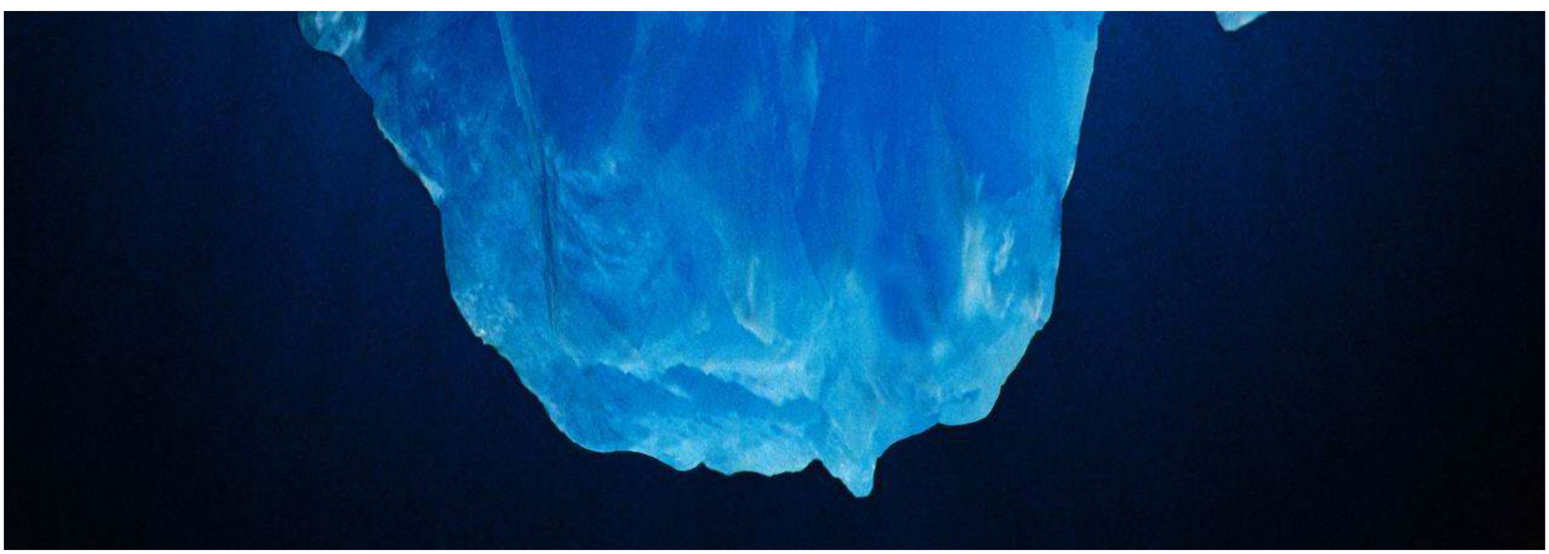
Iceberg Ahead

THE HIDDEN TAX INCREASE
BELOW THE SURFACE OF THE GALLAGHER FORMULA



A JOINT ANALYSIS OF PROPERTY TAX REVENUE TRENDS BY:

NFIB

BOULDER CHAMBER

Colorado Springs CHAMBER & EDC

COLORADO CONCERN

ABOUT NFIB IN COLORADO

For more than 77 years, NFIB has been advocating on behalf of America's small and independent business owners, both in Washington, D.C., and in all 50 state capitals. NFIB is a nonprofit, nonpartisan, and member-driven association. Since its founding in 1943, NFIB has been exclusively dedicated to small and independent businesses and remains so today.

ABOUT THE COLORADO SPRINGS CHAMBER & EDC

Serving as the area's largest chamber of commerce and economic development organization, the Colorado Springs Chamber & EDC works to build and maintain a superior business climate in which companies of all kinds can thrive, and supports current and future local business to fuel a diverse economy and high quality of life.

ABOUT THE BOULDER CHAMBER

The nonprofit Boulder Chamber is the region's flagship business advocacy and support organization. With more than 110 years of dedicated service to our members and the Boulder community, the Boulder Chamber's innovative programs help local businesses succeed while sustaining an economy that preserves Boulder's high quality of life, including its environmental and cultural assets.

ABOUT COLORADO CONCERN

Colorado Concern is a statewide CEO-based organization devoted to investing in and promoting a pro-business environment through the political process. Founded in 1986 by one dozen committed individuals, Colorado Concern's membership now includes more than 130 CEOs and business and community leaders from across the state.

Acknowledgment

We appreciate the assistance of Simon Lomax in conducting the research and developing the findings of this report. Mr. Lomax is a researcher and adviser to free-enterprise groups and business coalitions, a former congressional fellow with the American Political Science Association and a former Bloomberg News reporter. Based in Denver, Mr. Lomax has served as a policy adviser to a number of business groups and coalitions on Colorado's property tax system, including the campaign in support of Amendment B.

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FOREWORD

The Gallagher Amendment and its many layers of complexity is the focus of a high stakes public debate as voters consider Amendment B, a ballot measure that would repeal the 1982 property tax law.

At its core, Gallagher establishes statewide rules for how local governments and other local districts impose property taxes. Those rules require commercial property owners — namely, small businesses, farmers, ranchers and manufacturers — to pay a property tax rate 4 times higher than residential property owners. If the Gallagher Amendment is not repealed, next year those commercial property owners will be required pay an assessment rate 5 times higher than residential.

What is less well understood, and until this report largely unexamined by either legislative analysts or outside policy observers, is the cascading impact of the Gallagher formula on many thousands of local property tax mechanisms all across the state. Like an iceberg, the biggest and most destructive elements of the Gallagher formula lie beneath the surface, hidden from view.

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To start with, Gallagher's statewide rules require business owners to pay 4 times the tax that residential owners pay on the same amount of property value. And if Gallagher isn't repealed, this ratio will soon increase to 5:1.

But for local businesses, what makes this shifting burden even more ominous is a large and growing class of so-called automatic local mill levy increases. Sometimes these come in the form of a floating mill levy, other times they come in the form of a bond repayment levy, and sometimes they take the form of mill levy overrides. Whatever the form, voters have given authority in advance for mill levies to increase administratively instead of putting every future adjustment on the ballot for a standalone vote.

Typically, these automatic local tax increases are structured so that any loss of revenue a district experiences as a result of the Gallagher Amendment is immediately recouped by an offsetting new property tax increase at the local level.

However, the next round of tax increases triggered by the Gallagher Amendment will be especially punishing for the state's job creators, because they will pay for that tax hike at a rate of 5-1. That is unless voters approve Amendment B, which according to the text of the ballot question, would repeal Gallagher "to avoid automatic mill levy increases" triggered by the state-imposed formula.

This report is the first attempt we are aware of to quantify the cumulative cost and impact of these automatic local property tax increases, should the Gallagher Amendment remain in effect in 2021. At the start of this project, we discovered there was no single database or comprehensive record-keeping for all these tax provisions. Data was scattered across state agencies, county offices and lists independently compiled by trade associations and non-profit groups.

The size of these automatic property taxes is pertinent to the debate over the future of the Gallagher Amendment because (1) these self-executing tax hikes significantly water-down the purported benefits that homeowners receive from the Gallagher Amendment; and (2) these automatic property tax hikes increase the property tax burden on the state's local businesses at a rapidly compounding rate.

Every time the statewide Gallagher formula resets, it shrinks the property tax base of thousands of local districts without their consent. Many of the communities served by those local districts are then forced to choose between crippling budget cuts or higher mill levies.

To be clear: The communities that have approved adjustable mill levies, or are contemplating them, bear no responsibility for this. The Gallagher Amendment, which started out 38 years ago with the best of intentions, now puts these communities into an impossible position.

Every time the statewide Gallagher formula resets, it shrinks the property tax base of thousands of local districts across the state without their consent. Many of the communities served by those local districts are then forced to choose between crippling budget cuts for essential services, or higher mill levies to reverse the damage caused by Gallagher.

But when those mill levies are increased, an arbitrary statewide formula mandates that small businesses pay 4-5 times more than other property owners. Once again, this punitive tax policy against the job creators of our state is enforced without the consent of the local communities that are simply trying to maintain adequate funding for essential services using one of the only tools they have.

This situation is untenable. It cannot continue indefinitely. But it has remained hidden from view in discussions over the Gallagher formula and the debate over Amendment B. This report aims to change that.

EXECUTIVE SUMMARY

For almost 40 years, a statewide formula known as the Gallagher Amendment has reduced the housing market's share of Colorado's property tax base. Next year, the percentage of the housing market subject to property taxes – known as the residential assessment rate, or RAR – is projected to fall from 7.15% to 5.88%.

This is highly unlikely to deliver any real reduction in property taxes, however. In fact, historical data and forecasts prepared by the Colorado Department of Local Affairs indicate a **$975.7 million tax increase will occur because of the Gallagher Amendment over the next 1-3 years.**

While all property owners will be impacted, the vast majority of this tax increase will be paid by businesses, farms, ranches and other non-residential property owners. This is because, starting in 2021, the Gallagher formula will tax business and agricultural property at a rate five times higher than residential property, according to DOLA forecasts.

We estimate **the Gallagher formula will trigger $811.2 million in new taxes for Colorado businesses, farms, ranches and other job creators across the state.** This increase will hit small businesses and other enterprises at an extremely vulnerable time, as they struggle to keep their doors open and keep paying their employees due to the COVID-19 recession.

We estimate **at least $305.6 million in tax increases on businesses and homeowners will occur immediately** because they have already been authorized by local voters in the form of floating mill levies, mill levy overrides, repayment of bonds and other measures that can automatically adjust in response to the Gallagher formula. These automatic tax increases will take place in 62 of Colorado's 64 counties, impacting 99% of the state's population. Under the Gallagher formula, **small businesses and other commercial property owners would be responsible for $254.1 million of these higher taxes.**

There are also dozens of proposed floating mill levies on the ballot this November, and if these proposals are approved by local voters, **the immediate tax increase in 2021 could climb to $324.9 million, with businesses required to pay $270.2 million of the total.**

In practice, under a 5.88% RAR in 2021, this means the **Gallagher formula will be responsible for a tax hike of more than $300 million next year, while at the same time cutting budgets for essential local services by more than $650 million.**

History shows that communities will not be able to withstand these budget cuts for long. Based on a historical review of the last major change in the Gallagher formula's RAR, **we expect $650.8 million to $670.1 million of tax increases on businesses and homeowners will be approved within 1-3 years,** as voters in most parts of the state choose higher mill levies over cuts in essential services, as they have done before.

Taken together, the historical data and forecasts show that the Gallagher Amendment's real impacts are much different than its supporters would have the public believe. What has been sold to the public as a tax cut is actually a major tax increase, with small businesses and other employers footing most of the bill, and homeowners getting shortchanged on the tax relief promised by defenders of the Gallagher formula.

The Gallagher tax increase may be hidden across hundreds of cities, counties, school districts and other local tax authorities, but the impacts are painfully real. Left unchecked, the Gallagher tax's punishing impact on job creation and business investment will only prolong Colorado's recovery from the COVID-19 recession.

Section 1

HOW WILL THE GALLAGHER AMENDMENT IMPACT THE STATE'S PROPERTY TAX SYSTEM IN 2021?

A mix of statewide and local policies are used to determine property tax obligations in Colorado. For the vast majority of property in Colorado, the method for calculating the amount of property taxes owed is as follows:

Actual Value
(Locally Determined)

X

Assessment Rate
(State Determined)

X

Mill Levy
(Locally Determined)

=

Property Tax Due

The Gallagher Amendment, which was originally passed in 1982, created a formula that controls the assessment rate – or how much of a property's actual value will be subject to local mill levies. For 38 years, the Gallagher formula has kept the assessment rate for commercial, agricultural and other non-residential property classes fixed at 29%. However, the formula has required reductions in the assessment rate for residential properties, from 21% in 1983 to its current level of 7.15%.

Starting next year, the Gallagher formula is projected to reset the residential assessment rate once again, this time to 5.88%. In practice, this change will reduce the residential assessment rate in absolute terms by almost 18% between 2020 and 2021.

This change also means that retail stores, restaurants, office space, industrial buildings, farms, ranches and other forms of commercial property in a community could soon be taxed at a rate five times higher than residential property in the same community. This is because a 5.88% RAR under the Gallagher formula will force local governments and other tax districts to demand 4.93 times more tax from a business owner than a residential owner on the same amount of property value.

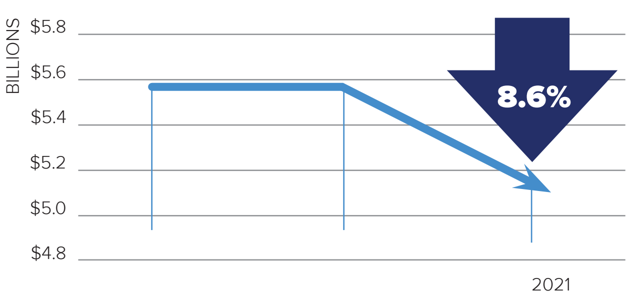
To inform policymakers and the public about the likely impacts of the Gallagher formula next year, the Division of Property Taxation at the Colorado Department of Local Affairs (DOLA) prepared an analysis of the new 5.88% residential assessment rate, or RAR.[i]

To account for recent economic trends amid the COVID-19 recession, the DOLA analysis also produced the following 2021-2022 valuation forecast for three major property classes:

DOLA then applied a 5.88% RAR under the Gallagher formula to school district and county budgets. The resulting forecast indicated major revenue impacts in 2021 – for example, DOLA estimated an initial revenue loss of $490.8 million for school districts across the state.

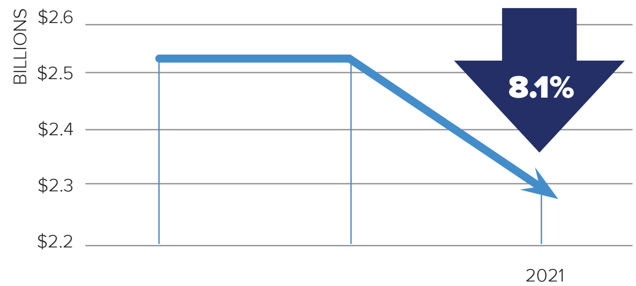
In proportional terms, these initial projected impacts represent losses of between 8% and 9% for school districts and counties across the state.

2021 Gallagher Formula: Potential Revenue Impact on Schools



Source: DOLA Division of Property Taxation

2021 Gallagher Formula: Potential Revenue Impact on Counties



Source: DOLA Division of Property Taxation

However, these initial projected impacts carry an important qualifier: According to DOLA, they do not account for anticipated increases in local mill levies, which have become a common strategy to claw back potential revenue losses under the Gallagher formula.

State Property Tax Administrator JoAnn Groff explained this trend in recent guidance to the state's Joint Budget Committee:

> ***[I]t is important to note that numerous taxing jurisdictions across the state do not have a static mill levy. Many levies are already voter approved to float up if/when the assessed value of the district drops.***

Administrator Groff cited a number of examples, including special districts that already have voter approval to increase mill levies in response to revenue shortfalls, and school districts with bond and override levies that were passed to bolster local K-12 education services.[ii]

The examples of floating mill levies provided by DOLA describe a large number of local tax authorities covering most of the state's population, businesses and jobs.

Section 2

HOW WIDESPREAD ARE FLOATING MILL LEVIES AND OTHER AUTOMATIC TAX INCREASES TRIGGERED BY THE GALLAGHER FORMULA?

Colorado has thousands of local-level entities with the authority to impose property taxes. Between counties, municipalities, school districts, fire protection districts, parks and recreation districts, hospital districts, library districts, metropolitan districts and many other kinds of special districts, there are more than 4,500 local tax authorities all across our state.

This analysis sought to identify the number of counties in Colorado where a floating mill levy or some other kind of automatic adjustment forms part of the local tax base. Our intention was not to produce an exhaustive assessment, down to every last dollar and cent, of property taxes that automatically adjust to changes in the Gallagher formula. Instead, this analysis was designed to produce a conservative estimate of the local-level tax consequences and a directional sense of the financial impacts if the Gallagher formula resets next year at the level forecasted by DOLA.

Our high-level review of local tax authorities concluded that floating or otherwise adjustable mill levies can be found across the vast majority of the state. Based on DOLA's guidance and data from the 2019-2020 property assessment cycle, our analysis identified dozens of counties where voters have already authorized local tax districts to increase mill levies in response to the Gallagher formula next year.

Prevalence of Adjustable Mill Levies in Colorado

Category	Number of Counties	% of Colorado population
Special districts with floating mill levy or other automatic adjustment	34	92%
School districts with bond levies and/or override levies	62	99.9%

Sources: DOLA Guidance, 2019-2020 Property Tax Data, County Population Estimates

These mill levies are tied to fire districts, local college districts, metropolitan districts, parks and recreation districts, school districts and other tax authorities. In many cases, the floating mill levy was approved by voters relatively recently, in response to another change in the Gallagher formula that occurred after the 2015-2016 property tax cycle.

For example, in the 2018 election alone, more than 120 fire protection, ambulance, hospital, library, metropolitan, water and recreation districts asked voters to provide relief from the Gallagher formula.[iii] So-called measures to "de-Gallagherize" or provide "Gallagher stabilization" included language that would allow mill levies to be increased automatically without further voter approval to prevent revenue losses due to the Gallagher formula.

A few months before the 2018 election, the move towards automatic mill levy increases was endorsed by former State Senator Dennis Gallagher, for whom the Gallagher formula is named. Testifying to a panel of state lawmakers in July 2018, Senator Gallagher encouraged the approval of floating mill levies instead of one-off elections to increase mill levies under the Taxpayer's Bill of Rights (TABOR)[iv]:

> ***Any problems with Gallagher are really because of the loathsome interaction with TABOR. So with that in mind, I hope you'll look at the idea of the floating mill levy, which allows any taxing district to raise as much revenue in the year following appraisal as in the previous year.***

However, while automatic mill levy increases may stabilize total revenues, the Gallagher formula does not evenly distribute those increases across the tax base. As the Common Sense Institute noted in a recent study, whenever mill levies are increased in response to the Gallagher formula, small businesses and other commercial property owners face much larger tax increases than anyone else[v]:

> ***While an increase in mill levy rates requires a vote of the people in many jurisdictions, a growing number of taxing jurisdictions already have approval to automatically raise mills in response to lost revenues under the Gallagher Amendment. …***
>
> ***These automatic increases are known as "floating" mill levies, and while they are designed to keep residential property taxes relatively stable, they also trigger significantly higher property tax increases on businesses and other non-residential property owners. For example: Under a residential assessment rate of 5.88% and a non-residential assessment rate of 29%, the impact of a mill levy increase will be almost 5 times greater for a business than for a homeowner.***

When the widespread use of floating mill levies is combined with the projected revenue impacts of the Gallagher formula next year, one thing becomes clear: Many local mill levies will automatically increase, and businesses will be hit five times harder than other property owners.

But how much does that mean in dollar terms? Using DOLA's guidance to lawmakers as a starting point, the amount of the tax increase can be quantified.

Section 3

HOW MUCH COULD THE GALLAGHER FORMULA RAISE BUSINESS PROPERTY TAXES IN 2021?

According to DOLA projections, the impact of a 5.88% RAR under the Gallagher formula – before automatic local mill levy adjustments – is a revenue loss of between 8% and 9% in 2021. However, as DOLA has described, many taxing jurisdictions have mill levies that "float up" immediately to keep revenues at their current level.

Having identified the counties where floating mill levies form part of the tax base, this analysis carried out a review of revenue data reported to DOLA during the 2019-2020 property tax cycle. An 8% potential loss in revenue was assumed, at the low end of the range in DOLA's guidance to state lawmakers. But even at this level, the impact of hundreds of school districts, special districts and other local tax jurisdictions increasing mill levies to offset this reduction can be measured in the hundreds of millions of dollars.

Overall, an 8% revenue impact triggers $305.6 million in automatic mill levy increases statewide. However, while this keeps total revenues stable in these districts, the Gallagher formula dramatically changes who pays. The increase in taxes for business property owners will be almost five times higher than the increase for residential property. In practice, this means stores, restaurants, farmers, ranchers and other business owners will pay 83% of any increase in local mill levies needed to offset the Gallagher formula's revenue impacts.

In dollar terms, this amounts to a $254.1 million tax increase on businesses of all sizes across the state of Colorado, and a $51.5 million increase for residential property owners.

Automatic Gallagher Tax Increases in 2021

Category	Amount
Estimated automatic mill levy increase (2021)	$305.61 million
Business share (29% assessment rate)	$254.09 million
Residential share (5.88% assessment rate)	$51.52 million

Sources: DOLA Guidance, 2019-2020 Property Tax Data

Categories of Automatic Gallagher Tax Increases in 2021

Category	Amount	Business share (29% assessment rate)	Residential share (5.88% assessment rate)
School Districts: Bonds	$99.22 million	$82.50 million	$16.73 million
School Districts: Mill Levy Overrides	$109.05 million	$90.67 million	$18.38 million
Local Tax Authorities: Floating Mill Levies	$77.71 million	$64.61 million	$13.10 million
Local Tax Authorities: Bonds	$19.62 million	$16.31 million	$3.31 million
TOTAL	**$305.61 million**	**$254.09 million**	**$51.52 million**

Sources: DOLA Guidance, 2019-2020 Property Tax Data

These property tax increases are distributed across school districts, fire protection districts, metropolitan districts and many other kinds of local taxing jurisdictions with mill levies that adjust to stabilize revenues, service bond-related debt and otherwise maintain services for the communities they serve. It should also be noted that local taxing authorities have no control over the state-level Gallagher formula and how it distributes the tax burden between different kinds of property owner.

Automatic property tax increases of $305.6 million under a Gallagher RAR of 5.88% are not the end of the story for property owners in 2021, however. The number of local tax authorities with automatic mill levy increases triggered by the Gallagher formula is on the rise, and in this November's election, at least 33 counties, municipalities, fire districts and other special districts will ask voters to authorize these automatic increases in order to prevent revenue losses and service cuts. Based on a review of these local tax authorities, their operational budgets from the 2019-2020 property tax cycle and the recent guidance provided to lawmakers by DOLA, these measures may result in a combined $19.3 million increase in local mill levy increases if the Gallagher formula changes the statewide RAR from 7.15% to 5.88% next year.

Proposals on November Ballot for Automatic Gallagher Tax Increases in 2021

Category	Amount
Estimated Mill Levy Increase Under 5.88% RAR	$19.33 million
Business share (29% assessment rate)	$16.07 million
Residential share (5.88% assessment rate)	$3.25 million

Sources: Municipal and County Election Records, DOLA Guidance, 2019-2020 Property Tax Data

Range of Automatic Gallagher Tax Increases in 2021

Category	Amount	Business share (29% assessment rate)	Residential share (5.88% assessment rate)
Existing	$305.61 million	$254.09 million	$51.52 million
Existing and Proposed	$324.94 million	$270.17 million	$54.78 million

Sources: Municipal and County Election Records, DOLA Guidance, 2019-2020 Property Tax Data

In practical terms, based on DOLA's guidance to lawmakers and a forecasted Gallagher RAR of 5.88%, this means a range of automatic property tax increases are likely in 2021 depending on how much the use of adjustable mill levies expands after this year's election.

Section 4

ARE OTHER PROPERTY TAX INCREASES LIKELY UNDER THE GALLAGHER FORMULA?

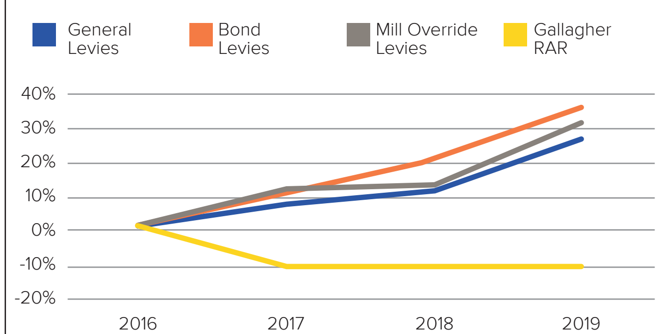
Recent history shows that local taxing jurisdictions respond to major changes in the Gallagher formula by increasing mill levies. These increases, which can be automatic or approved by voters on a case by case basis, are used to claw back revenue losses as quickly as possible, and in some instances, stay one step ahead of projected budget shortfalls.

For example: In 2016, after more than a decade of relative stability, it became clear that a major adjustment in the Gallagher formula was on the horizon. The Gallagher RAR, which had remained stable at 7.96% from 2003 to 2016, fell to 7.2% in 2017 and fell again to 7.15% in 2019.

In absolute terms, this reduced the overall share of residential property subject to taxation in Colorado by roughly 10%. But between 2016 and 2019, the amount of revenue collected from property taxes actually increased.

To be sure, some of this increase was a function of increased property values and population growth in Colorado. But data compiled by DOLA also shows that the reduction in the Gallagher formula's RAR was followed by significant increases in a number of key local property tax rates. Specifically, the 10% reduction in the Gallagher RAR was accompanied by a 27% increase in cumulative mill levies for general local government operations, a 32% increase in mill levy overrides used to finance K-12 schools, and a 36% increase in cumulative mill levies used to finance bonds.

Cumulative Mill Levies vs. Gallagher RAR: Percentage Change 2016-2019



Source: DOLA Division of Property Taxation Data

This is a critically important historical lesson for the next major reset of the Gallagher formula, which is expected in 2021.

As discussed earlier in this analysis, automatic mill levy increases that already exist or are currently before voters are likely to increase local property taxes by $305.6 million to $324.9 million across all property classes, with small businesses and other non-residential property owners shouldering approximately 83% of the increase.

But as the reset of the Gallagher formula between 2016 and 2019 has demonstrated, automatic mill levy adjustments are just the beginning.

Whenever the Gallagher formula resets, local districts without the ability to adjust mill levies automatically are often faced with immediate and drastic budget cuts that threaten the core services they were established to provide.

During the same July 2018 hearing that hosted Senator Gallagher, witnesses from local districts explained how they were fighting through the budget predicament created by the reset of the Gallagher formula after 2016. Don Lombardi, who then served as the President of the Colorado State Fire Chiefs, told the hearing:

> ***When we have less firefighters to respond, we have less equipment to use, we have no ability to expand and provide for our future ... the State of Colorado is in peril. ... I'm not quite sure what area, any area, is able to look at reductions of 23% over four years and still provide the high service that we are expected to provide. All at the same time of increasing call volume and increasing expectations.***

Sherrie Baca, the Chief Financial Officer of the Pueblo City-County Library District, also outlined the severe cuts in local services that many local districts were working to avoid:

> ***We are a very lean organization. More than 60% of our annual budget is salaries. That kind of cut over a number of years means really a reduction of services and layoffs and closures of library branches in our district.***

These comments reflect the tremendous pressure that local districts and the communities they serve are under whenever the Gallagher formula causes budget cuts to essential public services. They are forced to choose between an unacceptable loss of services on the one hand or higher local mill levies on the other. The data compiled by DOLA from 2016 to 2019 shows what happens next: Communities with the means to restore the service cuts caused by Gallagher formula choose to restore those cuts within a few years.

Whether mill levies are increased automatically in response to changes in the Gallagher formula, or whether they are increased on a case-by-case by voters, Gallagher triggers increases in local property tax rates. Therefore, it is reasonable to assume that most – if not all – of the revenue impacts identified in the DOLA analysis will be recovered within 1-3 years of the new Gallagher RAR of 5.88% taking effect.

Building upon DOLA's estimate – i.e. 8% of current revenues – it is possible to estimate the total dollar value of the mill levy increase that would be necessary to prevent or claw back the potential losses triggered by the Gallagher formula in 2021.

For example: DOLA estimated the revenue impact of a 5.88% Gallagher RAR to be $490.8 million for school districts in 2021. Based on data from the 2019-2020 property tax cycle, school districts currently account for approximately 50.3% of property tax revenues. Therefore, when 100% of revenue derived from property taxes is factored into DOLA's 2021 forecast, the potential revenue impact of a 5.88% Gallagher RAR is approximately $975.7 million.

Estimated Total Gallagher Tax Increase Over 1-3 Years

Category	Amount
School Districts	$490.79 million
Counties	$203.78 million
Municipalities, Special Districts and Other Local Tax Authorities	$281.15 million
TOTAL	**$975.72 million**

Sources: DOLA Guidance, 2019-2020 Property Tax Data

Based on the lessons from the last major change in the Gallagher RAR, this means local mill levies are likely to increase by almost $1 billion over the next few years, as a combination of automatic adjustments and stand-alone measures seek to reverse the Gallagher formula's erosion of the local property tax base. Assuming a 5.88% RAR and a 29% assessment rate for commercial property owners, this distribution of this increase would be skewed heavily towards retailers, restaurants, manufacturers, farms, ranches and other businesses.

Distribution of Total Gallagher Tax Increase Over 1-3 Years

Estimated Total Gallagher Tax Increase	$975.72 million
Business share (29% assessment rate)	$811.24 million
Percentage of Total Tax Increase	83.1%
Residential share (5.88% assessment rate)	$164.49 million
Percentage of Total Tax Increase	16.9%

Sources: DOLA Guidance, 2019-2020 Property Tax Data

While employers will bear the brunt of these property tax increases, homeowners will be impacted too.

Supporters of the Gallagher formula are quick to point out that changing the Gallagher RAR from 7.15% to 5.88% will reduce the share of residential property value that is subject to taxation in Colorado. However, the full story is more complicated, because as mill levies are increased to counter the Gallagher formula's erosion of the local property tax base, it will result in a higher local property tax rate for homeowners. Based on DOLA's forecasted revenue impacts of a 5.88% RAR, and historical data from the last major reset in the Gallagher formula, these higher local property tax rates are likely to cost residential property owners approximately $164.5 million over 1-3 years. Therefore, when the full implications of the Gallagher formula are weighed, the level of tax relief afforded to homeowners is less than meets the eye. At a minimum, when homeowners are evaluating any promises of tax relief under the Gallagher formula, they should anticipate being shortchanged by at least $164.5 million statewide.

CONCLUSION

Colorado's system of property taxation raises approximately $11 billion per year for essential public services at the local level, including K-12 schools, fire protection, healthcare facilities and water and sewer infrastructure. However, the mix of state and local influences that govern our state's property tax system are not well understood, especially in policy discussions concerning the Gallagher Amendment.

In recent years, a much more complex – and problematic – relationship has developed between the statewide Gallagher formula and the local property tax systems that fund essential services. As the Gallagher formula attempts to shrink the statewide property tax base, it forces local communities to expand the local property tax base by increasing local mill levies. If they don't, they face severe and permanent cuts to essential public services funded by local property taxes.

In some cases, those mill levy increases are automatic. In other cases, they are referred to voters as standalone measures. But the effect is the same: Reductions in the statewide Gallagher formula trigger increases in local property tax rates in communities seeking to maintain essential services at levels they consider to be acceptable.

The recent history of the Gallagher formula in Colorado shows that statewide reductions in the property tax base are quickly offset by increases in local property tax rates within 1-3 years. This analysis attempts to quantify the size of these property tax increases, based on a review of this historical data and recent guidance produced for lawmakers by property tax officials at DOLA on the effect of a 5.88% RAR.

At the same time, because the Gallagher formula also dictates the percentage of these tax increases that must be paid by different classes of property owner, this analysis also estimates the distribution of these higher taxes.

Timeline and Distribution of Estimated Gallagher Formula Tax Increases

YEAR 1	YEAR 2-3	TOTAL
$305.61 – $324.94 million	$650.78 – $670.11 million	$975.72 million
Business share: $254.09 – $270.17 million	**Business share:** $541.07 – $557.15 million	**Business share:** $811.24 million
Residential share: $51.52 – $54.78 million	**Residential share:** $109.71 – $112.97 million	**Residential share:** $164.49 million

Based on this analysis, the Gallagher formula will trigger a series of local property tax increases totaling $975.7 million over 1-3 years. A significant fraction of the total – roughly $305.6 million – will occur in the first year due to automatic mill levy increases that have already been approved by voters at the local level. This figure could grow to $324.9 million if dozens of pending local ballot measures to institute floating mill levies are approved by voters this November.

Under the Gallagher formula, more than 83% of any local property tax increase will be paid by businesses. This means the job creators of our state are facing a potential tax increase of $254.1 million to $270.2 million in 2021. At the end of three years, the likely tax increase on stores, restaurants, manufacturing firms and other businesses will be $811.3 million, according to our analysis.

These potential tax increases may be hidden beneath the surface, but they could deliver a crushing blow to small businesses and other commercial property owners in Colorado in the middle of the worst recession of our lifetimes. Likewise, the resetting of the Gallagher formula next year will also shortchange homeowners on any promised tax reductions by at least $164.5 million over the next few years.

In conclusion, a statewide formula that relies on a single number – the RAR – to govern our property tax system has a simple appeal. Quite possibly, this formula made sense almost 40 years ago when there was much less regional variation in Colorado's local communities and local property tax bases.

But over time, the Gallagher formula's reliance on a single number has made our property tax system less stable and harder to manage. It has become, in fact, a massive unfunded mandate that forces local communities to choose between higher property tax rates or cuts in essential services. And when those property tax rates increase, the vast majority of the tax hike is paid by small businesses and other job creators.

When the Gallagher Amendment was added to the Colorado Constitution 38 years ago, it was designed to cut taxes. But today, the formula no longer cuts taxes – it merely shifts taxes and allows the state to dodge responsibility for those taxes. In the end, local communities and local businesses are left holding the bag.

ENDNOTES

[i] Colorado Department of Local Affairs, Division of Property Taxation: COVID-19 Impact RAR and Local Government Revenues (May 11, 2020)

[ii] Colorado Department of Local Affairs, Division of Property Taxation: Clarification regarding Memo of May 11, 2020 on “COVID-19 Impact RAR and Local Government Revenues” (Sept. 16, 2020)

[iii] The Colorado Sun: Across Colorado, taxpayers granted Gallagher tax relief to a record number of fire protection districts (Nov 12, 2018)

[iv] Alternatives to the Gallagher Amendment Interim Committee (July 13, 2018)

[v] Common Sense Institute: The Inherent Tradeoffs in Amendment B (Sept. 16, 2020)

[vi] Alternatives to the Gallagher Amendment Interim Committee (July 13, 2018)