HOUSE RESEARCH ORGANIZATION *constitutional amendment*

Texas House of Representatives *June 19, 1997*

Proposition 1 (HJR 4 by Craddick, Junell, et al./Armbrister, Bivins)

Raising homestead exemption, portability of senior tax freeze

Texas voters have approved 364 amendments to the state Constitution since its adoption in 1876. Under Art. 17, sec. 1 of the Constitution, the Legislature proposes constitutional amendments in the form of joint resolutions, which must be approved by at least two-thirds of the membership of each house and presented to the voters for their approval. The Legislature decides the date of the election and the ballot description for proposed amendments. During its 1997 regular session, the 75th Legislature approved 15 joint resolutions proposing constitutional amendments: 14 will be submitted to the voters at the November 4, 1997, general election; one, HJR 4 by Craddick, Junell et al., will be considered as Proposition 1 at a special election on August 9, 1997. The earlier election is scheduled to allow school districts sufficient opportunity to revise their tax rates if the proposition is approved.

Background

School districts and many other local government entities raise revenue by levying ad valorem taxes on the appraised value of property. The Texas Constitution, Art. 8, sec. 1-b, includes several exemptions that reduce the taxable value of residential homesteads for determining ad valorem taxes. Two exemptions involve school district taxes exclusively: all residential property owners have a $5,000 homestead exemption, and the Legislature may authorize an additional exemption of up to $10,000 for those who are disabled or age 65 and over.

Art. 8, sec. 1-b also provides that the amount of school property taxes on the residential homesteads of persons age 65 or older may not increase from the time they reach that age until they cease to use the property for a homestead or make significant improvements. For example, if the taxable value of a homestead was $50,000 and the school district tax rate was $1.00 per $100 when the homeowner turned age 65, the person's school tax bill of $500 will never be higher, regardless of any subsequent increase in the value of the property (except for significant improvements) or in the school tax rate. The 65-and-over tax freeze may be passed on to a surviving spouse age 55 and over, but the Constitution does not provide for transferring the tax freeze to a new homestead.

Digest

Proposition 1 would increase from $5,000 to $15,000 the amount of the constitutional homestead exemption, thereby reducing the taxable value of residential property for calculating school taxes. The Legislature could provide that all or part of the exemption not apply to a district or political subdivision that imposed property taxes for public education purposes but was not the principal school district providing public education throughout its territory. The higher exemption would take effect starting in the 1997 tax year.

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Proposition 1 also would allow a proportional amount of the 65-and-over tax freeze to be transferred to another homestead. In addition, the tax paid by individuals now receiving the tax freeze would be lowered by an amount equal to the additional $10,000 exemption multiplied by the 1997 school tax rate.

The ballot proposal reads: "The constitutional amendment providing school property tax relief by increasing the residence homestead exemption by $10,000 and providing for the transfer of the tax limitation to another qualified homestead for persons over 65 and a reduction in taxes on homesteads subject to the limitation."

If voters approve Proposition 1, HB 4 by Craddick, Junell, et al., the enabling legislation, would appropriate $1.04 billion to cover the revenue lost to local school districts as a result of the additional homestead exemption. Since under state law the additional state money for the foundation school program would increase the teacher minimum salary schedule by six percent over the next two years, HB 4 also would appropriate money to school districts to cover the increased cost of teacher salaries. It would adjust the minimum contract length for teachers from 185 days to 186 days and would appropriate $65 million to an enrollment contingency fund to cover unexpected increases in enrollment growth. All of these provisions are contingent on voter approval of Proposition 1. (For other provisions of HB 4 that will take effect regardless of voter approval of Proposition 1, see "NOTES" following.)

Supporters say

The existing $5,000 homestead exemption should be increased to give meaningful and equitable property tax relief to homeowners in Texas. Proposition 1 would not reduce funding for the school finance system because the state would send school districts enough to cover the reduced amount of local property tax revenues caused by the $10,000 exemption increase. The net result would be one of the largest tax reductions in state history and would significantly increase the state's share of the school finance system. The Citizen's Committee on Property Tax Relief, formed by Gov. George W. Bush in 1995, found that property taxes on residential property were increasing faster than economic growth and income and some form of property tax relief was needed. Proposition 1 would be the first installment of property tax relief and allow time before the next legislative session for a broad consensus to be reached on even greater tax relief.

Homestead exemptions are considered a fair, progressive tax relief mechanism because a larger proportion of the value of lower-valued homes is exempted and a larger portion of the tax bill is reduced for owners of those homes. A family living in a $50,000 house would see a 20 percent reduction in the taxable value of their home, while a family in a $250,000 home would see a four percent reduction. The amount of actual dollar savings in property taxes would be based on the local tax rate applied to the property valuation. The owner of a home taxed at the average school district rate of $1.42 per $100 valuation would save $142 per year in property taxes.

A $5,000 exemption may have provided adequate tax relief in 1978, when it was originally approved, but with twin increases in inflation and the average value of homes, an adjustment is overdue. Based on the consumer price index, $5,000 in 1978 was worth nearly $14,000 in 1996. The average price of a home purchased in Texas in 1979 was $52,900; today, that price has gone up 95 percent, to $108,800, according to the Real Estate Center at Texas A&M University. Raising the exemption to $15,000 would just bring it back into line with current values, allowing the exemption to accomplish its original purpose of providing basic tax relief.

Property tax rates also have substantially increased in recent years. According to the comptroller's Annual Property Tax Report, the average school property tax rate in 1984 was 60 cents per $100 valuation; in 1996, the average rate was $1.42 per $100 valuation, an increase of more than 136 percent. Mandating lower school tax rates would not allow equal relief across the state because of the vast differences in property wealth among the various districts. An increased homestead exemption would guarantee that all Texas homeowners realized some diminution in their property tax bills.

Those districts not subject to the exemption would include special districts that do not receive state aid based on property tax collections. Such districts, like the Dallas and Harris County School Districts, provide aid to all school districts in the county, but do not receive state aid and do not serve as the primary school district for the area. These districts would be unable to make up for the loss in revenues without state aid. County rehabilitation districts, like the South Texas Independent School District, would also be excluded because they aas well receive no state aid.

The infusion of over $1 billion of state money to the school finance system would increase the state's share of the total cost of education from the current 46 percent to 49 percent, according to Legislative Budget Board (LBB) estimates. In reviewing the Texas school finance system in the four *Edgewood* cases, the Texas Supreme Court consistently said that the system would be better equalized if the state increased its share of the cost of education. This would reduce the disequalizing effect of the wealth disparities among the 1,044 school districts produced by property tax bases that vary widely in value per student. The more the state must rely on local revenues to fund education, the greater the disequalization in the system.

An increased state funding share also would elevate the basic allotment in the school finance system, i.e., the amount of money guaranteed to each student and used as a base for applying the school finance formulas. The current basic allotment is $2,387 per student. With the approval of Proposition 1 and its enabling legislation, HB 4, that amount would increase to $2,396, according to LBB estimates.

The increased homestead exemption also would reduce the effects of recapture, the "Robin Hood" system put into place with SB 7 by Ratliff in 1993 to mitigate the effects of the wide disparities in wealth among Texas school districts. Currently, any district with a per-student property wealth exceeding a certain amount must return part of the revenue collected due to its higher wealth to the state or purchase attendance credits from other districts. Any increase in the homestead exemption would reduce the overall property wealth of a district and thereby reduce the amount of local revenues that would be subject to recapture.

When the the Legislature enacted SB 1 by Ratliff in 1995, it tied the teacher minimum salary schedule to increases in the state share of the cost of education through the foundation school program. The state funding increase of $1.04 billion would result in a six percent raise over the next biennium for teachers on the minimum salary schedule, according to Texas Education Agency (TEA) estimates. HB 4, the enabling legislation for Proposition 1, would appropriate enough state money to cover the extra costs to school districts from the increase in teacher salaries. If Proposition 1 was not approved, the statewide teacher minimum salary schedule for the 1997-1998 and 1998-1999 school years would not be increased.

Portability of the 65-and-over tax freeze would provide additional tax relief for senior citizens. Current law penalizes persons 65 and over who move to a different residence, even though many people in this age category move to smaller homes because they need less space. Some are forced to move because they cannot afford the taxes, mortgage payments, or insurance premiums on their current home. However, by moving, they lose the school tax freeze that they enjoyed. Senior citizens should not be forced to stay in the same home after they turn 65 just to retain their property tax freeze.

The tax freeze for seniors is a benefit that should follow individuals, not the property they happened to be living in at the time they turned 65. HB 4, the enabling legislation for Proposition 1, would allow those age 65 and over to carry a proportional rate reduction with them if they moved to a new home. The proportional reduction calculation included in HB 4 would require appraisal districts to figure the difference between what homeowners paid with the 65-and-over tax freeze and what they would pay without the freeze. That difference would be computed as a ratio that would be applied to the property tax assessed on the new home to determine the proportional amount of taxes that would be frozen on it.

For example, an individual age 65 years or older living in a home with a taxable value of $85,000 taxed at a $1.40 rate would pay, without a tax freeze, approximately $1,190. If that individual's taxes were frozen when the tax rate was $1.25 and the home's taxable value was $75,000, he or she would continue to pay only $937.50, roughly 79 percent of what would be paid without a freeze. In moving to a home with a taxable value of $60,000 in a district with the same current $1.40 tax rate, the individual, or a surviving spouse age 55 or over, would have a tax bill of $840 without portability. If a proportional amount of the tax freeze on the previous homestead was transferred to the new home, the individual's new frozen taxes would be 79 percent of $840, or $663.60.

Proposition 1 also would ensure that the $10,000 increase in the homestead exemption would apply as well to those with frozen property taxes. The frozen taxes would be reduced by an amount equal to the $10,000 exemption multiplied by the 1997 school tax rate, not by the tax rate at the time of the freeze, which should give even more relief to seniors.

Opponents say

Proposition 1 and HB 4 would take more than $1 billion in state taxes already raised from all taxpayers and give it to the 60 percent of individuals who own their homes. The other 40 percent of individuals, those who rent, would not see any decrease in their rents. Moreover, businesses would not see any property tax relief, even though they pay roughly 60 percent of all school property taxes. Any state money saved during the current budget cycle should be used for the benefit of all Texans, not just a select few. The property tax relief would be no windfall, even for the select few, who would save only an average of $142 a year, barely $12 a month.

While Proposition 1 would shift more than $1 billion of state money to local school districts, there would be no net increase in spending on schools. Whatever amount districts received from the state would be offset by local tax revenue losses. The education system will be enhanced only if schools receive more money overall. The state would do better to simply spend the $1 billion surplus on schools without increasing property tax exemptions that would generate a $1 billion loss in local revenues. This approach would increase not only teacher salaries but also spending on other programs and mitigate even more substantially the inequities of the school finance system.

The amount of tax savings to homeowners would be minimal. The average homeowner would see a savings of less than $12 each month. After factoring in the federal tax deduction lost to those who itemize their property taxes, the net gain to many taxpayers would be even less.

If the $1 billion state budget surplus were not used for modest property tax relief, it could fund many other worthwhile state programs for the benefit of all Texans. The 1997 general appropriations bill contained more than $3 billion in unfunded "wish list" items, including more than $1 billion in health and human services needs, increased funding of public education programs such as additional library books and programs for at-risk students, nearly $800 million in higher education needs, improved child support collection enforcement, and enhanced environmental regulation and hazardous materials clean-up.

There is no guarantee that the state surplus used to replace local tax revenue lost by increasing the homestead exemption will be available in the next biennium. The $1 billion surplus used for this budget cycle is available only because of cost savings and overestimates in the growth of programs and underestimates in revenue growth. Such savings may not be realized over the next two years. If another surplus is not available, offsetting the local revenue loss caused by the higher homestead exemption would mean higher state spending, which may require either cuts in other programs or higher state taxes, or much higher school taxes, which would defeat the purpose of property tax relief. Another potential option would be to lower overall spending for public schools, which would be devastating to the future of the state.

In the end, residential homeowners may see modest tax relief in the next two years, but eventually may be forced to pay for that relief once the surplus runs out. Also, the amount of money needed to fund the homestead exemption would increase over time so long as more new homes were being built. Current LBB estimates of residential home growth indicate the cost of the homestead exemption would increase by $20 million each year it was in place.

Districts would have a very hard time making up the revenue lost to the increased homestead exemption if the state ever failed to offset the loss. Assuming no change in valuation, the tax rate on the average home valued at $61,500 would have to be boosted by nearly 30 cents to make up for the revenue lost due to the increased homestead exemption. Current law allows a maximum effective tax rate increase of only eight cents per year without being subject to a rollback election. Any offsetting revenue increase from higher property values also would be limited. SB 841 by Cain, enacted this session, would essentially limit property appraisal increases to no more than 10 percent each year, if voters approve SJR 43 in November 1997, which would limit revenue to local school districts even more.

The portability of the 65-and-over tax freeze should be carefully structured to provide relief only to those seniors who actually need the exemption. A senior who can afford to move to a larger, more expensive house should be required to pay the property taxes associated with such a move. One option would be to weight the amount of the exemption that was transferable based on the income of the individual. Other proposals introduced this session would have allowed the freeze to be transferred only if the person were forced to move because of governmental action, such as condemnation of the property.

There would be substantial costs in making the 65-and-over tax freeze portable. According to LBB estimates, districts would lose approximately $12 million per year due to tax freeze portability. The state ultimately would pay districts for that loss in property tax revenue, but state funding calculations include a one-year lag. Also, the cost to the state would be cumulative: for example, the cost in 2000 is estimated to be $12.4 million; in 2001, it would rise to $24.2 million, according to LBB estimates.

Other opponents say

Proposition 1 was proposed as a face-saving gesture after the failure of major property tax relief proposals during the 1997 legislative session. Three different proposals were introduced this legislative session proposing substantial property tax relief: the governor's plan called for nearly $3.6 billion in property tax savings, the House-passed plan proposed $4.1 billion in property tax relief, and the Senate-passed plan proposed over $2 billion in property tax relief. The problem with the band-aid approach proposed in Proposition 1 is that it would delay a thorough examination of how to go about providing significant property tax relief and overhauling the school finance system. By the time the Legislature is forced to re-examine the property tax issue in 1999 or 2001, the situation will likely have worsened, with more districts at the statutorily imposed school property tax cap of $1.50.

Voters can turn down the additional homestead exemption but still approve the portability of the 65-and-over tax freeze by voting against Proposition 1 in August and voting for SJR 43 when it is presented to the voters on November 4, 1997. SJR 43 contains an identical provision providing for portability of the 65-and-over tax freeze.

Notes

HB 4, the enabling legislation for Proposition 1, includes several provisions contingent on voter approval of Proposition 1. Regardless of the outcome of the Proposition 1 election, as of September 1, 1997, HB 4 will:

- statutorily dedicate lottery revenues to the foundation school program;
- increase the state share of lottery revenues by five percent, generating an additional $300 million in the next biennium;
- eliminate the recapture of revenue from debt service taxes levied by districts above the maximum wealth limit, at a cost of $56 million to the foundation school program;
- require rollback rate calculations to factor in state as well as local revenues, to conform with a recent state district court decision; and

- create a facilities tier for new debt, establishing a guaranteed yield of $28 per penny of tax effort per student in average daily attendance in order to assist school districts in financing construction and renovation of school facilities.

Another proposed constitutional amendment affecting property taxes, SJR 43 by Cain, will be presented to the voters on November 4, 1997. SJR 43 would authorize the Legislature to limit property tax appraisal increases in the value of residences to 10 percent or more in one year. If Proposition 1 is not approved by the voters on August 9, SJR 43 will include another opportunity for voters to approve the portability of the 65-and-over tax freeze. If voters approve portability of the 65-and-over tax freeze, SJR 43 and SB 841, its enabling legislation, would allow school districts in counties with fewer than 75,000 residents to transfer a proportional amount of the tax freeze for homestead changes occurring after January 1, 1993, but before approval of Proposition 1. The new tax freeze amount resulting from previous transfers would apply only to tax years after the district allowed such transfers — taxpayers benefiting from a tax freeze transfer could not obtain a retroactive refund.

For details on the current system of financing public education and revenue options considered during the legislative session, see House Research Organization Session Focus Report No. 75-11, *The Tax System and Public School Financing in Texas*, March 24, 1997.

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