

TEXAS ASSOCIATION *of* COUNTIES

October 10, 2011

Information for County Officials

INTERIM CHARGE #1: *Examine the system of appraising property for tax purposes, specifically include an examination of the appeals process, the application and effects of the rollback rate and the limit on annual tax increases of all property.*

The Rationale behind Appraisal Caps

Appraisal caps are an exception to Article 8, Section 1, of the Texas Constitution, which provides that all property taxes must be equal and uniform. They are also an exception to the statutory requirement that all appraisals be at market value. Appraisal caps prevent appraisals from growing beyond a certain percentage from year to year.¹ Under current Texas law, residential homestead property appraisals are “capped” at ten percent growth per year. Some states, such as Florida, apply a variable cap. Florida caps appraisal increases at the lower of three percent or the rate of inflation. California, through its now infamous Prop 13, caps appraisal increases at two percent. Various proposals in Texas would cap appraisal increases at five percent, three percent, or even zero percent. Some of the proposals would extend caps to non-homestead property, and some to commercial property as well.

Proponents of appraisal caps make three general arguments in their favor. First, it is argued that appraisal caps prevent people from being taxed out of their homes. According to this argument, when persons purchase a home it is assumed that they buy all the house that they can afford. While a mortgage is a relatively fixed expense, a property tax bill is not. Accordingly, rapidly increasing property taxes frustrate homeowners’ expectations and threaten their budgets. Presumably, taxes could rise so quickly that a person could no longer afford to pay them, and the house could then face foreclosure by taxing entities.

Though homesteads are justifiably not protected from foreclosure for non-payment of taxes, it is argued that the possibility of foreclosure due to increased taxes is unfair. When it is pointed out that rising tax bills reflect an underlying increase in net wealth through rising equity, proponents of appraisal caps counter that homesteads are an “illiquid” asset that cannot be conveniently tapped to pay those taxes. It is likely that this argument goes deeper, however, and reflects a general distaste for paying property taxes that exceed those paid at the time the home was purchased, regardless of rising equity. Otherwise,

¹ Unlike most property tax exemptions, which limit taxable value, appraisal caps literally limit appraised value according to the statute. Appraisers nevertheless continue to calculate the true market value of property prior to the application of the cap. Capped property thus has three different values for tax purposes: true market value; appraised value, which considers the application of caps; and taxable value, which considers the application of other exemptions.

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proponents of appraisal caps would be willing to pay the balance of capped taxes upon the sale of the home. This compromise is never offered, however.

Second, it is argued that appraisal caps force governments to be more honest about taxes. Local governments are accused of hiding their tax increases behind appraisal increases. For example, if appraisals increase by six percent in any given year, a city council can simply adopt the previous year's actual tax rate, thus enjoying a "free" six-percent increase in total tax revenue. Appraisal caps, it is argued, will limit the ability to use the previous year's tax rate in such a situation, and force the council to conspicuously raise the actual tax rate if increased tax revenues are desired. This forced increase in the actual tax rate, it is argued, is more transparent and "honest" than relying on appraisal increases.

Finally, it is argued that appraisal caps guard against improperly inflated appraisals. Some persons are convinced that all appraisals, particularly increasing appraisals, are grossly inaccurate. Thus, they view appraisal caps as a necessary check and balance on the process. It is argued that the so-called "mass appraisal system," which relies on trend data and statistics rather than individual appraisals of every property in the district, is inherently flawed. Appraisal cap proponents submit that caps, while not necessarily resulting in accurate appraisals by themselves, are necessary to rectify gross appraisal error.

While some of these arguments have merit, many are based on flawed assumptions. In addition, the benefits of appraisal caps tend to be overshadowed by their serious negative features.

Negative Consequences of Appraisal Caps

Although appraisal caps are enacted with the best of intentions, they generate very negative, unintended consequences. Some of these negative effects are discussed below.

Unfair Shift of Property Tax Burden

Appraisal caps unfairly shift the property tax burden from the wealthiest of property owners to the less wealthy. Caps are, in fact, intended to reduce the property tax burden of those whose residential property is appreciating in value. All other things being equal, caps will shift the property tax burden to those whose residential property is not appreciating or is appreciating more slowly.

It comes as no surprise that the wealthy tend to own the residential property that's appreciating. The Dallas Central Appraisal District (DCAD) reports that:

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1. The residential value loss due to the current ten-percent cap was \$1.642 billion in Dallas County in 2003.
2. Most of the neighborhoods experiencing the greatest advantage from the appraisal cap are also the wealthiest neighborhoods in the county.
3. The largest portion of the minority population receives little or no benefit from the appraisal cap.
4. Many communities in Dallas County never see any benefit from the appraisal cap because property values rarely appreciate above the mandated limit. This results in different communities paying taxes on a greater percentage of their actual market value.

In a *Dallas Morning News* article, Foy Mitchell, the DCAD chief appraiser, expanded on this tax-shift problem:

In 2003, more than 90 percent of the Dallas County properties that benefited from the current 10 percent cap were north of IH30, Mr. Mitchell said. (This is where most of the county's wealthiest neighborhoods are located.) In one neighborhood of 51 homes, \$25 million worth of property went untaxed because of the cap, he said. Averaged out, each home was undervalued by about \$500,000 for tax purposes. Each homeowner paid \$14,000 less in property taxes than he would have without the cap. Homeowners in areas where values stayed flat weren't so lucky. They paid taxes based on the full value of their properties, so they shelled out disproportionately more than homeowners who lived in fast-appreciating neighborhoods.

Finally, the State Comptroller's incidence analysis for the current ten-percent cap shows that for school property taxes, the two highest deciles of family income (families making more than \$90,149 annually) receive 48.3 percent of the cap's benefit to Texas residents.

Inequities between Similar Properties

An appraisal cap stays in place until a residential property is sold. At that time, the property's appraised value "pops up" to its market value. This creates some rather glaring inequities.

Suppose there are identical, \$75,000 properties at 100 Elm Street and 102 Elm Street. The chart below shows that after 15 years, each property would be appraised at \$148,495 with a five-percent cap in place. Further, suppose that the actual market value of each property grows by seven percent annually to \$193,390. If 102 Elm sells in the fifteenth year, the appraised values would be quite different. All other things being equal, the owners of 102 Elm would pay substantially more in property taxes than would their neighbors.

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The result would be the kind of appraisal unfairness that led to property tax appraisal reforms in Texas in 1979.

With appraisal caps in place, a homeowner's appraised value can increase even when market values are decreasing. If the cap results in 2-3 years of appraised value "catch-up," those appraisal increases can occur while market values are decreasing. This will clearly raise questions among homeowners who are notified of appraisal increases as their homes decrease in market value.

The fact is that any deviation from appraising at market value creates many kinds of unintended consequences and anomalies. Appraised values increasing while market values are decreasing is just one example of the anomalies.

Tax Shifts

Just as appraisal caps shift the property tax burden from some homeowners to others, they also shift the tax burden to businesses, industries, and renters, who don't benefit from caps.

Negative Effects on Real Estate Markets

Appraisal caps very likely to have negative effects on the real estate market. The following example shows why.

Suppose a young married couple purchase a starter home in Austin for \$120,000. Suppose that a three-percent appraisal cap is in place, and that the home's market value increases by eight percent annually. After ten years, the home is worth \$239,880, but the owners are paying taxes on an appraised value of only \$156,573. If the total property tax rate is \$2.50 per \$100 of assessed value, the owners are paying \$3,914 annually in property tax. That's just 1.63 percent of the home's actual value.

After ten years, the couple considers buying a larger home for \$300,000. Because a home's assessed value "pops up" to market value when it is sold, the couple will pay property taxes on the home's full market value of \$300,000. At a composite tax rate of \$2.50, the property tax bill will be \$7,500, or 2.5 percent of the home's actual value. The couple will probably be very surprised to find that purchasing a new home means that property tax (expressed as a percentage of market value) will go up by more than 50 percent! In this way appraisal caps represent a disincentive to purchasing a new larger home.

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Negative Effects on Property-Intensive Industries

While homestead appraisal caps would result in property taxes being shifted to business generally, they would have an especially detrimental impact on those business sectors with a property-intensive focus. It is a criticism of property taxes overall that they focus too much on the “old economy”: heavy industry, manufacturing, mineral extraction, agriculture, and so forth. These businesses have a disproportionately large degree of reliance on land and equipment. As the Texas economy shifts away from these industries and into personnel-intensive areas such as the high-tech and service industries, business property taxes will naturally become more concentrated on the remaining, old economy base. The tax-shifting effect of residential appraisal caps would unfortunately accelerate this process, further eroding the tax base to the detriment of those very industries that are presently suffering most. Representatives of the 43 timber-growing counties of East Texas testified before our Committee that appraisal caps would be “devastating” to them, because their industry is one in which taxable values are already headed in the wrong direction.

The Texas Legislature has chosen over the years to implement certain safeguards to prevent such a shift; these safeguards have taken the form of special appraisal rules for agriculture, timber, industrial pollution control equipment, manufacturing equipment, and others. Appraisal caps will effectively roll back many of those protections.

Appraisal Caps and Tax Increases

When property values are climbing, effective tax rates force local governments to start each budget year at a lower baseline tax rate than the year before in order to compensate for rising property values. Property values don’t always rise, however. When values fall, the effective tax rate will be higher than last year’s actual tax rate. Interestingly, cities facing falling property values are often reluctant to take advantage of the higher effective rate available to them. Sometimes a city will simply adopt the same actual tax rate it had in the previous year, despite the fact that this results in lower revenue. The City of Orange may be an example of this:

2001 Tax Rate	2001 Tax Levy	2002 Tax Rate	2002 Tax Levy
\$0.846/\$100	\$3,723,894	\$0.846/\$100	\$3,719,163

The fact that the tax levy fell from 2001 to 2002, even though the rate remained constant, indicates declining property values. Orange was free to raise its tax rate at least to the point

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necessary to generate the previous year's revenue, yet it chose not to.² Thus, cities find themselves constrained **both** by the effective and the actual rates, and occasionally refuse to put greater burden on homeowners, even though they are permitted to by law.

Appraisal caps significantly lower than the ten percent specified in current law could put an end to this largesse. By taking significant amounts of taxable value off the rolls from year to year, cities and other taxing entities will likely find themselves forced to take advantage of the full effective rate available to them every year, if not more. The psychological barrier imposed by last year's actual rate will fall to the reality of a shrinking tax base.

Differences between Cities

There are more than 1,200 cities in Texas, varying in population from nearly two million (Houston) to many with less than one hundred. Most cities levy both a property tax and a sales tax. Some cities have only a property tax. Some cities have only a sales tax. Some cities have neither. In some cities, property values are rising rapidly, while values stagnate in others. Proposals for significantly lower appraisal caps would apply to all these Texas cities, completely ignoring important distinctions that might render caps useless or, in some areas, harmful.

Much of the philosophical initiative for appraisal caps originates in the Houston and Harris County area. Houston is not necessarily typical of Texas cities in size or in revenue diversity. Applying a one-size-fits-all philosophy based on the experience of a single city could prove disastrous. Take Garland, for example. Garland is a sizable bedroom community, similar in many respects to Arlington. Unlike Arlington, however, Garland has an unusually small sales tax base. The mayor of Garland testified before our Committee that for a city of 200,000, Garland has relatively little retail sales: it is impossible to buy a man's suit there! Arlington, on the other hand, has the Parks Mall, one of the most profitable retail malls in the state. Obviously, the property tax/sales tax revenue mix for Garland and Arlington is completely different. Taking property off the tax rolls with an appraisal cap in Arlington could be harmful for many of the reasons discussed in this document. For a city like Garland, however, negative effects are greatly magnified and could prove disastrous.

Appraisal caps also ignore differences between cities with respect to the amount of tax-exempt property that is present in the city. The City of Denton is a good example. Denton has two public universities that occupy large amounts of land in an essentially medium-

² Orange probably experienced the same cost of living increase that all cities face. But some cities and counties are willing to take in less revenue, despite the effects of inflation.

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sized city. The result is a situation in which property taxes are by necessity concentrated on a smaller fraction of the city's area, and yet there exists a continuing need to provide full city services throughout the city, including to the tax-exempt properties. Cities such as Denton must further combat routine legislative efforts by public and private universities to exempt themselves from the payment of city services, such as stormwater utilities. As in a city like Garland, the ill-effects of appraisal caps will be magnified in a city struggling with large amounts of tax-exempt property.

In summary, each Texas city is different and faces a different set of challenges. A solution that is arguably appropriate for one city does not necessarily make sense for the 1,200 others. Houston is a large and important city, but tax policy proposed for it is not necessarily appropriate for other areas. Local taxes (property and other local taxes) rank Texas at 17th out of the fifty states per the latest report by the Comptroller's office. In an article in *Kiplinger's Personal Finance* magazine published recently, it was reported in a survey of state and local taxes for the most populous city of each state that **Houston ranked second lowest with an overall tax burden of \$3,257**. Compared to other states, this is hardly a condemnation of our overall tax burden.

Negative Effects on Economic Development

Targeted property tax incentives are powerful economic development tools used by cities, counties, and schools. Tax incentives were crucial in recent economic development success stories in Texas, including the new Texas Instruments facility in Richardson and the Toyota plant in San Antonio. Appraisal caps will threaten this type of economic incentive.

Property tax incentives – tax abatement, tax increment financing, and H.B. 1200 tax caps – forgive or delay present property taxes owed for the promise of greater taxable value in the future from the new improvements to the land. Appraisal caps undermine these economic development tools in two respects. First, as previous sections of this document have outlined, the effect of appraisal caps is to narrow the tax base, shifting taxes from one set of properties to another. Tax incentives do the same, at least in the short term. The problem is that while appraisal caps tend to shift taxes away from residential property onto business property, tax incentives are designed to temporarily do the opposite: shift taxes away from business. Obviously, these conditions cannot easily coexist and still leave a tax base sufficient to fund city services. The likely result is that cities affected by mandatory appraisal caps will forego optional economic development tax incentives to avoid losing overall revenue.

The second problem is that the application of a restrictive appraisal cap to a particular piece of property would make a tax incentive for that property legally difficult or impossible.

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Property tax incentives function by forgiving or deferring taxes on the increased value caused by the new development, then allowing the full taxable value to go into effect several years down the road. Appraisal caps prevent this mechanism from happening by restricting the very growth in appraised value that tax incentives are designed to cause. Cities, counties, and schools will have no reason to defer or abate property taxes on a parcel of capped property because caps will ensure that the desired increase in appraised value does not occur.

The problems that appraisal caps create for economic development efforts are really a subset of a larger problem with appraisal caps – the flawed assumption that property value increases are bad and ought to be guarded against. Increasing property values do result in higher taxes, but they also create new individual wealth through greater equity, protect the economic viability of communities, and create the conditions necessary for economic development tools to work as intended. When we “guard” against property value increases with caps, we are often being penny wise and pound foolish.

How Appraisal Caps Have Worked So Far

Texas currently has a ten-percent appraisal cap set by law. California, through its Proposition 13, essentially has a two-percent appraisal cap. Florida has a cap set at the lower of three percent or the rate of inflation. It is clear from what we know so far that becoming more like other states in terms of a property tax system is not the way to go.

The current ten-percent appraisal cap in Texas has had a tangible impact. The following are Comptroller figures from 2002.

City	Single-Family Appraised Value	Loss to 10 percent Cap	Percent Loss to Cap
Dallas	\$34.5 billion	\$1.3 billion	3.8 percent
Houston	\$51.4 billion	\$2.4 billion	4.7 percent
Fort Worth	\$12.4 billion	\$0.54 billion	4.4 percent
San Antonio	\$25.1 billion	\$0.26 billion	1.0 percent
Austin	\$25.9 billion	\$2.1 billion	8.1 percent

These figures show that the current ten-percent cap takes significant taxable value off the rolls, especially in fast-growing markets. Those “lost” tax base dollars, as high as two billion in some individual cities, represent tangible tax “relief” to certain homeowners. The current system appears to work, in other words, if tax relief is the goal. Further, the following table, also based on Comptroller data, shows that the ten-percent cap is high enough that single-

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family residential appraised value lost to the cap has stabilized somewhat over time.

City	2001 percent Loss to Cap	2002 percent Loss to Cap
Dallas	3.4 percent	3.8 percent
Houston	6.3 percent	4.7 percent
Fort Worth	2.8 percent	4.4 percent
San Antonio	1.0 percent	1.0 percent
Austin	11.7 percent	8.1 percent

These figures suggest that the ten-percent cap may be just right; lost taxable value has likely reached a manageable equilibrium in various large cities – sometimes the amount grows, sometimes it shrinks. We know what to expect from the current cap, indicating that we should stick with the current system.

Florida, on the other hand, has a much more severe cap: the lower of three percent or the rate of inflation. Though this cap has been in effect since 1995, the total potential loss is presently unknown. The following table, based on Florida Department of Revenue figures, shows the difference, by year, between the just value of residential properties and the assessed value as capped by Florida’s appraisal cap legislation.

Florida Real Property Assessment Differential Value of Capped Parcels	
Year	Differences
1995	\$3.506 billion
1996	\$5.939 billion
1997	\$9.058 billion
1998	\$14.132 billion
1999	\$20.754 billion
2000	\$27.815 billion
2001	\$47.679 billion
2002	\$80.364 billion
2003	\$117.831 billion

Florida Property Valuations and Tax Data book; Real Property Assessment Differential Value of Capped Parcels (Table 41) displaying the difference between the just value of residential properties with homestead exemption and the assessed value of the same properties which is capped by the Save Our Homes amendment. The cap limits increases in assessed value to the consumer price index or 3 percent, whichever is lower.

Already in effect for nine years, Florida’s appraisal cap results in an effect that is growing at an alarmingly exponential rate. Where will it end? If there is something positive to be said

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about Texas' current ten-percent cap it is that, unlike Florida, we have adjusted to it and know the outside bounds of the damage it can do to the taxable base. To ignore the potential damage of a radically lowered cap, as Florida appears to be doing, could threaten to make Texas ultimately resemble California, where Proposition 13 has jeopardized the ability of local governments to fund schools, public safety, and other municipal services; created resentment among neighbors who pay radically different property taxes on similar properties; and depressed the real estate market.

The point of an appraisal cap should be to "smooth over" periods of rapidly increasing property values, thus protecting certain vulnerable homeowners. Texas' current ten-percent appraisal cap appears to do that to some degree. Lowering that ten-percent threshold, however, will risk an end to the "smoothing" effect, resulting instead in a downhill spiral of local tax bases.

What's Really Wrong With the Property Tax System and Why Caps Won't Help

Appraisal caps have been an issue because local property taxes continue to climb. Some observers believe that the vast majority of local governments in Texas are engaged in wasteful spending and are generating revenue through "appraisal creep" and not through open, visible property tax increases. The two fundamental problems with the property tax system in Texas cannot be solved through the imposition of appraisal caps. Those two fundamental problems are:

1. The State of Texas relies very heavily on local governments (school districts, cities, and counties) to generate the revenue needed to pay for public goods and services that citizens want and need.
2. Local governments rely very heavily on property taxes for revenue.

The State's Dependence on Local Governments

Compared to other states, Texas relies heavily on local governments to raise the revenue necessary for public goods and services. This is especially true of public education, of course, but it is also true in the areas of public safety, transportation, indigent health care, operation of our courts, and much more.

The chart below has figures from 2000. The figures show that almost all the other populous states rely more heavily on state spending than does Texas. If the total per capita spending by the state and local governments in Texas (\$6,179) were to be split according to the national average (45.9 percent local and 54.1 percent state), the Texas state share would increase by \$312 per capita annually: a total of more than \$6.5 billion each year. The need

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for local spending would be reduced by an equivalent amount.

<u>Ten Most Populous States</u>			
	Per Capita Local Government Expenditures	Per Capita State Government Expenditures	Percent Local
California	\$4,434	\$4,936	47.3 percent
Texas	\$3,148	\$3,031	50.9 percent
New York *	\$5,872	\$5,588	51.2 percent
Florida	\$3,324	\$3,073	52.0 percent
Illinois	\$3,667	\$3,609	50.4 percent
Pennsylvania	\$3,188	\$4,187	43.2 percent
Ohio	\$3,251	\$4,205	43.6 percent
Michigan	\$3,620	\$4,663	43.7 percent
Georgia	\$3,149	\$3,319	48.7 percent
New Jersey	\$3,398	\$4,428	43.4 percent
U.S. Average	\$3,530	\$4,162	45.9 percent
* New York statistics are skewed by New York City's immense size.			

Local Government's Dependence on the Property Tax

Local governments in Texas rely very heavily on the property tax to fund their services and facilities. This is especially true of schools, less true of counties, and even less true of cities. The fact is the local governments in Texas don't have diversified revenue sources, largely because the legislature hasn't allowed for more revenue sources, particularly state aid.

Bottom Line

When we put these two facts together (heavy state reliance on local governments and heavy local reliance on the property tax), it should come as absolutely no surprise to anyone that there is constant, upward pressure on local property taxes.

Unfortunately, appraisal caps don't address either problem: they would simply make it more difficult for local governments to pay for public goods and services that the state doesn't pay for, and they would shift the tax burden in inequitable and unfair ways.

If the legislature ultimately adopts a school finance plan that increases state revenue and

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reduces local school property taxes, homeowners will feel relief. Why? Because one of the *real* problems discussed above (the state's dependence on local government) will have been addressed. But it won't reduce the state's dependence on cities to provide drinking water, to treat wastewater, to build and maintain streets and bridges, to provide for public safety, and to promote economic growth. Nor will it reduce municipal reliance on the property tax.

Additional Considerations

Appraisal and Levy Increase Data Can Be Misleading

Proponents of appraisal caps argue that appraisal increases and tax levy increases are spiraling out of control in Texas. Some cite statewide statistics that address value or levy increases only in the aggregate. For example, Comptroller publications show that total municipal property tax levy increased by 7.8 percent from 2001 to 2002. However, this does not mean that the average homeowner's municipal tax bill increased by 7.8 percent, as some suggest. These aggregate statistics aren't adjusted for new construction, taxable improvements to properties that were already on the tax roll, or newly annexed property.

More astute appraisal cap proponents have attempted to calculate "average" tax increases, but much of the data they rely on is fundamentally incomplete as well. In a June 3, 2004, *Houston Chronicle* article by the Harris County Tax Assessor-Collector, the following statement is made:

From the Rio Grande to the Red River, statewide home appraisals have ballooned 48 percent from 1997 to 2002. Homeowners in Houston, Dallas, Fort Worth, Austin, and San Antonio have seen their average appraised values inflate by 60 percent during the same five years.

Later in the article it is stated that, for the same time period, "homeowners in these cities are finding it difficult to withstand this average \$1,086 increase in their total property tax liability."

The use of both of these statistics is quite misleading. Comptroller data, upon which these statistics are purportedly based, can only reveal the following relevant data for each tax year: total single-family assessed value for each city, total levy for each city, and the total number of residential parcels in each city. From these figures it is possible to derive average appraisals and levies – simply divide value or levy by the number of parcels – but these averages mean little because they ignore certain important issues or make erroneous assumptions about the parcels:

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1. **Comptroller data cannot account for improvements to existing parcels.** For example, the number of single-family residential parcels in Houston increased from 407,478 in 1997 to 435,675 in 2002. This is all the Comptroller can tell us about those parcels, however. Simply dividing total value or levy by those numbers of parcels in each year cannot account for improvements – new construction, amenities, and so forth – on parcels that were already in existence in 1997. For example, some of the parcels in existence in 1997 were likely unimproved lots in recently subdivided areas. As new homes were built on those lots, appraisals on those existing lots increased by a significant amount, driving the city’s “average” appraisal up, but having no effect on the taxes of pre-existing homeowners.
2. **Comptroller data cannot account for the disproportionate value of new versus old parcels.** As indicated above, Houston had roughly 28,000 more single-family parcels of land in 2002 than it did in 1997. Because Comptroller data can tell us nothing about the relative value of those new parcels, the “averages” cited by cap proponents necessarily assume that the value of the new parcels is equal to the old parcels. This is a dubious assumption. It is more reasonable to assume that new development produces more modern homes with more square footage and better amenities, and therefore a justifiably higher appraisal.

The effect of failing to take into account the value of new improvements or the disproportionate value of new parcels is significant when reporting on allegedly out-of-control tax increases. While a crude “average” appraisal or levy can be calculated by appraisal cap proponents, it will be a poor representation of what has happened to an existing homeowner who has lived in the same Houston or Dallas house, for example, from 1997 to 2002. Assuming such homeowners did not make any additions to their homes, their appraisal and tax bill increase will likely be lower than the net average increases routinely cited by appraisal cap proponents.

Appraisals Are More Accurate Than Ever

Some proponents of appraisal caps argue that caps are necessary to police an inaccurate appraisal process. Many claim that any appraisal system that doesn’t re-appraise each individual property on a regular basis cannot help but be grossly inaccurate. Some critics go further, alleging that appraisers are in cahoots with municipal and county officials to increase appraised values so that tax revenues will go up.

Fortunately, state law mandates that property tax appraisals be equal, uniform, and at market value. To help ensure that this requirement is met, the State Comptroller’s property

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tax division conducts appraisal reviews of appraisal districts as mandated by state law. According to a Comptroller publication, “County appraisal districts (CADs) continue to appraise property with uniform results and close to market value, according to the Comptroller’s 2002 Final Property Value Study.” The following table from that publication, *Texas Property Tax Annual Report*, shows appraisal ratios that are calculated pursuant to Comptroller studies. Appraisal ratios measure how close typical CAD appraisals are to market value.

1992 through 2002 Property Value Studies											
The table below compares the statewide median appraisal ratios from the 1992 to 2002 Property Value Studies. The statewide median appraisal ratio for an individual property category was calculated using the appraisal ratios of all Property Tax Division sample properties in that category from across the state. The overall statewide median appraisal ratio was calculated using the appraisal ratios for all sample properties.											
Property Category	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
A. Single-Family Residential	0.98	0.98	0.98	0.98	0.97	0.97	0.98	0.98	0.98	0.97	0.98
B. Multi-Family Residential	1.00	1.00	0.99	0.99	0.99	0.98	0.99	0.98	0.98	0.99	0.98
C. Vacant Lots	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
D. Acreage (market value)	1.00*	1.00*	1.00*	1.00*	0.99*	0.98*	0.98*	0.98	0.98*	0.98*	0.99*
E. Farm & Ranch Improvements	*	*	*	*	*	*	*	*	*	*	*
F1. Commercial Real	0.99	1.00	1.00	1.00	0.99	0.99	0.99	0.98	0.97	0.98	0.98
F2. Industrial Real	**	**	**	**	**	**	**	**	**	**	**
G. Oil, Gas & Minerals	1.02	1.04	1.03	1.02	1.02	1.01	1.00	1.02	1.03	0.99	1.01
J. Utilities	1.02	1.00	1.01	1.02	0.99	1.00	1.00	1.00	1.00	1.00	1.00
L1. Commercial Personal	0.98	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
L2. Industrial Personal	**	**	**	**	**	**	**	**	**	**	**
M. Other Personal	**	**	**	**	**	**	**	**	**	**	**
O. Residential Inventory	**	**	**	**	**	**	**	**	**	**	**
OVERALL	0.99	0.99	0.99	1.00	0.99	0.99	0.99	0.99	0.99	0.99	1.00

* Beginning in 1989, taxable values for Farm & Ranch Improvements (formerly Category E) were merged into Category D with Acreage (market value).

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** Too few sample observations were available to produce meaningful statewide median appraisal ratios for these properties.

Source: Comptroller's Property Tax Division

The table shows that, in 2002, the average appraisal was exactly 100 percent of market value. (Interestingly, the table also shows that homeowners seem to enjoy a slight "break," in that their appraisals are usually a couple of percentage points below market.) The data in this table raise a very important question: if appraisals tend to be 100 percent accurate under current law, how much more accurate can they be with appraisal caps? It is likely that allegedly inaccurate appraisals are just a convenient straw man for persons who don't like the fact that rising home values may result in higher taxes.

Other Approaches Make More Sense

As previous sections of this document point out, most of the property tax "crisis" will be solved by fixing the school funding system. Other legislative efforts can assist as well, without the negative consequences of appraisal caps.

S.B. 340, passed during the 2003 legislative session, closed a loophole that effectively permitted businesses to avoid "rendering" business property for tax purposes. The fiscal note on the bill shows a \$6.8 million statewide gain to cities in 2004 by closing this loophole. By 2008, the positive fiscal note grows to \$110 million per year. This "new" revenue should result in an easing of the tax burden on other taxpayers, including homeowners.

Further, various legislative proposals during recent sessions would have provided for mandatory sales price disclosure to appraisal districts upon the sale of a home. Closing this loophole would add taxable value onto the rolls where it is warranted, and simultaneously benefit those few homeowners who are overpaying due to inaccurate appraisals.

Appeals Process

As of this date, the Dallas Central Appraisal District has received 77,335 official protests for the 2004 appraisal season. This is about 9 percent of their 840,000 accounts covering over 1,100,000 parcels of real and business personal property. Of these protests, they will actually hold hearings with about 22,000 citizens during the months of May through July. The balance of the protests (about 50,000 accounts) will be resolved via informal meetings between the taxpayers and their appraisers. Comment cards are provided for each appellant. To date DCAD has seen only one complaint out of several hundred received. Texans appear to understand the property tax process and can avail themselves of the process successfully if they prepare properly. Although we typically only hear of the horror

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stories that do occur, the majority of citizens apparently find the process very easy and usually their appeals result in an amicable settlement of the issue.

However, there is concern that the panels that arbitrate the disputes are made up of appointees of the same board that establishes the appraisal district. Some argue that these appeal boards are simply extensions of the same agency that is responsible for the alleged over-valuation or exemption denial. Unfortunately, in some counties this is a valid complaint. Texas is large and diverse. We have many interpretations of the same rules, laws and expectations.

The issue of insuring impartial appeals is a matter that has been wrestled with for many years. We must acknowledge that no matter whom you may appoint to a hearing panel, nor how that appointment is made, after a few weeks of sitting on a panel and hearing some of the stories that are presented by some taxpayers, the panelist will end up having a certain amount of affinity for the appraisal district representative(s) that appears before the panel. This is simply human nature at work. If the appraisal district is truly trying to do its work as required by law, this will become evident in the appeals process. The panelist will identify this and respect the appraisal personnel appearing before them. Respect or trust sometimes may cloud judgment but, in any case, will manifest itself to all in attendance. This cannot be eliminated by legislation; again it is human nature.

Recommendation

The state must provide mandatory direction to local appraisal districts concerning how to operate hearings in an objective and impartial manner. For the more egregious cases, there should be a simple, efficient and inexpensive process for addressing the issue.

It is proposed that a post Appraisal Review Board appeal be provided via the use of current provisions of law. At this time Section 42.225 of the Property Tax Code provides for Binding Arbitration in certain circumstances. We propose that the Rules of Civil Procedure be amended to allow a citizen, having appealed to the Appraisal Review Board and not receiving satisfaction, be allowed to directly petition the courts for access to binding arbitration.

Under current rules, the arbitrators are mutually selected by the parties. The arbitrators need not be attorneys (although they often are). The appellant would be required to pay a filing fee that would be refundable if they prevailed. The advantages of this system are:

- No additional level of bureaucracy is required to be established
- Arbitrators would be as impartial as practical

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- Cost would be much less than proceeding to court
- Would not require a professional to support the appeal
- Would avoid the politicization of an appeal
- Would reduce the dockets of the existing legal system

The Committee believes this would be a very efficient process that would be objective and fair, at little cost and risk to a property owner. It would require some modification of existing laws, but these should be achievable. It would certainly provide an alternative to the courts.

Application and Effects of the Rollback Rate

The *rollback rate* is a calculated maximum rate allowed by law without voter approval. The rollback rate provides the taxing unit with about the same amount of tax revenue it spent the previous year for day-to-day operations, *plus* an extra 8 percent increase for those operations plus sufficient funds to pay debts in the coming year. For school districts, the extra increase is six cents (\$0.06) per \$100 of property value, rather than 8 percent, based on different steps in the calculation.

Texas has attempted to provide some level of control of assumed “runaway taxes” via the existing provisions of the Property Tax Code in Chapter 26 governing the calculation of a maximum tax rate. In this section, it was the hope of the legislature that taxing entities would be encouraged to restrict their tax levy growth to approximately the same levy as in the prior year. To insure this happened, the provisions of this section placed the following requirements on an entity when it was in the process of calculating a tax rate.

If an entity wishes to raise the levy up to 2.99 percent over the prior year, it may do so without any notice to the citizens. However, if it wishes to raise the levy above 3 percent, it is required to publish notice of this intent.

If an entity wishes to raise the levy 8 percent or more, the levy is subject to a rollback upon petition and vote by the citizens.

These provisions have been on the books for many years. When passed initially, there were a number of rollback elections that were successful. However, in recent past there have been very few successful petitions. Citizens have become somewhat complacent about tax increases. Also, the process of notification has been largely ignored by them inasmuch as the statutory procedures require publishing notices of proposed levy increases in media that is seldom read.

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It is also true that many entities have been responsible in their calculations of their tax levies and have enjoyed the support of their communities for needed revenue. It is not prudent to condemn all increases as irresponsible and unreflective of the community's wishes as a whole. The argument put forth by a number of community leaders about alleged irresponsible tax levy increases is valid; that argument being that if the citizens don't like what they do, they will refuse to re-elect them. We do not believe that the Legislature of Texas is closer to the citizens than the mayor, county judge nor school board president. These people meet with the citizens on an almost daily basis. If there is a problem or abuse of governmental power, it has been our experience that they will be voted out of office in time. That is the democratic process at work.

However, it cannot be disputed that some entities have abused their rights of governance. Perhaps more effective guidelines and processes of citizen notification are appropriate.

The recent attempts to initiate limits on local government revenue were heavy-handed and ill advised. Had the issue been introduced in a more tactful manner, soliciting the understanding and joint resolution of the issue to the mutual agreement of most, those attempts might have been successful.

An examination of the increases in the Maintenance and Operations tax rate above the effective tax rate in Travis County shows that increases were consistent with the growth of the programmatic needs of the county. In the 12-year period of FY93 to FY04, Travis County's tax rate did not exceed the rollback rate (*8 percent above effective M & O*) and in five of those years the increase over effective was less than 2 percent. However, in four of those years it was necessary to increase above the proposed 5 percent rollback cap suggested in HB 1. This suggests serious programmatic cutbacks in essential services can be contemplated if a 5 percent cap is in place. This is particularly important because the counties cannot control the demand for most of the programs that the counties provide and because counties have to rely so heavily on the property tax as their primary revenue source.

The argument has been laid out that the rollback rate is not a problem; counties simply need to be prepared to place the budget on the ballot. While this may seem simple, it is not. In Travis County it costs approximately \$1 million to conduct a countywide non-presidential election. Because of the timing of the budget hearings and the laws governing the adoption of a budget and spending that budget, the budget would have to be adopted and implemented during the period in which petitions are gathered. If a rollback election succeeds the law requires a correction of the tax bill and also a refund to all taxpayers whose taxes are paid. A rollback election would reduce the budget back to rollback plus further erode budgeted funds by the costs of conducting an election and the cost of refunding. In Travis County's case where they collect taxes for numerous jurisdictions, any

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of which could be subject to rollback elections, this adds significantly to the cost of local government.

Recommendation

Any attempt to limit local government revenue must be extremely careful to avoid limiting responsible governance. No agency or citizen can operate on the same exact funds as in the previous year with inflation, growth and rising cost. Exacerbating this need is the fact that unfunded governmental mandates also add additional burdens on local government. The State of Texas' well-documented acts of passing much of the cost of schools to local school districts is an example of this problem. Finally, any legislation that attempts to restrict the growth in local government cost must also recognize that bond programs, authorized by the electorate, carry with them on-going operational costs that must be accounted for in any budget consideration.

Legislation that takes these and other issues into consideration, after reasonable input from those most experienced in managing local government, has a good chance of success. The idea should be to support local government in its responsible management of the citizens' obligations, but at the same time create a restraint on those governments who chose to use the appraisal process as their tax levy growth vehicle.