

- SUBJECT:** Reducing appraisal caps on real property from 10 percent to 5 percent
- COMMITTEE:** Ways and Means — favorable, without amendment
- VOTE:** 5 ayes — J. Keffer, Edwards, Grusendorf, Paxton, Woolley
2 nays — Villarreal, Ritter
2 absent — Luna, Smithee
- WITNESSES:** For — Paul Bettencourt, Self; Sharon Brady, Self; Jim Caldwell, Texas Silver Haired Legislator; Coach Dan Hart, Taxpayers for Equal Appraisal; Lisa Hendee, CLOUT; Pat Jackson, Self; Cheryl Johnson, Tax Assessor/Collector Gal veston County
- Against — Brandon Aghamalian, City of Fort Worth; Jim Allison, County Judges and Commissioners Association of Texas; Amy Beneski, Texas Association of School Administrators; Euline Brock, City of Denton, Daniel Casey, Texas School Alliance; Don Hudson, Texas Association of Community Colleges; David Kautz, City of Round Rock; Dick Lavine, Center for Public Policy Priorities; Donald Lee, Texas Conference of Urban Counties; Ken McCraw, Texas Association of Community Schools; Jay Millikin, Comal County Commissioners Court; Tom Morgan, Texas Association of Realtors; Kenneth Nolan, Dallas Central Appraisal District; Ray Perryman, Texas Municipal League, Texas Association of Counties, Texas Conference of Urban Counties; Ted Melina Raab, Texas Federation of Teachers; Katie Reed, Texas Association of School Boards and Northside Independent School District; Glen Whitley, Tarrant County, Texas Conference of Urban Counties
- On — Bill Carpenter, Houston Independent School District
- BACKGROUND:** Tax Code, ch. 1 applies the current 10 percent appraisal cap on residential homes authorized by Art. 8, sec. 1(i) of the Texas Constitution. Capped property has three different values for tax purposes: fair market value; appraised value, to which the cap applies; and taxable value, to which various exemptions apply. Chief appraisers must appraise residential homesteads at fair market value and record both the fair market value and the value computed under the appraised value limitation.

When homestead residential property assumes new ownership, it is taxed on the fair market value of the property during the first year of ownership. In subsequent years, under the same ownership, the 10 percent appraisal cap is applied to the property.

DIGEST:

HB 784 would lower the maximum increase on annual taxable appraised value from 10 percent to 5 percent and apply it to all real property, except mineral interests.

HB 784 would add to the information that must be contained in a property tax bill, or in a separate statement accompanying a property tax bill. This supplemental information would include, for the current tax year and each of the preceding five tax years:

- appraised value and taxable value of the property;
- total tax rate for the taxing unit;
- amount of taxes imposed on the property by the taxing unit; and
- percent increase or decrease per year in the amount of taxes imposed on the property by the taxing unit.

The bill would define “new improvement” as upkeep, repair, or improvements made after the most recent appraisal of the property, rather than the preceding year’s appraisal.

The cap would take effect January 1 of the tax year following the first tax year in which the owner took ownership of the property or in which the property qualified for a residence homestead exemption. It would expire on January 1 of the first tax year following the tax year in which the property owner ceased to own the property. Property to which the cap was first applied under the bill would be valued as of the 2005 tax year regardless of when it actually was acquired.

If ownership of the property transferred to the owner’s spouse or surviving spouse, the cap would continue until the spouse cease to own the property or it was further continued by a subsequent transfer to a spouse or surviving spouse.

If real property other than homestead was owned by two or more persons, the cap would expire on January 1 of the tax year following the year in which ownership of at least a 50 percent interest in the property was sold or otherwise transferred to a person other than the owners.

The bill would take effect January 1, 2006, if HJR 35 by Bohac, the constitutional amendment authorizing a 5 percent limitation on annual increases in appraised values on all real property, was approved by voters. The additional reporting requirements attached to property tax bills would take effect January 1, 2006, regardless of whether voters approved the proposed constitutional amendment.

**SUPPORTERS
SAY:**

Homeowners no longer can sustain annual increases in their property tax bills due to rising values, despite the 10 percent cap on annual growth in taxable appraised value. In 1997, the Legislature approved significant property tax relief by increasing the value of the mandatory homestead exemption. Few homeowners realized any benefit, however, because the savings were consumed by rapid growth in appraised values that primarily drove up school property tax bills. Houston homeowner tax bills, for example, increased by nearly 73 percent from 1997 to 2002. The appraisal cap must be lowered to curtail the ability of local government to passively raise and spend more money merely because appraised values increased.

Taxpayers are receiving no meaningful relief from excessively high property taxes through tax rate controls. Even with school district maintenance and operations (M&O) tax rate caps and other provisions, including truth-in-taxation requirements, that are designed to limit the growth of tax rates for counties, cities, and special-purpose districts, local property tax revenue nevertheless grew 4.5 times faster than population or inflation between 1996 and 2002. Most of this increase in local property tax levies stems from higher appraised values.

The persistent escalation of residential property values, in effect, penalizes Texans for home ownership. It unfairly increases their taxes regardless of their ability to pay. Lowering the cap would continue helping homeowners living in areas with rapidly appreciating property values level out their property tax payments to make it more affordable to remain in their homes. Higher values still would be taxed, but increases would be spread out more reasonably to avoid the sharp increases seen under the current cap. In the vast majority of cases, owners of lower-valued homes have benefited the most from the cap because their appraised values have been more likely to increase significantly. Regardless of capped values for tax appraisal purposes, property owners still would be able to sell their homes at true market value.

Extending the cap to business property would foster greater economic growth. Failure by local governments to rein in property tax growth exceeding inflation or income growth has hurt the state's economy. Burgeoning property taxes have discouraged in-migration, which reduces the labor pool and diminishes the state's investment appeal. Managing appraisal growth would attract business investments as well as help keep home ownership affordable as the housing market continued to thrive. Caps are wisely used in 14 other states, and lowering the permissible appraisal cap to 5 percent would give Texas a competitive advantage over neighboring states.

Appraisal caps do not interfere with local government spending or revenue streams. They merely balance local jurisdictions' need for additional resources with taxpayers' need for protection against surging tax bills. Taxing entities would be able annually to increase the appraised value of property by up to 5 percent and would continue raising substantially more money each year without changing their tax rate. Caps merely restrict the rate of growth in taxable property values, protecting property owners from shouldering a disproportionate share of the tax burden. Elected officials still could raise rates for property or sales taxes or for fees if more revenue were required or if priorities and needs dictated greater expenditures for public goods and services.

**OPPONENTS
SAY:**

According to the fiscal note, the loss of revenue attributable to lowering the appraisal caps between fiscal 2006 and fiscal 2010 would be \$1.2 billion to the Foundation School Fund, \$466 million to cities, and \$428 million for counties. Value losses per year would continue to escalate, draining taxing units and public education funding of much needed revenue. In view of these negative fiscal repercussions, the price of lowering appraisal caps is far too high.

Capping growth in appraised value of all real property would penalize local governments needlessly and unfairly. Cities, counties, and special-purpose districts are not responsible for, nor do they contribute to, the state's problems with its school finance system; hence, they should not be adversely affected by any attempts to solve them. Lowering the existing cap would hamper their ability to maintain crucial services, or expand them as needed, while giving individual property owners relatively little tax relief.

Appraisal caps interfere with real estate market forces and create artificial levels of taxable property value that distort the market value appraisal standard. Caps inhibit government's ability to provide public goods and services and respond to external factors such as population growth, recession, and emergencies. Between 1998 and 2003, the value loss attributable to the 10 percent cap on residential homesteads was \$54 billion. The existing 10-percent cap took nearly \$11 billion in residential property value off the tax rolls in 2003, according to the comptroller — \$2.4 billion in Houston alone. Lowering the cap and extending it to all real property would make matters considerably worse.

Any tax limitation disproportionately benefits owners of more expensive property. Appraisal caps are regressive in that they shift a disproportionate share of the property tax burden onto lower-priced real estate. Because high-end property value growth tends to exceed cap levels more than lower-end property, appraisal caps, even at 10 percent, shelter a greater amount of expensive property's taxable value, which benefits its owners to the detriment of all others. Lowering the cap to 5 percent only would exacerbate the inequity.

Because the cap is removed when property sells, property taxes on newly purchased real estate may be much higher than identical real estate nearby, depending on the sales price and the age and value trends of the area. Consequently, inequities arise among various segments of property owners.

Caps are a violation of equal taxpayer protection required by Art. 8, sec. 1 of the Constitution. They create inequities by causing the owners of similar property to pay different amounts of tax depending on how long the appraised value of the property has been capped. A further reduction in the appraisal cap only would increase such inequities.

Appraisal caps have disequalizing and regressive effects on education funding because they reduce the amount of property value used to calculate state aid. They also tend to shift tax burdens within school districts from rapidly appreciating neighborhoods to flat- or slow-growth neighborhoods. Owners of property whose appraised value does not increase as much as the cap must pay more than they would otherwise because tax rates have to remain constant or increase to make up for revenue lost due to the cap on property that is appreciating more rapidly.

By applying appraisal caps to all real property HB 784 would shifter higher tax burdens to residential homeowners. Nonresidential taxable property values are more volatile than residential values and often rise at rates significantly higher than 5 percent per year. Applying the appraisal caps to such properties would result in the loss of a great deal of tax revenue that municipalities no longer could collect.

Appraisal caps adversely would impact bond ratings, constrain local financial flexibility, and limit the ability of local governments to meet vital infrastructure needs. As outstanding debt mounted due to decreased property tax revenues, local governments would be saddled with higher interest payments, resulting in lower bond ratings and deteriorating ability to finance needed infrastructure improvements.

HB 784 would render economic development tools such tax increment financing and tax abatements less attractive to business. When business property is capped below the full market value, it takes significantly longer for a local government to recover the taxes it lost during the abatement period. A 5 percent appraisal cap would make it financially difficult, if not impossible, for municipalities to sustain economic development programs offering further tax advantages to lure businesses.

Also, appraisal caps could place business startups at a disadvantage and could make such companies less inclined to purchase property that would be valued much higher for tax purposes than property owned by established businesses. This could retard business growth and hurt local governments even more.

Commercial and industrial property owners potentially could avoid ever paying taxes on a property's full market value. For example, if a corporate entity that owned property changed hands, the property appraisal would remain capped at 5 percent and never "pop up" to full market value, since the property did not transfer even though ownership of the corporation did.

**OTHER
OPPONENTS
SAY:**

While appraisal caps should be lowered, they should continue to apply only to residential property. Business's share of property taxes has been declining steadily since 1982, and they do not need further relief in the form of an appraisal cap. Businesses have many more resources available than do homeowners to counter the effects of rising values and higher tax bills.

Cities and counties should be given the option of applying any appraisal cap policy changes. Granting flexibility would give local governments greater control over their relative levels of reliance on property taxes for local services. A local option would allow local governments to factor population, demographics, and local economy into their appraisal limits.

Further discretion should be granted so local governments could determine the amount of their appraisal limits below 10 percent. While some cities and counties could hold caps at 10 percent, others could provide taxpayer relief by lowering caps.

Greater fiscal restraint at the local level is needed. Local governments should be forced to restrain spending by limiting their property tax revenue growth to the previous year's levy plus inflation and population growth, unless voters approve higher levels. HB 1006 by Isett would hold government to such standards, revising "truth in taxation" provisions and lowering the rollback rate from 8 percent to 3 percent.

Appraisal caps further reduce city and county budgets that already are overly directed by the state through unfunded mandates. Lower caps on real property should not be applied to the appraisal system without legislation prohibiting further requirements of local government to undertake new activities without adequate subsidies. In the absence of such a provision, HB 784 severely could reduce revenue required not only for schools but also local law enforcement and indigent health care. Texas' tax system needs to be overhauled completely. If the state's tax system included income-based taxes, which would be constitutionally dedicated to education and school property tax reduction, the state would not need artificial limits on property appraisals.

NOTES:

The fiscal note attached to HB 784 estimates that the state would gain \$5.7 million in general revenue-related funds during fiscal 2006-07 as a result of the bill. Losses from fiscal 2006 through fiscal 2010, however, would total \$1.2 billion to the Foundation School Fund. During the same period, the LBB estimates that cities would lose \$466 million in revenue and counties would lose \$428 million.

HB 784 is the enabling legislation for HJR 35 by Bohac, et al., which would lower the cap on annual maximum increases in appraised taxable property value from 10 percent to 5 percent and apply it to all real property, not just residential homesteads. Yesterday, during consideration

of HJR 35, the House adopted an amendment by Rep. Villarreal that removed its resolving clause, effectively nullifying the proposed constitutional amendment.

A related measure, SJR 4 by Janek, would amend the Constitution to lower the permissible appraisal cap to 5 percent on residential homestead appraisals, but would authorize the Legislature to allow cities and other taxing districts to choose not to apply the cap following a majority vote of the governing body. SJR 4 has been referred to the Senate Finance Committee.

Other proposals would lower the permissible cap to 3 percent. HJR 8 by Bohac would apply the lower cap to residential real property. HJR 28 by Bonnen and HJR 40 by Riddle would apply it to all real property. HJR 36 by Leibowitz would apply it to homestead property. All have been referred to the Ways and Means Committee.

During the fourth called session of the 78th Legislature in 2004, HJR 1 and HB 1, both by Grusendorf, included proposals to reduce the permissible appraisal cap to 5 percent on all owner-occupied residential real property. HJR 1, which also included authorization for video lottery terminals among other proposals, failed to receive the necessary two-thirds vote of the House membership. HB 1 passed the House on May 5, 2004, but died when the Senate Committee of the Whole took no action.

During the 2003 regular session of the 78th Legislature, the House adopted HJR 4 by Bohac, which would have amended the Constitution to lower the permissible appraisal cap to 5 percent and applied it to all real property. The House also passed the enabling legislation, HB 3223 by Bohac, which would have retained the 10 percent cap for school districts and junior college districts and lowered the cap to 5 percent on taxable real property for all other taxing units. Both were reported favorably by the Senate Intergovernmental Relations Committee, but the full Senate took no action.