

BILL # HB 2508

TITLE: homeowner property taxes; class one

SPONSOR: Huffman

STATUS: House Engrossed

REQUESTED BY: House

PREPARED BY: Hans Olofsson

FISCAL ANALYSIS

Description

Over a period of 5 years, beginning in 2006 and ending in 2010, HB 2508 will: (1) reduce the assessment ratio for business property (Class 1) from 25% to 20% of full cash value, (2) increase the homeowner's rebate from 35% to 42% of primary school district taxes levied on owner-occupied residential property (Class 3), and (3) increase the homeowner's rebate limit from \$500 to \$600.

Estimated Impact

The JLBC Staff estimates that HB 2508 will increase the General Fund cost by \$19 million in FY 2007, \$41 million in FY 2008, \$67 million in FY 2009, \$96 million in FY 2010, and \$130 million in FY 2011. These estimates are based on projected property values and tax levies in the 5-year period between 2006 and 2010.

The Department of Revenue (DOR) estimates that the General Fund cost of this bill will be \$19 million in FY 2007, \$42 million in FY 2008, \$70 million in FY 2009, \$103 million in FY 2010, and \$142 million in FY 2011. The difference between the two estimates is believed to be attributable to different growth assumptions regarding future residential property values and school district primary tax levies.

Analysis

Each 1% reduction of the Class 1 assessment ratio will reduce the net assessed valuation (NAV) for Class 1 property by 4% and for all classes of property by about 1.5%. In dollar terms, this represents a projected statewide primary net assessed valuation (NAV) reduction of \$(743) million in tax year 2006. This amount is expected to increase to \$(4.7) billion in tax year 2010 when the bill is fully phased in. The NAV loss incurred under HB 2508 will affect both the state cost for K-12 school funding and state revenues from certain districts, as discussed below.

K-12 funding in Arizona is based on a statutory formula that is designed to equalize per pupil spending for maintenance and operation (M&O) among the state's school districts. The state share of K-12 funding is primarily driven by changes in local net assessed valuation and a statutory school district tax rate referred to as the qualifying tax rate (QTR). All else equal, any tax law change that reduces local NAV will cause the state share of the funding formula to increase. A reduction of the Class 1 assessment ratio from 25% to 24% would result in a statewide primary NAV loss of an estimated \$(743) million in tax year 2006, which would increase the state share of K-12 funding by about \$28.5 million in FY 2007.

However, the NAV loss resulting from the assessment ratio reduction would also cause the QTR to be higher under this bill than under current law. Under the state's truth-in-taxation (TNT) provision, the QTR is reduced each year to offset the growth in the valuation of existing property. The purpose of this provision of the law is to prevent property taxes from automatically increasing as a result of property appreciation.

Due to the TNT provision, the QTR would decline both under current law and under this proposal. However, the QTR reduction would be smaller under HB 2508 than under current law. This rate differential constitutes a "TNT saving" for the General Fund since it causes the state share of K-12 funding to be lower than it otherwise would be. Using projected tax year 2006 data, we estimate that the QTR would fall by 7¢ under this proposal compared to 12¢ under current law. This TNT saving of 5¢ will roughly generate enough local property taxes to offset the increased Basic State Aid cost of \$28.5 million due to the NAV loss. Similar calculations for tax years 2007 to 2010 show that the net cost for Basic State Aid would be largely unaffected by the provisions in HB 2508.

Under the state's provisions for Additional State Aid, the General Fund pays: (1) 35% of every homeowner's primary property tax levy for school districts up to \$500 and (2) that portion of any homeowner's overall primary property tax levy that exceeds 1% of the property's limited value. HB 2508 increases the rebate by 1.4% and the cap amount by \$20 each year for 5 years.

Using projected tax year 2006 data, we estimate that a rebate of 36.4% will increase the cost for the homeowner's rebate program by \$14.5 million in FY 2007. However, since the QTR will be about 5¢ higher under HB 2508 than under current law, this cost is expected to increase by an additional \$4.5 million to a total of \$19 million in FY 2007. The total cost increase for the homeowner's program is estimated to be \$41 million in FY 2008, \$67 million in FY 2009, \$96 million in FY 2010, and \$130 million in FY 2011.

The higher homeowner rebate percentages under HB 2508 are likely to reduce the future General Fund cost for the 1% Cap provided in the Arizona Constitution. The exact amount is difficult to predict since such a calculation depends on the future primary tax rates levied by all taxing jurisdictions in those school districts that are assumed to be above the cap in tax years 2006 to 2010. However, based on an analysis that uses actual tax year 2004 data, we expect that this cost-saving would be roughly offset by lower state property tax collections due to HB 2508. (Note that although the state property tax was repealed in 1996, the General Fund still receives property tax revenues from unorganized districts and school districts that levy the minimum qualifying tax rate (MQTR)).

Local Impact

The impact of HB 2508 on property owners in Arizona depends on the response of local governments to the reduced tax base under this proposal.

3/11/05