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**TO:** Chair Phil Barnhart and Members of the House Revenue Committee

**RE:** Support for HJR 12 and HJR 20; and Support for Comprehensive Property Tax Reform and Interim Work Group Formation

**Date:** May 6, 2015

**TAX REFORM:**

The League of Oregon Cities (League) agrees with the legislature that comprehensive tax reform is greatly needed in Oregon and we support such efforts. The League would welcome the opportunity to be involved in that reform and we specifically advocate for the inclusion of property tax within the discussion. While property tax revenues are received by local governments and schools, property tax is a vital component of the state's overall revenue system. **The League requests that an official legislative work group be formed regarding property tax** and the League stands ready to assist the legislature with the reform project.

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 been beating the drum for the last several sessions seeking reform—specifically, the League has presented reform bills 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 to the voters. 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. Ideally, all of these problems would be addressed in comprehensive reform. These problems are complex and thus this list is only a summary of the highlights.

## IDENTIFIED 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:
  - 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. 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. 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. Many of the statutory exemptions are automatic and do not permit local control. Other exemptions are outdated or overly complex. In addition, the popular homestead deferral program for seniors and the disabled continues to have funding shortages and needs review and reform.
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 the loss.

## 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.