SUBJECT: Increasing the margin of error in the comptroller's property value study

COMMITTEE: Ways and Means — favorable, without amendment

VOTE: 6 ayes — Keffer, Ritter, Otto, Bonnen, Y. Davis, Peña

1 nay — Pitts

2 absent — Flores, Paxton

WITNESSES: For — Alan Conner, Liberty County Appraisal District; (*Registered, but did not testify*: Michele Gregg, Texas Apartment Association; Donald Lee, Texas Conference of Urban Counties; Ned Muñoz, Texas Association of Builders; Carolyn Allen; Art Cory; Cheryl E. Johnson; Jim Robinson; Buddy Winn)

Against — Dick Lavine, Center for Public Policy Priorities; (*Registered, but did not testify*: Bill Allaway, Texas Taxpayers and Research Association)

On — Ted Melina Raab, Texas Federation of Teachers

BACKGROUND: Government Code, sec. 403.302 requires the comptroller of public accounts to conduct an annual study to determine the taxable value of property in each school district in the state to help ensure that state funds for public schools are distributed equitably. A secondary purpose of the study is to measure county appraisal district performance.

For a specific school district, the property value study compares the district's appraised value with the district's market value, as determined by the comptroller's Property Tax Division. A school district's "appraised value" is determined by the school district's central appraisal district. A school district's "market value" is the fair price at which a property would sell under normal conditions, as estimated by the Property Tax Division.

In estimating a school district's market value, the Property Tax Division uses generally accepted sampling, valuation, and statistical techniques. The Property Tax Division bases its estimate on market value of available sales data or, when such data is unavailable, on a third-party appraisal.

Under Government Code, sec. 403.302(c) the comptroller is required to determine whether the local value of a school district is valid. If a school district's reported value falls within a 5 percent margin of error above or below the district's taxable value as estimated by the Property Tax Division, the value is considered valid. If the value reported by the school district is outside the 5 percent margin of error, the value is invalid. For example, if the Property Tax Division determines that a school district's market value is $100 million, then a school district's appraised value would be considered valid if its appraised value was between $95 million and $105 million. The Property Tax Division is authorized to use a larger margin of error when the size of the sample of properties necessary to make the estimate is too small.

If a school district's appraised value is determined to be invalid because its margin of error is greater than 5 percent, the comptroller conducts a standards review examining the procedures of the appraisal district. Even if a school district's market value is invalid, taxes are levied on the school district's appraised value during a grace period of up to two years. During this time, the school district's appraised value also is used to determine state funding under the school finance system. However, if a school district's appraised value is held to be invalid for two consecutive years, the market value determined by the Property Tax Division is substituted for the school district's appraised value when the Texas Education Agency calculates the district's allocation of state funds under school finance formulas.

DIGEST:

HB 216 would require the comptroller to use a margin of error of 10 percent, rather than the current 5 percent, in determining whether the taxable value of property for a school district was valid.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2007, and apply to annual studies beginning in the 2007 tax year.

SUPPORTERS SAY:

By increasing the margin of error used in the comptroller's property value study from 5 percent to 10 percent, HB 216 would help slow the burdensome "appraisal creep" that has afflicted property owners across the state. Currently, the state forces local appraised value to fall within a stringent and unrealistic 5 percent margin around an estimate of market value by the comptroller's Property Tax Division. If a school district's appraised value falls outside that range, the school district must choose between raising property appraisals or losing state education funding — generally, the higher a district's property value, the less state aid it receives. HB 216 would correct this problem by authorizing a more appropriate margin of error, lessening the upward pressure on appraisals that have burdened property owners across the state with increasing tax bills.

Tax appraisal is more of an art than a precise science, and the 5 percent margin of error in the property value study is unreasonable. Market value is an inexact number, and two independent appraisals rarely will be within 5 percent of each other, as required under current law. The 5 percent margin is far too stringent to account for the variation in appraisals that local appraisal districts and the state often report.

Current practice creates a perverse incentive for appraisal districts to appraise property at a higher value in order to ensure that the school district's appraised value falls within the 5 percent margin of error. Appraisal districts often "shoot high" and appraise property at a level greater than market value in order to achieve validity under the Property Value Study. This practice has contributed to rising appraisals and property taxes across the state.

While some point to the large fiscal note for the bill as a reason not to increase the property value study's margin of error, the cost that the state would bear under HB 216 is money that otherwise would have to be paid by property owners through local property taxes. Without a method of holding down appraised value, increases in property value will undermine the progress made under the package of school finance legislation enacted by the 79th Legislature in 2006 during its third called session. Those bills bought down local property taxes while expanding the state's share of public education funding. However, if property appraisals are allowed to rise, citizens and businesses will see their taxes increase while the state's share of education funding erodes.

Much of the property value that would come off the tax rolls if the property value study margin of error were increased should not be taxed in the first place. Currently, if a school district's appraised value is determined to be invalid, the appraisal district may be forced to raise the appraised value of other property to move the district's appraised value within 5 percent of the comptroller's estimated market value. This can lead to over-appraisal of property that had been appraised properly.

In addition, the property value study does not take into account appraisal review board decisions that can result in lower appraised values after successful appraisal protests from property owners. For this reason, an appraisal district could be forced to increase otherwise accurate appraisals in order to raise the school district's appraised value within the 5 percent margin of error.

Current law improperly assumes that the Property Tax Division's estimates of property values are more accurate than appraisals performed by local appraisal districts, even though local appraisers have more immediate knowledge about the property they appraise. Local appraisal districts are forced to conform to the state's estimate, whether or not the local valuation is more accurate. By allowing greater variation between the comptroller's estimate of a school district's market value and the school district's appraised value, a 10 percent margin of error would prevent a scenario in which a school district had to increase appraisals when the appraised value of the district was more correct than the state's estimate.

The fiscal note is based upon a worst-case scenario that likely would not occur if HB 216 were enacted. Some may argue that if the Property Value Study margin of error were increased, then appraisal districts would lower values as much as they could, representing a substantial loss in taxable value for public education. However, this assumes that appraisal districts actively would avoid performing their duties. Appraisal districts operate in good faith and by-and-large are committed to ensuring accurate appraisal of property in their jurisdictions.

Appraisal districts face potentially severe consequences if they fail the unrealistic margin of error standard that exists in current law. If an appraisal district fails the property value study for one year, it must submit to an audit by the comptroller. If an appraisal district's valuation of property is more than 5 percent below or above the estimate made by the Property Tax Division for three years running, a process begins that can lead to the replacement of the appraisal board, the dismissal of the chief appraiser, and transfer of the district to a receivership. Given the challenging and inexact nature of an appraisal district's charge, these consequences are too steep when coupled with criteria as strict as the 5 percent margin of error.

OPPONENTS SAY:

According to the Legislative Budget Board (LBB), HB 216 would cost $1.9 billion in general revenue from the Foundation School Fund through fiscal 2012, a substantial diversion of state funds that should be used for other priorities in the state budget. State budget writers struggle every session to provide adequate funding for health care, public and higher education, criminal justice, and other important programs, and it would be imprudent to dedicate such a large amount of money simply to allow below-market property appraisals.

HB 216 would undermine the accuracy of property appraisals by authorizing a wider range of property valuation. Current law indirectly encourages appraisal districts to keep values appraised at a level that is at least 95 percent of market value by tying state education funding to appraised value. The state's school finance system is predicated on accurate local appraisals, and undermining the accuracy of those appraisals would upset the balanced school finance partnership shared by the state and local school districts.

HB 216 would have dramatic implications for the state's share of public education funding, as both property-poor and property-wealthy districts would have an incentive to under-appraise property for the purpose of determining state aid under the state's school finance formulas. By relaxing the deviation allowed from market value, poor districts could allow appraised values to fall, lowering the amount of money they had to contribute in local property taxes while relying on more state money to bring them up to a full, equitable funding level. Property wealthy districts also could allow their appraised value to drop by up another 5 percent beyond the current 5 percent margin, reducing the amount of money those districts would have to send back to the state under the recapture system. In addition, the hold-harmless provisions of HB 1, 79th Legislature, third called session could require the state to contribute further revenues if lower appraised values enabled districts to fund schools below the hold harmless funding level. For these reasons, HB 216 could cause a significant strain on state resources if equitable school funding levels are to be maintained.

While most appraisal districts certainly are committed to accurately appraising property in their jurisdictions, HB 216 would create an environment that could lead appraisers to lower the value of property by as much as an additional 5 percent. Chief appraisers know that the lower an appraisal on a property, the less likely the appraisal district would have to deal with a protest on the appraised value of the property. History shows that chief appraisers will seek to avoid the raft of protests and political fall-out generated by rising property values by keeping down appraised value when external incentives to maintain the link between appraised value and market value are weakened. Consequently, it is highly likely that a 5 percent expansion in the property value study's margin of error would result in a 5 percent erosion in the appraised value of property across the state.

Appraisal districts overstate the consequences of failing the property value study. A standards review by the Property Tax Division occurs when a school district's appraised value is held to be invalid, but this process is designed to be a cooperative effort to study and improve the practices of a local appraisal district. The Property Tax Division has been open to similar reviews, undergoing internal and external audits that have led to improvements in the division's practices. Additionally, the division will work with an appraisal district to correct appraised value and move a school district's appraised within the 5 percent margin of error. The potential consequence of a loss in state funding rarely occurs, and no appraisal district has ever been placed into receivership in the history of the Property Value Study.

The way to address the problem of rising appraisals is not through undermining the accuracy of property appraisals by allowing greater deviation from market value. Several other potential fixes exist, such as lowering the current 10 percent annual appraisal cap on residence homestead property taxable value increases or increasing the residential homestead exemption. Ultimately, the problem with appraisal creep lies in a state school finance system that relies too heavily on local property taxes rather than funding from other, more diverse state sources.

OTHER OPPONENTS SAY:

While appraisals may be inexact, HB 216 would adopt a permissive attitude to inaccurate appraisals rather than improving the appraisal process. A better strategy would be to equip appraisal districts with the tools they need to appraise property accurately. For example, a strong sales price disclosure law would allow appraisal districts access to all property sales records, strengthening the ability of appraisers to accurately reflect the market value of the properties they appraise. Additionally, the Legislature could adopt a more subjective method for evaluating the standards, procedures, and methodologies of appraisal districts, and allow local estimates of appraised value to prevail when generally accepted appraisal methods were used.

NOTES: According to the LBB, HB 216 would result in a $161.7 million cost to general revenue-related funds in fiscal 2008-09 and a $937,862,000 cost in fiscal 2010-11.

Several bills have been filed that would address the property value study or the appraisal process.

HB 3492 by Otto, which would require the comptroller to account for differing levels of appraisal resulting from appraisal protests and adjust estimates of school district market value accordingly, was reported favorably, as substituted, by the Local Government Ways and Means Committee on April 13 and recommended it be sent to the Local and Consent Calendars Committee.

HB 2513 by Villareal would do away with the current methodology of the comptroller's property value study and replace it with a review by the comptroller of the appraisal standards, procedures, and methodology used by each appraisal district. If the comptroller approved these practices, the value reported by an appraisal district for a school district would be considered valid. If the comptroller did not approve of an appraisal district's practices, the comptroller would substitute the state's estimate of market value for the district's. HB 2513 was considered in the Local Government Ways and Means committee on March 26 and left pending.

Rep. Villareal has filed several bills related to sales price disclosure, which are pending in committee. HB 133 and HB 3821 would require disclosure of the sales price of real property to appraisal districts. HB 1552, HB 2996, and HB 3820 would allow county voters to authorize requiring disclosure of the sales price of real property to appraisal districts.