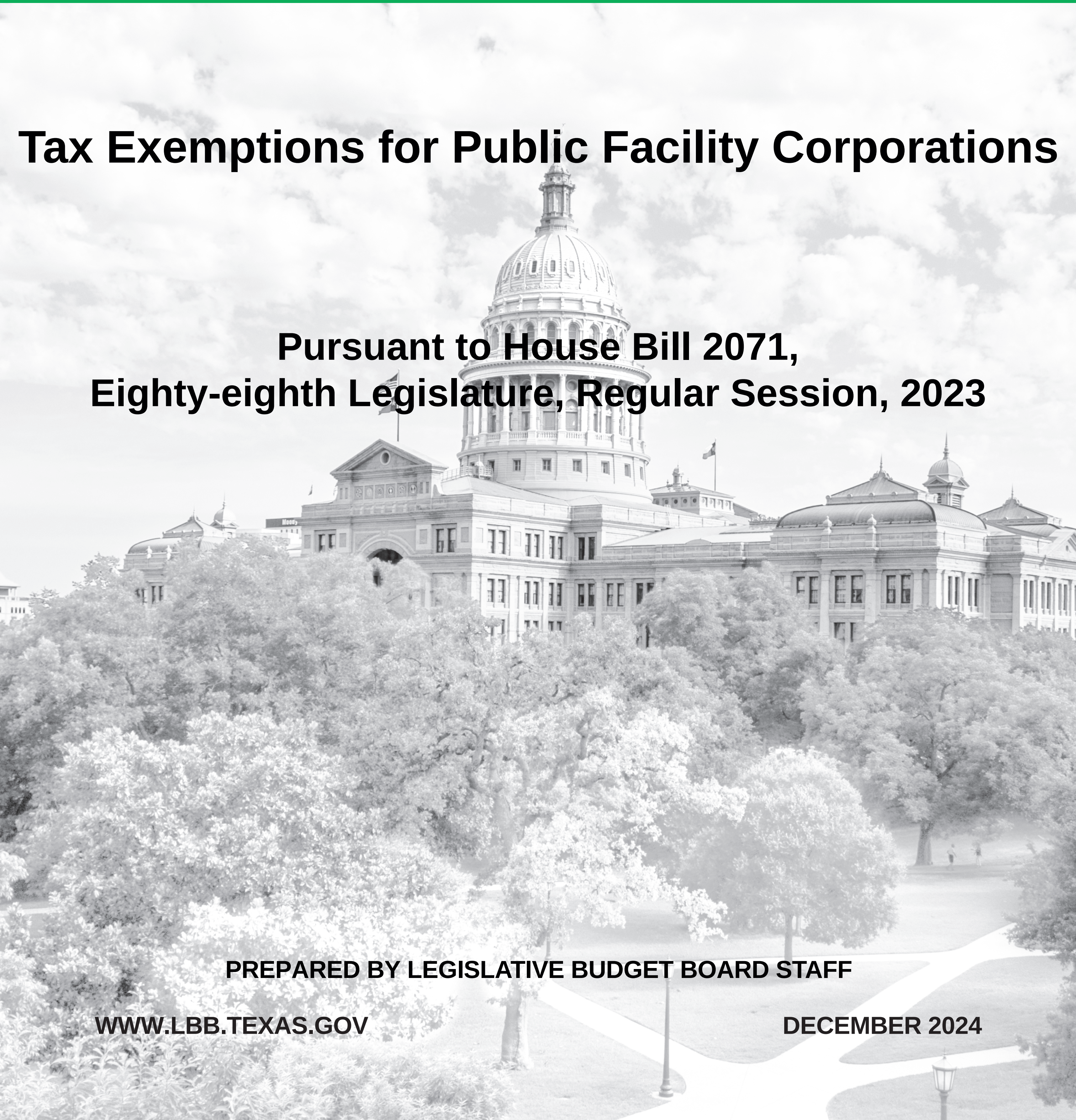
LEGISLATIVE BUDGET BOARD

Tax Exemptions for Public Facility Corporations

Pursuant to House Bill 2071, Eighty-eighth Legislature, Regular Session, 2023



PREPARED BY LEGISLATIVE BUDGET BOARD STAFF

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TAX EXEMPTIONS FOR PUBLIC FACILITY CORPORATIONS

A LEGISLATIVE POLICY REPORT PURSUANT TO HOUSE BILL 2071

House Bill 2071, Eighty-eighth Legislature, Regular Session, 2023, requires the Legislative Budget Board (LBB) to conduct a study of ad valorem tax exemptions and sales and use tax exemptions for multifamily residential developments owned by public facility corporations (PFC) pursuant to the Texas Local Government Code, Sections 303.042(c) and 303.0421(f). The study must include an estimate of the funding or revenue that the state has lost as a result of the exemptions and the potential increase in funding or revenue that would result from the repeal of the exemptions.

LBB staff estimate that the increase in the state share of funding for the Foundation School Program (FSP) due to the ad valorem tax exemption for multifamily residential developments owned by PFCs was $63.4 million during the 2024–25 biennium. Ad valorem taxes are based on the appraised value for a given property. This cost is expected to increase to an amount ranging from $112.9 million to $135.0 million for the 2026–27 biennium. The fiscal impact of repealing the property tax exemption for these developments pursuant to the Texas Local Government Code, Chapter 303, would depend on the language in the legislation, the interpretation of the legislation by property owners and appraisal districts, subsequent action by property owners and appraisal districts, and the result of any subsequent litigation. The number and value of properties that would be eligible for a different exemption is unknown. As a result, the state savings through the operation of the school finance formulas cannot be determined.

The Comptroller of Public Accounts (CPA) estimates that the revenue loss due to state sales and use tax exemptions associated with multifamily residential developments owned by PFCs was $4.5 million during the 2024–25 biennium. The revenue loss is expected to increase to $4.6 million for the 2026–27 biennium. According to CPA, repealing the state sales tax exemption for PFC multifamily housing developments pursuant to the Texas Local Government Code, Chapter 303, would result in no fiscal impact. CPA states that, in addition to provisions in Chapter 303, several provisions in statute and administrative rule provide for a sales and use tax exemption for purchases improving these properties.

FIGURE 1
STATE REVENUE LOSS AND FOUNDATION SCHOOL PROGRAM COSTS DUE TO AD VALOREM TAX EXEMPTIONS AND SALES AND USE TAX EXEMPTIONS PURSUANT TO THE TEXAS LOCAL GOVERNMENT CODE, CHAPTER 303, 2020–21 TO 2026–27 BIENNIA

(IN MILLIONS) BIENNIUM	FOUNDATION SCHOOL PROGRAM COST	SALES TAX REVENUE LOSS
2020–21	$22.2	$3.2
2022–23	$33.6	$4.2
2024–25	$63.4	$4.5
2026–27 (1)	$112.9 to $135.0	$4.6

NOTE: (1) Amounts for the 2026–27 biennium are projected.
SOURCE: Legislative Budget Board.

Figure 1 shows the estimated FSP costs due to the property tax exemptions and the estimated revenue loss due to the sales and use tax exemptions for the 2020–21, 2022–23, 2024–25, and 2026–27 biennia.

PUBLIC FACILITY CORPORATIONS

The governing body of a municipality, county, school district, housing district, or special district may establish a nonprofit PFC to finance or provide for the acquisition, construction, rehabilitation, renovation, repair, equipping, furnishing, and placement in service of public facilities. The unit of local government that establishes the PFC is referred to as its sponsor. The Texas Local Government Code defines a public facility as any real, personal, or mixed property, or an interest in property devoted to public use, and the property is authorized to be financed, refinanced, or provided by sponsor obligations or bonds issued pursuant to Chapter 303. The statute provides that a PFC is engaged exclusively in performance of charitable functions and is exempt from taxes imposed by the state and political subdivisions.

PUBLIC FACILITY CORPORATION MULTIFAMILY RESIDENTIAL DEVELOPMENTS

House Bill 2209, Seventy-sixth Legislature, 1999, authorized public housing authorities to establish PFCs to acquire, construct, renovate, equip, furnish, or provide assistance to a residential housing development to provide affordable housing or housing assistance. The legislation required any assistance provided to benefit individuals and families whose incomes are no more than 60.0 percent of the area median family income, adjusted for family size.

Senate Bill 929, Seventy-seventh Legislature, 2001, provided that a PFC-owned multifamily residential development would be eligible for the tax exemptions provided in the Texas Local Government Code, Chapter 303, if either at least 20.0 percent of its units were reserved for public housing or at least 50.0 percent of units were reserved for individuals and families who earn moderate income, defined as less than 80.0 percent of the area median family income.

House Bill 2679, Eighty-fourth Legislature, 2015, extended eligibility for the tax exemption to leaseholds by requiring that a leasehold granted by a PFC must be treated in the same manner as a leasehold granted by a defense base development authority. A leasehold is an arrangement in which the PFC owns the land and leases real property to a third party through a ground lease. A private housing developer can lease real estate from a PFC to construct a multifamily residential development. That private development could receive a 100.0 percent property tax exemption if 50.0 percent of its units are available to individuals and families who earn moderate income. These leaseholds are exempt from taxation pursuant to the Texas Tax Code, Section 11.11, relating to public property.

Before June 18, 2023, a PFC could enter a leasehold agreement with a housing developer outside the locational jurisdiction of its sponsor. No rules required the developer or PFC to provide notice to or request approval from a governing body by a municipality or county. Additionally, no oversight or monitoring requirements were in place to verify that the multifamily residential developments that received exemptions complied with the requirements to reserve units for households earning moderate income. Furthermore, no rent restrictions were applied to make the reserved units affordable to the population they were intended to serve.

HOUSE BILL 2071

House Bill 2071, Eighty-eighth Legislature, Regular Session, 2023, includes several reforms related to PFC multifamily residential developments. Pursuant to the legislation, PFCs are permitted to own, finance, or operate a multifamily residential development only if that development is located within the geographic boundaries of the sponsor entity. The PFC must notify the governing body of each taxing entity in which the development will be located. If a majority of the members of the board of the sponsor entity are not elected officials, the governing body of the municipality in which the development is located must provide approval. If the development is not located in a municipality, the governing body of the county must provide approval.

In addition, House Bill 2071 modifies income requirements to qualify for the exemption, decreasing the share of units required to be reserved for moderate income households from 50.0 percent to 40.0 percent. The legislation also requires that an additional 10.0 percent of the units in the development must be reserved for lower-income households, defined as income from 30.0 percent to 60.0 percent of the area median income.

The legislation requires that the percentage of income-restricted units reserved in each category of units in the development, based on the number of bedrooms per unit, must be the same as the percentage of each category of units in the development. House Bill 2071 also adds restrictions on the amount of rent that could be charged for the lower-income and moderate-income units and provides other renter protections.

House Bill 2071 requires the developer operating the housing development to submit to the Texas Department of Housing and Community Affairs and the local appraisal district an annual audit prepared by an independent auditor that determines whether the public facility user is in compliance with statutory requirements. The report must identify the difference in the rent charged for income-restricted units and the estimated maximum market rents that could be charged for the units without the rent or income restrictions. The legislation also establishes a process through which public facility users may resolve any noncompliance identified in the audit to avoid forfeiting the tax exemptions.

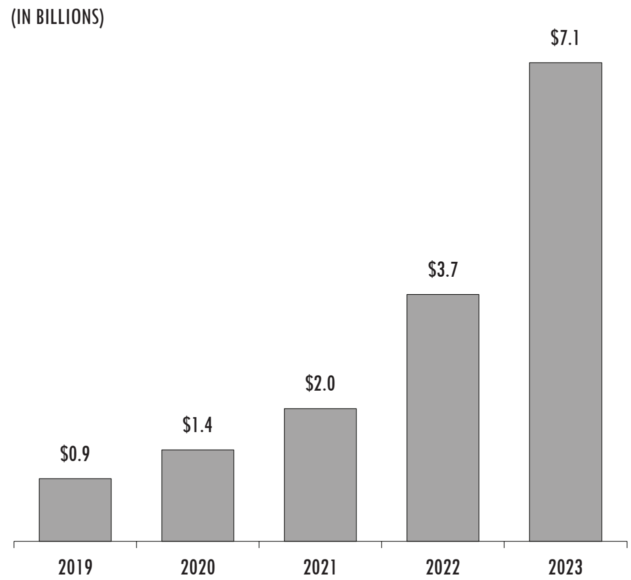
STATE COST OF AD VALOREM TAX EXEMPTIONS

Property is appraised at the local level by a system of central appraisal districts. The Texas Tax Code, Chapter 6, requires appraisal districts to appraise all property subject to property taxes in Texas. Unless otherwise provided by law, appraised values must represent market value, which is the value for which the property likely would sell on January 1 of a tax year.

PFCs are exempt from property taxation as public property pursuant to the Texas Tax Code, Section 11.11, because of the provisions of the Texas Local Government Code, Chapter 303. The property tax exemption for PFC multifamily residential developments decreases property value that is subject to local property taxes. When school district property values decrease, the result is a cost to the state.

To estimate the state costs associated with the property tax exemption, LBB staff first sought to identify an estimate of the school district property value loss due to the exemption. The information necessary to estimate school district value loss is not readily available from any publicly accessible sources. Appraisal districts report total value loss to CPA for properties that are exempt pursuant to the Texas Tax Code, Section 11.11. However, PFC properties represent a small share of all tax-exempt public property in the state. The Texas Association of Appraisal Districts surveyed its membership on behalf of the LBB. Appraisal districts provided information regarding the number of PFC multifamily residential developments receiving exemptions, the market value of those developments, and the taxable value of those developments, by school district, for tax years 2019 through 2023. LBB staff further contacted select appraisal districts to request information for tax year 2024. This period follows the implementation of the school finance reforms implemented pursuant to House Bill 3, Eighty-sixth Legislature, 2019. From tax years 2019 to 2023, the school district property value loss from the exemption increased 665.9 percent, from $0.9 billion to $7.1 billion. Approximately $5.1 billion of the value loss was reported in Harris ($3.2 billion) and Bexar ($1.8 billion) counties. In the school districts for which LBB staff have tax year 2024 data, value loss increased by 11.5 percent from tax years 2023 to 2024 despite a combined decrease in school district value loss of 1.3 percent in Harris and Bexar counties. Increases of $321.2 million in Dallas County and $379.9 million in Tarrant County contributed significantly to the 11.5 percent overall statewide increase. **Figure 2** shows the change in school district property value losses from tax years 2019 to 2023.

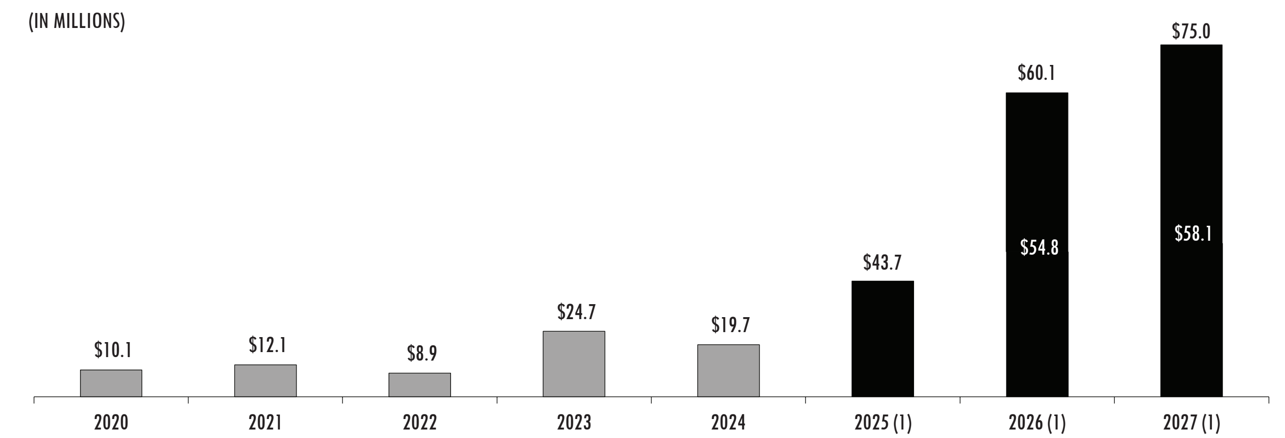
FIGURE 2
SCHOOL DISTRICT PROPERTY VALUE LOSS DUE TO PROPERTY TAX EXEMPTIONS, TAX YEARS 2019 TO 2023



SOURCE: Legislative Budget Board.

LBB staff used the school district property value losses reported by appraisal districts to forecast future value loss and used those estimates to calculate the state FSP cost due to the exemptions for PFC multifamily residential developments. Actual future value loss is dependent on the changes in the market value of existing developments that receive the exemption and the number of and market value of new developments. The effects of implementing the provisions of House Bill 2071 on the number of new PFC multifamily residential developments that will be eligible for an exemption is unknown and not included in this analysis. LBB staff estimate the increase in the state share of funding for the FSP due to the property tax exemption for multifamily residential developments owned by PFCs was $63.4 million during the 2024–25 biennium. The cost estimates for the 2026–27 biennium are expected to increase to a range from $112.9 million to $135.0 million. **Figure 3** shows the estimated increase in the state's FSP obligation due to school district value loss from these property tax exemptions from fiscal years 2020 to 2027.

FIGURE 3
INCREASED STATE COST TO FUND THE FOUNDATION SCHOOL PROGRAM DUE TO PROPERTY TAX EXEMPTIONS
FISCAL YEARS 2020 TO 2027



(IN MILLIONS)

YEAR	COST
2020	$10.1
2021	$12.1
2022	$8.9
2023	$24.7
2024	$19.7
2025 (1)	$43.7
2026 (1)	$54.8 to $60.1
2027 (1)	$58.1 to $75.0

NOTE: (1) Amounts for fiscal years 2025 to 2027 are projected.
SOURCE: Legislative Budget Board.

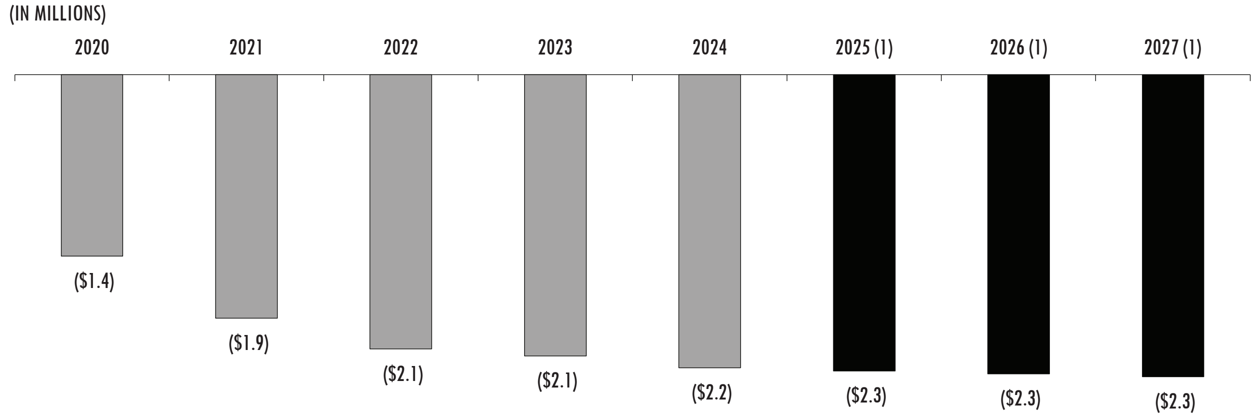
ESTIMATED FISCAL IMPACT OF REPEALING THE PROPERTY TAX EXEMPTIONS

The fiscal impact of repealing the property tax exemption for PFC multifamily residential developments pursuant to the Texas Local Government Code, Sections 303.042(c) and 303.0421(f), would depend on the language in the legislation, the interpretation of the legislation and action by appraisal districts and property owners, and the result of any subsequent litigation. If the exemptions were repealed, those properties no longer would qualify for exemption pursuant to the Texas Tax Code, Section 11.11. Appraisal districts would notify property owners of the change in legislation and the removal of the exemption. Property owners could apply for any other exemptions for which they qualify. It is unknown to what extent the PFC multifamily development operators and properties are qualified for additional exemptions from property taxes. As a result, the state savings through the operation of the school finance formulas cannot be determined.

STATE REVENUE LOSS FROM SALES AND USE TAX EXEMPTIONS

According to CPA, statutory provisions in addition to those in the Texas Local Government Code, Chapter 303, provide exemptions from sales and use taxes for purchases to improve properties owned by PFCs. Pursuant to Comptroller Rule 3.291(a)(5), an entity making improvements to the property of a charitable organization such as a PFC could make tax-free purchases for items purchased for the primary use of the charitable organization. CPA estimates that sales tax exemptions on improvements for PFCs' multifamily residential developments decreased sales and use tax collections by $1.4 million during fiscal year 2020, increasing to $2.3 million for fiscal year 2025. **Figure 4** shows the estimated annual sales and use tax revenue losses from fiscal years 2020 to 2027.

FIGURE 4
REVENUE LOSS DUE TO SALES AND USE TAX EXEMPTIONS ASSOCIATED WITH PUBLIC FACILITY CORPORATIONS' MULTIFAMILY RESIDENTIAL DEVELOPMENTS
FISCAL YEARS 2020 TO 2027



(IN MILLIONS)

YEAR	REVENUE LOSS
2020	($1.4)
2021	($1.9)
2022	($2.1)
2023	($2.1)
2024	($2.2)
2025 (1)	($2.3)
2026 (1)	($2.3)
2027 (1)	($2.3)

NOTE: (1) Amounts for fiscal years 2025 to 2027 are projected.
SOURCE: Legislative Budget Board.

ESTIMATED FISCAL IMPACT OF REPEALING THE SALES TAX EXEMPTIONS

According to CPA, repealing the state sales and use tax exemption for PFC multifamily residential developments pursuant to the Texas Local Government Code, Sections 303.042(c) and 303.0421(f), would have no fiscal impact. In accordance with Comptroller Rule 3.291(a)(5), an entity that makes improvements to the property of a charitable organization such as PFCs could make tax-free purchases for items purchased for the primary use of the organization.