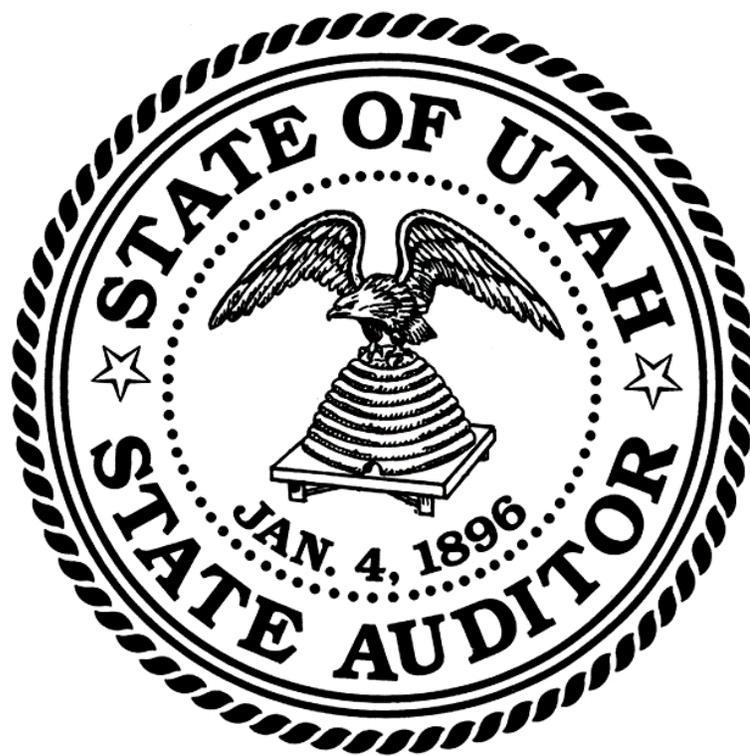


Analysis Report No. AR 14-01

New Growth Within Utah's Property Tax System

July 14, 2014



**OFFICE OF THE
UTAH STATE AUDITOR**

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Executive Summary

An analysis of the components of Utah's Property Tax System reveal ambiguity in the definition of new growth and a significant error that impacts the calculation of new growth as a part of the certified tax rate calculation. New growth was likely understated by a billion dollars annually statewide and improperly lowered property tax rates by roughly 0.01% each year. Statewide, the lower rate reduced property tax revenue by an estimated \$20 million in 2013, roughly 1% of annual property tax collections. During the last decade, the error in reappraisal likely caused over \$100 million of improperly reduced property tax revenue. Significant inaccuracy in the financial reporting of redevelopment agencies was also discovered during the analysis.

Utah's property tax system sets default tax rates to generate the same amount of property tax revenue for a government in a given year as was collected in the prior year. This process is commonly known as "Truth in Taxation." When property values increase, property tax rates decline so taxing entities collect the same revenue as the prior year. The rate that generates the same revenue as the prior year is called the certified tax rate.

New growth, commonly understood as the value of newly developed property, does not impact the calculation of the certified tax rate. The calculation of the certified tax rate is made by dividing the prior year tax revenue by the certified base (the adjusted current year property value less the computed value of new growth). A larger value for new growth makes a smaller denominator and a larger certified tax rate. New growth is currently calculated as the value of new real property plus any change, positive or negative, in the value of personal and centrally assessed property excluding the value of redevelopment projects.

The definition of new growth is ambiguous in both statute and in practice. The common conception of new growth is different than the policy described in statute and administrative rule. The definition of new growth in statute contradicts that used in rule to calculate the value of new growth. In addition, neither administrative rule nor Tax Commission process defines how to properly calculate the value of reappraisal in the calculation of new growth, leading to errors in double counting the reappraisal value for redevelopment projects.

The ambiguity and error in the calculation of new growth leads to lower certified tax rates and less property tax revenue than should have been levied in most years. The Salt Lake County Assessor documented the size of the error in reappraisal in Salt Lake City from tax years 2006 through 2013 totaling nearly \$1 billion. Due to the error in reappraisal, Salt Lake City tax rates were roughly 0.01% too low, contributing from \$1 million to \$3 million dollars and a cumulative \$17.6 million over the entire period in reduced property tax revenue.

Statewide, subtracting the reappraisal value of redevelopment projects twice misstates growth by as much as \$1 billion annually in property valuation over the last decade, which has the effect of improperly reducing all property tax revenue an estimated \$20 million annually. The cumulative reduction of local government property tax revenue over the last decade is likely over \$100 million dollars.

In aggregate, local governments also divert hundreds of millions of dollars in property tax to redevelopment projects with little transparency. According to governmental accounting standards, local governments should report all the property tax they levy on their own financial statements and record transfers of property tax increment to redevelopment agencies. Currently, because tax increment is distributed directly to redevelopment agencies, local governments are not properly accounting for these funds on their financial statements. This lack of transparency in financial reporting for redevelopment agencies contributes to the confusion of the impact of new growth on a taxing entity's property tax revenue.

Recommendations

Based upon this report we recommend the following actions be taken:

1. The Legislature should clarify the method for calculating new growth and its use within the certified tax rate calculation.
2. The Utah State Tax Commission should implement policies and procedures to eliminate the current practice of subtracting the change in the reappraisal value within redevelopment projects twice.
3. The Utah State Tax Commission should collect more detailed information on the tax bases, tax rates, and tax increments from redevelopment projects to avoid confusion in setting certified tax rates.
4. Local governments should properly report all property tax revenue and associated transfers of tax increment to redevelopment agencies.

New Growth Within Utah's Property Tax System

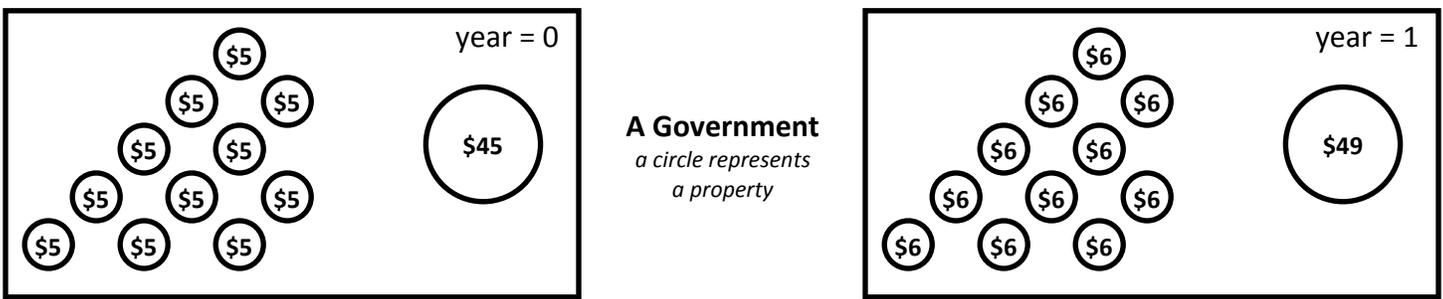
How Truth in Taxation Works

Utah’s property tax system sets default tax rates to generate the same amount of property tax in a given year as was collected in the prior year. This process is labeled “Truth in Taxation.” When property values increase, property tax rates decline so taxing entities collect the same revenue as the prior year. A government with a property tax can only raise this tax rate by holding a public hearing while advertising the amount of the tax increase. Critical to this process of taxation is the formula that calculates the certified tax rates.

The *Utah Constitution, Article XIII Section 2*, states that “all tangible property in the State that is not exempt under the laws of the United States or under this Constitution shall be: (a) assessed at a uniform and equal rate in proportion to its fair market value, to be ascertained as provided by law; and (b) taxed at a uniform and equal rate.” This establishes the policy for calculating the tax base. The value of each property in Utah is calculated by estimating the price that a willing buyer and a willing seller would exchange for the property in a voluntary transaction. Each county assessor, and in certain cases, the Utah State Tax Commission is responsible for estimating these values each year. Each taxable property within the boundary of the government is charged a property tax equal to the assessed value times the same tax rate, this rate is initially set as the certified tax rate each year.¹

Figure 1 shows how three elements, (1) the tax base, (2) the tax rate, and (3) the tax revenue, interact under Utah’s property tax system. In the simplified example, a group of properties increase in value over the course of a year. The calculation for the certified tax rate in year one takes as the numerator the tax revenue

Figure 1 - Increase in Valuation



year 0: **Tax:** $\$100 \text{ Base}_{\text{tax},0} \times 10\% \text{ Rate}_0 = \10 Tax_0

year 1: **Rate:** $\$10 \text{ Tax}_0 \div \$115 \text{ Base}_{\text{rate},1} = 8.7\% \text{ Rate}_1$
Tax: $\$115 \text{ Base}_{\text{tax},1} \times 8.7\% \text{ Rate}_1 = \10 Tax_1

1 - Some properties are exempt from taxation (eg, charitable organizations) or have valuations below market value (eg, agricultural properties with greenbelt exemptions).

When property values increase, property tax rates decline so tax entities collect the same revenue as the prior year.

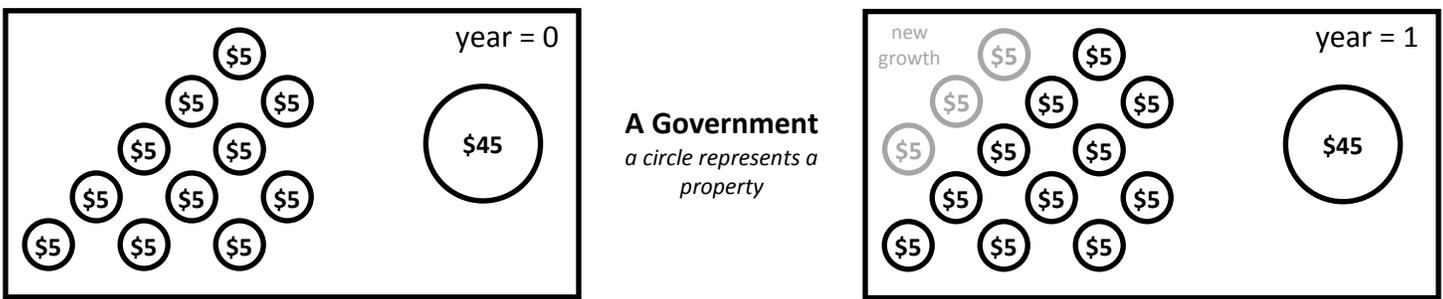
...higher values of new growth reduce the denominator in the calculation of the certified tax rate and lead to higher tax rates.

from year zero of \$10 and divides it by the certified base of \$115 as the denominator. The certified tax rate in year one would be $\$10 \div \115 or 8.7%.

In practice, the certified tax rate calculation is more complicated. The tax base may be affected by redevelopment projects, board of equalization adjustments, the value of new growth, and average collection rates (the amount collected relative to the tax due). The prior year revenue may also be complicated by similar factors. The focus of this analysis will be on how the treatment of new growth and redevelopment projects impact the certified tax rate. Specifically, higher values of new growth reduce the denominator in the calculation of the certified tax rate, and lead to higher tax rates. A cursory review of the other elements in the formula did not identify outsized risk to the proper calculation of the certified tax rate.

Figure 2 shows how adding the element of new growth affects the calculation of the certified tax rate. In the example, there was no change in the value of any of the existing property. Three new properties, each worth \$5, push the total value of all property within the government boundary to \$115. New growth generates \$15 of this amount. The calculation of the certified tax rate takes as the numerator the tax revenue from the initial year (year zero) of \$10 and divides it by the \$115 tax base less the \$15 in new growth. The certified

Figure 2 - New Growth Impact



year 0: **Tax:** $\$100 \text{ Base}_{\text{tax},0} \times 10\% \text{ Rate}_0 = \10 Tax_0

year 1: **Base:** $\$115 \text{ Base}_{\text{all},1} - \$15 \text{ New Growth}_1 = \$100 \text{ Base}_{\text{rate},1}$

Rate: $\$10 \text{ Tax}_0 \div \$100 \text{ Base}_{\text{rate},1} = 10\% \text{ Rate}_1$

Tax: $\$115 \text{ Base}_{\text{tax},1} \times 10\% \text{ Rate}_1 = \11.5 Tax_1

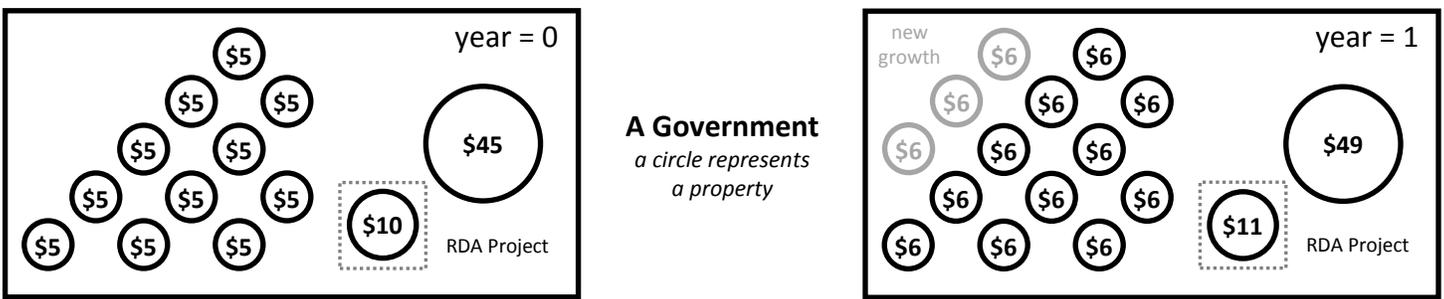
tax rate in year one would be $\$10 \div \100 or 10%. The addition of new growth did not affect the tax rate, instead tax revenue went up \$1.5 for the government.

Figure 3 shows how a redevelopment project could affect the calculation of the certified tax rate in combination with new growth. The value of the redevelopment property is excluded from both the tax base and the certified tax rate calculation. New growth of \$18 and the value of the redevelopment project of \$11 are subtracted from the total property value of \$144 to set the denominator for the certified tax rate calculation, the certified base of \$115. The numerator is the tax revenue from year zero of $\$10 \div \115 yields a certified tax rate of 8.7%. The tax base for the government is \$133, multiplied by 8.7% yields a higher tax of \$11.6 due to the new growth. The redevelopment project receives a \$0.96 tax increment.

The value of redevelopment property is excluded from both the tax base and the certified tax rate calculation.

Statutes and administrative rules establish the Utah property tax system. The system requires the estimation, collection, and calculation of many elements that establish property tax rates and the amount of tax revenue governments can collect through the property tax. The Utah State Tax Commission administers the collection, storage, and calculation of these elements through the Certified Tax Rate System.

Figure 3 - Impact of Redevelopment Projects



year 0: **Base:** $\$110 \text{ Base}_{\text{all},0} - \$10 \text{ RDA Project}_0 = \$100 \text{ Base}_{\text{tax},0}$
Tax: $\$100 \text{ Base}_{\text{tax},0} \times 10\% \text{ Rate}_0 = \10 Tax_0
 $\$10 \text{ Base}_{\text{RDA},0} \times 10\% \text{ Rate}_0 = \$1 \text{ Tax Increment}_0$

year 1: **Base:** $\$144 \text{ Base}_{\text{all},1} - \$11 \text{ RDA Project}_1 = \$133 \text{ Base}_{\text{tax},1}$
 $\$133 \text{ Base}_{\text{tax},1} - \$18 \text{ New Growth}_1 = \$115 \text{ Base}_{\text{rate},1}$
Rate: $\$10 \text{ Tax}_0 \div \$115 \text{ Base}_{\text{rate},1} = 8.7\% \text{ Rate}_1$
Tax: $\$133 \text{ Base}_{\text{tax},1} \times 8.7\% \text{ Rate}_1 = \11.6 Tax_1
 $\$11 \text{ Base}_{\text{RDA},1} \times 8.7\% \text{ Rate}_1 = \$0.96 \text{ Tax Increment}_1$

Calculating New Growth

New Growth is commonly viewed as the value of new real property that is readily identifiable. Under current practice, this concept does not match the calculation of the value for new growth. The calculation of new growth also includes any change in value of personal property, centrally assessed property, and redevelopment projects.

In the previous examples of how “Truth in Taxation” operates, new growth was easily identified as the new circles that did not exist in prior years. A change in value, or reappraisal, of a property was also easy to identify. County assessors likewise have systems that identify when real property, typically buildings, is first built and appraised. These local systems store the value of all locally-assessed property and can separately identify property within redevelopment projects. Following a meticulous process, local tax entities are instructed by the Utah State Tax Commission to communicate relevant data for calculating certified tax rates. The Certified Tax Rate System stores the data to calculate new growth and the certified tax rate, but it does not track the tax base, tax rate, and tax increment of redevelopment projects. This contributes to confusion regarding the interaction of the calculation of new growth and the property tax revenue taxing entities receive.

New growth is excluded from the calculation of certified tax rates so new property owners contribute to the public services they will use. For example, when a new subdivision in a city is built or a commercial property springs up with new retail stores, the owners of the new property demand public services. **Figure 4** shows an example of how quickly growth can occur. Eagle Mountain city collected \$125,046 in property tax revenue in 2000; without allowance for new growth, the certified rate may have fallen 80% with a five fold increase in property value and a nearly eight fold increase in people over the next decade. The additional people demand similar public services as earlier residents. “Truth in Taxation” is intended to not disad-

The Certified Tax Rate System stores the data to calculate new growth and the certified tax rate, but it does not track the tax base, tax rate, and tax increment of redevelopment projects.

Figure 4 - Eagle Mountain City

Year	Population	Property Value	Rate	Tax
2000	2,962	\$129,190,196	0.1241%	\$125,046
2002	6,645	\$217,974,179	0.1021%	\$159,316
2004	10,181	\$293,963,522	0.1861%	\$422,955
2008	18,002	\$821,361,872	0.1230%	\$879,503
2012	23,211	\$664,345,358	0.1668%	\$939,868

vantage communities that grow by excluding the initial value of new property from the calculation of the certified tax rate.

In concept, the value of new property (new growth) is separated from the change in value of existing property (reappraisal) to determine the certified tax rate. The value of the new growth does not lower the certified tax rate, even though it adds value to the property in the community. The government collects additional property tax revenue compared with the prior year proportionate to the value of the new growth. In aggregate, the existing property continues to pay the same level of tax regardless of changes in existing property values.

Complications arise in measuring new growth across all property types. It is difficult to separate a change in the value of existing personal property from a new piece of personal property. Businesses only submit the aggregate value of personal property to county assessors. Current practice is to count any change in value of business property as new growth, whether from new property or reappraisal of existing property. **Figure 5** shows how the computation of new growth is impacted by changes in business personal property.

Figure 6 shows examples of how central assessments can fluctuate under various market conditions. Computing the value of new property relative to the value of existing property for centrally assessed properties is impossible under current methodology. The Tax Commission values all mines, utilities, airlines, and railroads and apportions a value to each county based on the location of the property. Each county treasurer then bills and collects the tax. Rule and statute set

Figure 5 - Personal Property

Example 1: A business replaces an old board room table with a new board room table for \$25,000. The old table had a reported value of \$5,000. The difference in value adds \$20,000 to new growth. Does the replacement table increase the demand for government services?

Example 2: A company purchased new computers last year for \$300,000. Over the last year, the computers have depreciated and are now worth a reported \$200,000. The difference in value reduces new growth by \$100,000. Do the cheaper computers reduce demand for government services?

Example 3: A manufacturing facility adds a new production line to an existing factory. The old equipment had a reported value of \$2.0 million last year but has depreciated to \$1.8 million. The new equipment in the expanded facility was acquired for \$1.0 million. The aggregate change in personal property adds \$800,000 to new growth. Does the new equipment in the factory increase demand for government services?

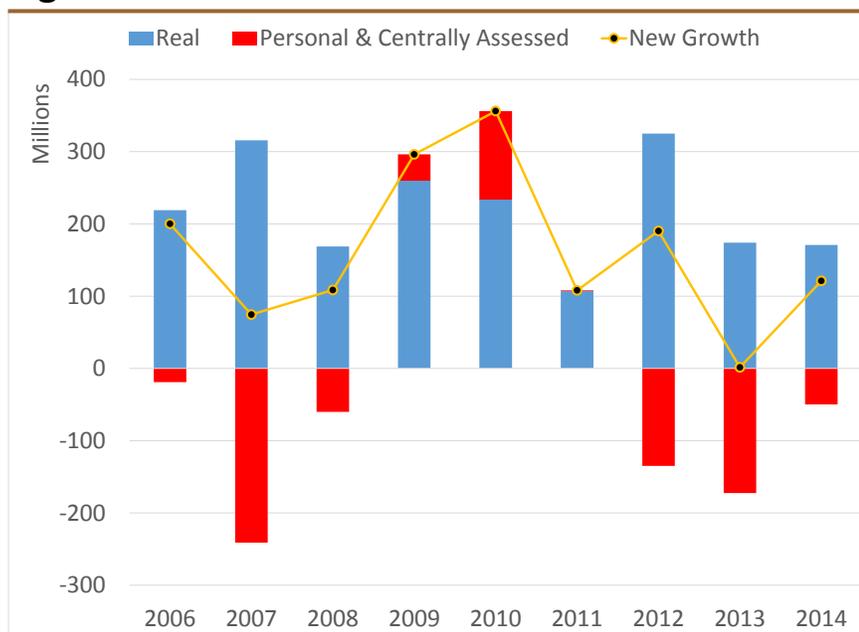
Figure 6 - Centrally Assessed

Example 1: A company loses market share providing telecommunication services. The shift in customer demand reduces the value of the large stock of infrastructure from \$2.0 to \$1.5 billion. The network infrastructure is physically unchanged with thousands of miles of cable and supporting equipment. The change in value reduces new growth by \$500 million. Does the change in the infrastructure value change the demand for government services?

Example 2: Turmoil in the Middle East increases oil prices. A Utah firm continues to extract the same amount of oil, but the increased price of oil increases the value of the firm from \$1.0 billion to \$1.2 billion. The change increases new growth by \$200 million. Does the company increase the demand for government services?

Figure 7 - Contributions to New Growth in Salt Lake City

Even with new real property development of nearly \$200 million in Salt Lake City in 2013, computed new growth was near \$0 because of the decline in the value of personal and centrally assessed property.



out the methods used to assess fair market value, these include a cost approach, a yield capitalization indicator, along with other cost, income, and market indicators.

Computed new growth adds the value of new real property to the change in value of other types of property. **Figure 7** shows how each property type has contributed to computed new growth for Salt Lake City since 2006. In six of nine years, the change in value from personal and centrally assessed property is negative, lowering the computed value of new growth. In three of the years, the contribution from these property types is positive. In 2007 and 2012 there was extensive development of real property, over \$300 million in new real property was developed in Salt Lake City. However, the value of the other property types decreased in these years and the computed value of new growth compared with the value of new real property was reduced. In 2013 the development of real property added \$174.0 million to computed new growth, but was offset by a reduction of \$172.5 million from personal and centrally assessed property. Thus, even with new real property development of nearly \$200 million in Salt Lake City in 2013, computed new growth was near \$0 because of the decline in the value of personal and centrally assessed property.

Excluding new growth from the calculation of the certified tax rate allows new property to contribute additional property tax revenue to a taxing entity to pay for the public goods and services the new property is likely to demand from the government. The current computation of new growth mixes the increased value of new real property with any change in value from personal and centrally assessed property. Computed new growth can be impacted by declining property values, causing confusion regarding a lack of new growth.

Ambiguity between Statute and Practice

There is ambiguity in the definition of new growth between statute and administrative rule. The relevant statute is *Utah Code Annotated 59-2-924 (4)(c)* (see **Appendix A**). This statute defines the formula for new growth as “the difference between the increase in taxable value” of real property and property assessed by the commission between the current and previous year, plus “the difference between the increase in taxable value” of personal property between the year prior to the previous calendar year and the previous year, minus “the amount of increase in taxable value” from factoring, reappraisal, any other adjustments, or a change in the method of apportioning centrally assessed value. This language translates into the formula represented in **Figure 8**. The plain language directs a ceiling function to bound certain values to never be negative. If some elements could be negative the language would read “the difference between taxable value” and not contain the qualifier “the increase in.”

The administrative rule defining the term “new growth” is found in *Utah Administrative Code Rule R884-24P-24 (11)*

(see **Appendix B**). This rule defines the new growth computation in three parts: (1) a single bounding function to prevent new growth from being negative, (2) a difference in the value of different property types adjusted for redevelopment between years, (3) a factoring of new growth for the mean collection rate over the previous five years. The administrative formula currently used to calculate new growth, found in **Figure 9**, is clearly different from the statutory formula. The bounding function in rule contradicts the bounding function in statute. The formula in rule introduces an adjustment for redevelopment not found in statute. The formula in rule modifies the calculation for collection rates, congruent with other statutory language affecting the property tax. *Utah Code Annotated 59-2-924 (4)(e)(i)* grants broad authority in making “any other adjustments” to real property, but it is unclear whether it allows these sweeping modifications to the definition of new growth. It is unclear where the authority to modify the new growth formula in rule is found.

Figure 8 - Formula in Statute

$$\begin{aligned} & \max(0, \text{sum}((\text{Real}_{\text{year}} - \text{Real}_{\text{year-1}}), \\ & \quad (\text{Central}_{\text{year}} - \text{Central}_{\text{year-1}}))) \\ & + \max(0, \text{Personal}_{\text{year-1}} - \text{Personal}_{\text{year-2}}) \\ & - \max(0, \text{sum}(\text{Reappraisal}, \text{Factor}, \text{Adjust})) \end{aligned}$$

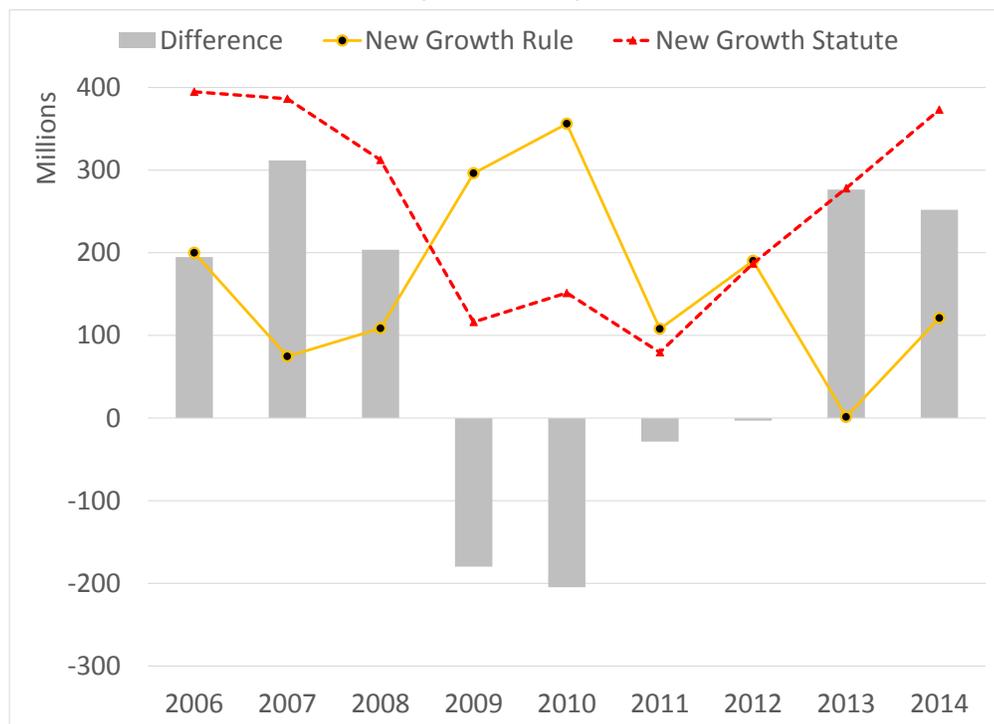
New Growth_{statute}

Figure 9 - Formula in Rule

$$\begin{aligned} & \text{sum}(\max(0, \\ & \text{sum}((\text{Real}^*_{\text{year}} - \text{Real}^*_{\text{adj,year-1}}), \\ & \quad (\text{Central}^*_{\text{year}} - \text{Central}^*_{\text{year-1}}), \\ & \quad (\text{Personal}^*_{\text{year-1}} - \text{Personal}^*_{\text{year-2}}), \\ & \quad -\text{sum}(\text{Reappraisal}, \text{Factor}, \text{Adjust}))), \\ & \quad \text{Annexations}) \\ & \times \text{collection rate}_{5 \text{ year average}} \end{aligned}$$

New Growth_{rule} *adjusted for redevelopment

There is ambiguity in the definition of new growth between statute and administrative rule.

Figure 10 - New Growth Calculation: Statute versus Rule*for Salt Lake City*

The difference in the value of computed new growth under the statutory and administrative rule formulas would have a significant impact on the calculation of the certified tax rates for Salt Lake City.

The example in **Figure 10** shows the calculation of new growth for Salt Lake City since 2006 under the statutory formula (figure 8) and the formula in rule (figure 9). The two calculations produce hundreds of millions of dollars of difference. These differences are large and positive in 5 years, large and negative in 2009 and 2010, and negligible in 2011 and 2012. The differences can be positive or negative. The sign of the difference largely depends upon how the bounding constraints eliminate negative values in the calculation. Substituting the new growth calculation per the narrower statutory formula (figure 8) would have a significant impact on the calculation of the certified tax rates for Salt Lake City.

The ambiguity in statute may contribute to confusion regarding the definition, application, and proper calculation of new growth. There are contradictory elements between statute and rule. Administrative rule contains calculations not contemplated by the statutory definition of new growth. The value of new growth is an important factor in determining the certified tax rate and by extension, the amount of property tax local governments are allowed to collect without raising tax rates.

Error in Calculating New Growth

Regardless of the ambiguity of the new growth formula, the current calculation of new growth performed by the Tax Commission contains a significant error. The error in computing new growth is caused by double counting the reappraisal value of redevelopment projects, which is now being subtracted from new growth twice.

The Certified Tax Rate System documents every element of the certified tax rate calculation for taxing entities in Utah. The system is transparent and enables users to recalculate any certified tax rate and verify the accuracy of any calculation. The error in computing new growth is not due to any inaccuracy in the system. Rather, the error is caused by a failure over time of the Utah State Tax Commission to communicate the proper method for calculating the correct value of reappraisal to county assessors.

Figure 11 shows the elements for computing new growth for Salt Lake City in 2013 (to see the elements of this calculation see **Appendix C**). Under current methodology, the computation of new growth is the sum of the annual difference in the value of real, personal, and centrally assessed property, minus adjustments for the change in the value of redevelopment projects, other adjustments, and the value of reappraisal. In calculating the certified tax rate, this value is multiplied by the average collection rate.

The Salt Lake County Assessor provided information (**Appendix D**) regarding the composition of the \$655,515,842 value of reappraisal. It is comprised of \$198,954,222 in value from redevelopment projects and \$456,561,620 outside of redevelopment projects. Crucially, the redevelopment portion of this reappraisal value has already been subtracted and is part of the \$225,757,454 redevelopment adjustment. The error in double counting reappraisal amounts resulted in an unwarranted subtraction of \$198,954,222 from

Figure 11 - Calculation of New Growth

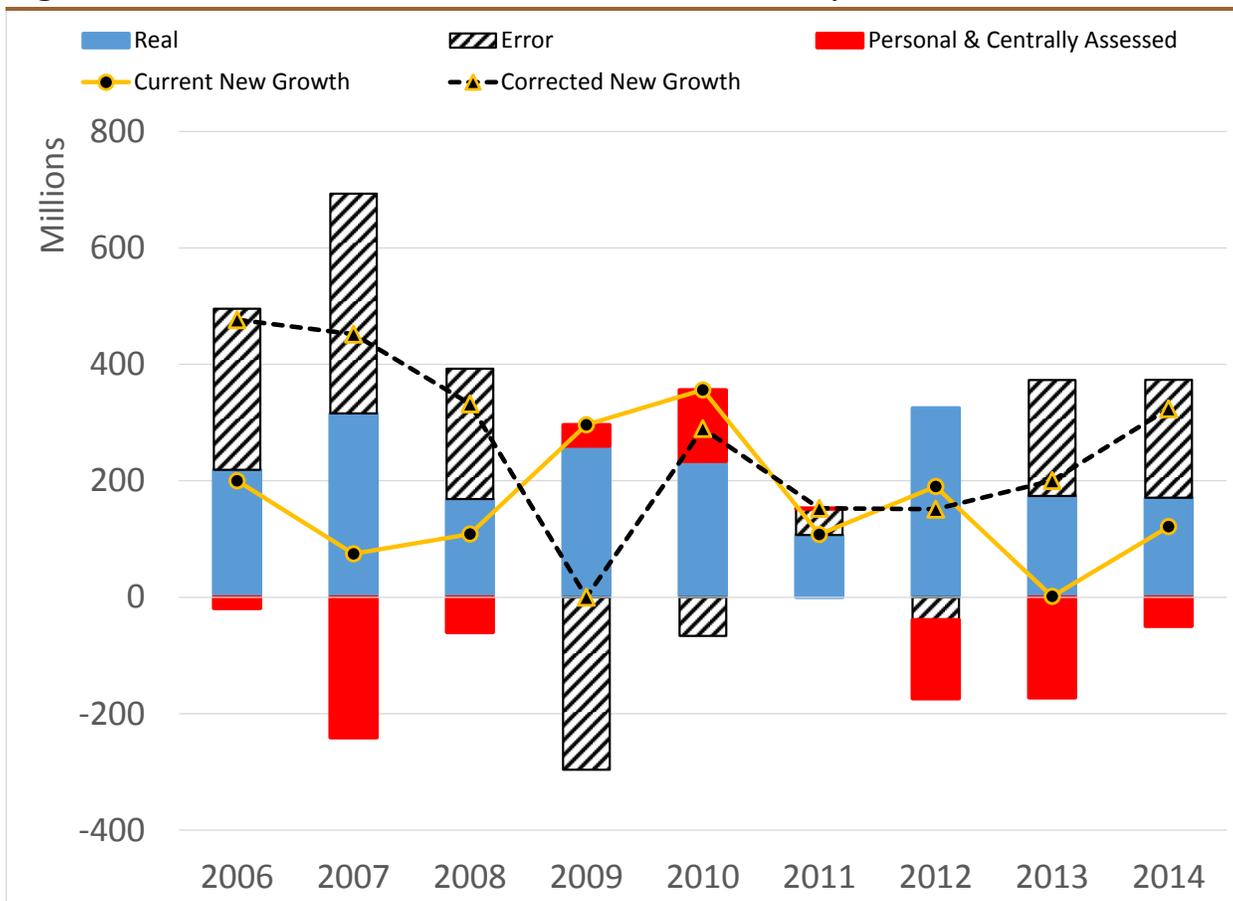
<i>Salt Lake City 2013 calculation</i>				
Element		Current	Corrected	
Real:	+	\$829,517,691	+	\$829,517,691
Personal:	-	\$50,469,104	-	\$50,469,104
Centrally Assessed:	+	\$103,980,682	+	\$103,980,682
Redevelopment:	-	\$225,757,454	-	\$225,757,454
Other:	-	\$290,654	-	\$290,654
Reappraisal:	-	\$655,515,842	-	\$456,561,620
New Growth:	+	\$1,456,319	+	\$200,419,541

The error in computing new growth is caused by double counting the reappraisal value of redevelopment projects, which is being subtracted from new growth twice.

the new growth of Salt Lake City in 2013. The Salt Lake County Assessor provided the decomposition of re-appraisal value inside and outside of redevelopment projects from 2006 through 2014. From this source data, a corrected figure for new growth was computed for Salt Lake City since 2006.

Figure 12 shows the size of the errors in new growth compared to the contribution of real property and personal property combined with centrally assessed property as originally calculated. The error from subtracting the reappraisal value of redevelopment projects twice is significant, shifting hundreds of millions of dollars from new growth. In five years, correction of the reappraisal error adds hundreds of millions of dollars to new growth. In three years, the correction of the error has a negligible effect on the calculation of new growth. In 2009, the correction of the reappraisal error reduces new growth from nearly \$300 million to zero. The cumulative impact on new growth was nearly \$1 billion for Salt Lake City over this time period. The following sections detail the net effects of these errors on the property tax system.

Figure 12 - Error in New Growth in Salt Lake City



The error from subtracting the reappraisal value of redevelopment projects twice is significant, shifting hundreds of millions of dollars from new growth.

Impacts to Salt Lake City from the Error in New Growth

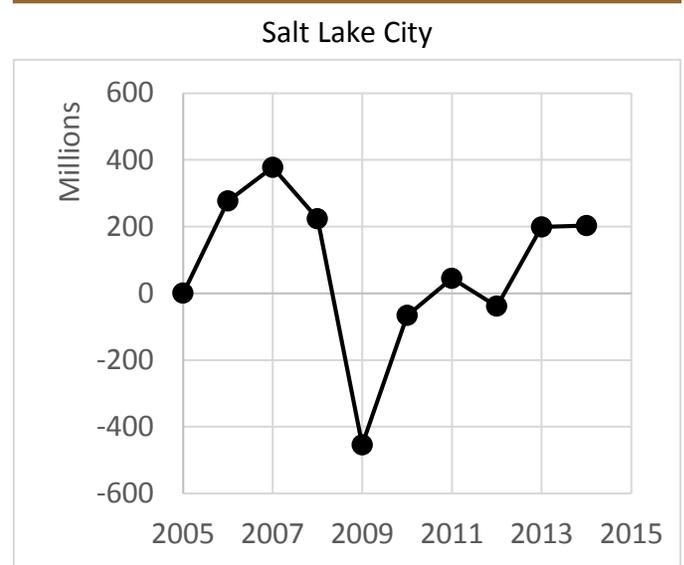
Double counting the reappraisal value of redevelopment property impacts the computation of new growth. Taxing entities with a large amount of property in redevelopment projects are likely most affected by the error of double counting redevelopment project reappraisal value. Determining the size of this error across all taxing entities would require all county assessors to separate the value of reappraisal between the amount inside and outside of redevelopment projects across all taxing entities. This can be a laborious process and depends upon the quality and historical integrity of county data systems. The Salt Lake County Assessor's Office provided this information for Salt Lake City from 2006 through 2014.

The following figures show how the initial error in computing new growth impacts each stage of the certified tax rate setting process, from the calculation of the certified base, to the effect on the certified tax rate, to the annual and cumulative impact on property tax revenue within Salt Lake City.

Figure 13 shows the difference in the value of reappraisal over time in Salt Lake City. The reappraisal error contributes hundreds of millions of dollars in additional new growth in five of nine years, little impact in three of nine years, and a \$400 million reduction to new growth in 2009.

Figure 14 shows how this reappraisal error impacts the certified tax base (the denominator in the

Figure 13 - Error in Reappraisal



Taxing entities with a large amount of property in redevelopment projects are likely most affected by the error double counting reappraisal value.

Figure 14 - Impact on Certified Base

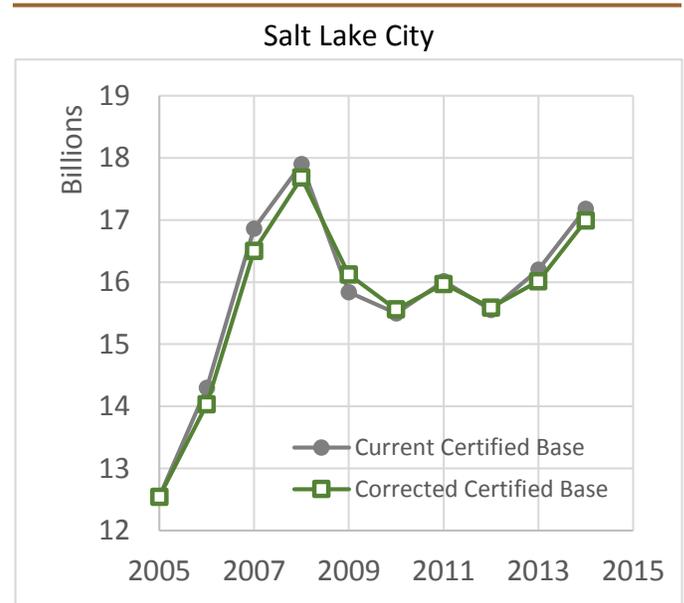
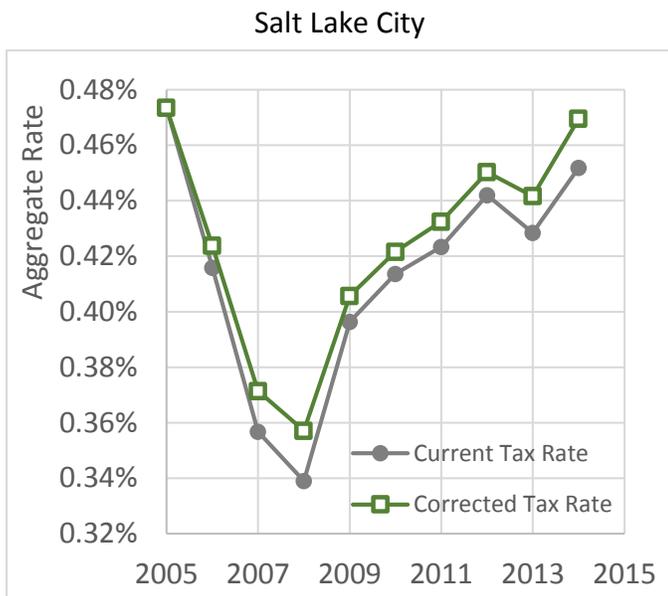


Figure 15 - Impact on the Tax Rate

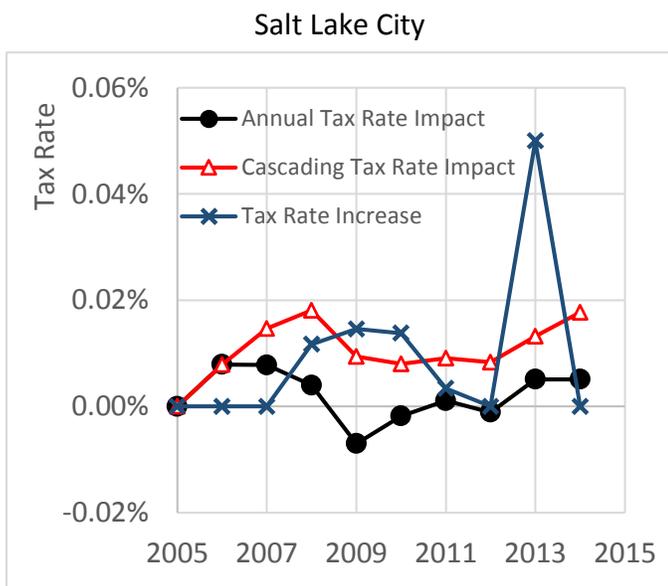


The cumulative impact of the error double counting redevelopment project reappraisal results in an artificially lower tax rate.

calculation of the certified tax rate). For Salt Lake City, from 2006-2008 and 2013-2014 the certified base would have been lower with larger values for new growth. In 2009 the base would have been higher. In 2010-2012 the error in new growth had little effect. A smaller denominator for the certified base in the certified tax rate calculation leads to higher tax rates.

Figure 15 shows how the reappraisal error impacts Salt Lake City's tax rates over this time period. The cumulative impact of the error double counting redevelopment project reappraisal results in an artificially lower tax rate. On average, if the reappraisal error was corrected starting in 2005, the tax rate would be 0.01% to 0.02% higher.

Figure 16 - Comparing Tax Rates



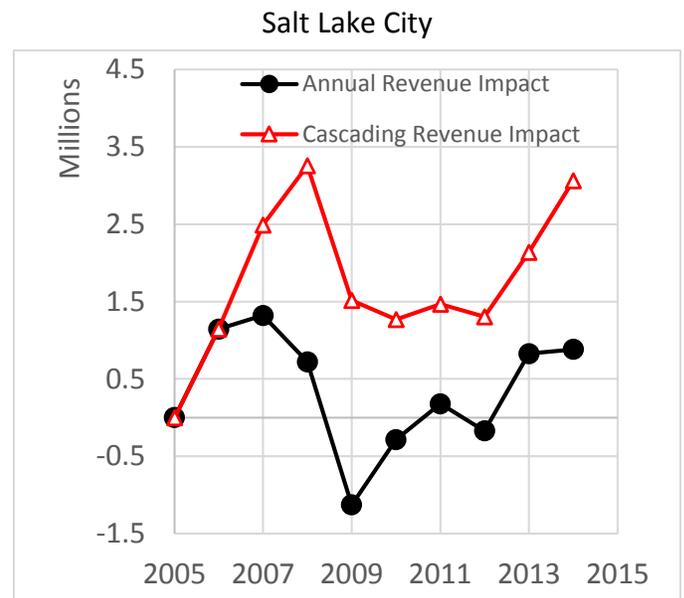
An error in one year impacts all future certified tax rates. **Figure 16** compares the size of Salt Lake City's increased tax rates over this period of time in relation to the annual and cumulative impacts to the certified tax rates if the error in reappraisal was corrected in 2005. Speculatively, Salt Lake City would have been able to avoid the tax rate increases in 2008 through 2010 and still collected a similar amount of property tax revenue. The size of the tax rate increase in 2013 generates more revenue than the cascading reappraisal errors produce. However, it is unknown what policy action Salt Lake City would have taken had the correct values of new growth been used over this time period.

Figure 17 shows the revenue impact that would result from the changes in these tax rates had the reappraisal error been corrected starting in 2005 for Salt Lake City. The error in reappraisal produces in any given year an effect of roughly \$1 million in property tax, in five of the years it results in more revenue, in one of the years less revenue, and in three of the years the same revenue. Because any change in value cascades through time, Salt Lake City ongoing revenue would have been higher in all of the years, from a maximum of \$3 million in 2008, \$1 million in 2009 through 2012, and recent growth in the revenue impact of \$2 million in 2013 and \$3 million in 2014.

Figure 18 shows the accumulation of the error through time for Salt Lake City. The sum of the cascading revenue impact in any given year shows how much revenue has been foregone since 2006. The graph shows the cumulative property tax revenue Salt Lake City would have been able to collect. The city would have collected an additional \$10 million as of 2010. Salt Lake City would have collected an additional \$17.6 million in one-time revenue as of 2014 if the reappraisal error was corrected beginning in 2005.

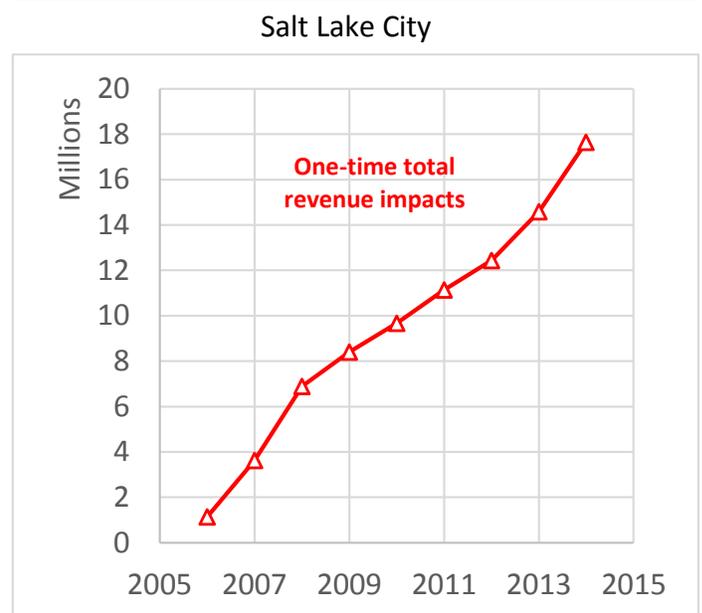
The cumulative impact on Salt Lake City of the error of double counting the value of reappraisal from redevelopment projects on new growth, the certified base, the certified tax rate, and the amount of property tax levied is large.

Figure 17 - Tax Revenue Impacts



Salt Lake City would have collected an additional \$17.6 million in one-time revenue as of 2014 if the reappraisal error was corrected beginning in 2005.

Figure 18 - Cumulative Revenue Impact



Accounting for the collection of property tax

Double counting the reappraisal value of redevelopment projects impacts taxing entities relative to the size and extent of the use of redevelopment projects. **Figure 19** shows rough estimates for the potential impacts the reappraisal error could have on Utah's property tax system. Exact calculations require detailed information from all county assessors. Statewide, double counting reappraisal from redevelopment projects could lower the property tax by \$20 million each year, nearly 1% of the \$2.4 billion property tax. Cumulatively, governments may have collected more than \$100 million in additional property tax over the last decade or could have avoided going through the "Truth in Taxation" process to raise tax rates.

Understanding Utah's property tax system is difficult and can be counterintuitive to policy makers inside and outside of local governments. Beside the confusion and ambiguity in the calculation of certified tax rates and expectations regarding the value of new growth, local officials may have a difficult time tracking the collection of the property tax. As shown above, nearly 10% of property value in Salt Lake City is within a redevelopment agency, statewide the figure is a little over 5%. The extensive use of redevelopment agencies moves a large share of property tax outside the normal budget process of local governments. These segregated funds can be used for public infrastructure, to reimburse the costs of developers, or other purposes. Lack of proper reporting on financial statements may cause these revenues and associated transfers to fall in a "black hole."

This lack of transparency is due to a prevailing practice among governmental entities to not include tax revenue levied by the government in the financial statements because the revenue is distributed directly to

Figure 19 - Estimation of Broader Impacts

Statewide, double counting reappraisal from redevelopment projects could lower the property tax by \$20 million each year, nearly 1% of the \$2.4 billion property tax.

<i>data from the Certified Tax Rate System for 2013, * are estimates</i>			
Element	Salt Lake City	Salt Lake County	State of Utah
Property Value	\$19,176,597,621	\$73,427,010,015	\$197,306,650,664
Redevelopment Projects	\$2,142,609,225	\$5,440,656,875	\$11,393,803,185
Reappraisal	\$655,515,842	\$2,569,321,628	\$3,918,879,814
Reappraisal Double Counted	\$198,954,222	*\$780,000,000	*\$1,189,000,000
Cumulative Impact on Tax Rate	0.0132%	*0.01%	*0.01%
Annual Property Tax Impact	\$2,138,869	*\$7 million	*\$20 million
Cumulative Property Tax Impact	\$14,586,127	*\$50 million	*>\$100 million
Budgeted Property Tax	\$94,887,994	\$1,023,456,520	\$2,353,425,655
Imputed Tax Increment	*\$12 million	*\$80 million	*\$140 million

the redevelopment agencies. This practice is contrary to accounting standards², but more importantly, it weakens accountability as the funds avoid public oversight during budget hearings and review by the governing body in financial reports. For example, a school district should show “property tax revenue” for all of the property tax it generates. The school district should then show a “contribution to other government” in its financial statement for monies transferred to a redevelopment agency. Similarly, the redevelopment agency should show a “contribution from other governments” in its financial statements for the monies it receives from the tax increment.

The lack of transparency and integration with the traditional budget process for redevelopment projects contributes to the difficulty in managing expectations for a government's property tax revenue. Statewide, hundreds of millions of dollars of property tax are diverted to redevelopment projects. The value of this tax increment can be easily lost while forming expectations regarding the future growth of property taxes.

2 - Accounting Standards are found in Governmental Accounting Standards Board, GASB Statement No. 33, paragraph 28 and 2012 Governmental Accounting, Auditing, and Financial Reporting, pages 129-130.

Recommendations

Based upon this report we recommend the following actions be taken:

1. The Legislature should clarify the method for calculating new growth and its use within the certified tax rate calculation.
2. The Utah State Tax Commission should implement policies and procedures to eliminate the current practice of subtracting the change in the reappraisal value within redevelopment projects twice.
3. The Utah State Tax Commission should collect more detailed information on the tax bases, tax rates, and tax increments from redevelopment projects to avoid confusion in setting certified tax rates.
4. Local governments should properly report all property tax revenue and associated transfers of tax increment to redevelopment agencies.

Recommendation 1 - Clarify Policy Regarding New Growth

Option 1: Limit New Growth to the Value of New Real Property Directly Measured by County Assessors

The Utah State Legislature should consider completely excluding the change in the value of personal property and centrally assessed properties from the calculation of new growth. New growth could be clearly defined as the value of real property that county assessors can directly measure.

The current formulas defining new growth are inconsistent with the commonly understood meaning of new growth. The local officials with whom we discussed the calculation were sometimes confused by the low amount of calculated new growth for a particular year when they were aware of significant development of real property within their boundaries. Officials were aware that they may have diverted some new growth to redevelopment projects, but could not reconcile their expectations of new growth with the computed values.

In some cases, local governments had significant new development of real property that were subsumed by a negative change in value of personal property or centrally assessed property. If the justification for the exclusion of new growth from the certified rate calculation is the desire to have new property owners pay for the services they are consuming, then there is little reason for including any change in value in personal and centrally assessed properties in the definition of new growth. This option would modify the property tax system to better align the calculation of new growth with the commonly understood concept of new growth.

Option 2: Restrict the Contribution of Personal and Centrally Assessed Property to Actual New Growth

There may be cases in which new personal property or new real property under central assessment are identifiable and estimable. Rather than counting any change in the value of this property as new growth, the Legislature could require methods to estimate reasonable approximations for new property regardless of the property type. This framework could eliminate confusion regarding the reduction of new growth from real property development because of declines in the value of property owned by businesses. There is a wide variety of reasonable methodology for approaching this type of discounting.

This option would modify the current system for calculating new growth to better align with the concept of measuring the value of new property that places a demand on government services. Legislative clarification of the reason for applying new growth in the certified tax rate formula could help create a formula that is clearly defined and measurable.

Recommendation 2 - Correct the Treatment of Reappraisal

Going forward, the Utah State Tax Commission should form policies and procedures to communicate to county assessors that the amount of reappraisal should not include any contribution from property in redevelopment projects. Subtracting these values twice is unwarranted and adversely affects the calculation of certified tax rates. This error has persistent and large impacts on the property tax received by local governments. The proper calculation and methodologies should be well documented and communicated by the Utah State Tax Commission to officials engaged in providing the data for these calculations.

Recommendation 3 - Improve Redevelopment Project Data Collection

The Utah State Tax Commission should collect more detailed information on the tax bases, tax rates, and tax increments from redevelopment projects. The Certified Tax Rate System has detailed records for the property valuation, tax rate, and property tax revenue for a tax entity. However, it is not comprehensive, a taxing entity cannot view the entirety of the property tax it levies from the existing system because it excludes redevelopment projects. A comprehensive system could reduce confusion regarding the property tax.

Recommendation 4 - Properly Report Tax Revenue and Transfers to RDAs

Accounting standards require local governments to report all property tax levied on their own financial statements (see Audit Alert 2014-3). Some taxing entities are not properly accounting for the amount of property tax they collect and transfer to redevelopment agencies. This lack of transparency contributes to the confusion in understanding how the property tax system works. The Office of the Utah State Auditor will continue to monitor the quality of the disclosures of local governments relative to the transfers they make to redevelopment agencies.

We concur with the response from the Utah State Tax Commission that a more comprehensive and clear method for calculating certified tax rates would include the property tax collected and transferred to redevelopment projects as tax increment. This structure would align with current financial reporting requirements of local governments and reduce the confusion of local officials regarding the source and movement of the property tax during the course of and completion of redevelopment projects.

Appendix A - Utah Code Annotated 59-2-924

As of January 1, 2014

- (4)**
- (a)** For the purpose of calculating the certified tax rate, the county auditor shall use:
- (i)** the taxable value of real property assessed by a county assessor contained on the assessment roll;
 - (ii)** the taxable value of real and personal property assessed by the commission; and
 - (iii)** the taxable year end value of personal property assessed by a county assessor contained on the prior year's assessment roll.
- (b)** For purposes of Subsection (4)(a)(i), the taxable value of real property on the assessment roll does not include new growth as defined in Subsection (4)(c).
- (c)** "New growth" means:
- (i)** the difference between the increase in taxable value of the following property of the taxing entity from the previous calendar year to the current year:
 - (A)** real property assessed by a county assessor in accordance with Part 3, County Assessment; and
 - (B)** property assessed by the commission under Section [59-2-201](#); plus
 - (ii)** the difference between the increase in taxable year end value of personal property of the taxing entity from the year prior to the previous calendar year to the previous calendar year; minus
 - (iii)** the amount of an increase in taxable value described in Subsection (4)(e).
- (d)** For purposes of Subsection (4)(c)(ii), the taxable value of personal property of the taxing entity does not include the taxable value of personal property that is:
- (i)** contained on the tax rolls of the taxing entity if that property is assessed by a county assessor in accordance with Part 3, County Assessment; and
 - (ii)** semiconductor manufacturing equipment.
- (e)** Subsection (4)(c)(iii) applies to the following increases in taxable value:
- (i)** the amount of increase to locally assessed real property taxable values resulting from factoring, reappraisal, or any other adjustments; or
 - (ii)** the amount of an increase in the taxable value of property assessed by the commission under Section [59-2-201](#) resulting from a change in the method of apportioning the taxable value prescribed by:
 - (A)** the Legislature;
 - (B)** a court;
 - (C)** the commission in an administrative rule; or
 - (D)** the commission in an administrative order.
- (f)** For purposes of Subsection (4)(a)(ii), the taxable year end value of personal property on the prior year's assessment roll does not include:
- (i)** new growth as defined in Subsection (4)(c); or
 - (ii)** the total taxable year end value of personal property contained on the prior year's tax rolls of the taxing entity that is:
 - (A)** assessed by a county assessor in accordance with Part 3, County Assessment; and
 - (B)** semiconductor manufacturing equipment.

Appendix B - Utah Administrative Code Rule R884-24P-24

As of June 1, 2014

- (11)** The following formulas and definitions shall be used in determining new growth:
- (a)** Actual new growth shall be computed as follows:
- (i)** the taxable value of property assessed by the commission and locally assessed real property for the current year adjusted for redevelopment minus year-end taxable value of property assessed by the commission and locally assessed real property for the previous year adjusted for redevelopment; then
 - (ii)** plus or minus the difference between the taxable value of locally assessed personal property for the prior year adjusted for redevelopment and the year-end taxable value of locally assessed personal property for the year that is two years prior to the current year adjusted for redevelopment; then
 - (iii)** plus or minus changes in value as a result of factoring; then
 - (iv)** plus or minus changes in value as a result of reappraisal; then
 - (v)** plus or minus any change in value resulting from a legislative mandate or court order.
- (b)** Net annexation value is the taxable value for the current year adjusted for redevelopment of all properties annexed into an entity during the previous calendar year minus the taxable value for the previous year adjusted for redevelopment for all properties annexed out of the entity during the previous calendar year.
- (c)** New growth is equal to zero for an entity with:
- (i)** an actual new growth value less than zero; and
 - (ii)** a net annexation value greater than or equal to zero.
- (d)** New growth is equal to actual new growth for:
- (i)** an entity with an actual new growth value greater than or equal to zero; or
 - (ii)** an entity with:
 - (A)** an actual new growth value less than zero; and
 - (B)** the actual new growth value is greater than or equal to the net annexation value.
- (e)** New growth is equal to the net annexation value for an entity with:
- (i)** a net annexation value less than zero; and
 - (ii)** the actual new growth value is less than the net annexation value.
- (f)** Adjusted new growth equals new growth multiplied by the mean collection rate for the previous five years.

Appendix C - Utah State Tax Commission Certified Tax Rate System

Currently, the value used for reappraisal includes the amount already subtracted from redevelopment projects (CDRA/RDA). The example below is from the calculation of new growth for Salt Lake City in 2013. The difference in property value is the first section of computation; it contains the value for new property and the change in value of existing property. This contributes +\$883,029,269 to new growth. Subtracted from the total property value is the value for redevelopment projects. The value of \$225,757,454 for property within redevelopment projects contains both new growth and any change in value (reappraisal) of the RDA property. The Salt Lake County Assessor shows that of the additional \$225,757,454 in additional RDA value, \$198,954,222 comes from reappraisal. County assessors directly calculate the value of property not assessed in the past (new growth) and subtract that value from the growth in real property to determine the value for reappraisal. Going forward, the Tax Commission should instruct county assessors to adjust this value of reappraisal for redevelopment projects, as is done with the Real, Personal, and Centrally Assessed property. Failure to make this adjustment results in the reappraisal value of redevelopment projects being subtracted twice, once in the redevelopment adjustment and a second time when the total reappraisal is subtracted. This has a significant effect on the computation of new growth for governments levying a property tax.

New Growth Calculated			
2013 New Growth Original Values:		2012 New Growth Year-End Values:	
Add:		Add:	
2013 Original Real	15,762,017,196	2012 Year-End Real	14,932,499,505
2012 Year-End Personal	1,680,519,901	2011 Personal Year-End	1,730,989,005
2013 Original CA	1,722,033,560	2012 Year-End CA	1,618,052,878
Sub-Total:	19,164,570,657	Sub-Total	18,281,541,388
Subtract:		Subtract:	
2013 CDRA Real / CA	2,018,049,623	2012 CDRA Real / CA Year-End	1,793,952,533
2012 CDRA personal Year-End	124,559,602	2011 CDRA Personal Year-End	122,899,238
2012 scme Year-End	303,776	2011 SCME Year-End	13,122
Subtract:		Subtract:	
2013 Reappraisal	655,515,842		- 655,515,842
2013 Factoring	0		
2013 Legislative Adj	0		
2013 New Growth Adj Value	16,366,141,814	2012 New Growth Adj Value	16,364,676,495
-----		-----	
Calculation:		Calculation:	
2013 New Growth Adj Value	16,366,141,814	2012 New Growth Adj Value	16,364,676,495
Subtract:		Subtract:	
2012 New Growth Adj Value	16,364,676,495		
=====		=====	
Calculated New Growth Value	1,465,319		1,465,319

Appendix D - Salt Lake County Assessor Reappraisal by Tax Area for Salt Lake City

This file from the Salt Lake County Assessor shows how the reappraisal value reported to the Utah State Tax Commission comes from all tax areas. The proper adjustments for redevelopment projects and the amount of reappraisal would only subtract the growth in value from a redevelopment project once in determining new growth. These values are accessible and should be properly computed and communicated to the Utah State Tax Commission in the future to properly compute the value of new growth used to determine the certified tax rates within Utah's property tax system.

Salt Lake City
Salt Lake City 2013
Numbers

Tax Entity	Tax Area	RDA Area Name	Real Values Year End 2013	Real Property RDA Areas	County Reappraisal by Tax Area	Reappraisal removing RDA Areas
Salt Lake City	13		10,819,078,172		364,073,101	364,073,101
Salt Lake City	01A	CBD	1,285,420,746	1,285,420,746	152,173,550	
Salt Lake City	01B	CBD	160,188,425	160,188,425	12,681,648	
Salt Lake City	01C	CBD	100,180,900	100,180,900	-2,174,670	
Salt Lake City	01D	Central City	79,959,322	79,959,322	2,008,301	
Salt Lake City	01E	CBD	7,906,800	7,906,800	14,300	
Salt Lake City	01F	CBD not used	169,800,583		8,766,593	8,766,593
Salt Lake City	01G	CBD not used	88,635,393		7,720,030	7,720,030
Salt Lake City	01H	CBD not used	129,360,258		9,296,077	9,296,077
Salt Lake City	01J	Sugar House	191,148,562	191,148,562	8,460,347	
Salt Lake City	01K	West Temple	99,364,523	99,364,523	2,386,494	
Salt Lake City	01M	West Capitol Hill	63,296,172	63,296,172	527,296	
Salt Lake City	01N	Depot District	377,402,292	377,402,292	9,939,912	
Salt Lake City	01P	not used	9,937,189		-4,461,205	-4,461,205
Salt Lake City	01Q	North Temple Urban	81,125,886	81,125,886	5,573,135	
Salt Lake City	02A	Granary	60,418,802	60,418,802	1,031,299	
Salt Lake City	02B	North Temple Viaduct	40,976,700	40,976,700	6,354,750	
Salt Lake City	13A		204,373,030		6,875,416	6,875,416
Salt Lake City	13B		80,904,580		4,191,595	4,191,595
Salt Lake City	13C				0	0
Salt Lake City	13E		995,242,276		38,937,357	38,937,357
Salt Lake City	13F		572,166,215		21,122,032	21,122,032
Salt Lake City	13G		5,998,140		-44,600	-44,600
Salt Lake City	13H	Baseball Stadium	1,869,250	1,869,250	-22,140	
Salt Lake City	13I		1,111,999		-29,472	-29,472
Salt Lake City	13J		14,330,400		70,800	70,800
Salt Lake City	13K		759,110		18,810	18,810
Salt Lake City	13L		12,170,783		25,086	25,086
	Total		15,653,126,508	2,549,258,380	655,515,842	456,561,620

Utah State Tax Commission Response



State of Utah

GARY R. HERBERT
GovernorGREG BELL
Lieutenant Governor

Utah State Tax Commission

R. BRUCE JOHNSON
Commission ChairD'ARCY DIXON PIGNANELLI
CommissionerMICHAEL J. CRAGUN
CommissionerROBERT P. PERO
CommissionerBARRY C. CONOVER
Executive Director

July 14, 2014

Dear Mr. Stringfellow,

RE: Utah State Auditor's Analysis Report on New Growth Within Utah's Property Tax System

Tax Commission Property Tax Division Response.

Thank you for your detailed analysis of the new growth calculation that is within the certified tax rate calculation. Your analysis is thorough and offers a number of excellent suggestions to improve the accuracy of these calculations. The new growth and certified tax rate calculations contain many pieces of data collected from different county systems in various formats. In addition the time constraints inherent in certifying rates, and a lack of consistent county computer systems in Utah all make the verification process required in the tax rate setting process a significant challenge. The Property Tax Division is very interested in discussions that may lead to improved accuracy and transparency.

Four recommendations were made in the report. These are listed below with the Property Tax Division's response:

1. The Legislature should clarify the method for calculating new growth and its use within the certified tax rate formula.

Property Tax Division response: The Division recognizes the need for greater clarity in the calculation of new growth and would be pleased to participate in legislative discussions to that end.

2. The Tax Commission should implement policy and procedures to eliminate the current practice of subtracting the change in the reappraisal value within redevelopment projects twice.

Property Tax Division response: The Property Tax Division sends out an annual letter to county auditors requesting data to be used in the certified tax rate process. The 2014 tax year data request letter did ask counties to verify that the reappraisal number used in the new growth calculation did not include reappraisal that was already reported in the redevelopment adjustment number.

The Property Tax Division produces Standards or "Best Practices" for counties to follow. The Division is currently in the process of updating Standard 10 Tax Rate Certification Standards of Practice. The updated standard will address reporting reappraisal numbers to be used in the new growth calculation.

3. The Tax Commission should collect more detailed information on the tax bases, tax rates, and tax increments from redevelopment projects to avoid confusion in setting certified tax rates.

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If you need an accommodation under the Americans with Disabilities Act, call 801-297-3811 or Telecommunication Device for the Deaf (TDD) 801-297-2020. Please allow three working days for a response.

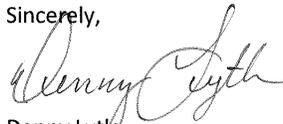
Property Tax Division response: Recently, the Tax Commission rolled out an online system to provide a transparent calculation of certified tax rates and associated data to all taxing entities and the public. The Property Tax Division has plans to incorporate additional screens in the system to display redevelopment project information as resources become available to enhance that system.

In addition there is statutory ambiguity in the requirements for redevelopment project reporting information and the tax increment calculation performed by the county auditor. The Property Tax Division is sensitive to the fact that no statutory oversight of redevelopment agencies and projects has been granted to the Division. The Division's interest has been limited to obtaining sufficient information to certify tax rates consistent with its statutory responsibility. The Division would not be opposed to more oversight and reporting requirements to ensure taxing entities affected by redevelopment agencies receive the revenue for which they are statutorily entitled to.

4. Local governments should properly report all property tax revenue and associated transfers of tax increment to redevelopment agencies.

It is unclear to the Division if "local government" means the taxing entity or community renewal and development agency (CDRA). A taxing entity is currently unaware of the total revenue generated from their tax rates. The redevelopment project value is removed in the certified tax rate calculation. If greater clarity is desired, a suggestion would be to change the certified tax rate calculation to remove the redevelopment adjustment and calculate a budgeted revenue based on the entire value of the taxing entity; a true budgeted revenue would be displayed for each taxing entity. Then, create a separate budget line for redevelopment tax increment revenue for each taxing entity that participates in a CDRA project. The taxing entity would receive all the property tax revenue generated by a tax rate. The taxing entity would then be responsible to distribute the agreed upon tax increment payment to the urban, economic or community development project. When a project is completed, the taxing entity would be allowed to shift the revenue from the project budget line to another budget line, in the taxing entity. This would solve the other issue taxing entities have of capturing revenue from an CDRA project that has been completed. The current method that relies on the new growth calculation to distribute "diverted" tax increment, can in years of negative changes in centrally assessed value, offset "new growth" in the form of CDRA projects being completed. A few changes in the statutes could bring about clarity and transparency in the reporting of property tax revenue and tax increment.

Sincerely,



Denny Lytle

Director, Property Tax Division

cc: John Dougall, State Auditor
Barry Conover, Executive Director State Tax Commission