Proposition 130
Constitutional Property Tax Exemptions
Fiscal Analysis

Estimated Impact

Proposition 130 would provide a property tax exemption for veterans with service- or nonservice-connected disabilities in direct proportion to the percentage rating of the veteran's disability.

The proposition could have a net General Fund cost of $1.6 million beginning in TY 2023, or FY 2024 for budgetary purposes. The proposition would reduce net assessed valuation (NAV), which would increase the state's Basic State Aid (BSA) cost for K-12 schools. At the same time, the proposition would also reduce the cost of the Homeowner's Rebate (HOR) program, under which the state pays 50% of a homeowner's primary school district tax.

This $1.6 million net cost increase would be more than offset by savings under the automatic school tax rate adjustments provided by under the state's Truth-in-Taxation (TNT) provisions. If such TNT savings were incorporated, the General Fund would realize a net savings of $(1.0) million, beginning in FY 2024.

The General Fund net savings under TNT would occur for the following reasons. First, the TNT calculation automatically increases the Qualifying Tax Rate (QTR), which is the statutory K-12 school tax rate, to offset the decrease in levies that would otherwise result from the NAV loss attributable to the proposition. This rate increase has the effect of essentially eliminating the Basic State Aid cost increase that would otherwise occur under the proposition.

Second, since the TNT calculation would result in a higher QTR, the property tax burden would shift from veterans with disabilities to other property taxpayers, especially owners of non-residential property (including commercial property). This tax shift has the effect of reducing the state cost for the HOR program.

The proposition allows the Legislature to determine in statute the maximum amount, income limit, and assessment limit for the new property tax exemption for veterans with disabilities.

Under the proposition, the Legislature would also be able to determine in statute the maximum amount for the existing agricultural and business personal property exemption. The proposition does not change the current maximum amount for the agricultural and business personal property exemption. To the extent that the Legislature raises the exemption level in future years, there would be a General Fund impact. We cannot determine the magnitude of this impact in advance.

Analysis

<u>Background</u> – Under the current Arizona Constitution, widows, widowers, and persons with total and permanent disabilities are eligible to receive a property tax exemption. The exemption is subject to both income and property assessment limits, which are adjusted for inflation each year. For TY 2022, the assessed value of the property cannot exceed $28,459, which corresponds to a limited property value (LPV) of $284,590. In addition, household income cannot exceed $34,901 (or $41,870, if minor children or children with total and permanent disabilities reside in the household). The exemption amount is limited as well. As with the income and assessment limits, the exemption limit is also indexed to inflation. For TY 2022, the maximum allowable exemption amount for widows, widowers, and persons with total and permanent disabilities is $4,188.

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The proposition would provide a property tax exemption to veterans with service- or nonservice-connected disabilities. The amount of the exemption would be in direct proportion to the percentage rating of the veteran's disability. As an example, a veteran with a disability rating of 50% would receive a property tax exemption equal to 50% of the maximum allowable exemption. However, a person who qualifies for more than one exemption (e.g., if a person is both a widower and a veteran with a disability) would be eligible to claim only one such exemption.

In addition to creating a property tax exemption for veterans with service- or nonservice-connected disabilities, the proposition would remove the constitutional limit for the exemption for agricultural and business personal property. Currently, the Arizona Constitution and A.R.S. § 42-11127(B) provide a limited exemption for business and agricultural personal property and adjust the exemption amount for inflation each year. For TY 2022, the maximum amount of the exemption is $207,366 of full cash value. Under the proposition, the Legislature would be allowed to determine the exemption amount for agricultural and business personal property in statute. As a result, in the future, the Legislature could change these amounts without voter approval. The proposition does not change the current maximum exemption amount.

Cost Estimate – According to the Arizona Department of Veterans' Services (ADVS), there are 110,345 veterans with disability ratings of at least 10%, but less than 100%, in Arizona. Our analysis assumes that veterans with disability ratings of 100% are already currently eligible for the property tax exemption. The distribution of veterans with each disability rating is displayed in *Table 1* below.

Table 1

Arizona Veterans with Disabilities

Disability Rating 1/	**Veterans**
10%	23,256
20%	10,808
30%	9,926
40%	9,796
50%	8,035
60%	11,471
70%	12,780
80%	12,811
90%	11,462
Total	**110,345**

1/ Disability rating is available only for veterans with service-connected disabilities. Analysis assumes the same disability rating for veterans with nonservice-connected disability.

According to estimates by the Housing Assistance Council, the homeownership rate among Arizona veterans is 76.6%. Based on this estimate, our analysis assumes that 84,524 of the 110,345 Arizona veterans with disability ratings of between 10% and 90% reside in homes owned by them.

To qualify for the exemption, the veteran's household income cannot exceed $34,901 (or $41,870, if minor children or children with total and permanent disabilities reside in the household). For the purpose of determining eligibility, this amount does not include cash public assistance, social security payments, and veterans' disability pensions.

According to the American Community Survey, 74% of Arizona veterans have wages or salary income of less than $34,901 (in 2020 inflation-adjusted dollars). Wages or salary income excludes cash public assistance, social security payments, and retirement income. As a result, we assume that 74% of the 84,524 homeowners that are veterans

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with disabilities have income below the proposition's income limit. This means that the number of veterans potentially exempted under the proposition is reduced from 84,524 to 62,962.

In addition, to qualify for the exemption, the home's LPV cannot exceed $284,590. The average statewide LPV of a primary residence is $210,638. Our analysis assumes that 80% of the 62,962 homes owned by veterans with disability ratings of between 10% and 90%, or 50,371 primary residences, have a LPV of $284,590 or less. The exemption amount for the 50,371 homes that are assumed to be eligible for the exemption is calculated based on the veteran's disability rating up to the maximum allowable amount under this proposition of $4,188.

For example, a qualified veteran with a disability rating of 20% and whose home is valued at $180,000 (and therefore with a corresponding net assessed value of $18,000), would receive an exemption of $838 [= $4,188 x 20%]. This means that the net assessed value (NAV) of the veteran's home would be reduced from $18,000 to $17,162.

Based on the data provided by ADVS regarding the distribution of Arizona veterans' disability ratings, we estimate that the proposition would reduce statewide NAV by approximately $(99.0) million.

By reducing NAV by $(99.0) million in TY 2023, the proposition would result in a direct cost increase of the Basic State Aid (BSA) program by $3.2 million, beginning in FY 2024. The $(99.0) million Class 3 (primary residence) NAV reduction would also have the effect of reducing the cost of the Homeowner's Rebate (HOR) by an estimated $(1.6) million. The direct net impact on the 2 state programs is a cost increase of $1.6 million, beginning in FY 2024.

Truth-in-Taxation (TNT) Impacts – The NAV reduction under the proposition would also have an impact on the state's TNT program. Under TNT, the Qualifying Tax Rate (QTR) is adjusted each year to offset the statewide annual valuation change of existing property. This rate change occurs automatically unless the Legislature decides to forgo the TNT adjustment. Due to the $(99.0) million NAV loss, the TNT adjustment would result in the QTR being an estimated 0.42¢ higher in FY 2024 under the proposition than under current law. The QTR increase of 0.42¢ under TNT would generate a small net savings of $(153,400) for the BSA program. This savings is attributable to the higher QTR generated on new construction under the proposition than under current law. After including the impact of TNT, the proposition would produce a net General Fund savings of $(1.0) million, of which $(153,400) is for the BSA program and $(838,700) is for the HOR program.

The $(1.0) million General Fund savings is primarily attributable to 2 factors: (1) the lower NAV for Class 3 property owned by veterans with disabilities receiving the exemption and (2) the higher QTR resulting from the TNT adjustment. The combined effect of these 2 factors is summarized in *Table 2* below.

Table 2

QTR Tax Shift and Change in HOR Cost

Property Class	**Change in QTR Levy**	**Change in HOR Cost**	**Change in Net QTR Levy**
Non-Class 3 – commercial and other	$1,830,800	$0.0	$1,830,800
Class 3 – other than veterans with disabilities	1,386,000	693,000	693,000
Class 3 – veterans with disabilities	(3,063,400)	(1,531,700)	(1,531,700)
Total Net Change	**$153,400**	**$(838,700)**	**$992,100**

The combination of lower Class 3 NAV and higher QTR would result in a QTR levy decrease of $(3.1) million for veterans with disabilities receiving the exemption. As shown in *Table 2*, the $(3.1) million savings incurred by veterans with disabilities would be shifted to other Class 3 (owner-occupied residential) as well as non-Class 3

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(commercial, rental residential, etc.) property owners in the amount of $1.4 million and $1.8 million, respectively. (The total net QTR levy increase of $153,400 is due to the higher QTR levied on new construction under the proposition than under current law.) These are the tax shifts before the HOR is applied. Under the HOR program, the state pays 50% of the QTR levied on Class 3 property. The remaining 50% is paid by the homeowner. Other classes of property do not receive the 50% QTR reduction.

As shown in *Table 2*, of the $1.4 million QTR increase on other Class 3 property, $693,000 would be paid by the General Fund in the form of higher HOR cost, while the remaining $693,000 would be paid by homeowners not receiving the exemption. Therefore, the QTR tax shift to other Class 3 property, net of HOR, would be $693,000. Since commercial and other non-Class 3 properties do not receive HOR, the tax shift for this category would remain at $1.8 million. The $(3.1) million QTR levy reduction on homes owned by veterans with disabilities would not be fully realized by them. Instead, the state General Fund would receive 50% of this savings, or $(1.5) million. The remaining $(1.5) million represents the net savings realized by veterans with disabilities.

In summary, the state General Fund impact of the proposition depends on whether the TNT impact is included or not. In the absence of a TNT adjustment, the projected General Fund cost under the sample scenario is $1.6 million, beginning in FY 2024. If the QTR is adjusted to account for TNT, however, the proposition would generate net General Fund savings of $(1.0) million, beginning in FY 2024. This amount includes the combined savings from both the BSA and the HOR programs. The General Fund savings would primarily occur due to a tax shift from veterans with disabilities to other property owners. To a smaller extent, such savings would also be generated from higher QTR levies on property added to the tax roll for the first time in FY 2024.

Local Government Impact

Apart from the QTR shift described above, the proposition could also result in a tax shift of other primary as well as secondary taxes levied by local taxing jurisdictions, such as counties, community college districts, cities, school districts and special taxing districts. The amount of such tax shifts would depend on the extent to which local taxing jurisdictions would raise their tax rates to make up for the loss of levies under the proposition.

Table 3 below shows the maximum potential shift of total (primary plus secondary) property taxes under the proposition.

Table 3

Maximum Potential Property Tax Shift
($ in Millions)

Property Class	Primary Tax Shift	Secondary Tax Shift	Total Tax Shift
Non-Class 3 – commercial and other	$4.1	$2.3	$6.4
Class 3 – other than veterans with disabilities	2.4	1.7	4.1
Class 3 – veterans with disabilities	(5.5)	(4.0)	(9.5)
General Fund	(1.0)	0.0	(1.0)
Total Net Change	**$0.0**	**$0.0**	**$0.0**

The estimates included in *Table 3* assume that taxing jurisdictions would levy the same amount under the proposition as under current law. Under this assumption, veterans with disabilities would have a total tax reduction of $(9.5) million. The higher QTR under the proposition would generate total General Fund savings of $(1.0) million. This means that under the assumption that local taxing jurisdictions would set their rates in a

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manner that would "hold harmless" their own revenues, the savings realized by veterans with disabilities of $(9.5) million and by the General Fund of $(1.0) million would essentially be "paid for" in the form of a tax shift of $6.4 million to non-Class 3 property and $4.1 million to Class 3 property (other than that owned by veterans with disabilities), for a total of $10.5 million.

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