

Appraisal Creep

What is “Appraisal Creep?”

“Appraisal creep” has been defined by some of the members of the public as the continual increase of property values by the appraisal districts throughout Texas.

Why does it happen?

There are two main causes of “appraisal creep”; the continual change in the real estate market and legal requirements within the property tax system.

First, the real estate market in Texas is undergoing significant change. The relative affordability of property coupled with low mortgage interest rates in this state is encouraging new investors to enter the real estate market. With this influx of buyers and capital to the market, prices have steadily increased. The Real Estate Center at Texas A&M University reports statistics about the residential market in Texas from the Multiple Listing Service. The following data was calculated from data obtained from <http://recenter.tamu.edu>:

Statewide Residential MLS Statistics

Year	Total Number of Sales	Percent Increase from Prior Year	Total Dollar Volume Sold	Percent Increase from Prior Year	Average Price	Percent Increase from Prior Year
2002	201,422	N/A	\$31,348,715,747	N/A	\$155,637	N/A
2003	215,648	7.06%	\$34,407,932,228	9.76%	\$159,556	2.52%
2004	241,751	12.10%	\$39,672,062,369	15.30%	\$164,103	2.85%
2005	267,029	10.46%	\$46,433,621,938	17.04%	\$173,890	5.96%

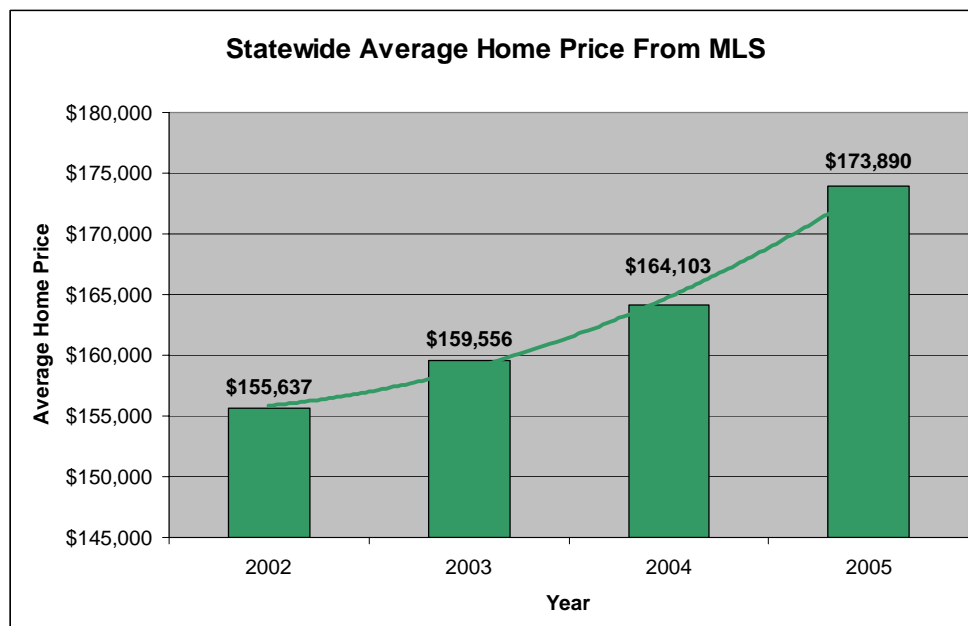
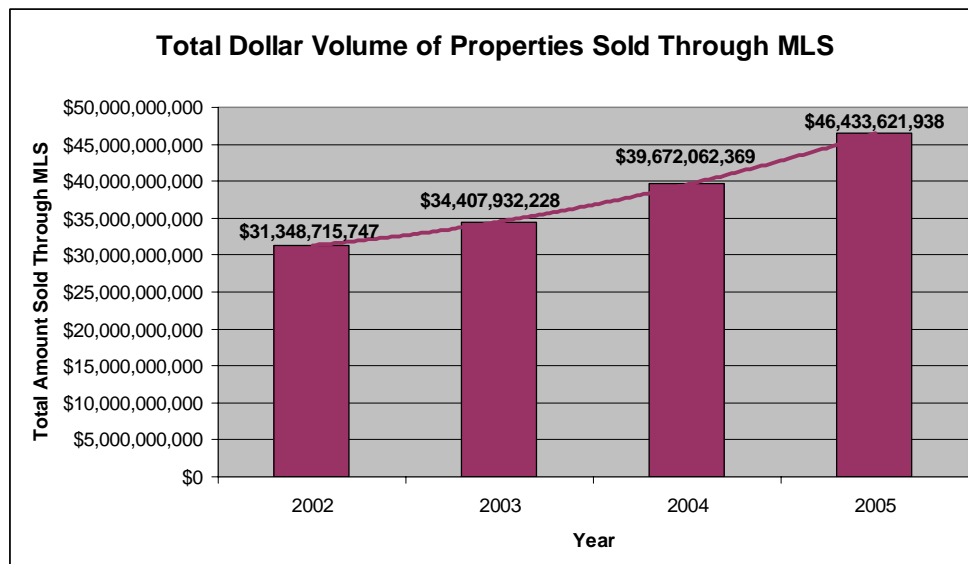
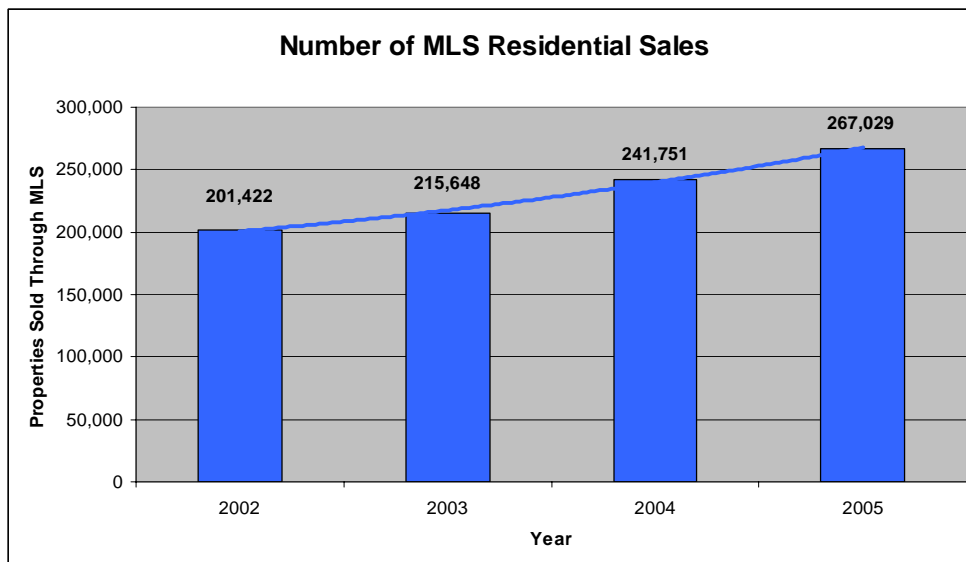
This chart exhibits that since 2002, the residential real estate market has seen significant increases in the total number of sales, dollar volume, as well as the average price of a home sold. Below are the percentages of increase comparing 2002 to 2005:

Statewide Percent Increase from 2002-2005

Number of Sales	Dollar Volume	Average Price
32.57%	48.12%	11.73%

Calculated from Real Estate Center Data

The following charts detail the characteristics of the residential market over this time period.



As is demonstrated above, sales prices of properties have increased, therefore, the market values of comparable properties have increased as well.

Appraisal Districts in Texas are required by Section 23.01 of the Texas Property Tax Code to appraise property at its market value:

Sec. 23.01. Appraisals Generally

- (a) Except as otherwise provided by this chapter, all taxable property is appraised at its market value as of January 1.

Appraisal districts must also comply with Section 25.18 of the code as it relates to reappraisal:

Sec. 25.18. Periodic Reappraisals.

- (a) Each appraisal office shall implement a plan for periodic reappraisal of property approved by the board of directors under Section 6.05(i).
- (b) The plan shall provide for the following reappraisal activities all real and personal property in the district at least once every three years...

Charged with this requirement of law, appraisal districts must reflect the increases of the market in their appraisals and must reappraise property at least once every three years.

If the Code requires once every three years, why do appraisal districts change values annually?

This leads to the second cause of “Appraisal creep”. As is stated in Section 25.18(b), the districts must reappraise **at least once** every three years. While districts are given this leeway in their operations, the law requires the Property Tax Division of the Comptroller of Public Accounts to act annually. Section 403.302 of the Texas Government Code and 5.10 of the Property Tax Code require the PTD to conduct a study that estimates the taxable value of all property within a school district and measures the level of appraisals in an appraisal district **annually**. This is referred to as the “Property Value Study.” Excerpts of these laws are as follows:

Texas Government Code § 403.302. DETERMINATION OF SCHOOL DISTRICT PROPERTY VALUES.

- (a) The comptroller shall conduct an annual study using comparable sales and generally accepted auditing and sampling techniques to determine the total taxable value of all property in each school district.

Texas Property Tax Code Sec. 5.10. Ratio Studies

- (a) The comptroller shall conduct an annual study in each appraisal district to determine the degree of uniformity of and the median level of appraisals by the appraisal district within each major category of property. The comptroller shall publish a report of the findings of the study, including in the report the median

levels of appraisal for each major category of property, the coefficient of dispersion around the median level of appraisal for each major category of property, and any other standard statistical measures that the comptroller considers appropriate. In conducting the study, the comptroller shall apply appropriate standard statistical analysis techniques to data collected as part of the annual study of school district taxable values required by Section 403.302, Government Code.

In the application of the Property Value Study, the PTD estimates the market value for each category of property within a school district. Its estimate is based upon a statistical weighted mean ratio of the aggregate CAD appraised value to sales prices or the PTD's independent appraisal of property, whichever is applicable for the category sample. If the local CAD value is within statistical tolerances (a margin of error of no more than +/- 5% according to 403.302(c) Government Code) of the PTD's estimate of value, the local CAD value is assumed to be valid. In this instance, the CAD is assumed to be valuing property statistically "close enough" to its market value. The local appraisal district's value is then used by TEA to determine the amount of state aid school districts receive.

Section 5.102 of the Texas Property Tax Code details the penalties for jurisdictions whose values fall outside that statistical margin of error in the PVS:

Sec. 5.102. Review of Appraisal Standards

(a) The comptroller shall review the appraisal standards, procedures, and methodology used by each appraisal district that appraises property for an eligible school district as defined by Section 403.3011, Government Code, to determine compliance with generally accepted appraisal standards and practices. The comptroller by rule may establish procedures and standards for conducting the review.

(b) In conducting the review, the comptroller is entitled to access to all records and reports of the appraisal district and to the assistance of the appraisal district's officers and employees.

(c) If the review results in a finding that an appraisal district is not in compliance with generally accepted appraisal standards and practices, the comptroller shall deliver a report that details the comptroller's findings and recommendations for improvement to:

(1) the appraisal district's chief appraiser and board of directors; and

(2) the superintendent and board of trustees of each school district participating in the appraisal district.

(d) If the appraisal district fails to comply with the recommendations in the report and the comptroller finds that the board of directors of the appraisal district failed to take remedial action before the first anniversary of the date the report was issued, the comptroller shall notify the judge of each district court in the county for which the appraisal district is established, who shall appoint a board of conservators consisting of five members to implement the recommendations. The board of conservators shall exercise supervision and control over the operations of

the appraisal district until the comptroller determines under Section 403.302, Government Code, that in the same year the taxable value of each school district for which the appraisal district appraises property is the local value for the school district. The appraisal district shall bear the costs related to the supervision and control of the district by the board of conservators.

As is demonstrated by this section of the code, especially part (d), there are significant penalties if the appraisal district is found not to be appraising property within statistical tolerances annually. Therefore, even though the Tax Code allows districts to appraise once every three years, the Government Code requires the Comptroller to study the districts' values each year. In areas where markets are active, annual reappraisals are required to keep up with these requirements.

The PTD's Annual Property Value Study carries significant weight with regard to the amount of state funds a school district receives and with the operation of an appraisal district. Below are several charts that detail the results of the PVS with Statewide CAD values and Comptroller's estimates of value by property category for the years 2003 – preliminary 2005:

2003 Final Findings			
State Category	Statewide CAD Value	PTD Estimate of Value from PVS	CAD Value As Compared to PTD Estimate
A Single Family Residential	\$593,360,567,955	\$607,433,568,103	-\$14,073,000,148
B Multi-Family Residential	\$55,245,957,986	\$57,506,669,879	-\$2,260,711,893
C Vacant Lots	\$27,398,669,338	\$28,463,703,834	-\$1,065,034,496
D Rural Real Property	\$53,758,179,719	\$54,651,959,667	-\$893,779,948
F1 Commercial Real Property	\$174,770,393,354	\$182,142,582,444	-\$7,372,189,090
F2 Industrial Real Property	\$67,425,881,039	\$67,425,881,039	\$0
G Oil, Gas, and Minerals	\$39,474,282,252	\$39,035,339,066	\$438,943,186
J Utilities	\$38,882,521,320	\$39,143,342,853	-\$260,821,533
L1 Commercial Personal	\$86,307,145,296	\$87,292,760,874	-\$985,615,578
L2 Industrial Personal	\$55,587,540,617	\$55,587,540,617	\$0
M1 Mobile Homes	\$5,357,026,434	\$5,357,026,434	\$0
N Intangible Personal	\$1,214,949,725	\$1,214,949,725	\$0
O Residential Inventory	\$4,895,909,142	\$4,895,909,142	\$0
S Special Inventory	\$3,514,648,590	\$3,514,648,590	\$0
Totals	\$1,207,193,672,767	\$1,233,665,882,267	-\$26,472,209,500

Source: <http://www.window.state.tx.us/taxinfo/proptax/>

2004 Final Findings

State Category	Statewide CAD Value	Statewide CAD Percent Change from Prior Year	PTD Estimate of Value from PVS	CAD Value As Compared to PTD Estimate
A Single Family Residential	\$638,031,599,296	7.53%	\$649,020,832,934	-\$10,989,233,638
B Multi-Family Residential	\$56,609,417,371	2.47%	\$60,239,558,012	-\$3,630,140,641
C Vacant Lots	\$28,341,244,387	3.44%	\$29,641,109,798	-\$1,299,865,411
D Rural Real Property	\$56,080,134,196	4.32%	\$57,238,539,945	-\$1,158,405,749
F1 Commercial Real	\$178,577,672,798	2.18%	\$192,580,317,986	-\$14,002,645,188
F2 Industrial Real Property	\$67,101,847,596	-0.48%	\$67,101,847,596	\$0
G Oil, Gas, and Minerals	\$51,889,539,655	31.45%	\$51,595,612,198	\$293,927,457
J Utilities	\$39,771,817,669	2.29%	\$39,925,724,444	-\$153,906,775
L1 Commercial Personal	\$92,216,478,695	6.85%	\$91,992,088,877	\$224,389,818
L2 Industrial Personal	\$58,737,434,141	5.67%	\$58,737,434,141	\$0
M1 Mobile Homes	\$5,427,726,549	1.32%	\$5,427,726,549	\$0
N Intangible Personal	\$464,931,396	-61.73%	\$464,931,396	\$0
O Residential Inventory	\$5,336,923,903	9.01%	\$5,336,923,903	\$0
S Special Inventory	\$3,389,001,170	-3.57%	\$3,389,001,170	\$0
Totals	\$1,281,975,768,822	6.19%	\$1,312,691,648,949	-\$30,715,880,127

2005 Preliminary Findings

State Category	Statewide CAD Value	Statewide CAD Percent Change from Prior Year	PTD Estimate of Value from PVS	CAD Value As Compared to PTD Estimate
A Single Family Residential	\$688,222,825,774	7.87%	\$707,884,446,012	-\$19,661,620,238
B Multi-Family Residential	\$61,580,028,732	8.78%	\$64,468,827,386	-\$2,888,798,654
C Vacant Lots	\$30,563,350,649	7.84%	\$32,780,731,244	-\$2,217,380,595
D Rural Real Property	\$59,312,101,212	5.76%	\$61,777,115,726	-\$2,465,014,514
F1 Commercial Real	\$193,705,152,893	8.47%	\$211,516,954,575	-\$17,811,801,682
F2 Industrial Real Property	\$68,262,164,657	1.73%	\$68,262,164,657	\$0
G Oil, Gas, and Minerals	\$67,410,569,581	29.91%	\$66,672,136,649	\$738,432,932
J Utilities	\$40,003,297,678	0.58%	\$40,484,276,676	-\$480,978,998
L1 Commercial Personal	\$96,248,833,362	4.37%	\$96,769,268,696	-\$520,435,334
L2 Industrial Personal	\$65,174,627,123	10.96%	\$65,174,627,123	\$0
M1 Mobile Homes	\$5,584,711,588	2.89%	\$5,584,711,588	\$0
N Intangible Personal	\$11,083,802	-97.62%	\$11,083,802	\$0
O Residential Inventory	\$6,145,723,493	15.15%	\$6,145,723,493	\$0
S Special Inventory	\$3,971,875,088	17.20%	\$3,971,875,088	\$0
Totals	\$1,386,196,345,632	8.13%	\$1,431,503,942,715	-\$45,307,597,083

Using this information as a case study, the results of the PVS indicate that CAD's increased property values for **Category A - single family residential** property by a total of **\$44,671,031,341** (7.53%) between 2003 and 2004. This category of property also increased an additional **\$50,191,226,478** (7.87%) between 2004 and preliminary 2005. At the same time, **Category F1 – commercial real** increased only **\$3,807,279,444** (2.18%) and **\$15,127,480,095** (8.47%) respectively. Overall, **total values** of all categories increased by **\$74,782,096,055** (6.19%) between 2003 and 2004 and another **\$104,220,576,810** (8.13%) between 2004 and 2005.

If the districts had minimally complied with Section 25.18 of the Property Tax Code and values had remained static for even two of these years, their values would have fallen below the five percent statistical margin of error in the PVS. This means that the CAD's would have failed to be in compliance with the other requirements of the Tax and Government Codes and would be subject to the penalties detailed in Section 5.102 of the Tax Code.

Is “appraisal creep” uniform across property types?

The answer to this question is, “Absolutely not.” Current Texas law does not require buyers and sellers to disclose the sales prices of real estate. The lack of mandatory sales disclosure in the state of Texas makes it difficult for appraisal districts to obtain the most elementary tool necessary to do their job. The lack of this data does not absolve appraisal districts of their requirement to appraise properties at their market values. Because of this, districts are often left to “guess” at the sales prices and associated market values of certain properties. Several districts have access to sources such as the Multiple Listing Service which provides substantial information on residential property, however commercial and high-end residential sales are difficult to obtain.

The following charts exhibit the number of deed transactions in three of the largest districts in Texas:

Bexar County 2005 Deed Statistics

Property Type	Total Number Filed	Deed Transfers without Sales Information	Percent of Transactions without Sales Prices
Single Family Residential	35,528	19,209	54.07%
Non-Residential	25,455	21,187	83.23%
Total	60,983	40,396	66.24%

Harris County 2005 Deed Statistics

Property Type	Total Number Filed	Deed Transfers without Sales Information	Percent of Transactions without Sales Prices
Single Family Residential	106,025	66,553	62.77%
Non-Residential	5,511	4,941	89.66%
Total	111,536	71,494	64.10%

Travis County 2005 Deed Statistics

Property Type	Total Number Filed	Deed Transfers without Sales Information	Percent of Transactions without Sales Prices
Single Family Residential	25,434	16,411	64.52%
Non-Residential	18,111	14,948	82.54%
Total	43,545	31,359	72.02%

Note the significant disparity in the percentage of residential and non-residential reported sales above. In all cases, over 80% of the non-residential transactions and over 60% of all transactions occur without the appraisal districts obtaining the sales price.

Appraisal districts have the burden of proof in appeals hearings so often, they underestimate values on those property types for which they have little sales data. In the categories where data is scarce, values tend not to increase as regularly or dramatically. This being the case, residential property owners in areas where the market is active are much more likely to experience “appraisal creep” than others might.

Factors contributing to “appraisal creep”

- √ The Texas Property Tax Code requires, in Section 23.01 that “all taxable property is appraised at its market value as of January 1.” Therefore, increases in sales prices must be reflected in appraisals.
- √ Section 25.18 of the Texas Property Tax Code requires the reappraisal of property by appraisal districts *at least once every three years*.
- √ Section 403.302 of the Government Code requires the Comptroller of Public Accounts to conduct a Property Value Study *annually* to determine the taxable value of each school district for funding purposes. The local CAD’s appraisals must fall within a +/- 5% margin of error of the PTD’s estimate in order to be in compliance.
- √ Section 5.102 of the tax code prescribes significant penalties for CAD’s found not to be in compliance by appraising property below the required level.

- √ “Appraisal creep” is not uniform across all property types due to the lack of mandatory sales disclosure. Homeowners see increases in values more regularly than non-residential property owners because appraisal districts do not have sufficient data on sales of non-residential property.
- √ The lack of strong, clear, and concise Truth-in-Taxation provisions in the tax rate adoption process allows taxing entities to achieve a windfall due to appraisal increases without raising tax rates. Higher tax bills are thereby blamed on “appraisal creep.” As values go up in a jurisdiction, tax rates should decline a commensurate amount.

None of these factors individually cause “appraisal creep”; they all have an effect collectively. “Appraisal creep” is a serious issue in any tax system that taxes based on value and relies on periodic reassessment. Under the current system we have in Texas, there is no way to eliminate “appraisal creep,” however we should seek ways to mitigate its effects and spread the property tax burden fairly.