FISCAL IMPACT REPORT

SPONSOR Neville **ORIGINAL DATE** 02/11/14
LAST UPDATED **HB**

SHORT TITLE Residential Property Valuation Limits **SB** 260

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
	$0.0	**	**	**	Recurring	General Obligation Bond Fund
	$0.0	***	***	***	Recurring	School, County, Municipal and Special District Debt Funds
	$0.0	****	****	****	Recurring	School, County, Municipal and Special District operating funds

(Parenthesis ( ) Indicate Revenue Decreases)

** See Fiscal Impacts below for detailed discussion of the effects of this bill on State General Obligation Bond debt rates and the shifts in property tax burden between different classes of taxpayers.
*** See Fiscal Impacts below for detailed discussion of the effects of this bill on School, County, Municipal and Special District Debt rates and the shifts in property tax burden between different classes of taxpayers.
**** See Fiscal Impacts below for detailed discussion of the effects of this bill School, County, Municipal and Special District operating rates and the shifts in property tax burden between different classes of taxpayers.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY14	FY15	FY16	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		***	***	***	Recurring	County Assessors
Costs related to increased protest activity		$0.0	$150.0	$150.0	Recurring	TRD/PTD operating

Parenthesis ( ) indicate expenditure decreases

*** Assessors in counties that currently have computer mass appraisal systems (CMAs) will have relative little difficulty implementing the provisions of this bill, although the 85 percent and 90 percent limitations will require some custom programming. Assessors in counties without CMAs will have a very difficult time with the provisions of this bill.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 260 adjusts the property tax valuation limitation provisions first enacted in 2000. The basic 3 percent annual valuation increase (7-36-21.2 NMSA 1978) would be increased to a basic 5 percent annual increase limitation and properties would gradually be increased over the years to current and correct, or to approximately 85 percent of current and correct. The bill also provides additional limitations on valuation for long-time residents: after the primary valuation limitations have been calculated, the total valuation is to be multiplied by 95 percent for homeowners who have owned their homes for ten or more years and 90 percent for homeowners who have owned their homes for 20 or more years and who are 65 years old or older. The bump in valuation ("tax lightning") is still allowed to occur on change of ownership, when new permitted construction is added or if there is a change in zoning or use of the property. The basic rule becomes that residential property will be valued at its current and correct value as a standard, with the Constitutionally permitted and mandated limitations expressed as a percentage of current and correct. A majority of residential properties in the state would be subject to some limitation, but the limitation would be, in general, less compelling that under the current 3 percent standard. By relaxing the 3 percent standard, "tax lightning" which strikes when properties are sold, would also be moderated.

EFFECTIVE DATE

Not stated; assume May 21, 2014. Applicable for property tax years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

As with all property tax bills, the combination of yield control and debt rate setting procedures will mean that the provisions of this bill will have modest impact on any of the revenue beneficiaries for some number of years in the future, although this bill will increase revenues for the beneficiaries over time. The provisions of this bill will moderate, but not eliminate "tax lightning" experienced by individual new property owners. The impact on beneficiaries will be discussed for two types of property tax rates.

- Debt rates are set by dividing the required debt service by the taxable base for all classes of property. Thus, the total amount of money generated by debt rates are exactly neutral to the bill's provisions. This is not the same as the impact on taxpayers. If some taxpayers do not have the 5 percent cap on their annual valuation, they will pay an increasing share of the total debt service over time. Taxpayers who have owned their homes before January 2015 and have continuously owned them after January 2015 will pay a steadily decreasing share of the total debt service. This general principle applies to all debt rates – state general obligation bonds and municipal, county, school district and special district debt.

- Operating rates are determined by a complex formula called "yield control." Bringing properties up to current and correct would be considered "valuation maintenance", while new construction is considered, "net new value." As more

> and more homes have their valuations increased each year to current and correct, the greater will be the valuation increase and corresponding decrease in yield-controlled rates. Beneficiaries will not receive much increase in revenue from the provisions of this bill because of this interaction with yield control. Beneficiaries will receive additional revenue from net new value and a relatively small portion of valuation maintenance will also add revenue to the beneficiaries' coffers. The impact on individual taxpayers will be complex as well. Taxpayers who have owned their homes before January 2015 and have continuously owned them after January 2015 will pay a steadily decreasing share of the total operating levies, because the lower yield controlled rates applied to their artificially low valuation will give this class of taxpayers a windfall for as long as they own their homes. This general principle applies to all municipal, county, school district and special district operating rates.

It should be emphasized that this bill does not create a tax expenditure, but modifies and reduces the magnitude of an existing tax expenditure over time.

TRD explains the same result from a different perspective:

> Impacts of the proposal would vary significantly from county-to-county because of regional housing market variations [and differences in the diligence of county assessors, ed.]. Raising the residential properties to 70 percent of the current and correct value in 2015, 85 percent in 2016 and setting the limitation on increases to 5 percent per year could cause a significant increase in residential net taxable value statewide. The resulting increase in net taxable value would generally be offset by reductions in rates that are subject to provisions of Section 7-37-7.1 NMSA 1978, commonly referred to as "yield control". The yield control statute requires rates to decrease when reassessment occurs, in a manner that prevents reassessment from generating increases in revenue yields.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditures may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures. This statement applies to reduction in a tax expenditure as equally as to the creation of a tax expenditure.

SIGNIFICANT ISSUES

For Property tax year 2015, the limitation would be the greater of:

- 105 percent of the 2014 valuation;
- 110.25 of the 2013 valuation; or
- 70 percent of current and correct.

For property tax year 2016 and subsequent tax years, the limitation would be the greater of:

- 105 percent of the preceding tax year's valuation;
- 110.25 of the valuation two years earlier; or
- 85 percent of current and correct.

The third provision – a reference to a percentage of current and correct – will make a big difference in counties with poor current sales-assessment ratios. As discussed in the "Fiscal Issues" section above, however, these substantial increases in some valuations will improve equity without generating revenue windfalls for the beneficiaries.

TRD is somewhat skeptical whether this bill will solve the "tax lightning" problem:

> This proposal repeats the generally acknowledged policy error of 2001 in which counties were effectively allowed to determine when they had reached 85 percent of current and correct value before instituting the 3 percent valuation cap. The failure of county assessment organizations to reach this goal over a decade ago, combined with the limitation on increases in residential valuation has resulted in widespread disproportionate assessments on similar properties. Statewide residential values average approximately 65 percent of market value. The dispersion in percentage of market values is much broader, ranging from about 30 percent to 11 percent.
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> This legislation does not address valuation methods for new construction. This omission could create strong property tax disincentives regarding newly constructed housing. New construction would likely be assessed at cost rather than value. PTD thinks that the law should provide that new construction be valued consistently with other assessed values for like properties in the taxing jurisdiction. This requires sales-ratio studies as well.
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> This proposal needs to be combined with full disclosure legislation to be effective. Assessors need to have a better grasp of non-residential property value to fairly distribute tax obligations. In 2012, the weighted average gap between residential and nonresidential rates was approximately 16 percent state-wide. In Santa Fe County, the 2013 gap is roughly 39 percent. This spread is attributable to negative valuation maintenance in nonresidential assessments. If assessors don't have uniform disclosure to verify the value of the properties they assess, they will continue to lose assessed value. Assessors will also need disclosure to verify that they have met the valuation targets of the residential properties they intend to increase.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> 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 limitations. However, DFA/LGD has access to all of the rate sheets from all of the property tax districts in the State. The format of these rate sheets could be changed so that either DFA/LGD or TRD/PTD could determine the effect of limitations in various classes.

ADMINISTRATIVE IMPLICATIONS

The 2015 effective date of this legislation is at odds with the county assessor's ability to perform the massive revaluation necessary before they are required to mail their notices of valuation on April 1, 2015. The common difficulty with many assessors' offices is that while they know the statutorily allowable value for their notices of value, they are not statutorily responsible for knowing the current and correct value of all of the residential parcels in their jurisdictions.

Without sales ratio studies that include appraisals on specific properties and mandatory disclosure, this goal will be difficult to reach.

Prior to any county starting a revaluation program, the assessor's and staff should have a reappraisal plan approved by PTD and the county commission. This plan should include regular reporting on the status of their revaluation effort and sales ratio studies.

TRD is concerned that an abrupt change in valuation procedures mandated by this bill may cause a dramatic increase in both informal and formal protests. Currently, there are approximately 30 thousand valuation protests per year, of which approximately 3 thousand reach a formal board hearing. This fills the PTD's protest schedule for roughly ten months per year. While PTD is in the process of filling its existing four vacancies, it would need to hire two full time employees at a likely additional (not including current vacancies) cost of $90 thousand per year. We would also have additional County Valuation Protest Board meetings to finance along with legal counsel to defend us in litigation and oversee the additional production of decision and orders. PTD estimates that this would increase protest board costs approximately 50 percent, or, $60 thousand. Total anticipated cost to accommodate this change at PTD is $150 thousand per year.

RELATIONSHIP

HB 178 proposes a different solution to the "tax lightning" dilemma. HB 221 proposes an exemption for low-income, elderly homeowners.

TECHNICAL ISSUES

Apparently, the bill requires assessors to value a property at current and correct in the year of sale, but at no more than 85 percent of current and correct in the year following a sale. This "up-and-down" valuation will cause a great deal of confusion. If the 85 percent of current and correct limitation were extended to the year of sale, then the uproar about "tax lightning" would be proportionately reduced.

TRD requests that the sponsor take the opportunity with this bill to add three elements:

- Address equitable valuation methods for new construction.
- Combine this proposal with full disclosure legislation.
- Require all New Mexico counties to move to a one-year valuation cycle. (There are nine counties on two-year valuation cycles.)

OTHER SUBSTANTIVE ISSUES

TRD/PTD is the administrative agency supervising the state's 33 assessors. The following comments relate to this supervisory role:

> This legislation specifies the highest of an annual 5 percent cap on value or current and correct value. PTD has had the opinion that the State Constitution Article VIII, Section 1 specifies that there shall be a limitation on the annual increases of residential values. It doesn't say what that limitation should be, but the limitation is described as annual. In PTD's view, an increase from 3.0 percent

> per year to 5.0 percent per year seems to satisfy the constitutional provision. It is difficult to argue that moving value from 50 percent to 70 percent of current and correct is a limited annual increase. The local option language in the Constitution is troubling as well.
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> If the decision is made that only percentage increases are constitutional, raising the limitation on increases from 3 percent to 5 percent per year presents an excellent opportunity to phase in current and correct values. Still, under-assessed properties will benefit more than their neighbors who are assessed at a higher percentage of market value. For example, if identical property A is assessed at 85 percent of current and correct, a 5 percent increase in valuation translates to a 4.25 percent move toward market value. For a residence assessed at 50 percent of market (identical property B), this same 5 percent increase equates to a 2.5 percent gain toward market value. If yield control was precisely applied and these two properties represented the market as a whole, rates would decrease 3.75 percent. This practice benefits under assessed properties. The fair alternative is to increase the values inversely to the ratio of current assessment to market value working from the bottom up.

TRD also comments on other aspects of the property tax system in New Mexico:

> Rates that are subject to yield control consist mostly of operating rates, or rates that generate operating revenues of counties and municipalities. Other rates, such as fixed voter approved rates, have historically not been subjected to the yield control statute, and would not adjust downward as a result of revaluation required by the proposed measure. The Property Tax Division (PTD) believes that this proposal needs to be combined with provisions to subject voter approved rates to yield control as the tax base increases. County debt management practices that maintain capacity rather than repay debt obligations should be reexamined in light of an unforeseen valuation increase

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

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

This proposal will improve adequacy, substantially improve efficiency and equity. However, it will make a complicated tax more complicated and further confuse the average taxpayer, who understands neither yield control, nor the setting of debt rates, nor the 3 percent residential valuation limitation.

LG/jl