

- 2 Constitutional and statutory framework
- 3 "Peveto" reforms
- 4 Establishing property values
- 5 **Box: The Annual Property Tax Cycle**
- 6 Appraisal district issues
- 7 The Property Value Study
- 7 **Box: Businesses Must Render Personal Property**

## *Property Tax Appraisal: Issues and Responses*

Texans pay more in property taxes than for any other state or local tax. In 2001, Texas school districts, cities, counties, and special-purpose districts levied more than \$25 billion in property taxes, of which school districts accounted for 60 percent. The property tax system also is subject to more contention than any other tax system, partly because of its connection with the formulas for distributing state aid to local schools, the largest single item in the state budget.

The backbone of the property tax system — and perhaps the largest bone of contention — is the appraisal of taxable property within each taxing entity, particularly within school districts. Despite state-mandated procedures for determining local property values, local appraisals are notoriously subjective; ask five different appraisers to put a value on a piece of property, it is said, and they will produce five different figures. Yet each year, the state faces the task of ensuring equal and uniform appraisals within more than 3,500 local taxing units.

Appraisal issues grow more controversial as local property valuations and tax bills continue to rise. For example, a survey by the Harris County tax assessor-collector found that the taxable value of residence homesteads rose by more than 46 percent from 1996 to 2001, while average tax bills rose by almost 57 percent. Statewide, the taxable value of single-family dwellings rose by 40 percent during that period, according to the Comptroller's Office.

*Rising property valuations and tax bills have spurred proposals for changing the system by which property values are assigned for school districts and other taxing entities.*

Distribution of state aid to public schools is based on the findings of the comptroller's annual study of school-district property values. The purpose of the study is to ensure equality and uniformity of local appraisals so that each school district

receives no more nor less than its rightful share of formula-driven state revenue. Local conflicts arise, however, when the comptroller’s finding of local property value differs significantly from the local appraiser’s valuation. The House Ways and Means Committee is reviewing the study process as part of its interim charges.

Criticism of the current appraisal system tends to focus on two broad areas: (1) the practices and procedures of county appraisal districts and (2) the impact and accuracy of the comptroller’s annual Property Value Study (PVS). This report reviews Texas’ system for establishing property values and outlines proposals for changes in the appraisal system and the PVS.

### Constitutional and statutory framework

The property tax first was levied when Texas was a republic and remained a source of general revenue after statehood. In 1948, Texas voters amended the Constitution to prohibit a general property tax effective in 1951, although a state property tax remained in effect for limited purposes. A constitutional amendment in 1968 largely phased out the state property tax, except for revenue dedicated to building construction at some colleges and universities. Finally, in 1982, voters abolished the state property tax for all purposes. Since then, property taxation in Texas has been a local government function subject to state oversight.

Article 8 of the Texas Constitution and Title 1 of the Tax Code provide the framework for property tax administration. For purposes of this analysis, the most relevant constitutional and statutory provisions fall into three broad categories.

**Basic principles.** Taxation must be equal and uniform. According to the Comptroller’s Office, this means that no individual property or type of property is taxed more than its fair share. Unless exempted by law, all real property (real estate and mineral reserves) and tangible personal property (all other physical property, excluding cash, evidence of wealth, and documentation of claims, interests, or rights) must be taxed in proportion to its value, ascertained as provided by law (Tex. Const., Art. 8, sec. 1).

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*Under the Texas Constitution, property taxation must be equal and uniform and must be administered locally, subject to state oversight.*

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**Local administration.** No state ad valorem tax may be levied on any property (Art. 8, sec. 1-e). All property valuations and tax assessments are performed locally, with county appraisal districts responsible for using and enforcing uniform appraisal standards and procedures (Art. 8, sec. 23).

**Appraisals.** No property may be appraised at more than its fair cash market value (Art. 8, sec. 20). Tax Code, sec. 1.04(7) defines market value as the sale price under prevailing market conditions if (1) offered on the open market for a reasonable time period; (2) both the buyer and seller know all the property’s possible uses and purposes and its enforceable restrictions; and (3) both the buyer and seller seek to maximize their gains without taking advantage of each other’s circumstances.

Property must be appraised on its market value as of January 1 of the tax year, with a few exceptions. Market value must be determined by generally accepted appraisal methods, applied uniformly in appraising the same or similar kinds of property, but each appraisal must be based on the individual characteristics that affect the property’s market value (Tax Code, sec. 23.01). The main exception is special appraisal of land in agricultural use and of open-space land used for farm, ranch, or wildlife management or timber production. Such property may be appraised according to the value of its productivity rather than its market value (Art. 8, secs. 1-d and 1-d-1; Tax Code, secs. 23.41-23.46).

The Legislature must provide for equalizing “as near as may be” the valuation of all taxable property. General law must provide for single appraisals within counties, unless taxing jurisdictions are located in more than one county or unless counties consolidate appraisal operations. Each appraisal entity must have a single equalization board responsible for ensuring equal appraisal of taxable property within the district. The Legislature must prescribe the method, timing, and administrative process for implementing these requirements (Art. 8, sec. 18).

For errors, protests, and appeals, Tax Code chapters 41-42 provide administrative and judicial remedies (appraisal review board hearings and district court trials, respectively).

## “Peveto” reforms

Movements in Texas to ensure equity in school finance and to provide property-tax relief came to the forefront in the 1970s. Debate on these issues, propelled largely by litigation, pointed up shortcomings in the way Texas appraised and assessed property for ad valorem taxation. In its 1977 report, the Legislative Council’s Property Tax Study Committee called the system “antiquated,” “unfair,” “unintelligible, and not uniformly applied around the state.”

Then as now, Texas financed public schools with a combination of local property-tax revenue and state appropriations. Differences in property values across school districts created wide disparities in their tax bases and in their capacities to generate revenue to pay for schools. In 1973, the U.S. Supreme Court found Texas’ school finance system constitutional but in need of reform (*San Antonio Independent School District v. Rodriguez, et al.*, 411 U.S. 1). When the Legislature faced the task of equalizing funding among school districts, it found no reliable way to determine the amount of taxable property in each district, because the lack of uniformity in appraisal practices resulted in unequal appraisals — that is, the percentage of market value placed on tax rolls varied across taxing entities in general and among school districts in particular.

Writing in the August 1995 issue of *Fiscal Notes*, published by the Comptroller’s Office, former state Rep. Wayne Peveto of Orange recounted the problem that lawmakers faced:

Some districts had not reappraised their property since their inception; others had reappraised more recently, and thus appeared richer than they actually were when compared with districts that had not reappraised. There was no uniformity in how appraisals were carried out nor in the appraisers’ qualifications. There was not even uniformity as to what types of property were placed on the tax roll[s]. Some school districts taxed chickens; others taxed cars; others taxed only real property.... The property tax was the largest single tax in Texas...yet it was not imposed uniformly on taxpayers.

Adding to the confusion was the “assessment ratio,” the percentage of a property’s value on which each entity would assess taxes. By raising this ratio, a taxing

entity could lower its tax rate and yet increase its revenue. Because each entity performed its own appraisals and set its own assessment ratios and tax rates, a taxpayer could have multiple valuations and differing fractional assessments on the same piece of property. Beyond the local equalization boards, taxpayers had no access to an effective appeals process.

In 1975, the Legislature created a new mechanism for distributing state funds to school districts on the basis of the taxable market value of property in each district. In general, the lower a district’s taxable value per student, the more state aid it received. This approach helped narrow the gap between districts’ tax-base values, but it required credible estimates of market value. That, in turn, required a statewide study of local property values to establish a standard of taxable value for use in distributing state aid. As explained in the Select Committee on Tax Equity’s 1989 report, *Rethinking Texas Taxes*:

School district property values must be adjusted to reflect the appraisal ratio in each district. If the school district values were used without adjustment, it would result in an inequitable distribution of state aid; those districts appraising at a lower level would receive more state aid at the expense of districts that appraise at or near market value.

In 1979, lawmakers enacted the landmark “Peveto bill,” which revised the Tax Code extensively. Among its major provisions were:

- establishing single central appraisal districts (CADs) for all counties;
- eliminating fractional tax assessments and requiring appraisal at full market value;
- requiring regular appraisals and reappraisals at least once every three years;
- replacing taxing entities’ equalization boards with county-wide appraisal review boards (ARBs) to rule on taxpayer protests for all entities in each CAD;
- allowing referenda to limit tax increases (rollback elections);
- requiring taxing entities to publicize proposed tax rates, hold public hearings, and publish other information showing how tax rates affect tax levies (truth in taxation);
- mandating professional standards for assessors and appraisers; and
- instituting state supervision of local tax offices.

Subsequent changes have sought to fine-tune the appraisal and appeals processes and to prescribe tax treatment for certain types of property. Some constitutional amendments have granted or authorized the Legislature to allow tax exemptions or other limitations. For example, in 1997, voters amended the Constitution to increase the mandatory homestead exemption for school property taxes from \$5,000 to \$15,000 (Art. 8, sec. 1-b(c)) and to authorize the Legislature to limit average annual increases in the appraised value of residence homesteads (Art. 8, sec. 1(i)). Under Tax Code, sec. 23.23, the 10 percent cap on increases in the appraised value of residence homesteads applies to each tax year since the property's most recent appraisal.

## Establishing property values

Property valuation in Texas reflects the state's overall approach to property taxation. Values are set locally, subject to an appeals process, judicial review, and administrative oversight. These functions are performed, respectively, by CADs, ARBs, state district courts, and the comptroller's Property Tax Division.

**Appraisal districts.** Each of the state's more than 3,500 taxing entities belong to at least one of 253 CADs. A single CAD encompasses each county except Potter and Randall, which share an appraisal district (their shared boundary bisects Amarillo). A taxing entity located in more than one county may belong either to a single CAD or to all CADs into which the entity's boundaries extend. Each participating entity shares the cost of CAD operations in proportion to the entity's share of the total tax levy of all entities in the CAD.

Each CAD is governed by a board of directors elected by voting entities within the district, which include counties, cities, school districts, and some conservation and reclamation districts. Most boards have five members, but state law authorizes up to 13. Each voting entity is allotted a number of votes that it may cast for one candidate or spread among several candidates. Each entity's number of votes is determined by a formula based on the entity's share of the entire tax levy within the CAD.

CAD boards appoint chief appraisers and ARB members, adopt budgets, and set policy. Chief appraisers are in charge of day-to-day CAD operations. Their duties include finding, listing, and valuing property; preparing appraisal records; organizing reappraisals; correcting

errors and omissions in records; determining exemptions and special valuations; preparing and certifying appraisal rolls; defending CAD appraisal values at ARB hearings; notifying taxpayers, taxing entities, and the public about matters affecting property values; and many other duties. Chief appraisers and others who estimate property values for tax purposes must register with the state Board of Tax Professional Examiners and seek designation as registered professional appraisers.

An ARB's main function is to equalize the appraised market values of taxable parcels of property within each district. Toward that end, ARBs hold hearings on property owners' protests of their valuations, exemptions, and agricultural appraisals. In 2001, ARBs throughout Texas scheduled nearly 307,000 formal hearings on protests, although petitioners failed to appear at about 129,000 of the scheduled hearings. ARBs may establish their own procedures and rules of order, but all ARB activities are subject to the state Open Meetings and Open Records acts. The effects of ARB rulings are incorporated into the lists of taxable values generated by CADs for each taxing entity.

ARB members serve two-year terms. Most boards have three to nine members, but they may have up to 75 auxiliary members in urban counties. A member must have lived in the district at least two years before serving. Other restrictions on eligibility, set forth in Tax Code, secs. 6.412 and 6.413, are designed to prevent conflicts of interest; for example, a CAD board member, officer, or employee, a comptroller employee, or a taxing unit board member, officer, or employee may not serve on an ARB.

**Comptroller's role.** The comptroller's Property Tax Division (PTD) has six major responsibilities:

- adopt rules and minimum standards for administration and operation of CAD and taxing entity offices;
- prepare and distribute appraisal manuals, a rules handbook, and other technical and legal materials for local tax professionals;
- publish materials explaining taxpayers' rights and remedies;
- prescribe the contents of property tax forms and a uniform records system for CADs and taxing entity offices;
- give professional and technical assistance to local tax officials and taxpayers; and
- conduct and publish a study of school districts' property values and CADs' appraisals.

## The Annual Property Tax Cycle

County appraisal districts (CADs) and appraisal review boards (ARBs) perform their work in four phases: appraisal, equalization and review, assessment, and collection. The Tax Code specifies most steps in the annual cycle, including time frames and deadlines.

**Appraisal (January 1-May 15).** CADs must appraise property as of January 1 of each tax (calendar) year, in most cases. After determining tax status, appraisers place a value on all taxable real and personal property. Applications for exemptions and special appraisals are due from taxpayers in April, as are lists (renditions) of taxable personal property. Chief appraisers decide which property receives exemptions and special appraisals. CADs must mail notices of appraised value to taxpayers by May 15. Also by that date, chief appraisers must submit appraisal records to ARBs for determination of challenges and protests.

**Equalization and review (May 15-July 20).** ARBs hear and rule on taxpayer protests and taxing entities' challenges, then send change orders to chief appraisers, protesting taxpayers, and challenging taxing entities. Property owners and taxing entities dissatisfied with ARB rulings may file suit in district court. ARBs must approve appraisal records by July 20. Chief appraisers have until July 25 to certify appraisal rolls to each taxing entity within their CADs.

**Assessment (July 25-September 1).** In this phase, taxing entities determine their tax bases (the value of taxable property) and how much tax to levy.

Upon receipt of certified appraisal rolls, each entity's tax assessor calculates the taxable value of each item of property on the entity's appraisal roll and subtracts exemptions. Assessors forward this information to the taxing entities' governing bodies on or about August 1. Assessors calculate total tax bases, effective tax rates (at which properties carried over from the previous year's appraisal roll would generate the same total revenue in the current year), and rollback rates (tax rate increases of more than 8 percent above the effective rate, except in school districts). In August, taxing entities must publish their tax-rate calculations, unencumbered fund balances, and debt schedule. If the proposed tax rate exceeds the effective tax rate by 3 percent, an entity other than a school district must publicize the proposed rate and hold a public hearing before adopting the tax rate.

In early September, taxing entities' governing bodies adopt tax rates. Assessors apply the rates to taxable values to determine the tax levies to be imposed. They also prepare the tax rolls for the governing bodies' approval. Assessors prepare and mail tax bills around October 1.

**Collection (October 1-January 31).** Each taxing entity's tax collector or assessor-collector is responsible for collecting property taxes and accounting for the revenue to their governing bodies. Some CADs handle collections for participating entities. Tax bills are due by January 31 of the following year and are delinquent as of February 1. Delinquent bills incur penalties and interest.

The PTD also reviews CADs' appraisal methodology, standards, and procedures each year to determine adherence to accepted standards and practices. The comptroller may appoint special masters to supervise CADs that fail two consecutive reviews and are deemed not to have remedied their problems (Tax Code, sec. 5.102(c)). The PTD must audit the performance of a CAD that scores poorly on certain statistical measures in the annual Property Value Study, or upon the request of property owners or a majority

of a CAD's taxing entities (Tax Code, sec. 5.12). However, a request for an audit may not be made if the CAD meets certain performance criteria. The PTD has averaged about one performance audit per year over the past 10 years, but the comptroller never has appointed a special master to oversee a CAD. The Board of Tax Professional Examiners investigates allegations or suspicions of unethical conduct or biased appraisals by appraisers, but not appraisal methods or CAD operations.

## Appraisal district issues

Changes to the appraisal system have become a perennial topic before the Legislature. Major issues revolve around CAD accountability and appraisal practices and procedures.

**CAD accountability.** Some taxpayers complain that the authority vested in CADs can lead to “taxation without representation.” They find unelected boards of directors too far removed from and unreceptive to taxpayers’ problems, leaving taxpayers little recourse but to take their concerns to individual taxing entities. During the past two sessions, lawmakers have considered several bills proposing to change the composition and selection of CAD boards.

In 2001, HB 1780 by Mowery would have increased board size to seven members in smaller counties and to 15 in larger counties, including the county tax assessor-collector. The bill would have required that half of the directors be elected in the county’s general election rather than be named by the taxing units. Proponents said this would give the electorate a say in board selection without removing taxing entities’ input altogether. HB 1781 by Mowery would have abolished CAD boards and put CADs under the direction of tax assessor-collectors, who also could have served as chief appraisers. Several bills in the 1999 session contained similar provisions. Also in 1999, HB 2610 by Greenberg would have authorized taxing units to give voting rights to assessor-collectors serving on CAD boards. The rationale for empowering elected assessor-collectors was to make CADs directly accountable to the electorate for their policies and decisions. All of these bills died in the House Ways and Means Committee.

Tax Code, sec. 43.01 authorizes a taxing unit to bring suit to compel its CAD to comply with the Tax Code, comptroller rules, and other statutes. HB 2496 by Haggerty, introduced in the 77th Legislature, would have extended this authority to property owners and their agents, lessees obligated to pay property taxes, and others, and would have allowed suits against ARBs as well. The House Ways and Means Committee reported the bill favorably, amended to allow suits only by taxing units and property owners, but the bill died in the House Calendars Committee.

**ARB composition.** SB 650 by Carona, enacted by the 77th Legislature, allows CAD boards to increase the

size of ARBs from 15 to 40 members in counties with populations greater than 250,000 and from 30 to 75 in counties of more than 500,000. Traditionally, smaller counties have been concerned about filling ARB positions in view of the eligibility restrictions in Tax Code, sec. 6.412. In 1999, the 76th Legislature considered at least nine bills aimed at easing restrictions in less populous counties to expand the pool of potential ARB members. Lawmakers enacted HB 79 by Gallego, which eased restrictions for ARB members in counties of less than 100,000 population. Citizens in these counties, unlike in larger counties, may serve on ARBs if they formerly served on the board of or worked for a CAD. ARB members in counties of more than 100,000 population are limited to three two-year terms; those in smaller counties may not serve more than three terms consecutively.

**Sale price disclosure and sales chasing.** For years, CADs have favored mandatory disclosure of sale prices for real property, which Texas does not require, unlike at least 35 other states. Appraisers maintain that not knowing how much buyers pay for property greatly inhibits their ability to appraise the property at full market value. The sale price, they argue, is the best measure of a property’s value. Realtors and some commercial businesses, however, oppose mandatory disclosure as an infringement on property owners’ privacy and a violation of their proprietary rights. They say mandatory disclosure could result in divulging information about products or processes that could put some business property owners at a disadvantage with their competitors. They also contend that sale prices can be misleading because they often are influenced by non-market factors not readily apparent without comprehensive analysis.

In the absence of a law mandating disclosure of sale prices, CADs sometimes use whatever sales data they can obtain to raise the appraised values of sold properties up to or near their selling prices. Selectively reappraising sold property while leaving unchanged the values of unsold properties is known as “sales chasing.” Critics say this practice, even if inadvertent, can overemphasize recently sold property, alter overall values erroneously, and create inequities throughout the appraisal system. In response to charges that the larger CADs were chasing sales systematically, the 76th Legislature approved a provision in HB 3211 by McCall, requiring the comptroller to adjust school-district property values in the annual Property Value Study to correct for possible sales chasing (see page 11).

To counteract the lack of disclosure, some CADs have used overappraisal as a lever to obtain sales data. According to the *Austin American-Statesman*, Art Cory, chief appraiser of the Travis County Appraisal District, acknowledged overvaluing some recently sold homes in hopes of provoking protests by homeowners who might introduce evidence on sale prices at ARB hearings. The CAD then could use this information in appraising similar property.

**Reappraisal.** Some fault CADs for infrequent appraisals. Tax Code, sec. 25.18 requires total reappraisal at least every three years. Many urban CADs reappraise annually with the aid of computer modeling, using sample sales data and statistical tools to estimate values of unsold properties on a mass scale, but some CADs do not perform regular reappraisals. This can create a problem when rapid growth occurs within a CAD, especially a small one that may have trouble tracking real estate market trends. If home construction or industrial expansion outstrips a CAD's ability to keep pace, the district's appraised values may remain too low or may lag behind market value; the opposite would be true in a contracting market.

The Equity Center, which represents low-property-wealth school districts, advocates requiring reappraisals at least every two years to ensure that CADs maintain current property values. Appraisers note, however, that increasing the frequency of reappraisal increases their overhead costs and that a shorter cycle might be onerous for smaller CADs with fewer resources.

## The Property Value Study

The comptroller's annual Property Value Study (PVS) is important on at least two levels. First, its findings are used to certify and, in some cases, adjust school-district property values reported to the Texas Education Agency (TEA). These data are an integral part of the formula TEA uses to calculate state aid to local school districts under the Education Code. In addition, the PVS measures the level and uniformity of CAD appraisals as required by Tax Code, sec. 5.10.

Ratio studies like the PVS compare appraised values estimated for tax purposes with independent estimates of market value based on either sale prices or independent appraisals. States commonly use these studies to adjust local values for purposes of equalization. The PTD and its predecessor agencies have conducted the PVS annually

## Court: Businesses Must Render Personal Property

Tax Code, sec. 22.01 generally requires a person to render for taxation — that is, report to the county appraisal district (CAD) — all personal property used for an income-producing business. However, in the absence of any penalty for noncompliance, enforcement has been rare. Appraisal districts claim that businesses' disregard for the law — Jim Robinson, chief appraiser of the Harris County Appraisal District (HCAD), estimates evasion as high as 70 percent — could be denying taxing entities millions of dollars in revenue. CADs also note the unfairness to businesses that do render personal property as required by the statute. Appraisers continue to seek broader auditing authority to pinpoint businesses that do not disclose all their taxable property, mainly those that maintain large inventories.

In June 2001, the First Court of Appeals in Houston ruled the rendition statute mandatory and judicially enforceable despite its lack of penalties (*Robinson v. Budget Rent-a-Car Systems, Inc., et al.*, 51 S.W.3d 425 (2001, Tex. App.)). In reversing the trial court's summary judgment, the appellate court found that the appraisal district could seek court orders compelling businesses to render their personal property. In November 2001, the Texas Supreme Court declined to hear the case (File 111501-0R, order on Cause 01-0685).

In cooperation with the Harris County attorney, HCAD has begun pursuing renditions from almost 4,000 businesses that have not rendered in the past three years and that have an estimated tax liability on their personal property of at least \$100,000. Robinson said he believes this is the first time a Texas CAD has threatened to sue businesses for not reporting such property.

since 1985. PVS procedures are based on state law, agency rules, industry standards on ratio studies, and generally accepted appraisal and statistical methods.

The PVS is an ongoing annual process — while the current year's study is under way, the previous year's study undergoes revision. Data collection begins anew

each January and ends in December. The PTD publishes a preliminary (pre-appeal) version of the study for the previous tax year by January 31 and the final report around July 1, in compliance with Government Code provisions. The PVS actually is three studies in one: the school district study estimating taxable property values; the appraisal district study analyzing CAD appraisals; and an unpublished review of CAD methods, standards, and procedures (MSP).

**School-district property values.** The objective of this part of the PVS is to estimate each school district's taxable wealth. The PTD may develop its own estimates of taxable value or may accept local estimates. The study analyzes residential, commercial, agricultural, mineral, and utility properties. It does not analyze industrial property, intangible personal property, or special inventory, although the taxable values for those categories as reported by CADs are included in the estimates of total taxable value for school districts.

The first step in the PVS is selecting random samples of property sales and/or appraisals for each property category with significant value in each of the state's more than 1,000 school districts. Sample data include sale prices obtained from real estate multiple listing services, local deed transfer filings, property owner questionnaires, CADs, and other sources, plus estimates from PTD field appraisals. Next, the staff compares by category each school district's total appraised value from the local tax roll to the total value estimated by sampling. This procedure yields a weighted mean (average) ratio equivalent to the percentage of market value indicated by the sample. Dividing this ratio into the total value reported for each category produces the PTD's estimated value. Summing the category estimates yields an overall estimate of a school district's market value. Subtracting allowable exemptions and reductions from that total results in a district's estimated taxable value.

The appraisal-roll value totals reported by school districts or their CADs form the basis of the PTD's category estimates. If the total value for sampled property categories falls within a computed margin of error (not less than 5 percent) or an assigned tolerance range that varies across districts, the PTD accepts these values as valid, and the comptroller certifies the district's "local

value" to TEA. If not, staff adjusts the total value by the appropriate weighted mean ratio, and the comptroller certifies "state value" for that district.

The PTD typically has accepted as valid and certified about three-quarters of locally determined school-district values. State values generally exceed local values, but not always. In the preliminary 2001 PVS, total pre-exemption state values exceeded local values by about 2 percent (\$1.118 trillion vs. \$1.098 trillion). Total taxable values (appraised value less exemptions) were \$979.1 billion state vs. \$961.6 billion local. Appeals narrowed the differences reported in the final PVS.

**CAD appraisals and MSP review.** Using school district data aggregated to the CAD level, the PTD staff measures each CAD's level and uniformity of appraisal. Level of appraisal refers to how close to full market value a CAD appraises typical properties. Level of uniformity refers to how widely appraisals vary within and across property categories. To accomplish this, the PTD staff compiles and analyzes five separate statistical measures of appraisal performance.

The 2001 PVS found that appraisals statewide were highly uniform and near full market value (a median appraisal ratio of .99 for all properties and .97 for residential properties). In contrast, when the Peveto reforms were enacted in 1979, most homesteads were being appraised at about 60 percent of market value.

The PTD staff begins the MSP review each January. Chief appraisers receive a lengthy questionnaire covering exemption documentation, appraisal manuals, internal controls, use of sale prices, and programs to improve appraisers' performance. Review findings may deal with such problems as insufficient mapping, lack of reappraisal plans, or sales chasing. Chief appraisers may respond to any recommendations made. The review process ends in December.

**Appeals and protests.** By law, school districts and some property owners have the right, respectively, to appeal or to protest the PTD's preliminary estimates of taxable value. By rule, property owners may protest if their property is used in a prior-year PVS and their total tax liability on the sampled property in the district exceeds

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*The PVS measures school districts' property wealth for purposes of distributing state aid and gauges the performance of county appraisal districts.*

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\$100,000. Typically, businesses and industries file protests because of concerns that CADs might use PVS findings to raise their appraised values, or in hopes of reducing them. CADs may challenge performance-measure findings just as school districts challenge taxable-value estimates.

Petitioners have 40 days from the certification of preliminary PVS findings to file appeals or protests, usually by mid-March. The PTD staff researches appeals, corrects clerical errors in the data, and may recommend adjustments. Petitioners who disagree with the recommendations meet with staff in informal conferences at which most challenges are resolved. Dissatisfied petitioners may seek formal hearings before the comptroller's hearing examiners, usually in early May. School-district, CAD, and property-owner challenges from the same CAD are combined into single hearings. Examiners issue written decisions with which either party may take exception in writing. After considering all written exceptions, examiners issue final decisions.

Examiners must hear school districts' challenges and make final decisions by July 1, in time for TEA to distribute state education funds. The PTD staff modifies study findings as directed by examiners and prepares the findings for final certification. By law, only school districts may appeal hearing outcomes to district court. Other parties' protests, however, can affect a school district's values even if the district does not appeal.

**Proposals for change.** Several ideas for modifying the PVS are under discussion, and a few have taken shape as policy initiatives. Generally, they are aimed at mitigating the study's impact on school districts and at retooling the study to improve its accuracy.

**Impact on school districts.** The most vocal complaints about the PVS come from school districts whose appraised values are deemed too low by the study. The final 2001 PVS (after appeals) assigned higher state values to 60 school districts. The adverse impact on these districts is two-fold. First, because state aid to public schools is based largely on districts' property wealth per student, reporting higher property values to TEA effectively reduces a school district's state funding below expected levels. The district must make up for the shortfall in anticipated state funds by either reducing spending or increasing tax rates. In addition, by levying taxes against a relatively smaller base, the school district receives less local property-tax revenue than it would receive if it

taxed its property at the same rate on the basis of the PVS value. Some of these districts experience budget deficits that can force them either to reduce programs and services or to increase tax rates.

The opposite phenomenon occurs in school districts whose CADs are found to be overappraising property. The 2001 PVS assigned state values *lower* than local values to 86 districts. In other words, the study found that property appraisals in those districts tended to be higher than market value. These districts realize a dual revenue gain, called "double-dipping": relatively more state aid under the TEA formula, and additional local revenue from levying taxes against higher local values. Critics contend that this practice rewards school districts for overappraisals at the expense of schools in other districts.

The gain (or, more commonly, loss) to a school district due to PVS findings generally can be projected by multiplying its tax rate by the difference in state and local values. From 1996 through 2000, preliminary local values were about 6 percent lower than preliminary state values, a difference of \$34.4 billion, according to the comptroller. After reductions due to successful appeals, however, final state values exceeded local values by only \$3.85 billion, or less than 1 percent.

Because school districts do not appraise their own property, many would welcome being held harmless financially for adverse PVS findings. Several current proposals would do so, to varying degrees:

- *Grace period.* School districts with budget shortfalls because the value certified by the state was higher than local values would have one to two years to work with their CADs and the PTD to realign values. During that period, they would incur no reduction in state aid. The cost to the state would be minimal and temporary, according to the PTD, and the need for appeals likely would decline. Others counter that this approach would encourage laxity among CADs by removing disincentives to appraise property at less than full market value. Eliminating the threat of reduced state aid would be counterproductive, they argue, and could result in appraisals dropping below the 95 percent level.
- *Amortization.* Any formula-funding reductions caused by PVS findings would be spread over several years to lessen adverse impacts.

- *Moving average.* The certification process penalizes school districts when adverse PVS findings for a given year become final. Each year's appraised values are weighed separately, regardless of how many previous years' values were deemed valid. A moving average would combine appraisal levels over a multi-year period. Each year, a new ratio would be added to the average, supplanting the oldest ratio. If the moving average fell too low, the PTD would issue a warning and presumably would allow correction before any punitive action ensued.

To remove the financial incentive for school districts to report higher-than-market property values, some have suggested requiring the PTD to assign local values even when they are higher than state values, rather than certifying lower state values. This would require revising Government Code, sec. 403.302. In effect, it would reduce state aid to overappraised districts, which proponents argue would be fair from an equity standpoint.

The 77th Legislature in 2001 considered a different approach to dealing with adverse PVS effects. HB 3319 by Ramsay would have required the comptroller to audit a CAD's performance when any of its school districts' local values were invalidated by the PVS. The bill also would have ended the automatic replacement of local values with state values in the TEA funding formula. According to the bill's fiscal note, HB 3319 would have cost the state more than \$900 million over five years, because eliminating adjustments for underappraised property would force the release of additional state aid to school districts with below-market local values. The bill died in the House Ways and Means Committee.

**Study design and conduct.** Some critics, most notably the Texas Taxpayers and Research Association (TTARA), say the focus of the PVS is too narrow and its operational resources are too small. In their view, instead of generating what amounts to a second opinion on school-district property values, the PVS should focus exclusively on CAD performance. The goal would be to determine whether local appraisals are conducted properly rather than to produce another set of school-district value estimates, unless a CAD was found to be in serious error. This type of study, TTARA contends, would be easier and less controversial, reducing the number of appeals.

Others say the PVS relies too heavily on CADs for valuation data. They maintain that CADs may be tempted to withhold potentially damaging information, and they note that the PTD cannot compel CADs to disclose data. As a result, calls have arisen for an independent review of each year's PVS by an outside source.

The comptroller has invited scrutiny of the PVS by the International Association of Assessing Officers (IAAO).

Evaluation of the 2000 PVS produced 31 recommendations, most aimed at modernizing the study. The PTD says it concurred with most of the IAAO's findings and has implemented many of them or is in the process of doing so. The IAAO's November 2001 report states that the PTD staff agrees that the PVS lacks

sufficient funding, staff, training, computerization, and information technology support. According to the report, the PTD is attempting to perform too large an annual study with limited resources, and the study's credibility will suffer unless funding is increased or the legal requirements for the study are changed to "a more realistic level" in light of expected future funding.

In recent biennia, the Legislature has approved the comptroller's PTD budget requests as submitted. From 1996 to 2001, the budget for the PTD grew by 48 percent, from about \$8.5 million to \$12.5 million per biennium. For fiscal 2002-03, however, the PTD budget dropped by 9 percent, to \$11.4 million. PTD officials attribute the reduction to replacing outside contractors with full-time employees, which they say has improved the continuity of work on the PVS.

**Appeals.** About one-fourth to one-third of all school districts appeal PVS findings in any given year. More than 80 percent of these appeals are settled informally before reaching administrative hearings. Since 1997, almost all appeal hearings have involved only low-property-wealth school districts that receive additional state aid under Education Code, chapter 42. If TEA uses state values from the PVS that are higher than those on which the districts are taxing, the districts receive less state aid than they otherwise would receive. Many of these districts see no choice but to appeal, either because their tax bases are so small or because they have reached or are approaching the state's tax-rate cap of \$1.50 per \$100 property valuation for maintenance and operations.

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*Some critics say the PVS should focus exclusively on appraisal district performance rather than generating estimates of school-district property values.*

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Although much of the PVS appeals process is nonadversarial, some have called for making it independent of the Comptroller's Office. Critics see inherent conflicts of interest in hearings held by examiners employed by one of the parties and who often rely on their employer (the comptroller) for guidance on rulings. In response, the PTD notes that PVS hearings are conducted in essentially the same manner as for other tax disputes and that PTD staff may not discuss cases with examiners.

In-house hearings are less expensive than court for school districts and taxpayers and probably less costly to the state than relying on the State Office of Administrative Hearings. Nevertheless, some taxpayers, mainly businesses and industries, would like to be able to appeal PVS findings to civil courts. TTARA has advocated alternatives to the general appeals process involving ARBs and district courts, noting that the current valuation appeals process is cheaper for CADs and for taxing entities but not necessarily for taxpayers. The same argument could be made for the PVS appeals process as it applies to school districts.

**CAD practices.** In its present form, the PVS depends heavily on property values generated by CADs. Some issues involving CAD practices directly affect the school district portion of the PVS.

Perhaps the most complex of these issues concerns sales chasing. If unsold properties are not reappraised in accordance with changes in the appraisal of sold properties, school districts' tax bases may appear artificially low, triggering an increase in state aid.

In a paper delivered at a 2001 conference of the IAAO, Tim Wooten, PTD executive assistant for policy, noted that sales chasing "often results in higher appraisal levels for the selling properties than for the balance of the population and results in a nonrepresentative sample."

In 1999, the 76th Legislature enacted HB 3211 by McCall, amending Government Code, sec. 403.302(b) to require the comptroller to ensure that different levels of appraisal on sold and unsold property do not reduce the accuracy of the PVS in determining the taxable value of property in each school district. The PTD staff responded by testing each CAD for signs of sales chasing and, where evidence was found, adjusting samples to correct for it. The adjustment involves adding staff appraisals or sale

prices unavailable to the CADs because of their timing or for other reasons. The addition of these data is being phased in so as to minimize adverse impact on the school finance system. By 2003, according to the PTD, adjusted samples in suspect CADs will exclude all property that may reflect sales chasing.

Some critics say the PVS and its companion MSP review insufficiently uncover appraisal inequities such as those caused by sales chasing. The PTD responds that its test has curtailed flagrant sales chasing but may not detect smaller or infrequent instances because the PTD lacks the data to perform more sophisticated additional testing. Wooten defends the phase-in approach as effective and notes its prior approval by the legislative leadership. Others, while acknowledging improvement in the study's ability to detect sales chasing, call the phase-in approach a concession to urban CADs that leaves too much room for error. The 2001 IAAO report called for additional testing by the PTD to confirm suspicions of sales chasing.

CADs and others continue to support some form of mandatory sale price disclosure on the grounds that this would provide some CADs with more data resources and help make the PVS more accurate. The Equity Center, for example, calls for requiring documentation of all sales transactions (including prices) to be filed with the deed in the county clerk's office and forwarded to the CAD, coupled with confidentiality provisions to protect buyers and sellers. Realtors and some commercial

businesses continue to oppose such proposals as an infringement on property owners' privacy with the potential to create a competitive disadvantage for some businesses.

Some fault the PVS for overlooking too many undervalued properties,

especially large commercial or industrial properties in areas that experience rapid development. The PTD responds that because the state requires too little information about property sales, the PVS is forced to rely on hard-to-obtain cost and income data in analyzing these properties.

CADs seldom appraise industrial property and usually contract with private appraisers to accomplish this. Reasons cited include lack of expertise and resources

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***Some fault the Property Value Study for overlooking too many large commercial or industrial properties in areas experiencing rapid development.***

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and difficulty in obtaining reliable data, especially for unregulated industries. The PTD accepts industrial values reported by CADs for inclusion in the PVS, largely for the same reasons. Low-property-wealth school districts represented by the Equity Center complain that the undervaluation of industrial properties costs schools money, and they advocate giving the PTD additional

resources to enable it to analyze all property categories for the PVS. While not opposing appraisal of these properties by CADs or the PTD, TTARA notes that private appraisers have little incentive to “lowball” industrial appraisals because of their vested interest in maintaining CAD contracts.

— by **Patrick K. Graves**

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