STATE OF NEVADA PROPERTY TAX SYSTEM RECOMMENDATIONS FOR SYSTEM IMPROVEMENTS INCLUDING REMOVAL OF DEPRECIATION AND CHANGES TO PROPERTY VALUATION

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INTRODUCTION

Recent budget shortfalls for local and State governments have politicians scrambling to raise revenues and decrease costs in order to balance budgets. Some, including the State of Nevada, are looking at system inefficiencies; changes that could be made to existing revenue or cost structures in order to generate more revenues or create lower costs. Many feel that the existing property tax system in our State has much room for improvement, leading not only to increased revenue for the State's governments, but also to a greater understanding by taxpayers.

One of the suggested system improvements is to remove depreciation on improvement (building) values. Another is to switch property valuation from the existing replacement minus depreciation structure to a more accepted market value appraisal system. This would not only remove depreciation, but also create a system that is easier to implement and understand. This report looks at the existing property tax structure in the State of Nevada, compares this structure to other states, provides suggestions for system improvements, and discusses the fiscal impact of these suggested changes on Washoe County jurisdictions and taxpayers.

NEVADA PROPERTY TAX SYSTEM

Much of Nevada's property tax system was development between 1979 and 1983, with the following major reforms: [1]

1 Nevada Revised Statutes (NRS) 361.

- 1979-a cap on property tax rate set at $3.64 per $100 (3.64%) of assessed value
- 1981-a change in the appraisal method was made from the Market Approach to the more conservative Replacement Cost approach[2]
- 1983-an annual depreciation of 1.5% of the improvements/buildings' replacement cost for up to 50 years was added.

These reforms were enacted in response to demands by residential property owners to address equity issues between commercial and residential property,[3] and curb runaway housing inflation leading to higher property taxes.[4]

Another significant change to the State's property tax system was made more recently; in 2005 Assembly Bill (AB) 489 introduced a partial abatement of ad valorem taxes imposed on property. AB 489 created a cap applied to the tax bill, allowing the tax bill for an owner-occupied single family residence to increase by no more than 3% annually, regardless of changes to assessed valuation, unless the change is due to improvements. For all other property, the annual cap is equal to the greater of (1) The average percentage change in the assessed value of a county over the current year plus the previous nine years, or (2) twice the increase in the CPI for the previous calendar year. If the greater of the two is higher than 8%, the cap is set at 8%.[5]

These reforms created a property system that is one of the most conservative in the nation. Property tax rates are capped at $3.64 per $100 of valuation, 1.5% of improvement values are depreciated each year for up to 75% of value (1.5% per year for 50 years), improvements are values at the cost of replacement, not market values, and tax bills cannot exceed 3% or 8% annual increase, depending on type of property. These conditions exist for the entire life of the improvement, they do not reset if the property is sold, as seen with some property tax reforms in other states.

[2] Washoe County Assessor defines Market and Replacement Cost approaches as follows:
Market approach- look at similar properties which have sold, adjust for the differences, and estimate the price the subject property might sell for.
Replacement Cost approach- determine what it would cost to purchase a vacant parcel and build a structure(s) with similar utility as that of the subject property.

[3] Prior to the 1983 reform, commercial buildings were depreciated, while residential buildings were not. This reform provided equity between commercial and residential improvement valuation.

[4] This reform was enacted in response to California's Prop 13 which limited property tax increases to 2% per year.

[5] AB 489.

The table below shows an example of a 3-year property tax bill calculation for an owner-occupied single-family home.[6] The example is a 10 year old home in Sparks, Nevada for which age, market and replacement value information is available from the Washoe County Assessor's website. The home is a single-family residence, with two bedrooms, 1,662 square feet of building (improvements) on an 8,123 square foot lot. The home was sold in 2011 for $200,000 (its market value). However, the cost to purchase the land on which the home sits and construct a similar structure (replacement cost minus depreciation) is currently valued at $149,758.

Table 1
Example of Property Tax Bill Calculation[7]
Nevada Single Family Residence[8]

	Year 1	Year 2	Year 3
Taxable Value	$ 149,758	$ 157,246	$ 165,108
Age of Home (*Years*)	10	11	12
Assessed Value (*35% of Taxable Value*)	$ 52,415	$ 55,036	$ 57,788
Expected Property Tax Bill (*Rate of $3.62 per $100 of Assessed Value*)[9]	$ 1,897	$ 1,992	$ 2,092
Amount of Abatement (*Difference between Expected Property Tax Bill and Tax Cap of 3% of Previous Year's Bill*)	$ -	$ 38	$ 79
Actual Property Tax Bill	**$ 1,897**	**$ 1,954**	**$ 2,013**

Even though latest market value is available, it is only used to value the land portion of this property ($57,400 or 38% of taxable value), land is valued at replacement minus depreciation, resulting in a lower taxable rate than the market value for the residence. Additionally, the property tax bill cap allows the bill to increase by 3% annually, regardless to what happens to the appraised value (which in this example is increased 5% annually), further reducing the final property tax bill for this property by $38 in Year 2 and $79 in Year 3. The various appraisal and

[6] The analysis focuses mainly on single family residences, for consistency purposes. However, with the exception of certain commercial properties that use the income method of valuation, residential and commercial properties use the same methodology and therefore these examples and conclusions can also be applied to commercial properties.
[7] This example excludes any actual abatement that may be incurred by this property as detailed data for these abatements is unavailable. The example assumes no past abatements exist.
[8] Home data from Washoe County Assessor's website.
[9] Analysis uses City of Sparks FY 2010-11 combined property tax rate from the "Property Tax Rates for Nevada Local Governments for Fiscal Year 2010-11" report published by the Nevada Department of Taxation.

taxation methods used to calculate property tax revenue in Nevada, result in a low property tax bill. A comparison of just how low is discussed later in this report.

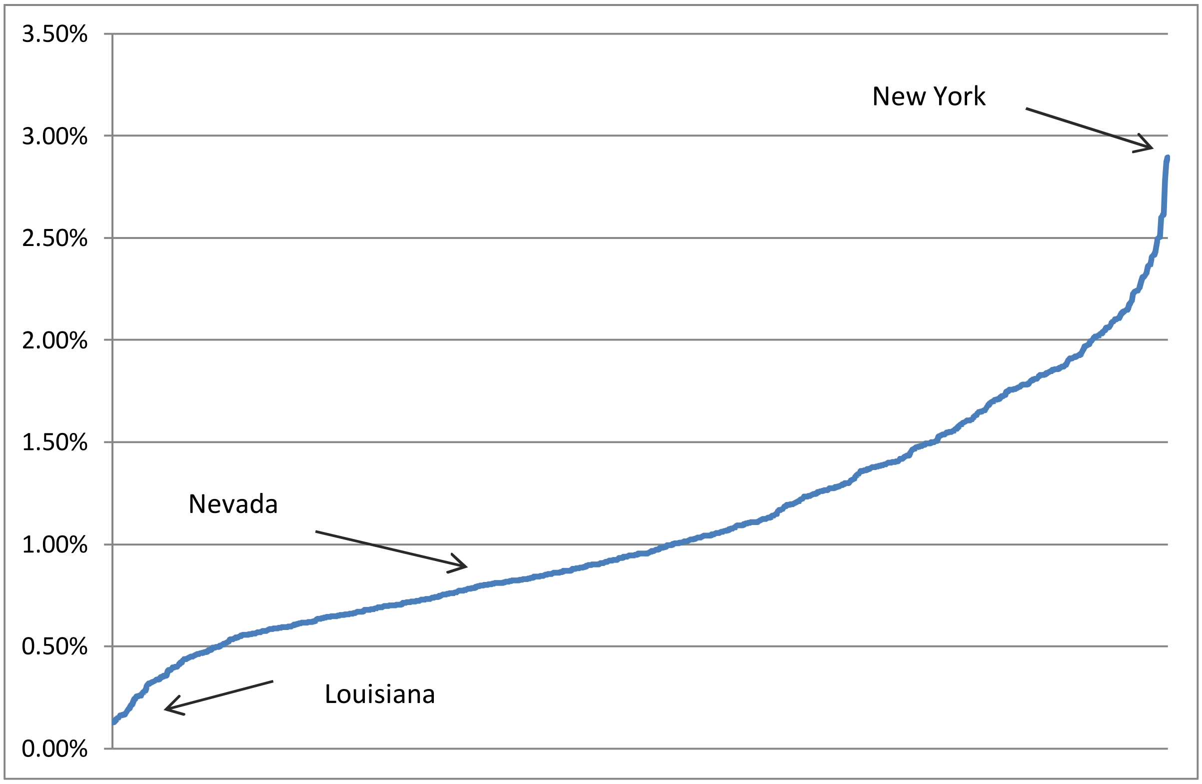
COMPARISON TO OTHER STATES

Until recently Nevada was one of only two states that used depreciation. The other state to use depreciation and the replacement cost approach was Indiana. However, in 1998 the Indiana State Supreme Court found this practice to be unconstitutional. Starting with the 2002 reassessment, Indiana began using the market value appraisal approach.[10] Currently, State of Nevada is the only state in the nation that applies an annual depreciation factor on real property improvements for purposes of property taxation. This is one of the reasons why Nevada property tax revenue is low compared to many other states.

According to data provided by the US Census Bureau, in 2009, Clark and Washoe counties were ranked 419th and 532nd out of a total of 792 large counties[11] across the nation, in terms of its property tax bill as percent of home value. Washoe County's property tax bill in 2009 was 0.77% of home value and in Clark County property tax bill was 0.92% of home value. Lowest property tax bill as percent of home value was in Tangipahoa Parish, Louisiana at 0.13% and highest in Monroe County, New York at 2.89%.[12] The graph shows Nevada's largest counties (Washoe and Clark) compared to other counties across the nation, in terms of property taxes as percent of home value. Nevada is positioned towards the bottom of the graph, indicating lower than average ratio.

[10] Purdue University "Overview of Indiana Property Tax" www.agecon.purdue.edu.
[11] Counties with population of over 65,000.
[12] "Property Taxes on Owner-Occupied Housing, by County* Ranked by Taxes as Percentage of Home Value." Data from U.S. Census Bureau; Tax Foundation calculations.

Graph 1
Property Taxes as % of Home Value
2009



PROBLEMS WITH EXISTING PROPERTY TAX SYSTEM

There are a number of problems associated with the existing property tax system in the State of Nevada. Three main problems will be discussed below:

1. Improvement depreciation creates an inequality among taxpayers
2. The system has a number of revenue generating restrictions including a rate cap, depreciation of improvements, and an abatement situation allowing property tax bills to increase by a set amount, regardless of actual economic changes
3. The system is confusing to taxpayers, creating distrust of the system

Taxpayer Inequality

Depreciating improvements creates a system where taxpayers pay different property tax amounts for homes of the same size in the same location because of the age of the home. Below is an example of two homes and the impact of the valuation system on the final property tax bill for each home.

In this example, one home is located in Reno and the second in Sparks. These are actual homes, chosen because market and appraised values and year of construction were available for these homes, also because their age differences will provide a good illustration of the inequality due to depreciation.

The first home, located in Reno, was constructed in 1963, making it 48 years old in 2011. The home has 2,028 square feet of improvements on a 25,352 square foot lot. The home was sold in 2011 for $200,000, but has a total taxable value of $110,048. The Sparks home was constructed in 2002, making it nine years old in 2011. The home has 1,662 square feet of improvements on an 8,123 square foot lot. The home was also sold in 2011 for $200,000, but its taxable value is $149,758. Already we can see that while the homes have a similar market value, the age of the older home has resulted in a lower taxable value for this home, despite the larger size of its land and improvements.

The table below summarizes the calculation of property tax bill for each home.

Table 2
Example of Property Tax Bill Calculation[13]
Older vs. Newer Homes by
Market and Replacement Value[14]

	Old Home		New Home	
	Market Value	Replacement Value	Market Value	Replacement Value
Taxable Value	$200,000	$110,048	$200,000	$149,758
Age of Home (*Years*)	48 years		9 years	
Assessed Value (35% of Taxable Value)	$70,000	$38,517	$70,000	$52,415
Property Tax Bill[15]	**$2,494**	**$1,372**	**$2,494**	**$1,867**

[13] This example excludes any actual abatement that may be incurred by this property as detailed data for these abatements is unavailable. The example assumes no past abatements exist.
[14] Home data from Washoe County Assessor's website.
[15] As these homes are located in different jurisdictions and have different combined tax rates, the analysis uses a tax rate of $3.56 per $100, Washoe County average county-wide combined rate for FY 2010-11 to allow for comparison.

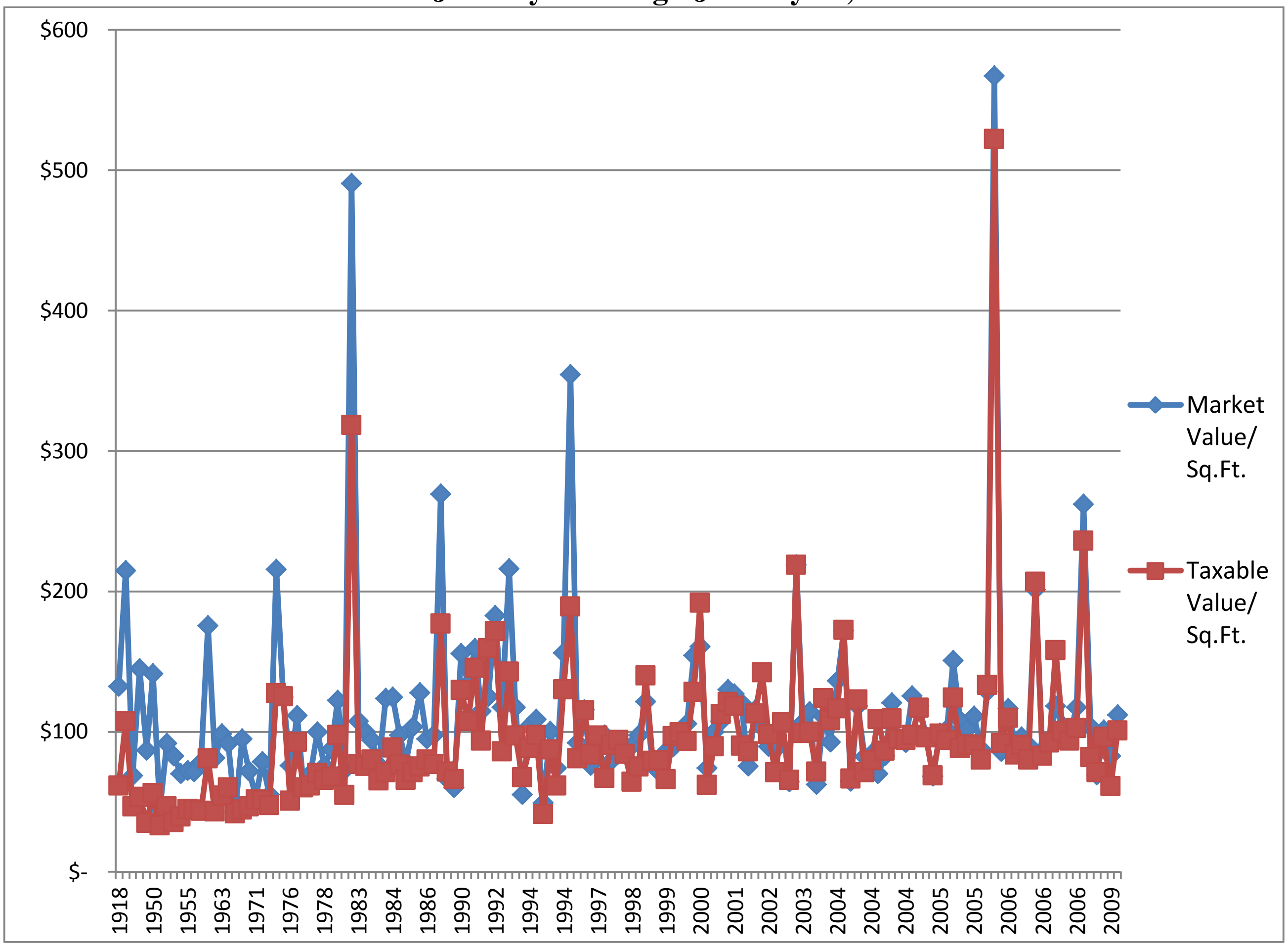
Table 2 shows that two homes with the same market value pay different property tax amounts based on their age. If market value is used to value the homes, they would have the same tax responsibility. However, the use of the replacement value minus depreciation creates a difference of approximately $500 between tax amounts for these homes. Not only does this system create an inequity between the two homes based strictly on age, it limits the amount of property tax revenue generated for local governments.

Revenue Generation Restrictions

The above example illustrates the difference between a property tax bill estimated using the market value and replacement plus depreciation approaches. It is unlikely, except in dire economic circumstances that the cost of construction for the home would exceed its market value. As a result, valuation of a home using the replacement value approach would, generally, yield a lower result than using a market approach. The graph below shows a comparison between the market value per square foot and taxable value (replacement minus depreciation) per square foot for single family home sales recorded in Washoe County in the first two weeks of January 2011.[16] The x-axis of the graph shows the year of home construction, data has been sorted and graphed by age of construction, with the oldest homes on the left.

[16] Home values and taxable values are shown by Washoe County Assessor in separate reports. It is time consuming to collect both sets of data for the same parcel. As a result, the analysis uses single family homes sales recorded between January 1 and January 14, 2011. This results in data for 147 parcels.

Graph 2
Market vs. Taxable Value per Square Foot
Washoe County Single Family Home Sales
Recorded January 1 through January 14, 2011[17]



The graph shows that with the exception of a few newer homes (constructed in 2000 and later), market value per square foot consistently exceeds taxable value per square foot. This is considering that Washoe County's recent drop in the median home price from its peak in January 2006 of $365,000 to $159,950 in January 2011. The last time Washoe County had home prices this low was in February of 2001.[18] While Washoe County's market values are the lowest in a decade, they still exceed taxable values for most properties. This means that Washoe County is not receiving as much revenue as it would if properties were assessed based on market values. This is the first revenuer restriction.

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[17] Market Value data from "Sales Report-2011 Sales YTD" and taxable value data from "Property Assessment Data" search for each parcel. Washoe County Assessor's website.
[18] "Washoe County Home Sale Price Hits 10-Year Low." Channel 2 News, KTVN. February 2011.

As discussed above, another revenue restriction was implemented recently by AB 489. Property tax bills for residential properties can increase by no more than 3% annually and up to 8% for commercial properties. This does not reset when the home is sold, property tax payments for that property remain restricted through the life of the property, unless additional improvements are made to the property.

Finally, the maximum combined property tax rate that can be imposed by an area is capped at $3.64 per $100 of assessed value, further limiting the local government's ability to generate additional revenues. It has been common practice for local governments to increase property tax rates to raise additional revenues necessary to fund increasing costs to provide public services. In fact, over the last 10 years, average countywide tax rates increased by as much as 30% for Douglas County, 28% for Storey County and 27% for Carson City. The only property tax rate decrease during this period was in Nye County, which decreased its property tax rate by 6% during this period. Table 3 below summarizes these changes. [19]

As jurisdictions increased their property tax rate, some approached or exceeded the $3.64 property tax rate cap. Table 4 below shows that a number of local jurisdictions are at or above the rate cap of $3.64. [20] This means that outside of voter approval, these jurisdictions are unable to raise their property tax rates to generate additional revenues.

[19] "Property Tax Rates for Nevada Local Governments." Nevada Department of Taxation. Reports for FY 2000-01 and FY 2009-10.
[20] "Fiscal Year 2009-2010 Property Tax Rates for Nevada Local Governments." Nevada Department of Taxation.

Table 3
List of Jurisdictions at Property Tax Rate Cap
FY 2009-10

County	Average Countywide Tax Rate FY 2000-01	Average Countywide Tax Rate FY 2009-10	Difference	% Change
Carson City	2.5904	3.2928	0.7024	27%
Churchill	2.7750	3.0556	0.2806	10%
Clark	3.0181	3.1849	0.1668	6%
Douglas	2.3583	3.0762	0.7179	30%
Elko	2.7216	2.9780	0.2564	9%
Esmeralda	2.8150	3.0195	0.2045	7%
Eureka	1.7029	1.9408	0.2379	14%
Humboldt	2.2510	2.7546	0.5036	22%
Lander	3.1509	3.3651	0.2142	7%
Lincoln	2.8477	3.1242	0.2765	10%
Lyon	2.7437	3.0328	0.2891	11%
Mineral	3.6400	3.6600	0.0200	1%
Nye	3.3519	3.1621	-0.1898	-6%
Pershing	3.0769	3.1563	0.0794	3%
Storey	2.7128	3.4607	0.7479	28%
Washoe	3.4278	3.5767	0.1489	4%
White Pine	3.6400	3.6600	0.0200	1%

Table 4
List of Jurisdictions at Property Tax Rate Cap[21]
FY 2009-10

Jurisdiction	Combined Property Tax Rate	Jurisdiction	Combined Property Tax Rate
Fallon, Churchill County	3.6400	Walker Lake, Mineral County	3.6600
Minden, Douglas County	3.6440	Amargosa, Nye County	3.6560
Carlin, Elko County	3.6560	Lovelock, Pershing County	3.6592
Austin, Lander County	3.6440	Reno, Washoe County	3.6460
Truckee Meadows Fire Protection District, Washoe County	3.6600	Palomino Valley GID, Washoe County	3.6600
Caliente, Lincoln County	3.6600	Kingston, Lander County	3.6600
Coyote Springs GID, Lincoln Co.	3.6600	Ely, White Pine County	3.6600
Hawthorne, Mineral County	3.6600	Lund, White Pine County	3.6600
Luning, Mineral County	3.6600	McGill, White Pine County	3.6600
Mina, Mineral County	3.6600	Ruth, White Pine, County	3.6600

Property tax revenue is a vital part of Nevada local government finance, making up large portions of General Fund. General Fund revenue is important to local governments as this is the revenue used to support major operating costs including administrative, law enforcement, fire

[21] Some jurisdictions are outside of the allowed cap rate due to approvals provided in AB 564.

and some public works costs. In Washoe County, property tax revenue is budgeted to make up 54% of total General Fund revenue in fiscal year (FY) 2010-11 as shown in Table 5 below. In the City of Reno, property tax revenue is expected to make up 28% of General Fund revenue in FY 2010-11 and 38% of General Fund revenue in the City of Sparks in the same year.[22]

Table 5
Property Tax Revenue as Percent of
Total General Fund Revenue
Washoe County, City of Reno, City of Sparks
FY 2010-11

General Fund	Washoe County	City of Reno	City of Sparks
Property Tax Revenue	$147,197,197	$47,893,270	$20,283,505
Total Fund Revenue	271,483,901	169,964,679	54,041,999
% of Total	**54%**	**28%**	**38%**

Property tax revenue is also used to provide funding for other programs, including Special Revenue, Capital Improvement, and Debt Funds. City of Reno is expected to receive a total of $63.3 million in property tax revenue in FY 2010-11 for all funds, including General Fund.[23] City of Sparks generates revenue only for the General Fund, which, as mentioned previously, is projected to receive $20.3 million in FY 2010-11.

Table 6
Total Property Tax Revenue by Fund
City of Reno-FY 2010-11

General Fund	
General Fund	$ 47,893,270
Special Revenue Funds	
Street Fund	$ 14,254,737
Debt Service Fund	
Debt Service	$ 1,182,721
Total Revenue	**$ 63,330,728**

Washoe County is projected to receive $186.8 million in property tax revenue for all County funds (including General Fund) in FY 2010-11, as shown below:[24]

[22] Data from Washoe County, City of Reno, and City of Sparks Budget, FY 2010-11.
[23] City of Reno Budget, FY 2010-11.
[24] Washoe County Budget, FY 2010-11.

Table 7
Total Property Tax Revenue by Fund
Washoe County-FY 2010-11

General Fund	
General Fund	$ 147,197,197
Special Revenue Funds	
Library Expansion	$ 2,701,041
Animal Services	4,043,561
Indigent Tax Levy	10,133,903
Child Protective Services	5,402,081
Senior Services	1,351,520
Other Restricted Revenue	1,353,020
Capital Improvements Fund	
Capital Facilities Tax	$ 6,762,601
Debt Service Fund	
Debt Service	$ 7,830,019
Total Revenue	**$ 186,774,943**

As important as property tax revenue has been to the ability of Washoe County's jurisdictions to fund their expenses, these jurisdictions have experienced a decline in property tax revenues recently, impacting their funding abilities. The below graph compares General Fund property tax revenue per capita for City of Sparks, City of Reno and Washoe County between FY 2005 and FY 2011.

The graph shows that starting in FY 2009 per capita General Fund property tax revenue began to decline, in FY 2011; Washoe County is expected to receive the same level of per capita property tax revenue in its General Fund as it received in FY 2007. Similar declines can be seen for City of Reno and City of Sparks.

Table 8 below shows that General Fund property tax revenue is declining while population either continues to grow, as is the case with City of Sparks, or declines slightly, but not enough to offset revenue declines.

Graph 3
General Fund Property Tax Revenue per Capita
Washoe County and Cities of Reno and Sparks

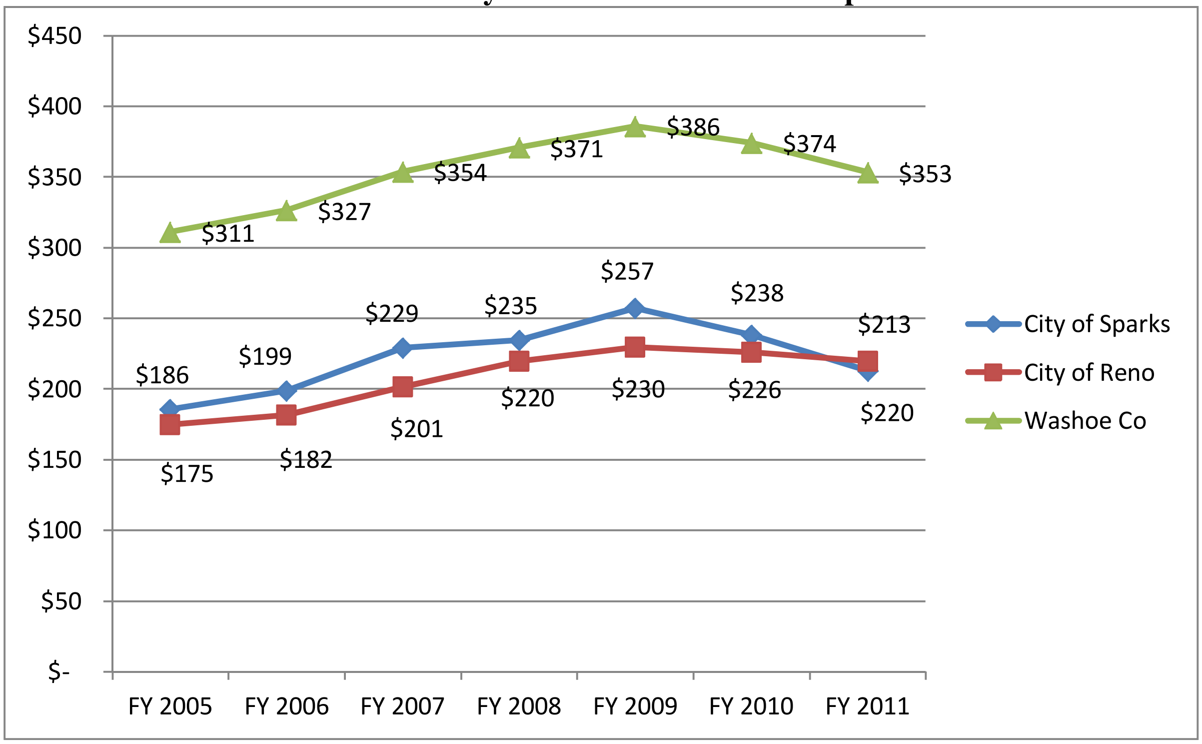

Table 8
General Fund Property Tax Revenue and Population
Washoe County and Cities of Reno and Sparks[25]

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
City of Sparks							
Revenue	$15,897,991	$17,475,666	$20,486,904	$21,518,866	$23,471,888	$22,252,948	$20,283,505
Population	85,618	87,846	89,449	91,684	91,237	93,335	95,202
Rev./Capita	$ 186	$ 199	$ 229	$ 235	$ 257	$ 238	$ 213
City of Reno							
Revenue	$36,173,857	$38,909,583	$44,438,035	$47,035,412	$50,632,981	$50,382,394	$47,893,270
Population	206,735	214,371	220,613	214,071	220,613	223,010	218,143
Rev./Capita	$ 175	$ 182	$ 201	$ 220	$ 230	$ 226	$ 220
Washoe County							
Revenue	116,094,464	125,233,434	140,497,535	151,801,488	161,406,754	158,664,701	147,197,197
Population	373,233	383,453	396,844	409,085	418,061	423,833	416,632
Rev./Capita	$ 311	$ 327	$ 354	$ 371	$ 386	$ 374	$ 353

[25] Washoe County, City of Reno, and City of Sparks annual budgets and Comprehensive Annual Financial Reports (CAFR), as available.

As important as property tax revenue is to funding of local government services, revenue restrictions created by the property tax system may preclude these jurisdictions from being able to grow revenues to meet increasing public service costs due to population changes and increasing medical and other employment costs.

Confusion Among Taxpayers

Washoe County Assessor's website features a section on the question of "Why did my tax bill increase when my assessed value decreased or did not change?"[26] This is a question I have heard on a number of occasions since the implementation of AB 489. In the case of AB 489, the property may have some value that was abated previously due to the 3% annual property tax bill increase limit, the property owner is now paying taxes on some portion of the abated assessed value.

A similar problem, however, may occur outside of AB 489. If home market values are decreasing rapidly, it may be some time before construction costs begin to decline. If this occurs, replacement values may not fall as quickly as market values. Homeowners may notice that while the value of their home decreased, their property tax bill has not decreased at the same rate. While the value of the land may have fallen, the value of improvements may not have changed significantly.

The currently system, composed of numerous components, including replacement value, abatement, and depreciation may be difficult for a typical taxpayer to understand. Most taxpayers are able to understand home values and have an general idea of the value of their home, few take the time to think of their home in terms of land and improvement values, and fewer still have an idea of their home's replacement value and the economic impact on this value.

While no one will complain that their tax bill is not increasing with the rate of market value growth, when the opposite occurs, someone not familiar with the system may think that either a

[26] "Frequently Asked Questions." Washoe County Assessor website.

mistake was made on the tax bill calculation or the government is increasing taxes in a recession. Both ideas may foster distrust and neither idea is positive to the local government's image.

SUGGESTED SOLUTIONS

Reno Gazette Journal, during the 2010 Election, posted a quote by Washoe County's Assessor, Josh Wilson. He stated the following:[27]

> "I would recommend that the Nevada Legislature amend the dual 3% or 8% property tax abatement to a single abatement percentage. I don't care what number they pick, but a single abatement percentage would be fairer and less costly to administer. The administration of the dual cap costs taxpayers thousands through the annual review process required and loopholes have been created as well. I don't think it's right that a taxpayer from the Bay area can qualify for the lower 3% cap on their vacation property because it's their "primary residence in Nevada" but a resident in Nevada who has another vacation property in the state does not qualify and gets hit with the higher cap. I am a strong supporter of the tax cap, but I would suggest doing away with the dual cap structure and replace it with a single cap.
>
> I would also recommend that real property assessments be based on Market Value like all of the other states in the Nation. The current bifurcated system in Nevada is difficult for the typical taxpayer to understand and places a higher tax burden on the newer home property owners due to the 1.5% straight-line depreciation rate pursuant to statute. While I've found homeowners typically understand what their total property value is worth, segregating the land value out separately from the improvement value creates confusion for most. Under Nevada's current system, land is valued at its "full cash value" (market value) and improvement are valued using the Marshall and Swift cost manuals and depreciated at 1.5% per year based on the age of the improvements. The implementation of this system produces a higher sales ratio (taxable value / market value) for the newer properties verses the older properties who receive the benefit of the generous 1.5% per year depreciation rate, which ultimately places a higher tax burden on newer homes. If the assessments were based on Market Value, tax burdens would be based on the property's value, not the property's age."

[27] "Washoe County Assessor." *Election 2010.* Reno Gazette Journal.

Given the problems with the existing system, as discussed in the above section, Mr. Wilson's suggestion makes much sense. Not only is the new abatement system unfair and confusing, it is added to an already complex system of replacement valuation minus depreciation.

Removal of Depreciation

Changes to the Nevada property tax structure have been discussed over the years. In 2001, City of Sparks conducted a number of studies on the impact of depreciation removal of local and State governments. Other organizations and groups have considered this as well.

One of the roadblocks on the road to depreciation removal is an opinion issued in 2001 by the Legislative Council Bureau (LCB) in response to two proposals by the City of Sparks to remove depreciation from property tax calculation. The first proposal was to remove depreciation completely once each existing property was sold. The second proposal was to restart depreciation each time a property was sold, restarting property depreciation once the property was transferred to the new owner, until the next sale.

LCB's opinion was as follows:

> "Based on the language of the Nevada Constitution and on the decisions of the Nevada Supreme Court.., it appears that each of the two proposals that we have considered would likely violate section 1 of article 10 of the Nevada Constitution because each proposal would provide a distinct tax advantage to certain owners of real property with improvements depending upon the date that the owners of such property acquired the property… Although the enactments of either one of the two proposals at issue does not appear to be constitutionally defensible at this time because each proposal would likely violate section 1 of article 10 of the Nevada Constitution, either proposal may be enacted if the Nevada Constitution were amended to allow for such a statutory scheme."[28]

This means that depreciation cannot be removed partially, nor can it be removed with the sale of the property, it must be removed completely or not at all. One of the least painful depreciation

[28] Letter to William Isaeff, City of Sparks from the Legislative Counsel Bureau, dated March 6, 2001.

removal methods would have been to remove it at property sale. That way the currently owner, who did not budget for higher property tax bills would not be impacted and the new buyer would have to consider the higher property tax bill when making the decision to purchase the home. However, as is clear from the above opinion, the only way to do this would be to make an amendment to the appropriate section in the Nevada Constitution, which will require much time and effort and is unlikely to be supportable.

There is no argument that removing depreciation will impact taxpayers, especially those in older homes, whose property tax bill would increase dramatically if depreciation of their older structures is removed. One of the options is to remove depreciation over a period of time, such as 5 years, allowing residents to catch up with the higher bill amount over a five-year period, rather than overnight. Another way to lessen the impact is as assessed values increase due to depreciation removal, property tax rates can be lowered to generate the same amount of property tax revenue as before, reducing the immediate impact on taxpayers.

According to Washoe County Assessor's office, the current value of all property improvements in Washoe County is $45.3 billion using the replacement value approach. Total depreciation on these improvements is $14.7 billion, resulting in $30.6 billion of taxable value of improvements on which property tax is assessed.[29] Table 9 shows that improvements are currently generating approximately $382.9 million in property tax revenue for Washoe County's local governments and the State[30] using the average county-wide property tax rate for FY 2010-11 of $3.5623.[31] Only improvements are considered as land values will not be impacted by the removal of depreciation and therefore are not necessary for this analysis.

Table 9 also shows the increase in taxable value and resulting property tax revenue of Washoe County improvements if all depreciation is removed in Year 1. For simplicity, the analysis assumes no annual increases in taxable value, as it is unknown at this point what these increases may be. This allows for easy comparison of impacts of depreciation removal without impacts of

[29] Information provided by Doug Dufva, Washoe County Assessor's Office.
[30] This is an example assuming no abatement or other property tax limitations and may not equal the actual amount collected.
[31] "Property Tax Rates for Nevada Local Governments for Fiscal Year 2010-11" report published by the Nevada Department of Taxation.

other changes. The table shows that if depreciation is removed, Washoe County will receive additional revenue of $183.0 million annually starting in Year 1.

Table 9
Impact of Depreciation Removal on Washoe County Improvements Revenue
Single-Year Removal

	Current	Year 1	Year 2	Year 3	Year 4	Year 5
Taxable Value	$30,585,888,673	$45,259,504,722	$45,259,504,722	$45,259,504,722	$45,259,504,722	$45,259,504,722
Assessed Value (35% of Taxable Value)	10,705,061,036	15,840,826,653	15,840,826,653	15,840,826,653	15,840,826,653	15,840,826,653
Property Tax Revenue	381,346,389	564,297,768	564,297,768	564,297,768	564,297,768	564,297,768
Difference from Current	**$ -**	**$ 182,951,379**	**$ 182,951,379**	**$ 182,951,379**	**$ 182,951,379**	**$ 182,951,379**

Table 10 below shows the impacts on taxable values and property tax revenue for Washoe County if depreciation is removed over a 5-year period.

Table 10
Impact of Depreciation Removal on Washoe County Improvements Revenue
Five-Year Removal

	Current	Year 1	Year 2	Year 3	Year 4	Year 5
Taxable Value	$30,585,888,673	$33,520,611,883	$36,455,335,093	$39,390,058,302	$42,324,781,512	$45,259,504,722
Assessed Value (35% of Taxable Value)	10,705,061,036	11,732,214,159	12,759,367,282	13,786,520,406	14,813,673,529	15,840,826,653
Property Tax Revenue	381,346,389	417,936,665	454,526,941	491,117,216	527,707,492	564,297,768
Difference from Current	**$ -**	**$ 36,590,276**	**$ 73,180,551**	**$ 109,770,827**	**$ 146,361,103**	**$ 182,951,379**

Table 10 shows that taxable value is increased by one-fifth of accumulated depreciation in each year, reaching total non-depreciated improvement value of $45.3 billion in Year 5. This gradual removal will still generate additional, albeit lower, property tax revenue for Washoe County, but will allow taxpayers time to acclimate to rising property tax burdens.

Table 2 earlier in the analysis discussed the inequity created due to depreciation, with the owner of the older home paying approximately $500 less in property tax bills than the owner of a newer home, despite the fact that the market value of both homes is the same. Taking this example and assuming the removal of depreciation, results in a different tax bill amount for both homeowners.

Table 11
Example of Property Tax Bill Calculation[32]
Older vs. Newer Homes
Assuming Depreciation Removal

	Old Home		**New Home**	
	Market Value	**Replacement Value**	**Market Value**	**Replacement Value**
Taxable Value	$200,000	$250,924	$200,000	$162,352
Age of Home (*Years*)	48 years		9 years	
Assessed Value (35% of Taxable Value)	$70,000	$87,823	$70,000	$56,823
Property Tax Bill	**$2,494**	**$3,129**	**$2,494**	**$2,024**
Increase in Property Tax Bill Due to Depreciation Removal	**$0**	**$1,756**	**$0**	**$157**

The 48-year home's improvements would be expected to be depreciated by 70%, paying taxes on 30% of improvement values and 100% of land values. Land values for this home are currently $51,100 and building/improvements values are $59,000. Assuming 70% depreciation, the actual value of improvements should be approximately $199,800, with the addition of land value, total home value should be approximately $251,000. In the above table, this value results in a new tax bill of $3,129, more than twice the amount of the bill calculated in Table 2.

For the newer home, approximately 12% of improvements have been depreciated to $92,300, resulting in an un-depreciated value of $105,000. Given then land value of $57,400, total taxable value for this home can be estimated at $162,300 as shown in the table above. The new tax bill for this home would be just over $2,000, a much smaller increase than the increase for the older home. If depreciation removal occurs over a 5-year period, the increase in property tax bills for both homes will happen more gradual, reaching the amounts shown in Table 11 in Year 5.

As shown, removal of depreciation will not be painless, tax burdens on taxpayers, especially those in older homes will increase as assessed values increase. When Indiana moved from a replacement minus depreciation system to one of market value-in-use[33] in 2002, they adjusted all values to 1999 levels in order to minimize the impact on taxpayers. Still the burden on the

[32] This example excludes any actual abatement that may be incurred by this property as detailed data for these abatements is unavailable. The example assumes no past abatements exist.
[33] Market value-in-use system differs slightly from the regular market value approach as it considers the property's existing use in determining value, not the "highest and best" use considered for most other market value estimates.

taxpayers was so large and unexpected that the State spent millions of dollars in tax relief payments to homeowners, mostly in the older homes.[34]

As discussed above, one of the options is to reduce the property tax rate as taxable values increase, thus generating the same level of revenue and having less impact on homeowners. It may be that owners of the oldest structures will still have to pay a higher amount and those of newest structures may actually see a bill reduction. A lower rate will also allow local jurisdictions to increase rates in the future to raise additional revenue. Table 12 below shows that in order to continue to receive the current level of property tax revenue; Washoe County can remove depreciation in Year 1 and cut the property tax rate to $2.4 per $100 of value.

Table 12
Impact of Depreciation Removal on Washoe County Property Tax Rate
Single-Year Removal

	Current	Year 1	Year 2	Year 3	Year 4	Year 5
Property Tax Revenue	$ 381,346,389	$ 381,346,389	$ 381,346,389	$ 381,346,389	$ 381,346,389	$ 381,346,389
Taxable Value	$30,585,888,673	$45,259,504,722	$45,259,504,722	$45,259,504,722	$45,259,504,722	$45,259,504,722
Assessed Value (35% of Taxable Value)	10,705,061,036	15,840,826,653	15,840,826,653	15,840,826,653	15,840,826,653	15,840,826,653
Property Tax Rate	**$ 3.5623**	**$ 2.4074**	**$ 2.4074**	**$ 2.4074**	**$ 2.4074**	**$ 2.4074**

If depreciation is removed over a 5-year period, property tax rate can be reduced gradually, reaching $2.4 per $100 of assessed value in Year 5.

Table 13
Impact of Depreciation Removal on Washoe County Property Tax Rate
Five-Year Removal

	Current	Year 1	Year 2	Year 3	Year 4	Year 5
Property Tax Revenue	$ 381,346,389	$ 381,346,389	$ 381,346,389	$ 381,346,389	$ 381,346,389	$ 381,346,389
Taxable Value	$30,585,888,673	$33,520,611,883	$36,455,335,093	$39,390,058,302	$42,324,781,512	$45,259,504,722
Assessed Value (35% of Taxable Value)	10,705,061,036	11,732,214,159	12,759,367,282	13,786,520,406	14,813,673,529	15,840,826,653
Property Tax Rate	**$ 3.5623**	**$ 3.2504**	**$ 2.9888**	**$ 2.7661**	**$ 2.5743**	**$ 2.4074**

Continuing with the example from Table 11, if depreciation is removed and property tax rates are decreased to capture the same level of revenue for the County, the tax burden on the older home

[34] "Indiana Property Taxes." Indiana Association for Community Economic Development. January 2008.

owner increases by $740, while the new home owner will pay almost $500 less than with depreciation.

Table 14
Example of Property Tax Bill Calculation[35]
Older vs. Newer Homes
Assuming Depreciation Removal and

	Old Home	New Home
Taxable Value	$250,924	$162,352
Age of Home (*Years*)	48 years	9 years
Assessed Value (35% of Taxable Value)	$87,823	$56,823
Property Tax Bill[36]	**$2,114**	**$1,368**
Change in Property Tax Bill Due to Depreciation Removal and Lower Tax Rate	**$742**	**($499)**

Market Value Approach

Many argue that removal of depreciation is only a part of the solution. Nevada is still the only state in the nation using the replacement value approach. As discussed above, Indiana, the only other state utilizing this approach, removed both depreciation and replacement value approach in favor of a modified market value approach. Replacement approach, with or without depreciation, still undervalues properties compared to the market approach as shown in Graph 2 of this report.

Table 11 of this report showed that for the new home, replacement value without depreciation was still lower than the market value. The older home's replacement value exceeds market value, though it is likely that the market value of the home was underestimated as the home was a foreclosure that was returned back to the bank, which is common for homes in this area, but is an anomaly that will likely be resolved once homes in the area begin recovering their values.

As discussed earlier in the report and shown in Graph 2, even now, when market values have been declining, market values per square foot for most homes exceed taxable value (replacement minus depreciation). Data for single family home sales recorded in Washoe County in the first two weeks of January 2011 showed average market values per square foot of $113 and taxable

[35] This example excludes any actual abatement that may be incurred by this property as detailed data for these abatements is unavailable. The example assumes no past abatements exist.
[36] Using a property tax rate of $2.4074 per $100 of assessed value.

values per square foot of $96, an 18% difference.[37] If this difference is consistent for multi-family, commercial and other uses, we would expect that the switch from replacement to market value to generate $215.9 million in annual additional property tax revenue for Washoe County starting in Year 5, if depreciation is removed over a 5-year period and in the fifth year market value approach replaces replacement value approach, an 18% additional increase due to the valuation approach change.

Table 15
Impact of Change to Market Value Approach on
Washoe County Improvements Revenue
Five-Year Change

	Current	Year 1	Year 2	Year 3	Year 4	Year 5
Taxable Value	$30,585,888,673	$33,520,611,883	$36,455,335,093	$39,390,058,302	$42,324,781,512	$47,900,755,611
Assessed Value (35% of Taxable Value)	10,705,061,036	11,732,214,159	12,759,367,282	13,786,520,406	14,813,673,529	16,765,264,464
Property Tax Revenue	381,346,389	417,936,665	454,526,941	491,117,216	527,707,492	597,229,016
Difference from Current	**$ -**	**$ 36,590,276**	**$ 73,180,551**	**$ 109,770,827**	**$ 146,361,103**	**$ 215,882,627**

Conclusion

Nevada is the only state in the nation that uses the replacement minus depreciation approach to value improvements, which yields lower values than the more accepted market value approach. In addition, a property tax rate and bill caps place further restrictions on revenues that can be generated through property taxes for Nevada State and local governments.

There are a number of issues with the existing property tax system in the State. It creates inequality among taxpayers; those with older homes pay lower property taxes than those with newer homes, due to home depreciation. The system also restricts the amount of property tax revenue that can be generated by properties for local governments. Finally, the complex system creates confusion among taxpayers and may build distrust of the entire system.

[37] Market Value data from "Sales Report-2011 Sales YTD" and taxable value data from "Property Assessment Data" search for each parcel. Washoe County Assessor's website.

A solution that may correct the majority of these issues is the removal of depreciation, or even more effective, the switch from the replacement value approach to the market value approach. These changes may take time and will have an impact on taxpayers; some of the impacts can be minimized through introducing changes over a period of time and reducing property tax rates. When fully implemented, both options can eliminate taxpayer inequity as all homes will be valued using the same approach and rates, regardless of structure age. These changes will also lead to increased assessed values, allowing local governments to generated additional revenues, as needed. Finally, a simpler replacement approach without depreciation should lead to an easier understanding of the system by taxpayers. A market system will be easier still as more homeowners already think of their property in market terms.

Overall, the removal of depreciation or a switch to the market value approach is viable option for the state facing large budget deficits. The process of implementing these changes, however, will not be easy as it will negatively impact taxpayers, who are also the voters who may have to approve these changes.