SB33

Lodging Property Tax Treatment: Revenue Impact & Economic Consequences Study

Prepared by
Laffer Associates

Colorado SB33 – Lodging Property Tax Treatment: Revenue Impact & Economic Consequences[1]

Laffer Associates

The following paper is an economic analysis based on a review of Colorado SB33 ("Lodging Property Tax Treatment Bill") using data from both government and private sector sources.

Executive Summary

- Reassessing short-term rental (STR) properties at a commercial rate under SB33 fails to generate any meaningful level of additional local property tax revenue and drives other tax revenues downward, likely resulting in a net negative impact on total state and local tax revenues.
- The Colorado Legislative Council Staff's Fiscal Note for SB33 overstates revenue projections due to an assumption that STR owners will not have a behavioral response to the property tax changes in SB33. Survey results suggest 89% of STR owners will completely avoid the rate increase by reducing annual bookings to 90 days or less. Further analysis of these survey results leads us to believe that SB33 would reduce total STR nights booked per year by 55.7%.
- SB33 threatens $1.36 billion in STR visitor spending per year and an associated 8,148 tourism-related jobs. In addition, SB33 depresses non-property tax revenues.
- Limiting STR value assessments to one allowable approach places STR at an unfair competitive disadvantage within the Colorado lodging market.

Background

Colorado's SB33 is a piece of legislation related to the property tax classification of properties used as short-term rentals (STRs). Drawing from the Colorado Legislative Council Staff's Fiscal Note for SB33.

> "The bill classifies property designed for use as a residence, but that is only used for short-term rentals, as lodging property under the definition of hotels and motels.
>
> The bill also requires that homes not used as primary residences and that are used mostly as short-term rental units be classified and assessed as lodging property, beginning with the 2026 property tax year. These homes will be classified as lodging property if they were leased for short-term stays more than 90 days during the year."[2]

SB33 has been labeled as a revenue raiser, with the Fiscal Note estimating an additional $371.2 million in annual property taxes once the provisions of SB33 take effect in 2026. The Fiscal Note arrives at this conclusion by estimating the size of 2026 assessed value for properties used as short-term rental units under the current residential classification ($1.97 billion of assessed value) versus SB33's lodging classification ($7.98 billion).[3] SB33's four-times-higher

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[1] For clarity, iterations of SB33 have also been know as "Bill 6" and "Bill C."
[2] "Fiscal Note SB33 (formerly labeled "Bill 6") – Lodging Property Tax Treatment," Colorado Legislative Council Staff, October 2023. https://leg.colorado.gov/sites/default/files/images/committees/fiscal_note_bill_6_-_lodging_property_tax_treatment.pdf
[3] Ibid.

assessed value for STR properties will translate into higher property taxes paid on those properties reclassified as lodging properties.

Reading the Fiscal Note alone leaves the impression that STRs will simply be moved from one property classification to another. This is, unfortunately, not the case. The excerpt from SB33 below stipulates that while STRs will be subject to the higher assessment rate, favorable assessment approaches that lower the assessed value of properties afforded to commercial lodging properties are not accessible to STR owners.[4]

> "Notwithstanding the provisions of subsection (5) of this section, the actual value of a short-term rental unit classified as lodging property is determined solely by application of the market approach to appraisal."

Tax Rate Changes and Revenue Estimates – Static vs. Dynamic Thinking

The logic used by the Legislative Council Staff is easy enough to follow, but the reality of tax rate changes and resulting revenue estimates is that they are notoriously difficult to estimate. Why? Because people respond to incentives.

Taxes, by nature, have a negative impact on economic growth and output. The magnitude of a tax's impact is most often a point of debate, however, there is no question that the tax will throttle output. Except for sin taxes (which are meant solely to discourage certain behaviors), taxes are levied for the necessary purpose of raising revenue to provide government services. As such, taxes should raise revenue in the least economically damaging fashion possible.

The most efficient and equitable tax policy is a tax structure where the broadest possible tax base is taxed at a single tax rate. Such an approach provides people with the least incentive to evade, avoid, or otherwise not report taxable activities or assets. While this is a topic for a separate paper, Colorado's use of separate assessment ratios according to property classification (residential property versus lodging property, in SB33's case) violates these principles because it creates multiple tiers of highly varied tax rates according to a property's use rather than maintaining a uniform tax rate and tax base system.[5] Nevertheless, Colorado's system of property taxation, like the property tax systems of many other states, maintains separate property tax classification tiers and allows taxing authorities to discriminate against one use of property versus another, as is the case with SB33.

[4] "SB33 – Concerning the property tax treatment of real property that is used for private lodging," Colorado Senate Finance Committee, January 2024. https://leg.colorado.gov/sites/default/files/documents/2024A/bills/2024a_033_01.pdf
[5] A property tax system such as that in California as set up by Proposition 13 in 1978, in which all properties, no matter their use, are subject to a property tax limit of 1% of market value, is a better system because it eliminates property tax rate arbitrage opportunities.

Ensuing incentive effects of tax rate increases are, classically, reductions in reported amounts of the activity being taxed. We use the word "reported" because there are always efforts to avoid taxation, whether the avoidance is legal or illegal. In SB33's case, the incentive effects of the tax change are obvious: owners of STRs will 1) reduce the number of days they offer their properties as STRs to 90 days or less per year in order to avoid an increase in property taxes, or 2) they will accept their property being reclassified as a lodging property and work to maximize their STR property's revenue to offset the now-higher tax bills they face.

The Fiscal Note's estimated $371.2 million in additional property tax revenue from SB33 is, in our estimate, greatly overstated because it fails to account for the incentive effects—or dynamic effects, as they are called in budgetary terms—from SB33's property tax increase on STRs. Instead, the Fiscal Note's estimates are created using static analysis which fails to account for any actions that property owners will take to avoid their properties being reclassified at lodging property tax rates—the Fiscal Note's methodology assumes that every current property with even 91 days of STR occupancy will be reclassified as a lodging property. Surely any property owner with only 91 rental days will reduce that number to 90 days, thereby avoiding a large property tax increase. In an understated line in the Fiscal Note, the Legislative Council Staff flags this concept as a concern: "Actual impacts may differ from estimates to the extent that the bill discourages listing properties as short-term rentals for more than 90 days."[6] But this isn't all there is.

Dynamic Effects: Tourism Spending

To estimate the state-wide economic impact of SB33, we start by estimating the effects on the supply of short-term rentals offered in Colorado using a combination of survey responses and tourism spending data from the Colorado Office of Economic Development & International Trade (OEDIT). Ultimately, we estimate the STR supply reduction (in the form of total nights booked) due to STR owners' tax avoidance responses. Our estimated supply decline is then applied proportionately to tourism spending figures from the OEDIT to determine the associated decline in tourist spending. This decline in spending will then be translated into job losses in Colorado's tourism industry, again using tourism employment data from OEDIT.

[6] "Fiscal Note SB33 (formerly labeled "Bill 6") – Lodging Property Tax Treatment," Colorado Legislative Council Staff, October 2023. (Page 4) https://leg.colorado.gov/sites/default/files/images/committees/fiscal_note_bill_6_-_lodging_property_tax_treatment.pdf

The survey, conducted by the Colorado Lodging and Resort Alliance (CLARA), gathered responses from over 2,500 current Colorado short-term rental owners throughout November and December 2023, asking respondents for information about their current short-term rental operations and their expected business responses to the tax policy changes proposed in SB33.

The summary of survey results are as follows: 54% would reduce annual STR bookings to 90 nights total, 3% currently book less than 90 nights and will continue to book under 90 nights, 13% would sell their properties, 19% would discontinue offering short-term renting, and only 8%[7] would accept the new assessment rate and continue business as usual.

CLARA's survey responses regarding current short-term rental offerings and plans for post-SB33 short-term rental offerings can be sorted into four categories reflecting the property's current annual nights booked (over or under 90) and planned reduction of offered nights if SB33 is implemented:

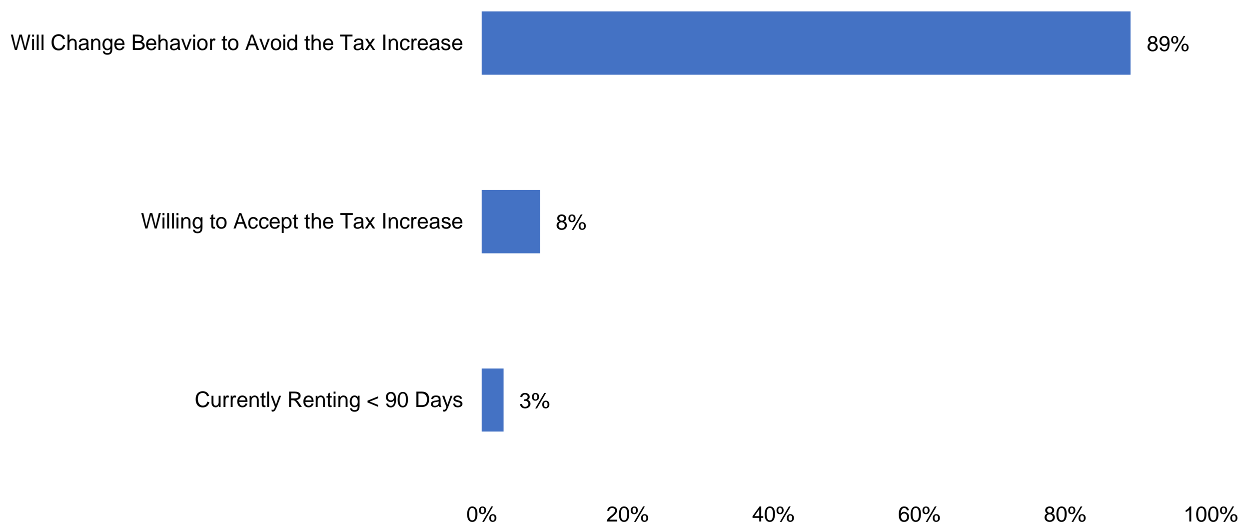
1. The property currently rents for 90 or more nights per year. The owner will limit the property to 90 nights.
2. The property currently rents for 90 or more nights per year. The owner will accept the higher tax rate.
3. The property currently rents for 90 or more nights. The owner will discontinue short-term renting entirely.
4. The property currently rents for less than 90 nights and will continue to do so.

Among survey respondents, the average number of annual booked nights per property is just over 145. After stratifying the respondents by number of annual booked nights over or under 90, we find that the average annual booked nights for the over 90 group is currently 168 and the under 90 group averages 48.79 nights per year. Seeing as there is no reason to alter the number of offered nights if the property already books under the 90-night threshold, all property owners responding they will alter behavior are assigned to the over 90 group. The over 90-night group is further separated into three strata: those maintaining a consistent number of booked nights, those reducing total nights booked to 90, and those reducing booked nights to 0.

We now calculate each of the four groups' relative weights within the sample as well as their average number of annual nights booked. We know that, currently, over 54% of respondents book 90 or more nights, plan to reduce total nights to 90 to avoid the higher assessment rate, and average 168 nights per year. This group's response to SB33 reduces

[7] Totals do not sum to 100% due to rounding and the removal of inconsistent responses.

their average booked nights per year to 90 from 168. By selling the property or discontinuing short-term renting, 33% of STR owners who currently average 168 booked nights per year will reduce booked STR nights to 0. The 3% of STR owners who rent their properties for less than 90 days per year and will continue to do so will average 48.79 nights per year regardless of SB33 implementation. The final group, the 8% of owners who rent out their properties for more than 90 days and are willing to accept SB33's tax increase, average 168 nights per year with or without SB33 implementation. To summarize, survey results suggest 89% of STR owners [100% minus 8% (those willing to accept the tax increase) minus 3% (those who rent for less than 90 days currently)] will completely avoid the rate increase by reducing annual bookings to 90 days or less.



Comparing the pre-SB33 (current) weighted average of nights booked per year of 145 to the post-SB33 weighted average of 64.2, we estimate that SB33 would reduce total STR nights booked per year by 55.73%.

To determine the total impact of lost nights booked, we turn to a measure of total STR guest annual spending. Colorado's OEDIT commissioned an analysis titled "The Economic Impact of Travel" that was published in July 2023.[8] The study seeks to quantify the tourism impact on the state in terms of job growth, earnings, tax revenue, and—most importantly for our purposes—traveler spending. The report breaks down direct travel spending by accommodation type, including short-term vacation rentals. In 2022, tourists who stayed in an STR while visiting Colorado contributed $2.44 billion in spending within the state.[9]

[8] "The Economic Impact of Travel," Dean Runyan Associates, Prepared for Colorado Tourism Office, July 2023. https://oedit.colorado.gov/sites/coedit/files/documents/2022%20DR%20Econ%20Impact%20Report.pdf
[9] Ibid. Page 20. https://oedit.colorado.gov/sites/coedit/files/documents/2022%20DR%20Econ%20Impact%20Report.pdf

Applying the 55.73% reduction in STR availability from current levels to the OEDIT's estimated $2.44 billion of total tourism spending attributable to STR guests in 2022, we arrive at an estimated $1.36 billion per year potential decline in tourist spending. $1.36 billion is a significant portion of Colorado's overall tourism industry. For comparison, $1.36 billion is equivalent to over half of all tourists' spending on recreation and entertainment in 2022 ($2.6 billion).[10]

A reduction in tourism brought on by a decrease in reasonably priced lodging options for visitors carries with it losses in sales, motor fuel, lodging, corporate income, and personal income tax revenues. Of course, every tourist will spend their dollars on some form of lodging, but they also make reservations at local restaurants, rent ski and snowboarding equipment, shop at retail outlets, and fill their gas tanks before driving home. Pricing tourists out of a trip to Colorado comes at a cost. Raising STR property tax rates *may* increase property tax revenue in the short term, but probably not over time, and it will come at a cost to most other forms of taxation. It's a game of Whac-A-Mole tax policy.

Using spending data applicable to aggregate 2022 Colorado overnight visitors from a 2023 OEDIT-commissioned Longwoods International study titled "Colorado Travel Year Report 2022,"[11] we can break our $1.36 billion in at-risk tourism spending figure down into more understandable components: $176 million in retail spending, $209 million in spending on recreation and entertainment, $253 million in restaurant spending, $342 million in transportation at-destination spending, and $378 million in spending on lodging per year. These large components of spending have serious sales (and other) tax implications associated with them and, importantly, thousands of jobs for Colorado residents.

Turning to the first OEDIT report, "The Economic Impact of Travel," asserting every $1 million in travel-related spending leads to six additional Colorado jobs, and our estimated $1.36 billion tourist spending in jeopardy, 8,148 tourism-related jobs are at risk.

The Impact of Property Tax Rate Changes on Property Values

Think of a rental property like you would a bond: its value is a discounted stream of its future cash flows, and anything that reduces the value of its future cash flows has a negative impact on the price you're willing to pay for that income stream. For the purpose at hand, think of rental income as the stream of future cash flows, and think of property tax

[10] Ibid. Page 20. https://oedit.colorado.gov/sites/coedit/files/documents/2022%20DR%20Econ%20Impact%20Report.pdf
[11] "Colorado Travel Year Report," Longwoods International, Prepared for Colorado Tourism Office, July 2023. (Page 28) https://oedit.colorado.gov/sites/coedit/files/documents/2022%20Colorado%20Travel%20USA%20Report_Longwoods%20International.pdf

increases as reductions to the value of those future after-tax cash flows. High property tax rates destroying the value of properties has become a common story in American media over the last decade, with notable examples of properties in cities such as Chicago, IL and Detroit, MI selling for next to nothing to a new owner willing to shoulder the property's excessive tax burden. It takes a long time to build a capital stock such as housing, and it takes a long time to destroy that capital stock, but with excessive property tax rates, it can and does happen.

In this section we will use the most recently available nationwide data to estimate the effect of property tax rate changes on property values.

On an annual basis, the U.S. Census Bureau releases data gathered from the American Community Survey (ACS), its largest household survey program.[12] Fortunately for the purposes of property tax analysis, the ACS collects housing characteristics and tax payments.

To evaluate the hypothetical impact of a property tax rate change, we can employ an empirical analysis of the changes in effective property tax rates (the independent variable) and the response of an economic performance metric over the last 12 years. With this approach, we can exploit the impact effective property tax rate changes have on growth in economic measures across the nation. Our selected performance metric, or response variable, is change in median home value. We expect the rising tax rates imposed by SB33 to have a negative impact on property value growth.

We employ an ordinary least squares (OLS) linear regression model consisting of median home value growth as the dependent variable and growth of effective property tax rates as the independent variable. Both metrics are calculated as the percentage change from 2010 levels to 2022 levels. Unlike median home value data, annual effective property tax rate data require an additional step prior to the growth calculation. Since the ACS does not collect data on tax rates, we derive a series of effective property tax rates using the ACS's median real estate taxes paid divided by median home values.

The 2022 ACS publishes home values and property tax payments across 646 localities, or "places" in the Census Bureau's terminology. 98 localities within the dataset are missing one or more annual recordings of values or tax

[12] U.S. Census Bureau. "ACS Information Guide" https://www.census.gov/content/dam/Census/programs-surveys/acs/about/ACS_Information_Guide.pdf

payments. These localities were removed, leaving a total sample of 548 locations with complete coverage (i.e., no missing data points).

Figure A plots the percentage change in median home value versus the percentage change in median effective property tax rates in 548 U.S. localities from 2010 through 2022. The percent change in median home value is plotted along the vertical axis, and percent change in effective property tax rates are plotted along the horizontal axis. Of the 548 localities included in our sample, 15 are located in Colorado. These observations are highlighted in red.

Figure A
Home Value Appreciation vs. Effective Property Tax Rate Increase
(2010 to 2022 cumulative percent change, datapoints represent 548 Census-defined localities)

Source: U.S. Census Bureau ACS 1-Year Estimates

Table 1
OLS Regression Results

	Dependent variable:
	Median Home Value %▲
Median Effective Property Tax Rate %▲	-1.781***
	(0.075)
Constant	0.580***
	(0.019)
Observations	548
R^2	0.510
Adjusted R^2	0.509
Residual Std. Error	0.329 (df = 546)
F Statistic	568.209*** (df = 1; 546)
Note:	*p<0.1; **p<0.05; ***p<0.01

Table 1 provides a summary of our statistical results. First, an adjusted R-squared value of 0.509 means that 50.9% of the variation in median home value growth is explained, or accounted for, by the percent change in effective property tax rates.

But more importantly, based upon our independent variable coefficient listed in Table 1, a 10% increase in effective property tax rate from 2010 to 2022 (e.g., 1.0% to 1.1%) leads to an expected 17.81% decline in median home value, holding all other influences on property value constant.

In plain terminology, using data from the last twelve years, if a government raises a property's effective tax rate by as little as 10%, in short order, just over one sixth of the property's value will vanish. No natural disasters caused damage to the home, the neighborhood is as safe and clean as it was yesterday, and the local public school is still a selling point to prospective buyers—a local tax rate shifts from 1.0% to 1.1% and the property depreciates nearly 18%. Plus, in due course, the fall in the value of the properties resulting from higher property tax rates will more than offset any tax revenue gain from the tax hike itself.

To address an anticipated misrepresentation of these results, a reduction in home value is not to be interpreted as more affordable homes. Home value is a market-determined value of the property. In other words, it is the price paid to purchase the home. This dollar amount differs from the total cost of home ownership, which is a function of sale price, general upkeep, and maintenance, as well as annual property tax payments. One should also consider the degradation of neighborhoods due to lower tax revenues, worse schools, less police and fire protection, etc.

Growth in home value, or sale price, will fall when property tax rates rise, however, the increase in property tax payments cancels out any cost savings. All other factors constant, the appeal of owning a home either stays flat or declines when higher property tax rates are introduced.

The deterioration in STR property value SB33 provokes carries strong negative dynamic revenue consequences with it—another reason that the Colorado Legislative Council Staff's statically estimated Fiscal Note provides an overly optimistic forecast. The Fiscal Note assumes home values will maintain course without regard to the higher tax rate, and the 4-fold increase in the assessment rate is applied to current projections of future STR values. The Fiscal Note also does not take into account reductions to other forms of tax revenues. Without a doubt, the Fiscal Note's conclusion of local property tax revenue's extraordinary growth from SB33 optimistically misses its mark.

Tax Incidence and Competition

STR property owners are directly responsible for property tax payments. On paper, property owners are the ones actually writing the check. Those tax dollars, however, will ultimately be paid in part by STR guests via higher nightly prices.

The exact degree to which the tax incidence is borne by the STR guests is unclear, but analysis of a 2015 hotel tax in the state of Georgia offers some evidence. In a 2017 article published in the *Journal of Regional Analysis & Policy*, Collins and Stephenson evaluated the outcome of the hotel tax, concluding that 70% of the tax burden was shifted to guests.[13] Applying this result to SB33, 70% of the new revenue collected will be reflected in the STR's rent prices, and these higher prices will be met with diminished quantity demanded, certainly pricing out some STR consumers.

Higher STR prices will also erode the relative competitive position of STRs compared to alternative lodging options such as hotels. In fact, the SB33 Fiscal Note's property tax revenue estimate of $371.2 million per year is larger than the property tax revenue paid by the entire commercial lodging industry in Colorado in 2022. Based on the total assessed value of commercial lodging properties of $2.66 billion, applying the statewide average mill levy shows the commercial lodging industry as a whole contributed only an approximate $226.6 million in property tax revenue.[14]

[13] Collins, Clay, and E. Frank Stephenson. "Taxing the travelers: A note on hotel tax incidence." *Journal of Regional Analysis & Policy* 48.1 (2018).

[14] "Fifty-Second Annual Report," Department of Local Affairs, Division of Property Taxation. https://drive.google.com/file/d/1YKehl5uh-8cNHt6VcKl162EfQxo--y01/view

Assessment Approaches and Competition

Colorado property values are assessed by county officials who use one of three approaches—market, cost, or income.[15] The market approach bases the valuation of the property on "an analysis of arm's-length sales of similar properties." The cost approach assesses property value according to the total cost of replacing the property with a substitute property "equivalent in function and utility." Cost approach assessments also consider accumulated depreciation of the current property. The income approach determines value by capitalizing the annual net income of the property, accounting for investors' financial return on the investment.

The approach county assessors are permitted to use is limited by the type of property in question. Commercial properties may be assessed using any of the three approaches. Residential property, which currently includes STRs, is assessed using the market approach. With no deductions for depreciation in the cost approach, or capitalization in the income approach, the market approach produces the higher valuations. Under SB33, all commercial properties may be assessed with any approach, except for STRs, which remain constrained to the market valuation approach—the approach with the highest valuation. It is unclear to us why SB33 removes alternative valuation approach options for STRs, and it seems to place STR owners at an unfair disadvantage against competing lodging options.

If a Colorado property owner disagrees with the assessed value, a lengthy appeals process ensues. The appeal is first addressed by the county assessor. If the property owner remains dissatisfied with the assessment, the appeals process continues to the county board of equalization. Further appeals are taken up by the court system. The market assessment approach, by far, is the most restrictive in the appeals process. Decisionmakers evaluating the appeals made by non-STR property owners have the option to use an alternative approach to reduce the assessed value and settle the matter. Large commercial lodging enterprises, armed with in-house lawyers and accountants, are far more likely to enjoy a successful appeals process than owners of STR properties.

[15] "Property Valuation and Taxation for Business and Industry in Colorado," Department of Local Affairs. https://dpt.colorado.gov/property-valuation-and-taxation-for-business-and-industry-in-colorado.