



Appraisal Caps' Impact on Government and the Economy¹

By

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Appraisals for raising revenue for local government and public schools are determined by local government officials, making the appraisals subjective and a tool by which local governments grow unabated. The only check against unfettered appraisal increases is the cap that currently exists in state law.

Proposals that lower the current 10% cap give local governments a generous window for growth. Whether the cap drops to 5% or 3%, lowering the cap is appropriate as it directly limits taxation and forces local governments to better manage their growth and expenditures. It should be noted that with even an appraisal increase cap as low as 3%, local governments can still increase their revenues by increasing appraisals or by raising tax rates. HB 784 (79thR) would have simply limited the amount that a local government can increase property tax bills without raising the rate, forcing more transparent taxation by local governments.

Problems inherent to the Property Tax System

The property tax experience in Harris County highlights the need for a lower appraisal increase cap. Appraisals have increased dramatically across the state, but especially in Harris County where the taxable value of homesteads, as determined by appraisers, rose by more than 46% from 1996 to 2001, causing tax bills to increase by nearly 57% (House Research Organization Focus Report, *Property Tax Appraisal: Issues and Responses*). Under the current cap, a 46% increase in taxable value in five years is allowed; in fact, taxable value in Houston during that five year period could have increased by 50% under the current cap (10% per year). If the cap is lowered to 3% however, the maximum five

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year increase in appraisals would be 15%. The increase in Harris County valuations, 46% in five years, points to just how local government appraisals can be used to raise revenue to local governments.

The property tax is imperfect in its administration, partly because it is based on the subjective valuation of real property. The disconnect between appraised values of a property and sales price can be significant, and for many reasons. First, each individual property is not appraised. Instead, one property is appraised and other surrounding properties, often in a large radius, are taxed based on the one valuation. This is known as blanket appraisals. Additionally, there is no requirement that property owners disclose the purchase price of their homes, leaving appraisers to roughly estimate the value of a home to maximize government revenue.

The underlying problem with the appraisal system is that an appraiser can never know the value of a home to a buyer or seller. Price, which is not only a function of cost but value, is an unattainable factor except to the parties involved in the transaction. It is only available to others after a transaction has been completed assuming the parties involved reveal the price. Although appraisal caps don't directly address the flaws inherent in the property tax and the accompanying appraisal system, they do provide taxpayers with a measure of protection from those flaws.

Prices versus appraisals

Appraisal caps are not the same thing as price controls. There is not - and should never be - any barrier to the price at which a person may buy or sell a home. Price controls distort the market and can lead to oversupply -- or shortages -- of every kind of good and service, including homes. Prices send signals to producers - in this case homebuilders and real estate agents - as to what extent people may desire new homes, older homes or rental properties.

“In a market economy, prices play a crucial role in determining how much each resource gets used where...prices are like messengers conveying news - sometimes bad news ... but also good news,” wrote Thomas Sowell in *Basic Economics*. “Prices not only guide consumers, they guide producers as well. When all is said and done, producers cannot possibly know what millions of different consumers want,” Sowell continued.

Furthermore, Sowell wrote, “in a society of millions of consumers, no given individual or set of government decision-makers sitting around a table can possibly know just how much these millions of consumers prefer one product to another, much less thousands of products to thousands of other products.”

That explains why the appraisal system is so fundamentally flawed. The appraiser cannot possibly know what a sales price for a home might be so the appraiser's chief incentive is to appraise the home at ever-increasing levels *regardless* of what a buyer and seller might conclude the price will be. Central Appraisal Districts have one objective: raise revenue for government. Nothing more. As long as the property tax revenues are tied to the

current system of appraisals, then appraisal caps are justified as a protection for the homeowner.

Government, for whatever purpose, should never have an unremitting claim to our income and property. Not even the federal income tax system, for all its flaws, is based on such an arbitrary premise. Federal income taxes are tied directly to what an individual earns in real dollars; property taxes are tied to what an appraiser *believes* a home might be worth -- but worth to whom and when? The only moment “market value” or “appraised price” has any real meaning is at the precise time the seller and buyer of a home agree to a price at the time of the closing.

A response to critics of Appraisal Caps

Some people have argued that appraisal caps are a violation of local control and beyond state interest. The Texas Municipal League in a report by economist Ray Perryman, argues that appraisal caps could have a deleterious impact on delivering government services and economic development. But those arguments are unfounded.

First, appraisals (and appraisal caps) are a matter of state interest – not simply local interest – for two reasons:

1. Appraisal caps *are already codified in state law*. §23.23, *Tax Code* mandates that property appraisals may not increase by more than 10% of the previous year’s appraised value. It is a legitimate function of state government to examine the impact of appraisals on homeowners, and to determine whether adjustments ought to be made to the current cap to protect taxpayers, which was the original intent of §23.23 when it was written into law by the Legislature in 1997.
2. Property tax appraisals have a direct effect on school finance. The *West Orange Cove* case and the last twenty years of school finance litigation are directly influenced by the entirety of the property tax system, which relies heavily on appraisals. Furthermore, §42.001, *Education Code* is explicit that “the provision of public education is a state responsibility.” And because public education relies significantly on property tax revenues to fund its operation, it is clearly within state purview to modify, or even scrap, the property tax system whenever the Legislature deems necessary.

Second, the TML-funded report by Ray Perryman, “The Impact of Potential Restraints on Local Government Activity,” makes several assertions about the impact of appraisal caps on government services and economic development that are easily refuted. One point of agreement is that local governments are heavily dependent on property tax receipts for their ongoing operations. As illustrated in the accompanying chart (see page 4), property taxes have increased substantially over the past decade (see the far right column, “Total Property Tax Levy”). While the best available complete data ends in 2003, the trend continues upward to the present.

Tax Year	Special District Levy	County Levy	City Levy	School Levy	Total Property Tax Levy
1991*	\$1,459,643,501	\$1,894,013,461	\$2,303,609,801	\$ 7,566,042,099*	\$13,223,308,862
1992*	\$1,492,043,534	\$1,996,116,460	\$2,311,630,199	\$ 8,181,309,478*	\$13,981,099,671
1993	\$1,535,769,813	\$2,176,974,573	\$2,362,404,482	\$ 8,681,859,148	\$14,757,008,016
1994	\$1,620,504,796	\$2,311,389,149	\$2,493,554,910	\$ 9,024,885,601	\$15,450,334,456
1995	\$1,628,217,607	\$2,391,961,283	\$2,596,742,540	\$ 9,340,994,056	\$15,957,915,486
1996	\$1,698,557,436	\$2,537,183,937	\$2,701,214,386	\$ 9,910,195,171	\$16,847,150,930
1997	\$1,759,622,591	\$2,658,308,076	\$2,847,081,480	\$10,394,500,372	\$17,659,512,519
1998	\$1,889,138,306	\$2,828,286,927	\$3,005,996,060	\$11,334,614,289	\$19,058,035,582
1999	\$2,041,041,011	\$2,979,279,400	\$3,247,964,177	\$12,009,923,498	\$20,278,208,086
2000	\$2,389,110,312	\$3,200,919,731	\$3,530,863,516	\$13,392,336,012	\$22,513,229,571
2001	\$2,703,512,059	\$3,566,857,130	\$3,884,829,249	\$15,155,217,587	\$25,310,416,025
2002	\$2,864,454,984	\$3,849,728,346	\$4,186,795,363	\$16,418,788,831	\$27,319,767,524
2003	\$3,092,285,295	\$4,121,758,950	\$4,415,212,819	\$17,264,153,972	\$28,893,411,036

**1991 and 1992 include County Education Districts.*

Source: Texas Comptroller of Public Accounts, Property Tax Division.

Like the chart above, one graph in the Perryman report is particularly illuminating because it tracks the rise of property tax revenue before and after appraisal caps were passed by the 75th Legislature (1997).

- * The report shows that in 1991-1992, units of local government raised \$13 billion from the property tax.
- * Then the report shows that over \$16 billion was raised in 1996-1997 for an increase of \$3 billion.
- * Finally, it documents that by 2001-2002, local government raised nearly \$25 billion in the next four-year period, an increase of almost \$10 billion over the previous measure in 1996-1997.

In other words, the existing appraisal cap has had no impact on the ability of local governments to raise revenue.

Appraisal Caps have not hurt the economy

While the report frequently uses the term “empirically” to emphasize a point, four things have happened since the 10% appraisal cap was first imposed by the 75th Legislature (1997):

1. The Texas economy continued to grow and create jobs:
Except for one year, employment continued to grow, and unemployment fluctuated largely with changes in the national economy.

Date	Employment		Unemployment	
	Total	% Change Year Ago	Rate	Unit Change Year Ago
1995	9,015,240	2.4	6.0	-0.4
1996	9,168,805	1.7	5.6	-0.4
1997	9,357,967	2.1	5.4	-0.3
1998	9,649,447	3.1	4.8	-0.6
1999	9,792,388	1.5	4.6	-0.2
2000	9,960,436	1.7	4.2	-0.4
2001	10,020,352	0.6	4.8	0.6
2002	10,009,395	-0.1	6.3	1.5
2003	10,172,828	1.6	6.8	0.4
2004	10,335,723	1.6	5.9	-0.9

Source: U.S. Bureau of Labor Statistics and Real Estate Center at Texas A&M University

2. Revenue to units of local government grew dramatically, outpacing economic growth:
Even after the imposition of the 10% appraisal cap, the total property tax levy in 2003 was \$11 billion greater than the 1997 levy, when the cap became law. The average year- to-year increase in the total property tax levy has been greater after the 10% cap than the year-to-year increases prior to the cap. [see chart on page 4]

The growth of local government has outpaced the Texas economy, as is evident when the growth in the property tax levy over the last four years is compared to the change in the Consumer Price Index (CPI) and Gross State Product (GSP):

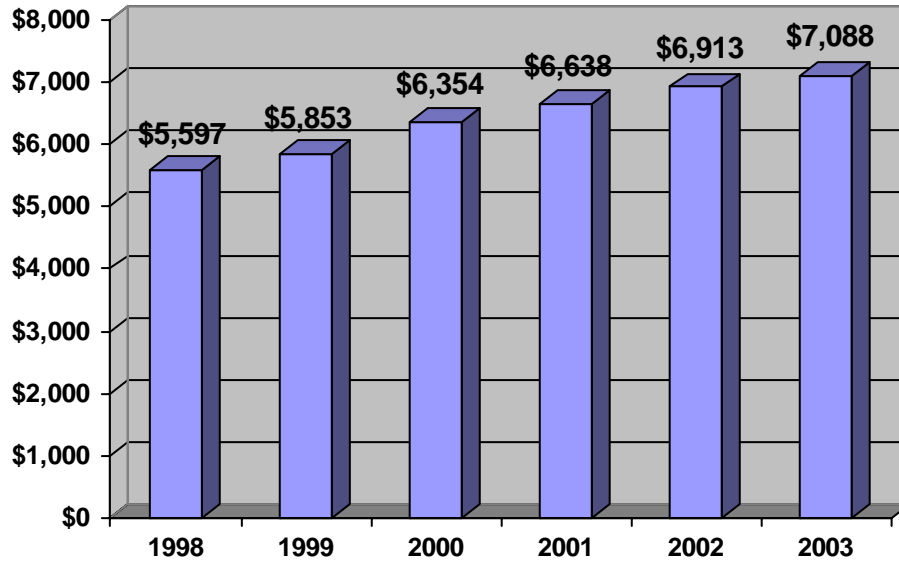
Tax Year	Total Tax Levy (in billions)	% Increase over Previous	% change in Consumer Price Index	% change in Gross State Product
2003	\$28.9	5.8	2.3	3.0
2002	\$27.3	7.9	1.6	2.7
2001	\$25.3	12.4	2.8	1.5
2000	\$22.5	11	3.4	4.2

Compiled from *Texas Comptroller of Public Accounts' Annual Property Tax Reports, Tax Years 2000, 2001, 2002 and 2003* and *Texas Economic Update, Fall 2004*

The sum of the increase in CPI and GSP for each year doesn't even equal the percent increase in the total property tax levy.

3. Spending on public education increased.
[see chart below]

Inflation Adjusted Spending per Pupil



4. The real estate market continued to flourish:
Whether measured by sales, median price, or total listings, the real estate market grew every year since 1997.

Growth of Texas Real Estate (1995 – 2004)

Date	Sales	Dollar Volume	Average Price	Median Price	Total Listings	Months Inventory
1995	121,823	12,722,518,715	104,400	81,600	75,346	7.6
1996	138,123	15,299,223,028	110,800	86,400	81,344	7.3
1997	146,402	17,267,931,897	117,900	90,700	78,984	6.8
1998	170,638	21,282,687,737	124,700	96,200	68,813	5.2
1999	184,056	24,334,751,340	132,200	100,900	67,754	4.6
2000	188,734	27,585,583,575	146,200	112,100	70,852	4.5
2001	195,702	29,414,276,216	150,300	119,500	81,813	5.1
2002	200,807	31,280,515,747	155,800	124,600	90,068	5.4
2003	214,873	34,315,212,228	159,700	127,900	104,936	6.1
2004	238,670	39,244,488,618	164,400	129,600	113,698	6.0

Source: U.S. Bureau of Census and Real Estate Center at Texas A&M University

Despite these facts, the Perryman report makes several unfounded assertions about the impact of appraisals, as captured in these paragraphs:

“By restricting the capacity of local governments to provide services, appraisal caps, revenue limits, and expenditure limits lead to a reduction in the quality of life and economic performance of the state.”

The report continues:

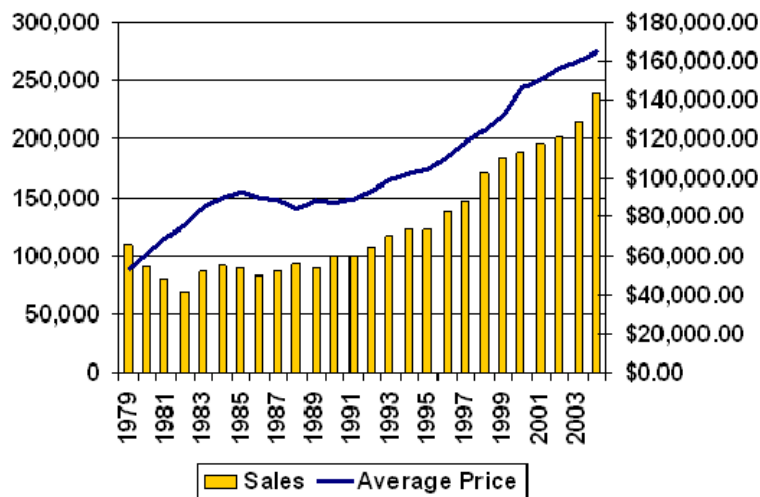
“If infrastructure investments are delayed, for example, productivity suffers. If school districts are unable to raise funds to meet their needs, educational quality declines. In addition, local governments are forced to operate in a less efficient manner if they are compelled to deal with perpetual fiscal crises.”

Also:

“Appraisal caps discourage real estate market activity and new home purchases. Caps on assessed values also introduce a disincentive to buy and sell property if a sale/purchase results in a significantly higher tax appraisal. Homeowners who remain in their homes could enjoy tax bills far lower than market levels; caps could keep appraised far below market values. There would, thus, be an incentive to remain in their current homes to maintain the favorable tax status. The real estate market would therefore be harmed. Analogously, appraisal caps discourage migration to the state by prospective homeowners.” [emphasis added]

For example, the Real Estate Center at Texas A&M University documents the growth of the Texas real estate market before and after the imposition of appraisal caps. It is clearly demonstrated the appraisal cap, first enacted in 1997, have had no negative impact on the growth in sales and increases in averages prices. [see chart below]

Texas Residential Housing Activity



Source: Real Estate Center at Texas A&M University

Appraisal Caps Necessitate Decision-making

Furthermore, the idea that a reduction in government spending would reduce quality of life is, at best, very subjective and not the grounds for sound public policy. One could believe that government owned and operated libraries are an important measure of quality of life, yet another could just as reasonably argue that the ubiquity of low-cost bookstores and the near-universal availability of the Internet make public libraries an anachronism. That is worthy of debate. But if local governments were forced to choose between delivering indigent health care and building light rail because of a reduction in local property tax revenue, the ensuing debate would benefit the community at large and to taxpayers specifically.

Public administration is about making public choices – what is in the best interest of most citizens and most taxpayers. It is not about meeting every need and fulfilling every wish, such as happens when the City of Austin subsidizes a public access cable show to showcase videos by local artists. However desirable that program may be to musicians, the cost of that activity cannot be justified under the rubric of “quality of life.”

The Perryman Report makes unfounded conclusions and claims adverse to conservative principles: “the appraisal caps and revenue or spending limitations create a ratcheting down of revenue generating capacity in times of weak economic growth and declines in property values.”

The chart on page 4 clearly shows that at no time since 1991 have local government revenues from property tax ever declined and, in fact, accelerated, after the first caps were imposed. The chart at the bottom of page 5 illustrates that property taxes have increased without regard to economic factors, even with the existence of a 10% appraisal cap.

More fundamentally, it is preferred that government be constrained during weak economic times as opposed to unconstrained. That is the only way to secure long-term protection for taxpayers. Government should never have unlimited claim to any person’s income or property, whether in good economic times or, and especially, in bad economic times.

The Perryman Report also argues that: “One set of proposals that has surfaced in Texas and elsewhere is an effort to severely limit the capacity of all local governmental units to raise additional revenues or expend additional dollars. If individuals alter their behavior patterns due to tax considerations, there can also be negative consequences for the economy.”

While it is not clear what the import of the above statement is other than to imply that appraisals caps are negative, it is true that individuals already alter their behavior *because* of the current tax system. Decisions about where to live, what schools to attend, whether to remodel a home or make some other purchase are directly impacted by property taxes.

A property tax levy of \$5,000 is the difference between buying a new car or whether one pays off credit card debts each month. Additionally, once taxation exceeds mortgage payments, which is an increasingly common occurrence, the perverse incentives of the current system are truly revealed and demand rectification.

Recommendations and Conclusion

Property taxes have risen excessively since 1991 (see chart on page 4), and, more often than not, the opaque vehicle by which they increase is the appraisal. Several bills filed during the 79th Regular Session made one much needed reform to end the excessive property taxation allowed by subjective appraisals: a lower appraisal cap than the existing 10% (HB 784, Bohac, was chief among them). Other bills proposals filed during the 79th Regular Session, such as HB 177, would have allowed local taxpayers to elect half of their appraisal district board of directors; HB 1006 and HB 1479 decrease the percentage of increase in rate for a rollback election and make the rollback election mandatory. This three-prong approach (lower appraisal caps, accountable appraisers, and lower rollback rate) gives local taxpayers the power to abate the excessive taxation that has plagued them for over a decade. –HB 784 simply acknowledged that even under the current cap, homeowners are still subjected to rapid property tax increases. The cap should be lowered and other measures proposed during the 79th Session should be reconsidered by the 80th Legislature.

There are three approaches to raising revenue from property tax that are superior to the current system:

1. Abolish the property tax altogether and generate tax revenue by applying a sales tax to the purchase of a home. A sales tax is fixed and knowable. It wouldn't rise year-to-year and could be rolled into a mortgage payment unlike the current property tax system which requires many homeowners to put money into escrow above their monthly mortgage payment as a set-aside for future tax liabilities.
2. Instead of taxing property based on government valuation, tie property taxes to a fixed increased year-to-year based on the purchase price of a home. This can be achieved by making the disclosure of purchase price mandatory and setting the property tax liability at that floor with the mandate that it could only be increased no more than 3% each year.
3. Elect appraisal district boards of directors and put a strict cap on appraisal increases.

The first two options would eliminate the vast apparatus needed to appraise, collect and contest property taxes. Eliminating the property tax infrastructure would be a major reform in the very best interests of the taxpayer.

Electing appraisal boards would create greater accountability and are important.

Yet, the partial remedy provided by lowering the existing appraisal cap is a necessary patch to the broken property tax system and should be considered during the Interim and passed by the 80th Legislature.