LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 81ST LEGISLATIVE REGULAR SESSION

May 4, 2009

TO: Honorable Rene Oliveira, Chair, House Committee on Ways & Means

FROM: John S. O'Brien, Director, Legislative Budget Board

IN RE: **HB3104** by Paxton (Relating to the ad valorem taxation of property used to provide low-income or moderate-income housing.), **Committee Report 1st House, Substituted**

Estimated Two-year Net Impact to General Revenue Related Funds for HB3104, Committee Report 1st House, Substituted: a negative impact of ($30,802,000) through the biennium ending August 31, 2011.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

The tables below only reflect the fiscal implication of the provision that would require appraisers of non-exempt property offered for rent to certain low or moderate-income tenants to deduct specified items from operating income in the income appraisal required by the bill.

The provision striking the requirement that a community housing development organization engage exclusively in nonprofit building, repair, sale or rental of low- or moderate-income housing to qualify for a property tax exemption and broadening the type of entity that may qualify for the exemption and the provision that would allow an appraisal district to use a capitalization rate less than 13.5 percent only if the appraisal district conducted a study based on sales of comparable properties proving the lower rate could create a cost to the state through the operation of the school finance formulas. However, the cost cannot be determined.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2010	$0
2011	($30,802,000)
2012	($37,363,000)
2013	($41,444,000)
2014	($45,971,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable Savings/(Cost) from *Foundation School Fund* 193	Probable Revenue Gain/(Loss) from *School Districts - Net Impact*	Probable Revenue Gain/(Loss) from *Counties*	Probable Revenue Gain/(Loss) from *Cities*
2010	$0	$0	$0	$0
2011	($30,802,000)	($10,248,000)	($12,046,000)	($13,755,000)
2012	($37,363,000)	($8,482,000)	($13,354,000)	($15,207,000)
2013	($41,444,000)	($9,759,000)	($14,803,000)	($16,813,000)
2014	($45,971,000)	($11,221,000)	($16,408,000)	($18,588,000)

Fiscal Analysis

The bill would amend Section 11.182 of the Tax Code to strike the requirement that a community housing development organization engage exclusively in nonprofit building, repair, sale or rental of low or moderate income housing to qualify for a property tax exemption.

The bill would also extend the exemption to limited partnerships and other entities that are 100 percent owned or controlled by a community housing development organization that meets the requirements of a charitable organization, if such partnerships and other entities are otherwise qualified. The bill would make conforming amendments.

The bill would amend Section 11.1826 of the Tax Code to require that audits of exempt organizations providing low or moderate income housing be performed by a licensed certified public accountant and that the audit include an unqualified opinion that an organization's financial statements are in order and that the organization has complied with all of the terms and conditions of the exemption. The bill would also make the audit binding on the appraisal district as proof of eligibility for an exemption under Section 11.1825

The bill would amend Section 23.215 of the Tax Code, relating to the appraisal of certain property used to provide low or moderate-income housing.

The bill would require appraisal districts to use an income method with a capitalization rate of at least 13.5 percent when appraising nonexempt housing offered for rent to low and moderate income tenants meeting certain requirements, unless the appraisal district conducted and published a study of sales of comparable properties in the appraisal district to determine a lower market capitalization rate. The bill would also require appraisal districts to use a specified list of deductions from gross income when performing the income approach. The Comptroller would have to use the methods provided in the bill if appraising property offered for rent to low or moderate-income housing in the annual Property Value Study.

The bill would require the owner, no later than April 15 of each year, to provide the chief appraiser an audited statement of the income and expenses for the property for the preceding year that included data on rental income and operation and maintenance expenses. The information in the statement would be confidential except for disclosure: 1) in a criminal proceeding; 2) an appraisal review board hearing; 3) on a judicial determination of good cause; or 4) to a governmental agency, political subdivision, or regulatory body if necessary for the enforcement of state and federal law.

The bill would take effect January 1, 2010.

Methodology

The bill's provisions striking the requirement that a community housing development organization engage exclusively in nonprofit building, repair, sale or rental of low-or moderate-income housing to qualify for a property tax exemption and broadening the type of entity that could qualify for the exemption would create a cost to taxing units and to the state through the operation of the school finance formulas. Information about the exclusivity of an organization's nonprofit building operations and the types of entities engaged in nonprofit building operations is unavailable. The fiscal impact, therefore, cannot be determined.

The bill's provision requiring that a certified public accountant perform the audit of an exempt organization and making the result of the audit binding on an appraisal district would have no significant fiscal impact on the state or units of local government.

The bill would allow an appraisal district to use a capitalization rate less than 13.5 percent only if the appraisal district conducted a study based on sales of comparable properties proving the lower rate. Capitalization rates used in an income appraisal express the relationship between income and market value. The higher the capitalization rate, the lower the market value, and vice-versa. Market capitalization rates vary from year to year, depending on changes in interest rates, supply, demand,

and other variables. Depending on the volume of sales of rent-restricted, low-and moderate-income housing, it could be difficult for all appraisal districts to conduct such a study. To the extent that appraisal districts use the 13.5 percent capitalization rate proposed in the bill, and that rate exceeded the market capitalization rate in a given year, the bill would impose a cost on local taxing units and the state.

Because future market capitalization rates, the availability of future comparable sales, and the extent to which appraisal districts would be able to conduct market capitalization rate studies cannot be predicted, the fiscal impact on local taxing units cannot be determined.

The bill would require appraisers of non-exempt property offered for rent to certain low or moderate-income tenants to deduct specified items from operating income in the income appraisal required by the bill. These items would include debt service and expenses incurred to satisfy lenders. These items are not customarily appropriate deductions in a market-value income appraisal. The International Association of Assessing Officers in *Property Appraisal and Assessment Administration*, page 257, cautions that "Debt service, the interest and principal payments that amortize a mortgage loan, is not included as an operating expense" in describing proper income appraisal methodology. This deduction would cause a cost to taxing units and the state through the operation of the school funding formulas. Information from the Texas Department of Housing and Community Affairs was used to estimate the total residential property value that would be subject to the deduction. A typical percentage deduction for debt service was applied to the total value subject to the deduction to estimate the value loss. The appropriate trended taxing unit property tax rates were applied to the trended value loss to estimate the revenue loss.

Because of the operation of the hold harmless provisions of HB 1, 79th Legislature, Third Called Session (2006), the portion of the cost related to school district compressed rates is transferred to the state. A portion of the school district debt (facilities funding) and enrichment costs is also transferred to the state after a one-year lag because of the operation of the funding formulas. All costs were estimated over the five year projection period.

Local Government Impact

The tables above only reflect the fiscal implication of the provision that would require appraisers of non-exempt property offered for rent to certain low or moderate-income tenants to deduct specified items from operating income in the income appraisal required by the bill.

The provision striking the requirement that a community housing development organization engage exclusively in nonprofit building, repair, sale or rental of low- or moderate-income housing to qualify for a property tax exemption and broadening the type of entity that may qualify for the exemption and the provision that would allow an appraisal district to use a capitalization rate less than 13.5 percent only if the appraisal district conducted a study based on sales of comparable properties proving the lower rate could create a cost to local taxing units. However, the cost cannot be determined.

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: JOB, MN, SD, SJS