



## *LIFT Perspective*

*Role of Government Series*

December 4, 2006

### **Recommendation to the Task Force on Appraisal Reform**

## **Sales Price Disclosure: A \$250 Million Tax Hike on Homeowners**

### **Recommendation:**

Reject mandatory disclosure of the sale price of residential or commercial property because it will result in a tax increase.

Sales price disclosure should only be required if:

- It is used to calculate the tax liability for a property, and this amount may not increase until the property is next sold; or,
- The current property tax is replaced with a sales tax on the purchase price of a home.<sup>1</sup>

### **Background**

In August 2006, Governor Perry appointed the Texas Task Force on Appraisal Reform to study ways in which the property tax appraisal process could be reformed. One of the issues studied by the Task Force is whether mandatory sales price disclosure should be required as part of the appraisal process.

Requiring sales price disclosure does not address many of the problems that are currently inherent to both the property tax and the appraisal process. The central problem with

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<sup>1</sup> A detailed recommendation advocating replacing the M&O property tax with a sales tax on the purchase price of a home is outlined in TCCRI's forthcoming publication "Abolishing the M&O Property Tax."

rising appraisals is not that they do not reflect accurate market prices; rather, it is that property taxes increase year-to-year unchecked. In fact, the only beneficiaries of sales price disclosure would be the taxing authorities.

Arguing in favor of sales price disclosure, a recent editorial in *The San Antonio Express-News* (November 25, 2006) contended that:

“[Between 2002 and 2005] the average appraisal on residential property rose from \$101,000 to \$118,000, or just less than 17 percent. That’s a slightly higher annual rate of increase than the sales values, but hardly an astronomical figure.”

The editorial explains that in 2002, average appraisals were 35% below fair market value, and that by 2005 this gap had narrowed to 32%. However, these arguments simply highlight the unavoidable fact that sales price disclosure will lead to a large increase in property tax bills, and will partially negate the property tax relief that was passed by the 79<sup>th</sup> Legislature during the 3<sup>rd</sup> Called Session.

### **Tax Increase**

In its Staff Performance Report to the 79<sup>th</sup> Legislature, the Legislative Budget Board pointed out that:

“In a survey conducted for the Comptroller of Public Accounts in 2003, chief appraisers estimated that \$18.8 billion in property value would be added to the tax rolls if the state enacted a mandatory [sales price] disclosure statute.”<sup>2</sup>

This increase in appraised property values would lead to a property tax increase of up to \$250 million, assuming the \$1.33 per \$100 of valuation tax rate that will be achieved by House Bill 1 (79S3). Even when the property tax rate is reduced to \$1.00 per \$100 of valuation, as is the purpose of the property tax relief fund created by House Bill 2 (79S3), an \$18.8 billion addition to the property tax rolls would equate to a \$188 million property tax hike.

Illustratively, if average appraised values were approximately one-third below fair market value, someone who currently owns a \$300,000 dollar home, is, on average, faced with a \$200,000 appraised taxable value. If this person sells their home for \$300,000, the buyer, who has to disclose the sale price, incurs a 33% increase in the taxable value of the property. Anyone who decides to purchase a new house will invite an immediate property tax increase that is derived from neither an M&O tax rate increase, nor an appraisal increase *per se*, but rather from sales price disclosure. The certainty of an increased property tax bill could be a considerable disincentive for a potential homebuyer.

Equally, when a house is sold, appraisers can use the sales price of a house to value neighboring properties. Therefore, an entire neighborhood of homeowners could incur a

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<sup>2</sup> Legislative Budget Board, Staff Performance Report to the 79<sup>th</sup> Legislature, January 2005.

one-third property tax increase simply as a result of a single property in the neighborhood being sold.

A cursory glance at property tax revenues over the past six years reveals that the total levy has grown by an average of 9% per year. As the table below demonstrates, property tax revenues have increased by almost \$10 billion since 1999.

<b>Year</b>	<b>Total Property Tax Levy</b>	<b>Growth</b>
1999	\$20.3bn	--
2000	\$22.5bn	\$2.2bn (10.8%)
2001	\$25.3bn	\$2.8bn (12.4%)
2002	\$27.3bn	\$2.0bn (7.9%)
2003	\$28.9bn	\$1.6bn (5.9%)
2004	\$31.0bn	\$2.1bn (7.3%)

Source: Comptroller Annual Property Tax Reports, 2000, 2002 & 2004<sup>3</sup>

In light of these figures, it is clear that cities, counties, school districts, or special districts are not in need of the new revenue. Revenue to these taxing entities has consistently increased over recent years, and a further stealth increase would place an additional and unnecessary burden on property tax payers.

Given the rapid growth of property tax revenues, it is evident that if sales price disclosure was made mandatory, a commensurate decrease of property tax rates would need to be enacted. Property tax rates would have to be decreased to a level that ensures that no additional revenue would be generated as a result of sales price disclosure. Reform of the appraisal process should not result in a covert tax increase; rather, it should create a less burdensome tax.

### **Administration**

The lack of sales price disclosure during the appraisal process actually limits the extent to which appraisers can increase their valuations. The Legislative Budget Board reports that “[c]hief appraisers indicate that they tend to be conservative in their appraisals when they lack adequate sales price data.”<sup>4</sup> The lack of sales price disclosure, therefore, is beneficial to property tax payers since it compels appraisers to limit themselves to moderate increases in appraised values.

Since there have been only 282,802 home sales in Texas over the past 12 months<sup>5</sup>, which represents just 3% of the state’s 9 million residential properties<sup>6</sup>, it is clear that sales price

<sup>3</sup> Figures shown relate to the total property tax levy, which includes cities, counties, school districts, and special districts.

<sup>4</sup> Legislative Budget Board, Staff Performance Report to the 79<sup>th</sup> Legislature, January 2005.

<sup>5</sup> October 2005-September 2006 – Residential Housing Activity, Real Estate Center, Texas A&M University. This measure of home sales is the most accurate reflection of how many transactions sales price disclosure would impact annually. The U.S. Census Bureau reported that in 2005, 19% of people living in Texas had moved residence since the previous year. However, this figure includes all persons

disclosure would not immediately reveal the true “market value” of every home in the state [in fact, at this rate, assuming every home in Texas was sold, but none more than once, and that no new homes were built, it would take more than 30 years for the value of each home in Texas to be known].

Given the small fraction of homes that are sold each year in Texas, mandatory sales price disclosure would simply provide appraisers with an extremely limited snapshot of the prices at which some homes are sold. These prices could only be used as a guide for appraisers, who would still have to rely almost entirely on their existing methods and procedures for valuing the vast majority of property in the state. This could not justify the costs of establishing a process by which sales prices are reported and how that information is shared with appraisers across the state.

### **Commercial Property**

One of the arguments made in favor of sales price disclosure contends that the current lack of price disclosure favors commercial property owners over residential property owners. *The San Antonio Express-News* (November 16, 2006) highlighted the case of a hotel in San Antonio’s riverwalk district which was purchased in March for an estimated \$100 million. In December, the hotel’s new owners settled a lawsuit with the Bexar County Appraisal District agreeing to appraise the hotel at \$24 million. According to the report, State Representative Michael Villarreal (D-San Antonio) argued that:

“The hotel case is just one example of a systemwide problem in which commercial properties are not being assessed fairly because appraisal districts lack sales disclosure information on the properties.”<sup>7</sup>

The basis of this argument is that commercial property owners often have the resources to devote to contesting the appraisals of their properties, whereas residential property owners are less likely to have the resources to successfully make such a challenge. It is argued that this results in a disproportionate share of the property tax burden being borne by residential property owners. However, placing a greater share of the property tax burden on commercial property owners would run counter to the intent of House Bill 3 (79S3), which, according to House Speaker Tom Craddick (R-Midland), spread the burden of a tax system that already “penalizes capital-intensive industries.”<sup>8</sup>

Also, legislators should be skeptical that if sales prices disclosure is made mandatory, appraisal districts will slow the growth of appraisals on residential properties, as is often argued. While sales price disclosure would be likely to increase property tax revenues from commercial properties, the relentless growth of property tax revenues (as shown in

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over one year old as well as people moving from, to, and between rented accommodation, and is not a reliable indicator of real estate sales.

<sup>6</sup> US Census Bureau, “State of Nevada and Atlanta Area Counties Lead in Housing Growth, Census Bureau Reports,” July 23, 2004.

<sup>7</sup> “Bill Targeting ‘Hidden’ Commercial Tax Break,” *San Antonio Express-News*, November 16, 2006.

<sup>8</sup> “Sales Tax Increase Advances in House,” Fort Worth Star-Telegram, March 3, 2005.

the table on page 3) gives no indication that appraisers would use this new revenue stream to lessen the burden on residential property tax payers.

While the Comptroller's Office reports the total number of contested appraisals in each appraisal district every year, no distinction is drawn between residential and commercial property. Therefore, it is difficult to substantiate whether commercial property owners successfully challenge their appraisals more frequently than residential property owners. However, if this problem does exist, it is unlikely that it will be solved through mandatory sales price disclosure.

As discussed above, sales price disclosure will lead to a massive tax hike for commercial and residential property owners alike. Although appraisers will have sales price data to assist their work, they still have to estimate the market value of all properties. Mandatory sales price disclosure will do nothing to make commercial property owners less able to challenge future appraisals. If the property tax burden is unevenly distributed between residential and commercial property owners, sales price disclosure will do nothing to even the balance; it will simply be a tax hike for all property owners.

### **Ending the Appraisal Process**

If sales price disclosure is to be used as part of the current property tax system, it should replace the appraisal process entirely. One argument frequently cited in favor of sales price disclosure is that, because appraisal districts will have access to precise real estate market values, the accuracy of appraisals will improve<sup>9</sup>. From a taxpayer perspective, inaccurate appraisals can be beneficial as the Legislative Budget Board's report indicates.

However, since sales price disclosure would provide an accurate market value for a property, the appraisal process should become redundant. Property owners would have to reveal the amount they paid for their property, but appraisers will still estimate the value of that property every year. Although these estimates will be based on the sale price of the property in question, as well as the sale prices of other similar properties in the same neighborhood, they will still only be estimates of its current market value. There is no guarantee that they will be better estimates than appraisers are currently able to calculate.

According to the Comptroller's 2004 Property Tax Report, County Appraisal Districts spent \$280 million appraising more than 16 million properties in the state. Similarly, the Legislative Budget Board reports that the state spends \$6 million each year on the Property Value Study<sup>10</sup>, which appraises the value of all property in the state to ensure equal distribution of school district funding. With costs approaching \$300 million per year, the property tax is clearly a very expensive tax to administrate. Since sales price disclosure will not eliminate the need for an appraisal process, it is clear that requiring both sales price disclosure *and* appraisal of property values is one of the most inefficient ways in which the property tax could be administered.

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<sup>9</sup> Legislative Budget Board, Staff Performance Report to the 79<sup>th</sup> Legislature, January 2005.

<sup>10</sup> Legislative Budget Board, Staff Performance Report to the 79<sup>th</sup> Legislature, January 2005.

The Texas Constitution (Article VIII, Section 20) declares that property in the state should never be assessed at “greater than its fair cash market value” for the purposes of property taxation. Since the true market value of a property can only be known with certainty at the time it is sold, if sales price disclosure is made mandatory, it should replace the appraisal process. When a property is sold, the tax liability on the property should be calculated based on sale price, and should remain its tax liability until the property is next sold. The property owner will pay exactly the same property tax bill each year that they own the property. When the property is sold, a new tax liability will be calculated. In this way, the administrative cost of the appraisal process will be eradicated [saving money for the state and local taxing entities], and the constitutional requirement will be fulfilled since properties will never be taxed at more than the fair market value at which they were purchased.

## **Conclusion**

The Task Force on Appraisal Reform was charged with addressing “the silent tax hike of rising appraisals.”<sup>11</sup> Recommending a reform of the appraisal process that will itself be a tax increase would plainly be at odds with the primary objective of the Task Force.

Therefore, mandatory sales price disclosure as a reform of the appraisal process should be rejected. Without a commensurate lowering of property tax rates, sales price disclosure would result in a large property tax increase. It would also be administratively costly, and of extremely limited use to the appraisal process.

However, if sales price disclosure is made mandatory, it should replace the appraisal process. The sale price of a property would determine its tax liability, which should be “locked-in” and not be allowed to increase until the property is next sold. This approach would create an entirely transparent system of property valuation, and would eliminate the administratively costly appraisal process.

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<sup>11</sup> Governor Rick Perry, August 21, 2006 speech.