TCCRI
Texas Conservative Coalition
Research Institute

FINAL
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FREE ENTERPRISE & GOVERNMENT REGULATION TASK FORCE

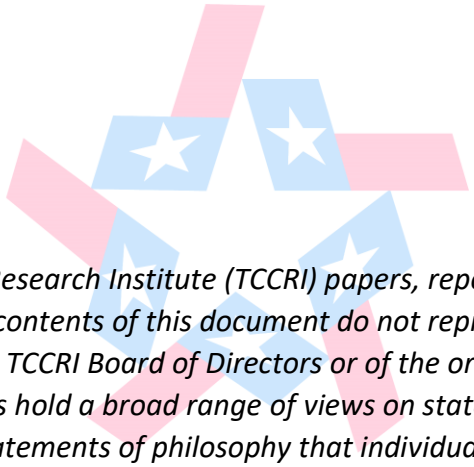
For more information about this document, please contact the Texas Conservative Coalition Research Institute:

Texas Conservative Coalition Research Institute

P.O. Box 2659, Austin, TX 78768

(512) 474-6042

www.txccri.org



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Texas Conservative Coalition Research Institute

2021-2022 Free Enterprise & Government Regulation Task Force

Final Report

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I. Introduction

The Texas Conservative Coalition Research Institute (TCCRI) bases its policy priorities and positions on its LIFT Principles, which are Limited Government, Individual Liberty, Free Enterprise, and Traditional Values. The Free Enterprise and Government Regulation Task Force focuses almost exclusively on policy areas touching these principles.

Once again, the Task Force's Final Report explores occupational licensing reform, which requires the government's permission to engage in the work of one's choice, and often has more to do with protecting an industry's existing workers from competition than it does with ensuring the health and safety of consumers.

The Task Force also explored alcoholic beverage regulations, which in many cases prevents businesses from competing on an even playing field.

Local governments in Texas, in many cases, continue to push the boundaries of limited government. This Task Force once again makes recommendations to protect individual liberty and free enterprise from overbearing local governments.

This Final Report discusses regulations that impact the housing market, such as zoning, property appraisal, fees in construction, and more.

An ongoing topic around the legislature and state government is the state of the Texas Universal Service Fund (TUSF), which provides financial aid to, among others, providers of telecommunications services in rural parts of the state. It is funded by a surcharge on existing phone service bills. This Final Report explores the policy implications of the current state of the TUSF.

Lastly, the Task Force once again recognizes anticompetitive and outdated laws that prevent modern companies from competing with older business models.

All of these issues are explored in detail and this Task Force Final Report makes several policy recommendations on each.

II. Occupational Licensing Reform

There is little doubt that occupational licensing—i.e. requiring the government's permission in order to pursue a specific occupation or trade—creates negative effects and distortions in the marketplace. Occupational licensing programs are estimated to reduce the rate of job growth by 20 percent and cost between $35 billion and $42 billion per year in decreased competition, higher prices for consumers, reduced job growth, and discouragement of innovation and investment.[1] Evidence suggests that licensed occupations that grew in employment by 10% from 1990 to 2000 would have grown by 12% without the license requirement in place.[2] Research from the National Bureau of Economic Research estimates that state-specific licensing examination requirements may reduce interstate mobility by as much as 36%.[3] One report shows that the growth in occupational licensing can decrease economic mobility, as supported by an average of 31 new licenses created in each state over a 20 year period (1993-2012) correlated with a 6.7 percent decline in absolute mobility over that same period.[4]

In addition to the negative economic effects of occupational licensing, existing research strongly suggests that licensing does little to protect consumers beyond protection that occurs within competitive labor markets. At least 19 studies have assessed the effect that occupational licensing has on quality. 12 of those studies categorized the effects as neutral, mixed, or unclear.[5]

Given the considerable negative effects, the justifications—or lack thereof—for occupational licensing should be given greater scrutiny. More than 500 professional activities require a state-issued license in Texas.[6] Though a good number of those 500 are sublicenses within the same profession (e.g. there are different tiers of plumber licenses and cosmetology licenses), that number is still considerable.

An estimated 1,100 occupations require licensure in at least one state, but fewer than 60 of those occupations require licensure in *every* state, which suggests that the vast number of licensing laws are unnecessary.[7] Few people could explain why interior designers require a license in three states (and the District of Colombia), but not the other 47, except maybe the interior design lobby in Nevada, Florida, and Louisiana.[8]

A. Reciprocity and Universal Recognition

One of the best ways to break down barriers to work is to grant licensure in Texas to individuals licensed in other states. The Texas Department of Licensing and Regulation (TDLR) purports to have broad reciprocity policies with other states, but that is not necessarily the case. There are two main provisions in Statute that provide TDLR with the authority to make licensing less burdensome:
First, under Section 51.4041(a) of the Occupations Code, TDLR "may adopt alternative means of determining or verifying a person's eligibility for a license issued by the department, including evaluating the person's education, training, experience, and military service." In using such alternative means, TDLR may consider things like licensure in other states and criminal history.

Second, under Section 51.4041(b), the state "may waive any prerequisite for obtaining a license if the applicant currently holds a similar license issued by another jurisdiction that: (1) has requirements for the license that are substantially equivalent to those of this state[.]"

It is the use of the "substantial equivalence" standard that prevents Texas from having true reciprocity with other states. According to TDLR, the department determines substantial equivalence on a case-by-case basis. In the most heavily licensed fields of cosmetology and barbering, TDLR has recognized a limited number of licenses and states from which to grant reciprocity. Between different professions, sub-licenses within those professions, and different states and territories, reciprocity licensure in Texas is a patchwork quilt.

1. Policy Recommendation: Adopt a True Reciprocity Licensing Policy Using the "Scope of Practice" Standard

True reciprocity recognizes that if another jurisdiction has authorized a person for licensure, then Texas should too. A prerequisite for such a policy is the belief that standards and eligibility for licensed professionals are more subjective than one's own state's requirements. Given that licensed industries tend to support the protection from competition that state licensure provides, legislators should expect opposition from those groups if another jurisdiction's requirements are lower (i.e. less burdensome) than one's own. Nevertheless, true universal reciprocity would be an incredibly beneficial policy for Texas, its workers, its consumers, and the state's economy.

Section 51.4041 of the Occupations Code should be revised with a standard for reciprocity that is more automatic and does a better job of recognizing qualified individuals coming to Texas. Model Legislation from the Institute for Justice would provide a strong substitute. The Universal Recognition of Occupational Licenses Act would require the issuance of a license to any applicant who meets the following conditions:

1) The person holds a valid occupational license or government certification in another state in a lawful occupation with a similar scope of practice, as determined by the board in this state;
2) The person has held the occupational license or government certification in the other state for at least one year;
3) The board in the other state required the person to pass an examination, or to meet education, training or experience standards;
4) The board in the other state holds the person in good standing;
5) The person does not have a disqualifying criminal record as determined by the board in this state under state law;
6) No board in another state revoked the person's occupational license or government certification because of negligence or intentional misconduct related to the person's work in the occupation;
7) The person did not surrender an occupational license or government certification because of negligence or intentional misconduct related to the person's work in the occupation in another state;

8) The person does not have a complaint, allegation or investigation pending before a board in another state which relates to unprofessional conduct or an alleged crime. If the person has a complaint, allegation or investigation pending, the board in this state shall not issue or deny an occupational license or government certification to the person until the complaint, allegation or investigation is resolved or the person otherwise meets the criteria for an occupational license or government certification in this state to the satisfaction of the board in this state; and
9) The person pay all applicable fees in this state.

The bill contains several other provisions, including a clarification that if the other state issues a government certification, but not a license, then that is satisfactory for requiring this state to issue the license. Should a legislator wish to go further, there are additional provisions in the model bill that would recognize work experience and private certification as qualifications for a license in this state. The full text can be read here.

2. *Policy Recommendation: Pass TCCRI's Occupational Licensing Consumer Choice Act*

The Occupational Licensing Consumer Choice Act ("The Act") is model legislation drafted by TCCRI. The Act "provides consumers with the right to choose a worker who best serves their needs irrespective of whether that person holds an occupational license." If a person works in an otherwise legal profession that requires a license, The Act provides that a license is not required so long as the person discloses the fact that they are not licensed by the state to prospective customers. The Act provides requirements for a written disclosure, and production of such a disclosure in any enforcement action for not having a license shall be dismissed. The full text of the bill is provided in Appendix A.

Where other model licensing bills focus on litigation and methods for striking licensing laws down, The Act takes a different approach. It is self-executing in that it provides a clear framework for working without a license. It focuses on consumer information and consumer choice. The Act's benefits are myriad:

- It does not repeal any licenses, but makes them no longer mandatory.
- It allows licenses to remain a market signal of qualification, but empowers consumers and other market participants (insurers, for example) to choose for themselves how important the license is.
- It creates more market competition. This is good for workers, consumers, and the larger economy.
- It empowers industry groups, trade organizations, and similar private associations to self-regulate without the participation of government.

The full text of TCCRI's model bill may be read here.

III. Alcoholic Beverage Regulations

Texas's laws and regulations pertaining to alcoholic beverages are both confusing and cumbersome. The Texas Alcoholic Beverage Code was drafted during the aftermath of Prohibition, a unique period of U.S. history ruled by sentiments very different than those that prevail today. Many of the restrictions on alcohol sales thought necessary at the time have since outlived their usefulness. For instance, times and locations of sales for alcohol differ depending on whether the alcohol is sold for on-premise or off-premise consumption, at a grocery store or a liquor store, whether food is served with the alcohol, or whether the alcohol type is beer, wine, or spirits. Those are but a few examples. There is a great opportunity for Texas to promote free market principles by lifting a number of these conflicting, anticompetitive alcohol regulations.

1. *Policy Recommendation: Create Uniformity in Hours of Sale*

Conflicting laws on hour of sale should be made uniform for a variety of reasons ranging from the promotion of economic growth, to alleviating anti-competitive effects, to potentially creating more revenue for the state. One proposal is to simply allow alcohol sales of all kinds from 7am until 1am across the board, with an option for a late-hours permit in those jurisdictions that allow it. This will eliminate the anti-competitive system we currently have where certain kinds of businesses may only sell certain kinds of alcohol at variously defined times. Such a reform would simplify the law, free the alcoholic beverage economy, benefit consumers, and make Texas a stronger free market leader.

2. *Policy Recommendation: Allow Sunday Liquor Sales*

Texas is one of only twelve remaining states that prohibits Sunday liquor sales for off-premise consumption.[9] Not only is this practice outdated, but it is anticompetitive in nature. Bars and restaurants are permitted to sell liquor on Sunday, which eliminates any kind of safety or moral argument against such sales. Indeed, purchasing a bottle of liquor and taking it home for consumption is arguably far safer than allowing a person to drink liquor on a bar or a restaurant and then driving home afterwards. Bills to remedy this anticompetitive law, such as Senate Bill 785 (86R, Johnson) and House Bill 937 (87R, Raymond) are filed every Legislative Session. The 88th Texas Legislature should consider and pass such legislation.

3. *Policy Recommendation: Repeal Package Permit Restrictions*

Section 22.16 of the of the Texas Alcoholic Beverage Code prevents publicly traded corporations from holding liquor permits. Stores such as Costco, Walmart, and many others, can freely sell beer and wine, but are not authorized under law to sell liquor. Costco, as an end-around, has found a way around this unnecessary regulation by leasing a portion of their property to a liquor store where membership is not required to purchase products.

This rule is anti-competitive, easily circumvented, and outright discriminatory. Indeed, hotels, restaurants, and bars may all serve liquor even if they are owned by publicly traded companies. Bills are filed to address this anticompetitive law every session. Senate Bill 645 (86R, Birdwell) which would have repealed these prohibitions, received bi-partisan support as it passed through the Senate with 27 Yeas and 4 Nays, but it did not receive a hearing in the House. Texas is the only state in the nation that prohibits publicly traded corporations from possessing liquor permits. Repealing these outdated prohibitions would benefit consumers and allow for greater market competition.

IV. Local Overreach

Federalism within the United States is a well-established principle, which lays at the heart of our system of government. Granted by the states and defined by the United States Constitution, the federal government wields immense power. Specifically defined within Article 1, Section 8 of the U.S. Constitution, Congress is granted the power to regulate commerce "among the several states," as well as "declare war," and "raise and support armies."[10] All other "powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people," as declared by the Tenth Amendment.[11]

Equally important and often misunderstood is the relationship between the state and political subdivisions which reside therein. Just as states granted consent to the federal government, the State of Texas consented to the establishment of local governments and subsequently defined their purpose and the scope of their powers.

Texas cities continue to expand, as do the powers of their local governing bodies. Three of the top five fastest growing large cities in the United States are in Texas and it comes as no shock that local governments are passing laws and ordinances that increasingly exceed the scope of their intended authority.[12] Austin has been a repeat offender over the years, passing bans on plastic bags, implementing burdensome regulations on ridesharing companies, and passing the CROWN Act which bans "hair discrimination," which is likely already covered by federal and or state anti-discrimination laws.[13] Other examples include requirements on construction materials used for private property and the infamous Denton hydraulic fracturing ordinance, all of which negatively impact the Texas economy, exceed the scope of power given to those local governments, and infringe on the liberty of its citizens. Defenders of such policies often decry state-level remedies as government overreach and defend their position under the banner of "local control". However, these policies represent considerable overreach on the part of the local governments and the State maintains a legitimate and compelling interest in stepping in to remedy these issues.

A. Government exists to protect liberty, not to "control"

Article 1, Section 19 of the Texas Constitution provides the following: "No citizen of this State shall be deprived of life, liberty, property, privileges or immunities, or in any manner disfranchised, except by the due course of the law of the land."

The most relevant part Section 19 in the context of overreaching local governments is "liberty." The Texas constitution protects liberty, even over the policy preferences of local governments or their constituents. When local governments pass laws and ordinances restricting liberty in burdensome ways that are disconnected from any rational need for the regulation, the state has a legitimate role to play in protecting the people from such encroachments.

B. Local governments derive their powers from the state

Article 1, Section 2 of the Texas Constitution provides, in part, the following: "All political power is inherent in the people, and all free governments are founded on their authority, and instituted for their benefit."

As Section 2 states, the State's authority is derived from the people, for the people's benefit. Through the Texas Constitution, the people have granted counties (Article 9) and municipalities (Article 11) the right to exist. They are creatures of state government, and state government reserves the right to define their legitimate functions. For instance, Article II, Section 13 states that "the legislature may by law define for all purposes those functions of a municipality that are to be considered governmental and those that are proprietary, including reclassifying a function's classification assigned under prior statute or common law." Should local governments impose burdensome laws and ordinances on the people, local control is a secondary concern.

C. It is appropriate and legitimate for the state to regulate economic activity to further the goals of free-flowing commerce and free enterprise.

The federal government may regulate interstate commerce to prevent states from burdening each other with anticompetitive taxes and regulations aimed at benefitting themselves at the expense of the rest of the union. Similarly, it is appropriate for state governments to regulate intrastate commerce for the purposes of promoting uniform market-friendly regulations. Where local governments enact burdensome, unnecessary laws and ordinances, State government should step in on the people's behalf.

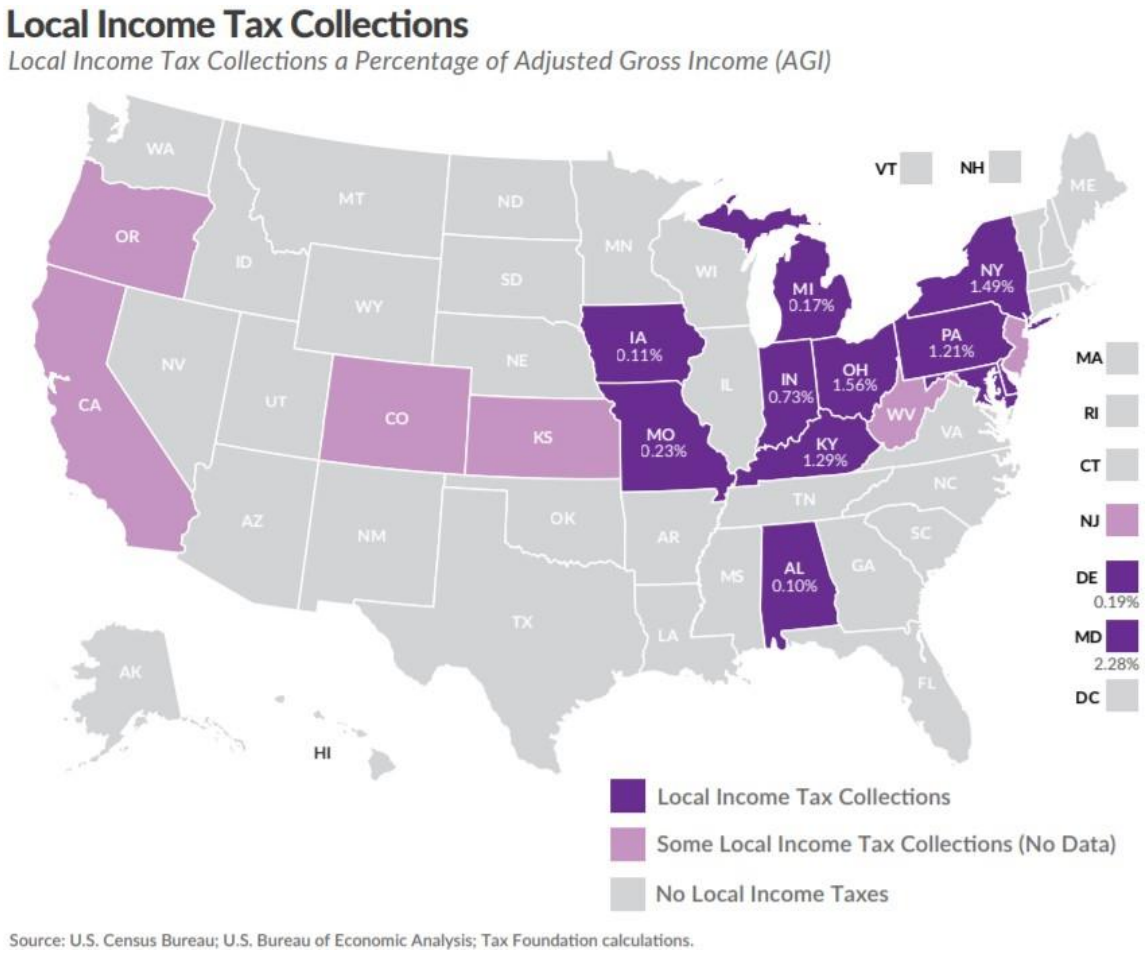
D. Policy Recommendations

There are several areas in which the state should step in to protect citizens from overreaching local governments.

1. Policy Recommendation: Constitutionally Prohibit the Enactment of a City-Level Income Tax

In 2019, the Texas Legislature passed, and voters approved, a constitutional amendment that strengthened an existing limitation on the creation of a state-level income tax. That amendment (HJR 38, Leach | et al.) replaced a narrow allowance for an income tax with a permanent ban that in order to repeal would require another constitutional amendment. Doing so would be a difficult task, as 74% of voters voted in favor of the permanent ban. However, the specific language of the Texas Constitution now states that "[t]he legislature may not impose a tax on the net incomes of individuals," which leaves the door open to the local imposition of an individual income tax.

Local income taxes are increasingly common. In 1932, Philadelphia became the first city to adopt a local income tax. Now, there are 4,964 jurisdictions across 17 states that impose an income tax at the local level. For example, every county in Indiana and Maryland imposes a local income tax. In Ohio, nearly 750 municipalities and school districts impose an income tax. In fact, municipalities are the vast majority of jurisdictions with local income taxes, and include such high-profile examples as New York City, Newark, Philadelphia, San Francisco, and Denver. The Tax Foundation provides the following graphic to illustrate:



Source: U.S. Census Bureau; U.S. Bureau of Economic Analysis; Tax Foundation calculations.

While Texas does not appear on the Tax Foundation's list, it is not entirely clear that local governments are prohibited from creating a local income tax. Under Article 11, Sections 4 and 5 of the Texas Constitution, cities may impose taxes "authorized by law," but are restricted in taxing more than 1.5% (cities with fewer than 5,000 population) or 2.5% (cities with more than 5,000 population) in one year the taxable property in the city.[14] Counties, detailed in Article 9, have similar limits on the amount of taxation, based on taxable property value, but no discernable restriction on the *type* of tax that may be imposed.

The legislature should clarify and strengthen the provision recently modified by HJR 38. The amendment requires little more than the addition of local governments in those prohibited from creating or imposing an income tax. A proposal is as follows:

> *Sec. 24-a. INDIVIDUAL INCOME TAX PROHIBITED. The legislature may not impose, or authorize a political subdivision to impose, a tax on the net incomes of individuals, including an individual's share of partnership and unincorporated association income.*

This amendment would protect future Texans from local governments seeking additional revenue from Texans already overburdened by state and local taxation.

2. *Policy Recommendation: State-Level Preemption of Short-Term Rentals*

Through services like Vrbo and Airbnb, homeowners can rent out their houses, apartments, and condominiums to visitors for short periods of time at nightly or weekly rates. These short-term rental (STR) properties are popular on a worldwide scale. Airbnb, for instance, offers more than 6 million properties for rent across more than 100,000 cities in more than 200 countries.[15] More than 1 billion people have used Airbnb to find a place to stay while traveling.[16]

At their most basic level, STRs involve a decision by property owners to lease out their own real property. This is a transaction that has taken place for thousands of years. That new technology facilitates it with greater ease today is no cause for alarm. And yet, local governments have imposed restrictive measures on property owners leasing their own property as STRs.

Given the broad range of regulatory approaches taken by cities with respect to STRs, the Texas Legislature has considered a statewide regulatory structure that would preempt the cities with a market-friendly approach that respects the private property rights of homeowners.

Despite a 2018 ruling from the Texas Supreme Court stating a homeowners' association that restricts home use to "residential purposes" does not prohibit home use as a short-term rental, little else has been done to protect STRs.[17] On December 9, 2022, the City Plan Commission of Dallas voted 9-4 to prevent short-term rentals in single-family residential neighborhoods.[18] Following the vote, the recommendation will be sent to the City Council for full consideration. If Dallas approves this measure, they will join a growing list of Texas cities like Fort Worth and Arlington that ban STRs in residential areas.[19]

Since the 85th legislative session, there have been numerous attempts to pass such a bill. Despite continued success in the Senate, support repeatedly fails to materialize in the House. While attempts to establish free-market regulatory structures on a statewide level continue their push, attempts to pass burdensome state-wide regulation are increasing. Attempts to address this issue in the 87th Legislative

Session failed to gain traction as well. Yet it remains the case that STRs represent an area in which local governments have overreached. These types of onerous local-level regulations and prohibitions should be either prohibited entirely or preempted by a sensible state-level regulatory framework.

E. The state of paid sick leave regulations and mandates

State preemption on paid sick leave ordinances was a recommendation of the TCCRI Task Force on Free Enterprise, Energy, and Infrastructure in 2019.[20] As explained in that report, most private employers already offer paid sick leave to their employees voluntarily because it is good policy for those private companies.[21] But good *private* policy is not necessarily good *public* policy.

In November 2018, Texas's 3rd Court of Appeals ruled that Austin's paid sick leave ordinance is unconstitutional by way of preemption through the state's minimum wage law.[22] The Texas Minimum Wage Act expressly prohibits municipalities from regulating the wages of employers. The court concluded that Austin's ordinance "increases the pay of those employees who use paid sick leave. Thus, under the plain language of the TMWA, the Ordinance establishes a wage."[23] The Texas Supreme Court denied review of the case, firmly establishing the unconstitutionality of mandatory sick leave policies across the state.

1. Policy Recommendation: State-Level Preemption of Paid Sick Leave

Despite a final ruling from the Texas Supreme Court on the larger question of unconstitutional mandates, local governments in Texas cannot seem to help themselves. Both San Antonio and Dallas passed paid sick leave ordinances though San Antonio's never went into full effect as the result of a legal challenge. Dallas on the other hand was successful but only saw temporary effects before a federal court blocked enforcement of the policy. If Democrat-led cities continue to undermine the free-market values of Texas, which it seems they are intent on doing, then the legislature has an obligation to step in.

V. Housing Supply and Affordability

Housing prices across the country have skyrocketed in recent years; the median price of existing homes in the United States reached $407,600 in May of 2022.[24] The period from the end of March 2021 to the end of March 2022 alone saw explosive growth of 20.6 percent in in home prices nationally.[25] An August 2022 article in The Wall Street Journal stated that, according to real estate company Redfin, housing prices were up a staggering 44 percent over the two previous years.[26]

As the state that consistently attracts the most new residents every year, Texas has seen its housing prices soar. In May 2022, the average and median price of houses sold in Texas reached all-time highs of $443,077 and $360,000, respectively.[27] In an effort to combat sustained inflation, the Federal Reserve in 2022 has raised interest rates that banks charge each other for overnight borrowing to their highest levels since 2007.[28] Mortgage rates have consequently increased, which has cooled the housing market somewhat. But the average and median prices of homes selling in Texas were still quite high in October 2022: $404,878 and $335,000 in October 2022, respectively.[29]

The rapid increase in housing prices in Texas is, unsurprisingly, particularly evident in its largest counties, where much of the state's population lives and where many businesses cluster. The table below illustrates this trend:

Table: Increase in Median Selling Prices of Homes in Select Texas Counties, May 2020 versus May 2022

County	May 2020	May 2022	Percentage Increase from 2020 to 2022
Bexar	$230,214	$315,000	36.8%
Dallas	$249,900	$395,000	58.1%
El Paso	$170,000	$235,000	38.2%
Harris	$232,895	$335,000	43.8%
Tarrant	$248,345	$376,000	51.4%
Travis	$390,000	$650,000	66.7%

Source: Texas Real Estate Research Center at Texas A&M University[30]

Renters have seen significant increases as well. A July 2022 report, for example, found that rent had increased year-over-year by double-digit percentages in Dallas, Houston, San Antonio, Austin, and Fort Worth.[31]

Given these rapid increases, middle-class Texans face the prospect of being priced out of Texas's largest cities. Additionally, the soaring cost of housing in the state could deter many businesses and individuals from re-locating to Texas. Without sound policies to provide affordable housing to average families, Texas' cities- Austin in particular- run the risk of watching their housing markets transform into those of cities like San Francisco. The Legislature should focus on (a) reducing costs associated with home ownership, and (b) easing regulations that have the effect of constraining housing supply. The latter will require preempting local law. A number of specific recommendations are discussed below in detail.

Note: Because a shortage of affordable housing is an issue in the large, populous cities of Texas, some of the recommendations below should apply only to cities with a population that exceeds a certain threshold (perhaps 400,000 residents). Property taxes and the fixed fees for title insurance, on the other hand, are statewide problems and accordingly the measures that address them should be applied statewide.

A. Reform the Property Tax Appraisal System

As discussed in TCCRI's *Budget and Taxation Task Force Report*, property taxes remain a significant problem in Texas despite key reforms in recent legislative sessions. In general, House Bill 3 (86R, Huberty, et al.) caps the year-over-year growth of a school district's maintenance and operations (M&O) property tax revenue (excluding new property in the district) at 2.5 percent unless a local election is held and voters approve a greater increase. For most taxing units other than school districts (e.g., cities and counties), Senate Bill 2 (86R; Bettencourt) applies a similar cap of 3.5 percent on year-over-year increases in M&O tax revenue, again subject to voters approving a greater increase in an election.[32] Senate Joint Resolution 2 (87S3, Bettencourt, et al.), approved by voters in May 2022, and its enabling legislation, Senate Bill 1 (87S3; Bettencourt), increased the homestead exemption from school district taxation from $25,000 to $40,000.

Despite these steps, Texas still ranks in the top ten states with the heaviest property tax burdens on single family homes.[33] High property taxes drive up the cost of home ownership (and renting). Attom Data Solutions reports that Texas had an average effective property tax rate of 1.31 percent on single family housing in 2021.[34] If a family purchases a $350,000 house in Texas, makes a 20 percent down payment, and has a 30-year mortgage at 6.5 percent interest, it will pay $,1769 in principal and interest each month. It will pay another $382 in property taxes each month, which is a full 21.6 percent of the principal and interest amount.

To further limit property taxes, the Legislature should change certain elements of the property tax appraisal system. Many Texas taxpayers are familiar with property tax appraisal process, through which the applicable county appraisal district (CAD) determines the value of their property. The Legislature could improve this process in several respects.

First, the board of directors (BOD) of a CAD is currently appointed by the governing bodies of the local taxing units which fall inside the CAD's boundaries. Greater accountability for appraisals could be achieved by having the elected heads of the taxing units within a CAD serve as the BOD and directly approve appraisals. By making the already-elected taxing entity officials serve as the BOD, real and long-overdue accountability and responsiveness would be injected into the administration of the property tax. Since these officials are already elected, voters would not have to educate themselves on another set of candidates, but would benefit because the appraisal process would become a subject for debate during election campaigns, with the members of the CAD's BOD having to defend their records.

1. *Policy Recommendation: Make the elected leaders of taxing units within a central appraisal district (CAD) serve as the CAD's board of directors (BOD).*

Section 23.23 of the Tax Code provides that homesteads cannot be appraised for an amount that exceeds 110 percent of the previous year's appraisal, although this cap does not apply to improvements to the property made in the last year. But this cap (the "10 percent appraisal cap") does not apply to second homes or to rental properties. Extending the 10 percent appraisal cap to all properties in the state would protect owners of rental properties, many of whom are "mom and pop" investors, from crushing year-over-year property tax increases. In turn, landlords as a whole should pass on at least a portion of those savings to renters, assuming a competitive market. The Legislature should pursue this idea, although a constitutional amendment would be required.

2. *Policy Recommendation: Extend the 10 percent cap on year-over-year growth in homestead appraisals to all real estate in Texas.*

Due to the 10 percent appraisal cap and its cumulative effects over time, there may be a significant gap between a homestead's appraised value and its market value. For example, a person's homestead could have a $400,000 market value but an appraised value of $300,00 with the functional equivalent of a $100,000 exemption attributable to the 10 percent appraisal cap. If the owner of the property sells this homestead and purchases another homestead, he or she would effectively be penalized because the sale results in the forfeiture of what is essentially a $100,000 exemption. Ideally, a homeowner should be able to transfer that $100,000 exemption to the new homestead. There are two possible ways in which to calculate the transferred exemption: either as a flat-dollar amount, or as a percentage of the previous homestead's value. In the above example, the exemption transferring to the new property would be either $100,000 or 25 percent.

Notably, a similar concept exists in current law with respect to the "tax ceiling" for homestead owners who are age 65 or older or who are disabled. This tax ceiling caps the amount of school district property taxes such an owner pays annually at the amount he or she paid in the first tax year in which he or she qualified for the ceiling.[35] Under the Texas constitution and Section 11.26(g) of the state Tax Code, when a beneficiary of this ceiling subsequently owns a different property that qualifies as a homestead, the tax ceiling transfers to the new property. This transferred exemption is in percentage terms rather than flat-dollar terms. For example, if a homeowner who currently qualifies for the ceiling pays $5,000 in school district property taxes but would pay $10,000 without the ceiling, then the ceiling on his or her subsequent homestead will be 50 percent of the school district property taxes that would be due on the subsequent homestead if no ceiling were in place.

This transferring concept can easily be applied to the 10 percent appraisal cap exemption. In the above example of the homestead with a $400,000 market value and $300,000 taxable value, 25 percent of the value of the new homestead (again, ignoring all other applicable exemptions) would be exempt from school district property taxes. Thus, if the new homestead is worth $700,000, the taxable value of the property would be only $525,000 (i.e., 75 percent of $700,000).

> *3. Policy Recommendation: Permit a homestead seller who purchases a new homestead to choose to either carry over his or her 10 percent appraisal cap exemption to the new homestead, or to inherit the 10 percent appraisal cap exemption of the person who sells him or her the new homestead.*

Alternatively, the law could be amended to permit the buyer of a property to "step into the shoes" of the seller and benefit from any 10 percent appraisal cap exemption that the seller had with respect to the property at the time of the sale, assuming that the property qualifies as a homestead in the hands of the buyer. Better still, the Legislature could give people who sell their homesteads the choice of either carrying over their ten percent appraisal cap exemption from the sold property, or assuming the seller's ten percent appraisal cap exemption (if any) on the new property.

Making an exemption attributable to the 10 percent appraisal cap portable would have the benefit of giving people the freedom to move to the location that is best for them and their families, without having to worry about what effectively is a financial penalty. Whatever its form, this policy recommendation would also require a constitutional amendment.

B. Title Insurance

The pricing of Texas title insurance under current law is anti-competitive and adds unnecessary costs to the purchase of a property. While title insurance itself unquestionably offers significant value, the manner in which the state regulates the price of it ensures that the price exceeds that which would exist in an unregulated market. Reforming title insurance will not solve the problem of unaffordable housing in Texas, but it can contribute to that end.

Title insurance protects homeowners and lenders against the loss of their interests in a property as a result of defects in title to the property. Although title insurance is not required in Texas, lenders as a matter of course require title insurance to be purchased on the property to protect the lender's interest.[36] This title insurance for the benefit of the lender is sometimes referred to as a loan policy. In addition, the homeowner can purchase an owner's policy, which protects him or her from problems arising from defects in the title to the property.[37] In Texas, it is customary for the seller to pay for the owner's policy, and for the buyer to pay for the loan policy, although this custom can be altered through negotiations between the buyer and seller.[38]

The price of title insurance in Texas is tied to the value of the policy purchased, which in turn is generally tied to the purchase price. For any given policy value in Texas, the price is fixed by state law; these "promulgated" rates for title insurance are an outlier compared to other states. According to a 2019 survey by the National Association of Insurance Commissioners, only Florida and New Mexico set their rates in similar ways.[39] In Texas, for policies ranging between $100,001 and $1 million, the premium is calculated according to the following formula:[40]

*[(policy value – $100,000) * 0.00527] + 832*

Thus, for example, a $350,000 policy would cost $2,149.50. Again, there is no variability in this fee: all title insurance companies must charge according to the formulas in law, no more and no less.[41] Title insurance is not a recurring cost, although a purchase of title insurance will effectively be required when the property is sold. Additionally, a new loan policy is likely to be required when a homeowner refinances.

Some discounted rates apply in certain circumstances. For example, the cost of title insurance is discounted if the relevant loan is refinanced within eight years of the loan date; the discount is 50 percent if the refinancing is withing four years of the loan date and 25 percent if the loan is five to eight years from the loan date. After eight years, no discount for title insurance in the case of refinancing is available.[42] In addition, if a loan policy and owner's policy are purchased at the same time, the cost of the loan policy is only $100.[43]

Texas government fixing the price of a service provided by the private sector is a rarity. The principle behind the free market is that businesses compete with each other on the basis of price, quality, and other factors in an attempt to attract consumers. Businesses that provide good value and consumers as a whole are the beneficiaries of a well-functioning market system. When companies do not compete on the basis of pricing, it is possible that consumers will be charged more for the relevant good or service than they would be in a market system.[44]

There is indeed considerable evidence that consumers are being overcharged for title insurance in Texas. A 2016 study by the University of Texas at Austin LBJ School of Public Affairs found that, when taking into account the discount for a loan policy and an owner's policy that are purchased simultaneously, the extra costs due to promulgation are $1,079.20. (If only a loan policy is purchased, the extra costs rise to $1,633.) That $1,079.20 represents a surcharge that Texans must pay for title insurance compared to states with non-promulgated prices.[45] A different 2017 study found that Texas had the fifth-highest title insurance costs in the country.[46]

Compared to other types of insurance companies, title insurance companies pay out little in the way of claims. In a 2019 hearing before the Texas Department of Insurance (TDI), the Texas Land Title Association estimated that loss ratios[47] over the preceding 10 and 15 years were 2.80 and 2.87 percent, respectively.[48] It assumed an additional 1 percent for catastrophic events, which do not occur with

consistency.[49] A 2021 news article stated that, in 2017, Texas title insurance companies took in $1.8 billion in premium revenue and paid $24 million (~1.33 percent) to settle claims.[50] By comparison, in 2018, the loss ratio was 58 percent for Texas property insurers and 57 percent for auto collision insurance.[51]

TDI has pointed out, though, much of the cost of title insurance is attributable to research expenditures rather than the paying of claims.[52] As AM Best, a credit rating agency, explains: "Since title insurance is an evidence-producing/loss-prevention line of insurance, its loss expense is less than - and its operating expense is greater than - that of other property/casualty lines of business. Insurance expenses are loss-prevention, underwriting-related and loss-related."[53]

It is also true that title insurance in Texas title insurance may cover some services that policies in some other states do not,[54] thereby making an "apples to apples" comparison difficult. On that point, however, it is worth noting that the 2016 study from the LBJ School of Public Affairs found that title insurance was still more expensive in Texas even when comparing it only to other states whose title insurance fee provided comprehensive services.[55]

While controlling for every variable in a comparison between state title insurance fees is difficult, it is important to focus on a fundamental question: why does the state of Texas fix the price of insurance, in contrast to thousands of other goods and services which are subject to market forces? Phrased differently, why is a title insurance company in Texas prohibited by law from competing with other companies by lowering its prices, thereby enabling consumers to shop for the best price?

Defenses of the current title insurance industry in Texas are unpersuasive. In a statement on its website,[56] the Texas Land Title Association features some words that its then-president made in 2016.[57] Those claims are listed below, with a response to each claim.

First, "Over the past two decades, Texas title insurance rates have decreased by approximately 15 percent, while the costs of other similar goods and services have increased. A $150,000 title policy on a home today costs $1,152, while in 1991 the same policy cost $1,347."

Assuming this claim is true, it still does not justify the current pricing structure of title insurance in Texas. The fact that a service was even more expensive years ago does not mean it is not overpriced today. Second, "Simplistic comparisons to insurance premiums in other states (like those cited by the Texas Association of Business and Texas Public Policy Foundation) don't show the full picture. In many states, while insurance premium rates may appear lower, other costs such as attorney's fees, abstract fees and higher closing fees drive the cost up, resulting in higher total costs. Having a known, consistent premium rate, as we do in Texas, takes the guesswork out of this part of the real estate transaction."

The response to this claim is that many consumers would gladly accept some fluctuation in the price of title insurance if, on average, it was significantly cheaper. After all, consumers accept some degree of price fluctuation in almost every market where companies compete on price. If the cost for a home

inspection fee were fixed by the state at $5,000, that would remove any uncertainty consumers have about what a home inspection would cost, but it would be a very anti-consumer measure, because most home inspections can be obtained at a much lower price.

Third, "Because title claims are much lower in Texas, Texas consumers have the peace of mind knowing they are at much lower risk of someone challenging their right to own and enjoy their home or property. During the first three quarters of 2015, Texas ranked first in the nation in the amount of premiums written, yet ranked 8th in the nation in lowest claims. This can be compared to California, which is second in the nation in premiums but ranks 41st in lowest claims, and Nevada, which ranks 40th in lowest claims."

The above data does not prove or even necessarily support the claim that Texas' price-fixing of title insurance reduces claims (presumably by the extra costs enabling more thorough work by insurance companies when researching titles). The data is not comprehensive, listing only a few states and covering only a nine-month period. Furthermore, there are numerous variables across states that could influence the number of claims filed, such as their relative population density, the degree of commercialization, and the type of properties insured. Even assuming that fixing title insurance rates reduced the number of claims, the magnitude of the reduction would need to be known; it is quite possible that many consumers would find the (alleged) reduction in risk is not worth the tradeoff of the higher cost of insurance. To use the analogy of a home inspection again, the state could mandate that all house inspections must cost $5,000. This inflated fee would permit a home inspector to make extraordinarily thorough inspections of homes, which might result in detecting more flaws in the homes. But that does not mean consumers would welcome fixed inspection fees of $5,000.

Fourth, "Texas has always put a priority on protecting individual property rights. The Texas title insurance system is part of that important public policy framework. Texans can count on knowing they have access to high quality title insurance services from local companies in their communities all across the state. Most importantly, this is a system that has worked well and served Texan's well for the better part of a century."

Charging people excessive prices for a good or service while eliminating the ability of prospective competitors to offer lower prices is not consistent with respect for property rights. The fixed-price title insurance system in Texas has worked well for title insurance companies, at the expense of Texas consumers. In 2021, there were roughly 414,000 houses sold in Texas.[58] If one assumes, conservatively, that the buyer and seller in the average transaction collectively overpaid by an average of $1,000, the title insurance industry extracted rents of $414 million from consumers in one year alone.[59] As the authors of the 2016 LBJ School of Public Affairs bluntly state:

> Our analysis indicates that the promulgation of rates [i.e., fixing prices by law] in Texas is a strong determinant that explains the state's higher title-related charges. By requiring the promulgation of title rates, Texas transfers wealth from property owners directly to title agents and title underwriters, with no additional value to the property owners. The

system functions as a 'reverse Robin Hood transfer.' It is unclear why the Texas Legislature requires the Texas Department of Insurance (TDI) to set rates for title policies when it allows competition in all other lines of insurance. The promulgation of title rates provides no known benefits to Texas property owners; it is just an additional cost for title insurance in Texas reflecting the absence of price competition that makes it more expensive and difficult for Texans to purchase land or properties. While it benefits the title insurance industry, there is no benefit to consumers who fare much better in nearly every other state.[60]

1. Policy Recommendation: Eliminate the Fixed Pricing of Title Insurance

Texas should eliminate the fixed pricing of title insurance in Texas and allow the market to work in the same way it does for life, auto, and other types of insurance.

2. Policy Recommendation: Extend the Time Frame in Which Title Insurance is Discounted When it is Purchased in Connection with a Refinancing

If fixed pricing cannot be abolished, extend the time frame in which title insurance is discounted when it is purchased in connection with a refinancing; a discount of 50 percent should apply to such title insurance policies if the owner of the property refinances within 30 years of the loan date and obtains title insurance from the original title company again. Of course, this would apply only if there were no intervening owner of the property between the loan date and date the property is refinanced. As current law recognizes, a discount in the case of a refinancing is appropriate because most of the property's title history has already been examined. A 30-year time frame would match the term of most mortgage loans in this country.

C. Allow homeowners to exercise their property rights

Many homeowners at some point consider the construction of a secondary dwelling on their property. The National Association of Home Builders states that these accessory dwelling units (ADUs) offer "an additional self-contained living unit that typically has its own kitchen, bedroom(s) and bathroom space, while maintaining independence and privacy from the primary home. ADUs can take many forms: a second small backyard cottage on the same grounds as (or attached to) a single-family house, an apartment over the garage or a basement apartment."[61] ADUs are sometimes referred to by a variety of other terms, including granny flats, in-law suites, and casitas.

ADUs have the potential to create a significant supply of new housing stock. However, many cities have ordinances which limit the ability of homeowners to construct (or if already constructed, to lease) ADUs.

For example, the city of Austin imposes various requirements on properties with ADUs, such as capping the size of an ADU, which cannot exceed the lesser of (a) 1,100 square feet, or (b) the square footage that is equal to 15 percent of the lot size; requiring in some circumstances that additional parking be constructed if an ADU is built; and prohibiting an ADU built after October 1, 20215 from being used as a short-term rental more than 30 days of the year.[62]

Policymakers around the country are recognizing the potential of ADUs to ease the housing crunch. In September 2022, Assembly Bill 2221 passed into law in California. Among other things, this bill narrows the ability of cities to impose height limitations on ADUs and requires cities to provide more detailed explanations for rejecting applications for ADUs.[63] In 2021, the Utah Legislature enacted House Bill 82, which permitted "internal" ADUs in residential areas, subject to certain exceptions, and preempted any local law to the contrary. An internal ADU is one within the primary dwelling unit, such as a basement apartment. In November 2022, the San Antonio City Council liberalized the rules regarding ADUs, eliminating a requirement that ADUs have only one bedroom and allowing the construction of ADUs nearer to property boundaries.[64]

Of course, unrestricted use of ADUs would have the potential to dramatically alter the character of neighborhoods, but a balance should be struck, one that recognizes the general right of people to use their property as they see fit and allows homeowners to utilize ADUs without dramatically altering the appearance of a neighborhood.

1. Policy Recommendation: The Legislature should preempt local law and provide that:

The Texas Legislature should preempt local law and provide for the following:

- ADUs may be constructed at any time on any property where single-family housing is permitted: before, after, or concurrent with the construction of the primary dwelling.
- Density or growth limits do not apply to ADUs.
- ADUs may be used for rentals (although a minimum rental term could be required), or sold as a freestanding unit.
- ADUs and their associated primary dwellings are not contingent on owner-occupancy.
- Additional parking may not be required for an ADU, unless the ADU's construction removes, replaces, or occupies what was formerly space for parking.
- ADUs may have utilities that are either shared with, or separate from, the primary dwelling. On this point, the Mercatus Center notes that "Austin, Texas, requires a rental ADU to have its own water meter and often to upgrade the tap line—and the cost of that reportedly runs to $25,000 there."[65]
- A local government may not charge the owner of a single ADU an impact fee. Alternatively, a fee could be permitted, as long as it is capped at a reasonable amount.

Existing zoning regulations would still apply, but could not discriminate against ADUs. For example, height limitations or setback requirements applicable to the primary dwelling unit would apply to ADUs as well. Deed restrictions or HOA rules prohibiting ADUs would remain in force.

Creating more ADUs will not solve the housing affordability problem on its own, but it can play a key role. In 2016, Los Angeles issued 80 permits for ADUs. In the first 10 months of 2017, that number increased to 1,980.[66] That number can be expected to grow as people learn more about ADUs. Vancouver, British Columbia, a city where awareness of ADUs has long existed, has almost 30,000 ADUs.[67]

D. Minimum Lot Size

Many cities across the country require property lots to be a minimum square footage. According to a 2019 article by the *Austin-American Statesman*, Round Rock and Pflugerville required new single family houses to be constructed on lots of 6,500 to 9,000 square feet, respectively. In Frisco, the corresponding figure is at least 7,000 square feet in most cases.[68] In Austin, the figure is generally 5,750 square feet.[69] In contrast, the figure in Houston is generally only 1,400 square feet.[70] Thus, 5,750 square feet of land in Houston can accommodate up to four houses, whereas the same area of land in Austin can accommodate only one.

The discrepancy between Houston and the other cities suggests that homeowners in the latter may be paying for a larger lot size than they wish. It is possible that some people in that group, given the option, would have gladly purchased a house on a lot of (for instance) only 3,000 square feet. Not only would these people save money, but more land would be available for housing, leading to an increase in the supply of housing over time. At least two studies[71] have found what common sense would suggest: high minimum lot requirements drive up the cost of housing.

Free market principles include a respect for property rights and the general freedom of parties to contract. Just as homeowners should be able to use their property to construct ADUs (subject to reasonable limitations), people should be able to purchase homes that have the characteristics they seek, provided real estate developers are willing to construct them. The case of Houston proves that there are many people in Texas who would happily purchase a lot that is much smaller than the minimum required size in many Texas cities.

1. Policy Recommendation: Preempt local law on minimum lot size

The Legislature should preempt local law and provide for a minimum lot size of no more than 1,400 square feet. Once that it in place, the market can take its course and people will not be forced to purchase houses on lots that are larger than what they seek. Given their smaller size, small lots perhaps

(those smaller than 3,000 or 4,000 square feet) should also less stringent setback and parking requirements than larger lots.

E. Allow Third Party Reviews of Development Applications

One way to increase the supply of housing is to increase the rate at which it can be built. Building even a simple single family home can require various inspections, approvals, and permits. If the local government body tasked with this oversight is understaffed or poorly run, the approval process is delayed, and less housing is built. Even when housing is built, delays results in additional costs (e.g., higher interest costs for developers), which translate into higher housing prices.

Dallas provides an instructive example. According to the Dallas Home Builders Association (DBA), the poor response by the city of Dallas to the onset of the COVID-19 pandemic resulted in lengthy delays in issuing permits, with some homeowners waiting three months rather than days.[72] Fortunately, the city of Dallas eventually hired three vendors to provide third party review of permit requests.[73] But the head of the DBA estimated that the delays by the city from March through November of 2020 resulted in a loss of between 587 and 849 homes, lessening the city's tax base by $264 million to $382 million.[74]

Similarly, the vice president of policy and government affairs for the Real Estate Council of Austin stated in 2020 that "Travis County has the reputation of having one of the most inefficient review processes in Texas."[75] The county acknowledged that it had difficulty keeping up with the flow of applications given its fixed staff, and that third party review should be considered to expedite applications. Notably, Tesla's negotiations with Travis County allowed the company to secure a third-party reviewer to oversee development.[76]

1. Policy Recommendation: Require cities to accept third party reviews from licensed, certified professionals (e.g., engineers).

There are certified and licensed professionals who have the ability to evaluate the plans and permits that are prerequisites for the development of housing. Developers and homeowners should have the ability to obtain a review from these parties if a local government body is not able to quickly process applications. Notably, the Legislature has already demonstrated a willingness to use third party reviews in some cases. Senate Bill 877 (87R; Hancock), which passed into law, authorizes qualified private inspectors to conduct municipal building inspections when the municipality is under a disaster declaration. That bill passed both the House and Senate unanimously. The logic behind that bill should be extended to be generally applicable, not just during disasters.

F. Promote Greater Transparency of Development Fees

Although many Texans do not realize it, there are a large number of fees charged by municipalities during the housing development process. These fees include site plan application fees, parkland

dedication fees, impact fees (these fees are for the construction of infrastructure that are required as a city grows, such as roadways), and building permit fees.[77]

There is, however, a pronounced lack of knowledge about these fees. Of course, that makes it hard for the public to demand, through their legislators, policies to promote transparency and reduce fees. As the Real Estate Research Center at Texas A&M University noted in a June 2022 study, "There is a remarkable lack of comprehensive information on local government's role in Texas' housing development process."[78]

That study attempted to shed some light in this area by examining the total per-unit fees charged by certain Texas cities for two types of developments: a 40-acre development yielding 200 single family homes, and a one-acre development yielding four single family homes. The table below, taken from the study, summarizes the fees.

Table 1. Estimated Per-Housing Unit Fee Charged by Select Municipalities for Two Developments

	40-acre suburban-style development yielding 200 single-family homes	One-acre infill-style development yielding four single-family homes
Houston min	$4,841	$5,014
Houston max	$4,867	$5,093
Dallas	$11,320	$13,099
Fort Worth min	$8,800	$12,424
Fort Worth max	$11,556	$15,180
Liberty Hill	$20,388	$22,009
Manor	$9,149	$11,011
Pflugerville min	$8,580	$9,060
Pflugerville max	$11,723	$12,278
Round Rock	$10,891	$11,256
San Marcos	$8,212	$10,188
Austin	$18,168	$41,303
San Antonio min	$9,202	$10,234
San Antonio max	$11,830	$12,862
Kyle	$11,320	$13,190
Georgetown	$11,170	$16,507
Buda	$10,214	$12,453
Leander	$10,488	$13,886
average	$10,845	$13,725
median	$10,891	$12,438
min	$4,841	$5,014
max	$20,388	$41,303

Source: Real Estate Research Center at Texas A&M University[79]

As the table shows, the average total fees per housing unit for the first type of development are $10,845, and those for the second type of development are $13,725. While Houston does an excellent

job of charging low fees relative to other cities, Austin's fees are on the opposite end of the spectrum, reaching a staggering $41,303 per unit in some developments.

The Legislature can take three steps to address these fees.

First, just as state agencies undergo sunset review every 12 years to ensure they are fulfilling their missions and operating efficiently, local development codes should be scrutinized periodically by a municipality's governing body. All new housing regulations, and all regulations subject to sunset-style review, should carry a fiscal note, similar to those prepared by the Legislature Budget Board for state legislation. Each report should include input by private sector actors as well as an explanation on what has been done, and what could still be done, to lower housing costs.

To prevent a conflict of interest, the fiscal note should be prepared by an entity selected by the state, rather than by the local government. The note should reflect the costs of the regulation, how it affects properties of different sizes, its effect on overall housing supply, and the extent to which it increases or decreases rent and/or mortgage payments.

Second, the Legislature should require a municipality to publish annually a link on its website that shows an itemized breakdown of all fees charged for common types of developments along with an explanation of the purpose of each fee. Additionally, the link should include the most recent sunset-style report, discussed above.

Third, the 88th Legislature should authorize a task force for the 88th Interim to examine how the state can best encourage local governments to reduce fees in the housing development process. A possible manner of doing so would be to direct grants from the Texas Department of Transportation and/or federal community development block grants to municipalities that show progress in reducing fees. The task force's composition could be modeled on that set forth in House Bill 2674 in Arizona, a 2022 bill that created a bipartisan committee with private sector members to study housing supply shortages in that state.[80]

1. *Policy Recommendation: More Accountability in Housing Regulations*

All new housing regulations should be accompanied by a fiscal note prepared by an independent party and by input from stakeholders, and that all existing housing regulations are subject to sunset-style review every 12 years.

2. *Policy Recommendation: Transparency in Development Fees and Regulations*

Municipalities should be required to list on their websites an itemized breakdown of all fees charged for common types of developments, an explanation of the purpose of each fee, and the most recent sunset-style report on housing regulations.

3. Policy Recommendation: Create an interim task force to study housing development fees

The legislature should create an interim task force to study how best to encourage local governments to reduce or at least freeze government fees currently assessed during the housing development process, perhaps by preferentially allocating grants to local governments that demonstrate progress in this area.

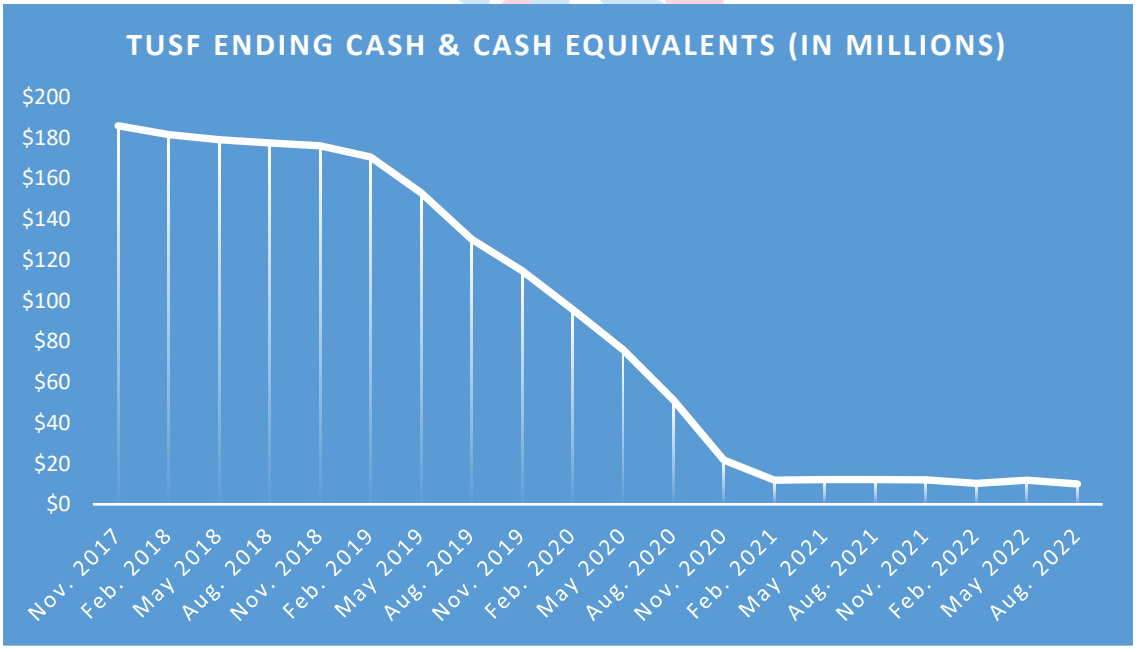
VI. Texas Universal Service Fund

A. Background

The Texas Universal Service Fund (TUSF) was originally authorized in 1987 to assist telecommunications providers in providing basic local telecommunications services to rural areas of Texas at reasonable rates, the idea being that these areas were otherwise too high-cost for the market to incentivize providing telecommunications services to them.[81] There are currently 11 programs that receive distributions from the TUSF, including low-income and disability programs, and schools and libraries assistance programs, but the majority of funds (60%-90%) go to telecommunications providers in rural Texas.[82]

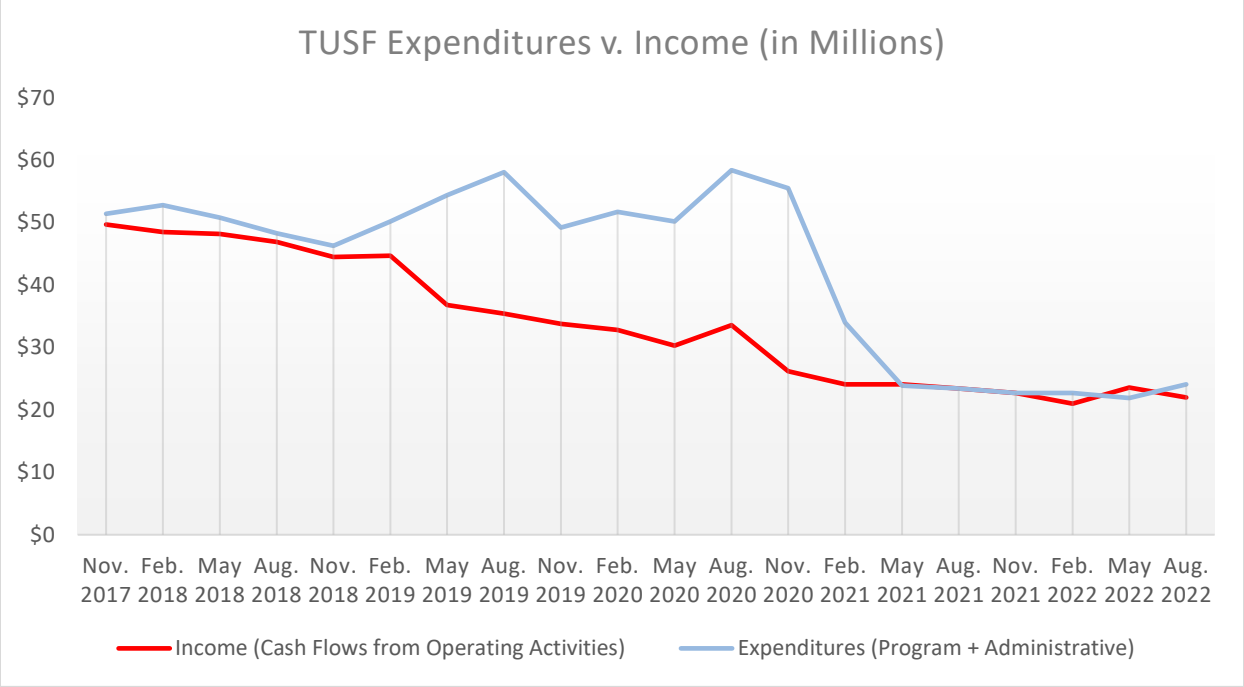
The TUSF is funded by a universal statewide assessment charged by telecommunications providers to their customers.[83] This typically appears on customer phone bills as a line item fee. Money collected through the fee goes into the TUSF, which is administered by the Public Utility Commission of Texas (PUC). The PUC distributes collected TUSF funds back to certain telecommunications providers, primarily in rural areas of Texas, using a preexisting formula.

The TUSF fee has never been a popular item on phone bills for customers, but the TUSF has come under scrutiny for additional reasons in recent years. Most notably, the TUSF is running out of money. At the height of the TUSF in 2006, the fund had a balance of $650 million.[84] As of August 2022, the fund has less than $10 million. The following chart tracks the TUSF quarterly since November 2017:



Source: TUSF Financial Reports[85]

It is clear that the TUSF's obligations are far greater than its collections, and this was particularly true during the period of rapid decline between 2017 and 2020, but given the fund's $650 million balance in 2006, the TUSF has been upside down for nearly two decades. The following chart tracks TUSF income and expenditures over the same period:



Income to the TUSF has been in gradual decline for years, largely because the TUSF and its assessments are meant to impact voice service, which is dying out as more and more customers move to data services that have voice capabilities. PUC was aware of this trend in 2020 and in order to meet TUSF obligations, the Commission considered increasing the TUSF assessment fee from 3.3% to 6.4%, which was proposed by PUC staff.[86] While this would have delayed further necessary changes, further increases would still be needed in the future, so PUC made the decision to not increase assessments during the COVID-19 pandemic.[87]

The resulting shortfall is apparent in the chart above. What can clearly be seen during this period is that despite steady, largely predictable decline in cash flow, expenditures did not come down proportionally. The TUSF balance was drained to a point that forced a sharp decline between late 2020 and mid-2021. As can be seen in both charts, the fund has been relatively stable since 2021, albeit with a low balance, low expenditures, and less income. Even now, as the fund balance dwindles, TUSF expenditures in the quarter ending in August 2022 were approximately $1 million more than income through TUSF assessments.[88]

What is clear is that the TUSF is financially insolvent, at least to the extent that it is intended to function. What is not clear is what action should be taken to address the insolvency. While legitimate questions

about the continued need for a TUSF exist, the overwhelming policy goals of the PUC, state legislators, and providers that receive TUSF funds is finding a "fix" for the fund.

B. Litigation

In January 2021, a group of rural telecommunications providers sued the PUC, arguing that they were due certain payouts under statute and PUC rule, and that the PUC violated those provisions when it did not pay the full amounts, and, more importantly, when it did not completely fund the TUSF to enable payment of the expected amounts, which were based on PUC orders.[89] The latter question relates directly to the PUC's decision not to increase assessments from 3.3% to 6.4% in 2020, which would have extended solvency of the TUSF through much of 2021.[90] The main PUC rule that the rural providers asserted established, they argued, that the TUSF administrator "shall determine, on a periodic basis, the amount needed to fund the TUSF" and that "[t]he determined amount *shall be approved* by the [C]ommission."[91] The Third Court of Appeals offered a succinct summary of the process for determining TUSF assessments and payouts:

> The Commission determines the amount needed to fund TUSF based on the cost of each program within TUSF, sets the uniform charge in the appropriate amount to cover the costs of those programs, requires every telecommunications provider with customers in Texas to pay its share of the uniform charge (which the providers collect from their customers), and then pays monthly to each TUSF-eligible provider the amount of financial support that the provider has demonstrated it needs in a contested-case proceeding and that the Commission has ordered.[92]

Essentially, over the period of several years, people rapidly moved away from traditional telecommunications services in favor of wireless service and voice over internet protocol (VOIP) service. The change was so rapid that the TUSF simply could not adjust in real time and the balance was depleted. Taxable receipts related to the telecommunications services tied to the TUSF dropped by $1 billion between 2018 and 2019.[93] There were a number of discussions had about raising the assessment rate, narrowing the scope of what qualifies as a "rural" area, but ultimately each PUC Commissioner agreed that the Texas Legislature should be responsible for addressing the TUSF's insolvency.[94]

While taking no action on assessment rates or rulemaking pertaining to the reach of TUSF assessments, PUC implemented what it called "triage," which essentially rationed TUSF funds by prioritizing certain recipients, requiring at least $4 million in the TUSF, and allocating remaining money paid out in support payments to rural and high-cost providers.[95] This effectively resulted in a 60%-70% reduction in rural providers' TUSF support payments.[96]

As these events unfolded, the Texas Legislature had convened for the 87th Legislative Session. In February 2021, 77 Texas Legislators signed a letter urging the PUC to "take emergency measures" to ensure that no one experiences a loss of connectivity due to rural telecommunications providers no

longer receiving fully expected payments.[97] The letter urged PUC to increase the assessment rate and broaden the assessment base to include VOIP service.[98] Perhaps disrupted by winter storm Uri, after which PUC Chairman Walker and PUC Commissioner Botkin both resigned, PUC took no action on these requests.[99] The Legislature did, however, pass a bill relating to these issues, which Governor Abbott vetoed. That bill, House Bill 2667, will be discussed in the next section.

In June 2022, the Third Court of Appeals ruled in favor of the rural providers, concluding that the PUC acted outside of its legal authority when it implemented "triage" and reduced TUSF obligations to rural providers.[100] The Court also ruled that PUC Commissioners violated their own rules by ordering reduced TUSF payouts to rural providers because the law did not provide them with that discretion. The Court's ordered remedies prohibited the PUC from continuing its "triage" approach to TUSF payments and required it to find a way to fully fund the TUSF.[101]

C. The Governor's Veto

The Texas Legislature is aware of the funding issues surrounding the TUSF, though rather than question why the balance is rapidly approaching zero and questioning whether or not the program remains necessary, the legislature attempted to "fix" the program by expanding it to include new streams of revenue. House Bill 2667 (Smithee) would have expanded the application of the TUSF beyond "telecommunications Providers" and required fee assessments of "voice over Internet Protocol service" (VOIP), which allows a person to make phone calls using the internet.[102]

The case for the bill was openly about increasing funding to the TUSF in order to sustain its long-term viability. The author's bill analysis explained that "The TUSF is currently underfunded and does not pay out the full obligation due to high cost providers."[103] Supporters of the bill argued that it "would address funding shortages of the Texas Universal Service Fund (TUSF)."

The problem with HB 2667 was its underlying premise, which is that the state has financial obligations to pay out using the TUSF and the TUSF needs more money to meet those obligations. As will be discussed in a later section, the TUSF is a success story that has long outlived its original purpose. Governor Abbott recognized that fact when the vetoed the bill, offering the following statement in doing so:

> Coming into the 87th Legislative Session, everyone knew that the Legislature needed to consider significant reforms on broadband and the Texas Universal Service Fund. Transformational broadband reform was achieved through multiple bills that have been signed into law, which significantly expand broadband access in Texas, especially in rural areas. Yet the only meaningful change made to the Texas Universal Service Fund was, in House Bill 2667, to expand the number of people paying fees. It would have imposed a new fee on millions of Texans.[104]

Governor Abbott astutely observes that expanding broadband services to rural Texas addresses the very same purpose of the TUSF as originally envisioned; it provides telecommunications services to high-cost, rural parts of the state. Expanding broadband services to rural Texas is a superior approach. Traditional phone service is still a useful technology, but it is no longer the only technology, and the state need not expand a program that subsidizes it at a high cost to Texans, particularly when other services are available.

D. The PUC Raises TUSF Assessment Rates

Governor Abbott vetoed HB 2667 on June 18, 2021. The Third Court of Appeals issued its ruling on June 30, 2022. In the span of one year, the TUSF went from having a legislative solution to its funding woes, to being back where it started before the legislative session began, to being ordered to take action to remedy the TUSF's funding and payment issues all on its own. And take action it did.

Only July 14, 2022, in response to the court's order, the PUC raised the TUSF assessment from 3.3% to 24% on all intrastate calls.[105] According to the PUC, this 627% assessment increase "will generate enough in fees to fully fund all outstanding obligations."[106] But "once the outstanding obligations are fulfilled, the Commission anticipates lowering the rate to a level that maintains the fund balance going forward."[107]

E. Modern Services and Technology Have Rendered the TUSF Obsolete

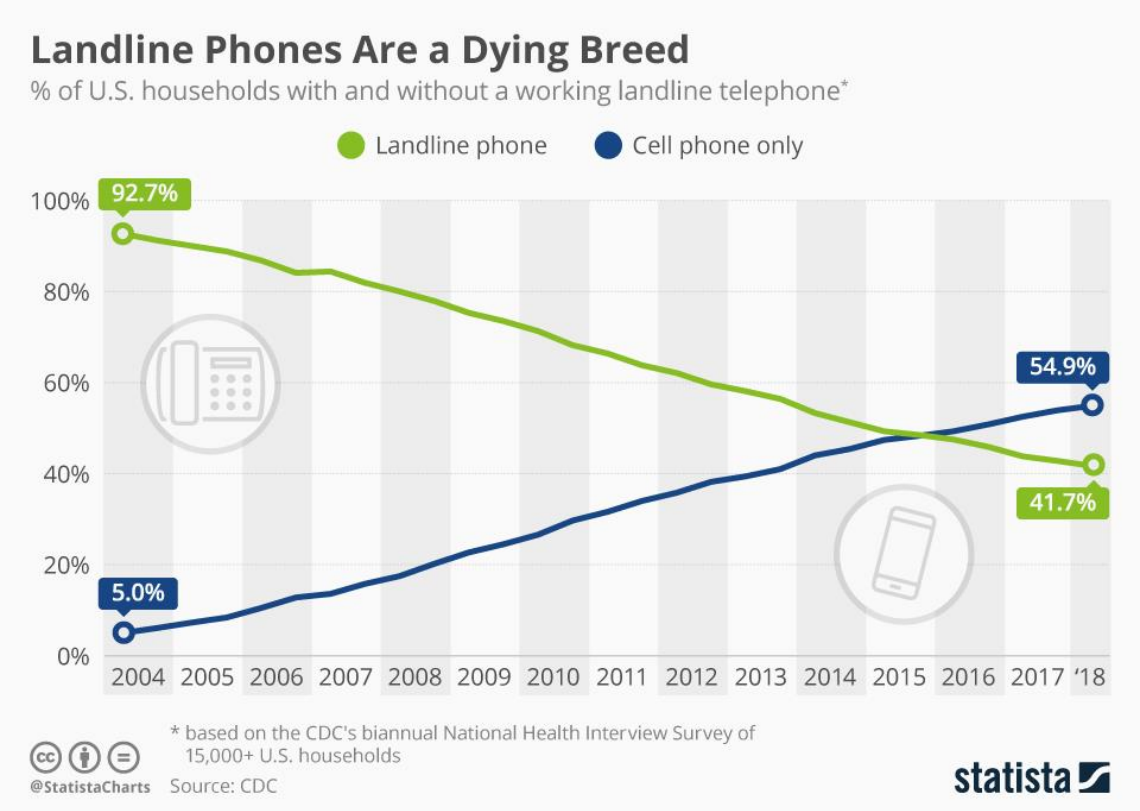
Too much of the conversation around the TUSF focuses on its funding and continued existence, and not enough attention is paid to why it is no longer self-sustaining in the first place, and whether it still serves an unfilled need.

Consider the development of telecommunications over the last century. Since the Communications Act of 1934, federal law has called for "making available, so far as possible, to all the people of the United States a rapid, efficient, nationwide and worldwide wire and radio communication service with adequate facilities at reasonable charges."[iv] Until the 1990's this almost exclusively applied to traditional landline telephone service, which is what the TUSF supports.

But the marketplace is unpredictable. Though government chose traditional landline phone service as the technology of necessity in rural Texas, it did not take long for new products and services to arise and compete with what had long been a telecommunications technology monopoly.

Cellular phones become affordable and popular in the 1990's. In 1998, AT&T began offering the "one-rate" plan, which eliminated roaming and long-distance charges, which paved the way for the proliferation of wireless services with unlimited long-distance calling. This set the stage for wireless devices to take over as the preferred phone service.[108] That takeover happened. Indeed, in 2004 only 5%

of U.S. households had a cell phone only, meaning a cell phone and no landline.[109] That same year, 92.7% of U.S. households had landline phone service, regardless of whether or not they also had a cellular phone.[110] It took little more than one decade for that to change. By 2015, exclusive cell phone ownership overtook landline service (with or without a cell phone).[111] The following chart clearly illustrates this trend, which continued beyond 2018 to present:



Source: Diverse Tech Geek[112]

As users have come to prefer alternatives to traditional landline phones, telecommunications companies have provided them. Indeed, the very same telecommunications companies that purport to need TUSF payouts in order to stay in business and offer landline phone service offer phone service through newer technologies. In the summer of 2022, TCCRI conducted a survey of telecommunications companies that receive funds through the TUSF and confirmed that they offer broadband service or high-speed internet, meaning they offer affordable phone service regardless of whether or not their traditional landline phone service is propped up by supplemental income from the TUSF. Take, for example, all of the telecommunications companies that received six-figure (or higher) TUSF disbursements for "small and rural support" between June 2022 and August 2022, and whether or not they offer broadband or high-speed internet services:

Company	TUSF Disbursement (Jun.-Aug. 2022)	Offers Broadband/High-Speed Internet

Big Bend Telephone Company, Inc.	$135,547.75	Yes
Brazoria Telephone Company	$110,520.54	Yes
Consolidated Comm of Texas Company	$190,352.98	Yes
Eastex Telephone Cooperative Inc	$318,183.71	Yes
Etex Telephone Cooperative	$177,333.92	Yes
Hill Country Telephone Cooperative	$204,589.84	Yes
Peoples Telephone Cooperative	$105,842.37	Yes
Poka-Lambro Telephone Cooperative Inc.	$104,409.55	Yes
Valley Telephone Cooperative, Inc.	$236,633.64	Yes

As the biggest small and rural financial recipients of TUSF support payment for a dying service, these companies all offer functionally the same service using a newer technology that is available in the areas they serve. This undercuts the primary argument against expanded and continued funding for the TUSF.

Supporters of House Bill 2667 argued that "[r]ecent decisions by the PUC have placed many rural customers at risk of losing basic telephone service or paying a significant increase for basic service, which overlooks the basic policy goal of universal service established by the legislature."[113] This assertion needs to be recognized for the slight-of-hand it is. Proponents of expanding and continuing the TUSF talk about "basic telephone service" as though we were still living in 1990, but the very companies that receive subsidy from the TUSF for basic telephone service also offer phone service through broadband and high-speed internet.

F. Policy Recommendations

It is important to remember that entities receiving streams of funding through government programs will never support the elimination of those programs. They will always have arguments in favor of maintaining a subsidy. Those arguments always sound persuasive, particularly when framed in terms of companies going out of business, people losing jobs, and constituents losing needed services. But as laid out in this report, the TUSF has evolved from an arguably necessary program into an unnecessary, but ongoing, subsidy to rural telecommunications companies. Those companies have prepared for the changing marketplace by offering telecommunications services untethered from the TUSF.

1. *Policy Recommendation: Reject Efforts to Expand the TUSF*

Governor Abbott was correct to veto House Bill 2667. Texas need not expand a government subsidy program that is dying out simply by virtue of the fact that the technology it supports is no longer being used to the degree that it once was. Wireless technology, broadband, and high-speed internet all offer telecommunications services. Efforts to broaden the TUSF's assessment base should be rejected.

2. *Policy Recommendation: Eliminate the TUSF*

To the extent that the TUSF was needed to ensure that rural parts of the state, high cost areas, and certain emergency and education related services had access to telecommunications services, the program should be viewed as one of government's greatest success stories. Government should recognize when a program has served its purpose and eliminate it. Rural Texas has access to more telecommunications services than were in existence at the TUSF's inception. There is infrastructure and a competitive marketplace that will continue to exist after government subsidies go away.

3. *Policy Recommendation: Narrow the Scope of the TUSF*

Should the political will not exist to eliminate the TUSF, the legislature should statutorily adopt the PUC's "triage" plan, prioritizing healthcare and education services before rural and high-cost areas. Even if one accepts the premise that the TUSF is absolutely necessary to provide telecommunications services in certain areas, it remains abundantly clear that the program's scope is far greater than those areas in which it is necessary.

VII. Direct Automobile Sales

The Occupations Code contains thousands of pages of regulations covering everything from "Healing Art Practitioners" to "Bingo" games. Quite often these regulations are anticompetitive and protectionist in nature. Take, for example, Section 2301.476, which prevents auto manufacturers from directly selling their products to consumers.[114]

The practical effect of 2301.476 is to set in law the means by which an automobile manufacturer must sell its automobiles in Texas.[115] That has been a successful model for a long time, but successful business models need to be protected in statute from new models that may challenge the status quo.

The old model was built around the internal combustion engine. Now, there is a competitor to that model in the form of electric cars that does not have the same needs in terms of engine service and upkeep. The old model does not translate directly to this newer technology. Manufacturers of this newer technology would like to operate under a different business model and there are multiple reasons why it makes sense for them to do so.[116]

Electric cars use a completely different kind of technology from the internal combustion engine, they are sold with a high level of customization, and the costs of maintenance on fully electric vehicles are quite low which is important because traditional dealerships earn most of their revenues through service, which would clearly not be the case for electric cars.[117] Moreover, selling through franchises and dealerships would increase their costs unnecessarily, making it more difficult for manufacturers to turn a profit and would undoubtedly increase the cost for the consumers. In short, the old business model codified in Section 2301.476 of the Occupations Code does not serve the needs of a changing marketplace.

A. The Ongoing Fight Over Direct Automobile Sales

The fight over maintaining the current statutory dealership franchise model in Texas is well documented. During the 87th Legislative Session House Bill 4379 was introduced which would have provided an exception for electric car manufacturers—like Tesla—would have been carved out of 2301.473.[118] In the 83rd Legislative Session a similar bill was filed and despite neither piece of legislation having a direct impact on the current automobile dealer model, the dealer industry objected loudly. Indeed, of the parties testifying against HB 3351 in its 2013 Business and Industry Committee hearing, five of the six were automobile dealers, and all six had an interest in maintaining the status quo:[119]

- **Texas Automobile Dealers Association**
- Texas Recreational Vehicle Association
- **Dallas Fort Worth New Car Dealers Association**
- **San Antonio Automobile Dealers Association**
- **Houston Automobile Dealers Association**

- **The New Car Dealers of West Texas**

Automobile dealers cannot be faulted for protecting their own interests. However, the purpose of government is not to protect the "franchise system" from competition. Other industries across the board are permitted to experiment with different means of distribution. Apple, for instance, sells their products in most retail stores *and* directly through their own stores. It is difficult to imagine any legislator supporting a bill that would prevent Apple from selling iPhones in its own stores, but that is essentially how 2301.476 treats automobile manufacturers. The main difference is that somewhere along the way, automobile dealers' business model became codified in law in a way that protects them from such competition.

Since Texas law prohibits motor vehicle manufacturers from also owning dealerships, Tesla, and companies like it are excluded from the Texas Light-Duty Motor Vehicle Purchase or Lease Program.[120] There is much debate to be had about whether or not the state should be funneling taxpayer money to subsidize expensive new electric vehicles but if the program is going to operate, it should not unfairly punish the most popular manufacturer of electric vehicles because they simply wish to do business differently.

It is unclear who—besides the automobile dealers—might object to lifting restrictions on direct automobile sales. What is clear, however, is that 2301.476 protects automobile dealerships from new business models. Leaving it in place is government endorsement of a one-size-fits-all distribution method for automobiles. This prevents new companies from innovating, and it restricts choices among consumers. Companies like Tesla may succeed or fail, but that outcome should be the result of the quality of their product, and not because they were restricted from using the business model that they believe gives them the best opportunity to succeed.

B. Policy Recommendations

1. Policy Recommendation: Repeal Restrictive Provisions in Section 2301.476 of the Occupations Code

Statutorily protecting a specific business model is anti-competitive, and it is not the proper role of government. As the cliché goes, government should not pick winners and losers in the marketplace. If Tesla and future companies want to try something different, they should be permitted to do so. The 88th Legislature should repeal 2301.476(c) and related provisions to allow automobile manufacturers to sell directly to their customers.[121]

2. Policy Recommendation: Create an Exemption for Electric Car Manufacturers

Should the Legislature be unwilling to open the automobile dealership market to free market competition, allowing direct sales by manufacturers of electric cars would be a step in the right direction. This would cause little to no disruption in the existing market and it would show that legislators in Texas are committed to reassessing market restrictions.

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