



TTARA

Texas Taxpayers and Research Association

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Appraising the Appraisals: Local Values and Property Taxes

Over the past few months, a number of Texas newspapers have written in a critical tone about Texas' property tax appraisal system. The thesis goes something like this:

Texas' process of disputing appraisals is being abused by crafty taxpayers who are getting huge, indefensible reductions in the values legitimately determined by their appraisal district. As a result, certain properties—particularly commercial real estate—are rampantly undervalued. This is driving huge tax increases on homeowners.

In fact, an objective analysis reveals no rampant under-valuations, and most of the reductions stemming from disputes are actually approved by the appraisal district. **Property tax bills are, indeed, rising, but not because of higher values. They are rising because of higher local spending.** And while homeowners are bearing an increasing share of the property tax, these shifts don't stem from value disputes—they simply reflect underlying changes in Texas' economic base.

The Role of the Tax Roll

The failure to correctly value a piece of property has serious consequences for the integrity of the property tax system. If a property is under-appraised, that error is offset by other taxpayers paying more than they should. On the other hand, if a property is over-appraised, the owner of that property pays more than they should.

Appraisal districts make an initial estimate of a property's value and the owner is free to contest that value with the district. If a taxpayer is not satisfied with the results of the informal conference, they may

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take their challenge before the local appraisal review board (ARB). If the taxpayer remains unsatisfied, they may pursue an independent review of their value in court—an expensive proposition justified if the amount in dispute is high, although winning taxpayers are entitled to recover attorneys' fees.

There are roughly 17.6 million parcels of property in Texas, all of which are assigned a market value for tax purposes by their local appraisal district (Table 1). In 2012, the last year for which data are available, appraisal districts report that property owners filed just over 1 million challenges to the districts' initial estimate of value. Of those, just under 700,000 went to an informal conference at the appraisal district (the remainder either chose not to pursue their challenge or decided to go directly before their ARB). About half of the challengers were actually granted a reduction from the appraisal district (an average reduction of 12.5 percent for both residential and commercial owners). Just under 400,000 cases went before their local ARB. About a third of these resulted in reductions (on average a 12 percent reduction for

residential owners, 16 percent for commercial property owners). Just over 5,000 cases were resolved in court, but of those, 90 percent were settled before trial by mutual agreement of the appraisal district and the taxpayer. Only 31 cases—or 0.0007 percent of all properties in the state—were actually decided in a trial.

So how rampant have the reductions been?

The value reductions—to both residential and business properties—agreed to by appraisal districts in the informal process totaled \$29.9 billion, or 1.4 percent of the initial estimate of market value across the state (Table 2). Reductions granted by ARBs knocked off another 0.8 percent. Cases that made it to the court system ultimately reduced the rolls by another 0.6 percent, but it's important to remember that most of those cases—90 percent—were agreed settlements between the appraisal district and the property owner and not from the 31 court decisions.

The 2.8 percent reduced from appraisal districts' initial value estimates (which includes the results of both homeowner and business protests) does **NOT** result in a revenue loss to taxing jurisdictions. Tax rates are not adopted until the tax roll is final (any values still in dispute are excluded from the final roll). At that point, tax rates are set at the level required to finance the budget the jurisdiction has adopted. Final taxable property values simply reflect who is going to pay how much of that predetermined total.

The valuation of commercial properties has come under particular scrutiny as a result of taxpayers receiving value reductions by challenging their appraisal based on the use of comparable properties. The Texas Constitution mandates that all property be taxed at market value and that taxes be "equal and uniform." Under Texas law, if a taxpayer—be it a business or a homeowner—can demonstrate that their value is higher than that of comparable properties, they may get relief. This ensures that comparable properties are on a level playing field. **Appraisal districts accuse commercial property owners of "cherry picking" undervalued properties for comparison, even though the values on those properties were either set by the appraisal district**

or the appraisal review board!¹

In response to the hubbub over commercial values, the Harris County Commissioner's Court recently

Table 1
Property Value Challenges by the Numbers

Number of Properties Appraised	17,630,494
Protests Filed by Taxpayers	1,018,555
<u>Informal Conference</u>	
Conferences Held	693,082
Protests Resolved	471,132
Reductions Granted	350,239
<u>Appraisal Review Board</u>	
Protests Heard	387,644
Reductions Granted	131,413
<u>District Court</u>	
Lawsuits Resolved	5,137
By Mutually Agreed Settlement	4,607
Withdrawn, Dismissed, or Other	499
Trial Verdict	31

Source: 2012 Operations Survey Data for appraisal districts published on the website of the Comptroller of Public Accounts.

Table 2
Value Reductions As A Result of Taxpayer Challenges

<u>Process</u>	<u>Total Value Reduced</u>	<u>Pct of State Mkt Value</u>
Informal CAD Conference	\$29.9 bl	1.4 %
Appraisal Review Board	\$18.1 bl	0.8 %
Legal Settlement or Trial	<u>\$13.8 bl</u>	<u>0.6 %</u>
Total	\$61.8 bl	2.8 %

Note: Legal Settlements or Trial category includes disputes carried over from previous tax years.

Source: 2012 Operations Survey Data for appraisal districts published on the website of the Comptroller of Public Accounts.

¹ Most commercial office properties pass their property taxes directly to their tenants as a part of their net lease agreement, so changes in property tax liability may provide them no direct benefit.

hired a consultant to review the preliminary commercial values set by the Harris County Appraisal District, but no major discrepancies were found:

The independent appraisal ratio study, which was authorized by Commissioners' Court several months ago, reviewed the appraisal district's preliminary values on several commercial categories including office buildings, retail properties, apartments and vacant land. The preliminary results indicate that the initial 2014 HCAD values of all of those categories, with the exception of vacant land, are close enough to their January 1 market value to be within the study's statistical margin of error.²

The Comptroller's value study does suggest vacant lots in Houston ISD are undervalued, but by just less than five percent (which is within allowable tolerances). If so, the impact on other taxpayers adds one-tenth of one percent to their tax bill. But before taxpayers bank that savings, it should be noted that the Comptroller says Houston utility property is *overvalued* by more than seven percent (an issue Harris County Commissioners are not investigating). Correcting that error would cost all other taxpayers far more than any savings realized by upping vacant lot values.

Travis County Commissioners also considered challenging the commercial property tax roll, but decided against it. They noted their information on value discrepancies was only anecdotal and the estimates of the resulting reduction ranged from \$5 to \$10 a year for the average taxpayer.³

All available information—be it from the appraisal districts themselves on the disputes they handle, or be it from the Comptroller's review of local values—does not offer evidence of the widespread undervaluation of commercial property. That is not to say there is no need for procedural change. However, proponents of such need to be honest and

acknowledge that those changes won't yield a noticeable impact on overall tax bills.

Economic Shifts Mean Tax Shifts

There is growing public dissatisfaction with the property tax as the Texas economy shifts into overdrive and homeowners and businesses are hit with rising appraisals. Homeowners, in particular, are suffering the tax consequences (but also reaping the rewards) of a hot real estate market.

Over the past 20 years, residential property has become a bigger part of the property tax. Residential property (of which perhaps 80 percent is homestead property) accounted for 39.5 percent of school taxes in 1994. By 2013 that number had risen to 47.7 percent. This shift is not because of any significant changes in tax law or practice. It's because of significant changes in our economy.

On the business side, Texas' economy (and that of the US) has become more services-based. Property-intensive industries are declining as a part of our economy as labor-intensive industries are growing. Over the past 20 years, Texas has lost 94,000 manufacturing jobs and gained 3 million services jobs. Those services jobs require much less property to support a productive worker than those at an industrial plant. As the jobs in our economy become less property intensive, the average property taxes of employers relative to each job lags overall economic growth, putting more pressure on homeowners and industrial properties. Further, a big part of the business tax base is personal property—which, unlike real estate, depreciates in value over its useful life.

There are shifts on the residential end, as well. In the past 20 years Texas has not only seen a 45% increase in the number of single-family homes, those homes are more expensive, even adjusting for inflation. People today are more urban than they were 20 years ago, and homes in the cities cost more than comparable homes in rural areas. Inner-city land values, in particular, have grown as cities have spread farther out. Homes built today are generally bigger than they were 20 years ago, too, and that extra square footage translates into higher cost and higher taxable value.

² Harris County Commissioner's Court Press Release, June 2014. It should be noted that the values used for comparison are those initially proposed by the appraisal district.

³ Andra Lim, "Travis County Won't Challenge Commercial Property Values," Austin American Statesman, June 10, 2014.

Appraisal caps, while popular politically, are not the solution. They may seem sweet, but they have no nutritional value. They do nothing to stem the tide of rising property taxes, they only impact who must pay them.

The real reason property taxes are rising is not because of increasing appraisals. It's because of increasing budgets. Values are only one part of the tax equation; rates are the other. Jurisdictions that blame rising property tax bills on someone else's appraisal are playing "hide the ball." Property taxes are rising because schools, cities, counties, and special districts are spending more. Whether those increases are justified or not, there is no denying they occur.

Texas property taxes today total near \$45 billion—up 58 percent from ten years ago and three times greater than they were 20 years ago. Property owners should certainly pay attention to their values, and contest them if they appear too high, but that will not put a dent in property taxes as long as spending continues to rise. Attention is better focused on the local budget process.

The Property Tax Equation, In Its Entirety:

$$\begin{array}{rcl} & \text{Property Value} & \\ \times & \underline{\text{Property Tax Rate}} & \\ = & \text{Property Tax Due} & \end{array}$$

Until Texans connect the costs of the services they want to the taxes they pay, there cannot be a rational discussion on fiscal policy.

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The problem is not the appraisal.

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