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Property Tax Reform Ideas for Colorado

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October 10, 2022

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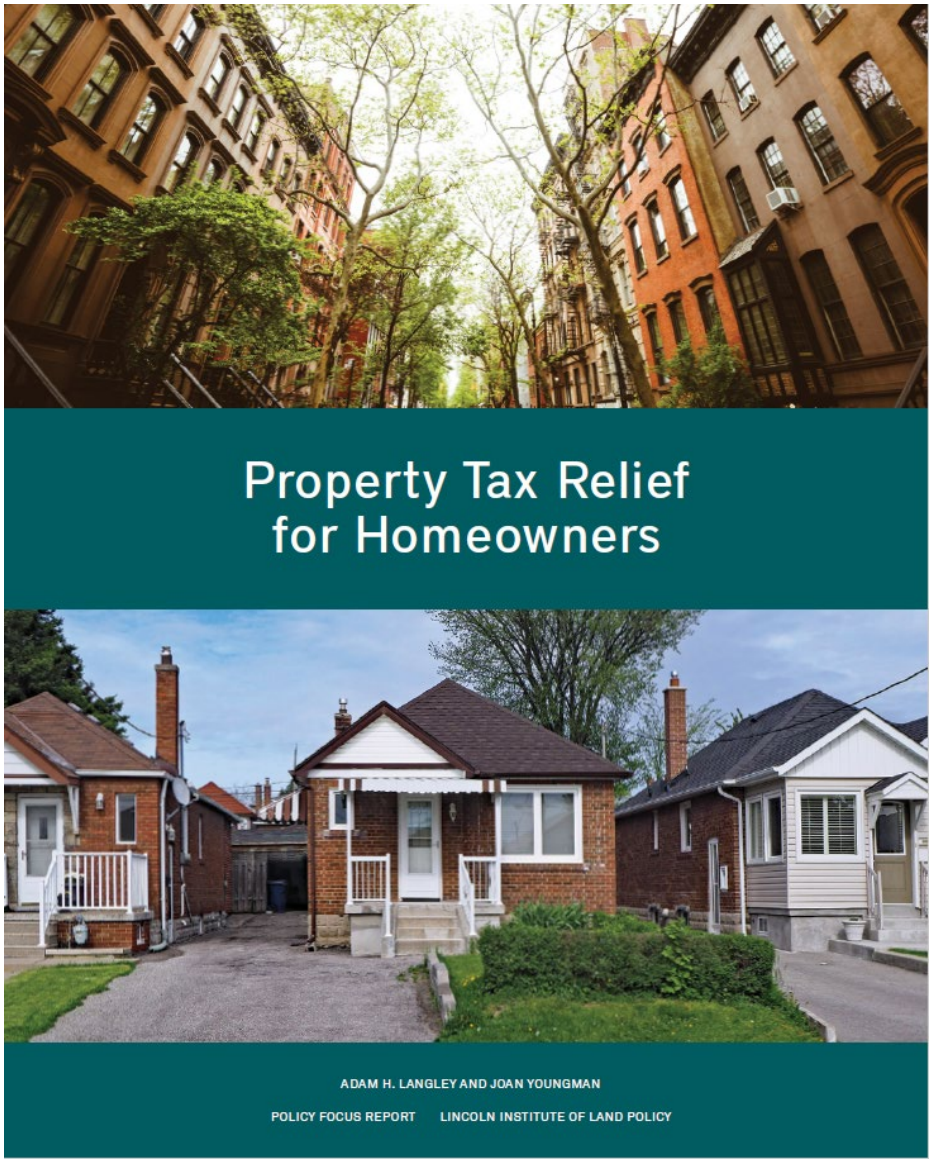

Download Report:

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- Policy focus report (64 pages)
- Policy brief (4 pages)

Outline

- Colorado's property tax system in a national perspective
- Two elements of property tax reform
  1) **Tax limit** to constrain property taxes **overall**
  2) **Targeted tax relief** to protect **individual** taxpayers

Colorado Property Tax in National Perspective

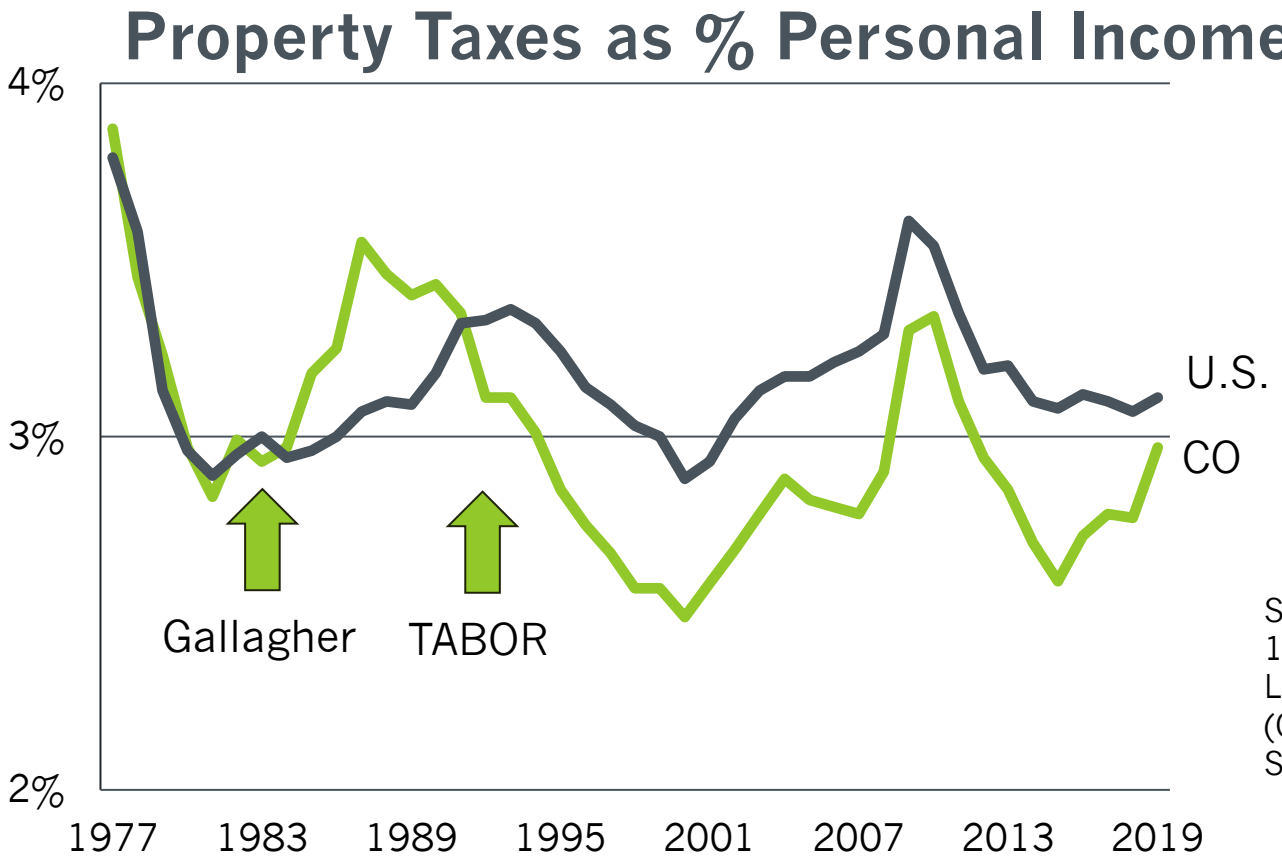
- **Overall collections close to national average**

Property Tax Collections as…	CO	U.S.
% State Personal Income	3.0% (20th)	3.1%
% Local Government General Revenue	30% (21st)	30%

Source: U.S. Census Bureau, 2019 Survey of State and Local Government Finances (Compiled by the Urban Institute via State and Local Finance Data).

Colorado Property Tax in National Perspective

- Overall collections close to national average
- **Trends in property taxes track national average**



Source: U.S. Census Bureau, 1977-2019 Survey of State and Local Government Finances (Compiled by the Urban Institute via State and Local Finance Data).

Colorado Property Tax in National Perspective

- Overall collections close to national average
- Trends in property taxes track national average
- **Highly classified**
  - Very low taxes on homestead property
  - Above average taxes on business property

Effective Property Tax Rates (2021)	Denver	U.S. Average
Median-Valued Home	0.531% (50th)	1.329%
$1m Commercial Property	2.119% (18th)	1.863%
Commercial-Homestead Classification Ratio	3.979 (3rd)	1.745

Source: *50-State Property Tax Comparison Study for Taxes Paid in 2021*.
Note: Rankings are out of 53 cities (Includes DC and two cities in IL and NY)

Colorado Property Tax in National Perspective

- Overall collections close to national average
- Trends in property taxes track national average
- Highly classified
- **Special districts get very high share of property taxes**

Share of Property Taxes Received by…	CO	U.S.
Special Districts	**18% (2nd)**	**4%**
Cities & Towns	11% (44th)	31%
Counties	20% (34th)	23%
School Districts	51% (17th)	42%

Colorado Property Tax in National Perspective

- Overall collections close to national average
- Trends in property taxes track national average
- Highly classified
- Special districts get very high share of property taxes
- **Regularly adjusting assessment ratios is unusual**
  - In other states…
    - Statewide assessment ratios are fixed
    - Local mill rates adjusted regularly

Outline

- Colorado's property tax system in a national perspective
- **Property tax limits**
  - Three types of tax limits
  - Common features of tax limits
  - Effects of tax limits
  - Truth in Taxation: An alternative to tax limits

Three Types of Tax Limits

Rate Limit	**Assessment** Limit	**Levy** Limit
Cap rate for specific local governments	Cap annual growth in assessed value of individual properties	Cap annual growth in overall property tax revenues in a jurisdiction
AR: Tax rate for municipalities can't exceed 5 mills	**CA:** Assessed value can't grow more than 2% per year	**MA:** Tax revenue can't grow more than 2.5% per year

Rate Limits

- Typically cap tax rate for specific local governments
  - Some states cap overall tax rate or freeze tax rates
- Rationale: Constrain **policy decisions** to raise taxes
- Downsides of rate limits
  - Do NOT restrict growth in property taxes if values rise
  - Large inequities between communities
    - Wealthier communities: No effect from rate limit
    - Poorer communities: Severe constraint on revenues

Assessment Limits

- Cap growth in assessed value of individual properties
- Rationale: Protect individual taxpayers against risk that rising property value will outpace their ability to pay tax
- Create large disparities in effective tax rates
- Tax savings depend on 2-3 factors

	Pay Less Tax	**Pay More Tax**
Appreciation Rate	High Growth	Slow Growth
Length of Ownership	Long-Time Owners	Newer Owners
Property Classes Covered	Residential (≈ ½ states)	Non-Residential (≈ ½ states)

Example: 2% Assessment Limit

- Market values grow at 2%, 4%, and 6% rate
- Tax rate = 1%

	2% Growth Rate			4% Growth Rate			6% Growth Rate		
Yr.	M.V.	A.V	ETR	M.V.	A.V	ETR	M.V.	A.V	ETR
0	500,000	500,000	1.00%	500,000	500,000	1.00%	500,000	500,000	1.00%
1	510,000	510,000	**1.00%**	520,000	510,000	**0.98%**	530,000	510,000	**0.96%**

No Change in Effective Tax Rate

Effective Tax Rate ↓

Larger Decline

Takeaway #1
Tax savings increase with the rate of appreciation

Note
M.V. = Market Value; A.V. = Assessed Value
ETR = Effective Tax Rate = (Tax Bill) / (M.V.) = (1% * A.V.) / (M.V.)

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1	510,000	510,000	1.00%	520,000	510,000	0.98%	530,000	510,000	0.96%
2	520,200	520,200	1.00%	540,800	520,200	0.96%	561,800	520,200	0.93%
3	530,604	530,604	1.00%	562,432	530,604	0.94%	595,508	530,604	0.89%
10	609,497	609,497	1.00%	740,122	609,497	0.82%	895,424	609,497	0.68%

Takeaway #2

Tax savings increase with length of ownership

(If property's growth rate exceeds the assessment cap)

Example: 2% Assessment Limit

- Market values grow at 2%, 4%, and 6% rate
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Effective tax rate is **47% higher** than high-growth property (1% vs. 0.68%)

Takeaway #3: Assessment limits create large disparities in effective tax rates

Example: 2% Assessment Limit

- Market values grow at 2%, 4%, and 6% rate
- Mill rate = 1%

	2% Growth Rate			4% Growth Rate			6% Growth Rate		
Yr.	M.V.	A.V	ETR	M.V.	A.V	ETR	M.V.	A.V	ETR
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10	609,497	609,497	1.00%	740,122	609,497	0.82%	**895,424**	609,497	0.68%

Newly purchased $895k property would also pay effective tax rate that is **47% higher** than $895k property purchased 10 years ago
(Tax bill = $8,954 vs. $6,095)

Evidence on the Effects of Assessment Limits

- **Large disparities in tax bills for similar properties**

Effective Property Tax Rates for 5 Blocks in Los Angeles (2015)

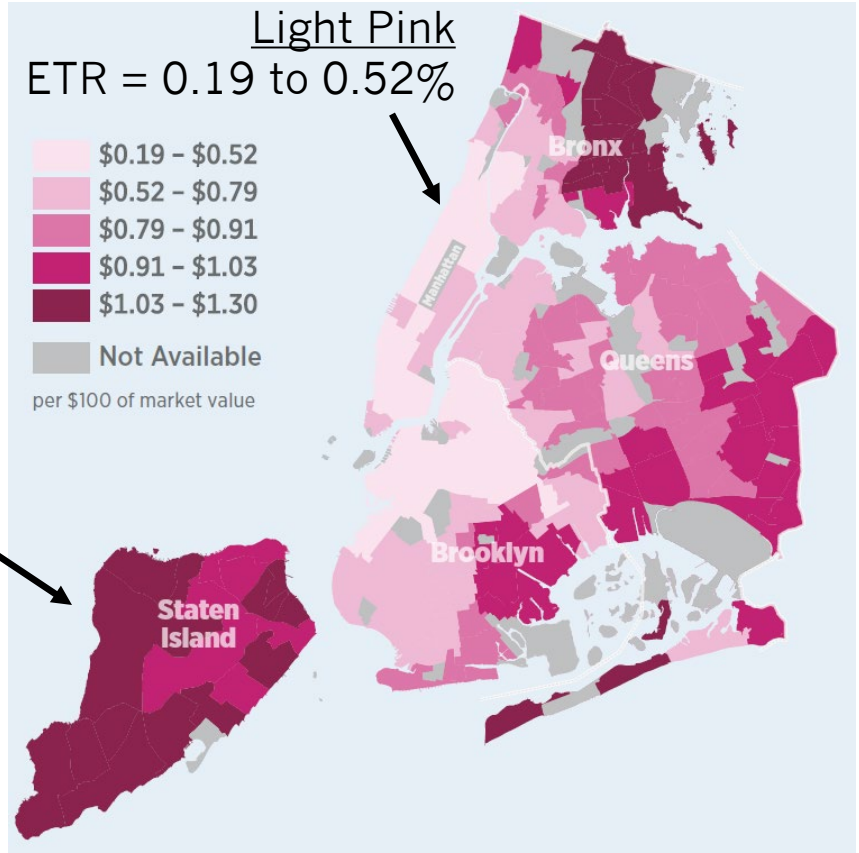
Effective Property Tax Rate	Households (Count)
0.8% +	20
0.6 to 0.8%	23
0.4 to 0.6%	20
0.2 to 0.4%	7
Under 0.2%	7

Source: Analysis of data from "Common Claims about Proposition 13," CA Legislative Analyst's Office (2016, 8).

Evidence on the Effects of Assessment Limits

- Large disparities in tax bills for similar properties
- **Shift tax burden to poorer neighborhoods**

Median Effective Tax by Neighborhood for Residential Properties with 1-3 Units (2017)



Source: "Residential Property Taxation in New York City." Regional Plan Association (2018).

Evidence on the Effects of Assessment Limits

- Large disparities in tax bills for similar properties
- Shift tax burden to poorer neighborhoods
- **Lock-in effect discourages mobility**
  - See: "Common Claims about Proposition 13," CA Legislative Analyst's Office (2016, Pg. 8).

Levy Limits

- Cap growth in overall property tax revenue in jurisdiction
- Rationale: Constrain growth in gov't revenues
- Typically, operationalized by adjusting the mill rate
  - Tax base grows rapidly → Mill rate ↓
  - Tax base stagnant → Mill rate ↑
- In Colorado, better to operationalize with mill levy credits

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Example: 4% Levy Limit

Yr.	Net Assessed Value Growth	Net Assessed Value (Millions)	Tax Levy Growth	Tax Levy (Millions)	Mills	Mill Levy Credit	Net Mills
0		500		10.00	20		20.00
1	**10%**	550	**4%**	10.40	20	**1.09**	**18.91**

All taxpayers get 5.5% tax cut (18.91 / 20)

(Compared to scenario where net mills stays at 20)

→ No disparities in effective tax rates

-Avoid negative effects of assessment limits

Levy Limits

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- Typically, operationalized by adjusting the mill rate
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0		500		10.00	20		20.00
1	10%	550	4%	10.40	20	1.09	18.91
2	10%	605	4%	10.82	20	2.12	17.88
3	-5%	575	4%	11.25	20	0.43	19.57
3	-5%	575	**-5%**	10.28	20	N/A	**17.88**

← Mill credit drops

What could happen if mill rates used to operationalize levy limit

Common Features of Tax Limits

- **Growth rate: Fixed rate or Index**

Approach	Measure	Notes
Fixed rate	3%, 4%, etc.	Impact will depend on future costs, which are unpredictable → Not recommended
Index	Consumer Price Index (CPI)	Could lead to reduced service quality over time, if costs to provide gov't services rise faster than overall inflation
Index	Implicit Price Deflator for S&L Gov't (BEA)	Maintain current service levels
Index	State Personal Income Growth	Allows service quality to grow with incomes, but tax burdens do *not* grow relative to earnings

Common Features of Tax Limits

- Growth rate

- **Overrides**
  - Localities can exceed cap with voter approval
  - Approval required each time locality exceeds cap
  - Simple majority allows for local preferences

Common Features of Tax Limits

- Growth rate
- Overrides
- **Debt exclusions (Rate and levy limits)**
  - Excludes taxes to pay debt service on voter-approved borrowing
  - Protects bondholders > Reduces borrowing costs

Common Features of Tax Limits

- Growth rate
- Overrides
- Debt exclusions (Rate and levy limits)
- **Exemptions for new construction (Levy limits)**
  - Important since new development requires services, but revenue from new construction does not impact existing taxpayers

Common Features of Tax Limits

- Growth rate
- Overrides
- Debt exclusions (Rate and levy limits)
- Exemptions for new construction (Levy limits)
- **"Banking" revenue (Levy limits)**
  - *Allowable* levy can exceed the *actual* levy
  - Avoids incentive for gov'ts to tax to max allowed under levy limit, if they would otherwise risk losing needed growth in future years

Effects of State-Imposed Property Tax Limits

- Reduced flexibility and local autonomy
- Change revenue mix to less reliable sources
- Restrictive tax limits erode quality of local services
  - "Tax and Expenditure Limits, School Finance, and School Quality" (2015)

Tax Limits Summary

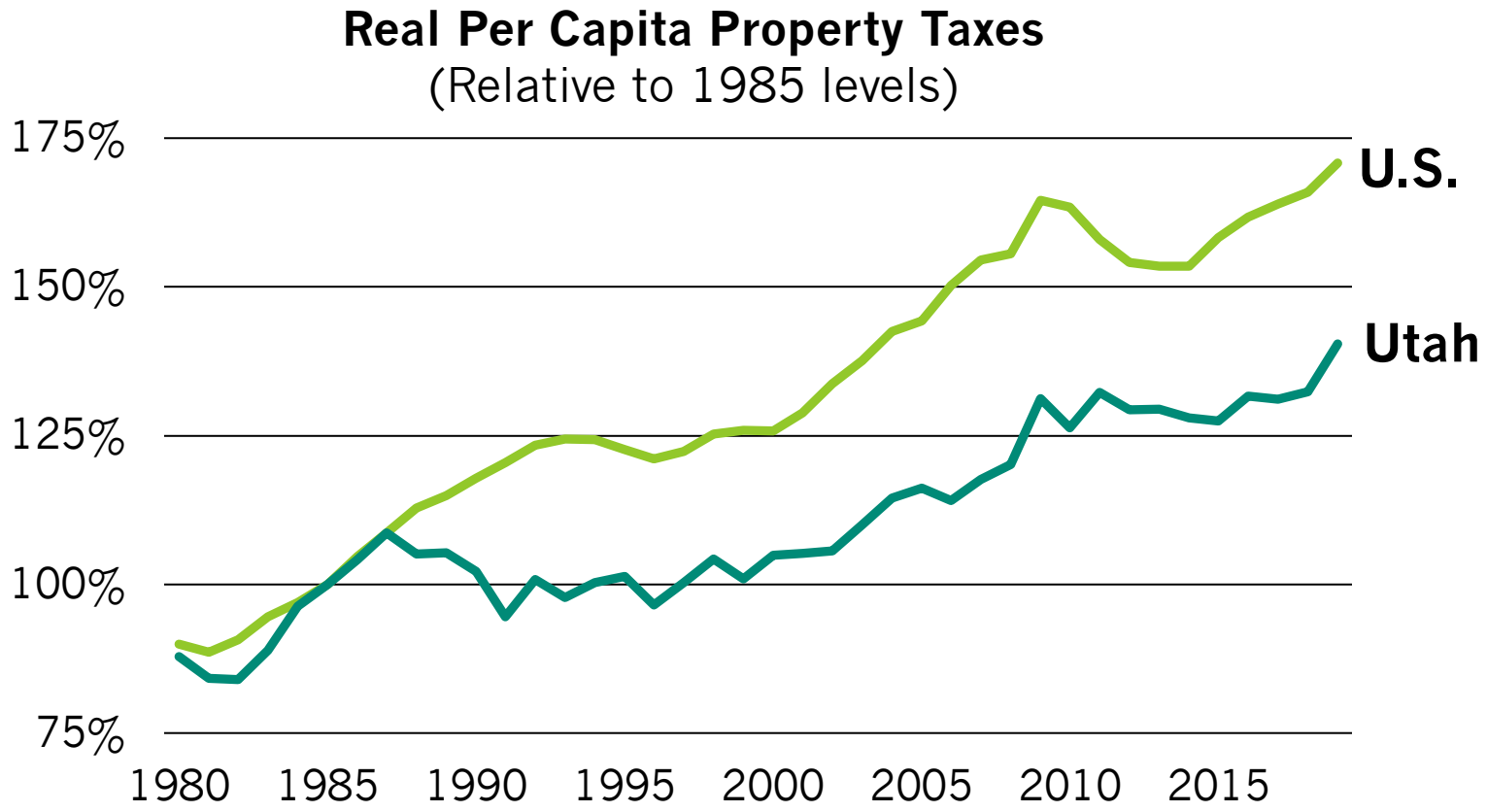
Worst	Assessment Limits
2nd Worst	Rate Limits
Least Bad	Levy Limits
Good	Truth in Taxation

Truth in Taxation

- Prevent "silent" tax increases
  - Can occur when rising property values produce higher tax revenues without any change in official tax rate
- Sets requirements that local gov'ts must meet to raise property tax revenue (Even when mill rate is unchanged)
  - Vote by governing body for any increase in property tax revenue
  - Mailings, public hearings, etc.
- Otherwise, tax rate automatically adjusted down to revenue neutral rate
- Facilitates transparency and responsive rate-setting without imposing a binding constraint

Truth in Taxation

- Ex: Utah passed Truth in Taxation in 1985



Source: Source: U.S. Census Bureau, 1980-2019 Surveys of State and Local Government Finances (Compiled by the Urban Institute via State and Local Finance Data).

Outline

- Colorado's property tax system in a national perspective
- Property tax limits
- **Targeted property tax relief**
  - Credits to offset rapid property tax increases
  - Circuit breakers

Credit to Offset Rapid Property Tax Increases

- Tax credit to offset growth in property tax bill above some level (e.g. 10% increase from prior year)

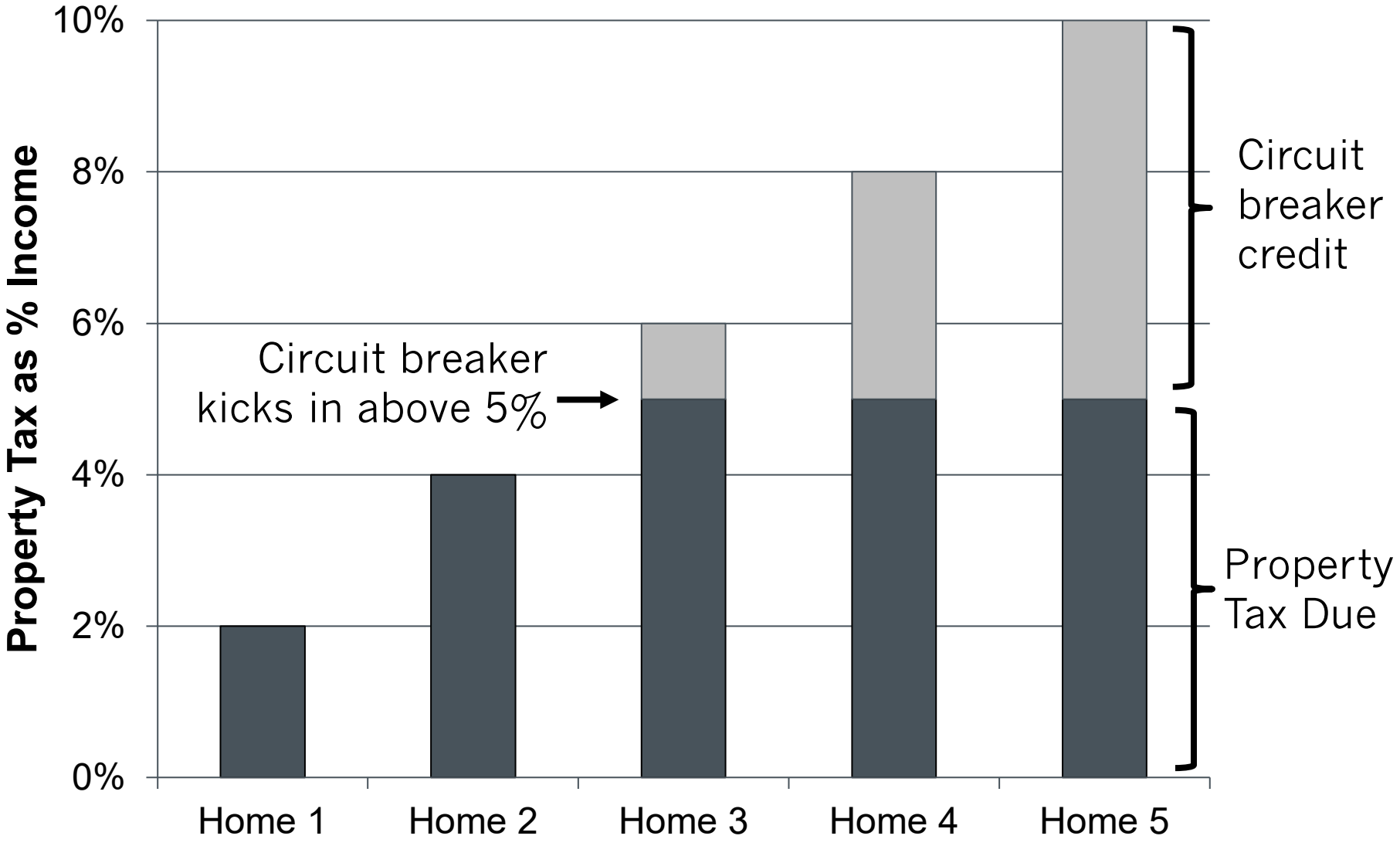
- Good alternative to assessment limit
  - Avoids large spikes in property tax bills
  - Provides temporary assistance, not long-term subsidy
    - Tax credits phase-in large tax increases, then phase out
    - In long-term, taxed based on market value
      - Avoids negative consequences of assessment limits
  - Can use eligibility criteria to target needier households
    - Ex: Homestead requirement, income ceiling

Circuit Breakers

- Prevent households from being overburdened by property taxes
  - Target relief to households with the heaviest tax burdens

- Definition: "Classic" circuit breaker sets a **threshold** percentage of income that property taxes must exceed before any tax relief is available
  - Circuit breaker benefit offsets taxes above this point

5% Threshold Circuit Breaker



Circuit Breaker Recommendations

- Avoid income ceilings or benefit caps that are too low
  - Otherwise, tax relief may be inadequate
- Use threshold approach
  - Multiple thresholds will increase progressivity
    - Ex: Credit offsets property tax…
    - Above 2% of income for the first $10,000 in income;
    - Above 4% of income for next $20,000 in income;
    - Above 6% of income for income from $30,001 - $60,000
- Use co-payment requirement
  - Helps ensure eligible taxpayers continue to scrutinize tax
  - Ex: Credit offsets 60% of tax above threshold percentage, and taxpayers covers the rest

Recap:
Ideas for Colorado Property Tax Reform

1) **Tax Limit to Constrain Property Tax Growth *Overall***
   - Truth in Taxation, or
   - Levy limit (Well structured)

2) **Targeted Tax Relief to Protect *Individual* Taxpayers**
   - Tax credit to offset rapid property tax increases, and/or
   - Improved circuit breaker

Learn More:
Property Tax Relief for Homeowners (2021)
www.lincolninst.edu/publications

Appendix:
More Details on Tax Relief to Protect Individual Taxpayers

Example: Credit to Offset Rapid Tax Increases

- Property value grows 20% in Year 1, then 4% per year
- Tax rate = 1%

		Property Tax Credit (Offsets Tax Increases > 10%)				**Assessment Limit** (4%)		
Year	Market Value	Tax Before Credit	Credit	Tax After Credit	Tax Increase	Assessed Value	Tax Due	Tax Increase
0	500,000	5,000		5,000		500,000	5,000	
1	600,000	6,000	500	5,500	10%	520,000	5,200	4%
2	624,000	6,240	190	6,050	10%	540,800	5,408	4%
3	648,960	6,490	0	6,490	7%	562,432	5,624	4%
4	674,918	6,749	0	6,749	4%	584,929	5,849	4%
5	701,915	7,019	0	7,019	4%	608,326	6,083	4%

New owner pays the same tax

New owner pays ≈ $1,500 more (ETR 27% higher)