



Luke Bell
General Counsel/VP of Governmental Affairs
3644 SW Burlingame Rd
Topeka, KS 66611
(785)633-6649 (Cell)
Email: lbell@kansasrealtor.com

To: House Taxation Committee

Date: March 17, 2015

Subject: **HB 2400** – Supporting Elimination of the Local Ad Valorem Tax Reduction Fund (LAVTRF) and Providing Research on the Growth of Property Tax Burden Imposed by Kansas Local Governments

Chairman Kleeb and members of the House Taxation Committee, thank you for the opportunity to provide testimony today on behalf of the Kansas Association of REALTORS® in support of **HB 2400**, which would eliminate the obligation of the state to transfer state income and sales tax revenues to subsidize local government spending through the ineffective Local Ad Valorem Tax Reduction Fund (LAVTRF). Through our comments, we hope to provide some additional context to the discussion on this very important issue.

KAR is the state's largest professional trade association, representing nearly 8,000 members involved in both residential and commercial real estate and advocating on behalf of the state's 700,000 property owners for over 90 years. REALTORS® serve an important role in the state's economy and are dedicated to working with our elected officials to create better communities by supporting economic development, a high quality of life and providing affordable housing opportunities while protecting the rights of private property owners.

Does Kansas have a property tax problem?

Over the last 16 years, the property tax burden imposed on Kansas families, farmers and small businesses by local governments has increased exponentially. From 1997 to 2013, the total amount of property tax revenues collected by Kansas counties increased from \$547.6 million in 1997 to \$1.2 billion in 2013, which is a total increase of 116.9% over this time period. On average, Kansas counties have increased the property tax burden by 7.3% each year.

Similarly, the total amount of property tax revenues collected by first class cities increased from \$226.8 million in 1997 to \$447.6 million in 2013, which is a total increase of 97.4% over this time period. On average, Kansas first class cities have increased the property tax burden by 6.1% each year. No reasonable individual could look at this data and conclude that the property tax burden was not skyrocketing on Kansas families, farmers and small businesses.

At the same time, inflation increased by an average of 2.4% and the Kansas statewide population grew by just 0.6% each year over the same time period. Traditional economic theory and common sense dictate that an economically efficient amount of tax revenue growth would be inflation plus population growth, which would be roughly 3.0% in Kansas over the last 16 years. Obviously, local governments need enough property tax revenue growth to cover the increased incremental costs to provide goods and services to residents due to inflation and to provide services to new residents of the community from population growth.

Unfortunately, the property tax burden is currently growing at a rate that is nearly double the rate of inflation plus population growth. Your constituents cannot continue to shoulder a property tax burden that vastly outweighs the growth of the Kansas economy, wages, inflation and the statewide population. As the growth of property tax revenues continue to outpace inflation and population growth, the per capita property tax burden continues to rapidly increase on Kansas property owners, which is simply not sustainable for property owners.

According to a detailed analysis by the Tax Foundation, Kansas currently has one of the most burdensome property tax systems for businesses with a ranking of 41st in 2012. In addition, the Tax Foundation recently ranked Kansas as 47th overall in terms of the most favorable tax climate for mature business operations and 48th overall for newly-established business operations. In doing so, the report stated that Kansas has one of the highest (if not the highest) property tax burdens on business operations across nearly all 14 varying categories of business operations.

Unfortunately, REALTORS® believe that this dramatic growth in the property tax burden stifles the economic prosperity of many Kansas farmers, self-employed professionals and small businesses that have seen a consistent and drastic increase in the amount of their income that is devoted to paying their property tax assessments. Regardless of whether the underlying business made a profit or not in a given year, every farmer or small business owner is required to pay an ever-increasing amount of property taxes each year to subsidize local government spending.

The ever-increasing property tax burden increases business input costs just like any other tax and decreases the amount of capital that can be poured back into the business by hiring new employees or investing in new business capacity. If Kansas wishes to continue on the path of becoming a low tax burden state for families, farmers and small businesses, then something must be done to address our exponentially increasing property tax burden.

If the Kansas Legislature does nothing to address this growing problem, then the total property tax burden on Kansas families, farmers and small businesses will most likely double again over the next decade. Can your constituents withstand another doubling of their property tax burden over the next decade?

What has caused local governments to increase the property tax burden on Kansas property owners?

Unfortunately, three inaccurate theories have been floated by local governments and certain members of the media in an attempt to explain why local governments have increased the property tax burden on Kansas property owners. These theories, none of which are backed up by the actual data on property tax revenues, are the following:

- (1) Elimination of funding since 2003 for the Local Ad Valorem Tax Reduction Fund (LAVTRF) and City-County Revenue Sharing Fund (CCRSF) has caused local governments to increase the property tax burden;
- (2) Exemption for commercial machinery and equipment (M&E) from property taxes since 2006 has caused local governments to increase the property tax burden; and
- (3) Reductions in state general fund spending by the Kansas Legislature from 2011 through 2014 have caused local governments to increase the property tax burden.

First, local governments and certain members of the media have asserted that local governments have resorted to increasing the property tax burden in response to the loss of state revenue transfers to local governments under the LAVTRF and CCRSF programs since 2003. Under this line of reasoning, the elimination of state funding transfers to local governments has forced local governments that have otherwise been responsible with property tax collections to increase property taxes to make up for this lost funding.

Basically, both of these funds worked by taking state income and sales tax revenues and transferring a portion of these funds to local governments to subsidize local government programs and services. Local governments were supposed to utilize the funds provided through these funding streams to reduce property taxes. The data provided in my testimony will demonstrate that this did not happen.

From 1997 to 2003, the Kansas Legislature appropriated nearly \$573.3 million in funding for these two programs, which was an average of \$81.9 million each year. At the same time, Kansas counties and first class cities continued to increase the property tax burden on Kansas property owners by \$372.8 million, or an average of \$63.8 million each year. As a result, while the Kansas Legislature appropriated nearly \$82 million each year for “property tax relief” through these two programs, Kansas counties and first class cities simultaneously continued to increase the property tax burden on Kansas families, farmers and small business owners by nearly \$64 million each year.

If you were to accept the theory advanced by local governments and certain members of the media that the loss of the revenue transfers from the state government to local governments caused the massive increases in the property tax burden, then you would anticipate that the total amount of property taxes collected by Kansas counties and first class cities would have increased at a more rapid pace since the elimination of the LAVTRF and CCRSF funding. If their theory was correct, then the annual growth of property tax increases should have been lower when these programs were fully funded and higher following their elimination by the Kansas Legislature in 2004.

However, the actual data on property tax collections in Kansas does not support this theory. In fact, Kansas has had a major problem with property tax increases by local governments since 1999 and the trend of property tax increases by local governments has actually slowed down since 2003 (when there has been no LAVTRF and CCRSF funding).

Not surprisingly, the data actually shows that the average annual growth rate of the property tax burden imposed by local governments was significantly HIGHER when the LAVTRF and CCRSF programs were fully funded by the Kansas Legislature. From 1997 to 2003, when the LAVTRF and CCRSF programs received record amounts of funding, the average annual growth rate of the property tax burden was 8.2%.

From 2004 to 2013, following the elimination of all funding for the LAVTRF and CCRSF programs, the average annual growth rate of the property tax burden was actually reduced to 4.6%. As result, the average annual growth of the property tax burden imposed by local governments is actually 43.9% lower following the elimination of funding for the LAVTRF and CCRSF programs compared to when the programs were fully funded by the Kansas Legislature.

In addition, the largest increase in the property tax burden on record by Kansas local governments took place in 2001 when property tax revenues were increased by \$92.5 million (a 10.0% increase). Not surprisingly, 2001 was also a year when the LAVTRF and CCRSF programs were fully funded with roughly \$88.7 million in SGF funding.

Second, an additional argument advanced by local governments and certain members of the media is that the passage of the property tax exemption for machinery and equipment (M&E) also caused the drastic increase in the property tax burden imposed by local governments. However, the same data also shows that the average annual growth rate of the property tax burden imposed by local governments is again significantly LOWER following the passage of the M&E property tax exemption at an average annual rate of 2.8%, which is 61.1% lower than the average annual growth rate in the years prior to the passage of the M&E property tax exemption.

Accordingly, the data proves that the elimination of funding for the LAVTRF and CCRSF revenue sharing programs and the passage of the M&E property tax exemption by the Kansas Legislature have not been the primary causes of the drastic increase in the property tax burden imposed by local governments. In fact, the data shows that the average annual growth in the property tax burden was actually significantly HIGHER during the years in which those programs were funded at record levels and no changes had been made to the taxation of machinery and equipment.

Third, another argument advanced by local governments and certain members of the media is that the reduction of state general fund (SGF) spending from 2011 through 2014 has shifted the cost of funding government programs to local governments, which has caused a drastic increase in the property tax burden. Again not surprisingly, the actual data on local government property tax revenues shows that reductions in SGF spending has absolutely no correlation with increases in local government property tax revenues.

If this theory were true, then the data would show that property tax revenues collected by local governments would grow at a higher than average rate in the years following larger than average reductions in state general fund spending and would grow at a lower than average rate in the years following larger than average increases in state general fund spending. By studying the actual data comparing local property tax increases to changes in state general fund spending, there is actually an inverse relationship (-0.30) between these two measurements.

This means that not only is there no correlation between these two measurements, but that there is actually a small inverse relationship that shows that local property tax revenues actually INCREASE by a larger percentage when state general fund spending also INCREASES by a larger than average percentage. By the same token, local property tax revenues increase by a much smaller percentage when state general fund spending also DECREASES or increases by a smaller percentage than average. Simply put, changes in SGF spending seem to have no effect on property taxes.

What is the real cause of the drastic growth in the property tax burden if these theories are not correct?

In contrast, the actual data demonstrates that local governments have continually increased the property tax burden on Kansas property owners since the Kansas Legislature's misguided decision to repeal the local property tax lid in 1999. Prior to the repeal, local governments were essentially prohibited from increasing property taxes over the preceding year (without jumping through some difficult hoops). Obviously, not many local governments had been able to circumvent these requirements and property taxes essentially did not go up significantly prior to 1999.

During the 1999 Legislative Session, local governments came to the Kansas Legislature and promised to be “responsible” with property tax increases if the Kansas Legislature repealed the “burdensome” and “unfair” property tax lid. During that session, the Kansas Legislature repealed the property tax lid in one very small provision tucked into a large income and sales tax reform package (**SB 45**) at the very end of the session. According to an article published by the *Topeka Capitol-Journal* at that time, the reaction from one prominent local government lobbyist was (not a joke and this is an exact quote) the following: “Whoopee! We’re out from under the tax lid!”

Even several Democratic members of the Kansas Senate, including Senate Minority Leader Anthony Hensley (D – Topeka), were shocked by the action and stated the following in an explanation of vote on **SB 45**:

It is very important that the public has the right to know whenever local government wants to reap a windfall due to higher valuations. However, with the sunset of the property tax lid, there is no longer a limit or control on local spending. Several proposals have been made which would give the public the right to vote on increases, and I am very concerned that this legislation gives no such provision for a public vote. At the least, there should have been a provision allowing protest petitions, providing a fair, simple outlet to call into doubt the decision of a local government when it chooses to benefit from higher property valuations. Kansas Senate Journal. May 2, 1999.

In response to the repeal of the property tax lid and in carrying out their promise to be “responsible” with property tax increases, Kansas counties and first class cities increased the property tax burden on Kansas property owners by new annual records of 6.9% in 1999, 7.5% in 2000 and 10.0% in 2001. This compared to a comparatively small 3.8% increase in the property tax burden in 1998, which was the year before the property tax lid was repealed.

The record annual increases in the property tax burden in 1999, 2000 and 2001 by local governments came at a time when the LAVTRF and CCRSF programs were fully funded, the Kansas economy was growing along with the national economy, property values were steadily increasing and the state government was flush with funding and experiencing no major budget problems. As a result, it is clear that the lack of funding for the LAVTRF and CCRSF since 2003 has not been the primary reason for the exponentially increasing property tax burden in Kansas.

By reviewing the historical data on local government property taxes from 1997 to 2013, it becomes very clear that the overwhelming driver behind the exponential increase in local property taxes is increasing assessed valuations on existing properties. When you compare the growth of residential valuations to the growth in local government property tax revenues since 1997, these two measurements have a very close correlation at 0.90.

This means that, in nearly every year from 1997 to 2013, local government property taxes go up at a rate each year that is very similar to the rate of growth in assessed valuations on residential properties. As a result, the only accurate indicator on whether local government property tax revenues will increase or decrease is whether assessed valuations on residential properties have increased or decreased.

As a result, there is no way to fundamentally reform our property tax system until something is done to rein in the escalating property tax revenues that result from assessed valuation increases. Although there will be no effort to modify how the value of properties is assessed for property tax purposes, the Kansas Legislature can approve reforms that would prevent local governments from automatically collecting more property tax revenues from property owners just because there was an increase in the assessed valuation of existing real properties.

Conclusion

In closing, we would respectfully request that the members of the House Taxation Committee support the provisions of **HB 2400**, which would the repeal of the LAVTRF program and eliminate a \$27 million annual obligation on the state general fund. The passage of **HB 2400** and the repeal of the Local Ad Valorem Tax Reduction Fund (LAVTRF) will thankfully have no effect on the property tax burden on Kansas property owners.

The research shows that the LAVTRF program has had no positive impact whatsoever on reducing the property tax burden. Thank you for the opportunity to provide comments on this very important issue for Kansas families, farmers and small business owners and the Kansas economy.