

SUBJECT: School district property value study and appraisal district accountability

COMMITTEE: Ways and Means — favorable, without amendment

VOTE: 5 ayes — Wilson, McCall, Hilderbran, J. Keffer, Woolley

0 nays

4 absent — Pitts, Luna, Paxton, Ritter

SENATE VOTE: On final passage, May 6 — 30-0

WITNESSES: No public hearing

BACKGROUND: The Texas Constitution prohibits a state property tax (Art. 8, sec. 1-e) and requires that property appraisals not exceed fair market value (Art. 8, sec. 20). Local governments — cities, counties, and school and special purpose districts — set tax rates and levy property taxes using valuations derived from appraisals by county appraisal districts (CADs). The entire property appraisal system is subject to state regulation, primarily by the comptroller.

Since 1991, the comptroller's Property Tax Division (PTD) has conducted the annual school district Property Value Study (PVS), which began in 1985. Its purpose is to establish a standard of taxable value for school finance purposes that ensures uniform appraisal and equitable distribution of state aid. The PVS is a ratio study, using sampling techniques to compare appraised values estimated for tax purposes with independent estimates of market value based on either sales prices or independent appraisals. PVS findings are used to certify and, in some cases, adjust school property values reported to the Texas Education Agency (TEA). These data are an integral part of the funding formulas used to calculate and disburse state aid to school districts under the Education Code. The PVS also measures the level and uniformity of CAD appraisals (Tax Code, sec. 5.10).

School property tax rates for maintenance and operations (M&O) generally are limited by statute to \$1.50 per \$100 of property valuation.

For additional background on the PVS and local property appraisals, see House Research Organization Focus Report Number 77-23, *Property Tax Appraisal: Issues and Responses*, August 5, 2002.

DIGEST:

SB 671 would modify elements of the PVS by amending pertinent sections of the Government Code and Tax Code. The bill would:

- establish a temporary “grace period” for state funding in 2004-05 to eligible school districts;
- enforce accountability through mandatory appraisal standards review of eligible school districts’ CADs and discretionary audits of CADs; and
- make technical changes addressing school funding equity and auditing and reporting procedures.

The bill would define “local value” as the market value of property in school districts determined by their CADs, less exemptions and allowable reductions. “State value” would mean the value determined by the PVS.

School districts eligible for the two-year grace period beginning with the 2004 PVS would have to have:

- been assigned state values lower than their local values in the most recent PVS;
- had valid local values in the two preceding annual studies; and
- reported aggregate values in the most recent PVS that did not exceed the 5 percent margin of error.

For the annual studies conducted for 2004 and 2005, the comptroller would have to substitute local values for state values in an eligible school district. Within 12 months of the substitution, the comptroller would have to complete an appraisal standards review of an eligible school district’s CAD.

School districts whose local values exceeded state values would have their local values certified for use in TEA funding formulas for fiscal 2004-05. TEA would have to calculate the effect on state funding created by certifying local values higher than state values and would have to distribute the

difference proportionately among school districts with certified state values and M&O tax rates that exceeded \$1.42 per \$100 of property valuation.

TEA and school districts could request revision audits to change value findings by the comptroller. Such audits would be limited to corrections and changes in school tax rolls occurring after preliminary certification of the PVS. Revision audit requests would have to be filed within three years after final certification of PVS findings, except for changes in value due to judicial determinations and material reductions in value made by CADs, which could be requested within one year after certification of changes by chief appraisers.

SB 671 would require the Comptroller's Office to review the methods, standards, and procedures of CADs of eligible school districts. The comptroller could set review procedures and would have access to all CAD records and reports, as well as assistance from CAD employees and officers. Findings and recommendations would have to be reported to superintendents and trustees of each school district in a CAD that underwent review. CADs that failed to comply with review recommendations and whose boards of directors failed to take remedial action within one year of the issuance of reviews would be subject to conservatorship. The state district judges in CADs' counties would have to appoint five-member conservator boards to implement comptroller recommendations. The conservators would have to supervise and control CAD operations until the comptroller determined that all school districts within the CADs had valid local values in the same annual PVS. CADs would have to pay the costs of conservatorship.

The comptroller also could audit CADs for effectiveness and efficiency of their policies, management, and operations. Findings and recommendations would have to be reported to CADs' chief appraisers and directors and to the governing bodies of all taxing entities in the CADs. The comptroller could require CADs to repay some or all audit costs.

The uniform record system prescribed by the comptroller for all CADs would have to include data submitted annually on property sales within CADs in a form prescribed by the comptroller for use in the PVS.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect

September 1, 2003.

SUPPORTERS
SAY:

SB 671 is the product of an interim study sanctioned by the comptroller and performed by a technical advisory committee representing school districts, appraisal districts, education organizations, and taxpayer groups. The bill would take a balanced and gradual approach to the complex problem of school district property valuation. It would focus on reducing the adverse impact on school districts, which must bear the consequences of value determinations largely beyond their control.

Each year, for school finance purposes, the PVS assigns up to one-quarter of all school districts property values different from those determined by their CADs. Many of these districts must navigate a time-consuming administrative appeals process, and some must go to court, to rectify problems and try to avoid financial hardship. Statistically, the problem may appear small, but it wreaks havoc on budgets and resources of these school districts.

Invalid local values can harm school districts and the state. School districts whose appraised values are deemed too low by the PVS are assigned higher state values for funding purposes. This hurts them twice. First, because state education aid is based largely on districts' property wealth per student, reporting higher values to TEA effectively reduces school districts' state funding below expected levels. Districts must make up any shortfalls in anticipated state funds by either reducing spending or raising their tax rates. Second, by levying taxes against a relatively smaller base, districts receive less local property-tax revenue than they would if they taxed property at the same rate on the basis of PVS value. Consequently, some districts experience budget deficits that can force them either to curtail programs and services or increase tax rates, if their rates allow them to do so.

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 PVS 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 on higher local values. This practice rewards school districts for overappraisals at the expense of schools in other districts.

To address the first scenario, the grace period proposed by SB 671 would hold harmless for two years those school districts deemed to have values too high in CADs that did not display a pattern of appraisal problems. The comptroller would have one year to determine why values were too high, giving the CADs an opportunity to correct any problems. Stronger measures could be taken if the problems were not corrected. School districts consistently receiving state values would be excluded from grace periods.

Requiring certification of school districts' local values even when they were higher than state values would remove school districts' financial incentive to report property values exceeding market value. Doing so would reduce state aid to overappraised districts, which would be fair from the standpoint of school finance equity.

The bill would create more efficient enforcement mechanisms to address appraisal problems prospectively, rather than retroactively. Allowing district judges to appoint conservators would bring objective third parties into the process. It also would eliminate a potentially unconstitutional provision that never has been used: comptroller-appointed special masters, which could violate the prohibition against state property appraisal.

The comptroller, in conducting the PVS, already reviews CAD performance annually to ensure adherence to accepted appraisal standards and practices. The comptroller may appoint special masters to supervise CADs that fail two consecutive reviews without remedying problems. The comptroller must audit CADs that score poorly on certain PVS measures or upon request of property owners or a majority of the CADs' taxing entities.

**OPPONENTS
SAY:**

SB 671 would make significant changes in the PVS process to address issues that ultimately affect less than 10 percent of the state's more than 1,000 school districts in any given year. In the preliminary 2001 PVS, total pre-exemption state values exceeded local values only by about 2 percent. Most of the relatively minor inequities created by assignment of state values are resolved in the administrative appeals process, which further narrows the gap between state and local values.

Many of the CADs involved are "repeat offenders" well known to school districts and the Comptroller's Office. Ample remedies are available to

address these problems, including appointment of special masters, which the comptroller never has done. The comptroller should exhaust these methods before seeking new ones. More importantly, the Legislature should correct the larger inequities in the flawed school finance system, mainly its overreliance on inherently subjective property values, rather than tweaking the margins of the issue.

Grace periods could encourage laxity among CADs by removing disincentives to appraise property at less than full market value. Eliminating the threat of reduced state aid could be counterproductive and could result in appraisals dropping below the PVS' 95 percent threshold of accuracy.

The bill would not address the fundamental problem of the PVS' inappropriate focus. Instead of using its limited resources to render what amounts to a second opinion on school property values, the PVS should concentrate strictly on reviewing CAD performance. Rather than generating another set of values, unless egregious errors surface, the PVS should determine whether local appraisals are being conducted properly.

The comptroller already has the capability to audit poor-performing CADs and enforce compliance. It does not need additional authority.

**OTHER
OPPONENTS
SAY:**

SB 671 would not address technical problems in the PVS that undermine its credibility, including flawed sampling methodology and overreliance on CAD information. The PVS should undergo annual independent review. The state should grant a blanket amnesty, regardless of the cost, and assign local values for formula funding purposes to all school districts until the problems with the PVS can be corrected.

To address property value equity issues fully, the bill should set penalties for businesses' failure to report tangible personal property and should require mandatory disclosure of real estate sales prices. Without these tools, CADs will continue to have difficulty appraising commercial and residential property accurately at fair market value.

NOTES:

According to the fiscal note, SB 671 would have no net fiscal impact on the state during fiscal 2004-05, because state aid withheld from overappraising districts (estimated at \$7.4 million) would be redistributed to eligible school

districts. During fiscal 2006-08, however, the bill would cost the state about \$7.5 million in payments to school districts.