PUTTING A STOP TO THE 'HIDDEN PROPERTY TAX'

When property values rise, tax rates should fall.

By Daniel R. Smith, Esq.

Owners should be delighted to see the value of their property increase, but in our current tax environment, higher property values have become synonymous with higher property taxes.

School districts, municipalities, counties and other taxing units have the power to limit property tax bills by lowering their respective tax rates as property values rise. Instead of doing this, however, many taxing entities opt for a tax revenue windfall.

Remarkably, as they collect this additional revenue, these same taxing units claim that they have not raised taxes because they have not increased their tax rate. This distinction has afforded taxing units a convenient escape from the ire of taxpayers. But is it fair?

The Texas property tax system has two components: appraisal districts and taxing authorities. First, appraisal districts assess the market value of taxable property within their boundaries. They then participate in protest hearings initiated by property owners about those values and subsequently certify appraisal rolls for taxing entities.

Second, the governmental bodies that levy and collect taxes prepare budgets and, with their certified appraisal rolls in hand, adopt tax rates sufficient to meet those budgets. Then these municipalities, school districts and other institutions send out tax bills and collect tax revenue.

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Both appraisal districts and taxing authorities have the power to affect property owners' ad valorem tax liability. Nevertheless, many media outlets and news publications have blamed appraisal districts exclusively when tax bills have increased.

For instance, on April 11, 2016, the *Austin American-Statesman* reported: "Home values rise 9 percent in Travis County." The *San Antonio Express-News* reported on May 4, 2016, "2016 Bexar County property value is up $13 billion over year before, real estate values up 7.5 percent." Similarly, on May 25, 2016, the *Dallas Morning News* warned about "A taxing problem," specifically discussing how "Dallas property taxes squeeze middle class" because homeowners in that demographic saw an average increase in the value of their homes of over 11 percent.

These news articles focus on the distress that rising appraised values have inflicted upon taxpayers as property tax bills have increased. Is it fair, though, to malign appraisal districts when they are simply fulfilling their charge to assess property values, especially when they do not participate in the tax rate setting process?

State Sen. Paul Bettencourt (R-Houston), who served as the Harris County tax assessor-collector from 1998 through 2008, formed the Senate Select Committee on Property Tax to look into the issue. The Committee has held public hearings all around the state to listen to taxpayers' concerns and frustrations about the system.

It has become apparent that the root of the rising property tax burden lies with tax rates set by taxing units, not in appraised values assessed by appraisal districts. Indeed, at a hearing in Arlington earlier this year, there were hundreds of property owners in the audience, but not one complaint about the Dallas Central Appraisal District or the work of its Chief Appraiser, Ken Nolan.

The issue has caught the attention of a number of politically astute organizations, including the Texas Association of Realtors, which has taken

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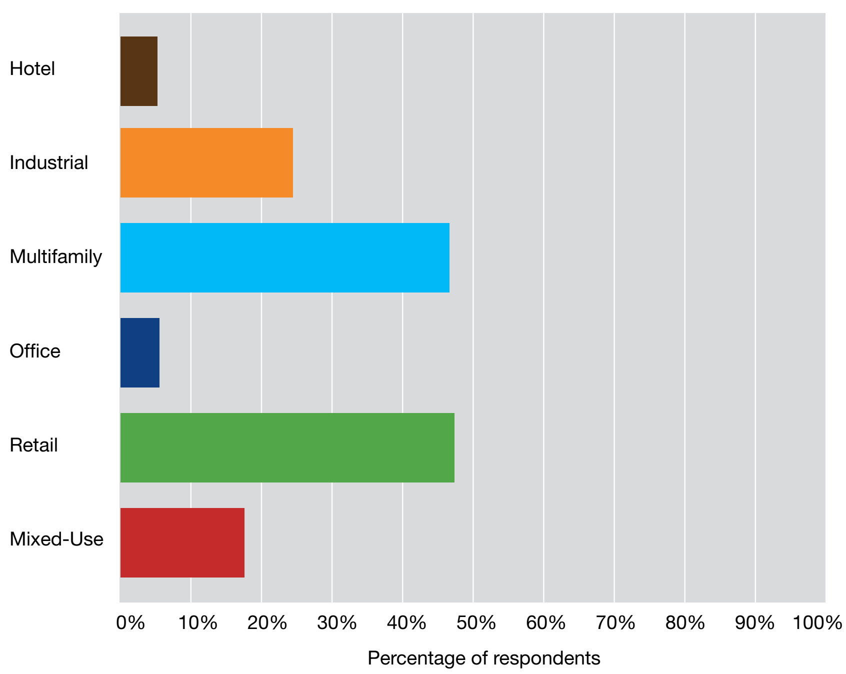
Noteworthy large-scale projects that are underway in Texas include Thor Equities' $125 million, 1-million-square-foot mixed-use development called The Kirby Collection in Houston that will deliver in the fourth quarter of 2017. In Plano, all eyes are on Legacy West, a $3 billion mixed-use development on a 400-acre parcel, where approximately 5 million square feet of various uses is being constructed. Karahan Cos., KDC and Columbus Realty's development is touted as potentially one of the largest real estate projects under construction in the United States. Many corporate campuses will build offices at Legacy West, including Toyota, FedEx, JPMorgan Chase and Liberty Mutual. The property also includes a 15-story hotel, a 55,000-square-foot food hall, and more than 1,000 residential units.

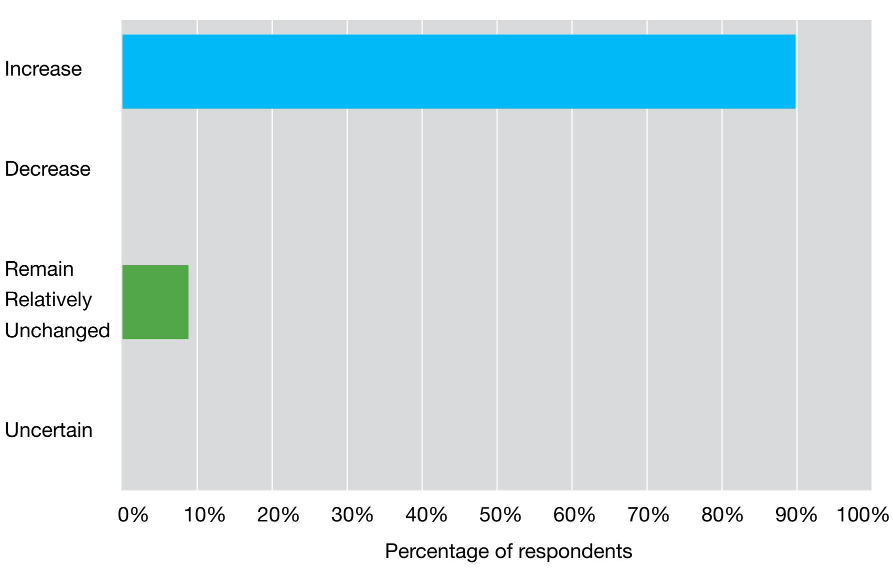
Industrial and office are also expected to be active sectors in 2017, particularly in Houston as it is expected to recover some of the notable vacancy in that market. "Texas' office development is coming off a year of noticeable differences," Kramp says. "DFW and Austin both saw occupiers take down more space than developers could deliver. Austin absorbed nearly twice what came on line, while DFW was not far behind with tenants turning the lights on in about 30 percent more space than developers did. Houston saw its first year of negative growth, to no surprise, as tenants gave back about a million square feet just as new construction completions topped more than 5 million square feet. However, Houston will be the market to watch in 2017 because sublease is finally on the decline, the construction pipeline is emptying and commodity prices have begun to rebound."

Fig. 2: If 'yes,' you plan to break ground in 2017, in which property sector(s) will you break ground?



Source: TREB 2017 Developer/Owner/Manager Forecast Survey

Fig. 3: Do you expect interest rates to increase, decrease or remain relatively unchanged during the next 12 months?



Source: TREB 2017 Broker Forecast Survey

Hot Houston

According to Jim Kirkpatrick, CBRE's senior vice president, debt and structured finance, it's wise to examine Houston separately from Texas as a whole due to oil markets being in the recovery stage. "A key factor in recent Houston market improvement is the improving investor perception, evidenced by the recent uptick in sales activity," Kirkpatrick says. "For 2017, the overall sense [for the office market] is that sales volumes should exceed 2016, inventory levels should increase, and the Houston market will continue to get better. Citing data from Real Capital Analytics, Kirkpatrick says multifamily sales volumes in institutional-quality assets in Houston are predicted to grow in 2017 because apartment deliveries will start to slow down, job growth expectations look promising, and many investors have been on the sidelines for institutional assets for too long.

Houston is a hotbed of retail expansion, adding approximately 1.3 million square feet of new space that delivered in the third quarter of 2016 with another 4.1 million square feet in the pipeline, according to data compiled by Colliers International and CoStar Group. This research also says Houston and Dallas lead the nation in retail development and that despite a significant amount of new square footage delivered, vacancy rates are historically low at 5.7 percent.

Retail, Interest Rates Rise

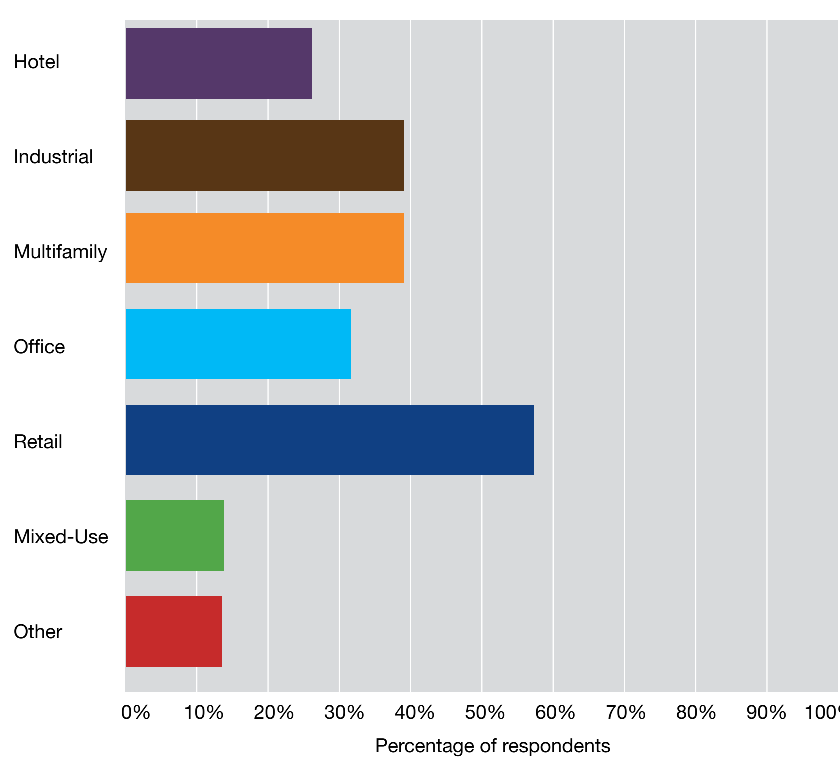
It's a given that interest rates are on the rise. One hundred percent of the region's brokers who answered the survey say interest rates will rise in the next 12 months. In a separate section of the survey that polled brokers, 10 percent maintain that rates could remain unchanged (*see Figure 3*). None of the respondents say rates will decrease. Almost 90 percent of the lenders we surveyed say they expect to close more commercial and multifamily loans in 2017 than they did in 2016. Loan-to-value ratios and debt-service coverage ratios will be the strongest factors affecting the debt financing market over the next 12 months.

Many Texas commercial real estate executives have a few warning flags they are keeping their eyes on.

"There are two significant challenges for the commercial real estate industry in 2017," says Charles Mohrle, owner of Mohrle-Morris & Associates. "First and foremost is how the overall real estate industry, and the market, will deal with the large dollar amount of CMBS maturities, as well as maturities from other lending sectors, during the next 18 months. A separate but somewhat related issue is how the industry will deal with higher interest rates, which although not back to the average levels of the past 30 years, will be somewhat higher than we have seen since the Federal Reserve Bank began its accomodative monetary policy."

Kirkpatrick says 10-year CMBS issuances were historically high in 2007, which will point to increased loan production in Texas and a good year for the debt markets. "If that turns out to be the case, there should be plenty of

Fig. 4: Generally speaking, which property sector(s) do you think will experience a high velocity of investment sales activity in 2017? (Multiple answers allowed)



Source: TREB 2017 Broker Forecast Survey