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Memorandum

July 30, 2020

TO: Interested Persons

FROM: Marc Carey, Chief School Finance Officer, (303) 866-4102

SUBJECT: The Gallagher Amendment

Summary

In 1982, voters approved a constitutional measure governing property taxes, including a provision known as the Gallagher Amendment (Gallagher). Gallagher sought to protect homeowners from rising property taxes by maintaining a relatively constant ratio of residential and nonresidential property values in the statewide tax base.

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Mechanically, Gallagher works by establishing target percentages for the portions of the property tax base comprising residential and nonresidential property. The target percentage is achieved using different statewide assessment rates for different classes of property. Because the nonresidential assessment rate is fixed constitutionally at 29 percent and the actual value of residential property has increased more quickly than that of nonresidential property, the residential assessment rate (RAR) has declined over time. This reduction has limited the tax base for local governments, while providing tax relief to homeowners.

The impact of Gallagher has varied across different regions of the state. In some rural areas where property values have not increased as significantly, Gallagher has resulted in substantial reductions in the tax base. Under the 1992 Taxpayer's Bill of Rights (TABOR) Amendment, local governments in these areas must seek voter approval to increase the tax rate if they wish to offset reductions to the tax base and maintain a constant level of service.

This memorandum is divided into four sections. First, it provides background information on key concepts related to property taxation and Gallagher. Second, it reviews the impacts on residential and nonresidential assessed values, the total tax base, and property taxes since the passage of Gallagher. Third, the memorandum explores how these impacts vary for different counties in the state, depending on the rate of appreciation in property values. The memorandum concludes by summarizing the potential effect of Gallagher on the 2021 reassessment cycle, given the current pandemic.

Background

In Colorado, all property taxes are imposed by and paid to local governments. There is no federal or state property tax. Property taxes are paid on residential and nonresidential property. Nonresidential property includes commercial, industrial, agricultural, business, and oil and gas property, among others. The largest classes of property are residential, commercial, and oil and gas properties.

How are property taxes calculated? Property taxes are determined by the actual value of the property, the assessment rate or share of the property value that is taxable, and the number of mills levied by local governments. Figure 1 shows the calculation of property taxes along with examples of property taxes on residential and nonresidential properties valued at $300,000.

Figure 1
Property Tax Calculation

Example 1: Home valued at $300,000 and taxed at 100 mills

Taxable value = Property value × Assessment rate
$300,000 × 7.15%* = $21,450 taxable value

Property taxes = Taxable value × Tax rate (Mills/1000)
$21,450 × 0.100 = **$2,145 owed**

Example 2: Business property valued at $300,000 and taxed at 100 mills

Taxable value = Property value × Assessment rate
$300,000 × 29%** = $87,000 taxable value

Property taxes = Taxable value × Tax rate (Mills/1000)
$87,000 × 0.100 = **$8,700 owed**

**2019 and 2020 residential assessment rate.*
***Assessment rate for most nonresidential property.*

County assessors determine the actual value of locally assessed property in their county. The division determines the actual value of large utilities and property that exists in multiple counties. The state legislature sets the RAR every two years based on requirements in Gallagher and state law. Finally, mills are a local tax rate determined by local governments, including school districts, cities, counties, and special districts.

The **taxable value** or **assessed value** of a property is equal to the actual value of the property multiplied by the assessment rate. The **property tax base** of a given local government is the sum of all the taxable values of individual properties within its jurisdiction, an area commonly known as a **taxing district**.

The actual value of most real property is updated on a two-year reassessment cycle[1] to reflect current property values. For residential property, county assessors use recent sales of similar properties to reassess every property in the county. For most nonresidential property, county assessors use recent sales, recent income, or recent cost estimates to value the property. For the 2021 reassessment cycle, county assessors will value each property as of July 1, 2020 and the property will be taxed on that value beginning January 1, 2021. The actual value will remain constant for 2021 and 2022 and be reassessed in 2023.

If assessment rates do not change, the taxable value of a property will change proportionally to the change in the property's actual value. The nonresidential assessment rate for most nonresidential property is fixed at 29 percent in the Constitution[2], and the residential assessment rate is adjusted every two years, following the reassessment cycle based on the requirements of Gallagher.

The Gallagher Amendment. In 1982 voters approved an amendment to Article X, Section 3 of the state constitution that:

- required certain methods for valuing property;
- specified uniform taxation of properties;
- instituted a statewide property tax audit;
- established an assessment rate of 29 percent for most classes of nonresidential property, excluding mines and lands producing oil and gas; and
- included a provision that has become known as the Gallagher Amendment.

Gallagher requires that the proportion of taxable value for residential and nonresidential property remain constant between each two-year reassessment cycle. This ratio, which is about 45 percent residential property and 55 percent nonresidential property, is known as the target percentage and is adjusted for any new construction and mineral production that occurs during the reassessment cycle. Adjustment of the RAR is the vehicle for maintaining a nearly constant target percentage.

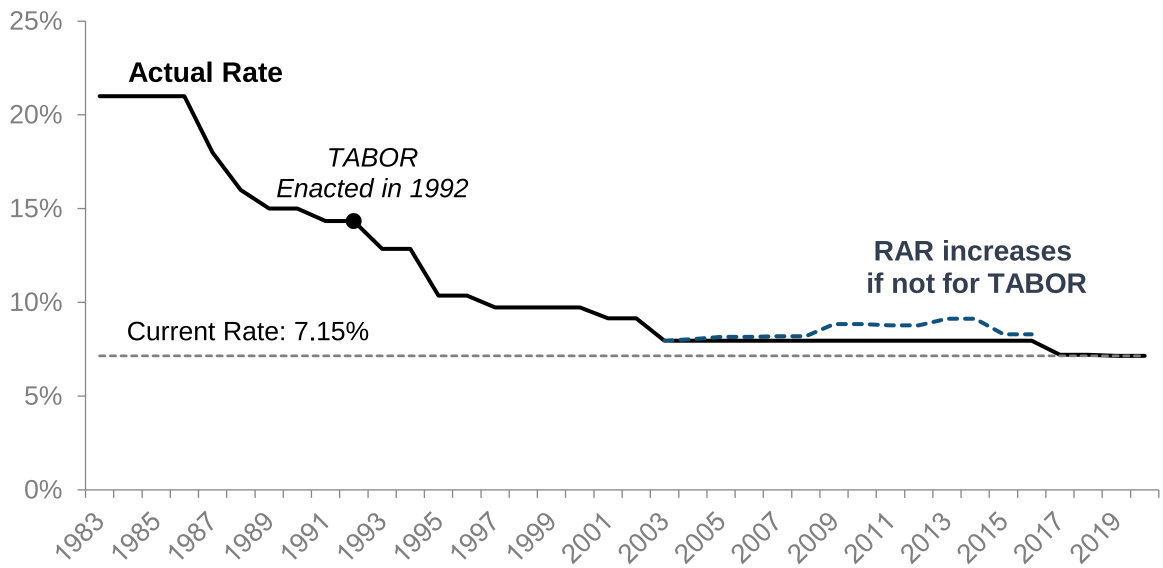
Target percentage. Every two years, the division estimates the residential and nonresidential share of the statewide tax base before properties are reassessed. This share is adjusted for new construction of residential property, new construction of nonresidential property, and the change in natural resource production that occurred during the previous two years. Adjustments to the target percentage allow the share of the tax base to change if the value of new residential construction grows at a different rate than the value of new nonresidential construction and natural resource production. Since 1989, the residential target percentage has remained close to 45 percent, ranging from a low of 44.5 percent in 1989 to a high of 47.4 percent in 2007.

Residential assessment rate (RAR). The RAR is set by the state legislature so that the statewide aggregate share of the assessed value from residential property meets the desired target percentage. The division uses estimates of the actual property values from each county assessor to determine the RAR that will achieve the desired target percentage. Since the enactment of the Gallagher Amendment, the RAR has declined from 21.0 percent in 1983 to 7.15 percent in 2019.

[1]Section 39-1-104 (10.2)(a), C.R.S.
[2]Colo. Const. art. X, § 3 (b).

When the Gallagher Amendment was enacted, it was assumed the RAR would move up or down, as necessary, in order to maintain the target percentage. Indeed, following seven separate reassessments since 1999, the division estimated that the RAR would need to increase to maintain the target percentage from the previous reassessment cycle. However, with the passage of the TABOR Amendment[3] in 1992, voter approval is required to increase assessment rates and, thus far, such a question has not been submitted to voters. Figure 2 graphically depicts adjustments to the RAR since 1983, along with the estimated levels it would have attained without the voter approval requirements of TABOR.

Figure 2
Enacted and Estimated Residential Assessment Rates, 1983 to 2020



Source: Section 39-1-104.2 (3)(a) through (3)(p), C.R.S. and Department of Local Affairs.

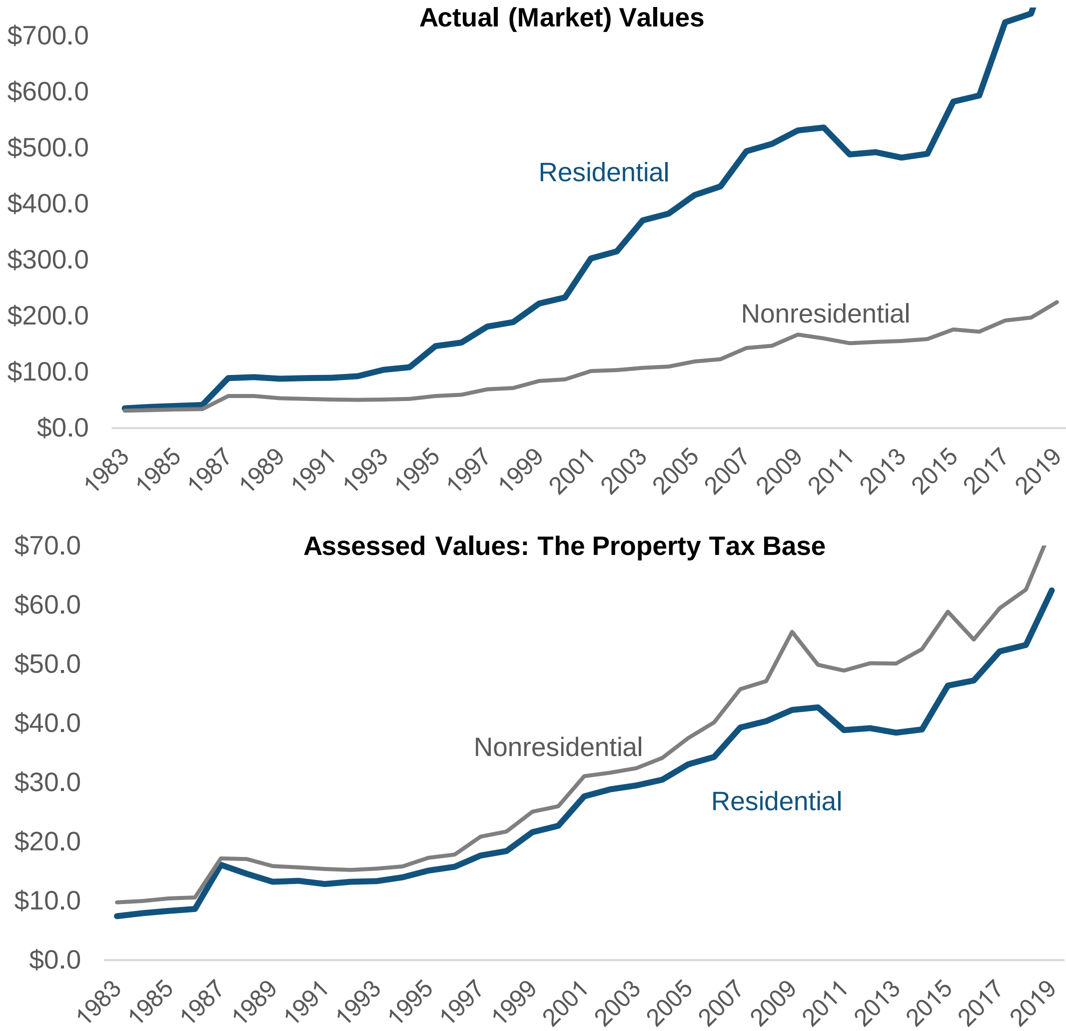
Statewide Impacts of Gallagher

Assessed values. The Gallagher Amendment maintains the desired target percentage of residential property by adjusting the residential assessment rate. If the actual value of residential property grows more rapidly than the value of nonresidential property, the RAR must decrease. This reduces the share of the actual value used to determine property taxes, called the assessed value.

Figure 3 shows the change in actual and assessed values of residential and nonresidential property in Colorado from 1983 through 2019. As is evident from the top graph, the value of residential property has grown much more rapidly during this period. Because the RAR has fallen in order to maintain the target percentage, the bottom graph shows that the rates of growth for residential and nonresidential assessed values are more similar.

[3]Art. X, § 20, Colo. Const.

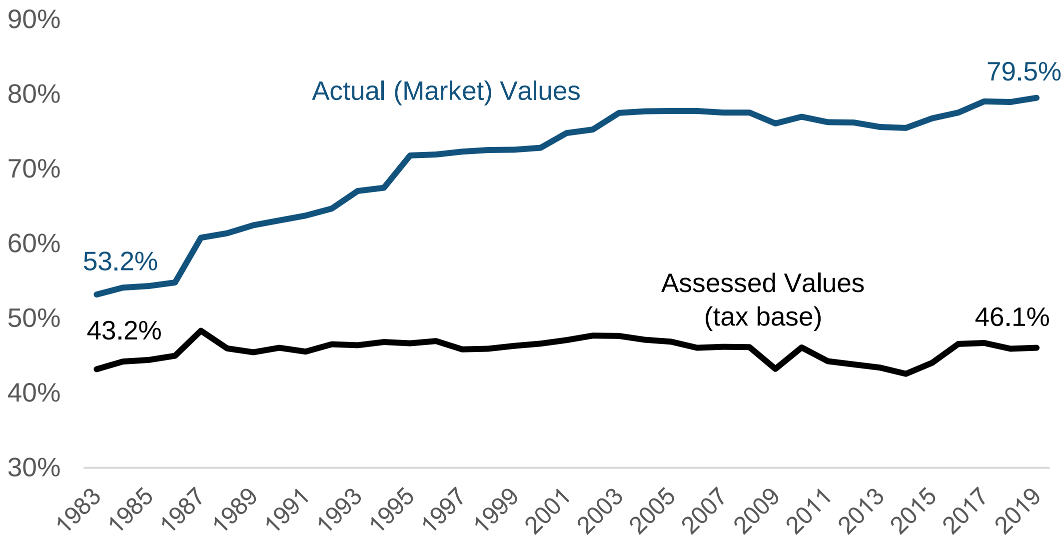
Figure 3
Actual Versus Assessed Values
Dollars in Billions



Source: Colorado Department of Local Affairs, Division of Property Taxation.

This impact may also be seen by comparing the percentage of total actual value and total assessed value attributable to residential property. Because the actual value of residential property has appreciated more rapidly than the actual value of nonresidential property, the share of actual value attributable to residential property has grown significantly. In contrast, the operation of the Gallagher Amendment has held the share of assessed value from residential property relatively constant. Figure 4 shows that while the share of actual value attributable to residential property increased from 53.2 percent in 1983 to 79.5 percent 2019, the share of the tax base attributable to residential property increased by only about three points over this same period.

Figure 4
Residential Share of Actual Versus Assessed Values



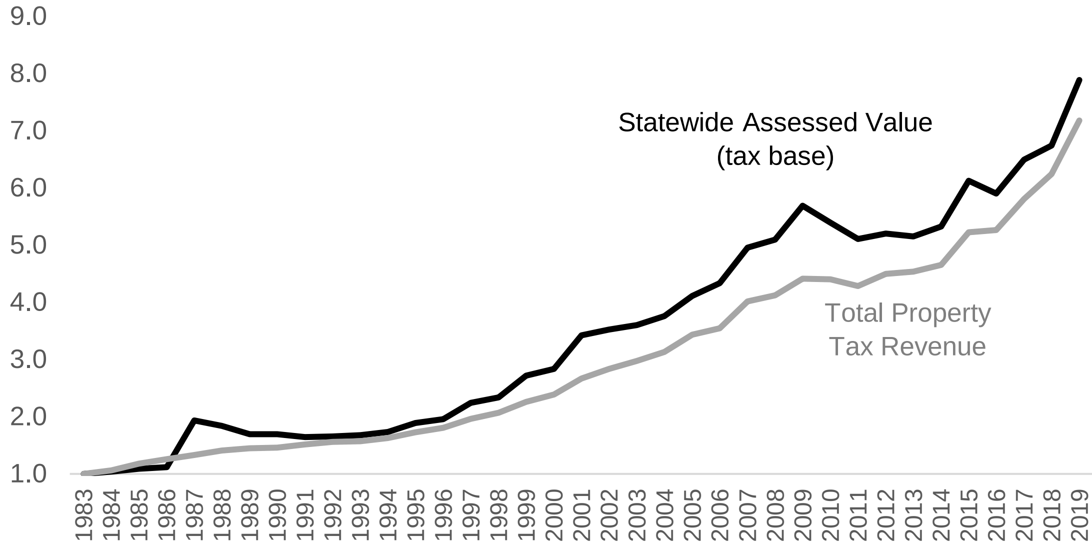
Source: Colorado Department of Local Affairs, Division of Property Taxation.

Property tax revenue. Property tax revenue is indirectly affected by Gallagher. Property tax revenue is determined by the number of mills levied by local governments on their tax base. Counties, municipalities, school districts, and special districts all receive operating revenue from property taxes. Since the passage of TABOR in 1992, mill levies may not increase without a vote of the people at a general election.

Since 1983, average county and municipal mill levies have remained relatively constant, while average levies for special districts have increased slightly. At the time Gallagher passed, all school district operating mill levies were controlled through the statutory school finance formula. After passage of TABOR in 1992, average school mills began to ratchet down so as not to generate more revenue than the formula required. Since the mid-1990's, however, many districts have relied increasingly on voter-approved mill levy overrides, and average school district mill levies have increased slightly.

Since 1983, the overall statewide average mill levy has declined from 89.8 mills in 1983 to 81.7 mills in 2019. This decline has caused total property tax revenue collected statewide to increase at a slower pace than assessed values. Figure 5 compares growth in total assessed values and total property tax revenue indexed to 1983.

Figure 5
Growth in Statewide Total Assessed Values and Property Tax Revenue
Index 1983=1.0



Source: Colorado Department of Local Affairs, Division of Property Taxation.

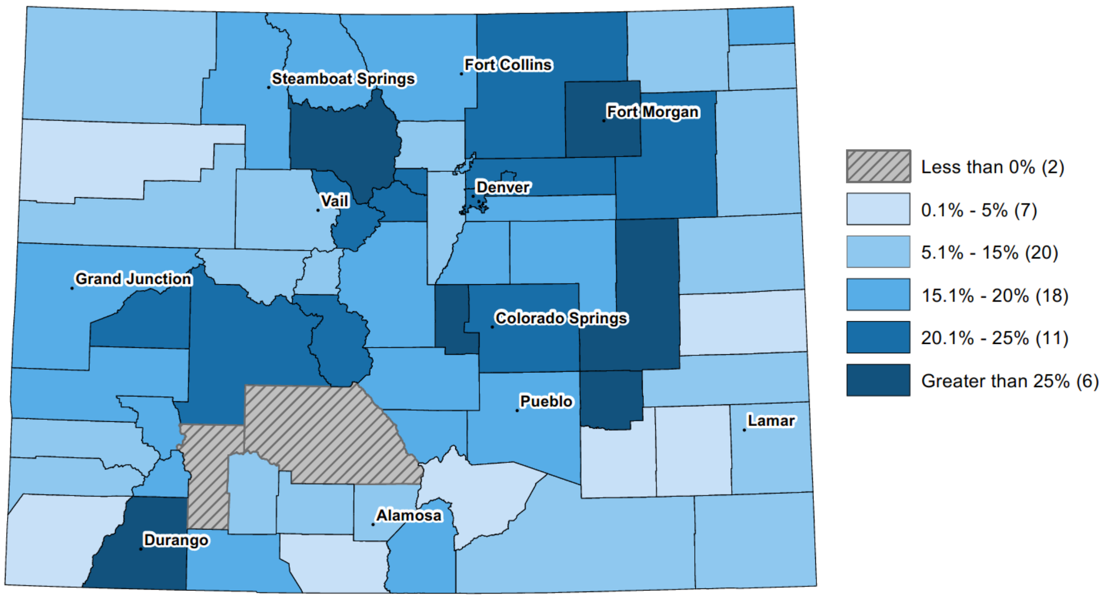
Regional Impacts of Gallagher

The calculation of the target percentage and the RAR is based on the total taxable property in the state. Because there is no statewide property tax, each individual taxing district has a unique tax base based on its unique mix of properties. As a result, the impact of Gallagher has varied across different regions of the state.

Regional impacts in the 2019 reassessment cycle. The 2019 reassessment cycle provides a recent example of variation in the impacts of Gallagher across taxing districts. In 2019, the RAR was reduced from 7.20 percent to 7.15 percent, a 0.7 percent reduction. In districts with less than 0.7 percent home price appreciation during the reassessment cycle, residential assessed values declined. In districts with greater than 0.7 percent home price appreciation, residential assessed values increased.

Figure 6 shows the growth in residential assessed values between 2018 and 2019 across the state. The fastest growth in home prices occurred in exurban housing markets along the fringes of the northern Front Range and El Paso County. Some counties that feature resort communities, including Grand and La Plata, were also among the fastest growing. Only two rural counties in the southern mountains experienced a reduction in their residential assessed values.

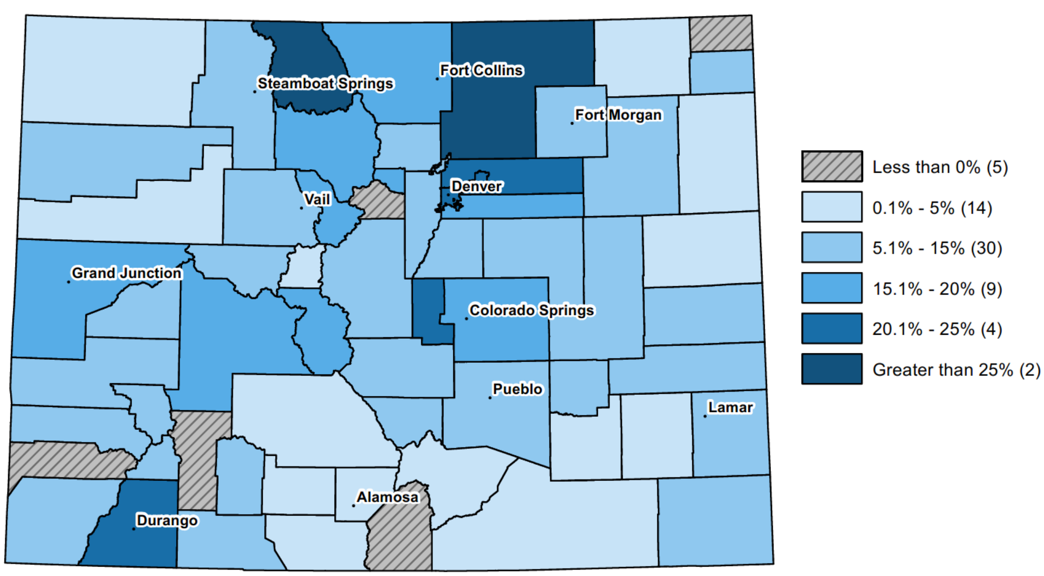
Figure 6
Change in Residential Assessed Values by County
2018 to 2019



Source: Colorado Department of Local Affairs, Division of Property Taxation.

Residential property accounts for only a portion of the tax base in every district. Including nonresidential property, the change in total assessed values is more moderate in almost every county compared with the change to the residential tax base. The notable exception is Weld County, where oil and gas development caused a significant increase in nonresidential property values. Figure 7 shows the change in the total tax base between 2018 and 2019.

Figure 7
Change in Total Assessed Values by County
2018 to 2019



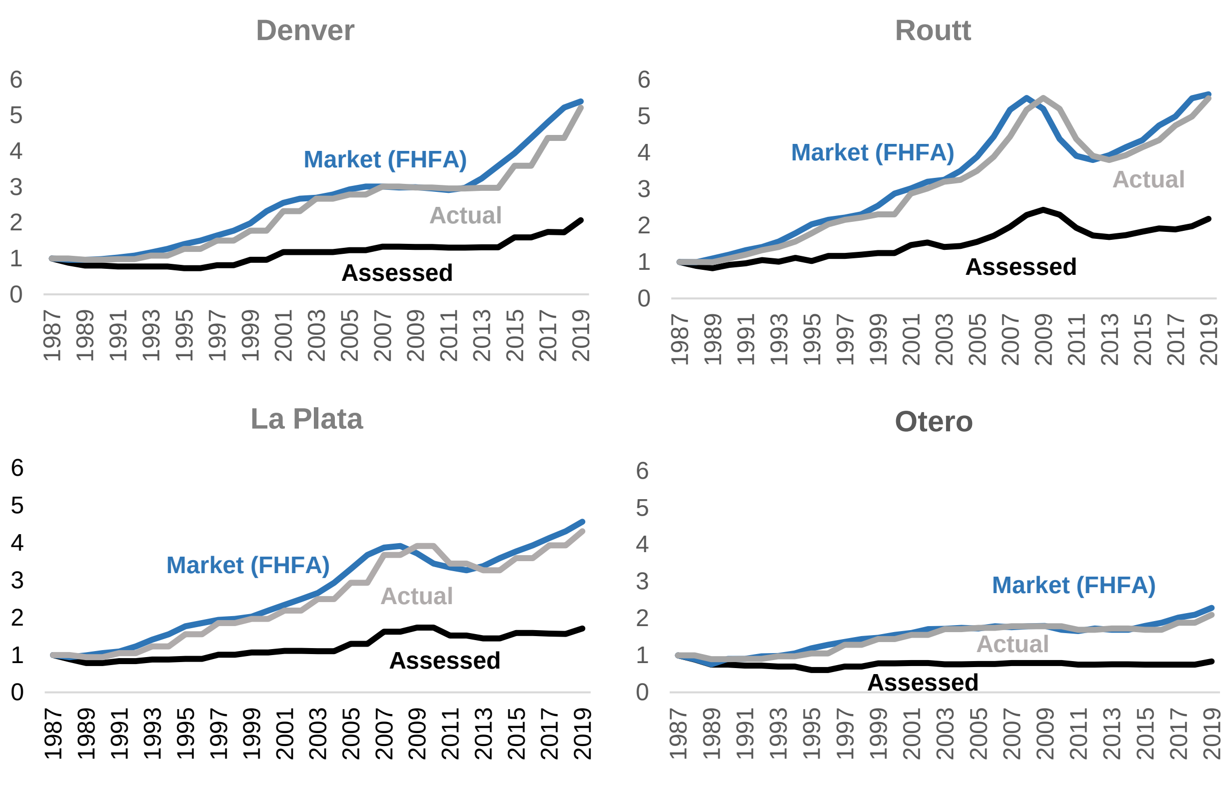
Source: Colorado Department of Local Affairs, Division of Property Taxation.

Regional historical impacts. Historical assessed value data are unavailable at the county level from 1983 when Gallagher was passed. An alternative way to show the long-term impact of Gallagher on the residential property tax base in different counties is to track changes in home prices in different counties over time. The Federal Housing Finance Agency (FHFA) publishes a home price index back to 1987 for 36 of the 64 Colorado counties. These data enable the estimation of historical market, actual, and assessed values of residential property in various counties.

Figure 8 depicts estimated market, actual, and assessed values for a typical home in select counties dating back to 1987. Actual value account for the fact that residential property is reassessed only every other year. Home price appreciation varied widely among counties between 1987 and 2019. The greatest amount of appreciation occurred in Routt County, where home values increased 459 percent during this period. Because of Gallagher, however, assessed values only increased by 118 percent. At the bottom of the range, Otero County experienced an increase in home prices of 129 percent but a decrease of 17 percent. Growth of both market and assessed values in Denver was similar to growth in Routt County, while growth in La Plata County falls in between. The declining RAR thus dampens growth in the tax base in counties with rapidly appreciating home values and reduces the tax base in counties where home values grow more slowly.

Other similarities exist between Routt and La Plata Counties, where residential values are dominated by the tourist destinations of Steamboat Springs and Durango, respectively. Both counties saw a sharp increase and steep decline in values during the housing bubble of the Great Recession. In contrast, values in Denver remained steady during this period and values in Otero County were unaffected.

Figure 8
Market, Actual, and Taxable Residential Property Values for Selected Counties
Index 1987=1.0

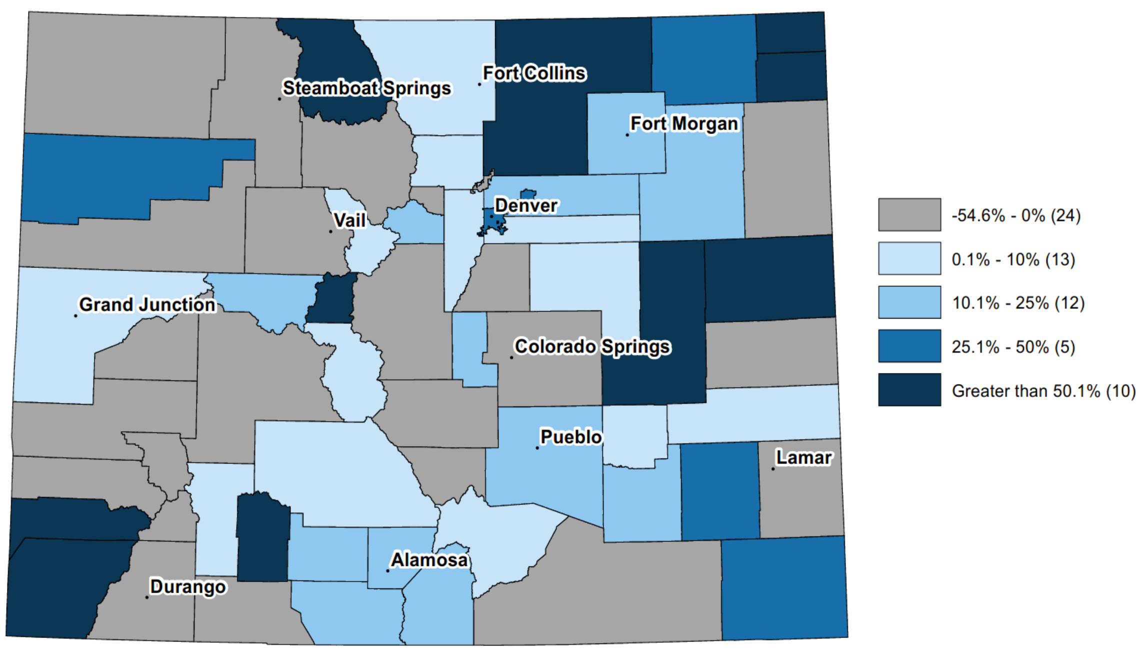


Source: Taxable values calculated by Colorado Legislative Council Staff based on FHFA home price indices.

Assessed value data at the county level for all current counties are available starting in 2004. Residential assessed values increased 105.1 percent statewide between 2004 and 2019. Changes in residential assessed values ranged from a reduction of 0.5 percent in Otero County to an increase of 177.4 percent in Broomfield over this 13-year period. Total assessed values increased 109.8 percent statewide during this period, with growth ranging from a reduction of 14.2 percent in Las Animas County to an increase of 425.6 percent in Weld County.

Inflation adjusted per-capita impacts. A better measure of the ability of a local government to provide services over time without increasing mills is the total tax base, adjusted for inflation and population. Per capita, inflation-adjusted assessed values decreased in 24 counties from 2004 through 2019. Figure 9 shows the geographic distribution of how inflation-adjusted per capita assessed values have changed during this period. On a per-capita, inflation adjusted basis, the strongest growth occurs in Weld County with its oil and gas development, select western slope counties with stable population and significant increases in value, and select counties on the eastern plains that have seen significant population declines.

Figure 9
Change in per Capita, Inflation-Adjusted Property Tax Base
2004 to 2019



Sources: Colorado Department of Local Affairs, Division of Property Taxation, Colorado Department of Local Affairs, State Demography Office, and the U.S. Bureau of Labor Statistics.

Potential Future Impacts of Gallagher

The impact of the Covid-19-related economic crisis on the RAR may be significant in the 2021 reassessment cycle. In January 2021, the division will estimate the RAR for this cycle. The state legislature will then pass a bill during the 2021 legislative session that officially sets the RAR. Local government revenues will be affected in FY 2021-22 and FY 2022-23.

The RAR is based on aggregate residential and nonresidential assessed actual values, and the estimated target percentage, which is dependent on new residential and nonresidential value. As noted above, the RAR declines in years when the growth of residential assessed values is faster than the growth in nonresidential assessed values. There is reason to believe that the RAR could drop significantly, as the result of the pandemic and its impact on various property classes.

The three most significant property classes in terms of value in Colorado are residential property, commercial property, and oil and gas property. In 2019, these three classes constituted 85.9 percent of total property value in the state. For the 2021 property tax year, residential and commercial properties will be valued based on their value as of June 30, 2020, while oil and gas properties will be valued based on 2020 production and price. Relative to the 2019 reassessment cycle, there are likely to be significant changes in value in these three property classes resulting from the pandemic. Specifically, while overall residential values have continued to rise, commercial values have likely fallen as a result of business closures and a trend toward remote work. Similarly, current trends indicate oil and gas production and prices will likely be significantly lower than 2019 levels. The combination of these changes would lead to a significant drop in the RAR, and a corresponding loss in local property tax revenue for municipalities, counties, school districts and other special districts.