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Repeal of Gallagher: Impacts on Property Owners

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For the past 38 years, the Gallagher Amendment to the Colorado constitution has shifted the bulk of the burden of property taxes from residential owners to non-residential (i.e., income producing) owners. However, with Gallagher contributing to a looming state funding catastrophe, Colorado lawmakers have determined that it is time to rethink the amendment's allocation of property taxes, passing Senate Concurrent Resolution 1 on June 12th in order to put the potential repeal of Gallagher on the November ballot.

Background

In short, the Gallagher amendment, which was added to the State's constitution in 1982, requires that property tax collections from non-residential properties account for 55% of all property taxes in the State, meaning that residential property taxes account for 45% of such taxes. This proportionate split remains fixed, regardless of fluctuations between the aggregate value of residential and non-residential properties. Gallagher's split is implemented through the use of (i) a fixed assessment rate of 29% for non-residential property, and (ii) a variable assessment rate for residential property, which is intended to fluctuate to compensate for changes in the relative valuations of the two classes. When Gallagher was first passed, the residential assessment rate was 21%. Today, it is just 7.15%, with predictions that it will need to fall to 5.88% next year. This precipitous drop in the residential assessment rate has been driven by the rapidly rising value of residential property in the State, especially along the Front Range. Currently, residential property makes up about 80% of the total valuation of Colorado property –

substantially more than the 45% cap implemented by Gallagher.

Although Gallagher gets less attention than the State's other tax-limiting constitutional amendment – TABOR – its impact is arguably just as dramatic, as its balancing act and fixed non-residential rate effectively set a ceiling on the State's ability to collect property taxes. Interestingly, TABOR also has a 'synergistic' effect on Gallagher, as once Gallagher's balancing act lowers the variable residential assessment rate for residential property, TABOR prevents subsequent increases (even to pre-lowered levels) without a public vote.

Crisis

The current impetus for a potential repeal of Gallagher is the looming crash in the valuation of non-residential properties across the State. With the COVID-19 pandemic crippling businesses (especially retail tenants) and the oil and gas markets in the doldrums, the aggregate value of non-residential property is expected to drop sharply in the coming year. As such, maintaining Gallagher's 55/45 split will require a significant decrease in the assessment rate for residential property. As noted above, current predictions suggest that it will be required to drop to 5.88% - approximately 1/5th of the non-residential property rate. This will, in turn, significantly limit the amount of residential property tax collections, driving sharp budget cuts across many State-funded services such as schools and fire departments. Current budget predictions suggest that this will mean additional cuts of approximately $491 million for Colorado's schools and $204 million for county governments.

To make up the shortfalls historically created by Gallagher, many communities have traditionally turned to mill levy increases. In some places this is already set to happen automatically through so-called floating mill levies. In any event, each mill levy increase hits non-residential owners four to five times harder than residential owners due to Gallagher's balancing.

Although Gallagher has long led to an increased burden on non-residential property owners and generally reduced property tax collections, it has been challenging to change due to its vastly varied effects across different Colorado communities. For Front Range homeowners, it has been a benefit, but it certainly hasn't offset the rapidly rising property values. For many rural homeowners, property tax bills may have actually been decreasing over the last number of years, although the trade-off may have been slowly decreasing budgets for State-funded services. The disparate impacts of Gallagher are further seen when comparing communities that have little non-residential property with those that have plenty of non-residential property. Increasingly reduced rates for residential property have hit communities without off-setting non-residential property the hardest.

Impacts

It is hard to predict with specificity what will happen if Gallagher is repealed in November. To provide some short-term certainty, State lawmakers have also added a bill to freeze the current assessment rates for four years following any Gallagher repeal. This would only go into effect if the repeal is approved by voters and would give property owners certainty that their taxes won't increase in the short-term, unless property values rise. It would not, however, provide long-term comfort or a plan for fixing and/or rebalancing assessment rates in the future. If repealed, in any event, the assessments rates will someday be simply set by the legislature (subject to TABOR), capable of changing fairly quickly based on control over that body.

Obviously, repealing Gallagher would stymie the short-term property tax-induced cuts to State budgets. Even a small drop in the residential assessment rate can have large impacts on those budgets, so a repeal would be a win for schools and local governments. This impact is multiplied for metro districts and other non-general purpose governments, which rely heavily on residential property taxes to fund debt repayment and operations.

For residential property owners, a repeal would likely be a two-edged sword. On the one hand, it would likely mean increased property taxes, as Colorado's residential properties are currently ranked as the third lowest in the country. On the other hand, it would mean better funding for local services such as schools and fire departments. Further, although challenging to prove, there is also an assumption that residential property tax rates and home sales prices are correlated, such that low taxes can lead to higher prices. As such, an increase in assessment rates could be partially off-set by a back-end effect on home valuations. Although this could be seen as detrimental to current Colorado homeowners, it could work to address some affordability issues seen across the state, especially on the Front Range.

For non-residential property owners, it would also seem to be a win initially, as a repeal would likely mean that the gulf between the residential assessment rate and the non-residential assessment rate is likely to shrink in the future. This would be true for property owners and tenants who carry property tax burdens under triple net leases. However, some property owners are wary of eliminating the constitutionally set assessment rate for non-residential property, fearing that this rate may be increased to help raise funds in the future.

Finally, for developers and other real estate professionals, a repeal of Gallagher could mean that local governments will be more willing to approve residential properties, as they could be less dependent upon non-residential property tax revenues. This, combined with the potential for already better funded services through State budgets, could have a dramatic impact on the way governmental actors look at land use decisions across the State.

Conclusion

Ultimately, it is hard to predict all of the long-term impacts that repealing Gallagher could have – for better or for worse. Nevertheless, the short-term impacts of not repealing it are evident, with State and local governments already bracing for brutal cuts. In any event, the decision now rests with the State's voters, who will have the final say in November. Otten Johnson will be closely following this issue as it continues to evolve.

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