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To: House Taxation Committee

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Subject: **HB 2377** – Neutral Testimony on the Ability of Taxpayers to Enter into Property Tax Installment Payment Plans and to Defer Property Taxes on Homestead Property

Chairman Kleeb and members of the House Taxation Committee, thank you for the opportunity to provide neutral testimony today on behalf of the Kansas Association of REALTORS® on **HB 2377**, which would provide taxpayers with the ability to enter into property tax installment payment plans and to defer property taxes on homestead property. 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 8,500 members involved in both residential and commercial real estate and advocating on behalf of the state's 700,000 property owners for over 95 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 17 years, the property tax burden imposed on Kansas families, farmers and small businesses by local governments has increased exponentially. From 1997 to 2014, the total amount of property tax revenues collected by Kansas counties and first class cities more than doubled from $774 million in 1997 to $1.7 billion in 2014, which is a total increase of 119 percent over this time period. On average, Kansas local governments have increased the property tax burden by seven percent each year.

At the same time, inflation increased by an average of just 2.2 percent and the Kansas statewide population grew by just 0.6 percent each year. Traditional economic theory holds that an economically efficient amount of tax revenue growth would be inflation plus population growth, which would be roughly 2.8 percent in Kansas over the last 17 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.

Currently, the property tax burden is growing at a rate that is more than two and a half times the rate of inflation plus population growth. As the growth of the property tax burden continues to increase at a rate that exceeds inflation and population growth, the per capita property tax burden will continue to increase on Kansas property owners. At the current growth rate, the per capita property tax burden will eventually increase to a point where the property tax burden is unaffordable for most Kansas families, farmers and small businesses.

Kansas has some of the highest rural property taxes in the entire nation

According to several national studies, Kansas has some of the highest property taxes in the entire nation and in our six-state region (Arkansas, Colorado, Kansas, Missouri, Nebraska and Oklahoma). For example, a 2014 study conducted by the Lincoln Institute of Land Policy concluded that Kansas has one of the worst effective property tax rates in the entire nation on commercial properties.

This study used the cities of Iola (rural) and Wichita (urban) as the test subjects for the study in Kansas. These two cities were chosen for the study because they are county seats and are consistent with other cities used in the multi-state study. Although the study just compares the property tax burden for certain properties in two cities in every state, we believe the results can be effectively used to compare the relative property tax burdens among the states.

First, the study found that a commercial property owner in the City of Iola (rural community) pays the highest effective property tax rates in the entire nation on rural commercial properties. The effective property tax rate in the City of Iola is 4.26%, which is nearly double the national average effective tax rate of 1.75% for rural communities. This means that a commercial property owner in rural Kansas most likely pays property taxes that are more than twice as high as an average commercial property owner in other states.

For comparison purposes, our neighboring states of Nebraska (12th – 2.13%), Colorado (14th – 2.07%), Missouri (15th – 2.06%), Oklahoma (43rd – 0.92%) and Arkansas (48th – 0.68%) all obviously rank better than Kansas on this study. The effective property tax rate on rural commercial property in Kansas is anywhere from 100% and 527% higher than the effective property tax rates in Nebraska and Arkansas, respectively.

According to the study, the owner of a commercial property valued at $1 million in the City of Iola, would pay total property taxes of $51,141 annually on the property. The same $1 million commercial property would only pay $25,539 in Nebraska (a $25,602 difference), $24,893 in Colorado (a $26,248 difference), $24,713 in Missouri (a $26,428 difference), $11,084 in Oklahoma (a $40,057 difference) and $8,196 in Arkansas (a $42,945 difference).

Second, the study found that a commercial property owner in the City of Wichita (urban community) pays the 15th highest effective property tax rates in the entire nation on urban commercial properties. The effective property tax rate in the City of Wichita is 2.74%, which is nearly 27% higher than the national average effective tax rate of 2.16% for urban communities. This means that a commercial property owner in urban Kansas most likely pays property taxes that are 27% higher than an average commercial property owner in other states.

For comparison purposes, only the state of Missouri (14th – 2.76%) has a higher effective property tax rate on commercial properties in urban communities than Kansas. Our neighboring states of Colorado (21st – 2.4%), Nebraska (27th – 2.06%), Arkansas (38th – 1.44%) and Oklahoma (43rd – 1.31%) all rank better than Kansas on this study. The effective property tax rate on urban commercial properties in Kansas is anywhere from 14% and 109% higher than the effective property tax rates in Colorado and Oklahoma, respectively.

Property taxes on residential properties generally fare a little bit better since residential properties have a much lower assessment rate (11.5%) compared to commercial properties (25%) under the Kansas Constitution. According to a 2015 study by the Tax Foundation, Kansas home owners pay an effective property tax rate of 1.39% on a median value owner-occupied home, which is the 15th highest effective tax rate in the entire nation.

For comparison purposes, only the state of Nebraska (7th – 1.84%) has a higher effective property tax rate on residential properties than Kansas. Our neighboring states of Missouri (26th – 1.02%), Oklahoma (29th – 0.86%), Arkansas (42nd – 0.62%) and Colorado (43rd – 0.61%) all rank better than Kansas on this study. The effective property tax rate on residential properties in Kansas is anywhere from 36% and 128% higher than the effective property tax rates in Missouri and Colorado, respectively.

Realizing that the effective tax rate on commercial and residential property is much higher in Kansas than in most other states, the discussion then turns to the causes for the disparity. Not surprisingly, there has been considerable discussion and disagreement on both sides of this issue. In this briefing, we will examine this discussion using actual property tax data obtained by the Kansas Department of Revenue on property tax revenues collected by Kansas counties and first class cities from 1997 to 2014.

<u>What has caused local governments to increase the property tax burden on Kansas property owners?</u>

In summary, three basic theories have been floated by local governments and 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 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 this briefing 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 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 significantly since 2003 (when there has been no LAVTRF and CCRSF funding). Again, property tax increases are LOWER compared to when the Kansas Legislature funded the LAVTRF.

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 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 2014, 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 3.8%. As result, the average annual growth of the property tax burden imposed by local governments is actually 55% lower following the elimination of funding for the LAVTRF and CCRSF programs compared to when the programs were 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% increase). Not surprisingly, 2001 was also a year when the LAVTRF and CCRSF programs were funded with roughly $89 million in SGF funding.

Second, an additional argument advanced by local governments 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 2.6%, which is 69% 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 CCSRF 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 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, changes in SGF spending seem to have no effect on property taxes.

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

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 repeal of the public vote requirement 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.* Kansas Senate Journal. May 2, 1999.

In response to the repeal of the public vote requirement 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 7% in 1999, 8% in 2000 and 10% in 2001. This compared to a comparatively small 4% increase in the property tax burden in 1998, which was the year before the requirement 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 funded at nearly record levels as well, 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 CCSRF since 2003 has not been the primary reason for the exponentially increasing property tax burden.

By reviewing the historical data on local government property taxes from 1997 to 2014, 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 0.80.

This means that, in nearly ever year from 1997 to 2014, 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.

Significant Concerns with Property Tax Installment Payment Plans and the Deferral of Property Taxes

Even though it is apparent that Kansas has a major property tax problem, we do not believe that **HB 2377** is the most efficient or least burdensome solution to the problem. When a property owner enters into an averaging or installment payment plan under the bill, there is a potential for a certain portion of the property taxes that are due on the property to be deferred, which means that the title to the property will be burdened by a lien in the amount of the deferred property taxes.

Unfortunately, the liens for deferred property taxes have the potential to cloud the title to the property and could make it more difficult for a subsequent purchaser of the property to obtain mortgage financing and title insurance. With all the recent changes to the real estate transaction closing process from the Consumer Financial Protection Bureau (CFPB), the last thing we need is for additional hurdles to be introduced that will make it more difficult for Kansas families to obtain the mortgage financing and title insurance coverage they will need to access their part of the American Dream.

Much Simpler Solution Exists to Provide Property Tax Relief to Kansas Property Owners

Thankfully, there is a much simpler solution that will provide Kansas families, farmers and small business owners with relief from the crushing Kansas property tax burden. During the 2015 Legislative Session, the Kansas Legislature passed legislation (**HB 2109**) that gives Kansas voters the right to vote when any city or county chooses to increase the property tax burden by more than the rate of inflation over the previous year.

Unfortunately, this law does is not scheduled to go into effect until January 1, 2018 and is riddled with loopholes that will deny many Kansas voters of the right to vote on their property taxes. Later this session, this committee will consider legislation (**SB 316**) that would eliminate some of these loopholes and move up the implementation date of the public vote requirement on property tax increases.

If you are really interested in providing Kansas property owners with relief from the ever-increasing property tax burden, then the simplest solution to the problem is to provide Kansas voters with the right to vote on whether their property tax burden will increase. Kansas voters are active in their communities and capable of making informed and intelligent decisions on local spending and property tax issues. When the time comes, we hope that you will trust your constituents and give them the right to vote on property tax increases.

Conclusion

In closing, we would respectfully request that the members of the House Taxation Committee carefully weigh the very real need for property tax relief for Kansas families, farmers and small businesses against some of the troublesome aspects of **HB 2377**. 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.