To: Governor Brian Sandoval

From: J.T. Creedon

Date: May 6, 2016

Re: Re-evaluating property tax abatements

Abstract:

Nevada was hit particularly hard by the Great Recession. Depleted reserves and financial difficulties for local governments were hastened not simply by depressed property values but also a number of restrictions that prohibit local tax revenues from recovering nearly as fast as property values. This has left local governments still struggling to provide and maintain the level of services that their citizens demand. This memo will argue that the State of Nevada needs to re-evaluate and reform its treatment of property tax in order to ensure that local governments are able to satisfactorily meet the needs of the people they serve. This paper will list three possible solutions that are not mutually exclusive: 1.) Raise or eliminate the property tax cap on primary residences, 2.) Reduce the depreciation factor on improvement value, and/or 3.) Reform or eliminate the nine-year rolling average option on commercial property tax.

Background:

The taxable value of property in Nevada is the full cash value of the land and replacement cost of improvements less depreciation of 1.5% per year up to 50 years. The assessment ratio is 35% of taxable value and the rate of taxation varies by jurisdiction with a legislatively imposed cap of $3.64 per $100. This is a result of the "Tax Shift of 1981," an earlier attempt by the legislature to provide property tax relief to homeowners. SB69 changed the method of appraisal from market value to "taxable value" as defined above. This reduced property tax collections by 50% and shifted local government revenues to sales tax (Nevada Department of Taxation, 2015).

The mortgage boom of the 1990's and early 2000's in Nevada, particularly in its economic and population center of Las Vegas, led to historic increases of property values up to 20-40% per year and tax burdens nearly doubling from year to year for some homeowners. To put this in perspective, a home purchased for $150,000 could be worth $210,000 within a year. Moreover, many low income families were leveraging the equity on their home values to invest in additional homes as rental properties. These prompted lawmakers to pass Assembly Bill 489

(AB489) in 2005, which provides a partial abatement of taxes by applying a 3% cap on the tax bill of the owner's primary residence. AB489 created a separate 8% cap applied to residences that the owner did not occupy. In addition, the 8% cap applies to all commercial property but commercial property owners have an option to pick between the 8% and a growth rate based on a nine-year rolling average of assessed value for each county. While these saved property owners over $3.8 billion in ten years by curbing their skyrocketing tax burdens, it resulted in unintended consequences as a result of the Great Recession and its subsequent recovery.

Because of the caps imposed by AB489, local government revenues have not been able to recover as quickly as property values. While Nevada led the nation in foreclosures, reaching 12.04% during the recession, the 42.7% decline assessed value from FY2008-09 to FY2012-13 had a greater impact on reducing revenues (Kim Rueben, 2010). Mayor Andy Hafen of Henderson, (Nevada's second largest city,) and Martin Leavitt, Chairman of the Committee on Local Government Finance both say it could be over 20 years before tax collection levels return to where they were before the recession, despite the fact that property values are recovering at a faster rate. This has left huge holes in local government budgets and forced cuts in services or lawmakers to explore other options of raising the lost revenue. Nevada schools' share of property taxes statewide declined from $1.4 billion in 2008-09 to $942 million in 2012-13Nevada's largest County and home to the Las Vegas Metropolitan Area fell from $383.1 million in property tax collections in FY2009 to $257.4 million in 2013, forcing a 20% reduction of the county's workforce. The City of Henderson has seen a decrease from $83.4 million in FY2009 to $58.5 million in FY2014 and has sought to increase property tax rates to make up the difference, but they remain limited by state law. The Las Vegas Metropolitan Police Department alone, lost $58.3 million in property tax revenues during the period between FY2009 and FY2013 and has sought a $0.15 increase in sales tax to fill in the shortfall. This paper will recommend three considerations for property tax reform to address the unintended shortfalls to local governments.

Raise or eliminate the property tax cap on primary residences:

Property tax caps have become a hindrance to recovery. Property values could grow at rates of 10-20% but government revenue will only inch a long at diminished rates. Eliminating the 3% property tax cap on primary residences will not actually leave homeowner's subject to skyrocketing rates because the Nevada Constitution already imposes a 5% cap on property tax increases for primary residences. Eliminating the cap would only have a marginal increase in a typical homeowner's tax bill. According to the Clark County Assessor's Office, if the cap were increased from 3 to 4%, a North Las Vegas home with a taxable value of $200,000 would face a $2,348 tax bill based on a rate of 3.3544. If the cap remained at 3%, then the same homeowner would be already subjected to an increase to $2,418 the following year, or $2,442 if a 4% cap was applied, a difference of only $23. The property tax base, however, is large enough that it would make significant gains in closing local government's property tax collection shortfalls. Another concern is the bifurcation between owner-occupied homes and non-primary residences. The bifurcation between 3% for owner-occupied homes, and 8% for non-owner occupied residences was intended to make a distinction between one's primary residence and revenue-generating properties that taxpayers rented out for additional income. However, this distorts the market and consumer behavior and leads to unintended inequities. A person who purchased a home that was previously a rental property instead of an owner-occupied house will pay more in property tax than their neighbor because its rate may have increased at rate in excess off the 3% cap. This results in multiple homes of similar size and design in the same neighborhood being subject to vastly different property tax rates and can impact consumers' purchasing decisions.

Reduce the depreciation factor on improvement value:

Nevada is unique in that it is the only state in the U.S. that permits a depreciation factor applied to any property's value improvements of up to 1.5% per year for 50 years. Nevada's taxable property values have dropped by 42.7% between 2009 and 2013 and ranks 51st in Residential Property Appreciation rankings, increasing only 16.9% since 1991. The sharp declines following 2008 has led to it to reporting the slowest appreciation rate nationally over the past 20 years. The depreciation factor means that local governments in Nevada not only experience the impact of falling values but also the impact of depreciation, creating a multiplier effect in the reduction of property tax collections. Despite the property tax increasing over time, revenues increase slower for the first 50 years due to the depreciation factor. Reducing this would only have a modest impact on taxpayers but help stabilize local government revenues over the long run. A study by Applied Analysis, showed that a phase down in the depreciation factor from 1.5% to 1% would've yielded $6.3 million in additional property tax dollars for Clark County during 2011, when the County brought in its least amount of property tax revenues before trending upward, for an increase of 0.28%. Reducing the depreciation rate to 5% would've generated an additional $12.7 million in revenue. Because of Nevada's unique method of appraisal, it would be more economically efficient to simply return it to market value, however, this would likely lead to a significantly greater increase in property tax burdens to the taxpayer, a politically inefficient option in a state that prides itself on its low tax rates that likely enticed hundreds of thousands of current constituents to relocate and buy property in Nevada.

Reform or eliminate the nine-year rolling average option on commercial property tax:

AB489 also created an option for commercial property owners to choose the lesser of an 8% cap or the result of a nine-year rolling average. While the latter kept the 8% cap a preferable option for taxpayers during the early year of the recession because of the inclusion of growth years in the average, the gradual inclusion of the recession and recover years has dramatically reduced the rate and yield to local government revenues. As a result of the valuation, commercial property owners paid 6.4% in 2012-2013, 4.2% in 2013-2014, and less than 3% in 2014-2015. Moreover, lower property values are not only established on the basis of the property value itself but income derived from it. A hotel facing a declining occupancy rate can claim reduced property values, decreasing the rate even further. The state should consider reforming the optional rates, developing another formula with a different valuation period, and/or consider closing the loopholes that allow businesses profitability to be considered into their real property values.

Conclusion:

Property tax revenues are not recovering as fast as property values. It is reasonable for lawmakers to want to protect taxpayers from property tax rates from skyrocketing out of control, however, there were already protections in place prior to AB489. Some aspects of AB489, as well as pre-existing laws such as depreciation, have made local government's financial situations even worse than otherwise would be expected during the Great Recession and its aftermath. The state can employ a number of options to lessen the impact of property tax declines on local government revenues including increasing or eliminating the property tax cap, reducing the depreciation factor, or reforming the commercial property tax rate to be more stable and equitable.

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