Analysis

Department of Revenue

Property Tax Revenue Shortfalls

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Request: Increase the Department of Revenue Property Tax Division General Fund appropriation by $1,360,125 and increase position full-time equivalents by 7.20 FTE.

Recommendation: The Legislative Fiscal Office recommends a $1,360,125 increase to the Department of Revenue's Property Tax Division General Fund appropriation and an increase of 7.20 full-time equivalents be included in the budget reconciliation bill during the 2016 session. The $1.8 million special purpose appropriation is be dis-appropriated from the Emergency Fund.

Analysis: During the 2015 legislative session, the Department Revenue (DOR) requested additional General Fund to backfill revenue shortfalls in the Property Tax Division (PTD). The Legislature deferred consideration of the agency's request in order to develop a more clear understanding of the underlying issues. A special purpose appropriation (SPA) of $1.8 million General Fund was established in the Emergency Fund as a contingency.

DOR is now requesting $1.3 million General Fund from the SPA to address revenue shortfalls in the County Assessment Function Funding Assistance Account (CAFFA) and Cadastral contract mapping services.

County Assessment Function Funding Assistance (CAFFA) Account
CAFFA is used to partially pay for essential assessment and taxation functions at both the county and state levels. By statute, 90% of CAFFA revenues are distributed to counties on a quarterly basis. DOR retains up to 10 percent of CAFFA revenue for the expenses incurred in the appraisal of state appraised industrial cites (formerly principal and secondary industrial sites), and centrally assessed companies. CAFFA funding supplements state and local General Fund dollars.

CAFFA is supported by two revenue streams: (a) document recording fees and (b) a portion of the interest from delinquent property taxes. A per recorded document fee for CAFFA is $9.00 and has been unchanged since 1999. These revenue streams originate with counties and are transferred to the state. Document recording fees are related to the number of real estate transactions, including refinancing activity with the amount of delinquent property taxes dependent upon the state of the economy and interest rates. These two revenue streams can be counter-cyclical.

CAFFA Revenue Shortfall
Actual CAFFA revenues have averaged $44 million per biennia from the 2003-05 through the 2011-13 biennia. CAFFA revenues have been in general decline after reaching $50 million in revenue during the 2001-03 biennia.

The most recent CAFFA revenue forecast for the 2015-17 biennium is projected at $38.8 million (spring of 2015). This is $2.6 million, or 6.3%, less than the 2013-15 biennium forecast of $41.4 million, which means that county grants may fall by around $2.3 million from $37.2 to $34.9 million and DOR's share will fall from $4.1 million to $3.9 million, or a reduction of $200,000. Actual distributions to counties for the period 2003-05 to 2013-15 have been around $39.9 million and $4 million for DOR.[1]

DOR economists believe that the reason for the decline in CAFFA revenue is due to a decline in mortgage refinancing activities or lower recording fees rather than falling delinquent interest charges. Long-term, the decline in CAFFA revenue appears to be more systematically driven by factors other than a decline in mortgage refinancing.

The next preliminary forecast is due in February with the final forecast being completed in April.

CAFFA-Related Expenditures

Since 2004, the PTD has managed to available CAFFA revenue well below the level budgeted for the program. After the 2001-03 biennium, and continuing through the 2013-15 biennium, DOR's CAFFA-related charges have exceeded available revenues by an average of $1.2 million per biennia. For the 2015-17 biennium, the shortfall is estimated at $1.8 million.

The shortfall occurred even as the PTD experienced an overall decline in the number of budgeted positions, which fell from 146 during the 1999-01 biennium to 87 positions in the agency's 2015 legislatively adopted budget.

With relatively flat CAFFA revenues, cost increases for personal services and services and supplies have outpaced CAFFA revenue. Compounding the PTD revenue shortfall was the fact that in 2004 DOR made the decision to start charging agency wide indirect costs to the CAFFA program to cover overhead expenses, a process which was deemed legal, but eventually suspended during the 2013-15 biennium.

Additionally, the PTD's ability to manage its CAFFA revenue shortfall became more limited when the agency consolidated, or more specifically transferred, General Fund for Attorney General and information technology costs from the PTD into its Administrative Services Division. This was done during by the Legislature in 2014, at the request of the agency.

Since 2004, DOR has undertaken a variety of management actions to cover the shortfall, including: holding CAFFA funded positions vacant; holding General Fund positions vacant; including those unrelated to CAFFA funding; and using General Fund services and supplies savings to pay for CAFFA position costs. Such actions may have certainly hampered, over an extended period of time, the operational and productive capabilities of the PTD.

The agency's actions over multiple biennia to manage the shortfall have been done entirely administratively. Only during the 2015 session was the Legislature apprised of the CAFFA revenue shortfall. CAFFA revenue forecasts are now aligned with the program's budget beginning with the 2015-17 biennium. During the 2015 legislative session the agency took a $1.8 million Other Funds reduction (10.00 FTE) related to the CAFFA shortfall.

DOR is requesting $1,119,139 General Fund in personal services in order to backfill the CAFFA shortfall. Position funding would move to a 63% General Fund to 37% CAFFA fund split.

[1] These figures do not represent the one quarter lag in CAFFA revenue distributions.

Option for CAFFA Revenue Shortfall
There are four options for resolving the CAFFA shortfall: (1) leave the PTD budget unchanged and do not backfill the CAFFA revenue shortfall (i.e., current law budget); (2) increase the percent of CAFFA funding going to the PTD thereby reducing the CAFFA share granted to counties (This would require a statutory change); (3) increase the revenue flow into CAFFA through a fee increase or change in delinquent interest payments (This would also require a statutory change); or (4) backfill the CAFFA shortfall with General Fund.

DOR's recommendation is to backfill the CAFFA revenue shortfall with General Fund and has not seriously considered other options. Such a recommendation represents an increasing commitment of state General Fund each biennia as cost increases will likely continue to outpace CAFFA revenue growth.

Cadastral Revenue Shortfall
Cadastral is a comprehensive statewide property tax mapping system for valuing properties. Most counties have in-house Cadastral mapping services or contract with other counties for such services. The PTD provides Cadastral mapping services to the few remaining counties. The number of counties requiring such services has decreased over the past several years from 14 to nine. As contract revenue declined, the PTD has diverted General Fund from other activities to backfill the Cadastral revenue shortfall, which is estimated at approximately $365,000 per biennium.

DOR is requesting an estimated $240,986 General Fund in personal services in order to backfill the Cadastral shortfall. Position funding would become 85% General Fund to 15% Other Funds (contract revenue).

Recommendation
In the short-term, for the remainder of this biennium, General Fund is the recommended solution to fund the PTD revenue shortfalls in CAFFA and Cadastral to minimize the impact to the upcoming 2016 valuation season.

General Fund, however, may not be the most appropriate long-term solution to the systemic funding issues facing the PTD. To properly evaluate alternative funding options, and appropriate program services levels, a programmatic review of the PTD would be needed. The last time such a review occurred was in 1999, which produced a number of studies the following years.

The Legislative Fiscal Office recommends a $1,360,125 increase to the Department of Revenue's Property Tax Division General Fund appropriation and an increase of 7.20 full-time equivalents be included in the budget reconciliation bill during the 2016 session. The $1.8 million special purpose appropriation is be dis-appropriated from the Emergency Fund.