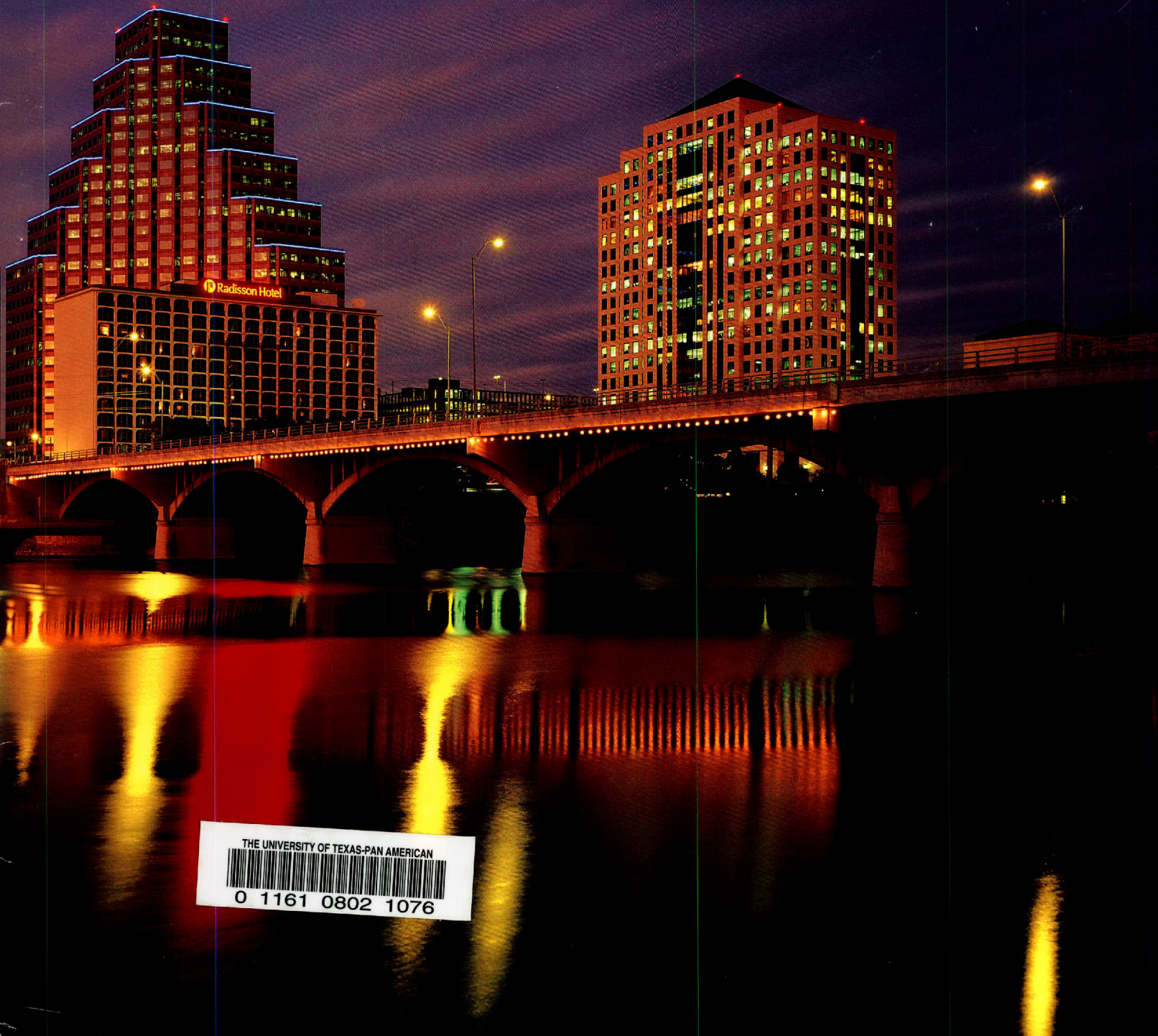


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Mexico Sorts Out after Economy Crumbles

Just when Mexico's economy seemed healthy and politics stable, the peso plunged 40 percent. The resulting economic shambles and political unrest created a disaster area. Citizens and leadership face the overwhelming job of sorting through the pieces and restoring order to their lives.

In an insightful analysis, Jared E. Hazleton explores some of the dynamics behind these unfortunate events. He says that President Zedillo faces the gargantuan task of persuading an already beleaguered citizenry to endure further fiscal austerity while convincing the reigning PRI party to give up some of its power.

Texas has a stake in Mexico's fate as the two economies are linked in several ways. Hazleton says that only restored investor confidence will reactivate the country's progress. He explains in "Economic Earthquake Shakes Mexico."



Land Sales at Risk?

The debate continues between landowners and environmentalists over the benefits and costs inherent in the Endangered Species Act. To find out how Texas real estate professionals view the situation, the Center surveyed 6,000 brokers in 1994. They were asked to rate the impact, if any, on sales of specific land types during the past decade and to estimate the average property value change in applicable markets during the next five years.



Texas brokers' opinions and conclusions are reported in "Impact of Habitat Protection on Property Values."

Special Provisions Tucked in Tax Code

Property owners who take time to search the Texas Tax Code will find little known rights and alternatives. Restricted use, for example, may lessen the tax bill.

Most people know that open-space and agricultural use valuation carry tax benefits. But what about restricting property to recreational, park or scenic purposes? This less familiar appraisal technique can save tax dollars given the required circumstances.

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The tax code also provides special treatment to co-owners facing a tax foreclosure sale. Another unique provision permits the transfer of a tax lien from the collector of the taxing unit to a third party. The rights of the property owner and existing lienholders change in at least four significant ways, however, when the taxing authorities foreclose.

As is always the case, a property owner must satisfy specific conditions and criteria to be eligible under these tax laws. Judon Fambrough, attorney and senior lecturer with the Center, explains basic details in "Unique Provisions Shelter Property Owners."

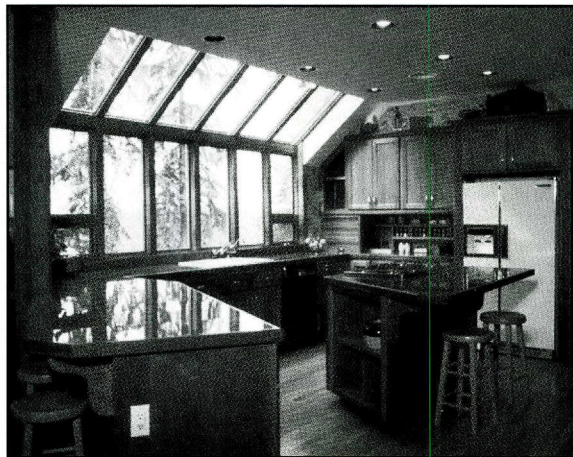
Market Research Spotlights Women as Homebuyers

Women hold the balance of power in the home-buying decision—85 percent of the time she makes the choice, even when the buyer is a couple. Knowing what this powerful economic segment desires better equips architects, designers, developers and real estate sales staff to offer the buyer the home she wants.

Market research revealed women's top five design concerns. Now, builders are constructing homes matching women's expressed demands. Merchandisers are incorporating these ideas into color scheme, lighting and low-maintenance features. Sales staff are recognizing that women earn their own money, and they want to invest it in a house. "Designing for Women" summarizes these and other major home trends.

¿Qué pasa?

City lights paint the night-black lake with vivid strokes. Austin's skyline reflected in Town Lake juxtaposes human creation with the natural world, suggesting a harmonious, peaceful co-existence. Cover photograph by Laurence Parent.



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Benchmarks

Thank You, TAR

Tierra Grande's circulation is about to double. Until now, only active brokers received the quarterly magazine free. Real estate salespersons will begin receiving *Tierra Grande* in October, and the magazine's circulation will jump from 40,000 to 85,000.

The change was made possible when the Texas Legislature approved the first funding increase for the Real Estate Center in 20 years. During the past decade, licensee numbers have declined as much as one-third. As the Center's only funding source dwindled, the Center staff was cut from 33 to 16.

Had the 1995 legislature not approved the increased funding, deep cuts in Center staff, products and capabilities were certain.

The Texas Association of Realtors led the legislative effort to secure adequate funding for the nation's most productive real estate research center. The Center's senior management worked closely with TAR's legislative staff and acquired an even greater respect for the effectiveness of the state's most visible real estate trade association.

"The staff of the Real Estate Center appreciates the support received from TAR's executive vice president, governmental affairs staff, legislative management team, board of directors and membership," says R. Malcolm Richards, Center director. "The compliments and

support will inspire the staff to work even harder to meet the research needs of today's real estate professionals."

Under the new legislation, salespersons will contribute \$17.50 and brokers \$20 annually to the support of the Center.

"Meeting the information needs of the Texas real estate industry is job number one," says Gary Maler, Center associate director. "Ideas and suggestions from all licensees for research topics or issues for study are welcomed."



Frances Griffin

Farewell, Frances

No longer will the familiar voice of Frances Griffin greet callers to the Real Estate Center. Griffin retired after 15 years of service at Texas A&M University. For 14 of those years she ran the Center's publications room; as a customer's first-and-sometimes-only-direct contact, she responded to requests with more than words.

Both Center patrons and professionals relied on Griffin, whose extensive knowledge about current publications and on-going research made her invaluable. As one staff member noted, "Frances could find a copy of our most obscure publication in ten seconds flat." And she knew it by author, number and title. She distributed more than 700,000 publications for the Center.

Griffin's ability to quickly recall pertinent information greatly facilitated getting research results to clientele. Numerous callers sought detailed information not always printed in a publication. Griffin's knowledge of each researcher's projects and expertise allowed her to connect the caller to the right person with little delay or hesitation.

Griffin will continue to reside in Somerville. Gardening and grandchildren rank high on her new priority list. Center staff will miss her but wish her many happy retirement years where the telephones ring less and publications come in on time.

The Center honored Griffin with a reception on May 30 in the E.L. Wehner Building; many friends and colleagues gathered to say, "Farewell, Frances."

Gas Industry Ad Valorem Seminar Set

A seminar for corporate managers in the refining and gas processing industry and others with an interest in ad valorem taxation is set for September 10-12 in San Antonio. The one-and-a-half day program at the Plaza Hotel will be presented by industry CEOs from Houston and Dallas. A Center economist will discuss property tax valuation.

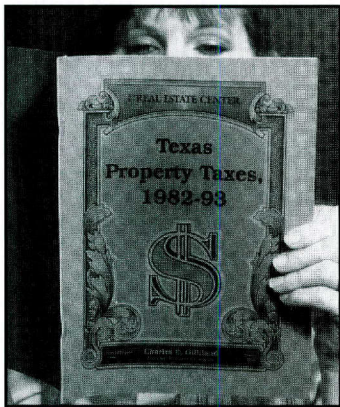
Continuing education credit has been requested to accommodate various professionals, including appraisers, accountants and tax examiners. Cost is \$450 if pre-registered and \$500 at the door. Deadline for hotel reservations is September 4 (telephone 210-229-1000).

To register or for more information, call Doris Hill at 409-845-9690. The Center and the Department of Finance at Texas A&M University are co-sponsors.

Sizing Up Texas Property Taxes

"Whither thou goest?" is a tax question on many property owners' minds. And with just cause. In a newly published special report, Charles E. Gilliland, associate research economist with the Center, reviews property tax movements between 1982 and 1993. "During this time," Gilliland finds, "Texas property tax burdens more than doubled."

Gilliland examines causes and compares Texas to other states. "Texas went from ranking 33rd nationally in 1979 and taxing property at 17.7 percent less than the national average to 15th with a burden of 13.6 percent more than the national level," the researcher reveals. At the same time, the purchasing power of the median effective buying income finished the decade slightly lower than the 1982 level.



Higher taxes and lower incomes have never been a happy combination for anyone. Gilliland documents how these circumstances evolved for Texas property owners during the recent past.

Are higher taxes inevitable? Readers of *Texas Property Taxes, 1982-93* will find their own answers. For a copy of the special report, order publication 1056 (p. 32).



Staff Brings Home Trophies

The list of winners for the 1995 IABC Brazos Bravo competition includes a number of Real Estate Center entries. Sponsored by the local chapter of the International Association of Business Communicators (IABC), the contest is judged by out-of-state chapters. Written critiques provide in-depth evaluations of publications based on demanding communications criteria.

Those projects garnering awards include:

Brazos Bravo:

Home-Buyer's Guide, Handbook, guidebook or manual division
Tierra Grande, Periodical division, one- to three-color magazine

Award of Excellence:

Real Estate Center Catalog, Publication division, catalog

Award of Achievement:

Texas at the Crossroads, Audiovisual division, one-time video program/overall production
Real Estate Center Communications Program, Communications program division, continuing

David S. Jones, senior editor with the Center, coordinates the communications staff, oversees *Tierra Grande* and developed the communications program. He holds the designation of Accredited Business Communicator,

granted by IABC only to communicators who successfully complete the organization's challenging accreditation exam.

In the editing division for a book, Shirley E. Bovey, associate editor, received an Award of Excellence for *On Great Service: A Framework for Action*. Author of the book is Dr. Leonard L. Berry, a professor of marketing and director of the Center for Retailing Studies in the College of Business Administration at Texas A&M University. Bovey worked as a consultant on Berry's book.

Dr. Jack C. Harris, research economist, wrote the *Home-Buyer's Guide*. Kammy Senter, assistant editor, and Bob Beals, art director, also helped develop the Center's award-winning publications. Greg Keith, student assistant, worked with Jones on *Texas at the Crossroads*.

Although the competition bestows three awards, none is given unless the entry has merit. Thus, the awards signify the level of excellence for a particular entry rather than its rank compared to others. The highest, Brazos Bravo, honors superlative work.



"Doc" Tells What's Up

Students who come to Texas A&M University in the fall of 1996 to study land economics and real estate will find a favorite professor missing. Dr. Ivan W. Schmedemann has announced his retirement, effective on May 31, 1996. Schmedemann developed the Land Economics and

Real Estate program that began in 1970. He has been the program's only coordinator. More than 400 students have earned master's degrees under "Doc's" tutelage. He will be missed, not only by students but also by his colleagues and friends across the state and nation.



Economic Earthquake Shakes Mexico

By Jared E. Hazleton

What a difference a year makes. Mexico was riding high last summer with NAFTA in hand, several years of economic reform under its belt, a balanced budget, a respectable level of external debt and a new president elected in a widely acclaimed open and fair election. Since then, however, the value of the peso has plunged 40 percent, casting a dark spell over NAFTA and recent reforms. Mexico's economy is in shambles, and the new president is facing rising political unrest.

How did the Mexican "miracle" turn into an economic and political disaster area in such a brief period? What are the prospects for Mexico's recovery? And how will these events affect Texas?

What Went Wrong

Devaluation of the Mexican peso resulted from familiar causes: a sizable and growing current account deficit (excess imports over exports), over-expansion of the money supply and over-reliance on short-term borrowing.

Mexico's leaders believed that the country's persistent current account deficits were simply the normal counterpart to huge capital inflows representing foreign investment in what seemed to be an exceedingly promising market. From 1990 through 1994, however, direct investment in plant and equipment accounted for less than a quarter of the total inflows.

The rest came from portfolio investment in equities and bonds, largely by mutual funds. Unlike direct investment, portfolio investment can depart for perceived greener pastures with the speed of light.

As long as the capital inflow continued, however, Mexico was able to maintain the value of the peso and accumulate foreign exchange reserves of more than \$25 billion at the end of 1993. In 1994, however, the situation changed. The PRI presidential candidate, Donaldo Colosio, was assassinated. The Zapatista uprising in the southern province of Chiapas heightened political tensions, and another assassination, of reform-minded PRI-leader Jose Francisco Ruiz Massieu, as well as kidnappings of prominent executives added to the political turmoil. The resulting uncertainty led many investors to take their money elsewhere. Meanwhile, in the United States, the Federal Reserve began raising short-term

interest rates to combat inflation, providing added reward to capital fleeing Mexico.

The Mexican central bank facilitated the conversion of pesos into dollars by purchasing foreign-owned financial assets directly and by extending credit to the banking system. Had the central bank refused, the sales of such assets would have caused their prices to decline and interest rates to rise, slowing the outflow of capital. Facing what was initially viewed as a close election, however, the Salinas administration opted for easy money and the central bank meekly complied.

When the inflow of capital fell short of plugging the gap between imports and exports, Mexico resorted to issuing short-term domestic debt. (The country's 1982 foreign debt crisis denied it access to the international market for long-term capital.) To attract investors, the Mexican treasury issued dollar-denominated instruments called *tesobonos*. As foreign capital continued to flow out and the import surplus continued to rise, Mexico's dollar reserves dwindled, and it was forced to enter the short-term money market more frequently.

In the end, given its rising current account deficit and the political uncertainty that was keeping foreign investors away, Mexico simply could not maintain both low interest rates and an over-valued peso. Only after its foreign exchange reserves were nearly depleted did newly installed President Ernesto Zedillo opt for devaluation. On December 20, the government announced that the restrictive band within which the peso was permitted to trade would be raised 15 percent. Unfortunately, the announcement caught investors by surprise and the government without a plan for restoring fiscal discipline. As a result, with confidence collapsing, a speculative run against the peso ensued on the following day, and the nation's foreign exchange reserves plunged by about \$6 billion in a few hours. Only then did the government decide to let the peso float, i.e., let market forces set its prices.

Recovery Plan

In the weeks following the devaluation, the country appeared to drift as President Zedillo negotiated a plan for dealing with the crisis. The plan had no sooner been released, however, than it was denounced as being "too little, too late." President Clinton quickly pledged American support, but more weeks were lost as his administration tried to convince a skeptical Congress of the wisdom of the bailout. Despairing of the fight, on January 31, President

Clinton announced a \$51 billion bailout plan that did not require Congressional approval.

The bail-out funds, with only \$20 billion coming directly from the United States, are intended to help Mexico weather the immediate crisis by restructuring its debt, lengthening the average maturity and assisting banks that require it. Mexico's basic economic problem, however, is its need to reduce dependence on short-term money flows by slashing its current account deficit. Devaluation helps, of course, because imports become more expensive and exports become cheaper. But devaluation gains can be lost if prices and



New Mexican businesses, such as this supermarket in Ciudad Juarez, must contend with spiraling wages and prices that threaten to wipe out peso devaluation gains.

wages are permitted to rise. As part of the bail-out plan, Mexico is required to rein in its central bank and its over-expansive monetary policy as well as to hold the line against inflationary pressures.

The austerity program, finally announced on March 9, contained bitter medicine for the Mexican people:

- raising the value added tax from 10 percent to 15 percent;
- increasing the price of gasoline by 35 percent, with additional 0.8 percent per month hikes throughout the year;
- increasing the price of electricity by 20 percent; and
- cutting government spending by 10 percent by scrapping planned infrastructure projects, laying off government workers and reorganizing departments.

These measures are expected to virtually eliminate the current account deficit and stabilize the peso's value at about six to the dollar. But this progress comes at high cost. The government estimates that in 1995 Mexico's output of goods and services will drop by 2 percent, 750,000 workers will lose their jobs and inflation still will average 42 percent for the year. Private sector forecasts are even more pessimistic.

At first glance, the austerity plan appears to be working. In the first quarter, Mexico's trade balance reversed, and the country ran a slight surplus. Exports grew 32 percent, aided by a 66 percent jump in exports from the Mexican factories of America's three major auto companies. Mexico already has retired \$16 billion of the \$29 billion in *tesobonos* maturing in 1995. The peso appears to have stabilized at about six to the dollar. While interest rates remain high, they are falling, and values on the bolsa have risen 40 percent from their March lows.

For the average Mexican, however, the current economic situation remains a crisis. In the first four months of 1995, prices rose nearly 24 percent. The interest rate on short-term government borrowing remains more than 60 percent. The shaky banking system is being battered by problem loans, which are estimated to total 10 percent of the nearly \$70 billion outstanding. Economic activity is at a standstill. Because one in two Mexicans is younger than 20 years of age, the country needs to create a million jobs a year just to stay even. Instead, more than half a million Mexican workers have already lost their job this year, and at least a quarter of a million more jobs are likely to disappear in the coming months.

Political Test

The austerity plan is tragic for a nation where per capita real incomes are perhaps as much as 10 percent below their 1980 level. Understandably, many Mexicans believe they have sacrificed long enough. Blaming the country's current problems on the Salinas reforms and believing that Mexico was not ready to be forcibly inserted into the international economy, they voice support for a return to the protectionist, heavily regulated economy of yesteryear.

While President Zedillo persuaded the major trade unions to agree to his austerity plan (albeit after-the-fact), the powerful business chamber, the Mexican Manufacturers Confederation, adamantly rejected it. Ordinary workers and proprietors of small and mid-size businesses view the plan as an unmitigated disaster. Fearing violence, Mexico's government-backed labor unions canceled their traditional May Day parade. But that didn't stop an estimated 70,000 independent union workers from thronging the Zocalo, the main plaza in Mexico City, to protest the massive job losses caused by Mexico's financial collapse. The major opposition party, the PAN, is taking advantage of the situation to make political gains in state and local elections.

President Zedillo, therefore, must play two demanding roles. As a tough fiscal administrator, he must persuade Mexicans to once again tighten their

belts to prevent devaluation gains from being wiped out by spiraling wages and prices. At the same time, as a political reformer, he must convince the different elements with his own party, the PRI, to willingly give up some of their traditional power. Leadership in the PRI is obviously concerned about the electoral fall-out from asking Mexicans to tighten their belt when they have the political freedom to express their discontent at the ballot box. Unfortunately, the more successful Zedillo is in reforming the party, the less power he has to successfully implement his austerity plan.

Texas Stake

Texas has a vital interest in the successful resolution of the economic problems south of the border. Approximately 40 percent of the state's international exports go to Mexico, and Texans account for one in six of the estimated 770,000 U.S. workers whose jobs depend on exports to Mexico. Moreover, the lower Rio Grande Valley leads the state in job growth year after year, largely as a result of wholesale and retail sales to Mexican consumers and businesses. Finally, illegal immi-

gration from Mexico affects labor markets throughout the state, particularly in the major cities.

While initially border job losses and store closings were widely reported, employment numbers in the major border cities for the first three months of 1995 show only a small decline in retail and wholesale trade and an overall growth in total jobs. However, the brunt of the impact from belt-tightening is likely to come in the second and third quarters. Overall, Mexico's economic problems are likely to knock about one-half percent off the growth rate of the Texas economy in 1995.

A Bright Future?

Many American companies have postponed investments in Mexico until a recovery is underway. But most have no plans to leave for good, for they see the longer term picture in Mexico as being very bright. The austerity plan should work toward economic stability by year-end, and a modest recovery could be underway by early 1996. For this to occur, however, it is essential that Mexico stay the course. President Zedillo is being pressured to lower interest rates and let prices and wages rise. While he might garner short-term political benefits by doing so, they will come only at the cost of prolonging the crisis. Only when Mexico has restored investor confidence can it begin to move forward once again. ☐

Dr. Hazleton is a research fellow with the Real Estate Center and director of the Center for Business and Economic Analysis at Texas A&M University.

*Texans account
for one in six of
the estimated 770,000
U.S. workers whose
jobs depend on exports
to Mexico.*

Brokers' Viewpoint

Impact of Habitat Protection on Property Values

By Ted C. Jones, Brittany A. Burnam,
Clinton H. Harrington and Roger J. Pelton

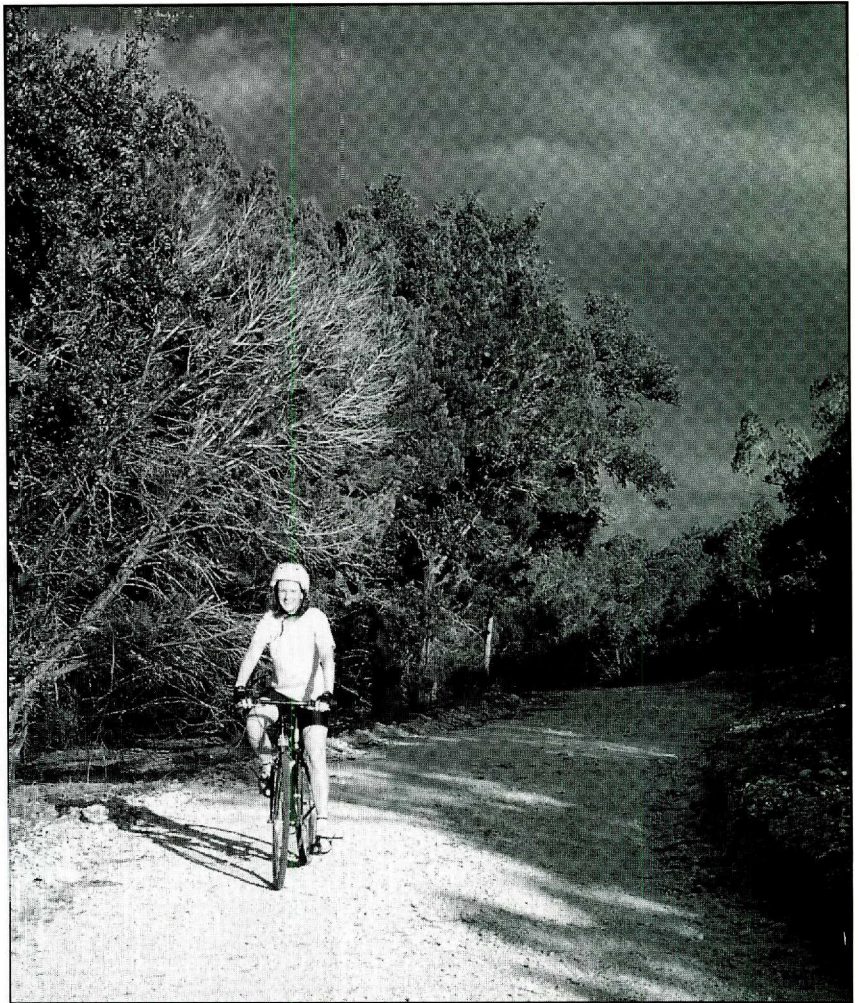
Since its inception, the Endangered Species Act (ESA) has been fiercely and emotionally debated by landowners and environmentalists, with each side emphasizing extreme positions. The full state-wide impact on

Texas is not yet known because many species are still under consideration for the endangered designation. For example, battle lines are now forming over the potential listing of the Arkansas River shiner in the Texas Panhandle.

The most direct method to measure ESA impact on Texas real estate markets would be a paired sales comparison approach used in the appraisal process. Such data, however, are limited and only give insight into historical transactions that may or may not contain the most current information.

The Real Estate Center surveyed 6,000 Texas real estate brokers in the fall of 1994 in an attempt to gauge the impact, if any, of the ESA on Texas real estate in the previous decade and in the next five years. Brokers were randomly selected who, at their last license renewal, indicated spending at least 50 percent of their time in some real estate activity.

Even in markets with designated habitat, not all property uses would be affected, nor would the impact on properties necessarily be equal. Six property types were analyzed: built-up urban real estate, developed but not-yet-built-on urban land, urban/suburban fringe land, transitional rural land, farmland and rangeland. Because habitat is not uniformly distributed across the state, any impact from the ESA was anticipated not to be equally distributed.



Mature Texas cedar trees are the battleground as both sides debate the value of the golden-cheeked warbler's habitat.

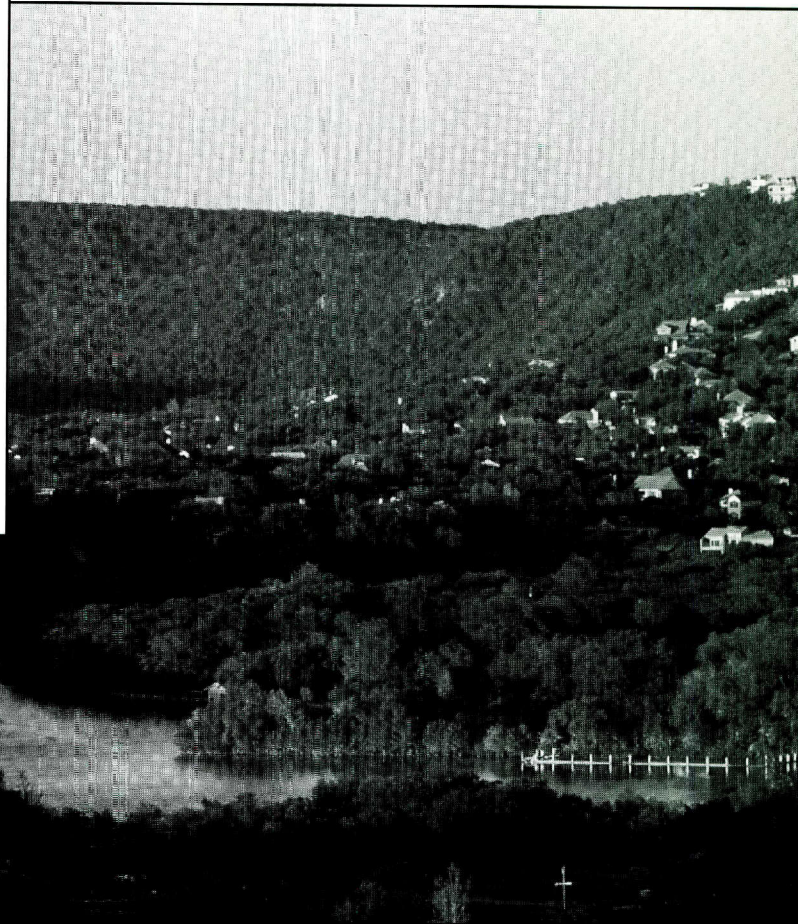
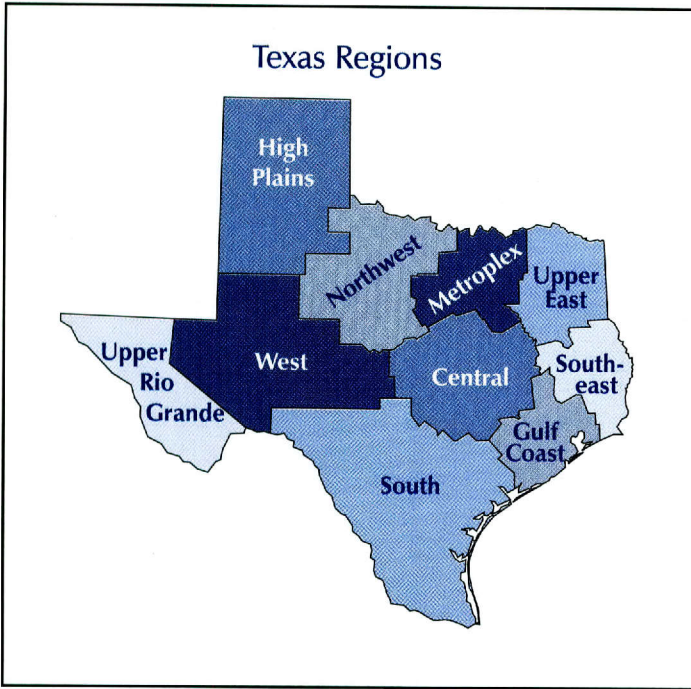
The survey included a map on which respondents shaded or colored the market area(s) on which their responses were based (Figure 1).

Impact on Total Sales

Risk is defined as uncertainty. To ascertain whether Texas real estate markets had an increased level of risk, respondents were asked if the ESA had changed the number of property sales across the entire market. Almost one-half of the respondents indicated that the impact of the ESA on the number of sales was unknown (Table 1). When these unknown responses are excluded, more than 70 percent of remaining respondents indicated a negative value impact on urban/suburban fringe land, transitional rural land, farmland and rangeland.

The two property types with greatest risk (buying and then not being able to develop) are urban/suburban fringe land and transitional rural land. For these higher-risk properties, most respondents indicated that the number of sales had declined as a result of the ESA. The level of uncertainty within the brokers, however, can not be overstated.

In the framework of modern finance, **the conclusion is that significant risk has been added to Texas real estate markets by the ESA.** In a



risk-return decision framework, the added risk can be compensated by an associated return that should be measurable in declining land values, or (as in the two higher-risk properties) reduced liquidity, or both.

Aggregate responses to changes in value, if any, in the past decade caused by the ESA in property having or suspected of having habitat for endangered species are listed in Table 2. If respondents indicated either positive or negative change in the first response, they were asked how much the property value had changed, on average, as a result of the ESA. Again, the majority of respondents indicated that values declined for urban-suburban fringe land and transitional rural land, with median declines of 20 and 25 percent and average declines in value of 29 and 28.6 percent, respectively. Following closely were drops in value for farmland (23.2 percent) and rangeland (24.3 percent). Average and median property value change estimates are listed at the bottom of Table 2, as is a 95 percent confidence interval of median property value declines.

Table 1. Effect of the Endangered Species Act on the Number of Texas Real Estate Sales

| | Increase Sales | No Change | Decrease Sales | Impact Unknown |
|---|---------------------|-----------|----------------|----------------|
| | Response Percentage | | | |
| Built-up urban real estate | 2.9 | 39.1 | 12.9 | 45.1 |
| Developed but not-yet-built-on urban land | 3.0 | 24.2 | 30.9 | 41.9 |
| Urban/suburban fringe land | 1.0 | 14.7 | 43.1 | 41.2 |
| Transitional rural land | 0.9 | 11.4 | 44.8 | 43.0 |
| Farmland | 0.6 | 15.0 | 33.2 | 51.2 |
| Rangeland | 0.9 | 12.3 | 35.5 | 51.4 |

Source: Real Estate Center at Texas A&M University

In the opinion of Texas brokers, the ESA has resulted in value declines ranging from one-fifth to one-fourth in all types of property other than built-up urban real estate. Given the large number of relatively consistent responses, the confidence intervals are moderately narrow and negative in all but the upper limit on built-up urban real estate.

The serenity of this scene on Lake Austin belies the tension created by the land-use debate.

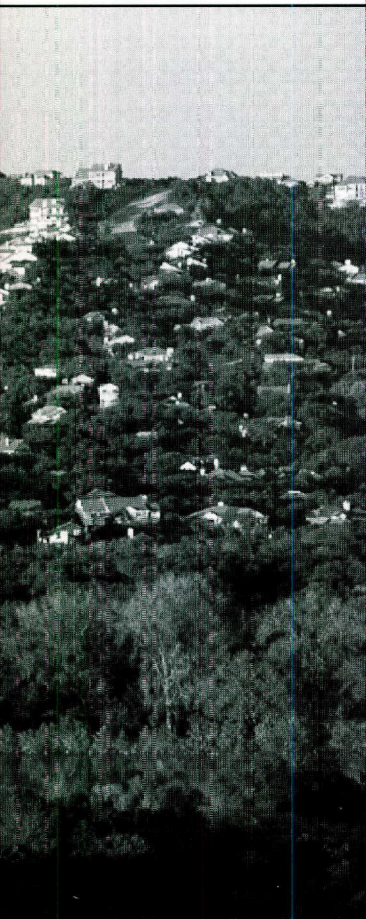


Table 2. Effect of the Endangered Species Act on Texas Real Estate in the Past Decade

| | Positive Value Impact | No Impact | Negative Value Impact | Impact Unknown |
|---|-----------------------|-----------|-----------------------|----------------|
| | Response Percentage | | | |
| Built-up urban real estate | 5.7 | 44.5 | 17.9 | 31.8 |
| Developed but not-yet-built-on urban land | 4.7 | 25.5 | 38.8 | 30.9 |
| Urban/suburban fringe land | 2.8 | 13.5 | 54.1 | 29.6 |
| Transitional rural land | 3.4 | 9.5 | 56.7 | 30.5 |
| Farmland | 2.9 | 13.8 | 45.7 | 37.6 |
| Rangeland | 3.2 | 11.5 | 46.8 | 38.4 |

Response Percentage on Value Change resulting from the ESA

| | Increase | Decrease | No Change |
|---|---------------------|----------|-----------|
| | Response Percentage | | |
| Built-up urban real estate | 20.1 | 51.8 | 28.1 |
| Developed but not-yet-built-on urban land | 9.6 | 79.7 | 10.6 |
| Urban/suburban fringe land | 5.0 | 90.6 | 4.4 |
| Transitional rural land | 4.5 | 92.9 | 2.6 |
| Farmland | 4.1 | 90.4 | 5.5 |
| Rangeland | 3.7 | 91.6 | 4.7 |

Estimated Value Change (Percent)

| | Average | 95 Percent Confidence Interval | | |
|---|---------|--------------------------------|--------|-------------|
| | | Lower Limit | Median | Upper Limit |
| Built-up urban real estate | -9.6 | -7.0 | -3.0 | 0 |
| Developed but not-yet-built-on urban land | -23.1 | -20.0 | -20.0 | -20.0 |
| Urban/suburban fringe land | -29.0 | -25.0 | -20.0 | -20.0 |
| Transitional rural land | -28.6 | -25.0 | -25.0 | -20.0 |
| Farmland | -23.2 | -20.0 | -20.0 | -15.0 |
| Rangeland | -24.3 | -20.0 | -20.0 | -17.0 |

Source: Real Estate Center at Texas A&M University

Travis County Data Support Survey

Regional analysis of the brokers' opinions indicated that the greatest value decline of transitional/suburban fringe land occurred in Central Texas with an estimated 40 percent drop in value (top half, Table 3). Separate from this survey

are data collected and analyzed by Charles E. Gilliland, associate research economist at the Center.

Gilliland's results coincide with the brokers' opinions. Gilliland's results are based on adjustments made by the Travis County Central Appraisal District to the assessed values of 727 properties. The land-owners furnished evidence of endangered or threatened species' habitat to the Central Appraisal District.

The adjusted properties were predominantly urban/suburban fringe land, for which the Central Appraisal

District reduced assessed values by 40 percent. The total reduced assessed value was \$50 million, or an average of \$68,775 per property. This separate approach, which used Travis County data and yielded identical results, supports the credibility of broker opinions.

Future Declines Anticipated

When the Texas brokers were queried about the impact of the ESA in the next five years, they

Texas has designated some 69 species as endangered or threatened (as of November 1994). A jaguarundi, protected under the ESA, peers warily at the world.

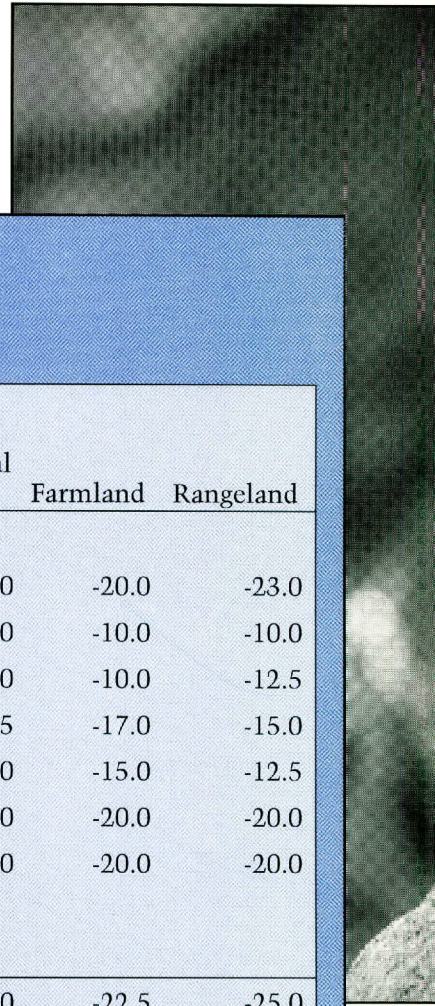


Table 3. Property Value Change
Estimated Median (percent)
Past Decade

| | Built-up Urban | Developed but Not- Yet-Built- on Urban | Urban/ Suburban Fringe | Transitional Rural | Farmland | Rangeland |
|------------------|-------------------|---|------------------------------|-----------------------|----------|-----------|
| High Plains | | | | | | |
| Northwest | | -25.0 | -35.0 | -25.0 | -20.0 | -23.0 |
| Metroplex | -3.0 | -11.0 | -18.5 | -15.0 | -10.0 | -10.0 |
| Upper East | -1.5 | -20.0 | -17.5 | -20.0 | -10.0 | -12.5 |
| Southeast | -12.5 | -20.0 | -20.0 | -17.5 | -17.0 | -15.0 |
| Gulf Coast | 0.0 | -12.5 | -20.0 | -20.0 | -15.0 | -12.5 |
| South | -5.0 | -20.0 | -25.0 | -25.0 | -20.0 | -20.0 |
| Central | 0.0 | -25.0 | -40.0 | -30.0 | -20.0 | -20.0 |
| Upper Rio Grande | | | | | | |
| West | | | | | | |
| Texas | -20.0 | -25.0 | -25.0 | -25.0 | -22.5 | -25.0 |

Next Five Years

| | Built-up Urban | Developed but Not- Yet-Built- on Urban | Urban/ Suburban Fringe | Transitional Rural | Farmland | Rangeland |
|------------------|-------------------|---|------------------------------|-----------------------|----------|-----------|
| High Plains | | | | | | |
| Northwest | | -17.5 | -30.0 | -30.0 | -17.5 | -27.5 |
| Metroplex | -1.5 | -12.0 | -15.0 | -20.0 | -15.0 | -20.0 |
| Upper East | -5.0 | -15.0 | -17.5 | -15.0 | -15.0 | -10.0 |
| Southeast | -5.0 | -13.5 | -20.0 | -17.5 | -15.0 | -12.5 |
| Gulf Coast | 0.0 | -10.0 | -20.0 | -20.0 | -17.5 | -15.0 |
| South | -10.0 | -20.0 | -20.0 | -20.0 | -15.0 | -20.0 |
| Central | 0.0 | -15.0 | -25.0 | -25.0 | -20.0 | -20.0 |
| Upper Rio Grande | | | | | | |
| West | | | | | | |
| Texas | -12.5 | -20.0 | -25.0 | -25.0 | -20.0 | -25.0 |

Note: Missing data had too few observations for statistical reliability.
Source: Real Estate Center at Texas A&M University.



estimated a further 20 percent decline in all but urban properties. In every instance, the confidence intervals imply declining values for all property types (Table 4). Regionalized breakdowns as projected for the next five years are in Table 3.

Uncertainties and restrictions established by the ESA are creating greater risk in Texas real estate markets, particularly for parcels that, while poised for a change in highest and best use, may be unchangeable. Opinion summaries of Texas real estate brokers indicate that this higher level of risk is being compensated by reduced property values and reduced liquidity in an already relatively illiquid commodity.

Estimated median value declines in the past decade resulting from property being or suspected of being endangered species habitat ranged from -20 to -25 percent for all types of property other than built-up urban real estate. Confidence intervals of estimated median value declines based on a 95 percent level ranged from -15 to -25 percent. Corresponding estimated average price declines for those same nonurban parcels ranged from -23.2 to -29 percent.

Safety Net

Endangered Species Act

The federal Endangered Species Act (ESA) was originally enacted in 1973 and has been reauthorized five times. Among other things, it provides a mechanism to protect the habitat of plants and animals that are classified as endangered or threatened with extinction.

Individual violators of the ESA are subject to a \$100,000 fine and one year in a federal prison. Organizations caught in violation may be fined \$200,000. A violation occurs when an individual or organization means to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture or collect an endangered species. It is a violation even to attempt such conduct. Property used in violations is subject to forfeiture. Individuals who provide information that leads to a civil penalty or criminal conviction may be eligible for cash awards.

Nationwide, the number of plants and animals designated as endangered or threatened has grown from 109 in 1973 to more than 1,400 today. An additional 3,700 are being considered. Two federal agencies, the U.S. Fish and Wildlife Service and the National Marine Fisheries Service, are responsible for assigning either the endangered or threatened status.

An endangered species is defined as "any species which is in danger of extinction throughout all or a significant portion of its range." Threatened species are those likely to become an endangered species within the foreseeable future throughout all or a significant portion of its range." Such designations are to be assigned exclusively on a scientific basis, ignoring both politics and economics. Once such an assignment is made, no development of any parcel that is considered to be habitat of designated plants or animals is allowed without the consent of these federal agencies.

Texas had 69 species designated as either endangered or threatened as of November 1994. Beyond the highly publicized golden checked warbler, whooping crane, Houston toad and Rio Grande silvery minnow, others include the Mexican long-nose bat, Louisiana black bear, Mexican spotted owl, brown pelican, San Marcos and Texas blind salamanders and numerous sea turtles. Other animal species include the fountain darter, Tooth Cave ground beetle, Attwater's greater prairie-chicken, Leon Springs pupfish, Concho water snake and the least tern.

Plants represented 27 of the designated Texas species. Examples include the black lace cactus, slender rush pea, star cactus, Texas wild rice, Navasota ladies'-tresses and Texas snowbells. The diversity of plants and animals covers a wide range of the state.

Analysis of reduced property tax assessments of 40 percent on land known to contain habitat for endangered or threatened species in Travis County were identical to the brokers' estimates for the region. Projected property declines for the next five years, while not as great as those for the past ten years, are estimated to be negative.

Time will reveal the extent of aggregate property value impact from the ESA. Texas brokers who are active in the market believe that the impact has

been negative and will continue. While a few respondents indicate that property values have risen, the majority either do not know the impact or believe that values have declined. Much more uncertainty exists in Texas markets today—uncertainty attributable to the Endangered Species Act. □

Dr. Jones is chief economist, Burnam a graduate research assistant and Harrington and Pelton former graduate research assistants at the Center.

Table 4. Effect of the Endangered Species Act on Texas Real Estate in the Next Five Years

| | Positive Value Impact | No Impact | Negative Value Impact | Impact Unknown |
|---|-----------------------|-----------|-----------------------|----------------|
| | Response Percentage | | | |
| Built-up urban real estate | 7.8 | 35.6 | 24.7 | 31.8 |
| Developed but not-yet-built-on urban land | 6.3 | 20.0 | 46.9 | 26.8 |
| Urban/suburban fringe land | 3.8 | 9.5 | 61.4 | 25.4 |
| Transitional rural land | 3.4 | 5.2 | 65.7 | 25.7 |
| Farmland | 3.3 | 9.2 | 55.6 | 31.9 |
| Rangeland | 3.6 | 7.2 | 56.3 | 32.9 |

Response Percentage on Value Change Resulting from the ESA

| | Increase | Decrease | No Change |
|---|---------------------|----------|-----------|
| | Response Percentage | | |
| Built-up urban real estate | 28.5 | 72.7 | 19.0 |
| Developed but not-yet-built-on urban land | 11.6 | 81.1 | 7.3 |
| Urban/suburban fringe land | 5.6 | 90.9 | 3.5 |
| Transitional rural land | 4.8 | 93.9 | 1.3 |
| Farmland | 4.9 | 92.3 | 2.9 |
| Rangeland | 4.7 | 92.7 | 2.6 |

Estimated Value Change (Percent)

| | Average | 95 Percent Confidence Interval | | |
|---|---------|--------------------------------|--------|-------------|
| | | Lower Limit | Median | Upper Limit |
| Built-up urban real estate | -10.3 | -7.0 | -5.0 | -5.0 |
| Developed but not-yet-built-on urban land | -20.2 | -20.0 | -15.0 | -12.0 |
| Urban/suburban fringe land | -25.6 | -25.0 | -20.0 | -20.0 |
| Transitional rural land | -27.0 | -25.0 | -20.0 | -20.0 |
| Farmland | -23.7 | -20.0 | -20.0 | -17.0 |
| Rangeland | -25.1 | -20.0 | -20.0 | -20.0 |

Source: Real Estate Center at Texas A&M University

Intangible Assets

Owners, Assessors Face Off

By Charles E. Gilliland

A new and potentially potent issue is emerging as an arena of confrontation between property taxpayers and assessment officials. The controversy centers on real estate valuation and the intangible personal property exemption.

Specifically, some business owners have realized that a portion of their apparent real estate value may result from intangible assets like goodwill. In Texas, these intangible assets should be excluded from tax assessments. Faced with the prospect of a dwindling tax base and consequently higher tax burdens on the remaining taxpayers, assessment officials have disputed some of these claimed exemptions. Reviewing the concepts of value and the property tax system's exemption provisions sheds light on this controversy.

Property taxes exact a proportion of taxable property value for government each year. At its inception in an agrarian age, values changed slowly, and most property was held as real estate. Personal property included livestock, household furniture, some equipment and valuable personal effects, such as watches. Assessors and property owners paid little attention to noncorporeal property because few intangible assets existed.

As society and the economy evolved, more wealth became invested in nonphysical assets and intangibles assumed greater importance. In addition to the usual tangible items, individuals began to acquire stocks, bonds, bank accounts and other nonphysical properties. However, discovering and listing such wealth was extremely difficult, if not impossible. Furthermore, establishing the market-tested value for many of those items was a nettlesome problem. As a result, much of this kind of taxable property went untaxed. This dilemma led many states, including Texas, to formally exempt intangibles from the annual property tax levy.

Because property tax rates had been relatively low, Texas taxpayers initially took little note of the intangibles exemption. As effective tax rates have risen, however, owners of unique and complex properties have begun to search for ways to limit overall tax liability. Identifying and eliminating taxes on intangible assets may provide a legal and effective method of cutting property taxes. Attempts to identify intangible value promises to emerge as an

area of controversy in property taxation for some time to come.

Intangibles in Property Taxation

The Texas *Property Tax Code* defines *intangible personal property* as

... a claim, interest (other than an interest in tangible property), right, or other thing that has value but cannot be seen, felt, weighed, measured, or otherwise perceived by the senses, although its existence may be evidenced by a document. It includes a stock, bond, note or account receivable, franchise, license or permit, demand or time deposit, certificate of deposit, share account, share certificate account, share deposit account, insurance policy, annuity, pension, cause of action, contract, and goodwill.

At first, this catalog of exempted items appears to be clear-cut, but reflection reveals potential gray areas. For example, when an operating business sells, how much of the purchase price results from the physical real estate and how much accrues to "goodwill?" Once the question of business operation becomes an issue, the seemingly clear-cut distinction between intangible assets and real estate and tangible assets blurs.

Consider the example of bare farmland. The founder of a well-known agricultural service was fond of saying that "there is more in the man than there is in the land." This assertion recognizes that a superior farmer achieves exceptional results through management skills. The capitalized value of income from such an individual's farming operation would exceed the market value of tangible assets used in the operation. However, an active market for these assets limits land and equipment values. The "extra" value in the farming enterprise accrues to the farmer. That extra value reflects the skill of the farmer and is an intangible asset. Because a competitive market provides independent evidence of value of the tangible assets, this kind of intangible

asset is rarely the subject of controversy in property taxation.

Complications proliferate when the subject enterprise has a unique characteristic. For example, a franchised hamburger restaurant has exclusive use of the brand name for product plus the advantages conferred by the management system, national advertising campaign and purchasing power of the franchising organization. Clearly, these advantages confer value on the restaurant enterprise in excess of the value of the building, land and equipment. Basing value on the income stream to such a property risks attributing some of that exempt intangible value to the tangible assets.

Intangibles encompass a wide variety of the business facets that permit recognition of the enterprise as a functioning entity. Prominent among the intangible items are franchises that create an identity for a business and provide instant credibility. Affiliation with a nationally franchised hotel communicates an expected set of goods and services enticing the public to patronize those establishments authorized to use that name to the neglect of locally owned hostelrys of equal quality. Payments made by the hotel to the franchiser provide one indicator of the value implied by the franchise; however, the value of the franchise to the enterprise must exceed the discounted value of these payments in all but the marginal hotel. Otherwise, the hotel owner would be indifferent between maintaining the franchise or letting it lapse. Thus, the capitalized value of franchise payments represents a minimum value for that franchise. However, attempting to establish a defensible estimate of the value of the franchise to the operating enterprise leads to complicated and legally unresolved issues in Texas. The picture becomes even more murky when such nebulous items as goodwill, an assembled workforce and other such assets exert a substantive influence on business value.

Accounting concepts provide some guidance in dealing with these difficult issues by classifying intangibles according to their attributes. Accountants differentiate between intangibles that can be *identified* or separated and sold independently from the business and those inextricably joined to the going concern. Franchises, patents, copyrights, licenses and even trademarks have the potential of being separated from the business and sold. In essence, these items have achieved status as a distinct asset.

An assembled workforce, established sources of supply and goodwill, however, are examples of assets that cannot be disposed separately from the business. This kind of asset is *nonidentifiable* and the subject of much dispute in the debate on taxation of intangible assets. In fact, some theorists and property tax administrators dispute the idea that nonidentifiable intangibles deserve recognition as separate assets. They argue that any value generated by those assets is similar to the influence of a spectacular view on land values. It has become an intrinsic part of the operating property and should not be separated. Like the spectacular view, the nonidentifiable intangibles have essentially become part of the real estate. Texas courts have not ruled on these issues.

Adding complexity to this situation, valuation of intangibles is a vexing problem in itself. To the extent that they could be purchased and sold, identifiable assets present the possibility of direct market valuation. However, the character of nonidentifiable assets preclude the possibility of direct market valuation and require allocation of the value of the entire enterprise to its various assets.

Identifiable intangible assets with clearly recognized influences on business income can be valued using traditional cost, sales comparison or income approach techniques. For example, a patent promising to provide measurable returns to a business for a specified period could be sold to another business. An appraiser could estimate the value of that patent by totaling the cost of developing the technology plus legal costs incurred in enforcing the patent less the portion of patent costs already realized.

Cost does not always equal value. Therefore, if similar patents are routinely exchanged in the market, application of the sales comparison approach strongly indicate market value. Such sales are frequently private, however, limiting the information available to appraisers and making sales comparison applications unlikely for estimating the value of intangibles. Finally, the patent's effect on income to the enterprise could be identified and capitalized. Although complicated in the details of application, valuation of identifiable intangible assets can be a straightforward extension of familiar appraisal techniques.

Nonidentifiable intangibles present an entirely different and much more difficult appraisal problem. By definition, these assets have no value apart from the ongoing business. They are inextricably wrapped in going concern value, and valuation must be accomplished indirectly. In essence, the value must be extracted from the business enterprise value. In other words, the enterprise is appraised and values of tangible and identifiable intangible assets are then removed from that unit value. Presumably, the remaining value represents value accruing to nonidentifiable intangible assets. As a practical matter, valuation questions involving intangibles and property taxes probably will involve the income approach to the exclusion of the cost and sales comparison approaches.



Texas property tax laws that dealt with the appraisal of intangibles had conformed to a similar process. For example, before Texas law exempted intangibles of transportation companies, the comptroller appraised those properties by estimating an *intangibles residual value*. The appraisal formula began with an estimate of the market value of the operating property that could be reasonably assigned to Texas. Next, the comptroller obtained an appraisal of the tangible operating properties. The tangible value was then deducted from the business value to leave the residual intangible value.

Although the issues surrounding claims of intangible exemptions have not proceeded through Texas courts, California taxpayers and assessors have fought a series of legal battles over similar provisions in California's tax laws. The experience of California taxpayers indicates that exemption of intangibles may not excuse as much value from taxation as suggested by the statutes. California taxpayers expected to escape taxation of intangible values when the exemption was adopted. However, in 1948 the courts ruled that although the value of a license was exempt from taxation, the assessor could take the effect that the presence of that license had on the value of the real property into account when appraising the real estate.

Through the years, California assessors have sought to access such values for their tax base. These efforts resulted in a number of notable courtroom confrontations including the case of *Service America Corp v. County of San Diego*. The courts ruled that the assessor erred when he included the entire income stream from a firm holding concession rights at a publicly owned stadium. Obviously, the court ruled, the part of the income resulting from exempt intangibles should be excluded from Service America's taxable value. But the court further declared that the exclusive nature of the concession agreement obviously contributed to profitability and that the county could not overlook that fact in estimating a value. The decision gives precious little guidance about how to take the influence of intangibles into account but states that the

taxable value should be less than the value derived by capitalizing the entire income stream for Service America. The court admitted that the final valuation would ". . . bear some characteristics of arbitrary selection."

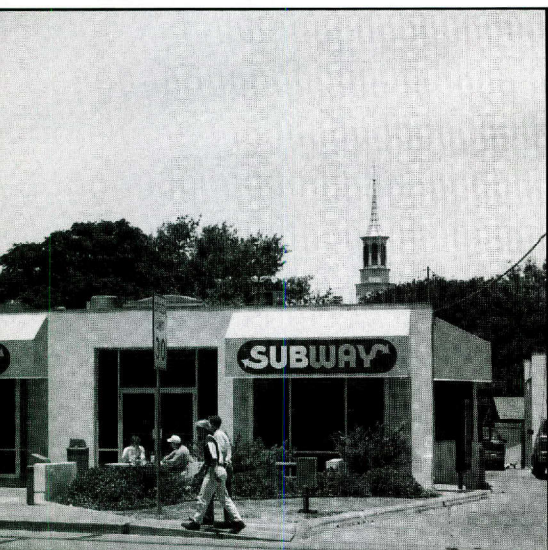
In the case of *Shubat v. Sutter County Assessment Appeals Board*, the court had more valuation information to consider. The case involved the allocation of value between intangibles and taxable tangible values of the Nor Cal Cablevision Company. The assessor used a sales comparison approach, having a sale involving the firm in question. After making some adjustments, the assessor allocated amounts to the taxable tangible items and the remaining \$16.2 million to a single intangible possessory interest in publicly owned rights of way, which were taxable under California laws.

Nor Cal objected, contending that its subscriber list, franchise operating rights, a lease, assembled workforce, noncompete agreement and going concern value were all nontaxable intangibles that had been ignored by the assessor. Nor Cal's appraiser employed an excess earnings approach to value the intangibles of the company. The net income was allocated among the intangibles using income approach techniques to substantiate the allocation. Nor Cal's resulting estimate of the value of the taxable possessory interest was \$4 million.

The board substantially agreed with Nor Cal's analysis but adjusted to arrive at a value for the possessory interest of \$6.01 million. The assessor objected and initiated the court action to restore the original value. However, the court found Nor Cal's appraiser and his thorough analysis to be overwhelming valuation evidence and accepted the appeal board's decision.

In the first two California cases, the courts refused to consider all business value irrelevant when setting taxable values. The third case indicates that taxpayers must present a well reasoned case, founded in accepted appraisal methodology, to prevail in a claim of exempted intangible value. The crucial element is the reasonableness of the individual's position and thorough documentation.

Exemption of intangibles raises numerous thorny questions for properties that combine a variety of legal and social functions to provide a product or service. Separating the value of the tangible properties from the value residing in the intangibles requires expert knowledge of both the markets and processes involved. Many issues of the problem remain to be resolved in terms of identifying acceptable and unacceptable methods of deriving a market value for intangibles in a going concern enterprise. Taxpayers should concentrate on sustainable estimates of market value for their real estate and tangible assets if possible. When an appraisal of intangibles becomes necessary, the resolution will depend on the knowledge, experience and abilities of the valuation experts analyzing the problems. □



Prominent among intangibles are franchise names that create an identity for a business and provide instant credibility.

Dr. Gilliland is an associate research economist with the Real Estate Center at Texas A&M University.

Texas Tax Code

Unique Provisions She

By Judon Fambrough

With a rise in real estate market values comes a corresponding rise in property taxes. People scheme and dream of ways to avoid paying taxes, but these efforts generally fail.

Texas landowners, however, might take advantage of the unique provisions in the Texas Tax Code—legally. The provisions may not lower the tax bill, but they do apprise landowners of their rights and alternatives.

First, some basic information. Property taxes create a personal obligation (liability) for the owner each January 1. Subsequent sale of the property does not remove the liability. If the property is residential and held by a trust qualifying for the homestead tax exemption, both the trust and trustor (the person who transferred the property to the trust) are jointly liable for the tax.

The assessors for each taxing unit mail tax bills to landowners by October 1 or soon thereafter. Each taxing unit may allow a discount for early payment. The discounts, if permitted, are 3 percent if paid in October, 2 percent in November and 1 percent in December. Different discounts are permitted if the tax bills are mailed after September 30. The taxes are delinquent if not paid by February 1.

Delinquent taxes incur a penalty of 6 percent the first month plus 1 percent for each additional month they remain unpaid until July 1. After this date, the taxes incur a 12 percent penalty regardless of the length of delinquency. In addition to the penalties, the delinquent taxes accrue 1 percent interest each month.

Waivers of penalties and interest are permitted in limited circumstances. For example, waivers were granted to eligible persons serving on active duty during the Persian Gulf War. The other circumstances entail mistakes caused by the taxing unit or appraisal district, such as mailing the tax bill to the wrong address. Generally, taxpayers must file a formal request for the waiver within six months of the delinquency.

In addition to penalties and interest, the taxing units are entitled to recover certain other costs and expenses in a suit to collect delinquent taxes:

- usual court costs, including service of process,
- costs for filing *lis pendens* against the property,
- expenses of the foreclosure sale,
- reasonable expenses incurred in determining the name, identity and location of necessary parties and also in procuring the legal description of the property, and
- reasonable attorney's fees, not to exceed 15 percent of the total amount of taxes, penalties and interest due.



All real property not subject to an exemption is appraised for tax purposes at its market value on January 1 of each year. Generally accepted appraisal techniques must be used. However, if the property is located in an area later declared a natural disaster by the governor, the taxing unit may authorize reappraisal of damaged property at the market value immediately following the disaster.

Restrict Use, Save Taxes

The tax code describes several special appraisal techniques for qualifying property. Open-space and agricultural use are the two most popular. A lesser known technique exists for property subject to deed restrictions. Here are the requirements.

An owner of at least five acres may restrict the use of the property to recreational, park or scenic purposes. To do so, the owner must file with the county clerk a written instrument in the form and manner of a deed. The term length, a minimum of ten years, must be stated in the filed document.

Note. The phrase "recreational, park or scenic use" is defined in the tax code.

The owner then is entitled to have the property valued subject to the restriction if four conditions are met.

1. The owner devoted the land exclusively to the restricted use during the preceding year.
2. The owner files a formal application for the special valuation with the chief appraiser before May 1.

Alter Property Owners



The tax code describes several special appraisal techniques for qualifying property. Open-space and agricultural use are the two most popular.

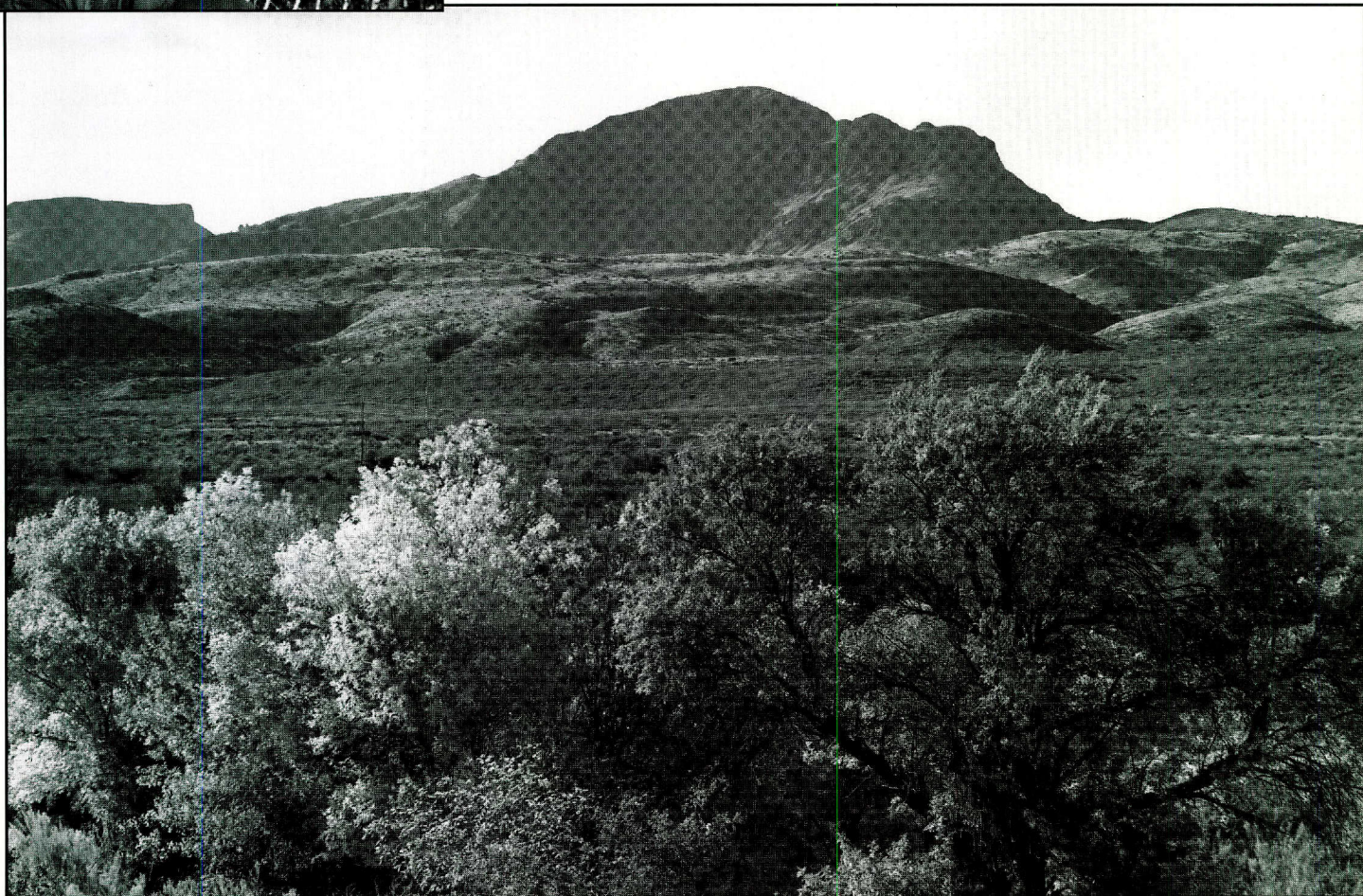
3. The owner intends to use the land in compliance with the deed restriction for the duration of the current year.
4. The owner does not generate a financial gain in excess of the reasonable allowances for salaries or other compensable services.

The ownership of an undivided surface interest and an undivided mineral interest is listed differently on the tax rolls. Undivided surface interests are listed jointly while undivided mineral interests are listed separately. However, either can be listed the other way if a formal request is made to the appraisal office before May 1.

After the taxes become delinquent (February 1), the taxing unit may file a lawsuit to collect the taxes, penalties, interest and costs due. The lawsuit may seek to foreclose the tax lien on the property or to acquire a personal judgment against the owner, or both.

Special Treatment for Foreclosure Sales

The tax code affords special treatment to co-owners (owners of an undivided interest) facing a tax foreclosure sale. One or more of the owners



may have the property partitioned as prescribed by law. The court apportions the taxes, penalties, interest and costs among the various owners according to their undivided interest. As part of the costs, the court allows reasonable attorney's fees and other expenses associated with the partitioning. An owner may be dismissed from the lawsuit by paying his or her apportioned share.

Taxing units contemplating the foreclosure of a tax lien must determine the priority of the lien over other existing liens on the property. The highest priority lien is satisfied first with the proceeds from the sale. All subordinate liens are eliminated. Here are the rules:

- If a federal tax lien exists on the property, federal law dictates priority. In the absence of federal law, the taxing unit's lien takes priority.
- If the property is the taxpayer's homestead, the tax lien prevails over any homestead interest.
- If property is subject to a creditor's lien, secured or unsecured, the tax lien takes priority. All creditors' claims are extinguished against the property by the tax sale.

A tax lien, however, is inferior to claims for any survivor's allowance, funeral expenses or expenses from the last illness. Similarly, the lien is inferior to any recorded restrictive covenant running with the land or any valid easement, as long as either was recorded before the inception of the tax lien on January 1.

Transferring the Tax Lien

A unique provision of the tax code permits the transfer of a tax lien from the collector of the taxing unit to a third party. To do so, the delinquent taxpayer must authorize another to pay the delinquent taxes, penalties and interest by filing a sworn document with the collector. The collector certifies the payment when received and transfers the tax lien to the third party (payor). The instrument transferring the lien must be recorded to be enforceable.

The payor is entitled to charge no more than 10 percent annually on the taxes, penalties, interest and recording fees paid on the property owner's behalf. If the property owner does not reimburse the payor within one year, the payor may foreclose on the tax lien. In this case, the payor may recover attorney's fees not to exceed 10 percent of the amount of the judgment.

The lien transfer vests existing lienholders with certain rights. Any pre-existing lienholder may purchase the tax lien within six months after the lien is transferred to the payor. Thereafter, the lienholder may foreclose on the tax lien in the same manner and time frame as the payor.

If the holder of the transferred lien forecloses, the tax code details exactly how the proceeds are distributed. First, the court costs are paid, followed by the judgment (with accrued interest) and attorney's fees. Second, the lienholders are paid in the order of their priority. And finally, any remaining proceeds go to the property owner.

Following the tax foreclosure sale, either the **first lienholder** or the **property owner** has one year to

redeem the property. The redemption price is the lesser of the purchase price, costs and accrued interest on the judgment or 110 percent of purchase price. If the property owner redeems the property, existing liens not extinguished by the proceeds from the tax sale remain in effect.

Funds Kept Seven Years

If the taxing authorities foreclose rather than the transferee of a tax lien, the legal process remains unchanged. The procedure general creditors use to seize and sell a debtor's nonexempt property is followed. Generally, this entails the sheriff's conducting a public auction. However, the rights of the property owner and existing lienholders change in at least four significant ways when the taxing authorities foreclose.

First, upon the request of the property owner, only the amount of land necessary to cover the delinquent taxes, penalties, interest and costs is sold. The sheriff (party conducting the sale) divides the land accordingly for the sale.

Second, the highest bidder at the foreclosure sale receives title to the property subject to two exceptions. The tax code prohibits the sale to an owner of the property for less than its market value or the aggregate amount of the judgment against the land, whichever is less. Consequently, if the highest bid is from the owner but less than the specified amount, the highest bidder will not get the property.

The other exception is similar. If the highest bid is insufficient to cover the adjudged amount due (taxes, penalties, interest and costs), the sheriff bids the property for its market value or the adjudged amount due, whichever is less, on behalf of a taxing unit holding the lien. The taxing unit then receives title and may resell the property if not redeemed.

Third, the proceeds from the sale are handled differently. First, the costs of the sale are paid, followed by the tax liens held by the various taxing units. If the amount is insufficient to retire the liens, all taxing units share proportionately. If the amount is sufficient to retire the tax liens, however, the sheriff gives the excess to the clerk of the court ordering the sale.

The court clerk must keep the funds for seven years. During this time, any person having a claim may petition the court. If the claim is found valid, the court will order disbursement. No interest or costs are recoverable. The tax code mentions no priority among the claimants. Presumably lienholders would be paid before the property owner. If no petition is filed within seven years, the funds go to the taxing units.

Fourth, only the prior owner may redeem the property after the sale. Lienholders have no right of redemption. The redemptive period lasts from six months to two years, depending on the type of property. ☐

Fambrough is an attorney, member of the State Bar of Texas and senior lecturer with the Real Estate Center at Texas A&M University.

To Buy or Not to Buy?

The Affordability, Sales Link

By Jack C. Harris

Texas housing has never been more affordable. Consequently, sales have been buoyant. In fact, sales (as tracked by Multiple Listing Service statistics) in most areas were higher in 1993 and 1994 than anytime since the early 1980s. Such trends support the common sense idea that affordable conditions draw out homebuyers. Yet the association between affordability and sales volume is not as strong in some markets as it is in

others; in a few areas sales have tailed off despite improving affordability.

The importance of the link between affordability and sales is emphasized by the recent reversal in mortgage interest rates. If rates begin to rise again, will this end the sales boom? If so, which markets are most susceptible?

Interest Rates and Affordability

Masures of housing affordability focus on the typical household's difficulty in arranging financing to purchase the standard home sold in the local market. Although one of the biggest obstacles, particularly for first-time buyers, is the cash down payment, statistical measures of affordability commonly bypass this problem to concentrate on the threshold income required to qualify for a mortgage loan. The down payment hurdle is not considered trivial, but data on household liquid wealth are not available on a timely basis; income data are accessible. Therefore, researchers are left with an imperfect affordability measure.

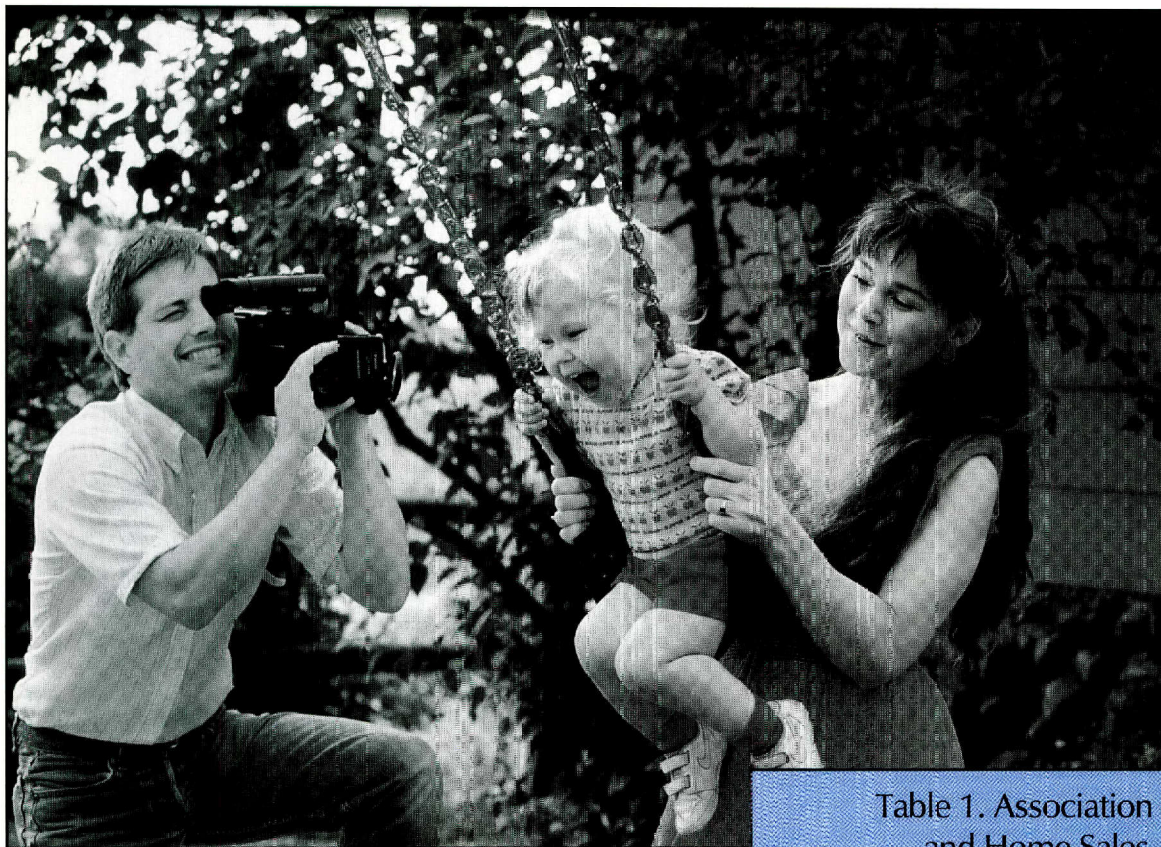
The Texas Housing Affordability Index (THAI) is such an indicator of affordability. The THAI compares an area's median household income to the income needed to qualify for a mortgage loan—at prevailing interest rates—large enough to buy the median priced home for that area. The basic index (supplemental indexes relax this assumption) assumes that all households have sufficient wealth to make a 20 percent down payment.



The down payment assumption may overstate the level of affordability in a market, but it should not affect the way affordability changes over time. Therefore, the THAI seems an appropriate measure to compare affordability changes to changes in market sales volume. Most of the change in affordability over time is caused by changes in mortgage interest rates. The prevailing fall in interest rates during the past six years explains why affordability steadily improved.

For much of 1994, the Federal Reserve Board worked to reverse that decline. In their view, higher interest rates were necessary to deflect inflationary tendencies in the economy. Hardest hit were short-term interest rates. The national average prime rate charged by commercial banks increased from 6 percent at the beginning of 1994 to 9 percent by early 1995. Long-term rates experienced similar, though milder, increases. The average contract rate on fixed-rate mortgage loans went from slightly more than 7 percent to 9.2 percent during 1994.

The effect on affordability was dampened. The THAI for the first quarter of 1994 was the highest on record, and, even by the end of the year, the level was not significantly lower than the previous year. One reason is that incomes rose faster than home prices in most areas. However, the main reason stems from using an interest rate for THAI that is an average of loans actually closed in local areas. That is, it reflects both fixed- and adjustable-rate loans. Because adjustable-rate mortgages carry



Areas with higher percentages of households with heads 35 years old and younger have a greater correlation between affordability and sales.

lower interest rates than fixed-rate loans, any shift to adjustables causes the average to rise much slower than the fixed-rate alone.

Thus, the average contract rate in Dallas-Fort Worth rose only from 6.73 to 7.07 percent during 1994, while in Houston it went from 6.81 to 7.36 percent. In the fourth quarter of 1994, 61 percent of Dallas area homebuyers financed through adjustable-rate mortgages. In Houston, the share was 33 percent. A year earlier, the proportion of adjustables was negligible in both markets.

The good news in this story is the strong motivation homebuyers have shown to find a way to purchase in the face of higher interest rates. Many are willing to take on the risk of adjustable rates to keep buying a home a viable prospect. The bad news is less room for further shifting; if interest rates climb, affordability will suffer.

In sustaining a housing market, strength of buyer motivation is the most important ingredient. Local residents must want to upgrade their housing, and new households must be attracted to the area to generate sales. Potential buyers must feel sufficiently financially secure to take on the obligations of buying a new home. If these conditions are satisfied, affordability then will determine if they can proceed with their plans. Affordability alone will not create sales, but its absence can stifle potential sales.

Varying Influence of Affordability

As noted, most Texas markets enjoyed growing volume when affordability was improving. The revised THAI has been calculated for reporting Texas MLS areas from 1989 to the present. In the

Table 1. Association of Affordability and Home Sales, 1989-94

| MLS Area | Coefficient (percent) |
|-----------------------|-----------------------|
| Lubbock | 90.9 |
| Bryan-College Station | 88.3 |
| Wichita Falls | 88.2 |
| Corpus Christi | 87.8 |
| Austin | 87.4 |
| Temple-Belton | 86.0 |
| Dallas | 85.7 |
| San Angelo | 83.9 |
| San Antonio | 81.8 |
| Brazoria County | 77.0 |
| Longview | 76.8 |
| Amarillo | 73.2 |
| Victoria | 69.1 |
| Texarkana | 66.9 |
| El Paso | 55.0 |
| Beaumont | 50.7 |
| Fort Worth | 43.9 |
| Sherman-Denison | 41.8 |
| Abilene | 41.0 |
| Port Arthur | 22.6 |
| Houston | 12.2 |
| Oceasa | -0.9 |

Source: Real Estate Center at Texas A&M University

first year of the series, index values were less than 1.00, indicating that fewer than half of area households could afford the median priced home. By 1994, all markets well exceeded 1.00, and many were more than 2.00 (the higher the index, the more affordable is the market).

The extent to which affordability is linked to sales can be measured by calculating a correlation coefficient between an area's THAI value and the number of homes sold during the same period. This is just a statistical way to see how well changes in sales and changes in affordability coincide. Because the THAI is calculated on three-month periods, sales figures were gathered quarterly for the analysis. Quarterly sales figures are highly seasonal. Sales normally increase during the summer and fall but drop in the winter and spring. Affordability would not be expected to show a similar seasonal pattern. Therefore, to remove the interference of seasonal variation, the raw sales data were statistically deseasonalized. This procedure

yields a smoother series more indicative of the long-term trends in the data.

The resulting correlation coefficients (missing data prevented using all reporting MLS areas) are shown in Table 1. High coefficients suggest that affordability has influenced sales strongly in most areas. These markets may be considered the most susceptible to changes in affordability, that is, changes in interest rates. Areas with low coefficients apparently have been affected by factors that effectively counter the stimulus of improved affordability.

Admittedly, the strength of the correlation between two data series does not "prove" anything. Market volume could just happen to be increasing when THAI values are increasing. If so, the fact that some markets "correlate" would be meaningless. However, reason supports the theory that affordability affects sales in a market, and the fact that most markets show high correlation tends to confirm that expectation. The correlations are useful to point out those

In sustaining a housing market, strength of buyer motivation is the most important ingredient.

Table 2. Comparison of Ranks on THAI Sales and Related Measures

| Area | THAI-Sales Correlation | Home-ownership Rate* | Percent of Households Aged 15-35 | Percent of Single-family Stock Rented | Average Unemployment Rate 1990-94* | Change in Unemployment Rate 1990-94* |
|-----------------------|------------------------|----------------------|----------------------------------|---------------------------------------|------------------------------------|--------------------------------------|
| Lubbock | 1 | 6 | 4 | 4 | 4 | 9 |
| Bryan-College Station | 2 | 1 | 1 | 1 | 1 | 1 |
| Wichita Falls | 3 | 13 | 13 | 5 | 11 | 7 |
| Corpus Christi | 4 | 9 | 18 | 7 | 19 | 20 |
| Austin | 5 | 2 | 2 | 3 | 2 | 6 |
| Temple-Belton | 6 | 3 | 3 | 2 | 13 | 3 |
| Dallas | 7 | 5 | 5 | 19 | 8 | 11 |
| San Angelo | 8 | 12 | 14 | 8 | 5 | 5 |
| San Antonio | 9 | 8 | 15 | 11 | 9 | 2 |
| Brazoria County | 10 | 19 | 12 | 23 | 14 | 19 |
| Longview | 11 | 18 | 19 | 15 | 20 | 14 |
| Amarillo | 12 | 14 | 11 | 9 | 3 | 4 |
| Victoria | 13 | 15 | 17 | 10 | 6 | 15 |
| Texarkana | 14 | 23 | 22 | 21 | 18 | 21 |
| El Paso | 15 | 7 | 16 | 12 | 23 | 10 |
| Beaumont | 16 | 21 | 20 | 17 | 21 | 22 |
| Fort Worth | 17 | 10 | 6 | 20 | 10 | 12 |
| Sherman-Denison | 18 | 20 | 23 | 14 | 15 | 13 |
| Abilene | 19 | 11 | 8 | 6 | 7 | 8 |
| Port Arthur | 20 | 22 | 21 | 18 | 22 | 23 |
| Houston | 21 | 4 | 7 | 13 | 12 | 16 |
| Odessa | 22 | 16 | 10 | 16 | 17 | 18 |
| Midland | 23 | 17 | 9 | 22 | 16 | 17 |

*Ranked from low to high. All other columns are ranked from high to low.

Source: Real Estate Center at Texas A&M University

markets that do not follow the norm. There should be an explanation for why these markets behave in this way.

Market Response Varies

Affordability should produce more sales in markets with a relatively large number of potential new homebuyers. First-time homebuyers are most constrained by high interest rates and home prices and, therefore, more responsive to changes in affordability. These neophyte buyers are important to the whole housing market because they release current owners to move up the housing scale. Newcomers also play this role. Aside from migration, a market with a relatively low rate of homeownership, and, therefore, a large pool of renters should be more responsive to affordability.

The lower a city ranks in homeownership rate, the higher the correlation between affordability and sales is expected to be.

Among the ranks of renters are those who will never become homeowners, as well as former homeowners, who do not plan on owning again. To measure an area's potential new homebuyers, it may be better to focus on households in the age

group of first-time homebuyers. Younger households probably are most constrained by mortgage qualifying criteria that are reflected in the THAI. Consequently, a second expectation is that **areas with higher percentages of households with heads less than 35 years old have a higher correlation between affordability and sales.**

Another way to look at potential homebuyers is to concentrate on current renters who live in single-family homes. The logic here is that those who live in single-family homes are renting primarily for economic reasons rather than life-style choice or preference for more minimal, low-responsibility housing. Such renters may be induced to buy as the market becomes more affordable. Expect the **affordability-sales correlation to be higher in areas where a high percentage of the single-family stock is rented.**

Affordability also should be more persuasive when economic conditions encourage homebuying. During economic downturns when unemployment is high or increasing, fewer people feel confident enough to make major purchases. This explains why Texas housing markets performed so poorly in the late 1980s despite generally falling interest rates and home prices.

Areas with low or falling unemployment might be expected to have the highest correlation of affordability and sales.

Various measures were devised to test these ideas. Homeownership rates, percentage of households aged 15 to 35 and percentage of single-family homes rented were measured with data from the 1990 U.S.

Bureau of Census report on population and housing. Unemployment figures were taken from Texas Employment Commission data for 1990-94. Two measures were used: average unemployment rate and the absolute change in unemployment during the period. The areas for which correlation coefficients were calculated were ranked on each of these measures. The rankings were arranged to coincide with their expected relationship to the correlation coefficients. For example, homeownership was ranked from low to high because higher homeownership is expected to decrease the influence of affordability. It is easier to compare ranks this way because all rankings should be roughly in the same order.

Rankings are shown in Table 2. In general, each hypothesis is supported by the data although exceptions abound. Given such simplistic measures and techniques, a perfect fit should not be expected. In particular, the measures related to potential homebuyers are more successful in explaining the high correlation group than the low correlation group.

Areas where affordability was most dominant generally had relatively low homeownership rates. The exceptions were Brazoria County, Longview,

Texarkana and Wichita Falls. The first two cities had strong in-migration during the 1990s that could have made up for a lack of extant renters. The affordability dominant group also tended to have a high percentage of rental single-family housing. Exceptions were Brazoria County, Dallas and Texarkana. Each city in this group, except Corpus Christi and Longview, had low unemployment during the period.

Therefore, conditions were fertile for affordability to encourage homebuyers.

The story of the low correlation group appears to be economic. The four areas with lowest correlations—Houston, Port Arthur, Midland and Odessa—are heavily concentrated in the petroleum industry. Each has suffered significant unemployment increases in recent years. Furthermore, each market's sales peaked in 1990 or 1991. Improvements in affordability were fighting against both economic instability and a cyclical downturn in the market.

In summary, affordability appears to be an important factor in sparking home sales in the majority of Texas cities. Cities most affected had a large store of potential new buyers and enjoyed economic stability. Those whose markets flagged despite affordability gains were beset by rising unemployment. These areas may bounce back as their economic prospects improve, even if affordability diminishes. The areas where sales are highly correlated with affordability are more vulnerable to the effects of higher interest rates. ☐

Dr. Harris is a research economist with the Real Estate Center at Texas A&M University.

Tax Credit Attracts Investors, Creates Housing

By Wayne E. Etter

The Tax Credit for Low-Income Rental Housing Program (TCLIRHP), initially enacted as a temporary program through the 1986 Tax Reform Act, became a permanent program in 1993. The program's purpose is to encourage private sector development and rehabilitation of multifamily housing for lower-income individuals and families.

The TCLIRHP does not directly subsidize tenants or a low-income rental property's development, rehabilitation, financing or operation. Instead, the property's equity investors receive federal income tax credits in return for providing the rental housing at predetermined below-market rents.

Not all units in a TCLIRHP development need be for low-income individuals and families. As few as 20 percent of the units must be reserved for these persons if the units are occupied by households with incomes less than 50 percent of the area's median gross income; as few as 40 percent of the units need to be reserved for these persons if the units are occupied by households with incomes less than 60 percent of the area's median gross income. Thus, the property need not (and ordinarily does not) resemble typical public housing projects. Of course, tax credits are received only for that portion of the property allocated for low-income individuals and families.

State Allocates Tax Credit

The TCLIRHP provides investors with federal income tax credits which individual investors use to reduce their total federal income taxes up to a maximum of \$9,900 per investor per year. Corporations have no limit on the annual amount of tax credits they may use, although tax credits cannot be used to reduce a corporation's alternative minimum tax liability. Accordingly, corporations are important investors in TCLIRHP properties. And, although the TCLIRHP results in federal income tax credits for particular investors to construct or

rehabilitate selected multifamily housing projects, these tax credits are allocated by the states.

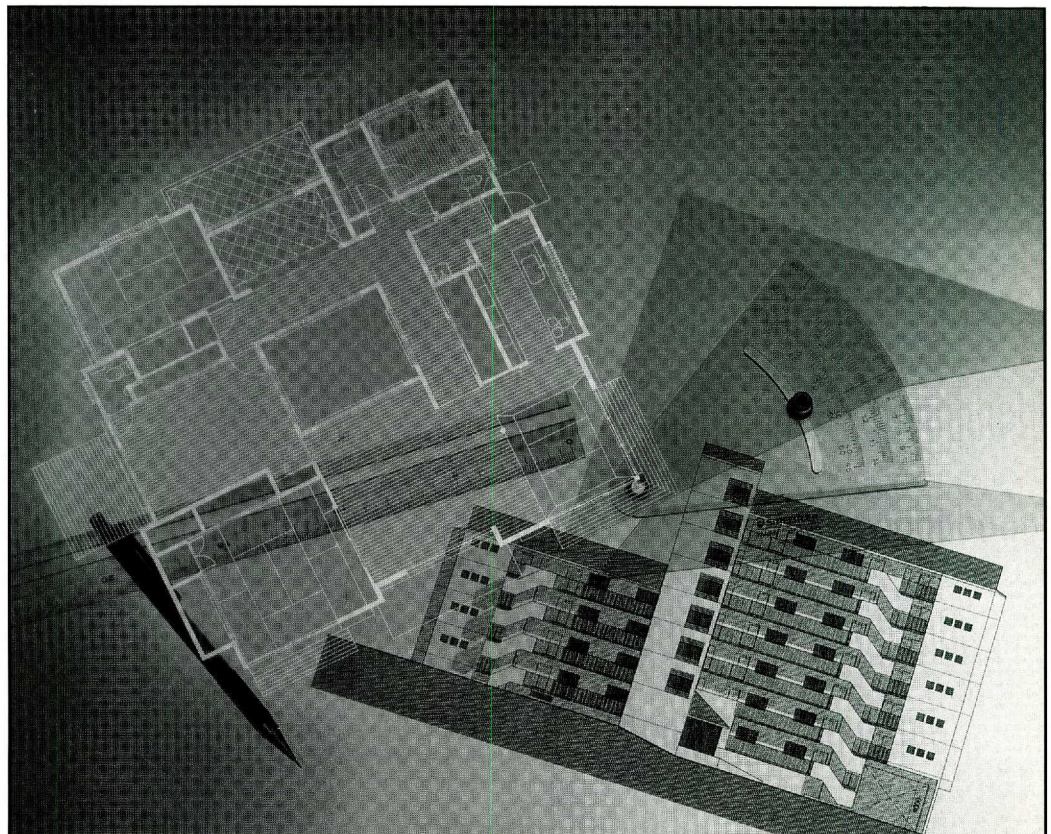
Each state may allocate tax credits equal to \$1.25 per person per state; the most recent allocation in Texas resulted in the distribution of tax credits totaling \$30.5 million.

In Texas, investors receive tax credits by having their proposal to construct or rehabilitate a multifamily housing project selected by the Department of Housing and Community Affairs. For example, suppose a partnership's proposal to construct 50 units of low-income rental housing with the following cost is selected.

| | |
|------------------------|-------------|
| Land cost | \$ 250,000 |
| Hard cost | 2,000,000 |
| Soft cost | 200,000 |
| Total development cost | \$2,450,000 |

The investors' tax credits are calculated as follows:

| | |
|------------------------------|-------------|
| Total development cost | \$2,450,000 |
| Less land cost | 250,000 |
| Eligible costs multiplied by | \$2,200,000 |
| Tax credit rate | × .09 |
| Annual tax credit | \$ 198,000 |



Instructor's Notebook presents a lecture on a basic real estate subject. Written by an expert, *Instructor's Notebook* takes readers into the classroom to hear the professor's talk. This regular feature is designed as an introductory lecture on a different topic each issue.

The annual tax credit is received for ten years; thus, the project's selection as a TCLIRHP property results in total tax credits of \$1,980,000 during the ten-year period—slightly more than 80 percent of the property's total development cost on an undiscounted basis. Changes in the property's ownership or use within 15 years may result in the recapture of the tax credits.

The TCLIRHP differs significantly from the former use of tax shelter by real estate investors. Prior to the 1986 Tax Reform Act, investors gained tax benefits by offsetting a rental property's tax losses against their other taxable income. Tax losses were brought about through the use of rapid depreciation schedules and interest deductions; properties that could supply these losses were sought after by investors. Except for local land-use controls, no government agency—federal, state or local—normally had a role restricting the supply of properties entering the market. As a result of the perceived value of tax losses and the lack of control over supply, too many properties were constructed in some areas.

With the TCLIRHP, however, the tax inducement to construct or rehabilitate low-income rental housing is limited each year within each state to the state's available tax credits. Furthermore, the Department of Housing and Community Affairs normally requires that a market study be part of the developer's application; this should preclude overdevelopment in particular markets.

Evaluating the Market

The market study provides information about the supply and demand for low-income housing in the market area and the suitability of the proposed development or rehabilitation for the market area. In particular, an independent, qualified market analyst must evaluate the physical condition, occupancy rates and absorption rates of comparable rental property within the proposed project's market area. The analyst also must evaluate the need for low-income housing in the market area and the suitability of the proposed project's unit size, amenities and location to meet the need. Finally, the analyst must evaluate the appropriateness of the proposed project development or rehabilitation cost and its expected operating costs. Based on these evaluations, the analyst must certify whether or not the:

- projected development or rehabilitation costs and the projected operating costs are reasonable,
- proposed project is likely to result in an excessive vacancy rate for comparable properties in the market area,
- proposed rents are affordable by the target tenants,
- proposed rents are below the rental range for comparable properties within the market area and

- project reserves are sufficient to cover operating shortfalls until sufficient occupancy is achieved.

If the data required to support these evaluations and certifications are carefully collected by a qualified, independent market analyst and carefully reviewed by the Department of Housing and Community Affairs when proposals are being evaluated for designation as a TCLIRHP property, particular market areas should not be overbuilt with low-income rental housing.

Investor Considerations

The development or rehabilitation of a property is financially feasible if it can generate adequate annual net operating income to support the debt necessary to finance the property and provide a satisfactory cash return to the investor. Ordinarily, financial feasibility analysis begins with either using the market rental rate to determine the maximum project cost that can be financed or using the estimated project cost to determine the market rental rate required to finance the estimated cost. In the case of a TCLIRHP property, however, the analysis must begin with the determination of the **allowable rental rate**.

Eligibility to occupy a particular unit is a function of a family's gross income, the number of persons occupying the unit and the MSA's or the county's median gross income. Because gross income varies among Texas MSAs and counties, allowable maximum income varies and affects a family's eligibility to occupy a unit.

For example, assume a TCLIRHP property that is available for families with gross incomes equal to 60 percent or less of the MSA's gross family income. In Dallas, in 1994, a three-person household with gross family income of \$24,660 would be eligible, but in Laredo the gross income of the same-sized family could not exceed \$15,480.

Furthermore, total housing payments for a TCLIRHP unit of a particular size, including utilities, can not exceed 30 percent of the family's monthly gross income. Thus, the maximum rental rates for different sized units vary by county and are a function of each MSA's or county's medium gross income, utility costs and family size. For example, for a family with a gross income no greater than 60 percent of the area's median gross income, the 1994 monthly total housing payment for a two-bedroom apartment is \$616 in Dallas and \$387 in Laredo. The monthly cost of utilities for each area is then subtracted from these rents to determine the maximum rent that can be charged to an eligible tenant.

Ordinarily at these maximum monthly rents, undertaking the development or rehabilitation an apartment property might not be financially attractive



Each state may allocate tax credits equal to \$1.25 per resident. The most recent Texas allocation resulted in \$30.5 million in tax credits.

because the property's maximum rent might be inadequate to pay operating expenses, support sufficient debt to finance the property and provide a satisfactory return on equity to the owner.

However, the additional benefits of the tax credits must be considered. Because these benefits are received annually for ten years, their present value is the proper measure of their worth. Using the annual \$198,000 example tax credit cited earlier, the present value of the annual tax credit received each year for ten years discounted at 10, 12 and 14 percent is:

| Discount rate | Annual tax credit | Present value |
|---------------|-------------------|---------------|
| 10 percent | \$198,000 | \$1,216,624 |
| 12 percent | 198,000 | 1,118,744 |
| 14 percent | 198,000 | 1,032,791 |

Viewed simply, the present value of the annual tax credits is a significant offset to the project's total development cost of \$2,450,000. If a discounted cash-flow analysis were being used, the annual tax credits would be added to each year's after-tax cash flow to equity; they, together with the property's residual value, would be an important component of the project's expected internal rate of return. Viewed either way, the property's rate of return would be enhanced as compared to developing the property without the tax credits.

However, this analysis suggests an investor bias toward higher-income areas and away from lower-income areas for the following reasons:

- Higher rents can be charged in these areas.
- Although development and rehabilitation costs vary, it is likely that these costs vary less than median incomes across the state.
- The tax credit is directly related to eligible cost; therefore, for a given project, the potential tax credit is reasonably the same in different geographic areas of the state.
- Accordingly, investors can maximize their return by developing or rehabilitating low-income rental properties in areas where they can charge the highest allowable rent because their potential tax credit is not significantly affected by location.
- Developing or rehabilitating TCLIRHP properties may not be financially feasible in lower-income areas.

Rental housing development under the TCLIRHP offers considerable incentive because the present value of the tax credit received during the ten-year period is a significant proportion of the property's total development costs. Thus, the requirement for a market study by a qualified, independent analyst is an important part of the TCLIRHP as it should ensure that the low-income rental market is not overbuilt in particular market areas. Guarding against this possibility is important because investors seeking to maximize their returns will initiate proposals to develop or rehabilitate TCLIRHP properties in the higher-income areas of the state. □

Dr. Etter is a professor with the Real Estate Center and of finance at Texas A&M University.

Sell Her,
Sell the House

Designing for Women

By Shirley E. Bovey

Most homes are sold to couples, but the woman has the primary influence on the buying decision. She makes the decision 85 percent of the time.

What does this major market segment want in a home?

At their 1995 show in Houston, the National Association of Homebuilders (NAHB) offered some answers based on focus groups composed of women homebuyers, a Harvard University housing study and surveys conducted by firms such as Yankelovitch.

Four professional women talked about "Design and Merchandising for Women Buyers" during a panel focused on how some developers and designers have used this information to create houses and products that respond to women homebuyers' specific input.

Knowing what this powerful economic segment desires better equips the real estate sales professional for customer-matched selling.

Here's how some builders and designers have incorporated women's demands and desires into today's homes:

Market Research

- Women's top five design concerns: first, an open kitchen-family room; second, a master suite retreat space, including a bath and sitting area; third, a home office or multi-functional room; fourth, dramatic formal areas; and fifth, elegant elevations.



- After extensive market research, Ryland Homes in Houston designed 15 new plans reflecting women's dream homes; sales increased by 22 percent in one year, compared to 2 percent across the board in Houston.
- Some 40 million people headquarter their careers at home; "flex space" or "smart space" allows the same house plan to be adapted to different buyer's needs for customer-matched selling. This is not the same space as the retreat area.
- A dramatic entry or foyer, a formal space for entertaining and well-designed external elevations communicate *status symbol*, part of a home's value for today's buyers.
- NIKEs are here—"no income kids with education" are moving back home; parents preserve their privacy with a second master bedroom suite. Other buyers need a second suite for elderly parents who are also moving in.

Design

- The command-center kitchen forms part of the great room—a family room, breakfast nook and kitchen combination. Work areas oriented toward the media center or fireplace offer a pleasant view. Women want to use this space for both private festivities and formal entertaining.
- Wrapping the breakfast room in glass brings light into the kitchen; a dark kitchen is a negative in home design.

- His/her closets, his/her vanities and oversized showers with dual showerheads accommodate two-career families.
- A master bath zoned with a "getting-to-work triangle" allows two adults efficient use of the same space when grooming for the office concurrently.

Merchandising

- The most important room in the house in the homebuying decision? The kitchen.
- Black, one of the fastest growing decorator colors for kitchens, ranks as the number three choice for countertops.
- Appliances are becoming invisible; one manufacturer has a refrigerator cabinet on the market, setting a new standard for appliances. (The refrigerator is the most-used appliance in the home.)
- Color consistency in interior decor prevents an emotional roller coaster ride.
- Lower maintenance products preferred—women who can afford them will pay more for less drudgery.
- The lighting trend is toward more natural lighting; uncovered windows let sunlight bathe the rooms. Under- and over-counter lights are replacing fluorescent boxes.
- More money is spent on furnishing the master suite than any other room; second is the dining room.
- Dining rooms are a must, but size is less important than artful execution of detailing.

- The "Imaginarium," one builder's name for the children's play area, is uncarpeted because flat floor coverings work best under most toys. Durability is an important concern of women homebuyers.

Sales

- The cost is significant to get a customer in the broker's door, but product is not the first thing to talk about; real estate professionals are selling a lifestyle, not a product.
- The gender gap has closed; the female buyer has her own checkbook. For the 25-to-54 age group, chances are seven in ten that the woman holds down a job.
- Single women buy more than half the suburban houses priced from \$70,000 to \$120,000.

- A salesperson has only eight minutes to interest the buyer. ☐

Source: National Association of Home Builders and Real Estate Center at Texas A&M University.

Dr. Bovey is associate editor with the Real Estate Center at Texas A&M University.

Texas Licensees

Profile of a Professional

By Ted C. Jones
and Shirley E. Bovey

Texas real estate licensees are experienced and well educated. Buyers who purchase property through a broker or salesperson benefit from hard-earned expertise and knowledge.

Of the nearly 86,000 active licensees in the state, just more than one-half (51.6 percent) hold sales licenses. A statistical profile further portrays the typical Texas licensee as predominately Anglo (89 percent), male (54 percent) and older (average age more than 49 years). More than one-half have a college degree. Contrary to expectations, most licensees do not sell single-family homes.

Experience, Education, Staying Power

Many of these professionals run a diverse business offering multiple real estate services. When expressed in full-time equivalents, one in four (26.5 percent) sells single-family residences. Slightly more salespersons (29.5 percent) than brokers (23.2 percent) focus on housing sales. One in five brokers conducts no real estate business. These individuals acquired licenses but developed

careers in other fields. Nearly 10 percent of the salespersons fall into the same category.

Brokerage firm management takes 8.4 percent of licensee time, while commercial and industrial sales account for 7 percent. Appraisal, leasing, property management for others and for themselves each represents approximately 5 percent of licensees' real estate activities.

Nearly one-half of Texas's 25 years old or older have attended college or hold a college degree. Given that Texas has stringent pre-licensing educational requirements, finding that more than 94 percent of Texas real estate licensees have some college or university training—double the state average—is not surprising. The 58.6 percent rate of college graduates among licensees is nearly triple the statewide average of 20.3 percent. One in seven has a master's degree, while three of every 100 have earned law degrees. One percent hold doctorates.

The average licensee has held a Texas real estate license for slightly more than 12 years. Sales licensees average less than seven years, while the typical broker



has held a license for nearly 17 years. Close to one in five Texas brokers has held a license for 25 or more years, although just 2 percent of sales licensees fit in this category.

Ethnicity, Age and Gender

While Texas is an ethnically diverse state, the same can not be said about real estate licensees. Anglos make up 56 percent of Texas' current population, but today's minorities are projected to become the majority within the next ten to 15 years. Fully 89 percent of those holding active licenses are Anglos. For brokers, the percentage shifts to 92 percent. Although more diverse than brokers, sales licensees are 86 percent Anglo. Hispanics total 28 percent of the state's population but represent just 4.7 percent of active licensees. Salespersons are 6.3 Hispanic, but that rate falls by more than half (3.1 percent) for brokers. African-Americans represent 3 percent of Texas real estate licensees, with brokers and

salespersons at 2.1 and 3.8 percent, respectively. Within Texas, 11 percent of the population is of African-American descent. Asian Texans represent 3 percent of the population and are similarly represented by 2.2 percent of licensees.

Men make up 54 percent of active licensees and two out of three brokers. Women represent 57.3 percent of sales licensees. The median age of brokers is 53 years and of sales licensees is 46 years. Examined in five-year increments, the majority of licensees are age 46 to 50. Only 4.2 percent are younger than age 31, while 11 percent are 66 years old or older.

Licensee-Population Ratios Differ

The number of Texans per licensee, as shown in the table,

varies widely. Given the low percentages of Hispanics holding Texas real estate licenses, it is not surprising to find the largest population per licensee in predominantly Hispanic metropolitan statistical areas (MSAs). The McAllen-Edinburg-Mission MSA, which has the highest homeownership rate in Texas, has 679 people per licensee compared to a statewide average of 213. Laredo follows closely at 601, while the Austin-San Marcos MSA has the lowest population per licensee at 125 with Houston at 156 and Dallas registering 160. El Paso has the highest sales licensee per broker ratio (1.67), while Bryan-College Station has the lowest (0.73).

This profile is based on information gathered by the Texas Real

Estate Commission (TREC) from new applicants and renewals. Prior to TREC's collecting demographic information (at the Real Estate Center's request), the only such statistics were based on periodic samples. Because TREC data are no longer being recorded, however, this profile is not only the first but perhaps the last.

Texas must struggle with the under-representation of today's minorities as it becomes even more ethnically diverse. Recruiting these fellow Texans is a challenge that must be met to serve fully the needs of consumers across the state. ☐

Dr. Jones is chief economist and Dr. Bovey associate editor for the Real Estate Center at Texas A&M University.

Active Texas Real Estate Licensees

| Metropolitan Statistical Area | Number of Licensees | | | Population | | | Number of Sales Licensees Per Broker |
|----------------------------------|---------------------|---------|----------------|------------|------------|--------------|--------------------------------------|
| | Sales | Brokers | Total Licensee | Per Sales | Per Broker | Per Licensee | |
| Abilene | 203 | 264 | 467 | 608 | 468 | 264 | 0.77 |
| Amarillo | 343 | 392 | 735 | 581 | 509 | 271 | 0.88 |
| Austin-San Marcos | 3,660 | 3,777 | 7,437 | 253 | 245 | 125 | 0.97 |
| Beaumont-Port Arthur | 408 | 383 | 791 | 889 | 947 | 459 | 1.07 |
| Brazoria County | 286 | 339 | 625 | 717 | 605 | 328 | 0.84 |
| Brownsville-Harlingen-San Benito | 336 | 323 | 659 | 856 | 890 | 436 | 1.04 |
| Bryan-College Station | 190 | 260 | 450 | 655 | 478 | 276 | 0.73 |
| Corpus Christi | 903 | 690 | 1,593 | 409 | 535 | 232 | 1.31 |
| Dallas | 9,378 | 9,089 | 18,467 | 316 | 326 | 160 | 1.03 |
| El Paso | 1,411 | 844 | 2,255 | 467 | 780 | 292 | 1.67 |
| Fort Worth-Arlington | 3,017 | 2,739 | 5,756 | 509 | 561 | 267 | 1.10 |
| Galveston-Texas City | 476 | 523 | 999 | 473 | 431 | 226 | 0.91 |
| Houston | 12,533 | 10,395 | 22,928 | 286 | 345 | 156 | 1.21 |
| Killeen-Temple | 551 | 406 | 957 | 486 | 659 | 280 | 1.36 |
| Laredo | 141 | 113 | 254 | 1,083 | 1,352 | 601 | 1.25 |
| Longview-Marshall | 264 | 301 | 565 | 751 | 659 | 351 | 0.88 |
| Lubbock | 359 | 476 | 835 | 627 | 473 | 270 | 0.75 |
| McAllen-Edinburg-Mission | 329 | 322 | 651 | 1,345 | 1,374 | 679 | 1.02 |
| Odessa-Midland | 363 | 428 | 791 | 657 | 558 | 302 | 0.85 |
| San Angelo | 198 | 215 | 413 | 525 | 483 | 252 | 0.92 |
| San Antonio | 3,891 | 2,781 | 6,672 | 367 | 513 | 214 | 1.40 |
| Sherman-Denison | 139 | 181 | 320 | 692 | 531 | 301 | 0.77 |
| Texarkana | 100 | 94 | 194 | 832 | 886 | 429 | 1.06 |
| Tyler | 378 | 367 | 745 | 419 | 431 | 213 | 1.03 |
| Victoria | 99 | 112 | 211 | 777 | 687 | 365 | 0.88 |
| Waco | 229 | 311 | 540 | 832 | 613 | 353 | 0.74 |
| Wichita Falls | 243 | 218 | 461 | 545 | 607 | 287 | 1.11 |
| Non-MSAs | 3,943 | 5,230 | 9,173 | 744 | 561 | 320 | 0.75 |
| Texas | 44,371 | 41,573 | 85,944 | 412 | 440 | 213 | 1.07 |

Source: Real Estate Center at Texas A&M University

Timing Home Sales Crucial

By Jerrold J. Stern

When a principal residence is sold, two rules help sellers avoid paying tax on part or all of the gain from the sale. The rules are straightforward for married couples filing joint tax returns. But what if the couple divorces? Without careful planning, one or both spouses could be surprised by a taxable gain when their pre-divorce home is sold.

Under the first rule, tax on the gain is postponed if the replacement residence costs more than the sales price of the old residence (net of selling expenses), and it is purchased within two years of the sale of the old home.

Under the second rule, taxpayers 55 or older may make a one-time election to exclude up to \$125,000 of gain from the sale of their principal residence.

These rules may be unavailable for married couples who are separating unless they plan properly. Three typical scenarios suggest how tax planning can secure tax advantages.

Retiring Couples

The purpose of the second tax rule is to enable an elderly couple to step down in the housing market, incurring little or no tax cost, as their housing needs change. However, once the rule is elected, **neither spouse may use the rule again** even if one of them remarries. For example, assume Jim and Harriet retire and use the rule to eliminate gain on the sale of their house.

If Jim dies and Harriet later marries Bob, Harriet and Bob can not benefit from tax rule number two even if Bob has never elected the rule.

If Bob plans to sell his house after marrying Harriet, he should consider selling the house **before** they marry. He then would be entitled to the \$125,000 gain exclusion.

First Spouse Transfers Interest in Home to Spouse Two

Henry and Ann divorce. Ann continues to live in their house, and Henry moves to a new residence. Henry transfers his one-half ownership interest in the house to Ann as part of the divorce settlement, stipulating that he receive one-half of the sales proceeds (net of selling expenses) if the house is sold. Asset transfers between spouses are nontaxable whether or not they relate to a divorce.

When Ann sells the house, she must recognize the **entire gain** herself, even though she is giving one-half of the net proceeds to Henry. To avoid paying tax on the gain, the cost of Ann's replacement residence must equal or exceed the net sales price of the old residence—yet she has only one-half of the proceeds to reinvest. In other words, Henry receives **pre-tax** sales proceeds with no responsibility for **after-tax** consequences.

The divorce agreement should include a formula that computes Henry's share of the net proceeds on an **after-tax** basis. Henry should receive one-half of the sales proceeds **after** subtracting selling expenses and all related taxes paid by Ann. The payment to Henry is nontaxable.

Couple Divorces Soon after Selling Home

Ellen and Ken sell their principal residence for \$200,000 (net of selling expenses) resulting in a gain of \$50,000. Soon after the sale date and before they move

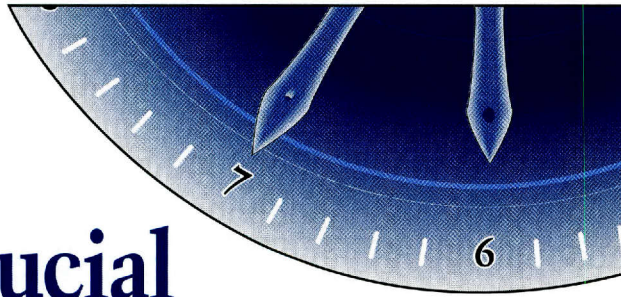
into a new residence, they divorce. Recall that the first tax rule requires replacement residences to be acquired within two years to avoid tax on gain. Ellen purchases a new residence for \$120,000, within the two-year period, but Ken rents an apartment.

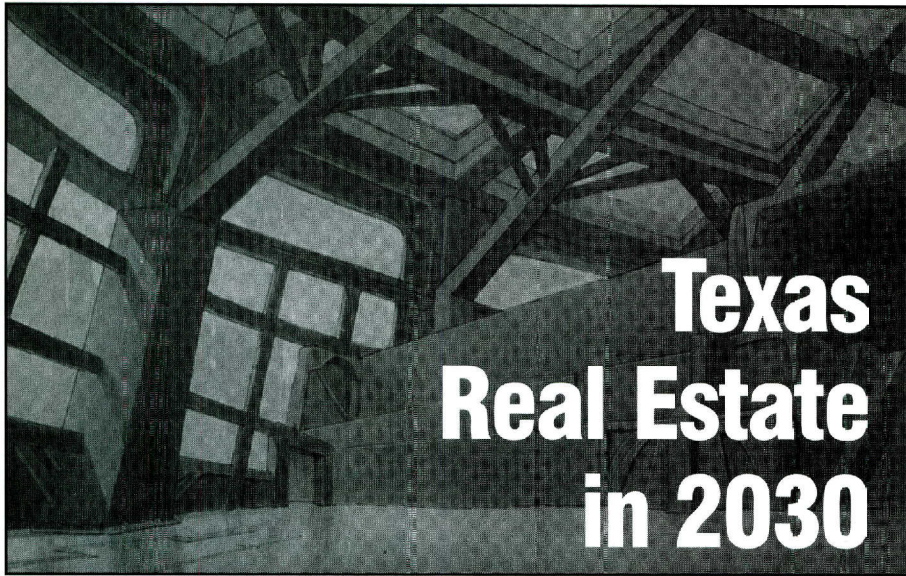
The entire \$50,000 gain becomes taxable because not enough was invested in a replacement residence. Under the first tax rule, if the replacement residence costs less than the net sales proceeds from the old residence, the gain recognized for tax purposes is the smaller of (1) the gain realized on the sale of the old residence (\$50,000), or (2) the excess of the net sales proceeds (\$200,000) over the cost of the replacement residence (\$120,000), which is \$80,000 given these facts. For example, if Ellen paid \$190,000 for a new home, then only \$10,000 of the gain would have been taxable: \$200,000 less \$190,000 is \$10,000. Ellen and Ken are jointly and individually (severally) liable for the tax on the \$50,000 because the gain arose from their jointly filed tax return. Thus, the government can seek **entire tax payment** (plus interest) from either Ellen or Ken or one-half from each.

Unfortunately, Ellen and Ken are out of luck. Other couples contemplating divorce, however, could learn from the fate of Ellen and Ken by selling their principal residence **after** they divorce and dividing the net proceeds equally. This way, each spouse has the option of avoiding tax on their half of the gain by fully reinvesting it in a new home. If Ellen and Ken had used this approach, only Ken would have tax liability for the sale.

Selling a principal residence in connection with a divorce can have significant and unexpected tax consequences. Consultation with an accountant or tax attorney is recommended before structuring the agreement. ☐

Dr. Stern is a research fellow with the Real Estate Center at Texas A&M University and a professor of accounting in the Graduate School of Business at Indiana University.





Texas Real Estate in 2030

By Steve H. Murdock, Nazrul Hoque and Beverly A. Pecotte

Waves of population change are bearing down on Texas. As they sweep across the state, the effects will influence everyone, every place and every aspect of real estate.

Falling vacancy rates and rising construction hint that the tide has already begun to change. Tomorrow's success requires understanding and preparation today. Here are some points licensees might consider as they chart their course into the next century. Unless otherwise noted, the numbers contrast 1990 to 2030.

Overall population. Texas' population will hit 33.8 million and will be growing roughly twice as fast as the nation. The annualized growth rate of 1.7 percent will be slower than the current 2 percent rate but substantially faster than the 0.8 percent growth rate expected for the nation.

The state's population growth will be influenced extensively by immigration from other states and immigration from other countries.

Owners and renters. Homeowners and renters will be older and more likely to be minority. For real estate, an older population means more owners, and the increased minority population translates into more renters. Effects of aging will be more dominant for real estate.

Owner households will increase by nearly 130 percent. Meanwhile, total renter households will jump almost 105 percent. Fifty-two percent of all owners and nearly 67 percent of all Texas renters will be minority by 2030.

Households. Total Texas households will increase by 120 percent. Most of these new households—roughly 79 percent—will be minority. Nearly 61 percent of households will have a

householder 45 years old or older by 2030.

Minorities. Texas minority populations will increase substantially faster than Anglos. While the total population increases 99 percent, Anglos will add about 20 percent. Blacks will increase 62 percent, and the Hispanic population will grow by 258

percent. Other ethnic groups will increase by 648 percent.

Texas' population will be less than 50 percent Anglo by 2010, and, by 2030, nearly 46 percent will be Hispanic.

Aging. Thanks to the babyboom generation (those born between 1946 and 1964), substantial aging will characterize the population by 2030. Beginning in 2011, this generation begins to enter the elderly ages and by 2030 one in six Texans (compared to one in ten in 1990) will be 65 years of age or older.

In 2030, almost 23 percent of the state's population will be less than 18 years old. Nine percent will be 18 to 24. Texans aged 25-44 will compose nearly 28 percent of the population. Persons 45 to 64 will account for almost 24 percent while those 65 and older will make up 17 percent of the total. ☐

Dr. Murdock is a research fellow with the Real Estate Center and director of the Texas State Data Center. Dr. Hoque is an assistant research scientist and Pecotte is a research associate with the Texas State Data Center.

Texas Population by Ethnic Group

| Year | Anglo | Black (percent) | Hispanic | Other |
|------|-------|--------------------|----------|-------|
| 1990 | 60.7 | 11.7 | 25.5 | 2.1 |
| 2000 | 54.6 | 11.4 | 30.9 | 3.1 |
| 2010 | 48.6 | 10.9 | 36.1 | 4.4 |
| 2020 | 42.6 | 10.3 | 41.1 | 6.0 |
| 2030 | 35.7 | 9.5 | 45.9 | 7.9 |

Source: Texas Population Estimates and Projections Program, Department of Rural Sociology, Texas A&M University

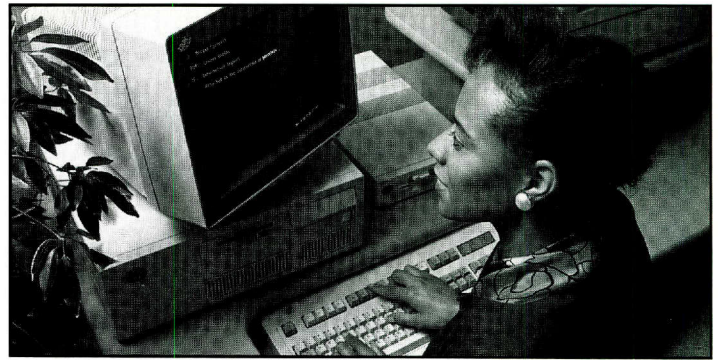
Texas Households (millions)

| Year | Owner Households | Renter Households |
|------|------------------|-------------------|
| 1990 | 3.7 | 2.4 |
| 2000 | 4.6 | 2.8 |
| 2010 | 5.7 | 3.4 |
| 2020 | 7.0 | 4.0 |
| 2030 | 8.4 | 4.9 |

Source: Texas Population Estimates and Projections Program, Department of Rural Sociology, Texas A&M University

Pros and Cons of CLO

New tools to assist the real estate professional bring both great promise and potential problems. In the last *Tierra Grande*, readers were introduced to one such tool that could change the way sales professionals serve their clients. Computerized



FAXback: Research Ideas

Here's an opportunity to influence the research program of the Real Estate Center at Texas A&M University. The Center wants to know what questions you think should be explored in the coming year. These ideas will be combined with those from the staff, advisory committee and others to form the future research agenda. Fax us your thoughts today. Who knows? Your idea may be the basis for a research project that benefits licensees statewide.

List the three most pressing questions facing the Texas real estate profession today.

1.

2.

3.

Check the appropriate block. Texas broker Texas salesperson
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Other comments:

If we may use your name and quote in *Tierra Grande*, please sign.

FAXback replies to: *Tierra Grande*, Attn: FAXback, Real Estate Center,
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Loan Origination (CLO) has the potential to consolidate the sales and financing transactions leading to swifter and more successful closings. FAXback asked readers to give their opinions on the prospect of adding CLO to their business.

Although response was extremely limited, the answers and comments are worth noting. All respondents said that the greatest payoff of CLO would be in attracting more homebuyers by providing an attractive service. None viewed the service as a significant source of additional profits. All respondents agreed that if a system were too hard to operate, too expensive to acquire or too loaded with legal or ethical problems (such as possible agency violations), they would reject that system. The features most likely to appeal to respondents are ease of use, an adequate array of lenders in the network, system support from the CLO vendor and convenience for homebuyers.

One respondent expressed apprehension about working with out-of-town lenders, feeling that the lack of face-to-face contact might cause delays and other problems. On the other hand, another respondent said the system would be especially helpful in rural areas where local lenders are scarce. ☐

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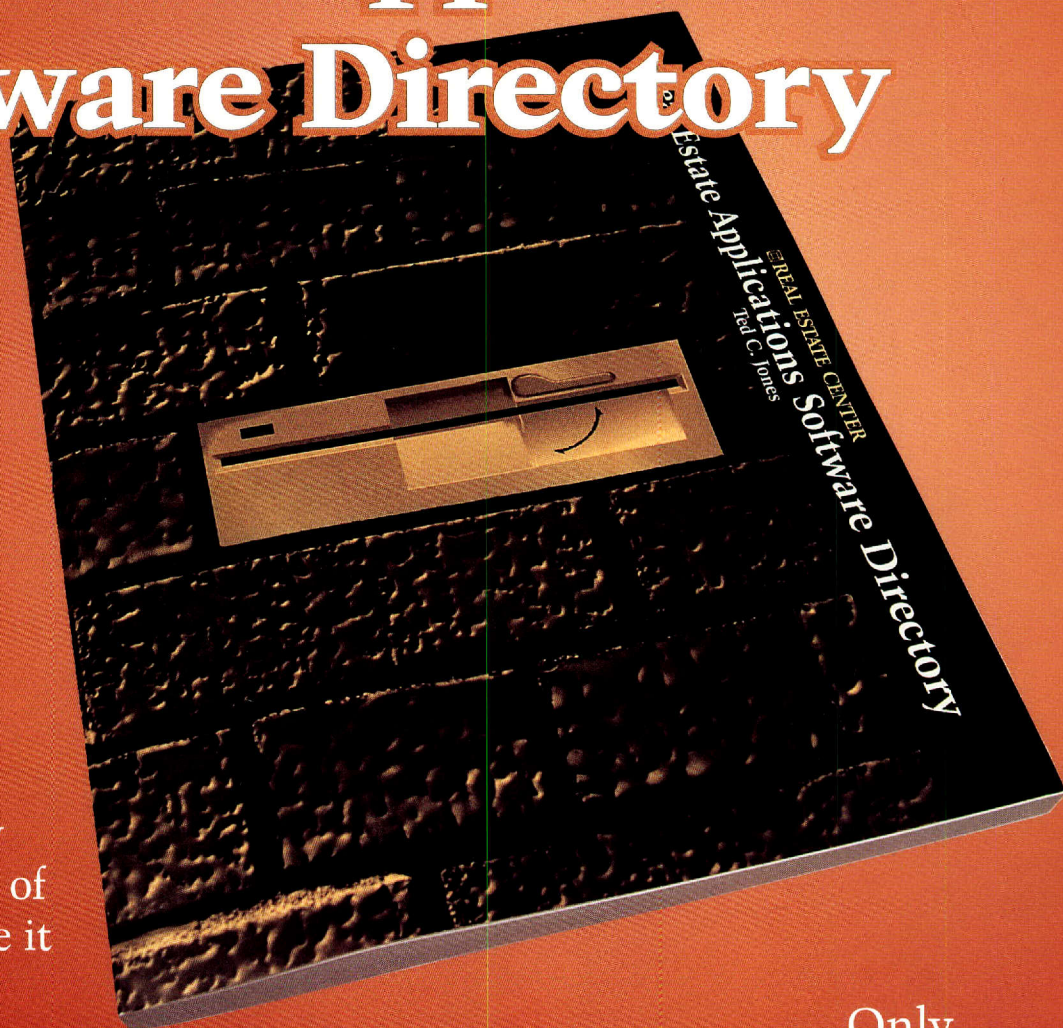
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