

SUBJECT: Ad valorem tax appraisals on property used for low-income housing

COMMITTEE: Local Government Ways and Means — favorable, without amendment

VOTE: 5 ayes — Hill, Hamilton, Puente, Quintanilla, Uresti

0 nays

2 absent — Elkins, Laubenberg

SENATE VOTE: On final passage, May 11 — 28-3 (Brimer, Nelson, Staples)

WITNESSES: (*On House companion bill, HB 1993 by Talton:*)

For — Steve Ford; Jerry Wright, GMAC

Against — None

On — Michael Amezcuita, Bexar Appraisal District/Texas Association of Appraisal Districts

BACKGROUND: Capitalization rate or cap rate is a ratio used to estimate the value of income-producing properties. The capitalization rate is the net operating income divided by the sale price or value of a property calculated as a percentage. Investors, lenders, and appraisers use the cap rate to estimate purchase prices for different types of income-producing properties.

When adequate financial data on a specific property is unavailable, appraisers may construct a cap rate by the income method through analysis of component parts—for example, rental income and expense data. A cap rate calculation can incorporate a property's gross rents, non-rental income, vacancy amount, and operating expenses and provide a reliable estimate of value, especially on types of properties that sell infrequently. The lower the selling price is, the higher the cap rate; the higher the selling price, the lower the cap rate.

Tax Code, sec. 23.012 establishes the income method of appraisal. Under

current law, if the chief appraiser uses the income method of appraisal to determine the market value of real property, the appraiser must:

- use rental income and expense data pertaining to the property if possible and applicable;
- make any projections of future rental income and expenses only from clear and appropriate evidence;
- use data from generally accepted sources in determining an appropriate capitalization rate; and
- determine a capitalization rate for income-producing property that includes a reasonable return on investment, taking into account the risk associated with the investment.

In 2003, the 78th Legislature enacted HB 3546 by Hamric, which created tax exempt status for community housing development organizations (CHDOs). A provision of that bill established sec. 23.215, relating to appraisal of nonexempt property used for low-income or moderate-income housing. It applies only to real property owned by an organization other than a CHDO that:

- on January 1, 2004, was rented to a low-income or moderate-income individual or family satisfying the organization's income eligibility requirement and that continues to be used for that purpose;
- was financed under the low income housing tax credit program in Government Code, ch. 2306;
- does not receive an exemption under sec. 11.182 or 11.1825; and
- has an owner who has not entered into an agreement with any taxing unit to make payments to the taxing unit instead of taxes on the property.

When appraising the property, the chief appraiser considers the restrictions on income of the individuals or families to whom the dwelling units may be rented and the amount of rent that may be charged for purposes of computing the actual rental income from the property or projecting future rental income. The chief appraiser uses the same capitalization rate used to appraise other rent-restricted properties.

**DIGEST:**

SB 724 would amend Tax Code, sec. 23.215, affecting appraisals for ad valorem tax purposes of non-exempt property rented to a low-income or moderate-income family or individual. The bill would apply to specified

real property on the date of the appraisal, not on or after January 1, 2004 as in current law. Under the bill, the chief appraiser would use the income method of appraisal as provided in sec. 23.012 and would apply the capitalization rate established by this provision.

The capitalization rate would be at least 13.5 percent unless the appraisal district where the property was appraised performed a study of capitalization rates based on the sales of comparable properties meeting the same requirements for appraisal purposes. If the study determined a capitalization rate other than 13.5 percent, that capitalization rate would be used. The net operating income computed would include all property taxes.

If the capitalization rate were other than 13.5 percent, the appraisal district, not later than January 31 of each year, would give public notice in a manner determined by the district, including posting on its website if applicable, the capitalization rate to be used that year to appraise property under this provision.

SB 724 would require the comptroller's annual study determining the taxable value of all property in each school district to use the capitalization rate established by the bill for the specified low-income or moderate-income housing.

The bill would take effect January 1, 2006, and would apply only to ad valorem taxes imposed for a tax year beginning on or after that date.

**SUPPORTERS  
SAY:**

SB 724 would set a capitalization rate for the appraisal of certain non-exempt properties used for low-income or moderate-income housing to represent more fairly the market value of these properties. It would require the chief appraiser to use the income method of appraisal and apply a cap rate of 13.5 percent, unless the chief appraiser determined, based on a study of sales of comparable properties, that a different cap rate should apply. The cap rate provided in the bill would be the market value of the properties used in the comptroller's annual School and Appraisal Districts' Property Value Study.

Currently, the appraised value of rent-restricted property is determined using the same method that the chief appraiser uses for market rate properties. This practice discriminates against non-exempt properties that are rent-restricted, have little marketability, and will be rent-restricted for

15 to 30 years. With rent restrictions in place for such a long period and with increasing expenses, including rising taxes, the financial feasibility of maintaining these properties is threatened. While there is a market for the development and ownership of these properties, there is not a market for resale of the properties owned by limited partners. In fact, these properties usually are traded or given away to another developer. SB 724 would attempt to attain some parity in the market and to offer guidance to taxing authorities on a fair level of assessment.

The bill would not apply to properties, such as CHDOs, already receiving a low-income housing property tax exemption. The properties that are the subject of this legislation currently pay 100 percent of property taxes. By allowing chief appraisers to adjust the capitalization rate if a study of comparable properties so warranted, it is possible that little or no revenue would be lost by taxing units or the state under the bill, and the fiscal note prepared by the comptroller's office would reflect this.

**OPPONENTS  
SAY:**

Since 1979, Texas has based appraisals for ad valorem tax purposes on fair market values. Cap rates are market driven. By establishing a fixed cap rate, the bill could have the effect of generating artificially low values on these properties for certain geographic areas unless an appraisal district determined a different cap rate based on a study of comparable properties.

**OTHER  
OPPONENTS  
SAY:**

By providing a set cap rate of 13.5 percent, SB 724 likely would differ from appraisals based on market values, particularly for big cities, and could result in a value loss. At a time when the Legislature is searching to resolve school finance issues, particular attention should be given to any bill that could allow properties to be assessed below market value.

**NOTES:**

The House companion bill, HB 1993 by Talton, was heard before the Ways and Means Committee on April 7 and left pending.