

HOUSE SELECT COMMITTEE ON PROPERTY TAX RELIEF AND APPRAISAL REFORM

JOHN OTTO, CHAIRMAN



KEN PAXTON, VICE-CHAIRMAN

December 1, 2008

The Honorable Tom Craddick
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol
Austin, Texas

Dear Mr. Speaker and Fellow Members:

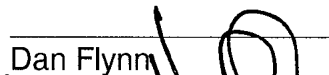
The House Select Committee on Property Tax Relief and Appraisal Reform
hereby submits its report for consideration by the Eighty-first Legislature.

Respectfully submitted,


John Otto, Chairman


Ken Paxton, Vice Chair

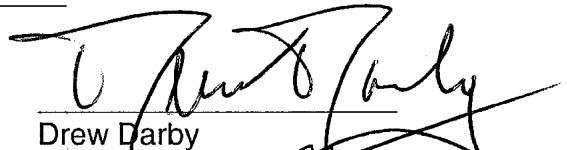

Gary Elkins


Dan Flynn



Joe Heflin

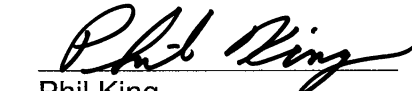
Tracy King


Inocente "Chente" Quintanilla



Drew Darby


Ismael "King" Flores


Dan Gattis


Phil King

Ruth Jones McClendon

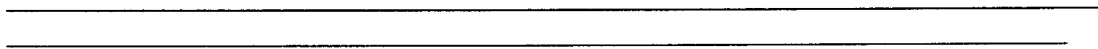

Larry Taylor

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INTRODUCTION:

On April 23, 2008, the Honorable Tom Craddick, Speaker of the Texas House of Representatives, appointed 13 members to the Select Committee on Property Tax Relief and Appraisal Reform: John Otto, Chair; Ken Paxton, Vice Chair; Gary Elkins; Ruth Jones McClendon; Ismael "Kino" Flores; Tracy King; Phil King; Dan Flynn; Dan Gattis; Inocente "Chente" Quintanilla; Larry Taylor; Drew Darby and Joe Heflin.

In 2006 the Legislature passed substantial property tax relief in a special session. Yet property owners claim they have not received meaningful tax relief due to the sharpening rise in appraisal values. The select committee was formed to examine the current property tax system and identify ways in which it could be reformed.

The committee conducted hearings across the state in Austin, McAllen, Arlington, San Antonio, Beaumont, Lubbock, Houston and El Paso. Each locality presented familiar themes and concerns about the appraisal process. The select committee heard testimony from the public and invited testimony from chief appraisers, members of appraisal review boards and others involved in the process of property taxation.

Armed with the input of hundreds of Texans from around the state, the committee offers this report to the members of the 81st Session of the Texas Legislature.

PROCLAMATION

I, Tom Craddick, Speaker of the House of Representatives, create the Select Committee on Property Tax Relief and Appraisal Reform under the authority of Rule 1, Section 16(b), of the Rules of the House, 80th Legislature.

The Select Committee on Property Tax Relief and Appraisal Reform is composed of the following members of the House of Representatives:

Rep. John Otto (Chair)

Rep. Ken Paxton (Vice Chair)

Rep. Drew Darby

Rep. Gary Elkins

Rep. Ismael "Kino" Flores

Rep. Dan Flynn

Rep. Dan Gattis

Rep. Joe Heflin

Rep. Phil King

Rep. Tracy O. King

Rep. Ruth Jones McClendon

Rep. Chente Quintanilla

Rep. Larry Taylor

The Select Committee on Property Tax Relief and Appraisal Reform has jurisdiction over all matters pertinent to the goals of providing relief from property taxes and reforming the property tax system. The select committee's jurisdiction includes examining the appropriateness of the provisions of the Texas Constitution and the Tax Code that limit or authorize limiting the appraised value or

increases in the appraised value of certain property for property tax purposes.

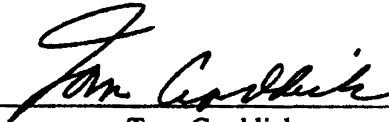
The Select Committee on Property Tax Relief and Appraisal Reform may request assistance from any executive branch agency.

The Select Committee on Property Tax Relief and Appraisal Reform shall report the select committee's findings and recommendations to the House of Representatives and the Speaker of the House not later than December 1, 2008. The select committee's report may include draft legislation or recommendations for legislation.

The Select Committee on Property Tax Relief and Appraisal Reform is dissolved on the issuance of the select committee's report.

April 23, 2008

Date



Tom Craddick
Speaker of the House

Change the Property Value Study

Subchapter M, Chapter 403 of the Government Code provides for an annual study of school district property values, referred to as the Property Value Study (PVS), to be performed by the Comptroller of Public Accounts to ensure equity among taxpayers in the burden of school district funding and equity among school districts in the distribution of state financial assistance for public education.

The school district's appraisal value, as determined by the Central Appraisal District (CAD), must fall within a five percent margin of error of the comptroller's findings. If the school district's appraised value falls outside the margin of error for more than two years, then the value determined by the PVS is used instead of the local value determined by the CAD. This can affect a school district's education funding, as districts with less taxable property value will receive more state funding, and vice versa. Although a school district may appeal such findings, such a decision may result in significant legal costs to the district and take appraisal district personnel away from their normal duties.

Throughout testimony, chief appraisers suggested the PVS is causing them to reappraise annually to avoid falling outside the margin of error, and consequently is contributing to the rise in appraisal values. Further, the current measurement may result in acceptance of appraised property values that are more than market value.

The Committee heard testimony at its initial hearing that the PVS no longer serves its intended purpose, and should be replaced with an Appraisal Standards Review (ASR), similar to Section 5.102 of the Property Tax Code. This change would result in the Property Tax Division (PTD) checking the methods and procedures used by appraisal districts. If the CAD complies with standards established by the state, then the CAD value would be accepted for purposes of education funding. If the CAD does not comply with proper methods and procedures, a PVS could then be conducted to arrive at the value used for education funding.

Changing the PVS to encompass the purpose described above could be preferable to increasing the margin of error. An ASR would bring about greater consistency in the appraisal of property throughout the state, and each appraisal district would be encouraged to make improvements to meet the standards desired.

Consistent Reappraisal Cycles

Current law provides that a CAD may adopt a reappraisal cycle at least once every three years. As discussed in the previous section, most appraisal districts testified they reappraise every year because it is necessary in order to "pass" the PVS. Yet the Committee did receive testimony from a CAD in a fast-growth county that reappraises every other year and still passes the PVS.

The Committee questioned why some taxpayers are subject to annual appraisal increases, while others receive increases every other year. It could be argued that all real property should be on the same cycle for reappraisal to achieve fairness and consistency. It was suggested during testimony to shift to an every other year appraisal cycle for real estate, which would provide several benefits to both taxpayers and appraisal districts. Among the advantages would be that CAD staffs would be able to spend more time gathering data and working on upcoming reappraisals and lessen the number of Appraisal Review Board (ARB) hearings in non-reappraisal years. Classes of property that are usually contracted out by CADs for appraisal, such as minerals, may have to be considered separately because of the volatility in those markets.

Objections could be raised that moving to a two-year reappraisal cycle would not pass “fair market value” muster; as appraisal districts are required by the Texas Constitution to appraise to fair market value. Challenges to the system could arise if real estate values decline or increase in the years between reappraisals. But as the current system uses a “mass appraisal system” and some properties currently are appraised above fair market value (based on results from the PVS), accuracy in appraisals would not be reduced by a two-year reappraisal cycle.

Appraisal Review Boards

The members of the ARB are appointed by the CAD board of directors, who are appointed by the taxing entities within the CAD. These appointments encourage taxpayers’ perception of bias within the ARB. Taxpayers throughout the state testified they did not see the ARB as an independent body and did not feel they would receive a fair hearing if they chose to protest their appraised value. Many of those who had gone before the ARB testified they felt they were mistreated, and that the ARB had made their decision before the taxpayer presented their case.

Lack of confidence in the ARB may cause taxpayers to avoid protesting their valuations, which could result in inaccurate values as appraisers do not know the details of the quality and type of materials inside a structure without a taxpayer’s input. If a taxpayer presents information differentiating their property from similar classes of property in the neighborhood, the CAD may discern the differences in values and settle on a different appraised value.

The quality and qualifications of the members of the ARB varied throughout the state. There were suggestions in favor of more training and education for ARB members to alleviate this issue.

Testimony was also heard about the necessity for a taxpayer liaison in each CAD to assist taxpayers who wish to protest their appraised values. While CADs in counties with populations exceeding 125,000 are required to employ a taxpayer liaison, the duties of this position could be expanded. New responsibilities could include requiring liaisons to assist in educating and instructing protestors on the appeals process, and discussing with protestors what data may be presented at the ARB hearing.

Regional Appraisal Review Board

The Committee believes taxpayers' perception of appraisal review boards will not change until the current system is reformed. Any proposed change, however, should be tested as a pilot program in test markets around the state and subsequently evaluated before implementing changes statewide.

One possible approach would be to create a pool of qualified and trained ARB members, similar to the method used in the arbitration process. The Legislature should also explore the possibility of allowing counties to form regional ARBs, which would expand the pool of qualified people to serve on the boards. If this process allows property owners to believe they receive fair treatment and due consideration of their arguments, the cost of litigation could be substantially reduced for both the CAD and the taxpayer. This is particularly beneficial in counties that contain large amounts of commercial real estate and incur substantial litigation costs.

Effective Tax Rate

Testimony revealed that very few citizens understand or heed the effective tax rate notices, which are published by the various taxing entities. Calculating an effective tax rate requires many steps and numerous "back-outs". Simplification and transparency are needed in order to convey to taxpayers what taxing jurisdictions are doing. The most basic approach would be:

- Publicize the effective tax rate as the rate that would raise the same amount of revenue as the prior year (excluding new property added to the tax roll);
- Disclose the proposed rate and the percentage increase it represents from the previous rate;
- State the amount of revenue the new rate would generate

Taxing entities should also be required to disclose the previous two years' fund balance and the projected fund balance at the end of the proposed budget cycle. Such disclosure would enable taxpayers' ability to discern increases in rates, revenues, and whether fund balances were being increased beyond current needs.

Highest and Best Use

It is a generally accepted standard when conducting appraisals to consider the "highest and best use" of the property in arriving at fair market value, yet this term is not defined nor contained in the Tax Code. Among real estate professionals, however, highest and best use is that use which is legally permissible, physically possible, financially feasible and maximally profitable.

The Committee heard testimony on homesteads which had their appraisal values increase by 200 - 400 percent in one year as a result of the highest and best use standard. While areas under zoning laws are somewhat protected from

this phenomenon, those areas of the state without zoning are susceptible to tremendous appraisal increases based solely on activity occurring in the area.

While agricultural land is protected from the highest and best use standard by agricultural exemptions (taxing land on its production value), no protection exists for homes. Statutory change is needed in this area to protect homeowners from appraisals and tax increases on their homes that are based on the assumption that the property is valued on a higher and better use.

Arbitration

A property owner seeking reconsideration of an Appraisal Review Board's decision appraising the market value of real property has two options: (1) filing suit in state district court, or (2) engaging in binding arbitration. Pursuant to Section 41A.01 of the Tax Code, binding arbitration is only available when two conditions are met: (1) the determined value of the property is \$1 million or less; and (2) the appeal does not involve any matter other than the determination of the market value of the property. The Committee heard testimony on raising the \$1 million ceiling in order to allow more real estate subject to that provision.

Indeed, commercial property owners prefer elimination of the cap in its entirety. Generally, however, proponents of raising the cap contend that binding arbitration is preferable to filing a suit in district court because of the time and cost savings that result from private dispute resolution.

Commercial property owners expressed a preference for binding arbitration because the appraisal of commercial property requires consideration of very complicated transactions and valuation data. They also favor raising the cap because litigation expenses often exceed any tax savings resulting from a district court's reduction of the property's appraised value.

Sales Price Disclosure

Texas is a non-disclosure state, which provides that when a real estate transaction occurs, the sales price does not have to be rendered to the county clerk's office. Therefore, appraisal districts must use alternative methods to compile sales data such as the multiple listing services (MLS) to approximate market value of property. Occasionally property owners will voluntarily submit sales information to the appraisal district, although most times this does not occur.

There are eleven other states that are considered non-disclosure states: Alaska, Idaho, Kansas, Louisiana, Mississippi, Missouri (some counties), Montana, New Mexico, North Dakota, Utah and Wyoming. In early 2008, the Florida Legislature repealed its sales price disclosure laws, citing that the information was not as reliable as had been expected.

Appraisal districts frequently cite the prohibition on sales price disclosure as the reason they are not able to attain accurate market data. Appraisers contend that if mandatory sales price disclosure were allowed under state law, then residential and commercial properties would be appraised at current market

value because recent sales data would be available. However, when members of the Committee questioned chief appraisers on whether they gave consideration to builder's concessions or other information that affected the contract sales price, it was stated that they typically did not consider such factors and used the contract price provided to them on the HUD 1 settlement statement. One chief appraiser testified that he would use the contract price without taking into account builder concessions because that is the value that would be assigned in the PVS if the property were selected for study.

Opponents contend that mandating sales price disclosure creates privacy and confidentiality concerns for property owners and business owners. Concerns about appraisal districts using the highest sales price in a comparable area to assess value were also raised at many hearings.

The Committee also received testimony from taxpayers about the difficulty in obtaining comparable sales data from the CAD when protesting their values before the ARB. In the 80th Legislative Session, HB 2188 was passed that made changes to Chapter 552 of the Government Code to require the CAD to release information on real property to the protesting taxpayer with certain confidentiality conditions. Due to statutory changes in the 80th Legislative Session about disclosures allowed by CADs, there have been interpretations of the statute that would prohibit access to data protesting taxpayers should have available. Many CADs began to prohibit taxpayers from accessing data at the CAD, when data should have been made available to them. The 81st Legislature should look into clarifying this section of the law to allow protesting taxpayer's access to appraisal district data prior to their ARB hearing.

Reappraisal vs. Equity

The Committee heard testimony from a commercial property owner who had been to state district court each of the last three years to protest the appraisals on several of his properties. In each case the property owner was successful in significantly lowering the appraised value of his property based on the evidence he submitted. When the taxpayer received his 2008 appraisal notice, however, it was higher than the value he successfully challenged on his 2007 appraisal notice.

The chief appraiser who assessed the above-stated values defended the increases in the reappraisals as representing market value for that year, even though the property owner had been successful in district court in prior years.

It was during this testimony that the issue of equity was discussed. Statutes allow a taxpayer to protest under an equity argument that the property should be appraised at the same price per square foot as a similar property. Thus, taxpayers look for similar properties on appraisal rolls that allow them to use equity as their argument in hopes of obtaining lower values.

With regards to commercial property, the equity comparison does not take into account whether the property was the subject of a district court decision in favor of the taxpayer (with full disclosure of the data necessary to arrive at a value using the income approach). Therefore, the CAD may avoid using the

court determined value as a starting point because other commercial property owners may choose to use the equity argument, even though they submitted no data about the income approach on their property.

While equity arguments are a valid and desirable part of the law in order to treat all taxpayers the same, property owners who successfully challenge the appraised value of their property should not be repeatedly penalized. All protestors who challenge under the equity appeal method should be expected to submit the same type of information as those who successfully challenged their values.

Election of CAD Board

Current law provides that the board of the CAD is made up of directors appointed by a vote of the taxing entities that participate in and fund the district. At the discretion of the taxing jurisdictions, the board members may be comprised of citizens and elected members of the taxing jurisdictions.

The CAD board of directors is responsible for hiring the chief appraiser, adopting the budget for the CAD, and appointing the members of the ARB. The Committee heard testimony from citizens who felt that public election of the CAD board of directors would be preferable to the current system, especially where board members serving the taxing jurisdictions dominate such boards. As discussed in the previous section about ARBs, the perception is that there is no accountability to the voters from those serving in these capacities.

Replace Property Tax with Sales Tax

Dissatisfaction with the ad valorem tax system is high across the state. Escalating values have caused taxpayers to feel that the one-third rate reduction in school maintenance and operation (M&O) taxes, mandated in the legislation passed in the special legislative session in 2006, has been consumed by appraisal increases and other taxing jurisdiction increases. Homebuilders testified that for every \$1,000 increase in the cost of a home, 38,000 Texans are unable to qualify to purchase a home. As property taxes continue to increase, fewer Texans will realize the dream of homeownership.

Proposals to replace the M&O tax for public schools by utilizing part of the state's surplus and expanding the sales tax base as well as increasing the rate were heard at each hearing. It currently costs the state approximately \$18 billion a year in revenue to replace school M&O taxes. Based on current collections, the state's sales tax rate of 6.25 percent would have to be significantly increased in order to raise enough revenue to replace M&O. A lesser increase in the rate could be accomplished if some current exclusions and exemptions were repealed. However, removing these exemptions could have adverse economic impacts and are politically difficult to accomplish.

Lower the Appraisal Cap

Numerous discussions centered around lowering the current 10 percent appraisal cap to five percent on residential homesteads. The reduction of school taxes from 2006 – 2007 resulted in \$7 billion of tax savings, yet many homeowners feel as if ever increasing appraisals have wiped out that relief.

Supporters claim a reduction in the appraisal cap would slow the rate of appraisal growth and lessen the likelihood that property taxes will increase faster than their incomes.

Opponents claim that lowering the cap results in inequities, as similar property is valued based on when it was purchased or built rather than what its market value is. Also, if the appraisal cap is only applied to homesteads, the growth in appraisals, and therefore taxes, is shifted to business.

Disaster Reappraisals

Hurricane Ike made landfall on September 13, 2008 and caused extensive damage to the Texas Gulf Coast. The Committee held an additional hearing to obtain testimony about reappraisals following a disaster. Chapter 23.02 of the Tax Code provides that any taxing jurisdiction may request a reappraisal be performed within its jurisdiction immediately after a declared disaster. The values are then prorated for that tax year based on the January 1 value, up to the date of the disaster, and then a post-disaster value from that date until the end of the year. Taxing jurisdictions are responsible for the cost of the reappraisals.

This provision of the code has been implemented when a flood occurred in the city of Cuero on October 20, 1998. The CAD was requested to reappraise the property to determine declines in values as a result of the flood. Due to the small size of the city and the clear delineation of the flood-affected area, it was relatively easy to accomplish the reappraisal.

With regard to those areas affected by Hurricane Ike, the Committee heard testimony from Galveston Independent School District (GISD) about their decision not to pursue a reappraisal following Hurricane Ike. Among the factors the GISD school board considered was the cost to reappraise, which would be an unexpected burden on the school district's budget. Additionally, consideration was given to the cost of mailing notices to taxpayers and conducting ARB hearings on post-Ike appraisals. While the code dealing with disaster reappraisals is silent on these considerations, legal counsel for the CAD advised that such notices and hearings were necessary based upon the statutes dealing with reappraisals other than disasters.

The Committee discussed whether the normal reappraisal that would take place on January 1, 2009 could be used as a starting point and work back to the date of the storm. However, questions arose about repairs and replacements that would be conducted between the date of the storm and January 1st.

Additionally, the Legislative Budget Board and the Texas Education Agency testified that under the current system, districts could possibly see an adverse effect on their four enrichment pennies from the state.

While the disaster reappraisal statute is meant to give relief to taxpayers who have had their property diminished in value from a disaster, it does not appear that it will be invoked in many cases until some of the questions raised during testimony are resolved.