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1. Introduction

Property taxes. None of us likes them. We especially don't like them when they go up significantly like they have in Idaho, particularly in some parts of our state. In fact, there have been efforts by some to get a voter initiative on the ballot that would limit the rise in property taxes. Concerned that a complicated topic like property taxes may not be effectively addressed through ballot initiative, the Legislature established an interim committee last year to study the issue and come back this year with recommendations.

The result of all this property tax concern is a raft of property tax bills—more than 30—in this session of the Legislature. In Sections 4 through 8 of this brief, we review these proposals. First, however, we provide background information that provides perspective on the debate currently taking place in the Legislature. In Section 2 we review the problem—growth in property taxes—in a little more detail. In Section 3 we review the competing explanations for the rise in property taxes which lead people to different conclusions about the appropriate solutions that we review in Sections 4 through 8.

2. The Problem: Rising Property Taxes

Property taxes have been going up fast in recent years. In 2005 property taxes were up 8.6% statewide over the previous year. In the five years before that, 2000 - 2004, property taxes rose an average of 5.8% each year. But those overall figures mask the growth that is causing so much concern. Taxes on owner occupied homes were up 11.7% on average in 2005. This more rapid rise in taxes on ***residential*** property reflects a long-term trend. While taxes on residential property have increased rapidly in the last few decades, commercial property taxes have increased slowly and taxes on on agricultural, timber, mining, and utility property have tended to increase even more slowly. In areas where there has been more rapid growth and appreciation in home values, the taxes on homes have gone up even more rapidly than the 11.7% average. Some homeowners who live in a particular neighborhood where expensive new homes are being built have seen their property taxes increase 20% or 30% in a single year. These areas of particularly fast growing residential property taxes include the Coeur d'Alene and Sandpoint areas, the McCall and Cascade resort areas, the Sun Valley area, the areas close to the Tetons, and Boise and surrounding communities.

3. The Causes of Rising Property Taxes

Why the rapid increase in property taxes, particularly on homes? Here's where the policy debate begins. There is considerable disagreement over how much various factors contribute to rising property taxes. Much of the disagreement about policy solutions stem from these differing explanations of the problem.

Too Much Spending by Local Government

The first explanation given for rising property taxes is the simplest. Many argue that the rise in property taxes is primarily a local problem. Governor Kempthorne expressed this perspective in his State-of-the-State Address when he said, "[T]he State does not assess, collect, or spend a single penny of property taxes." Those who view the issue from this perspective observe that although property values go up, this does not mean that local governments must actually tax more. If citizens are concerned about their property taxes being too high, they should take their concerns to their county commissioners, city councilors, school board members, and other local elected leaders.

Increased spending by schools is particularly singled out as a problem. All local governments, except schools, are limited to 3% annual increases in the budget, plus the amount of new construction. Schools cannot increase the rate at which they tax property, but they can apply the current rate to rapidly rising property values and thus tax more.

Three of the elected officials who have the greatest influence on such policy share the perspective that increases in property taxes are primarily a local problem. In addition to Governor Kempthorne, Representative Delores Crow, who chairs the House Revenue and Taxation Committee in which tax bills originate, strongly adheres to this perspective. The Speaker of the House, Bruce Newcomb, also shares this view. These three individuals present significant hurdles for major efforts to address property tax concerns at the state level.

Growth Not Paying for Itself

Idaho's population is growing fast. In fact, Idaho is now the third fastest growing state in the nation. A second explanation that is offered for rising property taxes points to the costs that growth imposes. In areas growing rapidly, local governments incur significant costs to provide services for new arrivals. For example, cities must pay for new police and fire stations. School districts must build new schools and buy more buses. And, of course, local governments face all the personnel and operational costs associated with new facilities. While growth imposes significant new costs on local government up front, the revenue from taxes on new construction lags a year or more behind. From this perspective, increased local government spending is the problem, but not because irresponsible local officials are wasting taxpayer money.

Most of those who argue that growth doesn't pay for itself also observe that this problem needs to be addressed at the state level. It is state law that creates the lag in property taxes paid on new construction. State law does, however, provide many local governments like cities and counties with the authority to assess "impact fees" on new development. Impact fees are charged to developers to help cover costs imposed by new development such as the costs of building a new fire or police station.

The interim committee heard extensive testimony from local government officials, however, that the state impact fee law is very difficult, time consuming, and expensive for local governments to implement. For example, Kootenai County found that they would have to spend $80,000 to go through all the planning and evaluation steps required by the impact fee law. Many local governments conclude that it's not worth the effort, particularly given the fact that even if they do successfully complete the process, the scope of impact fees is quite limited in the statute. For example, they can only be used for projects that have a 20-year life. Impact fees will help build a fire station, but won't help buy a police car or help pay the officer in it. New growth imposes some of its greatest costs on schools, but the existing statute does not allow school districts to charge impact fees at all.

Insufficient State Support for Local Government at a Time of Rapidly Rising Costs

A third explanation offered for increasing property taxes is that during the difficult state budgets of the last several years state support for local governments has been low, just at a time when governments have been experiencing costs that are rising at an unusually high rate. In addition to the costs that new growth has been imposing on local government, local governments have been experiencing a particularly dramatic rise in such costs as healthcare benefits and fuel.

On the revenue side of the equation, state support for local governments has been more limited in recent years. This is partly because the state has also faced rapidly growing healthcare costs, particularly through its obligations under the federal Medicaid program. Another rapidly rising cost at the state level is the result of a dramatically increasing population of convicted criminals on probation or in prison. These costs have been spiking at the same time that a flagging economy has resulted in lower than expected income and sales tax revenues. Although the economy, and thus income and sales tax revenues, have turned around in the last year, local governments have leaned on property taxes more as state support has been more limited.

Rapid Appreciation in the Residential Real Estate Market

The first three explanations for increasing property taxes do little to account for the more rapid increase in residential property taxes specifically. A fourth explanation directly addresses this issue. According to this explanation, a higher rate of inflation, in other words appreciation, in the price of existing residential real estate is a major reason that homeowners are paying so much more in taxes. Under current law, the same tax rate is supposed to be assessed against the market value of all categories of property. In this system, if the market value of residential property goes up and the market value of other categories of property stay flat, then the residential *proportion* of the property tax burden goes up and the other categories' *proportion* goes down. This occurs regardless of whether a local government is spending more, the same, or less in property taxes.

Many who argue that this higher rate of appreciation in the residential real estate market explains much of the increase particularly in residential property taxes point out that while homes might be worth more "on paper," the homeowners don't actually have that new value in their checking account and won't until they sell it, which they may not do for decades. Yet they have to write the check for their higher property tax now.

Two arguments are offered against the conclusion that rapid residential real estate appreciation is a problem that needs to be fixed. First, some argue that the rise in the residential proportion of the property tax burden is less a function of appreciation of existing homes than of considerable construction of new homes. With Idaho growing so rapidly, there is clearly a great deal of new home construction taking place. The reason the residential piece of the property tax pie is growing, some argue, it that there are more people living in more homes who are paying residential property taxes. Many of those who argue that new construction is the major explanation for rising residential property taxes often also argue that there is, therefore, little need for property tax reform at either the local or state level.

Second, some argue that even if some or much of the rise in residential property taxes is due to appreciation rather than new construction, it is perfectly fair that homeowners pay more of the property tax burden and that owners of other property get a break when homeowners' property appreciates much more than other property. The only reason that a homeowner is paying more is because that homeowner now has greater property wealth while owners of other kinds of property do not. The property tax is designed, after all, to be a tax on market value.

Differences in the Way Residential Property is Treated

A fifth explanation that is offered for increasing property taxes also specifically addresses the particular rise in residential property taxes. Some argue that although all categories of property are theoretically supposed to be treated the same, in practice, they argue, different categories of property are treated differently in several ways. First, assessors primarily rely on the price at which comparable homes in a given area were recently sold to determine the market value of a given home. Other categories of property involve other considerations. So commercial and agricultural property, for example, are assessed partly based on their costs and the amount of income they produce. Some argue that these other assessment methods used on non-residential property tend to undervalue those properties relative to what they would actually sell for and relative to how residential properties are valued. A number of knowledgeable people on this matter, including senior staff at the State Tax Commission, however, believe that this effect is negligible.

A second differential treatment of non-residential property identified is the range of exemptions that are granted for other categories of property. For example, large corporations like Micron have been granted property tax exemptions to encourage them to stay or expand in Idaho. Agricultural property has a "speculative value" exemption that exempts the market value of agricultural property above the income it will produce when devoted to agriculture. It should be noted, however, that one of the largest exemptions in current law is the homeowner's exemption.

A third way in which some argue the non-residential property is treated differently is that powerful and wealthy owners of many other categories of property appeal and otherwise contest their property taxes more than homeowners do and consequently win more favorable treatment for themselves. The effect of this was amplified, some argue, when the burden of proof for showing an excessive property tax assessment was reduced a few years ago.

Evidence for the Competing Explanations

The differences in explanations for increasing property taxes are partly matters of differences in judgment or perspective where there is no objectively right or wrong answers. Some of the explanations, however, are based largely on factual claims that can be tested against available evidence. We have analyzed data regarding how much the rise in overall property taxes is due to increased local government spending and regarding how much new construction and appreciation explain the rise in residential property taxes in particular. The results of this analysis can be seen in Tables 1 and 2 below. We also discuss the relevance of these results for each of the relevant explanations.

Increased Local Spending. There is a wide range of local taxing districts, including everything from counties to mosquito abatement districts. The three main units of local government that can collect property taxes are cities, counties, and school districts. Overall, local government spending of property taxes has been growing at a fairly steady annual rate that has averaged a little over 6% over the last ten years.

School spending is particularly singled out by those pointing to local spending as a major cause of increased property taxes. This is because school districts are the only unit of local government whose spending increases are not capped at 3% annual increases plus the value of new construction.

Are increases in local school spending a significant part of the property tax problem? Table 1 summarizes the evidence. First, we should explain that Table 1 reports increases in Maintenance and Operation (M&O) spending because this is the portion of their budget for which school districts can collect property taxes. M&O accounts for about three-quarters of all school spending and includes everything from the cost of instruction to the cost of building maintenance. Property taxes account for roughly one-quarter of all the revenues that fund school M&O. Most of the rest of the revenue comes from the state.

Table 1: Evidence for the School Spending Explanation

	Last Ten Years	Last Five Years	Last Two Years	Last Year
1. Avg Annual Increase in Property Taxes		$65 Million	$79 Million	$98 Million
2. Annual Rate of Increase	6.4%	6.3%	7.1%	8.6%
3. Avg Annual Increase in Assessed Market Value of Residential Property	$520 Million	$1.41 Billion	$3.02 Billion	$4.22 Billion
4. Annual Rate of Increase	9.4%	11.1%	14.9%	18.6%
5. Avg Annual Increase in School M&O Spending		$52 Million	$43 Million	$59 Million
6. Annual Rate of Increase		3.2%	2.9%	4.4%

Proponents of the school spending explanation can draw the comparison between rows 1 and 2, on the one hand, and rows 5 and 6 on the other hand, in Table 1 to support their argument. Overall school M&O spending increases (from all sources of revenue, not just property taxes) are equal to well over half of the overall increase in property taxes (row 1 compared to row 5). Those who argue that local government spending is the problem can use these figures to argue that if school districts had chosen not to spend as much, they could have taxed property less.

Proponents of this argument further observe that much bigger increases in school M&O property taxes are coming. When the assessed market value of property increases, the resulting increase in school M&O property taxes lag a year behind increases in other property taxes. This means that the record-setting market value increases in the last year are yet to be felt in terms of school property tax increases.

Critics of the school spending explanation offer several responses. First, they point out, as we noted, that only about one-quarter of the revenue for school M&O spending comes from property taxes. In fact, this proportion has been growing somewhat as state funding of school M&O costs, generally around 70% of overall M&O revenue, have been fairly flat in recent years. Accordingly, some argue, property tax increases due to M&O spending is partly the result of more limited state support in a time of increasing costs.

Second, critics of the school spending explanation point out that school spending has been increasing less than spending for other units of local government. Again, overall local spending of property taxes has increased steadily at a little over 6% annually in recent years while row 6 of Table 1 shows that school M&O spending has grown about 3-4% annually. The schools part of the state budget has also been growing slower than overall state spending in recent years.

Third, beyond contending that these numbers not only defy the argument that school spending is a major component of increases in property taxes, they also argue that increases in school spending should actually be greater. According to BSU's annual public policy survey, most Idahoans believe that far from being excessive, spending on K-12 education should be increased in Idaho. We can include a large majority of members of The Common Interest with those who have this view. Both last year and this year we chose school funding as one of our issues. After reviewing the issue of school funding thoroughly last year, 82% of our members assigned to this issue opposed the Legislature's level of funding as too low. The vast majority of our members argued that it is penny-wise and dollar-foolish to shortchange investment in education. Among other things, our members commented that by investing more in education, we would increase revenues because a more highly educated workforce would attract higher paying jobs and would decrease costs because those with better education rely less on the government for health care and end up in prison less.

Those who argue that school spending is excessive respond that Idaho is generous relative to other states in terms of how much of the income that we have we contribute to education. Our briefing materials on K-12 education funding last year reported that Idaho ranked 15th out of the 50 states in terms of the proportion of our personal income dedicated to funding public schools. Those who say that school funding is excessive argue that we can only fund what we can afford as the concern over property taxes indicates.

The majority of our members and other Idahoans, even recognizing the generous proportion of our income that we dedicate to schools, argue that it is not enough. They point to another ranking reported in our briefing materials: Idaho ranks 45th out of the 50 states in terms of spending per student. There are two reasons that Idaho is 15th in terms of proportion of personal income dedicated to schools and 45th in terms of per student spending. First, we have a lower average income per person in Idaho than in most other states. Second, we have a higher proportion of school age children whose education must be funded by a smaller proportion of the population who are adults, relative to most states. Many of our members and others argue that one way we increase the lower average income level is to educate our people better.

New Construction & Appreciation Explanations of Growth in the Residential Proportion of Property Taxes. As we noted above, the residential proportion of the property tax burden has increased significantly in recent years. This is because the assessed market value of all residential property in the state has grown much more quickly than it has for other categories of property. As seen in rows 3 and 4 of Table 2, the annual increases in residential property value are large and getting larger.

Table 2: Evidence for New Construction and Appreciation Explanations

	Last Ten Years	**Last Five Years**	**Last Two Years**	**Last Year**
1. Avg Annual Increase in Property Taxes		$65 Million	$79 Million	$98 Million
2. Annual Rate of Increase		6.3%	7.1%	8.6%
3. Avg Annual Increase in Assessed Market Value of Residential Property	$520 Million	$1.41 Billion	$3.02 Billion	$4.22 Billion
4. Annual Rate of Increase	9.4%	11.1%	14.9%	18.6%

5. Avg Annual Increase in Assessed Market Value of Residential Property Due to NEW CONSTRUCTION	$180 Million	$270 Million	$500 Million	$760 Million
6. Annual Rate of Increase	13.6%	16.3%	27.1%	40.3%
7. Avg Annual Increase in Assessed Market Value Due to APPRECIATION	$2.10 Billion	$3.49 Billion	$6.18 Billion	$7.55 Billion
8. Annual Rate of Increase	5.2%	7.9%	12.9%	15.1%
9. Estimate of Percentage of Increase in Assessed Market Value of Residential Property Due to NEW CONSTRUCTION	43.5%	37.9%	26.6%	20.4%
10. Estimate of Percentage of Increase in Assessed Market Value of Residential Property Due to APPRECIATION	50.3%	67.0%	87.9%	81.2%

Why has the assessed market value of residential property grown so quickly, while the value of properties in other categories has been flat or decreasing? As noted above, two of the leading explanations offered for the increase in the market value of residential property are new construction and appreciation. Each explanation can be tested with evidence. We used the monthly *Idaho Construction Report* published by Wells Fargo Bank, and formerly First Security Bank, as well as data on new construction provided to us by the State Tax Commission to estimate how much of the growth in residential market value is due to new construction. We used the House Price Index (HPI) for Idaho, which is maintained by the federal government, to estimate how much growth in residential market value is due to appreciation of existing residential property. (For more details on the methodology of our analysis click here.)

The evidence indicates that the value of new residential construction has been significant, as seen in row 5 in Table 2, and has been rapidly accelerating, as seen in row 6. The increase in market value due to appreciation of existing residential property has also been significant, as seen in row 7, and has been accelerating significantly, as seen in row 8. Although the rate of increase has been more rapid for new construction than for appreciation, the increase in absolute dollars of market value due to appreciation is greater. This is because the growth in appreciation applies to all existing residential property while the rate of new construction applies only to that proportion that is new construction.

Consequently, even though we are building new houses at a faster rate every year in Idaho, over time the proportion of the increase in residential market value that is due to new construction is decreasing and the proportion that is due to appreciation is increasing. As seen in rows 9 and 10, last year only about 20% of the increase in residential market value was due to new construction and about 80% was due to appreciation.

Our analysis can be summarized in terms of two trends. First, the annual increase in the market value of residential property is large and accelerating. Second, a large and rapidly growing proportion of that accelerating increase is due to appreciation rather than construction.

Implications for Property Tax Policy

So where does this discussion of the competing explanations for rising property taxes—and the evidence for those explanations—leave us? Two central factual conclusions are clearly warranted. First, local government spending has increased and contributed to rising property taxes. If local government generally, and schools specifically, had increased their spending less in recent years, the overall amount of property tax in Idaho would have increased less. Taxes specifically on residential property would also have increased less if local government spending increased less.

Second, while residential property taxes would have increased less if local government spending had been less, they still would have increased significantly for most homeowners even if local government spending had not increased at all. The evidence is clear that because the market value of residential property in Idaho in recent years has grown much more rapidly than other categories of property, and because that increase is due mostly and increasingly to appreciation and not new construction, most residential property owners were going to experience significant increases in property taxes even with no increase in local government spending.

Beyond these factual conclusions, different people can draw different policy implications. We turn now to a discussion of the specific property tax proposals before the Legislature. A wide variety of solutions have been proposed to the problem of rapidly increasing property taxes. Most of those solutions can be characterized in terms of the explanation of the problem at which they are targeted. In Section 4, we review policy proposals that are based on the conclusion that increasing property taxes are primarily a result of increased spending by local governments. In Section 5, we review proposals based on a conclusion that taxes that are rising much more for residential property is the problem. In Section 6, we review proposals based on a conclusion that new growth does not pay for itself. In Section 7, we review proposals for alternatives to property taxes for school funding. In Section 8, we review proposals to eliminate tax exemptions that are thought to not be justified.

4. Solutions Aimed at Local Government Spending

Proposals that focus on local government spending as the problem can be divided into two types: local solutions and state solutions.

Local Problem, Local Solutions

We have already noted that one proposed approach is to have citizens take their complaints about increasing property taxes to their local elected leaders who levy and collect property taxes. Governor Kempthorne, House Speaker Newcomb, and Representative Crow, Chairman of the House Revenue and Taxation Committee, and others subscribe to this view and conclude that there is no or only a limited role for the state to play in solving the problem.

As discussed above, our analysis found that most homeowners' property taxes would have gone up significantly in recent years even if local government spending had not increased at all because of rapid appreciation in home values and little appreciation for property in other categories. Since local officials do not have the discretion to tax different categories of property at different rates, seeking property tax relief from local officials would do little to address this significant component of increasing property taxes.

State Limits on Local Taxes

Many who see local government spending as the explanation for the problem of rising property taxes believe that the state can nevertheless play an appropriate role in addressing the problem by placing more restrictive limits on local taxes than currently exist. Three different strategies for dealing with local government spending have been advanced.

Spending Caps. House Bill (HB) 478, would simply cap increases in the spending of property tax revenues for every unit of local government at 3% each year. Existing law provides for a 3% cap, but this bill would make that cap more restrictive in two major ways. First, the bill eliminates the option that currently exists that allows local governments to add to the 3% the amount of tax that could be assessed against the value of new construction. Second, the bill would apply this 3% cap to school districts who are currently the one unit of local government whose budget is not capped. To provide a safeguard that these limits are not overly restrictive, HB 478 provides local governments with the option to increase spending from property taxes more than 3% if two-thirds of the voters approve it. Again, our analysis indicates that if home values continue to appreciate much more rapidly than other categories of property, such a cap will provide limited tax relief for homeowners.

Market Value Caps. HB 503 and HB 455 would cap increases in the *market value* that can be taxed rather than limiting spending itself. For any given real property owner, the annual increase in the value of real property subject to tax would be capped at 3% under HB 503 and capped at 5% under HB 455. Both valuation caps would apply to school districts as well as other units of local government.

Unlike caps on local government spending, these limits on the increase in market value that can be taxed aim to specifically address the problem of residential property appreciating much more rapidly than other categories. If a home appreciates more than 3% or 5% in a given year, then they would receive the tax relief offered by this exemption. Proponents argue that because these valuation caps are property specific, unlike spending caps, they would give tax relief for those whose property is appreciating rapidly, but not to those whose property taxes are not increasing rapidly. Accordingly, value caps appear to be an approach that is much more tailored to the problem of rapidly rising home values then spending caps.

Alan Dornfest, a nationally-recognized property tax expert who works for the Idaho State Tax Commission, thought this might be a promising approach and tested the value cap idea by analyzing what the effects of such caps would have been in Kootenai (Coeur d'Alene area) and Ada (Boise area) counties. The results indicated that value caps have a strong, unintended consequence: they disproportionately benefit those who have very high value homes while actually leading to higher taxes for most other homeowners, particularly those who starter or middle class homes. Because very high value homes have tended to appreciate more rapidly than others, these homes would get enormous tax breaks that is then borne, in the form of higher tax rates, by all other homeowners. Even many homes that qualify for the value cap would end up paying more, not less. In Kootenai County, for example, the owners of large, beautiful vacation homes on lakefront property would be the big winners in a value cap system while starter and middle class home owners in typical Coeur d'Alene neighborhoods would be the losers and would actually pay more property taxes because of the value cap. The study will be published shortly in the *Journal of Property Tax Assessment and Administration*.

Spending Limits by Voter Initiative. A modified version of a bill introduced earlier would give taxpayers a mechanism for lowering their property taxes through the ballot box. If 10% of the voters within a given taxing district signed a petition that proposed a specified dollar amount limitation in the property tax budget for that district that district would be required to hold an election on that proposal. A two-thirds majority vote in that election would require that the specified budget restriction for the following year be implemented.

Proponents of this bill argue that since voters have a mechanism for approving increases in their property taxes through a bond levy election, it is only fair that they should be given a ballot box mechanism for reducing the taxes they pay.

Opponents of this bill argue that, like with the spending limits discussed above, voter-driven limits on spending will provide limited relief for homeowners if homes continue to appreciate at a greater rate than other categories of property.

5. Solutions Aimed Specifically at Rising Residential Property Taxes

A number of bills specifically address the problem of home values increasing more rapidly than the value of other categories of property.

Expansion of the Homeowner's Exemption

Three bills propose expansions of the Homeowner's Exemption (HOE) to varying degrees. The HOE was originally passed by voter initiative in 1982 during another time when homeowners were concerned that their property taxes were going up too rapidly. It exempts 50% of the assessed market value of owner-occupied homes or $50,000, whichever is less, from property taxes. At the time that it was passed, it was not indexed so that the $50,000 maximum value would increase with inflation. If it had been, the maximum allowable amount would now be about $100,000 dollars. Many observe that if that were the case, homeowners wouldn't be feeling so much property tax pain.

All three bills would change that existing HOE to make the land on which the home sits part of the assessed market value eligible for the exemption. All three would also mandate that maximum amount would go up at the rate of inflation in the future, as measured by the Consumer Price Index (CPI). They differ in terms of the one time adjustment they would make to the maximum amount for the coming year that would then be adjusted for inflation going forward.

One of the three bills, HB 421, was introduced as the recommendation of the interim committee. HB 421 would raise the maximum amount allowed for the exemption to $75,000 or 50% of the assessed value of the home, whichever is less, in 2006, and then be indexed to inflation after that. The second bill, HB 456, and would do the same as HB 421 except that it would raise the maximum amount allowed for the exemption to $100,000. The third bill, HB 423, would leave the maximum amount allowed for the exemption at $50,000, but would index it for inflation going forward.

Arguments for Expanding the Homeowner's Exemption. The primary rationale for expansion of the HOE is the rapid rise in home values. Proponents argue that it is not fair for homeowner's to pay so much more in taxes on wealth they have not yet realized. Some also argue that to maintain the policy voters put in place, the maximum eligible value should be increased to $100,000. Those who support the expansion also argue that the different assessment methods for different categories of property is a major factor explaining the disproportionate rise the assessed value of homes.

The combined effect of rapid increases in homeowners' property taxes due to appreciation and the differences in the way properties are valued may provide the strongest justification for expansion of the Homeowners Exemption. Because valuation methods for property in categories other than residential include a substantial income factor, the amount of taxes that must be paid on those properties is more closely related to the owners' current income than it is for homeowners. It is only homeowners, particularly under conditions of rapid appreciation, who have to pay much higher taxes on their property even when their current income hasn't increased. This strikes many homeowners as fundamentally unfair.

Arguments against Expanding the Homeowner's Exemption. Several arguments are offered against expansions of the HOE. First, opponents argue that new construction is a significant component of the growth in homeowner's share of the property tax burden. Second, they argue that even if a significant component of the growth in the homeowner's share of the property tax is also due to rapid appreciation, it is appropriate for homeowner's to pay more taxes on property that has grown that much more valuable. Third, opponents argue that expanding the HOE does nothing to limit local spending.

A fourth argument is that expansion of the HOE will mean decreased funding for schools. Unlike other local government units who can increase their property tax rates, school districts property tax rate is fixed at .3% of market value. Consequently, a substantial increase in a property tax exemption of any kind translates directly into less property tax revenue for schools. Proponents of expansion of the HOE acknowledge that it has this effect on schools, but argue that expansion is still advisable and that funding for schools should be increased from other sources to offset the loss.

A fifth argument against expansion of the HOE is particularly emphasized by opponents. The higher the HOE, they observe, the more it shifts property taxes to others. Again, this shift effect occurs even if local governments don't spend any more. If the total market value of property that local governments can tax is reduced because more of the value of homes is exempt, the rate at which they tax the market value of all property will increase in order to provide the same level of services.

This is unfair in the view of those who oppose expansion of the HOE, particularly since they tend to attribute more of the growth in homeowner's share of the property tax burden to new construction. They also point to analyses that indicates that other categories of property, such as agricultural and commercial property, tend to use less services for every dollar of property tax they pay than do residential properties. Imagine 400 acres of pasture with an assessed value of $200,000 compared to the home of a family of five worth $200,000. The home of the family of five creates much more demand on local government services, including fire protection, police protection, and schools than the pasture does.

Since the HOE exemption applies only to owner-occupied homes, those who make this third argument that the HOE exemption shifts taxes to other property point out that it also shifts more property taxes onto residential properties that are rented. Since those who rent tend to have lower incomes than those who own homes, the shift in taxes from wealthier homeowners to renters—through the increase in rents charged—is seen by opponents as particularly unfair.

This shift argument is also applied to owner-occupied homes worth either much less or more than whatever the maximum amount of the exemption is. If a home has an assessed value of $500,000, then expanding the maximum exemption amount from $50,000 to $100,000 will mean that $50,000 more of that value will be exempt from property taxes. It also means that the $400,000 in assessed value above the exemption will be taxed at a higher rate, since property tax rates will presumably increase to keep revenue at the same level after the expanded exemption is implemented. That higher rate on the $400,000 not eligible for the exemption will likely more than offset the savings of having $50,000 less value subject to property tax.

On the lower end of the home market, opponents also argue, a $100,000 home would still only have $50,000 worth exempted from taxes, because not more than 50% of the value of the home can be exempted. Yet, the tax rate on the $50,000 they still have to pay taxes on would now be higher.

Supporters of expanding the HOE concede that the net effect will be higher taxes on more valuable homes, but argue that it is sound policy to have a "progressive" tax in which those in a position to pay more do. They respond to the argument on lower value owner-occupied homes by pointing out that all of the HOE bills also make the land on which the home sits eligible for the exemption. The house assessed at $100,000 has to sit on a lot that also has an assessed value on which tax is paid. Imagine that the lot is assessed at $50,000 for a total of $150,000 in assessed value of the home and the lot. That would mean that 50% of the assessed value would now be $75,000 rather than $50,000. That $25,000 more of their property that is exempt from the property tax, proponents argue, would offset the effect of the increased rate being paid on the remaining $75,000 worth of property they still pay taxes on. Some supporters of expanding the HOE also suggest that Idaho could implement "renters credits" like many other states. These are modest income tax credits that renters receive in recognition that some of their rent likely goes to help pay the landlord's property tax bill.

Arguments for Compromising at an Expansion to $75,000. Some argue that the way to resolve the arguments for or against expansion of the HOE is to split the middle and expand it, but only to $75,000. Proponents of this compromise argue that it provides substantial property tax relief to homeowners who need it most while limiting the negative effects of increasing the tax on other categories of property, including rental properties, and decreasing funding for schools. Proponents of this solution argue that it is not simply a mindless, split-the-middle compromise. They observe that the first $25,000 increase in the exemption (from $50,000 to $75,000) shifts substantially less tax onto other property and takes less revenue away from schools than does the second $25,000 exemption (from $75,000 to $100,000) because so many homes are worth between $150,000 and $200,000. They also point out that the actual tax benefit for average and higher priced homes, typically about $200 - $500, is fairly negligible for those with higher value homes and not worth the increase in property taxes for others and the decrease in funding for schools. Largely for these reasons, HB 421 (the expansion to $75,000) was the recommendation of the interim committee.

Finally, we should note that the analysis done by The Common Interest on the contribution of home appreciation to increased property taxes for homeowners has led an increasing number of legislators and others to suggest that the House Price Index (HPI) for Idaho should be used as an index for the Homeowner's Exemption going forward, rather than CPI which measures inflation more generally. That way, the HOE would expand at the same rate that homes appreciate. It would also not expand as rapidly if the housing market cools considerably in future years. In either case, some argue, the HPI maintains the value of the HOE where it should better than the CPI.

Proposals that Focus on Elderly, Low Income Homeowners

The burden imposed by large increases in property taxes, particularly on residential property, is perhaps most acutely felt by the elderly on low, fixed incomes. While their homes may be worth more on paper, they in particular do not have an increase in income to pay the increased tax. The problem is significant enough that some have to consider selling their home. Three bills aim to lessen the property tax burden specifically on low income, elderly homeowners.

Expansion of the Circuit Breaker Program. One of these three bills, HB 422, enlarges the "Circuit Breaker" law which provides property tax relief to low income elderly, widowed, and disabled homeowners. In this program the state pays all or part of their property taxes. The lower the income level of the recipient the more property tax relief is provided. The income qualification thresholds go up each year at the same rate as the overall rate of inflation in the economy, as measured by the Consumer Price Index (CPI).

House Bill (HB) 422, which was introduced on behalf of the interim committee, recognizes that residential property taxes have increased faster than inflation generally and would raise the highest annual income level allowable to qualify for the program from $22,500 to $28,000. It would also raise the maximum benefit from $1,200 to $1,320 for those with less than $12,050 in annual income.

Perhaps no other property tax reform enjoys more widespread support than the proposal to expand the Circuit Breaker. HB 422 addresses the problem of rapidly rising residential values and taxes for those who are most impacted by them. Since this is a program in which the state pays the property tax for the eligible recipient, rather than exempting them from property tax, there is no shift in the property tax burden to others (though the costs of the program are paid out of income and sales tax revenues that we all pay).

The most common criticism raised in response to this bill, and the current Circuit Breaker program, is that the income eligibility requirement does not take into account income from various kinds of assets such as capital gains. Accordingly, some argue that wealthy retired people who should not qualify for the program can. Some, including members of the Senate Local Government and Taxation Committee, are exploring whether some sort of asset test might be included. Others suggest that it would be difficult to implement an asset test in a feasible way and that the number of people who take advantage of this loophole is likely small.

Others have also suggested that credits for renters should be part of the Circuit Breaker program, as it is in the vast majority of other states with Circuit Breaker programs. Supporters of this modification observe that this would be particularly appropriate to do if the Homeowner's Exemption is expanded because it would help offset its tendency to shift taxes to rental properties and thus to increase rents.

As with the HOE, others reviewing our analysis of the causes of increases in residential property taxes have suggested that the Circuit Breaker be indexed to the HPI for Idaho rather than to the CPI.

"Reverse Mortgages." The second of the three bills aimed at lessening the property tax burden on low income and elderly homeowners was also introduced on behalf of the interim committee. HB 425 would make it possible for financial institutions to offer "reverse mortgages" to homeowners over age 62. A reverse mortgage is a loan used to pay property taxes and other expenses on the person's home that can then be repaid with the proceeds when the owner chooses to sell the home or after the person passes away. This addresses the problem of retired homeowners having to pay rising property taxes on unrealized wealth from appreciation by giving them a way to tap into that wealth. Little criticism has been offered to this proposal.

Tax Deferrals. The fourth bill is another proposal where Governor Kempthorne sees an appropriate role for the state to play in addressing property tax concerns (he also supports expansion of the Circuit

Breaker). HB 439 is sponsored by the Governor and allows individuals who qualify for the Circuit Breaker to defer payment of the property taxes on their homes. The deferred taxes and 6% interest would be due when both the homeowner and spouse have died, or the home is sold or no longer eligible for the homeowner's exemption. This is another mechanism by which older homeowners can deal with the problem of paying taxes on the unrealized wealth in their home. It has stimulated little criticism.

6. Solutions Aimed at School Funding

As explained above, school districts are essentially the only unit of local government whose spending of property taxes is not caped at 3% annual growth plus new construction. School districts can simply tax the market value of property in their district up to .3%. Accordingly, property taxes for schools can go up at the same rate that property values go up. Given the rapid appreciation in residential value in recent years, many argue that this must be changed.

HB 678 would replace half of the .3% school property tax, in other words .15%, with state revenue for schools. This translates into roughly a $125 million reduction in property taxes. HB 679 would make up most of this, roughly $105 million, through an increase in the sales tax from 5% to 5.5% (a half cent on every dollar). HB 678 also caps increases in spending from the remaining school property tax at 3%. HB 679 does not specify that the new revenue from the half-cent sales tax increase go to support schools.

Proponents argue that replacing half of the school property tax with state revenue from sales tax would relieve property owners of the only portion of their property tax that can rise as fast as their values rise. Because the sales taxes from which the replacement revenue would be raised do not have the problem of taxing homeowners on unrealized "paper wealth," proponents argue, these measures go to the heart of the problem identified in our analysis showing that appreciation is driving the rise in residential property taxes. Particularly given that last year's historic appreciation of home values has yet to be reflected in school M&O property taxes, proponents argue that this measure is important and urgent.

Opponents argue that while these measures may provide real property tax relief, they do so at the expense of a reliable, stable source of funding for schools. The proposed replacement revenues are problematic for several reasons, they argue. First, they point out, HB 678 provides new revenue that would only party make up the lost property tax. Given that the Legislature has provided only very small increases in the funding they are already responsible for providing to schools, opponents question whether it makes sense to increase the state responsibility for school funding dramatically. Opponents point out that much of the justification for flat school funding from the state in recent years is the budget pressure created by rapid increases in the costs of healthcare and prisons. Since few people think those pressures are going to lessen substantially anytime soon, opponents argue that the state cannot be relied upon to fund schools adequately.

Second, opponents argue that history confirms their suspicions. In 1995, Idahoans were also concerned with rising property taxes. On the basis of the same arguments that proponents are now making for replacing school property taxes, the Legislature passed a measure that reduced the school property tax from .4% to the .3% that it is today. Under this law the costs to the state for replacing school property taxes went up as fast as property values went up, creating the same problem for the state that homeowners have faced. Two years ago the state responded to their end of the problem by capping the total amount of replacement funding they would provide at $75 million. If not for the cap, school districts would have received almost $84 million in replacement funding this year.

Third, opponents contend that the combination of HB 678 and HB 679 provides even less reliable replacement of property tax revenue for schools than the 1995 legislation since, unlike the 1995 legislation, the new half-cent sales tax revenue is not dedicated to supporting schools. Rather, schools have to compete each year with Medicaid, prisons, and every other aspect of the budget for those revenues.

Fourth, opponents argue that property taxes are a better source of revenue for schools than sales and income tax because they are both more stable and because they are local. The fact that property taxes are local, they argue, means there is greater local accountability.

Fifth, opponents argue that the effect of replacing property tax with sales tax will be to increase the combined taxes on lower income households and decrease the combined taxes on higher income households. This is because sales tax tends to be more "regressive" than property taxes because the purchase prices of essential goods are a larger proportion of lower income households' total income. A study by economists at the University of Idaho and Washington State University found that the breakeven point for HB 678 and HB 679 was at $100,000 of household annual income. Households with less than $100,000 in income would pay slightly more combined sales and property tax and households with more than $100,000 in income would pay slightly more in combined sales and property taxes.

7. Solutions Aimed at Growth Not Paying for Itself

Two main approaches to make growth pay for itself to a greater degree have been discussed.

Impact Fees

The first approach to making growth pay for itself to a greater degree is for the state to expand the ability of local governments to assess impact fees. HB 504 and HB 426 would both give school districts the authority to assess impact fees. HB 504 would extend the same impact fee authority to schools that cities and counties have. HB 426 was introduced on behalf of the interim committee and would give school districts the authority to assess up to $2.50 per square foot of new homes. Proponents of both these bills argue that schools particularly bear the burden of growth. Accordingly, they argue, it is only appropriate that they have impact fee authority.

Although a formal bill has not yet been introduced, there is also serious discussion of a need for a bill that would modify the existing impact fee law so that it would be less burdensome to implement and so that impact fees could be used for a broader range of costs imposed by growth.

Developers and realtors have been opposed to these expansions of impact fees. Given how powerful they are as a lobby in the Legislature, some have doubted whether serious impact fee legislation can be passed.

Local Option Sales Taxes

The second approach for dealing with the costs of growth, as well as the implications of rapidly appreciating residential property, is to extend the authority for counties to implement a local sales tax if approved by the voters. Current law allows counties to assess up to a half-cent sales tax if approved by two-thirds of the voters in that county. The proceeds from this half-cent sales tax can only be used for county property tax relief or for building jails. This law is set to expire in 2009, but two bills would modify and extend it.

This legislation was originally passed with counties in mind that are growing rapidly and that have resorts in them. As already discussed, these circumstances tend to be associated with rapid residential appreciation and the costs that high growth rates impose. These areas also see large influxes of visitors who use local government services. The result, proponents of the existing law successfully argued, was that existing property owners were unfairly bearing the costs for new construction and services for short-term residents. The solution was to provide for a sales tax through which visitors would help pay for the services they used. Kootenai County, which has seen annual residential appreciation rates in excess of 20%, has availed itself of this option. If it were not for this provision, property taxes in Kootenai County would be even higher than they are now.

The first bill, HB 501, would remove the sunset provision of this law and require that half of the revenues be used for property tax relief. It would also broaden the uses of the revenue to include not only property tax relief and capital or infrastructure projects but also for affordable housing for full-time employees of local governments. The proponents of HB 501 argue that in counties like Blaine County, where Sun Valley is, residential property has appreciated so much that local governments cannot hire and retain employees because these employees can't afford to buy a home there. This is particularly a problem, proponents argue, for public safety employees such as firefighters and police who must be on a call and able to respond quickly to an emergency.

The second bill, HB 502, would similarly remove the sunset provision of this law and require that half of the revenues be used for property tax relief. It would also broaden the uses of the revenue to include property tax relief and any capital or infrastructure projects but would not authorize the use of these funds specifically for affordable housing. Finally, HB 502 would require that 40% of the registered voters in the county had actually voted in an election in which a local option sales tax was approved by two-thirds of the voters.

The most common criticism of these bills is that they do not address the issue of local government spending. In fact, opponents argue, they just give local governments one more way to raise taxes. A second criticism is simply that these mechanisms do not work as well for non-resort areas.

Public Infrastructure Improvement Districts

HB 485 would authorize the creation of "public infrastructure improvement districts" (PIDs) within cities and counties. These PIDs would be a new local government entity with the authority to levy property taxes to finance the construction of public infrastructure such as water and sewer systems and roads. The process for creating a PID would be initiated by a petition asking a city or county to create a PID. The petition would have to be signed by all landowners within a proposed PID. After a hearing on the question, the city council or county commission then would decide whether or not to approve the creation of the PID.

After a PID had been created, it could levy property taxes up to 5% of the market value of the property within the PID (average overall property tax rates currently tend to be a little over 1% of market value). The revenue for the property taxes can be used to pay off bonds that the PID can issue (i.e. debt) to pay for the development of public infrastructure projects. All such bonds must be approved by two-thirds of the voters within the PID. This bill modifies the usual definition of registered voters to include landowners who may live out of the PID or even out of the state.

HB 485 has been proposed by the realtor and developer community as a means of financing the costs of growth. They emphasize the voluntary nature of PIDs. They can only be created where the landowners within the proposed PID and the city or county agree to do so. PIDs can only issue bonds when two-thirds of the voters approve of such a bond.

Opponents of the PID argue that they are, in fact, not voluntary for those who would actually end up paying the property taxes that they levy. Imagine that a developer purchases a substantial amount of undeveloped land on the outskirts of a growing Idaho city. That development company could petition the county to create a PID for its land and planned development. Since the development firm is the only landowner within the proposed PID, the petition process is rather meaningless, opponents argue. The representative of the firm would be the only signature on the petition. If the developer can then convince the county to create a PID, then they would then have the power to issue bonds to finance the construction of much of the infrastructure, such as sewer, water, and roads, that counties would usually require developers to construct and pay for themselves. Opponents point out that the bond levy election could be held while the development firm still owned most or all of the property. The development firm would thus be in a position to pass a bond so that future owners of the homes being constructed would have to pay off the costs that the developer otherwise would have paid.

Some are particularly alarmed at the prospects of a PID given the experience in Ada County with the recent approval of the large Avimor development next to Highway 55 north of Boise. Although many citizens opposed the development, the county approved it nevertheless. Critics argue that this experience demonstrates the ability of large, wealthy development firms to persuade local officials to do things not in their citizens' best interest. SunCor, the developer who proposed Avimor, is owned by a large Arizona utility. Critics are skeptical of the access that SunCor officials had to Ada County commissioners when the public wasn't present. Critics argue that this access included trips for Ada County commissioners to Arizona where they were inappropriately wined and dinned.

8. Solutions Aimed at Eliminating Tax Exemptions

Discussions of tax fairness inevitably turn to questions about whether many of the various tax exemptions that have been granted over the years are justified and whether they create an unfair tax burden on those who do not qualify for these exemptions. Accordingly, during this legislative session that has seen so much attention given to issues of tax fairness, one proposal has been made to address one particular property tax exemption. A second proposal has been made to address the problem of tax exemptions generally.

Repealing the "Developer Discount"

While general dissatisfaction with property taxes has intensified in recent years, perhaps no other aspect of the current property tax system has generated more intense protest than a provision in current law that has come to be known, not at all affectionately, as the "Developer Discount." Current property tax law exempts land "devoted to agriculture" from property taxes on the "speculative portion of the value of the land." "Speculative portion" is defined as that portion of the value for which it could be currently sold that is above the income that the land will generate from agricultural production.

Several years ago there was a proposal that farmers and ranchers should be able to prepare their land for development by platting it (developing and recording a plan for subdividing land into smaller parcels) without losing the agricultural exemption as long as they were still farming or ranching it. Developer and realtor lobbyists managed to modify the language of the bill such that a developer who purchased platted land that had been, but was no longer, devoted to agriculture could also receive the exemption until construction began.

This has created an enormous property tax break for those who have purchased agricultural ground around resort areas for investment and development purposes rather than for agricultural purposes. The attention and controversy has been further fueled by the fact that Governor Kempthorne is one of the beneficiaries of this loophole. Governor Kempthorne purchased 14 acres in the area around Tamarack resort in 2004. Although this property would sell for a significant sum on the market today, his property tax bill is only $9.73.

All this controversy has created significant pressure to close the loophole. Two bills, HB 428 and HB 510, use slightly different technical language to repeal the current provision outright, but would provide elsewhere in statute that land currently "devoted to agriculture" would not loose the "speculative portion" exemption simply by platting the land. The interim committee has introduced another bill, HB 427, that does not repeal the existing provision but amends it such that individual platted parcels that are sold are no longer eligible for the exemption unless they continue to be "devoted to agriculture." Proponents of these three bills argue that they will, in fact, close the unfair loophole.

Another bill, HB 569, is sponsored by Tamarack resort. It would repeal the current provision that provides the "Developer Discount." However, it would also establish a new law called the "Economic Development Initiative" which would exempt vacant lots in subdivisions from property taxes on two-thirds of their market value. Although this means a one-third reduction in the current "Developer Discount," it actually provides a new exemption for two-thirds of the market value for lots that had not previously been eligible for an exemption. The existing "Developer Discount" applies only to land that was farmed or ranched and that was located in counties that had less than 100,000 in population. The new "Economic Development Initiative" would apply to vacant subdivision lots in all counties, regardless of population and regardless of whether it had been farmed or ranched by the previous owner. Because so many more vacant sub-division lots are in larger counties than in rural counties, HB 569 actually creates a substantially larger, new "Developer Discount" at the same time it repeals the old one. Proponents argue that this will stimulate new development and thus economic growth.

Given the uproar about the "Developer Discount," many believe that something along the lines of HB 427, HB 428, or HB 510 will pass the Legislature this year. Given the power of the development and realtor lobby in the Legislature, however, many think it is likely that something new along the lines of Tamarack's HB 569 will replace the existing "Developer Discount."

Review of Tax Exemptions Generally

For many, the "Developer Discount" is just one example of a serious, more general problem with the fairness not only of property taxes, but income and sales taxes as well. Every year, special interests of one variety or another propose legislation that would give members of their interest group a tax benefit. Because the tax breaks provide a benefit that is concentrated on a sub-group of Idahoans—often a small minority—the benefit to them can be substantial. Because the burden that one specific tax break would impose is spread out among everyone else who doesn't get it—usually the vast majority of Idahoans—the burden of that tax break, in terms of higher taxes and/or less government service, for any one taxpayer is relatively small.

Consequently, those who would receive the tax break are far more motivated to promote it than those who would be burdened by it are motivated to oppose it. The high motivation for tax break beneficiaries translates into time and money invested in researching out the tax break, mobilizing to contact and to donate to legislators, and hiring powerful professional lobbyists. The more powerful and wealthy the special interest that pursues the tax break, the more disproportionate their influence is. And, of course, those who are promoting a tax break are smart enough to pitch it as a measure that would promote the common interest, not just their special interest.

The low motivation to oppose that the rest of us have who would bear the burden of a given tax break translates into a lack of awareness that such a tax break is even being proposed, not to mention our failure to mobilize politically. Consequently, many argue that too many tax breaks are passed that serve special interests at the cost of the common interest of Idahoans. Even those tax breaks that did serve a compelling public interest when passed, many argue, stay on the books long after the original justification for it has passed.

While the burden of any one tax break may be small, the cumulative effect of this special interest influence year after year is substantial. If all the tax breaks that didn't serve the common interest were eliminated, many argue, property, sales, and income tax rates could be substantially lower and more fairly distributed without compromising government services.

How can this age-old problem of special interests and taxes be addressed? Although it may be tempting simply to eliminate all tax breaks, there are clearly many tax breaks that, most of us would agree, do serve the public interest. How do we discern the appropriate tax break that serves the common interest versus the unjustified tax break that serves a special interest at the expense of the common interest?

Amidst the flurry of attention on property taxes specifically, an intriguing approach to the general problem of special interests and taxes has been suggested. Republican Senator Tim Corder has proposed legislation that would require the Joint Legislative Oversight Committee to review 10% of all tax breaks each year for the next ten years so that by 2016 every tax break would have been reviewed. The two co-chairs of the Joint Legislative Oversight Committee (JLOC) are required to be from different houses and different political parties. By law, JLOC includes an equal number of members from each major party and an equal number of members from each house.

The proposed legislation would require JLOC to instruct the director of the Office of Performance Evaluations to conduct the required analysis of all tax breaks. OPE is staffed by full-time professionals trained in conducting independent evaluations. The proposed legislation would require OPE, under JLOC's supervision, to conduct an analysis of the:

- Public purpose intended or gained by the original enactment of the tax exemption or credit
- Amount of money the tax exemption or credit represents
- Affected taxpayers who would pay additional taxes because of the repeal of the exemption or credit
- Public benefits or detriments that would occur because of the repeal of the exemption or credit

9. Updates

Update, February 20, 2006

With so many property tax bills before the Legislature this year, we made a decision not to review every one of them. One bill has received considerable attention since we initially posted this brief and we think it warrants review. We explained above that local governments can increase their property tax spending by 3% per year, plus the value of new construction. Cities can also add the value of property within newly annexed areas. HB 508 would change this so that cities could only add 50% of the value of property in the newly annexed areas in terms of how much they can increase their budget.

This does not mean that property owners in the newly annexed area would only pay half as much city property tax as everyone else. Rather, it means that the city's overall property tax *spending* could go up half as much as it now does because of annexed property. In other words, everyone's property taxes inside and outside the newly annexed area would be a little less than they otherwise would when a city annexed a new area.

Proponents argue that cities currently annex simply to increase their budgets and that this legislation would discourage that. They also argue that currently citizens who don't want to be annexed can be annexed against their will and that HB 508 would limit these forced annexations. Proponents also argue that in cities in the state are growing so much that they are beginning to run into each other, calling into question the role of counties.

Opponents argue that property taxes go up by the same as demand for services goes up due to annexation. That is the case under current law, they argue, but would not be the case under HB 508. They also observe that the vast majority of annexations are "friendly" annexations, meaning that the residents in the area ask the city to annex them. Often, the residents of new subdivisions just outside existing city limits want the services, including fire and police protection and water and sewer services, that come with being in a city. Sometimes, residents of older subdivisions to which the city has grown welcome annexation in order to gain those same services. Under HB 508, they argue, cities will almost never annex again because they won't be able to afford having providing more services without a proportional increase in revenue to fund those services.