

# **The Texas Association of Property Tax Professionals Opposes Appraisal Caps**

The Texas Association of Property Tax Professionals (TAPTP) opposes appraisal caps. The members TAPTP and the clients they represent have experience in the property tax systems of every state in the United States. It is our informed opinion that appraisal caps are not an effective method for the provision of property tax relief. While artificial limitations on appraised values will negatively affect our industry, we stand in opposition to appraisal caps primarily because they are bad public and economic policy and bad for Texas. Before considering a Texas version of California's Prop. 13, it is important to understand the ramifications of value caps, as well as some basics about the Texas property tax system (which is the model system for the nation).

There has been much discussion of the need for property tax relief. Caps on property tax appraisals have been proposed by some as a potential source or method of providing property tax relief. An appraisal cap is an artificial limit on the annual increases on the appraised value of a property. Such a proposal would require a constitutional amendment because it would be contrary to equality and uniformity of taxation and the principle of taxation based on market value. Currently, there is a 10% appraisal cap on residence homestead property, but no appraisal cap on business property. During the last special session on school finance, a proposal to place a 5% cap on all property was defeated in the House.

## **Negative Consequences of Appraisal Caps**

It is the opinion of TAPTP that appraisal caps have consequences as follows:

- 1. Caps coupled with a flat school tax rate will have a devastating effect on schools**
- 2. Caps create an artificial and unfair competitive advantage**
- 3. Caps will deter new construction, real property purchases, and remodel**
- 4. Caps restrict economic development and hurt related industries that serve new growth**
- 5. Caps limit local governments' ability to use property tax structures for economic development**
- 6. Caps on real property values will shift tax burden to owners of high value machinery and equipment**

7. **Artificial value caps on real property will result in a declining tax base that cannot keep up with changing economic conditions:**
8. **Caps on real property values will result in higher tax rates**
9. **Caps on real property unfairly favor high dollar real estate vs other real estate**

### **Studies Find Appraisal Caps Are Bad Public Policy**

The fact that appraisal caps are bad public and economic policy for Texas has been concluded in numerous studies including:

- **“House Committee on Local Government Ways & Means, Interim Report 2004”; Chairman Fred Hill;**
- **“Study of Alternative Tax Plans for Public Education in Texas”; Texas A&M Real Estate Center; Charles Gilliland;**
- **“Appraisal Limits: A Wrong Turn on the Road to Property Tax Relief?;” Moak Casey & Associates;**
- **“The Impact of Potential Restraints on Local Government Activity (Appraisal Caps, Expenditure Limits, and Revenue Limits) on the Economy of Texas;” The Perryman Group;**
- **“The Myth of Property Value Caps: Do They Really Control Taxes?;” Foy Mitchell; Chief Appraiser; Dallas Central Appraisal District.**

These studies, as well as the experience of states with appraisal caps, clearly indicate that appraisal caps are not an effective method for the provision of property tax relief. I encourage you to read these studies and believe that after you do, you will also reach the conclusion that appraisal caps are bad for the State of Texas.

### **The Property Tax System is Not Broken**

The property tax equation is simple: Value (V) x Rate (R) = Levy (L). As discussed below, caps on value (V) create inequities among similar taxpayers and bring a host of unintended consequences. Caps on tax rates (R) limit the ability of local governments and communities to make their own decisions regarding local taxation. Caps on rates have been implemented by many jurisdictions, however, and can be effective for property tax relief. But if the economy is booming, the anticipated tax

savings will be wiped away by increases in appraised value (what the Governor has referred to as “Appraisal Creep”).

Those who practice in the property tax area know that the only way to achieve meaningful and equitable property tax relief is by focusing on the right side of the equation: the levy (L), not on the variable value (V) or Rate (R). Better truth in taxation statutes can solve the perceived property tax problem and will treat all taxpayers equally while at the same time giving local communities the flexibility to raise more tax revenue if they vote for an increase in their levy. Similarly, effective property tax relief in other states has been provided through the use of homestead exemptions.

Having outlined the basics, the next step is to consider the macro and micro economic ramifications of appraisal caps on commercial and industrial property. The conclusions of the above-referenced studies and y the experience of our clients evidence the following difficulties with appraisal caps.

## **Why Caps Are Not the Answer and Are Unfair Policy**

### **1. Caps Coupled with a Flat School Tax Rate Will have a Devastating Effect on Schools**

School finance discussions in both the Senate and the House have agreed on a flat tax rate for schools. The flat tax rate would result in some property tax relief with the loss in local property taxes replaced by state money. However, if an appraisal cap is coupled with a flat tax rate, even more local dollars will be lost which will require additional state funding. In addition, school finance discussions have assumed rising property values to keep pace with rising school funding needs. This, of course, will not occur if appraisal caps are instituted. As in California, caps will have a devastating effect on school finance.

### **2. Caps Create an Artificial and Unfair Competitive Advantage**

Property taxes account for anywhere from 20% to over 50% of total expenses for commercial properties that rent space to tenants (office buildings, regional malls, shopping centers, apartment complexes, industrial warehouses, etc.). The property tax expense is recovered through the gross or net rental rate charged to the tenant. Properties that do not receive a cap on their values (newly built, purchased, or remodeled properties) will have an economic disadvantage when compared to competing properties that benefit from the cap. Leasing retail and commercial space is highly competitive. New owners who do not benefit from the cap will suffer reduced income due to the fact that their rental rates must remain competitive with older properties, yet they will be paying much higher operating costs.

### **3. Caps will Deter New Construction, Real Property Purchases, and Remodels**

If I represent a national REIT that owns office buildings or regional malls, one of my primary considerations is determining where in the nation is it best to build or buy commercial property and have the best return or profit on the potential investment. If I know that in Texas (as in California) I will be in a competitive disadvantage with respect to property taxes which will result in a lower return on my investment, I may decide to build or buy property in another state where there are no artificial barriers to competition. California has lost real estate development projects due to Prop. 13 – even with its low 1% property tax rate. The negative implications for Texas would be far greater because our tax rates are generally between 2.5% to 3.0%.

### **4. Caps Restrict Economic Development and Hurt Related Industries that Serve New Growth:**

Economic development only happens when investors affirmatively decide to invest in a venture that will result in a maximum return on their investment. If, as a result of the competitive disadvantage created by appraisal caps, national corporations and REITs decide to spend their investment dollars in other states, Texas loses needed tax revenue and all of the industries that serve new growth will see a drop in revenue. Builders, contractors, Realtors, brokers, title companies, banks, and real estate professional service providers would all be negatively impacted by appraisal caps.

### **5. Caps Limit Local Governments' Ability to Use Property Tax Structures for Economic Development:**

Under current law, local taxing units have many options when attempting to foster economic development in their communities. One option is tax increment financing (“TIF”) bonds which can be used to pay for necessary infrastructure and are paid off through future property tax revenues from the proposed real estate development. In many cases, large real estate development projects take many years after initial construction to reach “stabilization” and operate at profitable levels. Appraisal districts recognize this fact by annually valuing these projects consistent with their ability to generate income. It is not uncommon, for example, for the appraised values of such developments to be valued at less than half of the construction cost in the early years and then be increased over time as the project begins to make more money. If caps were in place, the appraised values of these projects would never catch up to their market values. This in turn would throw a wrench in the underwriting of TIF bond payments and, in many cases, make such economic development tools unworkable and unavailable to local governments.

### **6. Caps on Real Property Values will Shift Tax Burden to Owners of High Value Machinery and Equipment**

Because the proposed cap on real property values does not, and generally cannot, apply to business personal property (furniture, fixtures, machinery and equipment), owners of high value machinery and equipment would be forced to pay taxes based on the

properties' full market value. Industrial utility, refinery, chemical, and manufacturing plants typically have the greatest concentration of taxable value in machinery and equipment. For example, I represent an electric generation plant in North Texas where the appraised value of its personal property is \$340,000,000, while the value of the real property is only \$11,000,000. It is axiomatic that a cap on real property would likely result in higher overall tax rates. This would mean that not only would the plant be paying taxes based on the full \$340,000,000 value of its machinery and equipment, it would also be paying at a higher overall tax rate. This result is fundamentally unfair to taxpayers with a high concentration of personal property and, if implemented, would likely deter future development of such facilities in Texas.

### **7. Artificial Value Caps on Real Property will Result in a Declining Tax Base that Cannot Keep Up with Changing Economic Conditions:**

Values of commercial and industrial property change dramatically with economic cycles and specific market conditions. It was not uncommon, for example, for hotels to experience a 30% drop in value after September 11 and the recent economic recession. With or without caps, a taxpayer will seek to lower their taxable values when the economy warrants a reduction. When the market recovers, those properties who receive the benefit of an appraisal cap will be dramatically undervalued. An artificial appraisal cap that restricts the tax appraisal authority's ability to recover the lost value virtually insures this property will remain significantly undervalued for an indefinite period of time. This fact makes the primary problems with appraisal caps (unfair competition and restraint on economic development) grow by several orders of magnitude. What will a potential investor of a shopping center do if he knows that a competing center across the street can charge its tenants half as much in expense reimbursements for property taxes? Invest his money elsewhere.

### **8. Caps on Real Property Values will Result in Higher Tax Rates**

For those taxing units that are able to raise their tax rates, appraisal caps will simply shift the variable in the property tax equation from the property's value (V) to the taxing unit's tax rate (R). The property owner's ultimate tax bill may not be reduced, but instead will be significantly increased if they build, purchase or improve a property because they will be required to pay at full market value and at a higher tax rate.

**9. Caps on Real Property Unfairly Favor High Dollar Real Estate vs Other Real Estate:** As demonstrated in several of the reports included with this letter, caps create a significant tax shift among and between various classes of property. Property in highly desirable areas tend to appreciate rapidly during periods of economic growth. In many cases the appreciation of such properties can be double digit growth. Poorer areas seldom experience this level of growth. As a result, in such periods, high value growth areas will not be taxed on their full appreciation inasmuch as the caps limit the appraisal

growth to 5%. Poorer areas, usually in the best of times, seldom appreciate 5%. Under the proposed scenarios offered by appraisal cap proponents, the poorer areas would continue to be taxed at their full appreciating market value. This results in creating serious inequities among different classes of property.

### **Summary**

These are only a few of the potentially devastating ramifications of appraisal caps on real property values. Anyone who carefully studies this issue and is intellectually honest must come to the conclusion that caps are bad for Texas and for economic development. Before we dismantle the Texas property tax system (as California did with Prop. 13), we must conduct a thorough and careful analysis of the impact the proposed cap would have on our economy and our ability to fund local government.

If the goal is to reduce the property tax burden, caps are clearly not the answer. They are merely gimmicks with significant negative impacts. True property tax relief for all property owners can only be achieved by limiting the amount of tax dollars collected. This can only be done by limiting the tax rate or limiting the revenue raised. If the goal is to provide tax relief for homeowners, the most effective approaches are through homestead exemptions and tax freezes.