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SUBMITTED BY: MICHAEL NOVAK

LEAGUE of Oregon CITIES

Measures 5 and 50: A Primer

Oregon's current property tax system is shaped by two constitutional amendments passed in the 1990's: Measures 5 and 50. Previously, Oregon property taxes were assessed under a levy-based system, with the levy amount applied to each property's real market value. In order to meet community service demands, each taxing district calculated its own levy based on budgetary needs. However, Measures 5 and 50 combined to create a rate-based tax system while reducing taxable values and limiting tax rate growth. The rate became a constitutionally-fixed amount restricting local government and school revenues.

Measure 5: Tax Limits & Compression

Passed in 1990, Measure 5 sets limits on the amount of tax levied per $1,000 of a property's real market value (RMV): $5 per $1,000 for education districts and $10 per $1,000 for general government districts, which includes city and county governments. If taxes in either the education or general government category exceed their designated limits, the taxes are reduced until the limits are met. This reduction, known as **"compression,"** results in millions of dollars in lost revenue for schools and local governments each year. An allowance exists for temporary voter-approved debt service to be outside the $10 limit.

Property Tax Limits

Schools:
$5 per $1,000 of RMV
General government:
$10 per $1,000 of RMV

Measure 50: Permanent Rates:

Passed in 1997, Measure 50 gave all existing tax districts a **permanent** operating rate limit. A district's permanent rate was primarily determined by combining whatever tax levies existed locally when Measure 50 passed. These tax rates cannot be changed by any action of the district or its voters, and remain as they were set in 1997. However, voters can approve a "local option levy," which allows a taxing authority to temporarily exceed the permanent rate limit. These local option levies are limited to general governments, and are restricted to five years for operations and 10 years for capital projects.

Permanent Tax Rates
Forever
set at 1997 level

Measure 50: Assessed Value

Measure 50 also separated property tax from real market value. As a result, properties in Oregon are no longer taxed at their actual value. Instead, taxation is now based on a newly created **assessed value** (AV) which was established by reducing the real market value of the property in 1995-96 by 10 percent. The permanent rate was then applied to the assessed value. Prior to Measure 50, properties were typically assessed across a county on a six year cycle to produce fair and equitable taxation. However, the 1995-96 snapshot dictated by Measure 50 caught properties wherever they may have been during the assessment cycle; assessed value on properties at the beginning of the

Created Assessed Value

Properties
no longer taxed
at their actual value

cycle during this snapshot would be set higher than a similar property at the end of the cycle creating inequities between taxpayers.

Measure 50: Growth Limits

Measure 50 also **limited the annual growth rate** of taxable property value to 3 percent of the assessed value, well below average rate of inflation. By setting assessable values based on 1995-96 market rates and capping the annual rate of growth, Measure 50 permanently locked into place property tax imbalances between similar properties with near identical market values.

Capped Annual Rate of Growth

Increases limited to 3% annually

Measure 50: Changed Property Ratio

For new properties or those that undergo a significant change, such as major remodeling, new construction, rezoning or subdivision, the property tax rate is determined by applying a ratio of the assessed value to market value of all existing property within the same class (residential, commercial, industrial or multifamily) in that county to the improved property. This **changed property ratio** (CPR) is calculated county-wide, resulting in significant inequities across neighborhoods. The classification of a changed property as either commercial or industrial can also cause considerable differences in property tax liabilities, since industrial property is assessed at 100 percent of market value, whereas commercial property, which had experienced a large increase in market value, is calculated based on the CPR.

Changed Property Ratio

Calculates value of new properties, but creates inequities across neighborhoods

Measures 5 and 50: Compression

To determine a property's tax obligation, each year both the assessed value, created by Measure 50, and real market value tax limits, created by Measure 5, are calculated for each property. When a property's assessed taxes exceed the Measure 5 limit, the tax obligation is reduced – or "compressed" – to the Measure 5 limit. The amount compressed is lost forever to the district, resulting in millions lost each year to local governments that rely on property taxes for a majority of their revenue to provide services. In FY2009-10, more than half of Oregon's cities were negatively affected by compression, resulting in more than $15.6 million in lost revenue for cities statewide. This amount was $4.8 million higher than the year prior, a trend likely to continue as the market values and assessable values of properties throughout the state grow closer together, increasing the likelihood of compression.

Compression

Revenue lost forever to local taxing districts when AV is reduced to $5 and $10 limits

Measures 5 and 50: Impacts

The revenue challenges caused by Measures 5 and 50 are significant. Adjusting the property tax system from one based on market values to one primarily based on assessable values resulted in an immediate $51.4 million reduction in property tax revenues collected statewide in 1997-98. Since that time, inflation, particularly for primary city expenses like employee healthcare and pension costs, has regularly exceeded Measure 50's 3 percent rate of growth limit, resulting in the slow but steady strangulation of city finances as costs increase far faster than revenues. These concerns, as well as growing frustration with the numerous inequities embedded in the property tax system, have leaders throughout the state advocating for increased local control over the property tax system.

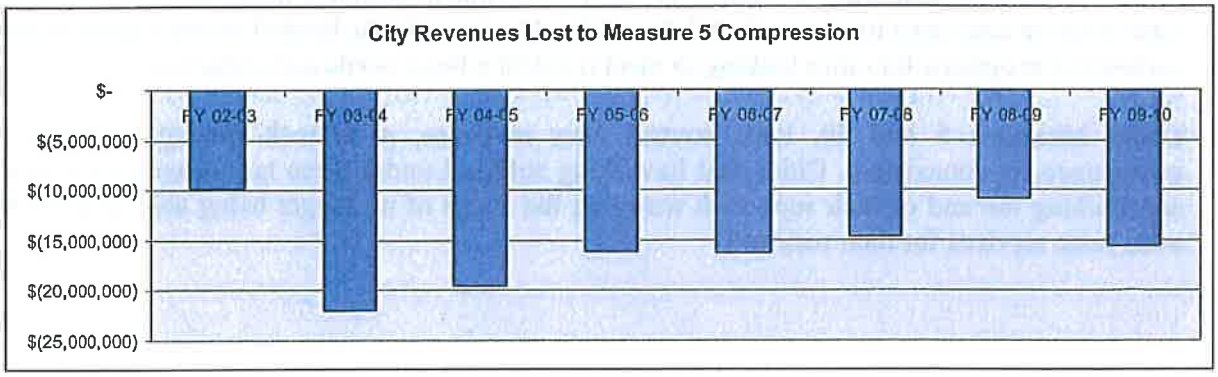
How Measures 5 and 50 Affect Oregon's Cities

Measures 5 and 50 have had an enormous negative impact on city and other local governments' ability to meet the basic service needs of their citizens. These constitutional changes significantly reduced city revenues by detaching property taxes from market value, imposing permanent district tax rates, capping property tax growth, and setting arbitrary limits on local taxation. With their local autonomy compromised, cities sink deeper into a financial hole as costs continue to rise, populations grow, and community demands increase.

Measure 5

In FY2009-10, more than half of Oregon's 242 cities lost revenue due to Measure 5 compression, resulting in over $15.6 million in lost revenue for cities statewide. Compression results when the property taxes imposed by general government taxing districts exceed the $10 limit per $1,000 of real market values. Taxes over the limit are "compressed" down to meet the limit and any compressed amount is lost forever to the local government. As evidenced in the chart below, compression has grown worse over the last year, as the real market value of thousands of properties stagnate or fall. For several years prior, compression had decreased as market values increased, reducing the number of properties affected by Measure 5's tax ceiling. From FY2008-09 to FY2009-10, however, compression in Oregon cities increased 44.1 percent, costing cities nearly $4.8 million in additional lost revenue.

Compression Loss as a Percentage of Tax Extended				
	2008-09		**2009-10**	
	Total	*Percent of cities*	*Total*	*Percent of cities*
Oregon cities in compression	132	54.5%	135	55.8%
Cities losing 0 to 1 percent of tax extended	98	40.5%	99	40.9%
Cities losing 1.01 to 5 percent of tax extended	25	10.3%	27	11.2%
Cities losing 5.01 to 10 percent of tax extended	6	2.5%	5	2.1%
Cities losing over 10 percent of tax extended	3	1.2%	4	1.6%



Compression has often been exacerbated by the emergence of special districts, independent governmental units that offer specific services, such as hospitals, fire protection, sewer service, etc., that are not provided by the city or county government. In FY2009-10, 707 special districts in Oregon levied a property tax, up from 664 in FY1998-99. These districts collected

$607 million in revenue in FY2009-10, a 10.1 percent increase over the prior year. Creation of these districts can often squeeze city budgets by pushing tax rates above the Measure 5 limits, resulting in or worsening existing compression.

Measure 50

The affects of Measure 50 on city revenues are just as detrimental as those of Measure 5. By changing of the property tax system from one based on market values to one based on the newly created assessable value, Measure 50 resulted in an abrupt $17.5 million drop in city property tax revenue statewide in FY1997-98. Overall, taxing districts lost $51.4 million in the change to assessable values.

Measure 50 also imposed a permanent tax rate on cities. Determined largely by combining whatever operating tax authority existed locally when Measure 50 passed. The permanent rate prevents city officials and residents from modifying tax rates to meet local needs or preferences, inhibiting cities from efficiently addressing unforeseen revenue issues, such as plummeting tax revenues from the departure of an industrial manufacturer or utility company. Measure 50 does allow for a "local option levy;" however, with the need for voter approval, there are often unpredictable and costly, while the arbitrary limit on their timeframe offers only a temporary remedy for cities searching for longer term fixes.

A significant element of Measure 50 is the limit it sets on the annual growth of assessed value. The measure limited growth in assessable value to 3 percent annually at a time when real market values for houses were regularly growing at three times that rate. Moreover, inflation and employment costs, particularly for primary city expenses like employee healthcare and pensions, have regularly exceeded the measure's 3 percent rate of growth limit, resulting in the slow but steady strangulation of city finances as costs increase far faster than revenues.

The Perfect Storm

Today, after more than a decade of this slow strangulation, Oregon cities face the perfect fiscal storm. Real market values have declined or flattened as a result of the housing market's collapse, only increasing the amount of revenue lost to cities by Measure 5 compression. Yet city costs have continued to increase and demands for social services have only grown as the economy has worsened. State assistance is likely to decline as stimulus funds are exhausted and state revenue continues to plummet. All the while, Measure 50 has limited revenue growth and narrowed the options for cities looking to meet resident's basic needs and expectations.

Under Measures 5 and 50, local control over revenues, a bedrock principal of sound governance, is nonexistent. Cities that have long suffered under these tax measures are now approaching the end of their rope with many on the verge of no longer being able to provide even basic services for their residents.

How Compression Works

While Measure 50 determines the tax rate and caps the rate of growth, Measure 5 sets a tax ceiling. If either the school or general government taxes exceed the Measure 5 imposed ceiling, then each corresponding taxing district has its tax rate reduced proportionately until the tax limit is reached.

For example, imagine two similar houses, Home A and Home B, located across the street from one another (see graph below). Both have a real market value of $200,000. Accordingly, Measure 5 limits the education districts taxing authority to $1,000 (the $5 limit multiplied by the $200,000 market value) and the general government taxing authority to $2,000 (the $10 limit multiplied by $200,000 market value).

However, Home A has an *assessable value*, as determined by 1995-96 property values plus the 3 percent limited annual growth, of $155,000. Home B has an *assessable value* of $190,000. Remember that Measure 5 limits only apply to *market value*. The local education and general government districts therefore levy $5.45 and $11.80 taxes per $1,000 of *assessable value* respectively.

This means Home A has an overall education district tax burden of $845 ($5.45 multiplied by 155,000) and a general government tax burden of $1,892 ($11.80 multiplied by 155,000). These amounts are below the Measure 5 limit of $1,000 and $2,000 respectively.

Home B, on the other hand, faces a different tax burden because of its higher assessable value. For this property, the education tax levied totals $1,035 (5.45 multiplied by $190,000), which exceeds the Measure 5 limit of $1,000 by $35, resulting in compression. Similarly, the general government levy of $2,052 surpasses the Measure 5 limit of $2,000 by $52. The result is $87 in compression.

HOME A	HOME B
Real Market Value = $200,000 Assessable Value = $155,000	Real Market Value = $200,000 Assessable Value = $190,000
Measure 5 limits Education: $5 x 200[1] = $1,000 General: $10 x 200[1] = $2,000 [1] For every $1,000 of Real Market Value	Measure 5 limits Education: $5 x 200[1] = $1,000 General: $10 x 200[1] = $2,000 [1] For every $1,000 of Real Market Value
Measure 50 tax rates Education: $5.45 x 155[2] = $845 Measure 5 Compression: $0	Measure 50 tax rates Education: $5.45 x 190[2] = $1,035 Measure 5 Compression: $35
General: $11.80 x 155[2] = $1,892 Measure 5 Compression: $0 [2] For every $1,000 of Assessable Value	General: $11.80 x 190[2] = $2,052 Measure 5 Compression: $52 [2] For every $1,000 of Assessable Value

The total impact of thousands of properties in compression, however, is considerable. More than half of all Oregon cities lost revenue due to compression in FY2009-10, with foregone revenue exceeding $15.6 million – a 44.1 percent increase over the prior fiscal year, as the real market values and assessed values of properties throughout the state merge.

Measure 50 Inequities

Several provisions of Measure 50 created inequity amongst property owners. These include base year inequity, neighborhood to neighborhood inequity, existing vs. new construction inequity and commercial vs. industrial inequity.

Base year inequity arises from the fact that Measure 50 locked in assessed value limits based on 1995-96 assessments. Prior to Measure 50, assessments were conducted every six years, with one-sixth of properties being assessed in any given year. Since more recent assessments would likely be more accurate, any errors or inequities in the assessed market value in 1995-96 will remain forever, since the measure provides no way of altering the assessed value limits. This means for all practicable purposes that approximately one-sixth properties were given an assessed value based on their 1989-90 real market values.

Imagine, for example, two properties of equal value in 1990 ($150,000) and with equal 8 percent annual increases in market values between 1990 and 1996. Home A, assessed in 1990-91 has an assessed market value of $150,000 six years later. Home B, assessed in 1995-96, is valued at $220,000 after six years of compounded 8 percent annual growth in market value. Based on Measure 50 formulas (1995-96 assessed market values minus 10%), Home A would have an assessable value of $135,000, and Home B roughly $200,000. A modest tax rate of $10 per $1,000 of assessed value would result in a significant difference in property taxes ($1,350 to $2,000).

The inequities embedded in the assessable value only grow worse over time. Assuming an annual capped growth rate of 3 percent, Home A would have an assessable value of roughly $200,000 by 2010. Home B, however, would have an assessable base of nearly $300,000. As a result, the property tax burden of Home B would be 50 percent higher than that of Home A, $2,000 to $3,000, despite identical real market values.

Exhibit A: Base year inequity

	Home A	Home B
Real Market Value in 1990:	$150,000	$150,000
Annual rate of growth	8%	8%
Assessment year:	1990	1996
Market value according to assessors in 1996:	$150,000	$220,000
1996 Assessed Value Limits according to Measure 50 formula:	$135,000	$200,000
Property taxes owed in 1996:	$1,350	$2,000
Assessed Value Limit in 2010:	$200,000	$300,000
Property taxes owed in 2010:	$2,000	$3,000

Neighborhood to neighborhood inequity is a direct result of the fact that assessable values were locked in according to 1995-96 market values. These values may no longer accurately reflect the market values of all neighborhoods. Imagine one neighborhood that has seen market prices increase by an average of 10 percent annually, while another neighborhood has seen 5 percent annual growth. In both neighborhoods, the tax rate has risen at the Measure 50 limit of 3 percent annually. This means that the ratio between real market value and assessed value is vastly different, and those property owners in the slower growing

Exhibit B: Neighborhood to neighborhood inequity

	Faster growing	Slower growing
Market value in 1996	$150,000	$150,000
Market value in 2010	$400,000	$300,000
Property taxes owed in 2010	$4,000	$4,000
Property taxes as percentage of RMV	1%	1.33%

neighborhoods are paying a higher tax rate as a percentage of their real market value than those property owners in the faster growing area.

New property inequity is caused by the county-wide calculation of the changed property ratio. To calculate the assessed value of a new property, assessors multiply the ratio of real market value to assessable value of all similar property in the county. In the above example, the changed price ratio would be calculated using the average increases, or seven and half percent. Since increases in assessed value are capped at 3 percent annually, the faster growing district has a ratio smaller than the slower growing neighborhood, since there is a larger difference between market and assessable values.

By averaging the ratios, however, the new property in the faster growing area would have an assessed value (and property tax liabilities) higher than that of other properties in the neighborhood. Meanwhile, the property in the slower growing area would have an assessed value lower than its neighbors. This harms taxing districts that levy in the slower growing areas of a county, particularly neighborhoods with faster growing urban areas. For the slower growing cities, this inequity results in lower assessed values, and lower property tax collections, for new property than if the changed property ratio were calculated by neighborhood.

Exhibit C: New Property Inequity

	Neighborhood with 10% annual growth		***Neighborhood with 5% annual growth***	
	Home A	New Home	Home B	New Home
1996-97				
• RMV	$150,000		$150,000	
• AV	$150,000		$150,000	
2010				
• RMV	$570,000		$297,000	
• AV	$227,000		$227,000	
Ratio	0.398		0.521	
CPR for new property		0.46		0.46
2011				
• RMV	$627,000	$627,000	$312,000	$312,000
• AV	***$234,000***	***$288,000***	***$234,000***	***$143,000***

Commercial vs. industrial inequity occurs due to the different way these two types of property are valued. The changed property ratio is calculated based on the type of property (residential, commercial, industrial or multifamily). Industrial property, which includes equipment, depreciates over time and generally has a changed property ratio of 1. Commercial property, on the other hand, has seen a rapid increase in market value since the Measure 50 assessable values were set, meaning that its changed property ratio is far below that of industrial property making the categorization of a property enormously important. For example, a property equally suitable for commercial or industrial activities has a market value of $1 million. If that property is designated as commercial, the changed property ratio of commercial properties county-wide may lower the assessed value to only $500,000. That same building, classified as industrial, would likely have a $1 million assessed value. Recent rule changes on property classification have addressed, but not eliminated, this inequity.

Exhibit D: Commercial vs. Industrial

	Commercial	***Industrial***
Market Value	$1,000,000	$1,000,000
Changed Property Ratio	.50	1
Assessable Value	$500,000	$1,000,000
Property taxes owed at $10 per $1,000 of AV	$5,000	$10,000