than three percent per year, but the tax rate will be lower.

For investors, the effect depends on how under-assessed the property is now. Under-assessed properties will be brought up to their "current and correct" market value. However, since yield control also applies to these properties, rates will go down as well.

Under the current system the assessment of a property increases to market when it is sold. That aspect of the law will remain. What will change is that new homeowners will benefit from a lower tax rate, and thus lower overall tax burden than they currently do. This may affect the sales/purchase price of any given property, again depending on how much increase in taxes a new owner might experience. Since most new homeowners pay property taxes at the same time and in the same manner as making payments on a mortgage, the changes may result in lower monthly payments and thus make it easier for potential homeowners to buy a home. But some of the effects will be counterintuitive as markets adjust to the new tax regime.

Investment properties may experience a reduction in market value. The value of investment property is typically determined by capitalizing the property's net income. If expenses increase and rents remain constant, the market value may decrease.

Real estate investors typically set rents at the fair market rent, which is "the rent currently prevailing in the market for properties comparable to the subject property."[1] That is, investors charge what the market will bear. If landlords ask more than the fair market rent, tenants will go elsewhere.

In fact, there is a good indication that rents will not increase, long term. The reduced property tax rate will encourage construction of new rental units, because it lowers the costs of operation. If tenants have the option of leasing new units at the same market rent, investors cannot raise rent on existing units and remain competitive.

Moreover, if new units are built, that will increase the supply, which results in more competition and this effect can be expected to bring rents down.

Some comments on the provisions of the bill include, "…doesn't the bill give a tax break to wealthy homeowners?" The short answer is "yes", but the longer answer is, "… under our constitution the benefits of the cap on increases can be limited based on income, and doing so would result in a more progressive property tax system. HB 647 will reduce rates for all homeowners, and it does not attempt to remove the cap for higher income individuals. As a practical matter, such a bill would be controversial because it would raise taxes for the majority of homeowners throughout the state."

Every residential property will be affected. There are 656,000 residential properties in the state. Data from Bernalillo County indicates that 63 percent of residential properties are owner occupied. Statewide data from the ACS survey indicate that 76 percent of all properties are owner occupied. In rough numbers, the taxes for 498,000 homeowners will be expected to decrease and the taxes for 159,000 investors and second homeowners will be expected to increase. This is an approximate estimate and does not take into account properties that have been renovated or expanded in the course of the tenure of the owners.

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[1] International Association of Assessing Officers, *Glossary for Property Appraisal and Assessment*

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking advantage of the three percent cap. These data may be transmitted in the abstracts submitted each year to DFA/LGD to aid in the calculation of yield control changes in imposed operating rates. However, although DFA/LGD publishes the property tax rate sheets, including aggregate valuations by property tax jurisdiction, the abstracts are not generally available to the public or the legislature. One only has to look at the difficulty of quantifying the effects of the provisions of this bill to determine that more information would be desirable.

ADMINISTRATIVE IMPLICATIONS

The Assessors have on file for each residential property a declaration and claim for the $2,000 deduction for head of household. To a first approximation, these declarations are a surrogate for home ownership and occupation as a principal residence. To the extent that this is true, each assessor may bear the price of programming changes to each county's computer assisted mass appraisal (CAMA) system. These costs can probably be borne out of each county's 1 percent revaluation fund.

TRD indicates that the provisions of this bill would not affect TRD operations to any extent. LFC staff believe, however, that there will a considerable effort required by TRD to regulate or instruct some of the details of this change.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

There are an unusually large number of bills this session proposing changes in the property tax.

HB332 establishes a separate class of undeveloped land used for conservation purposes.
HB429 increases the property tax valuation freeze of 7-36-21.3 NMSA 1978 from $32 thousand modified gross income to $50 thousand modified gross income.
HB520 redefines solar systems as tangible personal property under certain circumstances and creates a property tax exemption for qualifying systems.
HB596 redefines the structure housing the data center, the HVAC systems, special cabling and wiring as tangible personal property and proposes a special method of valuation that equals 5 percent of initial cost.
HB647 proposes limiting the 3 percent valuation cap to owner-occupied properties.
HJR2 proposes a property tax freeze for low-income elderly, with household income less than $15 thousand.
HJR3 proposes a property tax freeze for low-income 100 percent disabled, with household income less than $15 thousand. SB220 proposes an increase in the income cap for the property tax valuation freeze of 7-36-21.3 NMSA 1978 from $32 thousand modified gross income to $35 thousand modified gross income.

SB-352 is a duplicate of HB596.

TECHNICAL ISSUES

There are two major issues that should be resolved. Perhaps it would be best to resolve these issues in statute rather than rely on the property tax division (TRD/PTD) to regulate these elements.

Historically, TRD/PTC has been critically understaffed, and, perhaps for that reason alone, uses letters of instruction to the assessors rather than proposing, then promulgating regulations. The most recent regulation posted in the New Mexico Administrative Code (NMAC) for property taxes is dated 2001. Numerous property tax issues are not resolved.

The two issues that should be resolved here are: (1) if the landlord occupies one unit of a multiple-unit apartment complex, is that sufficient to grant all units in the property the three percent cap? Note that a typical Santa Fe casita, separate from the main house which is owner occupied, would qualify the entire property for the cap; and (2) it is unclear if the increased valuation from removing the three percent cap would be considered as new value or valuation maintenance in the yield control formula. This is property that has been on the rolls – sometimes for years – so an increase in value would be considered as valuation maintenance and would cause the yield control procedure to reduce the effective operating rates by a similar amount to the valuation increase. However, County Commissioners and elected assessors might feel that this increase in valuations should be considered net new value. The difference is whether revenues to the beneficiaries would increase or be approximately level despite a significant increase in valuation.

LFC staff recommend that both of these issues be resolved in statute.

OTHER SUBSTANTIVE ISSUES

A series of stories in the Santa Fe New Mexican in early February by Thom Cole has highlighted the distortions implicit in the three percent valuation cap.

/http://www.santafenewmexican.com/news/local_news/taxing-inequities-effects-of-cap-on-residential-property-increases-vex/article_1440b04e-4515-5d91-927b-8bf67f99f8f5.html

Taxing inequities: Effects of cap on residential property increases vex policymakers

- By Thom Cole | tcole@sfnewmexican.com
- Feb 9, 2019

An extract of significant issues uncovered by Mr. Cole relating to property in Santa Fe include the following:

- Nearly 26,000 homeowners received a tax break last year because of the law, but about 8,900 didn't.
- Newer homebuyers often may pay substantially more in property taxes than their neighbors.
- The average tax break last year for the owner of a home valued at $300,000 or less was $221.

• The average tax break in 2018 for the owner of a home valued at $1 million or more was $1,345.
• The biggest tax break last year for a homeowner was more than $16,000.
• The homeowners who received the biggest tax breaks in 2018 included a corporation, investment bankers, business entrepreneurs, a Texas oilman, a psychologist, artists, a physician, a lawyer and a philanthropist.
• Eighty-one owners of multiresidential properties got a tax break in 2018, but 105 didn't.
• A California real estate investment company that owns a large south-side apartment complex and a Tennessee company that owns a senior living center each received a tax break last year of more than $40,000.

ALTERNATIVES

So much of the impact of the provisions of this bill are speculative and certainly highly variable between and among the 228 property tax jurisdictions. One LFC staff suggestion is to phase in the fiscal impacts of the provisions of this bill to approximately parallel economic behavioral responses. Contractors may choose to accelerate building plans for more affordable homes (to give middle-income renters the option of buying a home) or more rental housing. (With a higher vacancy rate, out-of-state landlords would be less likely to pass the property tax increases on to their, perhaps, lower-income tenants.) Phasing in the impact would also tend not to encourage investors to increase rents to capture the full effect of the revaluation.

The following was an LFC staff suggestion to moderate the tax increases for non-owner occupants. Although the suggestion was to double the cap for non-owner occupied properties, this substitute increased the cap to 10 percent:

> One way to phase in the economic effects would be to double the three percent cap to six percent for non-owner-occupied properties. Assuming there is never again a massive "housing bubble", such as occurred in 2006-2008, then in five- to ten-years, most rental and second-home properties would be at or near current and correct. At that point the housing market would have re-equilibrated and rents and housing prices would have fully incorporated the change in valuations.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The distortions and disincentives implicit in the three percent cap will persist. Other data from the ACS indicate that homeownership is not as popular as it has been in history. Homeownership is the best way of enhancing civic pride and participation. Any law that discourages home ownership should be changed. If the provisions of this bill are not the right solution, then the debate on this proposal might invigorate the search for a better solution.

One of the LFC's tax policy principles is equity. This bill addresses a critical inequity in the state's property tax system.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

Note: the following is a sample of far more extensive analysis of the effects of the bill and an analysis of the baseline effects of the three percent cap. Full data are available from the Legislative Council Service.

Geography	Total Residential Properties	Properties eligible for 3% Cap	Properties Not-Eligible	2005_2010 Median Home Value	2012_2017 Median Home Value	ACS average Annual Growth Median Price	Avg Ann. Growth, Res. Taxable Value, from yield control
Bernalillo County	214,991	73.3%	26.7%	$188,800	$189,700	0.1%	2.8%
Catron County	2,761	53.9%	46.1%	$129,400	$164,600	3.5%	7.4%
Chaves County	21,447	71.9%	28.1%	$86,200	$106,400	3.1%	3.7%
Cibola County	7,057	75.6%	24.4%	$74,800	$89,800	2.6%	2.9%
Colfax County	7,208	51.8%	48.2%	$103,100	$105,900	0.4%	1.3%
Curry County	16,540	59.6%	40.4%	$98,500	$131,200	4.2%	0.0%
De Baca County	913	64.6%	35.4%	$71,100	$67,700	-0.7%	5.1%
Doña Ana County	56,148	78.9%	21.1%	$137,200	$140,700	0.4%	2.3%
Eddy County	17,610	77.2%	22.8%	$90,700	$143,100	6.7%	6.7%
Grant County	9,466	95.9%	4.2%	$125,000	$125,300	0.0%	2.1%
Guadalupe County	1,514	72.3%	27.7%	$74,500	$81,100	1.2%	3.2%
Harding County	442	62.7%	37.3%	$70,300	$67,800	-0.5%	2.8%
Hidalgo County	1,461	76.4%	23.6%	$90,800	$81,200	-1.6%	0.5%
Lea County	18,199	78.6%	21.4%	$87,500	$118,500	4.4%	6.5%
Lincoln County	12,699	50.8%	49.2%	$166,600	$171,900	0.4%	2.3%
Los Alamos County	6,588	84.3%	15.7%	$297,100	$285,300	-0.6%	0.5%
Luna County	5,960	93.3%	6.7%	$91,700	$83,800	-1.3%	2.4%
McKinley County	18,184	68.7%	31.3%	$69,300	$62,800	-1.4%	0.5%
Mora County	1,868	76.9%	23.1%	$107,500	$109,100	0.2%	4.0%
Otero County	20,876	73.1%	26.9%	$104,500	$106,300	0.2%	3.6%
Quay County	4,051	68.3%	31.7%	$65,200	$72,200	1.5%	2.2%
Rio Arriba County	11,618	97.9%	2.1%	$136,300	$167,100	3.0%	1.4%
Roosevelt County	6,053	64.9%	35.1%	$94,800	$114,300	2.7%	9.8%
Sandoval County	47,633	72.8%	27.2%	$184,400	$183,300	-0.1%	0.8%
San Juan County	31,236	94.8%	5.2%	$149,400	$143,300	-0.6%	3.7%
San Miguel County	9,394	81.6%	18.4%	$112,200	$132,900	2.4%	2.8%
Santa Fe County	53,661	76.3%	23.7%	$291,700	$277,700	-0.7%	0.4%
Sierra County	4,175	84.9%	15.1%	$92,800	$99,600	1.0%	1.9%
Socorro County	4,743	91.1%	8.9%	$108,400	$103,000	-0.7%	2.2%
Taos County	14,821	62.7%	37.3%	$212,400	$218,400	0.4%	1.9%
Torrance County	4,591	95.9%	4.1%	$92,300	$111,700	2.8%	2.8%
Union County	1,949	62.2%	37.8%	$91,900	$89,500	-0.4%	3.4%
Valencia County	20,689	95.7%	4.3%	$129,900	$133,100	0.3%	1.5%

Geography	Total Residential Properties	Properties eligible for 3% Cap	Properties Not-Eligible	2005_2010 Median Home Value	2012_2017 Median Home Value	ACS average Annual Growth Median Price	Avg Ann. Growth, Res. Taxable Value, from yield control
Total	656,546	75.8%	24.2%	$158,268	$162,780	0.4%	2.3%

LG/al/gb/sb/gb