TTARA Testimony Against HJR 1

Dale Craymer
President, Texas Taxpayers and Research Association
(512) 472-8838
dcraymer@ttara.org
www.ttara.org

March 13, 2023

TEXAS TAXPAYERS
TTARA
AND RESEARCH ASSOCIATION

The Property Tax Equation in Action: Lower Tax Rolls = Higher Rates

$$\text{Revenue} = \text{Value} * \text{Rate}$$

Appraisal Caps:

- ✓ **Do** reduce values
- ✓ **Don't** reduce revenues

Appraisal caps mean you have to levy higher tax rates to raise the same amount of revenue

The Property Tax Equation in Action: Lower Tax Rolls = Higher Rates

2019's HB 3 & SB 2 Limit **Revenue**		Tax Roll **Value** Set by Appraisal District		**Rate** is Set Annually Based on Revenue & Tax Base

With 10% Appraisal Cap on Homesteads

Revenue		Value		Rate
Revenue to Finance Budget = $1,000,000 (which is 3.5% above last year's revenue as allowed under **SB 2**)	=	**Value** of Tax Roll = $200,000,000 (10% homestead appraisal cap applies; tax roll is up 12% from last year)	X	**Rate** of Tax = $0.50 per $100 (which is calculated as: $1 ml/$200 ml * $100)

With 5% Appraisal Cap on Real Estate

Revenue		Value		Rate
Revenue to Finance Budget = $1,000,000 (which is 3.5% above last year's revenue as allowed under **SB 2**)	=	**Value** of Tax Roll = $180,000,000 (5% cap on all real estate applies; tax roll is up 6% from last year)	X	**Rate** of Tax = $0.56 per $100 (which is calculated as: $1 ml/$200 ml * $100)

Tax Effects of Appraisal Caps

1. **Appraisal Caps don't cut *overall* taxes.** Under Texas law, cities, counties and special districts are allowed to increase their property tax revenues by either 3.5% or 8.0% over the previous year without voter approval (Tax Code 26.04). HB 2 does not amend these provisions to reduce property tax revenues.

2. **Appraisal caps mean higher tax rates.** By reducing the amount of taxable value, jurisdictions will adopt higher tax rates than they would have otherwise to raise the amount of revenue they are entitled to under Tax Code Chapter 26.

3. **Appraisal caps simply shift taxes from one taxpayer to another**. Uncapped properties, or those in which the cap offers little-to-modest benefit, end up paying more in taxes because of the higher tax rates necessary to finance the cost of the appraisal cap.

4. **Caps can create tax avoidance opportunities.** Under HB 2, the appraisal cap is reset when a property is sold. To avoid resetting the cap, the ownership of the property can be placed under, for example, a limited liability company (LLC – Business Organizations Code, Chapter 101). If the owner sells the LLC, rather than the property itself, on paper the ownership of the property does not change and the cap would be retained, even though the ultimate owner may have changed.

5. **Converts the property tax from one based on value to one based on tenure.** Article VIII, Section 1(a) of the Texas Constitution states that "Taxation shall be equal and uniform, and based on a market value appraisal standard that applies to all property. A 5% appraisal cap benefits long-time property owners at the expense of newer property owners. Tax bills will be less dependent on the value of property and more dependent on the length of ownership.

6. **The lower tax base under appraisal caps could hurt Texas bond ratings and drive up debt tax rates.** Local property tax bases are used to guarantee debt. Artificially constraining local tax bases with appraisal caps may be viewed negatively by rating agencies and threaten local debt ratings, which translate into higher debt payments. In addition, a lower tax base will require a higher debt tax rate to cover debt payments.

7. **Negates the benefits of 2019's massive reform bills: HB 3 and SB 2. P**roperty tax due is the product of taxable value and the tax rate. HB 3 and SB 2 require excess value be used formulaically to drive down tax rates. Appraisal caps will limit value growth, reducing the ability of jurisdictions to drive down tax rates.

Economic Effects of Appraisal Caps

1. **Appraisal caps create huge inequities in taxing similar properties.** Identical properties can have vastly different tax bills – simply because of when they were purchased – even though the households place the same demands on public services.

2. **Caps punish new home buyers.** New home buyers are penalized by paying both higher prices (above) and higher taxes. Appraisals reset to market value when a home is sold, so new homebuyers see no cap, but they face the higher tax rates needed to pay for caps.

3. **"Lock-in Effect**." Caps punish homeowners for selling and can lock them into their existing homes. Studies show appraisal caps increase the length of time homeowners will stay in a property by as much as 6 years.[1]

4. **Appraisal caps distort the free market and artificially drive up home prices.** With lower turnover of properties, the supply of homes for sale is diminished, which drives up prices for new home buyers.

5. **Appraisal caps do little for seniors.** In Texas, school tax bills – the biggest part of Texans' property tax bills – are already frozen for homeowners over the age of 65. Appraisal caps will do nothing to reduce their school taxes.

6. **Caps benefit the wealthiest taxpayers.** The Comptroller reports that the wealthiest 20 percent of taxpayers pay 33% of the property tax, but get 40% of the benefit of Texas' current appraisal cap. Studies in California have found that caps disproportionately benefit wealthier neighborhoods.[2]

7. **Barrier to Entry.** An appraisal cap on all property creates a substantial barrier to new investment, as new properties will be taxed at their market rate while existing properties may be taxed well below market value. For example, a new office building may not be able to compete for tenants. Under a triple net lease, their renters will face substantially higher pass-through costs than they would on established properties.

[1] Hodge, T., Sands, G., and Skidmore, M., Assessment Growth Limits and Mobility: Evidence from Home Sale Data in Detroiot, Michigan, National Tax Journal, 68(3), 573-599,.

[2] Bedayn, Jesse, Prop, 13 Offers Bigger Tax Breaks to Homeowners in Wealthy, White Neighborhoods, CalMatters, April 14, 2022

What do the Experts Say About Appraisal Caps?

The evidence shows … that limits on assessed values, while favored by many homeowners, are a deeply flawed measure to counter rising property taxes. Assessed property value limits are used in hope of reducing property tax bills and slowing the shift in property tax burdens to residents, but in fact they can result in higher property taxes for the very homeowners they are intended to assist and can cause unpredictable new shifts in tax liabilities…. Thirty years of experience suggests that these limits are among the least effective, least equitable, and least efficient strategies available for providing property tax relief

> **Lincoln Land Institute** https://www.lincolninst.edu/publications/policy-focus-reports/property-tax-assessment-limits

Unfortunately … [appraisal caps] create their own set of problems, locking people into their homes, taxing similarly situated homeowners at dramatically different rates, and introducing a raft of other inequities and inefficiencies into property taxation.

> **Tax Foundation**: https://taxfoundation.org/property-tax-limitation-regimes-primer/

[An appraisal cap] … *typically shifts taxes based on length of ownership from long-term owners to newer owners. This can cause long-term owners to feel trapped in their property …. At the same time, …[an appraisal cap] discourages potential buyers, especially first-time buyers. If the assessment cap also applies to business property, businesses may become more inefficient, because the same mobility penalty may cause some of them to stay longer in less suitable properties.*

> Research Committee of the **International Association of Assessing Officers**, *Assessed Value Cap Overview*, 2010.

Winners and Losers Under a Broader, Lower Appraisal Cap

In 2019, the legislature restructured Texas property tax system by requiring that growth in local tax rolls driven by appraisal increases be used to reduce tax rates. Appraisal caps means there will be less value growth available to drive down tax rates meaning tax rates will stay high without special appropriations from the legislature.

The following chart compares actual 2022 school M&O property taxes paid versus what they would have been had a 5% appraisal cap been put in effect in 2019 along with that session's HB 3 school finance reforms ($ billions):

Category of Property	**Actual Value**	**Value w/5% RE Cap**	**Actual Levy**	**Levy w/5% Cap**	**Difference**
Single Family	$1,890.5	$1,634.2	$17.1	$17.1	$0.0
Multi Family	$320.7	$256.3	$2.9	$2.7	($0.2)
Commercial Real	$630.8	$602.6	$5.7	$6.4	$0.7
Industrial Real	$157.3	$135.3	$1.4	$1.4	($0.0)
Oil and Gas	$218.9	$109.1	$1.9	$1.1	($0.8)
Utilities	$106.4	$84.9	$1.0	$0.9	($0.1)
Business Personal Property	$288.4	$288.4	$2.6	$3.1	$0.5
Agricultural Property	$18.6	$15.7	$0.2	$0.2	$0.0
Other	$104.3	$88.1	$0.9	$0.9	$0.0
TOTAL	$3,735.9	$3,214.7	$33.8	$33.8	$0.0

Had real estate values been capped at 5% since 2019, taxable values would have been roughly 15% lower in 2022 than they actually were; however, to raise the same amount of school property tax revenue, tax rates would have been much higher. HB 3 reduced the average school M&O tax rate from $1.09 in 2018 to $0.91 by 2022. Had a 5% cap on real estate value growth been in effect, the tax rate needed to raise the same amount of revenue in 2022 would have been $1.06. Appraisal caps would have meant very little tax rate reduction.

Ironically, homeowner taxes would have been little different. The higher tax rates would have eliminated much of the benefit from a lower and broader appraisal cap. The big winner would have been oil and gas, as valuations based on low oil and gas prices would have stayed in place even as prices later soared. The losers would have been commercial property and business personal property. Though commercial property would have seen lower appraisals, any benefit was lost to higher tax rates. Business personal property values would not have been capped, leaving it to only see the higher tax rates needed to offset the diminished value of other properties.

Technical Issues with HB2/HJR1

1. **Where is the line drawn between capped real property and uncapped tangible personal property?** Current law does not provide a clear cut distinction between tangible personal property and real property, and there are substantial differences across appraisal districts. There will be confusion between property owners and appraisal districts as to how to draw the line.

2. **How will certain business property be valued?** Many business properties are valued on a "unit" valuation method or one based on income. The entire property is valued without distinction between tangible personal property and real property. How should appraisal districts account for this?

3. **What constitutes a "new improvement" that is not subject to the cap?** "New improvements" are not subject to the cap, but many business properties are not valued in a way that allows new improvements to be separately valued.

4. **What constitutes a sale of the property?** Many business properties (and some residential properties) are owned by a business entity such as a corporation or LLC. A property can be "sold" simply by selling the business unit rather than the property itself. Under HB 2 the sale of the business unit would not be considered a sale that resets the cap, as there is no "look-through" provision.

5. **How will a property under an abatement or 313 agreement be valued when the incentive expires?** Tax abatements and Chapter 313 agreements restrict the taxable value of a property. If HB 2 limits value growth to 5%, will these properties be fully valued once the incentive expires, or does the 5% cap apply to the incentivized value?

6. **Does subdividing a property cause the cap to be lifted?** Selling off a piece of a parcel. How would the cap apply (or not) if a property is subdivided? Does the limit continue to apply to each parcel, or does the limit reset?

7. **How will rollback be calculated on the conversion of agricultural to some other use?** Agricultural property that is converted to some other use, typically with the sale to a new owner, is subject to three years of back taxes based on the full value of the property. Would these taxes be calculated based on the full market value of the property or on the capped value of the property?