

Volume 22, Number 5

May 5, 2000

Dear Client:

If you are still reeling from the appraisal notice you received in the mail last week, take heart.

Unless you bought your house this year, you will (in most cases) only be assessed on the first 10% of the increased value of your residence.

In 1997 the Texas Legislature capped how much the assessed value of a residence homestead can increase in a year. The **10% cap** was designed to mitigate the effects of rapidly escalating values fueled by red-hot housing markets. And no market is redder or hotter than Austin's, where market values for homes have skyrocketed anywhere from 30% to 70% this year.

However, the cap **does not apply if the homestead changes hands** in a tax year. This exception allows the appraisal district to "catch up" all at once. Consequently, your new neighbor, whose home is similar to yours, may be paying taxes on a substantially higher value than you are. (If you value peace and amity in the neighborhood, you might not want to mention this matter in casual, over-the-fence conversation.)

The cap has another potentially inequitable effect. While the 10% limitation shields most homeowners from a staggering one-time hit, it virtually **assures an incremental annual 10% increase** in your home value for the foreseeable future.

Regardless of whether the real estate market flattens or turns south, assessed values will continue to go up for as long as value is in the bank. So, the cap could theoretically be used to soften the blow of economic downturns to local taxing units, perhaps providing a disincentive for appraisal districts to adjust values to lower market-based levels.

Moreover, as we see both residential and commercial property values shoot through the roof, it will be interesting to see how the City of Austin, Travis County, and AISD treat the revenue windfall the increasing values will produce. Remember the property tax burden increases in two ways: local governments can increase tax rates, or they can simply hold the rate level and let rising values do the job for them.

Finally, don't let politicians get away with claiming credit for holding the line on taxes, if all they're doing is taking advantage of higher values to increase government spending. In fact, **it is legitimate to ask whether tax rates should be reduced to offset those higher values.**

The state's top environmental regulator has called on Austin and Travis County to consider adopting voluntary air emissions controls. Robert Huston, chair of the Texas Natural Resource Conservation Commission, urged local government and business leaders to adopt a plan to reduce air pollution in anticipation of Austin's possible designation as a non-attainment area in 2001.

As you probably know, the centerpiece of such a plan is **vehicle emissions testing** (Austin has little problem with stationary, fixed emissions sources). Simply put, when you take your car in for its customary safety inspection, you would also have your car's emissions checked to see if your car is "clean" or needs repairs.

This process not only increases the cost of a vehicle inspection (by as much as \$15 to \$25), but it requires inspection stations to install expensive testing equipment (\$40,000 and up) to run the test.

You can see the political problems here: motorists, at least initially, resist the added cost and inconvenience of the additional test, and garage owners balk at the huge equipment and maintenance cost associated with the additional equipment.

In fact, in 1995 the Texas Legislature killed off an EPA-approved plan that would have required vehicles in Harris and Dallas Counties to submit to a centralized, state-administered emissions test. If that program had been allowed to go forward, **we might not be facing federal Clean Air Act sanctions today**. Be that as it may, the TNRCC and state legislators are once again about to require vehicle emissions testing — the only question is what type of test will be required and how the program will be administered.

A few weeks ago in this newsletter, we urged both the Greater Austin Chamber of Commerce and/or the Austin 360.00 Summit high-tech group to take the lead in creating a **local effort to devise a compliance plan** before the EPA and TNRCC tell us we have to do it. Chairman Huston has now seconded that call.

If the right plan can be promulgated and sufficient public education is done, Austin motorists will accept the additional testing. And if the right technology is selected and the program is properly managed, the regulators will bless the program and garage owners will be able to implement it without excessive cost.

As Chairman Huston noted, there is really no alternative to compliance. **The issue is whether Austin proposes a plan it can live with or the regulators impose one on us.**

Nina and Tim Zagat, owners of the New York-based Zagat surveys of America's top restaurants, have been making the rounds in Austin for the first time. Their millennium edition included Dallas-Fort Worth and Houston, with other large metro areas. Now, perhaps, it's our turn.

The state's E-Commerce and Technology Advisory Group (ETAG) has gone into deliberation mode, as its three working groups attempt to agree on recommendations for legislative action.

The **infrastructure** group, chaired by AT&T's Austin tax representative **Bill Dvorak**, is focused on the sales tax treatment of telecommunications equipment purchases. Currently, state and local sales taxes apply when, for example, AT&T or Southwestern Bell buys switching equipment. The phone companies represented in the working group argue that these "business inputs" should be **tax-exempt**, just as purchases of manufacturing machinery and equipment are. Since consumers also pay sales taxes on telecommunications services at the output end, they in effect pay twice. The problem is, the Comptroller estimates that the exemption would cost the state \$300-400 million per year -- a huge drain on the state revenue stream.

On the **Internet applications and intermediaries side**, the issues are perhaps more complex, but just as expensive. Chaired by Hughes & Luce tax attorney **Cindy Ohlenforst**, the group is studying the economic development benefits of exempting various Internet-related taxes: Internet access, data processing and information services, and telecommunications services. It is also considering how much presence a web-based merchant must have in Texas to become subject to state taxation (the "nexus" issue), as well as the overall simplification of Internet taxes. The price tag for these items range from \$50-200 million per year for the Internet access exemption, to \$70 million for exempting data processing and information services.

Finally, the **electronic commerce group**, headed by Texas Taxpayers and Research Association President **Bill Allaway**, is examining the equitable tax treatment of downloadable or "digital" goods and services, such as books, DVDs, software, CDs, cable TV, and telecommunications. The issue here is how to treat these "intangible" goods and services the same way as their tangible counterparts. Simply exempting everything -- tangible and intangible alike -- could cost the state up to \$1.4 billion a year.

Clearly, the revenue impact is immense, but state tax policy has to account for the portability of Internet-related businesses. If **tax burdens are too high or discriminatory**, these businesses -- and the jobs and economic activity they create -- could flee to tax-friendlier venues.

A few weeks ago we told you *New York Times* political writer R. W. Apple, Jr. was poking around in the Capitol City for a national story on Austin's boom. If you saw the 4/28/00 piece, entitled "Booming in Size and Brio", you know that the *Times* heaped plaudits on Austin and San Antonio in a lengthy feature.

Apple is particularly impressed by Austin's culture, singling out the Austin Symphony, Austin Lyric Opera, Harry Ransom Center and Museum of Art. Our town also boasts the restored Driskill Hotel and the Four Seasons as prime places to stay. The feature story is available via www.AustinLetter.com. Go to our "Links" page and click on *The New York Times*.

As you may know by now, the Metropolitan Club will close its doors in the next couple of months. One American Center can't continue to subsidize the Club's \$6 per sq.ft. lease, and the Club can't afford to triple their lease payments (and their membership dues) to stay put. With potential tenants drooling over the Club's 38,000 feet of prime downtown office space, the Club's demise was probably just a matter of time.

In years past, downtown building managers viewed dining and exercise clubs as tenant-attracting amenities. Moreover, prior to the current boom in downtown retail and restaurant development, downtown lacked the kinds of options clubs could provide. However, with office space at peak capacity, subsidized clubs are no longer necessary to draw in customers.

As **Charlie Betts**, executive director of the Downtown Austin Alliance, points out, Austin now sports a variety of athletic and dining options within a few minutes drive of downtown office buildings. The Metropolitan Club was simply a victim of economic realities in a market that, at least for the next 15-24 months, will have a hard time accommodating additional downtown growth.

Other downtown clubs don't have the Met's problems. The **Headliners Club** has paid competitive lease rates since 1974. Although the Club's lease is up for renewal in 2003, club manager **Sue Meller** is optimistic that this particular Austin tradition will stay right where it is. The **Austin Club**, owns its own building and does not face the uncertainties of the downtown lease market.

Dr. Louis Overholster reminds his middle age patients that life begins at 40, but then, so does arthritis and the habit of telling the same story three times to the same person!

NEAL SPELCE AUSTIN LETTER (ISSN 1071-0612) is published weekly, except last two weeks of the year, for \$150 (plus tax) per year or \$249 (plus tax) for two years. To subscribe, call 512-498-9495. Periodical Postage Paid at Austin, TX 78767 by Austin Letter, Inc., 1407 Wild Cat Hollow, Austin, TX 78746. POSTMASTER: Send address changes to: Neal Spelce Austin Letter, P.O. Box 1905, Austin, TX 78767-1905.

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