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

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|---|---|---|---|---|---|
| | | **ORIGINAL DATE** | 01/31/14 | | |
| **SPONSOR** | Egolf | **LAST UPDATED** | 01/31/14 | **HB** | 178 |
| **SHORT TITLE** | Correct Residential Property Valuations | | | **SB** | |
| | | | | **ANALYST** | Graeser |

## REVENUE (dollars in thousands)

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **FY14** | **FY15** | **FY16** | **FY17** | **FY18** | | |
| | $0,000.0 | ** | ** | ** | Recurring | General Obligation Bond Fund |
| | $0,000.0 | *** | *** | *** | Recurring | School, County, Municipal and Special District Debt Funds |
| | $0,000.0 | **** | **** | **** | 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** | | *** | *** | *** | Nonrecurring | Local Assessor's Operating Funds |

(Parenthesis ( ) Indicate Expenditure Decreases)

## SOURCES OF INFORMATION

LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)

## SUMMARY

Synopsis of Bill

House Bill 178 proposes that the current 3 percent annual cap on residential property valuation no longer apply to properties that have changed ownership after January 1, 2015. This proposal was studied extensively during the interim by Revenue Stabilization and Tax Policy Committee. The charge from the committee was to address all or a portion of the "tax lightning" problem, while allowing the property tax base to gradually migrate toward current and correct permanently.

House Bill 178 amends Section 7-36-21.2 NMSA 1978, to expand the exceptions to the limit the increases in value of residential property for property tax. It broadens the revaluation upon change in ownership exception to the valuation cap (commonly called "tax lightning") by eliminating the single year protection for properties that change ownership. This results in perpetual assessment for these properties at current and correct value. Pursuant to current statute, the 3 percent valuation increase cap does not apply to: (a) a change of ownership of the property occurred **in the year immediately prior to the tax year** for which the value of the property for property taxation purposes is being determined. This bill adds another exception to the 3 percent cap for valuation <u>of a residential property **in any tax year** in which a change of ownership of the property occurs on or after January 1, 2015.</u>

**EFFECTIVE DATE** January 1, 2015

**FISCAL IMPLICATIONS**

The provisions of this bill will have modest impact on any of the revenue beneficiaries for some number of years in future, although this bill will increase revenues over time. On the other hand, it will have little additional impact on "tax lightning" experienced by individual new property owners. The valuation for the year of the change in ownership will reflect what the new owners actually paid for the property. This initial "sticker shock" will continue every year thereafter, but at far lower levels of additional taxes after the initial shock. Valuations for this class of homes will be maintained at current and correct, even when the annual increases in market value exceed 3 percent If the average New Mexico property changes hands every ten years, then it will take approximately 6 years for 50 percent of the properties in the state to be current and correct and 12 years for 75 percent of the properties to be current and correct. In 25 years, 90 percent of properties will be current and correct. 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 3 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.

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**

TRD/PTD commented in the December 11, 2014 testimony to RSTPC.

> This proposal eliminates the cap in perpetuity for homeowners who purchase their properties after January 1, 2015. This creates two classes of taxpayer by statute, those homeowners who are protected by the constitutional provision that limits annual increases of residential property and those who are not. This change to Section 7-36-21.2 NMSA 1978 will expand single year "tax lightning" to perpetual assessment lightning.
>
> The New Mexico Appeals Court ruled that increases in value for property tax purposes attributable to a change in ownership are equitable. It was a close call and the opinion made it clear that if different arguments were made to counter the exception to the cap, it might have been a different decision. The PTD isn't confident that the courts will be as supportive of this proposed measure if it becomes law.
>
> This proposal will create a distortion in the property market both for home sales and new construction. Both will suffer strong disincentives, the worst of which will be uncertainty regarding future property tax assessments. This could cause people to make economic decisions for property tax reasons.
>
> The New Mexico 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. PTD doesn't think it's constitutionally possible to remove the post tax lightning annual increase protection target toward residential properties sold after January 1, 2015. There is constitutional language which allows local jurisdictions to "include conditions under which the limitation is applied", but it would have to be broadly construed.

It should be emphasized that this proposal will not relieve "tax lightning." Over time, however, the proposal will greatly improve the shock from "tax lightning." If a property is already in the current and correct class, then there will be only insignificant increases in property taxes as the property tax valuation is updated to the actual price paid for the home. Only when properties in the protected class transfer will "tax lightning" strike. As a greater and greater portion of all homes in the State are in the current and correct class, the proportion of property sales for which "tax lightning" will strike will eventually decline to zero.

## PERFORMANCE IMPLICATIONS:

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

The LFC tax policy of accountability is not met since neither TRD/PTD nor DFA/LGD are required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers remaining in the protected class or detailing the amount of "tax lightning" driven increases in individual valuations. This is difficult data to obtain and difficult data to render into meaningful report.

This bill improves adequacy and efficiency. Over time it will dramatically improve equity as all taxpayers will end up in the current and correct class. Unfortunately, this is not a simple solutions, but neither is the underlying property tax.

## TECHNICAL ISSUES

Because all issues in the area of property tax are contentious, it would be wise for the legislature to solicit an opinion on the bill from an attorney who is experienced in and knowledgeable of the issues. The contract attorney that drafts Decisions and Orders on behalf of all of the State's Property Tax Protest boards would have the suitable qualifications to serve as an expert witness.

## WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Every year that goes by without resolving this valuation cap problem means that counties, municipalities, school districts and some special districts possibly will end up with a residual obligation to repay taxes previously paid. While this proposal will not solve the problem immediately, within 25 years, the problem will affect fewer than 10 percent of all of the properties.

LG/svb:jl