TEXAS TAXPAYERS
TTARA
AND RESEARCH ASSOCIATION

Research Report April 2022

Relief from Rising Values

2019 Property Tax Reforms Cutting Tax Rates at a Record Pace

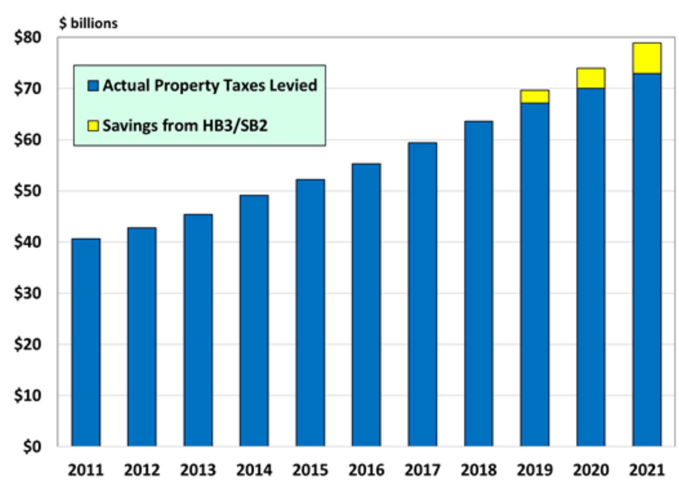
Appraisal notices will be in the mail soon, and Texas property owners need to be prepared for the sticker shock that home shoppers have been experiencing the past year. BUT, unlike years past, rising appraisals aren't likely to drive tax bills through the stratosphere. The massive property tax reforms of 2019 are protecting property owners from their appraisals.

Texas' hot real estate market is driving up property values, and the truth is, many of those sky-high appraisals simply reflect the current market; however, those appraisals are only half of the tax equation. The other half is the tax rates those values will be subject to. Unlike sales, gasoline, franchise and other taxes, property tax rates are set each year based on the budget desires of the local jurisdictions that levy the tax. In 2019 lawmakers passed two landmark bills – House Bill 3 by Dan Huberty (R-Humble) and Senate Bill 2 by Paul Bettencourt (R-Houston) – that made major reforms in school finance and local government budgeting practices. Both were long and complicated bills, but each included provisions granting Texans some degree of relief from spiraling property tax increases.

Now almost three years after both bills became law, enough time has passed to assess that promise of tax relief. Though few tax bills are actually shrinking, the spiraling growth of property taxes of the past few decades has been abated. As property values rise, jurisdictions are finding they must cut tax rates or face voters. As a result, property tax rates are dropping like never before. And that has translated into taxpayer protections. Based on historical trends, TTARA estimates Texas property tax bills would have been $6 billion, or 8%, higher in 2021 had it not been for property tax reforms lawmakers enacted recently (Figure 1).

HB 3 and SB 2 constrained the ability of taxing jurisdictions to raise the amount of property taxes they collect without the approval of their voters. HB 3 essentially limits school tax growth to 2.5%, while SB 2 limits most other large taxing units to increases of 3.5% before voters must approve. And the timing couldn't be any better, as the housing market in Texas

Figure 1
Texas Local Property Taxes, 2011-2021
The Impact of 2019's HB 3 and SB 2



Source: Texas Taxpayers and Research Association is exploding, with values spiraling upwards. In years past, those value increases would have almost automatically translated into commensurately higher tax bills. Instead, jurisdictions now must cut their tax rates to limit the amount of tax increases their property owners face. Tax bills may still grow as values rise, but a 10% increase in one's appraised value no longer means a tax bill roughly 10% higher. That tax bill will now grow closer to 3 to 5%. And with the healthy economy padding paychecks, property taxes as a percentage of household income are falling for the first time in decades.

The simple truth is no matter what your appraisal, property tax bills would not be going up unless local jurisdictions wanted to spend more money. Regardless of your 2022 appraisal, right now your 2022 tax bill is zero. Your tax bill won't be set until the jurisdictions in which you reside decide how much money they want to raise and set their tax rates.

As positive as SB 2 and HB 3 have been for taxpayers, it will take many years for Texas to become more tax competitive with other states absent additional infusions of state funds to bring our local taxes more in line. That could happen in 2023. Comptroller Glenn Hegar projects the state will end the current budget period with a $12 billion surplus – an estimate that may prove to be conservative. Lawmakers in 2023 should have more than sufficient funds to further buy down tax rates for Texas property owners.

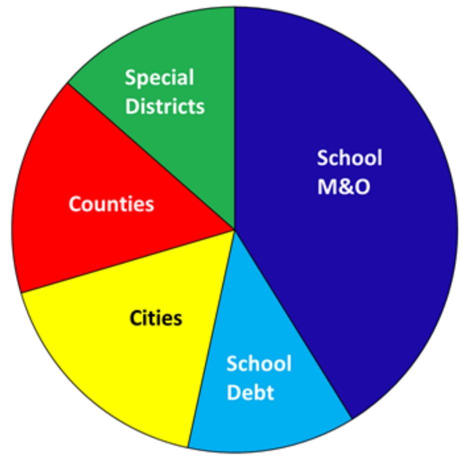
Property Taxes in Texas Today

While we often refer to it as the "property tax," in fact, the average Texas property tax bill is the sum of separate taxes for maintenance and operations (M&O) and for debt service of a variety of local jurisdictions – school districts, cities, counties, and a variety of special districts including those for hospitals, water/wastewater, flood control, emergency services, etc. School M&O and debt taxes combined are 53% of the average Texas property tax bill, with the remainder split roughly evenly across cities, counties, and special districts (Figure 2).

School taxes and rates operate a bit differently from other types of taxing units. Huberty's HB 3 addressed school tax rate setting, and Bettencourt's SB 2 revamped how cities, counties, and special district rates are set.

Figure 2

Texas Property Tax Levies, 2021



2021 Tax Levy ($bl)	
School M&O	$30.1
School Debt	$8.9
Cities	$12.5
Counties	$11.7
Spec Dists	$9.9
Total	$73.1

Source: Texas Comptroller of Public Accounts.

HB 3: School Property Tax Rates Falling.

Texas public schools are funded through a complex system of formulas that guarantee a certain dollar amount of funding per student. The design of Texas' school finance system has been heavily driven by court orders and is highly equalized. The state guarantees school districts a uniform amount of revenue per student (with some adjustments for various student weights and other factors). Each school district levies a property tax, and if that tax falls short of the guaranteed amount, state aid makes up the difference. If the school district's tax revenue exceeds the guarantee, the state "recaptures" the excess and distributes it to other districts.

The state guarantee has been fixed at a dollar amount stated in law – it does not grow with inflation. However, property values grow with the economy from one year to the next. Prior to the passage of HB 3, school districts would become "wealthier" simply from normal economic growth, resulting in a loss of state aid. To offset that loss, districts kept tax rates high. Historically, as local tax collections grew and as state aid diminished, the share of public education funded by the state edged lower each year.

HB 3 by State Representative Dan Huberty (R-Humble) and State Senator Larry Taylor (R-Friendswood) revamped those formulas. Now as values grow above a certain rate, rather than suffering a corresponding loss of state aid, districts are instead required to reduce their tax rates. Over time, school tax rates will drop as values rise, limiting increases in individual tax bills. Tax bills will still rise, but at a much lower pace than in prior years. In 2021, the average school district tax rate was $1.24 per $100 of taxable value (Figure 3) – a penny less than the $1.25 rate in 2006 after a massive education finance reform bill. In fact, 2021's school tax rates were the lowest since 1991, or 30 years ago.

HB 3 in 2019 created two different methods by which school districts must reduce their tax rates for maintenance and operations (M&O, excluding taxes for enrichment) without any corresponding loss in state aid: 1) based on statewide value growth, and 2) based on the local district's value growth. The school district must adopt the lowest tax rate of the two.

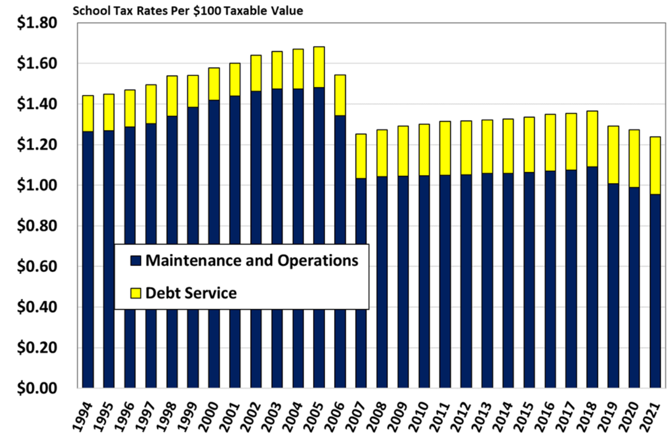
Figure 4 illustrates how school tax rates for maintenance and operations are driven down.

Statewide Compression. Statewide property value growth above 2.5% is essentially used to compress school M&O tax rates–forcing tax rates down as values rise.

Looking at how tax rates were set in 2020 illustrates how HB 3 works (Figure 4). In appropriating funds for the Foundation School Program, the formulas by which state aid is distributed to (or local taxes recaptured from) a school district, the budget bill relies on an estimate of statewide property value growth. [1] For the 2020 tax year, lawmakers estimated overall values would increase 4.01%. The Texas Education Agency (TEA) calculated a tax rate compression factor used to

Figure 3

Texas School Tax Rates on the Decline
Statewide Average Rate Per $100 of Taxable Value



Source: Texas Comptroller of Public Accounts

determine the "maximum compressed rate (MCR)" based on the excess over a statutorily-set 2.5%. The factor for the 2020 tax year was 0.9854 (1.025 / 1.0401), which, when applied to the previous year's MCR tax rate of $0.93, resulted in a maximum compressed rate of $0.9164 for all school districts ($0.93 x 0.9854).

Any year in which statewide school district value growth exceeds 2.5% will trigger statewide tax rate cuts. That will be most years, as school values have exceeded 2.5% roughly nine years out of 10 since 1994.

Additional District-Specific Rate Cuts. TEA also calculates a second MCR based on each school district's

Figure 4

School District Tax Rate Calculations Under 2019's HB 3

Statewide Tax Rate Compression		District-Specific Tax Rate Compression	
2019 School M&O Tax Rate (MCR)	$0.93	$0.93	2019 School M&O Tax Rate (MCR)
State Value Growth Estimate	4.01%	10.00%	Local District Growth Estimate
State Value Growth Limit	2.50%	2.50%	State Value Growth Limit
Compression Calculation	98.55%	93.18%	Compression Calculation
2020 School M&O Tax Rate (MCR)	$0.9164	$0.8665	2020 School M&O Tax Rate (MCR)

Source: Texas Taxpayers and Research Association

[1] Stated in Rider 3 of the budget for the Texas Education Agency in the General Appropriations Act.

local value growth. In the example in Figure 4, the local school district's tax roll grew by 10% – well above 2020's projected state average of 4.01%. TEA calculates the district's unique factor based on the 10 percent growth relative to 2.5% – 0.9318 (1.025 / 1.10) – which is multiplied with the district's prior year MCR tax rate to produce a 2020 district MCR of $0.8665. In order to maintain an acceptable level of equity, a district's MCR tax rate may not be more than 10% lower the rate in any other school district.

The district compares its rate based on the statewide MCR and its district-specific MCR and is required to adopt the lower of the two – the district-specific MCR of $0.8665.

Since these tax rate compression formulas were adopted, school M&O tax rates have dropped from an average of $1.09 in 2018 to $0.95 in 2021 – a 13% rate reduction in just three years. That has taken substantial sting out of appraisal growth. Over the past three years taxable values have increased by 23%. Under the old school finance system, school tax bills for M&O would have risen by roughly that amount. Instead, thanks to falling rates, school tax bills increased by only 8% – two-thirds less. Even though those tax bills increased, tax bills for most Texans were more affordable, as Texans' personal income over the past three years has grown 17% – more than twice as fast as school tax bills have risen.

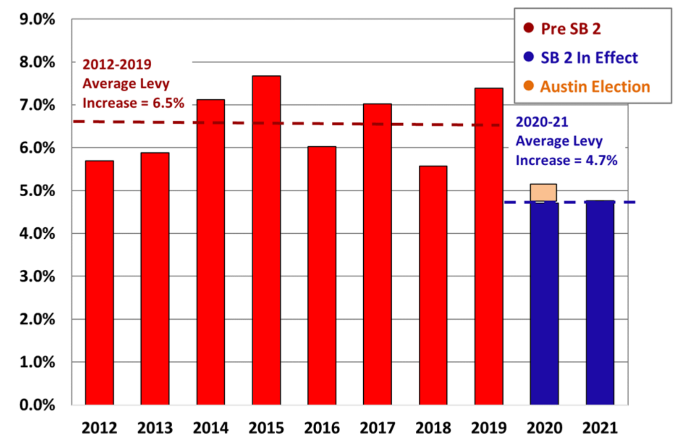
SB 2: City, County, and Special District Tax Rates Falling, Too

Cities, counties, and special districts do not receive state aid, so the state cannot substitute state dollars to bring down their tax rates, as it can for schools. Instead, the state simply imposes revenue thresholds above which jurisdictions must get voter approval.

Prior to 2019's SB 2, in the event a city, county or special district adopted a tax rate for maintenance and operations that produced property tax collections that were more than 8% higher than the previous year (excluding taxes on new property), the jurisdiction's voters could petition for a "rollback" election, which, if successful, rolled back the tax rate to one which would generate 8% revenue growth. With inflation over the past several years running near zero, the 8% threshold, adopted in 1981, offered little protection for taxpayers.

Figure 5

City, County, and Special District Property Taxes Percent Increase from the Prior Year, 2012-2021



Source: Texas Taxpayers and Research Association

SB 2 reduced the threshold for most large taxing jurisdictions to 3.5% tax revenue growth while making the rollback election automatic – no petition required. Though not all districts observed this new 3.5% threshold during the pandemic, most did, and the impact on property tax collections was significant.

Excluding a massive voter-approved tax hike in Austin, which would have occurred regardless of the new thresholds, property taxes levied by cities, counties and special districts over the past two years have increased by 4.7% (Figure 5), almost two percentage points less than the 6.5% average increases of the prior eight years (dating back to the Great Recession). [2]

Overall Property Tax Burdens Easing

In absolute terms, property taxes do continue to rise, but at a much slower rate as Texas voters have a greater degree of control over their tax bills than ever before. In 2021 Texas property taxes were a record $73 billion, but had HB 3 and SB 2 not been in effect, tax bills would have tallied $79 billion.

It's difficult to develop a statewide average tax rate for all jurisdictions, as schools, cities, counties, and special districts all have different tax bases and different exemptions. However, comparing total property taxes levied against the market value of all property – its value prior to exemptions – the trend of declining effective rates on the market value of all property in the

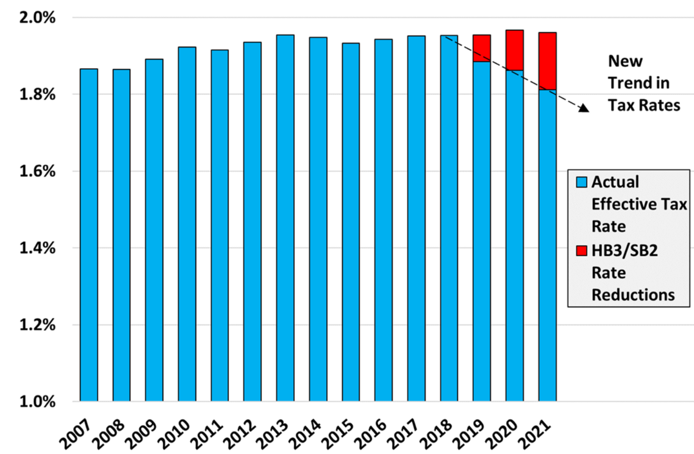
[2] These growth rates are higher than the new 3.5% voter threshold imposed on many large taxing units for two reasons. First, taxes collected on new value are not subject to the limit. This allows a jurisdiction to add new revenue as its population and the corresponding demands on services grows. Second, many jurisdictions are not subject to the 3.5% threshold. Hospital districts, junior college districts and any district with a tax rate below $0.02 per $100 of valuation are exempted, and the 3.5 percent threshold does not apply if the tax increase amounts to less than $500,000.

state is clear (Figure 6). Property taxes levied in Texas relative to the market value of all property hovered around 1.95% from 2012 to 2018. By 2021 that figure dropped to 1.81% and will continue to decline in the coming years.

Property taxes relative to people's ability to pay as measured by personal income has also seen a recent decline. From 2011 to 2019, property taxes as a percent of Texans' personal income crept upwards from 3.8% to 4.4%. Over the past three years that upward trend has been reversed and the percentage is now in decline, dropping to 4.2% in 2021, and will continue to decline over the coming years.

HB 3 and SB 2, though not cutting existing tax bills, has taken a substantial sting out of future tax increases and will benefit Texans for years to come. By no means has the property tax beast been slain, but its power is clearly being tamed.

Figure 6
Total Property Tax Levies as a Percent of Market Value Effective Property Tax Rates—2012 –2021



Source: Texas Taxpayers and Research Association

Tax Rates Matter: Track Them on Texas.gov/PropertyTaxes

No matter what your appraisal, the truth is your tax bill is zero until the local jurisdictions in which one owns property adopt their tax rates for the year. Unlike other taxes, there is no permanent property tax rate. Local jurisdictions set a new tax rate every year based on their budget desires. Those tax rates are usually set in poorly-attended public hearings late in the summer, after appraisals have been finalized.

A new provision of SB 2 gives Texans greater information about their property tax bills at the internet website Texas.gov/PropertyTaxes. This website will direct you to your county webpage where you can enter a property address and access information about the tax rates jurisdictions propose to adopt and how they will impact the tax bill for that specific property. The time, date, and location of tax rate hearings is provided. For those who can't or choose not to attend the public hearing, the webpage for the property includes a link by which taxpayers can submit comments on the proposed tax rates by email.

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