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Colorado property owners: What to expect if Gallagher Amendment is repealed

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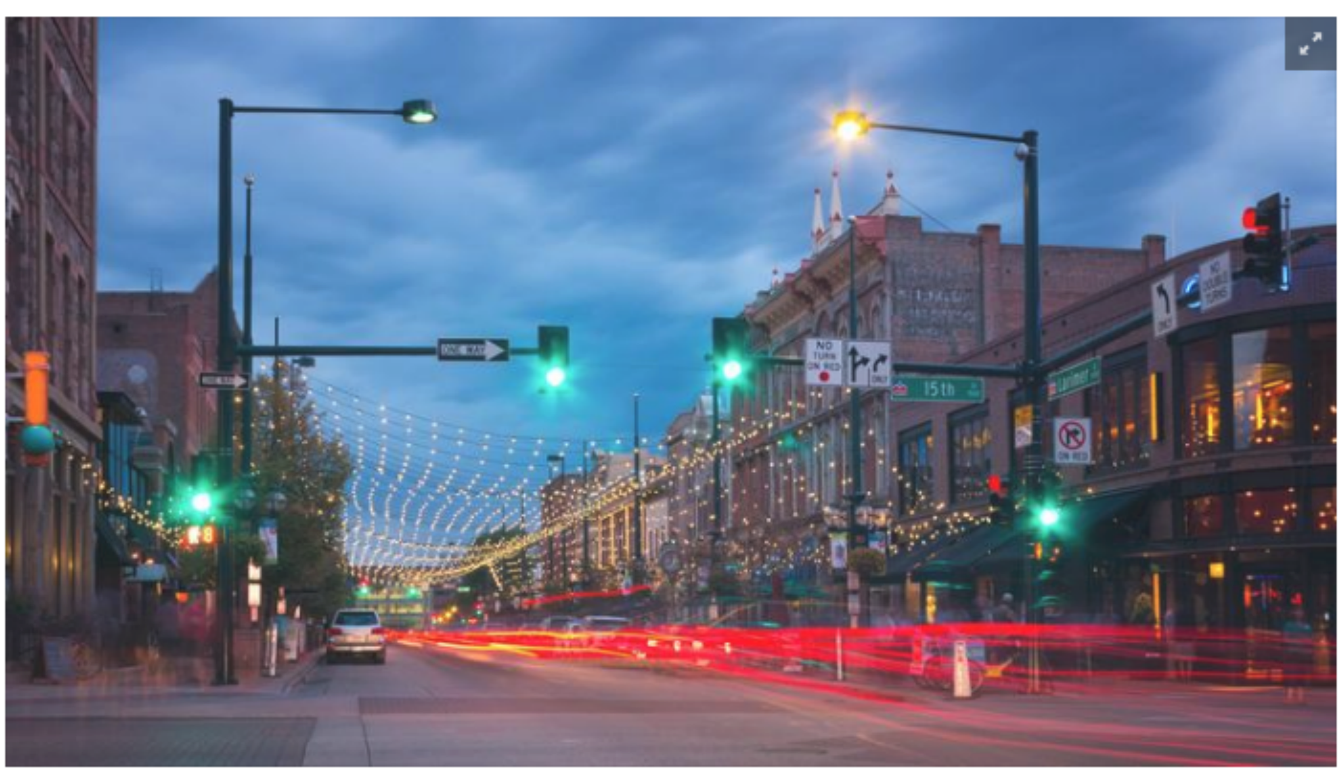

The November vote will have a profound effect on commercial and residential property owners.
ROLAND ROLLINGER

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While the repeal of the Gallagher Amendment would be a welcomed change for commercial property owners and developers, it comes with other societal impacts and increased financial burdens on homeowners. Nevertheless, in light of current circumstances, those burdens seem relatively small compared to the alternative.

Gallagher Amendment background

Originally added to Colorado's constitution in 1982, the Gallagher Amendment sought to curb snowballing residential property taxes. It mandated that, regardless of the total amount of collections, state property tax revenue be comprised of: (1) 45% residential property taxes, and (2) 55% non-residential property taxes. To achieve this 45/55 split, the Gallagher Amendment set the commercial property assessment rate at 29% of market value, while the residential property assessment rate, originally set at 21% in 1982, would adjust to satisfy the 45/55 split.

Today, as a result of these mechanisms and a dramatic rise in residential property values across the state over the last 38 years, the residential property assessment rate has fallen to just 7.15% of the market value for such residential property. Accordingly, Colorado homeowners now enjoy some of the lowest property tax rates in the United States, while commercial property owners pay four times the property tax rate of residential properties, some of the highest property tax rates in the country.

Communities across Colorado have continued to see increased need for public services arising from population growth, juxtaposed with declining property tax revenues. As the aggregate market value of residential properties increase, the residential property assessment rate has needed to be continuously lowered to satisfy Gallagher's 45/55 split. Although residential properties now make up approximately 80% of all market value in the state, they collectively comprise only 45% of the state's property taxes. For that reason, many parts of Colorado find themselves severely underfunded - particularly rural communities that have not seen the same housing market boom as the Front Range.

As another consequence of the Gallagher Amendment, local governments may be less inclined to approve residential projects as compared to commercial or industrial projects. Residential development contributes relatively little in property tax revenue and can even be viewed as an additional cost burden on already underfunded local governments. And, as the continued shift to online retail diverts the receipt of critical sales taxes, local governments will find themselves in increasingly dire revenue circumstances.

These effects are now exacerbated by a global pandemic that is threatening to send the market value of commercial property plummeting. Any such crash in commercial property values would necessitate a drastic reduction in the assessment rate for residential properties, thereby substantially reducing the state's total property tax collections. Current predictions estimate that this reduction in tax revenues could reach $500 million.

The other side of this coin is that, once the assessment rate for residential properties falls, it will be very difficult for it to be raised back to pre-pandemic levels, as a tax increase would require a vote of Colorado residents under the state's other seminal tax limiting constitutional amendment.

These factors are the driving force behind the proposed repeal of the Gallagher Amendment.

Repeal and implications for residential and commercial property owners in Colorado

In June, the repeal proposal gathered the requisite number of votes from Colorado legislators to be placed on the November ballot. There is considerable uncertainty surrounding the potential repeal of the Gallagher Amendment, as repealing it will require a simple majority of voters and it is unknown what assessment rates or scheme would fill its void.

If the Gallagher Amendment is not repealed, commercial property taxes are sure to increase. As residential property values continue to rise, the residential property assessment rate is now projected to drop to 5.88% if the Gallagher Amendment isn't repealed. The future for commercial property owners looks bleak, as they will pay almost five times the residential assessment rate in the next year.

The repeal may be coupled with a moratorium on changing the assessment rates, as a separate bill (SB 20-223) contemplates just that. If enacted, it would lock in residential assessment rates at 7.15% and commercial assessment rates at 29%. This option would stave off additional cuts to the residential assessment rates. Importantly, such a freeze would also shelter commercial properties from increased property tax payments (due to the potential for an increase in the residential property assessment rate following a repeal of Gallagher). Nevertheless, this option would not immediately level the disproportionate assessment rates and residential properties would still be paying one-fourth of the assessment rate of commercial properties – meaning rural communities would certainly still be underfunded. The benefit here, at least for commercial property owners and developers, is that the situation would not continue to get worse, as it has for so many years.

If the Gallagher Amendment is repealed but no freeze is implemented, the state legislature could adjust assessment rates, subject of course to voters approving such a measure. This would likely mean an increase in residential property tax rates to bolster state property tax collections. In this circumstance, even if commercial property assessment rates remain the same, the result would be a more equitable split in property tax burden. Small businesses could be protected from increased rent due to triple net leases, which pass through tax payments to tenants. In any event, it would all be up to the legislature, which Coloradans have historically been reluctant to trust.

The repeal could lead to other factors that impact real estate development. For instance, the increase in tax revenue in communities would lead to subsequent improvement of local services provided by local governments, such as fire and police protection, and additional school funding. This, in turn, should make underserved and rural communities more attractive places to live, thereby presenting additional development opportunities to support Colorado's continued growth. In the absence of Gallagher, local governments may also be more inclined to approve residential development where they previously chased commercial and industrial uses as a result of revenue consequences.

However, increasing the residential assessment rate creates additional financial burdens for home owners across the state, including those living in the Front Range that are already struggling with a high cost of living. The increased tax burden will make home buying even more unattainable for low income families and force individuals further outside the metro area, leading to additional urban sprawl. The increased residential tax burden would also likely impact renters, as additional taxes are likely to increase residential rent rates. Affordable housing development may be even more challenging.

The potential repeal of the Gallagher Amendment brings a variety of possible and long-lasting consequences for all Coloradans. Whether the repeal results in a moratorium or an adjustment in assessment rates, commercial properties are sure to benefit so long as the Gallagher Amendment is repealed. In either event, the November vote will have a profound effect on property owners.

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