LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 82ND LEGISLATIVE REGULAR SESSION

April 4, 2011

TO: Honorable Steve Ogden, Chair, Senate Committee on Finance

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

IN RE: **SB1505** by Uresti (Relating to the appraisal for ad valorem tax purposes of a real property interest in oil or gas in place.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for SB1505, As Introduced: a negative impact of ($234,775,000) through the biennium ending August 31, 2013.

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

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2012	$0
2013	($234,775,000)
2014	($293,710,000)
2015	($316,999,000)
2016	($342,139,000)

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*
2012	$0	$0	$0	$0
2013	($234,775,000)	($82,228,000)	($91,468,000)	($5,520,000)
2014	($293,710,000)	($50,397,000)	($98,840,000)	($5,955,000)
2015	($316,999,000)	($56,495,000)	($106,804,000)	($6,424,000)
2016	($342,139,000)	($63,214,000)	($115,406,000)	($6,929,000)

Fiscal Analysis

The bill would amend Chapter 23 of the Tax Code, regarding property taxation, to require that ad valorem (property) tax appraisers use an average of the monthly oil and natural gas prices over the most recent two calendar years as the price for each year in any income appraisal.

The bill would take effect January 1, 2012 and applies to a tax year beginning on or after that date.

Methodology

Property tax appraisers use an income method to appraise oil and natural gas leases in the great majority of cases. Income appraisals are forward-looking and appraisers must predict several future variables to estimate market value. An important variable in the appraisal is the oil or natural gas price used over the projected future life of the lease. The appraiser estimates the market oil or natural gas price for the first year and escalates (or de-escalates) the price to account for future price changes. In most years oil and natural gas prices increase, so normally the price is escalated. The bill's requirement that appraisers use a fixed two-year average product price in each year of the appraisal would prevent appraisers from escalating (or de-escalating) prices and would disconnect the oil and natural gas prices used in the appraisal from the current oil and natural gas market prices thereby removing oil and natural gas appraisal from the normal market value standard. In most years the bill's prohibition of price escalation would result in reduced appraised values.

Further, in some years the bill's price averaging requirement would result in a lower than current market price for oil and natural gas and, in turn, an appraised value that is less than market value. In other years, depending on the amount and direction of price movement, the price and the appraised values could be higher than market value.   Article VIII, Section 20, of the Texas Constitution prohibits assessments in excess of market value so oil and natural gas lease values resulting from the bill's pricing mechanism would be overruled if they exceeded market value. Values below market value are not constitutionally prohibited so the pricing mechanism would result in oil and natural gas lease values significantly below market value in some years but would never result in final values significantly above market value.

The reduced oil and natural gas lease appraised values resulting from the bill's proposed pricing mechanism would create a fiscal cost to the state and to local taxing units. A sample of oil and natural gas leases was appraised using a standard price escalation scenario and compared to appraisals of the same leases with no price escalation. A reduced-price factor was added to estimate a percentage value loss.   The estimated percentage value loss was applied to projected statewide oil and natural gas taxable values to estimate the value loss. The applicable projected tax rates were applied to estimate the levy loss to cities and counties and to estimate the initial school district loss. Because of the operation of the hold harmless provisions of HB 1, 79th Legislature, the school district cost related to the compressed rate is transferred to the state. The enrichment cost and a portion of the school district debt (facilities) cost are transferred to the state after a one-year lag because of the operation of the enrichment and facilities funding formulas. All costs were estimated over the five year projection period.

Local Government Impact

The estimated fiscal implication to units of local government is reflected in the table above.

Source Agencies: 304 Comptroller of Public Accounts

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