

Analysis of Changes to the Commercial Property Assessment Ratio - State of Arizona

March 2021

Prepared For:



Prepared By:



Rounds Consulting Group



Table of Contents

<i>Executive Summary</i>	1
Economic Fundamentals.....	1
Proposed Property Tax Changes	2
Historical Property Tax Changes	2
Summary of Key Points.....	3
<i>Introduction</i>	4
<i>Arizona’s Property Tax System</i>	5
Calculated Property Taxes	7
<i>Arizona Tax Burden by Class</i>	8
<i>Tax Competitiveness</i>	9
State Property Tax Comparisons.....	9
How Arizona Ranks Among Competitors.....	11



Executive Summary

Synopsis: State tax policy must be designed so businesses can remain competitive. If a particular tax is relatively high, benefits typically arise from a reduction in the effective tax rate. In Arizona, the commercial property tax remains relatively high despite recent efforts to reduce the business tax burden. The assessment ratio on commercial property, which is part of the tax formula, currently stands at 18%, versus 10% for residential property. This means that office, industrial, retail and other business properties are paying significantly higher property taxes than comparable residential properties.

The 2021 legislative proposal to gradually reduce the commercial assessment ratio from 18% to 17% would positively impact economic development in the state. In fact, it is recommended that the reduction in the assessment ratio continue to be reduced in future years to approximately 15%.

Economic Fundamentals

There are two approaches to addressing statewide economic competitiveness – economic fundamentals and targeted economic development programs. Economic competitiveness matters because it helps drive business attraction, retention and expansion. By bringing new companies into the state and creating a climate where existing businesses can grow, the total number of jobs increases, economic activity goes up and new government tax revenues are realized.

Regarding economic fundamentals, it means maintaining a competitive position related to tax policy, infrastructure investment, and workforce development, among a dozen or more other categories. In this case, a state can establish a strong position of growth by remaining competitive in the fundamentals. However, a balance must be established because a certain level of government expenditures are necessary to provide quality services. Those tax categories that are disproportionately higher than competitor states are candidates for reduction.

The timing is good for implementing such a change in the state’s tax code. The global economy experienced a severe recession related to COVID-19, as did the U.S. and Arizona. However, Arizona’s strong fundamentals allowed the state to be better fiscally equipped to deal with the crisis, following years of coordinated efforts after the 2008 Great Recession when necessity translated into action on a variety of economic measures to bring in new industries that diversified the economic base.

The COVID-19 recession provides an opportunity for a similarly aggressive economic response. In this case, action taken now will make it possible for the state to become a national leader in most economic categories throughout the decade. One of these opportunities relates to modifying a tax category where Arizona is relatively uncompetitive: commercial property taxes.



Proposed Property Tax Changes

In the first session of the 55th State Legislature of Arizona, legislation is being considered to change how commercial property taxes are calculated. The proposed change would gradually phase down the Class 1 (i.e., commercial property) assessment ratio from 18% to 17% over two years.¹ The assessment ratio determines a property's assessed value to which property tax rates are then applied.

Commercial property in Arizona has the highest assessment ratio of any other property type. The proposed reform establishes a new assessment rate of 17.5% for tax year 2022. After 2022, the rate would drop to 17%.² While not in the current reform proposal, ideally, the assessment ratio should be gradually decreased to 15%.

The goal of the proposed legislation is to add to the competitiveness of the state's economic fundamentals. In the longer term the enhanced level of competitiveness could allow for modest reductions in the need for project-specific incentives.

There will exist short-term "costs" absent any consideration for tax rate changes. However, that is not a likely scenario. Ultimately, the reductions in the commercial assessment ratio of the property tax formula will result in modifications to local government tax rates, resulting in a more competitive balance in the tax code.

The Legislature's estimate of net assessed value (NAV) reduction will equal \$1.39B by tax year 2023, which represents only a 1.7% reduction.³ However, statewide commercial property values have been increasing by more than 6% per year over the last 5 years.⁴ Thus, the anticipated growth will more than fully offset any modest reductions in the assessment ratio. In addition, business cycle impacts to the property tax formula have been met with modifications in the tax rates. This means it is likely that a portion of the NAV reduction will be offset through the flexibility of rate adjustment.

When examining economic fundamentals, individual categories (i.e., competitive tax policy, infrastructure investment, workforce development, etc.) cannot be fully separated. In other words, the shift in property tax burden, when combined with other fundamentals, will indeed lead to additional economic growth. In fact, the potential for a full offset of any tax revenue losses will be greater as the assessment ratio for commercial property is reduced to the recommended 15%.

Historical Property Tax Changes

The legislation currently being proposed is not the first passed in Arizona that is focused on equalizing the tax burden and lowering the assessment ratio for commercial properties. Prior to 2006, the assessment ratio on commercial property was 25%. Beginning after December 31, 2005, the assessment ratio was gradually reduced until reaching 18% in 2016.⁵ Since property taxes are levied on net assessed values, this

¹ See Arizona Senate Bill (SB) 1108 (<https://www.azleg.gov/legtext/55leg/1R/bills/SB1108S.pdf>)

² See Arizona Senate Bill (SB) 1108 (<https://www.azleg.gov/legtext/55leg/1R/bills/SB1108S.pdf>)

³ JLBC Fiscal Note (<https://www.azleg.gov/legtext/55leg/1R/fiscal/SB1108.DOCX.pdf>); Arizona Tax Research Association (ATRA)

⁴ According to the ATRA (<http://www.arizonatax.org>)

⁵ See Arizona Revised Statutes (A.R.S.) § 42-15001



resulted in effective tax rate declines going from 3.01% in 2000, to 2.03% in 2016 and, most recently, 1.76% in 2020.⁶

As the effective rate declined, the value of commercial properties increased at an average annual rate of 5.1% between 2000 and 2020.⁷ This indicates that as the effective rate declined, Arizona's improved competitive position helped fuel additional economic growth and resulted in a net gain in tax collections.

While many factors influence economic growth, maintaining a competitive position related to tax policy encourages economic development, business procurement, retention and expansion. This leads to wage enhancements and employment growth throughout the state.

Summary of Key Points

- Arizona's effective property tax rate for commercial uses is currently uncompetitive with other states and metro areas despite progress being made to reduce the assessment ratio over the last 15 years.
- Given the fact that the state's commercial property tax is uncompetitive, economic benefits will arise when effective tax rates are reduced.
- Competitive economic fundamentals allow for more discrete, targeted use of project specific incentives.
- One should expect additional job and wage growth to occur as a result of the proposal.
- Job and wage growth is particularly important during and following a recession.
- The reduction in the assessed values that are identified with the proposal do not consider how the change to a more competitive tax category will positively impact the economy, both through more efficient local tax rate policies and through additional business development.
- This policy change should continue at a slow but steady pace until the assessment ratio reaches 15%.
- The monumental changes brought to the global economy and the nature of work by the COVID-19 pandemic present a window of opportunity for Arizona. This includes making impactful policy changes, such as reduced commercial property taxes, that will position the state to attract businesses that are looking to relocate.
- Building owners and landlords often pass along property taxes to their tenants in the form of higher rent payments. In the wake of the COVID-19 pandemic, reducing the assessment ratio could provide some additional relief for small businesses struggling to recover.

⁶ According to the ATRA (<http://www.arizonatax.org>)

⁷ According to the ATRA (<http://www.arizonatax.org>)



Introduction

Rounds Consulting Group, Inc. was retained to analyze changes to Arizona's assessment ratio for commercial property. This analysis is part of the Arizona Chapter of NAIOP's, the Commercial Real Estate Development Association, larger effort to position the state to be a preferred choice for business locations and expansions, support commercial real estate development, and grow the state's economy.

In order to continue advancing the state's economy, Arizona will need to remain competitive. At the present time, legislation is being considered that would gradually phase down the commercial property assessment ratio from 18% to 17% over two years.⁸

Lawmakers should give consideration to the economic benefits that would result from lowering uncompetitive business tax burdens. Enacting commercial property tax reforms would help equalize the varying tax burdens among commercial and all other property, incentivize additional real estate development, and advance the state's business attraction and expansion efforts.

⁸ See Arizona Senate Bill (SB) 1108 (<https://www.azleg.gov/legtext/55leg/1R/bills/SB1108S.pdf>)



Arizona's Property Tax System

All property in Arizona, whether real or personal, is subject to property taxes unless specifically exempted.⁹ Examples of exempt properties include government buildings, educational institutions, hospitals, and churches.¹⁰ Property taxes are levied on real and personal property based on the state's statutory classification system, valuation methods, assessment ratios, and the taxing jurisdiction's tax rate.

Property in Arizona is classified and valued by the Arizona Department of Revenue (ADOR) and county assessors.¹¹ The value of the property refers to the monetary worth of the property based on market values and statutory formulas.¹²

With the exception of centrally valued properties and personal property, all property is valued based on its full cash value (FCV) and limited property value (LPV). FCV is synonymous with market value with no limit to annual growth, while LPV is the basis for the assessment of property taxes and is determined by a constitutional formula utilizing the previous year's LPV and capping growth at 5% annually.¹³

Arizona's property tax system classifies property according to its use under nine classes (each with one or more additional subclasses), and each class is assigned an assessment ratio ranging from 1% to 18%.¹⁴ The assessment ratio is applied to a property's LPV to determine the net assessed value (NAV).¹⁵

The following table summarizes Arizona's property classes and assessment ratios.

⁹ See Arizona Revised Statutes (A.R.S.) § 42-11002 (<https://www.azleg.gov/viewdocument/?docName=https://www.azleg.gov/ars/42/11002.htm>)
¹⁰ See A.R.S. § 42-11001 through 42-11333 (<https://www.azleg.gov/arsDetail/?title=42>)
¹¹ See A.R.S. § 42-13002 through 42-13056 (<https://www.azleg.gov/arsDetail/?title=42>)
¹² See ADOR *Assessment Procedures Manual Part 2: Approaches to Values* (https://azdor.gov/sites/default/files/media/PROPERTY_AssessmentPart2Ch1.pdf)
¹³ See A.R.S. § 42-11001
¹⁴ See ADOR *Assessment Procedures Manual Part 3: Assessment Procedures* (https://azdor.gov/sites/default/files/media/PROPERTY_AssessmentPart3Ch1.pdf)
¹⁵ Ibid



Tax Year 2020 Property Classification and Assessment Ratios		
Property Class	Assessment Ratio	Description of Class
Class 1	18%	Mines and mining claim property and standing timber. Local telecommunications service, gas, water and electric utility company property, pipeline company property, producing oil and gas property. Commercial and industrial real property (A.R.S. § 42-12001).
Class 2	15%	Agricultural real property, golf courses, and vacant land (A.R.S. § 42-12002).
Class 3	10%	Primary residential residence of owner or owner's relative (A.R.S. § 42- 12003).
Class 4	10%	Property used for residential rental purposes, including property owned in foreclosure by a financial institution that is not otherwise included in any other class (A.R.S. § 42-12004).
Class 5	15%	Railroad, private rail car, and airline flight property (A.R.S. § 42-12005).
Class 6	5%	Noncommercial historic property, foreign trade zone property, qualifying military reuse zone property, enterprise zone property that qualified prior to the 7/1/11 sunset (primary taxes only), qualifying environmental technology property, and qualifying environmental remediation property (A.R.S. § 42-12006).
Class 7	18%	Historic commercial and industrial property (18%) and renovations (1%) (A.R.S. § 42-12007 and 42-12101).
Class 8	10%	Residential rental historic property (10%) and renovations (1%) (A.R.S. § 42-12008 and 42-12101).
Class 9	1%	Possessory interests and real property and improvements, regardless of ownership, leased and used exclusively by a nonprofit organization that operates as a charter school or church, religious assembly, or religious institution (A.R.S. § 42-12009).

Source: ADOR Assessment Procedures Manual Part 3: Assessment Procedures.
https://azdor.gov/sites/default/files/media/PROPERTY_AssessmentPart3Ch1.pdf

Property taxes are levied on a property's NAV by government bodies (i.e., the state, counties, community college districts, school districts, cities and towns, and special taxing districts) using the tax rate of each taxing jurisdiction.¹⁶ Property taxes are composed of two rates, primary and secondary.¹⁷ Primary tax rates typically fund the operational budgets of governments, while secondary tax rates typically fund voter approved general obligation bonds and overrides, and special taxing districts (i.e., fire districts and countywide special taxing districts for library, flood, jails, etc.).¹⁸

The sum of the two rates is the total tax rate. The statewide average total property tax rate for tax year (TY) 2020 was \$12.17 per \$100 of assessed values.¹⁹ The tax rate applies to all property types, unless exempt, no matter the class.

¹⁶ See A.R.S. § 42-17001 through 42-17401 (<https://www.azleg.gov/arsDetail/?title=42>)

¹⁷ See A.R.S. § 42-17051 through 42-17203 (<https://www.azleg.gov/arsDetail/?title=42>)

¹⁸ Ibid

¹⁹ According to the ATRA (<http://www.arizonatax.org>)



Calculated Property Taxes

For context on calculating property taxes, the table shows the tax calculations for a residential home and a commercial property using the simplified property tax formula: $t = (x * y) * z/100$. Where t is the tax, x is the LPV, y is the assessment ratio, and z is the total (primary and secondary) tax rate. Taxes are paid on a rate that is per \$100 of assessed valuation.

In the following example, the commercial property value is five times greater than the residential property value. However, the total taxed owed is nine times greater. This results in an uncompetitive economic position.

Property Tax Calculation Examples		
Property Class	Class 3: Residential Home	Class 1: Commercial Office Building
Full Cash Value	\$200,000	\$1,000,000
Limited Property Value	\$180,000	\$900,000
Assessment Ratio	10%	18%
Net Assessed Value	\$18,000	\$162,000
Total Tax Rate	\$12.17	\$12.17
Total Taxes Owed	\$2,190.60*	\$19,715.40

* Does not account for the 47.19% "homeowner rebate" the state pays for Class 3 (residential) primary school district taxes. In this example, the rebate would reduce the total residential taxes owed by \$312 in tax year 2020.

Source: Arizona Tax Research Association.



Arizona Tax Burden by Class

Although all property classes are subject to the same taxing jurisdiction’s tax rate, the amount of tax owed as a percent of property value ranges by use because of the state’s property classification system and varying assessment ratios. The actual amount owed (i.e., tax liability) is the effective tax.

Comparing effective tax rates is a more accurate representation of a property’s overall tax liability given Arizona’s varying assessment ratios. For context, based on the previous example, the effective tax rate for the Class 3 (residential) property is 1.1% (e.g., \$2,190.60/\$200,000) vs. 2.0% (e.g., \$19,715.40/\$1,000,000) for Class 1 (commercial) property.

The following table summarizes the tax year (TY) 2020 effective tax rates in Arizona, the FCV, and tax liability by class type.

TY 2020 Full Cash Value, Tax Liability, and Effective Tax Rates by Class							
Class	Type	Assessment Ratio	Full Cash Value	Percent of Total	Total Liability	Percent of Total	Effective Rate
1	Business, industrial, telecom, utility, mines	18%	\$157,474,354,302	20.27%	\$2,774,678,108	34.29%	1.76%
2	Agricultural, vacant land, golf courses, nonprofits	15%	\$28,634,763,379	3.69%	\$340,231,943	4.21%	1.19%
3	Owner occupied residential	10%	\$384,724,534,914	49.51%	\$3,194,863,898	39.49%	0.83%
4	Rental residential; nonprofit residential	10%	\$196,455,693,981	25.28%	\$1,706,415,967	21.09%	0.87%
5	Railroads & flight property	15%	\$2,155,280,389	0.28%	\$33,760,595	0.42%	1.57%
6	Historic prop; FTZ; enviro tech; (more)	5%	\$7,069,367,584	0.91%	\$37,651,269	0.47%	0.53%
7	Comm historic property	18%/1%	\$63,669,468	0.01%	\$762,850	0.01%	1.20%
8	Rental residential historic property	10%/1%	\$22,702,792	0.00%	\$657,739	0.01%	2.90%
9	Possessory interests; leased churches	1%	\$424,713,434	0.05%	\$1,792,740	0.02%	0.42%
Total			\$777,025,080,244	100.00%	\$8,090,815,110	100.00%	1.04%

Source: Arizona Tax Research Association.



Tax Competitiveness

There are two approaches to addressing statewide economic competitiveness – economic fundamentals and targeted economic development programs. Economic competitiveness matters because it helps drive business attraction, retention and expansion. By bringing new companies into the state and creating a climate where existing businesses can grow, the total number of jobs increases, economic activity goes up and new government tax revenues are realized.

First, a state must have solid economic fundamentals. This means maintaining a competitive position related to tax policy, infrastructure investment, and workforce development, among a dozen or more other categories.

In this case, a state can establish a strong core position when it comes to growth by remaining competitive in the fundamentals. However, a balance must be established since a certain level of government expenditures are necessary to provide quality services. Those tax categories that are disproportionately higher than competitor states are candidates for reduction.

The other approach, targeted economic development programs such as incentives, can be analyzed based on a return on investment calculation where the state taxpayer receives a positive return on their tax payments. However, this review focuses on comparisons of economic fundamentals.

State Property Tax Comparisons

A 2020 study by the Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence compared property tax rates for commercial, industrial, and residential properties across the largest cities in each of the country's 50 states.²⁰ The 50-state property tax comparisons rank the effective tax rates of 53 cities because it includes Washington, DC, plus two cities in Illinois and New York since property taxes in Chicago and New York City are vastly different than the rest of the state. Effective tax rates were ranked highest to lowest.

The average effective tax rate for owner-occupied residential homes in the U.S. was 1.40% in 2019.²¹ In Phoenix, the state's largest city, the average effective tax rate for a residential home was 1.25% in 2019. In terms of owner-occupied residential property, Phoenix was ranked 24th highest.

²⁰ See *50-State Property Tax Comparison Study* (https://www.lincolinst.edu/sites/default/files/pubfiles/50-state-property-tax-comparison-for-2019_full.pdf)

²¹ See *50-State Property Tax Comparison Study* (https://www.lincolinst.edu/sites/default/files/pubfiles/50-state-property-tax-comparison-for-2019_full.pdf)



Top 25 Highest Effective Tax Rates - Residential Houses							
Effective Tax Rate for Median Valued Home							
Rank	State	City	Tax Rate	Rank	State	City	Tax Rate
1	IL	Aurora	3.30%	14	TX	Houston	1.71%
2	CT	Bridgeport	3.21%	15	NY	Buffalo	1.59%
3	NJ	Newark	3.02%	16	SD	Sioux Falls	1.54%
4	MI	Detroit	2.93%	17	IL	Chicago	1.52%
5	OR	Portland	2.46%	U.S. Average			1.40%
6	WI	Milwaukee	2.41%	18	DE	Wilmington	1.39%
7	VT	Burlington	2.31%	19	MO	Kansas City	1.38%
8	IA	Des Moines	2.25%	20	MN	Minneapolis	1.37%
9	MD	Baltimore	2.22%	21	MS	Jackson	1.37%
10	NH	Manchester	2.03%	22	RI	Providence	1.29%
11	NE	Omaha	2.02%	23	FL	Jacksonville	1.25%
12	OH	Columbus	1.93%	24	AZ	Phoenix	1.25%
13	ME	Portland	1.83%	25	OK	Oklahoma City	1.24%

Source: Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence.

For commercial office property, Phoenix had the 20th highest property tax rate. The average effective tax rate for the 53 cities across the U.S. was 1.92%, while the effective rate in Phoenix was 2.14% in 2019.

Top 25 Highest Effective Tax Rates – Commercial Office Property							
Effective Tax Rate for \$1 Million Valued Property (plus \$200K in personal property)							
Rank	State	City	Tax Rate	Rank	State	City	Tax Rate
1	MI	Detroit	3.77%	14	VT	Burlington	2.54%
2	RI	Providence	3.61%	15	NJ	Newark	2.52%
3	IL	Chicago	3.51%	16	OR	Portland	2.46%
4	CT	Bridgeport	3.30%	17	TX	Houston	2.29%
5	IA	Des Moines	3.02%	18	CO	Denver	2.22%
6	IL	Aurora	3.01%	19	NY	Buffalo	2.18%
7	IN	Indianapolis	2.91%	20	AZ	Phoenix	2.14%
8	MO	Kansas City	2.82%	21	LA	New Orleans	2.14%
9	MD	Baltimore	2.80%	22	NE	Omaha	2.06%
10	MN	Minneapolis	2.77%	23	ME	Portland	2.02%
11	MS	Jackson	2.67%	24	PA	Philadelphia	1.97%
12	WI	Milwaukee	2.58%	25	OH	Columbus	1.93%
13	KS	Wichita	2.56%	U.S. Average			1.92%

Source: Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence.



As for industrial property, Phoenix had the 10th highest effective property tax rate since industrial properties include additional personal property taxes on machinery and equipment. The average effective tax rate for the U.S. was 1.40%, while the effective rate in Phoenix was 1.90%.

Top 25 Highest Effective Tax Rates – Industrial Property							
Effective Tax Rate for \$1 Million Valued Property (plus \$1 Million in personal property)							
Rank	State	City	Tax Rate	Rank	State	City	Tax Rate
1	MS	Jackson	2.75%	14	IA	Des Moines	1.80%
2	SC	Charleston	2.39%	15	CT	Bridgeport	1.79%
3	IN	Indianapolis	2.37%	16	CO	Denver	1.78%
4	TX	Houston	2.29%	17	VT	Burlington	1.73%
5	MO	Kansas City	2.23%	18	NE	Omaha	1.68%
6	MI	Detroit	2.22%	19	MN	Minneapolis	1.67%
7	LA	New Orleans	2.19%	20	AK	Anchorage	1.53%
8	IL	Chicago	1.98%	21	NJ	Newark	1.51%
9	OR	Portland	1.96%	22	OK	Oklahoma City	1.47%
10	AZ	Phoenix	1.90%	23	WI	Milwaukee	1.42%
11	RI	Providence	1.89%	24	GA	Atlanta	1.40%
12	WV	Charleston	1.85%	25	AR	Little Rock	1.40%
13	IL	Aurora	1.81%	U.S. Average			1.40%

Source: Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence.

How Arizona Ranks Among Competitors

Through interviews with professionals in business attraction, retention and expansion, six competitor markets were identified in California, Colorado, Idaho, Nevada, Texas, and Utah. The following chart shows how Phoenix’s effective tax rate ranks among the largest cities in each of the listed competitor states. For example, Phoenix ranks as the 10th highest region for industrial property taxes.

However, ranking business tax burdens is complicated because states and communities have different tax structures. For example, Texas does not have an income tax. Therefore, Houston can levy a relatively high property tax rate while the overall tax burden in Texas is relatively low.



Competitor Market Highest Effective Tax Rates								
Residential Houses			Commercial Office Property		Industrial Property			
	Rank	Tax Rate		Rank	Tax Rate	Rank	Tax Rate	
Houston, TX	14	1.71%	Houston, TX	17	2.29%	Houston, TX	4	2.29%
Phoenix, AZ	24	1.25%	Denver, CO	18	2.22%	Phoenix, AZ	10	1.90%
Los Angeles, CA	33	1.16%	Phoenix, AZ	20	2.14%	Denver, CO	16	1.78%
Las Vegas, NV	35	1.11%	Salt Lake City, UT	39	1.26%	Salt Lake City, UT	37	1.02%
Boise, ID	43	0.80%	Boise, ID	42	1.20%	Boise, ID	40	0.99%
Salt Lake City, UT	46	0.71%	Los Angeles, CA	43	1.17%	Los Angeles, CA	41	0.94%
Denver, CO	50	0.56%	Las Vegas, NV	44	1.12%	Las Vegas, NV	42	0.90%

Source: Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence.

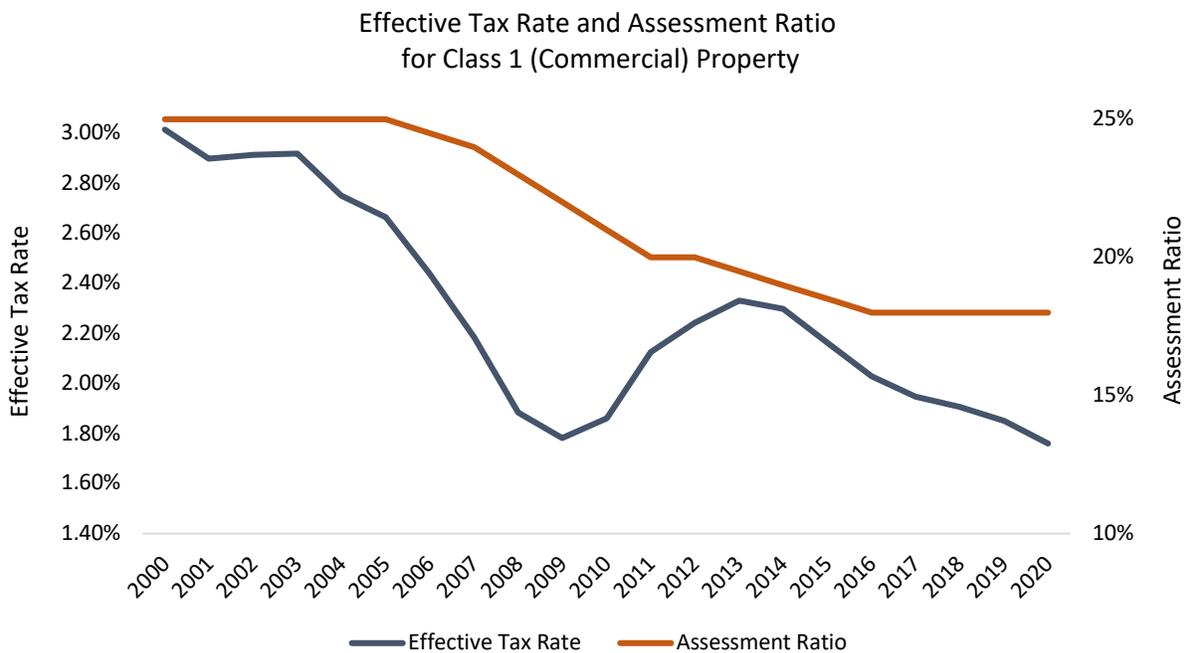


Historical Changes to the Assessment Ratio

The legislation currently being proposed is not the first passed in Arizona that is focused on equalizing the tax burden and lowering the assessment ratio for commercial properties. A competitive tax policy is often linked with economic growth and development.²² A review of historical changes to the commercial assessment ratio in Arizona provides support to this idea.

Prior to 2006, the assessment ratio on commercial property was 25%. Beginning after December 31, 2005, the assessment ratio was gradually reduced until reaching 18% in 2016.²³ As a result, the effective tax rate declined from 3.01% in 2000, to 2.03% in 2016 and, most recently, 1.76% in 2020. This resulted in a gradual decline in the effective tax rate between 2000 and 2009.²⁴

However, in 2009, property values and construction activity began to decline as a result of the Great Recession of 2008. To offset this reduction in property taxes, taxing jurisdictions began raising property tax rates. This brought the effective rate up until it began to decline again in 2013.



Source: ATRA

Employment, a key indicator for economic growth and overall economic health, increased over this timeframe as the effective tax rate on commercial property declined (see the following chart). Employment grew at an average rate of 1.2% per year.²⁵ The FCV of commercial property grew at an

²² According to the Tax Foundation (<https://taxfoundation.org/what-evidence-taxes-and-growth/>)

²³ A.R.S. § 42-15001

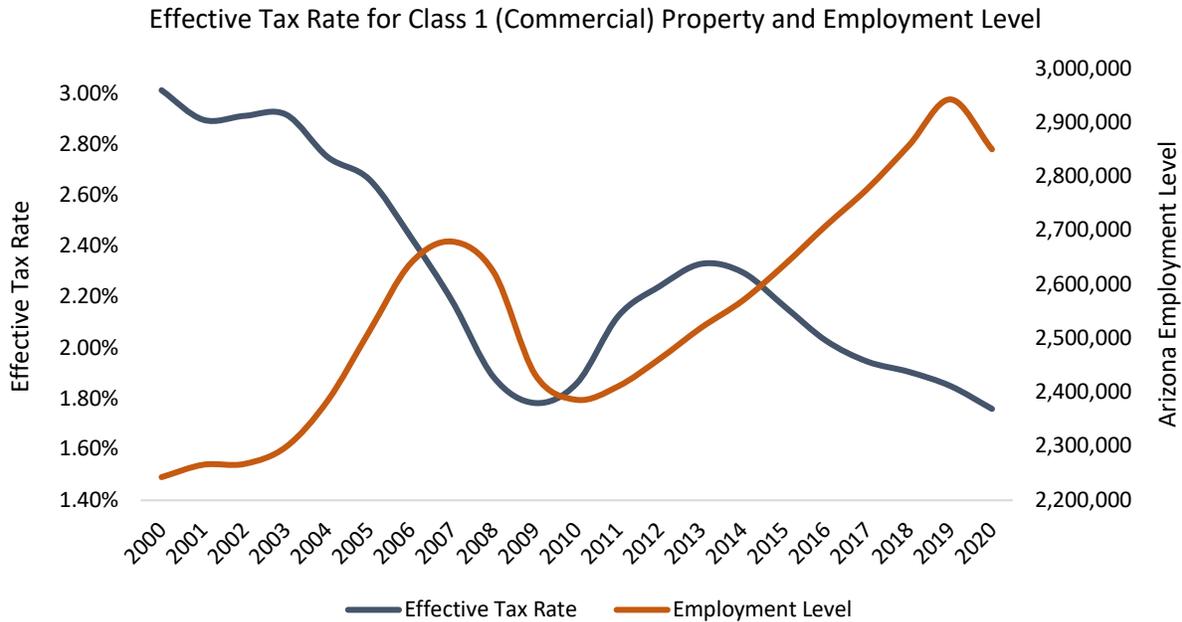
²⁴ According to the ATRA (<http://www.arizonatax.org>)

²⁵ According to the Arizona Office of Economic Opportunity (<https://www.azcommerce.com/oeo/>)



average annual rate of 5.1%.²⁶ This indicates that as the effective rate declined, Arizona's improved competitive position helped fuel additional economic growth and resulted in a net gain in tax collections.

Arizona was experiencing strong employment growth from 2000 to 2007 until the economic downturn in the business cycle. If not for the Great Recession of 2008, employment would have grown at a faster rate. In fact, after the Great Recession employment grew at an average annual rate of 2.4% between 2010 to 2019 (the year before the most recent economic downturn).²⁷



Source: Arizona Office of Economic Opportunity; ATRA

While many factors influence economic growth, maintaining a competitive position related to tax policy encourages economic development, business procurement, retention and expansion. This leads to wage enhancements and employment growth throughout the state.

²⁶ According to the ATRA (<http://www.arizonatax.org>)

²⁷ According to the Arizona Office of Economic Opportunity (<https://www.azcommerce.com/oeo/>)



Proposed Changes to the Assessment Ratio

In the first session of the 55th State Legislature of Arizona, legislation is being considered, which would gradually phase down the Class 1 (i.e., commercial property) assessment ratio from 18% to 17% over two years.²⁸ Commercial property in Arizona currently has the highest assessment ratio of any other property type.

Under the proposed reform, the assessment ratio of 18% would be extended no further past December 31st, 2021, upon which a new rate of 17.5% would be enacted until December 31st, 2022. After the one-year time frame at 17.5%, the rate would drop to 17%, where it would stay in perpetuity.²⁹

According to the Arizona Joint Legislative Budget Committee (JLBC), from a fiscal standpoint, reducing the assessment ratio for commercial property to 17.5% in TY 2022 and 17% in TY 2023 would reduce the statewide NAV of commercial property. Fiscal notes conducted by JLBC estimate a NAV reduction of \$669.2M in TY 2022 and \$1.39B in TY 2023.³⁰

Under the state's K-12 Basic State Aid (BSA) funding formula, the estimated NAV reduction would increase the BSA formula cost by \$24.6 million in FY 2023 and \$51.1 million in FY 2024, according to JLBC. However, under Arizona's Truth in Taxation (TNT) provision for equalization assistance to schools, the Qualifying Tax Rate (QTR) and State Equalization Tax Rate (SETR) are automatically increased to ensure the same amount of property tax levies. Therefore, due to the automatic TNT adjustments of the QTR and SETR, there would be no impact on the state's BSA, meaning that funding for K-12 public schools would not be reduced.³¹

Improved Competitiveness

The reduction in the commercial assessment ratio would improve Arizona's competitiveness. If the commercial assessment ratio was lowered from 18% to 17%, the effective tax rate in Phoenix for industrial property would decline from 1.90% to 1.79%. This would move Phoenix from being ranked 10th for highest effective tax to 15th. The commercial office ranking would improve Phoenix's position from being 20th highest to 23rd highest.

When site selectors are evaluating locations for business expansions or relocations, improvements in metro Phoenix's ranking could make a meaningful difference in whether a city in Arizona is ultimately chosen. Thus, the local economy will receive the benefits of new jobs, investment, overall economic activity and government revenues.

²⁸ See Arizona Senate Bill (SB) 1108 (<https://www.azleg.gov/legtext/55leg/1R/bills/SB1108S.pdf>)

²⁹ See Arizona Senate Bill (SB) 1108 (<https://www.azleg.gov/legtext/55leg/1R/bills/SB1108S.pdf>)

³⁰ See JLBC Fiscal Note (<https://www.azleg.gov/legtext/55leg/1R/fiscal/SB1108.DOCX.pdf>)

³¹ See JLBC Fiscal Note (<https://www.azleg.gov/legtext/55leg/1R/fiscal/SB1108.DOCX.pdf>)



Moving from a Commercial Assessment Ratio of 18% to 17%								
Residential Houses			Commercial Office Property		Industrial Property			
	Rank	Tax Rate		Rank	Tax Rate			
Houston, TX	14	1.71%	Houston, TX	17	2.29%	Houston, TX	4	2.29%
Phoenix, AZ	24	1.25%	Denver, CO	18	2.22%	Phoenix, AZ	15	1.79%
Los Angeles, CA	33	1.16%	Phoenix, AZ	23	2.02%	Denver, CO	16	1.78%
Las Vegas, NV	35	1.11%	Salt Lake City, UT	39	1.26%	Salt Lake City, UT	37	1.02%
Boise, ID	43	0.80%	Boise, ID	42	1.20%	Boise, ID	40	0.99%
Salt Lake City, UT	46	0.71%	Los Angeles, CA	43	1.17%	Los Angeles, CA	41	0.94%
Denver, CO	50	0.56%	Las Vegas, NV	44	1.12%	Las Vegas, NV	42	0.90%

Source: Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence.

If the commercial assessment ratio is reduced further to 15%, the state would realize additional economic benefits. If the commercial assessment ratio was lowered to 15%, the effective tax rate in Phoenix for industrial property would decline from 1.90% to 1.58%. This would move Phoenix from being ranked 10th highest in the nation to 19th. The commercial office ranking would move Phoenix from 20th to 27th.

Moving from a Commercial Assessment Ratio of 18% to 15%								
Residential Houses			Commercial Office Property		Industrial Property			
	Rank	Tax Rate		Rank	Tax Rate			
Houston, TX	14	1.71%	Houston, TX	17	2.29%	Houston, TX	4	2.29%
Phoenix, AZ	24	1.25%	Denver, CO	18	2.22%	Denver, CO	16	1.78%
Los Angeles, CA	33	1.16%	Phoenix, AZ	27	1.79%	Phoenix, AZ	19	1.58%
Las Vegas, NV	35	1.11%	Salt Lake City, UT	39	1.26%	Salt Lake City, UT	37	1.02%
Boise, ID	43	0.80%	Boise, ID	42	1.20%	Boise, ID	40	0.99%
Salt Lake City, UT	46	0.71%	Los Angeles, CA	43	1.17%	Los Angeles, CA	41	0.94%
Denver, CO	50	0.56%	Las Vegas, NV	44	1.12%	Las Vegas, NV	42	0.90%

Source: Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence.

When examining economic fundamentals, individual categories cannot be fully separated. In other words, the shift in property tax burden, when combined with other fundamentals, will ultimately lead to additional economic growth.

Property tax payments are typically factored into the rent a tenant pays. Many small businesses were significantly impacted by the COVID-19 pandemic. Building owners and landlords worked with their tenants to temporarily modify rents to help these local merchants survive. Moving forward, a reduction in the property tax assessment ratio has the potential to provide additional relief to small businesses in the form of lower rent payments.

Further, this review clearly identifies a tax category that is uncompetitive, and modifications to the assessment ratio will yield positive economic benefits. Continuing to reduce the rate to 15% over time will produce similar benefits.