LEAGUE of Oregon CITIES

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TO: Chair, Rep. Phil Barnhart and Members of the House Revenue Committee
RE: Support of SB 925 and Support for Comprehensive Property Tax Reform
Date: June 22, 2015

TAX REFORM:
The League of Oregon Cities (League) supports SB 925 as the League agrees that comprehensive tax reform is greatly needed in Oregon. SB 925 would require the Legislative Revenue office to work this interim on proposing tax reform recommendations, offering alternative reform scenarios for presentation to the 2016 regular session using its computer modeling system. SB 925 specifically requires recommendations in two areas: 1) state corporate and personal income taxes (with a new commercial activity tax); and 2) property taxes (with a return to a market value based system and with a new homestead exemption). See Section 1 (a) and (b). While property tax revenues are received by local governments and schools (and not the state), property taxes are a vital component of the state's overall tax revenue system and provide the revenues for key services throughout the state. Cities greatly rely on property taxes, composing generally about 60% of their revenues. The League's Board has placed property tax reform as one of its key priority issues for the past several sessions and the League is pleased with the Senate's recognition of this need for reform in SB 925. <u>The League stands ready to assist and provide comments to the legislature and staff throughout this tax reform project as permitted</u>.

Measure 5 turns 25 years old this year and Measure 50 is 18 years old. These Measures have made Oregon's property tax system incredibly complex, arbitrary, and full of inequity. The League has presented reform bills of its own to the legislature to 1) permit local option levies outside of state limits **(see HJR 20)**; 2) reset assessed value at sale **(See HJR 12)**; and 3) change the new property discount tax ratio to utilize city averages rather than county averages **(see HB 2993)**. To date, however, few law changes have occurred since the passage of Measures 5 and 50—largely because most changes require constitutional amendments and thus a referral or initiative to the voters. <u>A legislative referral is the ideal vehicle as only a referral can handle comprehensive property tax reform with a constitutional revision</u> (note that a revision requires a 2/3 vote from the legislature for a referral). See Art. XVII, sec. 2. Initiatives are limited by the single subject restrictions. See Art. IV, sec. 1 (2)(d). Now is a good time to address the problems and present a comprehensive package to the voters.

One of the key principles for the League is that laws aimed at controlling the level of property taxes and assessment of property should be constructed in a way that recognizes the differences between various communities' desired levels of services and the ability to finance those services. Limitations on revenue authority, including the Measures 5 and 50 limits, and also the numerous legislative automatic property tax exemptions, undermine the ability of cities to maintain a healthy mix of revenues and erodes local control.

Rather than attempt to provide a list of specific solutions, below are a list of property tax problems the League has identified. <u>Ideally, all of the following problems would be addressed in comprehensive reform and be a part of the Legislative Revenue staff's recommendations</u>. These problems are complex and thus this list is only a summary.

IDENTIFED PROBLEMS NEEDING REFORM:

1. **PERMANENT RATE:** Each taxing district has a permanent operating property tax rate that is frozen at whatever it was in 1997. Some districts had a rate that was incredibly low, some even were $0. These permanent rate limits, from Measure 50, are arbitrary and have prevented taxing districts from voting to modify the rate to meet today's needs; instead, they must rely on temporary local option levies or other revenue sources.

2. **ASSESSED VALUE:** Until Measure 50, property taxes were assessed on the real market value (RMV) of the property. With Measure 50, a new term was created (assessed value) that created a new formula. The formula was Real Market Value (RMV) in 1995-1996 minus 10% == Assessed Value (AV). Today, there are significant disparities between similar properties with nearly identical real market value due to the use of AV instead of RMV. The problems are structural in part and a return to market value is necessary:

    - There is a base year problem—the 1995-1996 numbers were taken as a snapshot in time but property taxes were assessed on a 6 year cycle then. Some properties were set then at lower numbers (i.e. toward the end of 6 years in 1995-1996) and others at higher numbers (property had been recently assessed before the snapshot in 1995-1996) for their base year; this disparity has never been adjusted and this occurred during the housing boom.
    - New and significantly improved property does not use the 1995-1996 RMV base and instead a county average ratio is used to try to approximate a discount to RMV. This ratio calculation often creates property tax disparities for similar

property with nearly identical RMV. (See **HB 2993** which permits a city wide average rather than a county average for the ratio)

- In addition, while locking in a 1995-1996 value as a base provided stability for property owners who haven't moved, it locked in an arbitrariness that doesn't recognize how neighborhoods change in RMV over time.
- Industrial property is taxed on RMV under present law. However, commercial property is taxed using the AV formula. Such disparities in taxes based upon class of property also seem arbitrary.

In short, the use of AV rather than RMV has created complexity, arbitrariness, and inequities. (See **HJR 12**, which provides for a reset at sale for a partial solution)

3. **CAPS:** The $5 (education) and $10 (local government) caps per $1000 RMV (i.e. 1.5%) were arbitrary numbers from Measure 5. At the time, voters seemed to expect a sales tax to be coming along with these caps but that has never occurred. While the League understands the need for predictability and the need to curb significant rate hikes, local voters should ultimately be in control of their property taxes and services. Local control is compromised/usurped with these present caps. (See **HJR 20** which permits voters to approve local option levies outside of these limits)

4. **3% GROWTH LIMIT:** Measure 50 imposed a 3% limit on the property tax annual growth rate of the AV. That is, Assessed Value for properties may increase up to 3% per year maximum. This limit does not cover inflation and is arbitrary. In addition, when housing prices crash, and RMV is greater than AV, there is no growth limit. Instead maximum AV freezes and RMV becomes the basis of the tax (rather than AV). When the economy picks up, property taxes can take big jumps as Measure 50 does not have a limit on RMV growth (e.g. Bend saw this problem with double digit percent increases).

5. **LEVY TIMELINES:** Measure 50 provides that local option levies (voter approved tax levies) are temporary. Specifically, operation levies are restricted to 5 years and capital project levies are restricted to 10 years. These timelines are arbitrary and make it difficult for taxing districts to address unforeseen issues and costs.

6. **COMPRESSION:** If taxes from education and local government are greater than the respective caps, taxes must be reduced until the limits are met. Each taxing district's rates must be reduced proportionately. This reduction is known as compression. This provision has led to the creation of some new districts to in effect end run limits to get specific services (e.g. a library), but the effect is that existing tax districts are all compressed. In addition, it has meant that voters can vote for a levy but not actually get what they want as the tax levy will be reduced due to compression. Some property

owners will vote for a local option levy and not actually be taxed at all if their property has hit compression limits; meanwhile, their neighbor may pay the tax. With the rebounding economy, compression has eased (the gap between RMV and AV is broadening again), but it is subject to volatility and will occur again. When RMV decreases again, compression will increase.

7. **PROPERTY TAX EXEMPTIONS AND DEFERRALS:** The ORS is riddled with a long list of statutory exemptions (abatements) and deferral programs. See e.g. ORS 307.040 to 307.835. See also 2015-2017 State of Oregon Tax Expenditure Report, pages 13-16 (listing exemptions and special assessments). Some are automatic and some are local options. Many were passed in the name of economic development but it has become apparent that many property improvements and personal property purchases would be done without the property tax incentives (they fail the "but for" test). Exemptions with targeted business industries must be granted wisely as each exemption decreases revenues and the expected return on the exemption should be carefully considered. Other exemptions are outdated or overly complex. All provisions should be reviewed and revised as necessary. Lastly, the bill's proposed new homestead exemption will require particular study and adjustments elsewhere to keep local governments whole.

8. **INTANGIBLE PROPERTY**: Oregon taxes the intangible property of only centrally assessed businesses as provided in ORS 308.505 to 308.665. Businesses that fall under central assessment are generally utilities and communications companies. The business community would like to exempt all intangibles from property taxes as many states have done. Such exemptions would translate to significant property tax revenue losses; however, in comprehensive reform, this issue and other business property tax issues could be addressed as there would be enough levers to adjust to temper changes.

CONCLUSION

When one looks at the list of problems, it is difficult to justify retaining Measures 5 and 50 any longer, particularly Measure 50. Instead, perhaps Measure 50 should be repealed altogether and replaced with a new system. In addition, ORS Chapter 307 should be reviewed and revised in its entirety to reform the property tax system. Such a system should be built with such goals as the following:

- stability/predictability;
- fairness/equity;
- simplicity/clarity;
- adequacy/sustainability; and
- voter/local control

In short, property tax reform that addressed the problems listed above would affect comprehensive property tax reform that is truly needed in Oregon.