

Texas Property Taxes Soar as Homeowners Confront Rising Values

By Jason Saving

ABSTRACT: A precipitous rise in the amount of property taxes Texans pay has accompanied an uncharacteristically large increase in property tax valuations. Because a variety of local jurisdictions provide services that elsewhere are state responsibilities—particularly public education—there are limited ways to rein in rising property taxes across Texas.

Property taxes in Texas have risen markedly in recent years. Complaints about soaring appraisals have become ubiquitous as have calls from the public to “do something” about ever-rising property tax bills. The situation has begged the question of whether these developments have jeopardized Texas’ status as a relatively low-tax state, potentially harming long-term economic growth.

Yet Texas is distinctive as one of only seven states without an income tax at either the state or the local level, suggesting that sales and property taxes might be somewhat higher in Texas than elsewhere.

The amount of property taxes has jumped in recent years because of not only tax rate changes, but also rapidly rising home prices—a product of people having more housing wealth. The increase has created a sense that the total state and local tax burden in Texas is no longer competitive with taxes in other states, even as the total burden today remains well below the national average.

Still, property tax rates are comparatively high in Texas and pose a greater burden as personal income rises more slowly than property values, raising questions about both the economic arguments for property taxation and the implications of reducing that burden.

Relatively High Burden

The first step in assessing the property tax situation is determining how much higher property tax rates are in Texas than elsewhere. In 2016, Texas’ average property tax rate of 1.86 percent was the sixth-highest in the nation, over 50 percent more than the national median of 1.19 percent (*Chart 1*).¹ For a \$250,000 house, this translates into a tax payment of \$4,650, compared with the national average

of \$2,975—a sizable burden in a state whose average income remains slightly below the national average.

An examination of where all of this money goes and who imposes property taxes in Texas sheds additional light. Numerous local taxing entities provide a wide variety of services. School districts are perhaps the best known. Fifty-four percent of Texas property taxes were paid to school districts in fiscal 2015, the last year for which full data are available (*Chart 2A*).

Property taxes are also levied by counties (17 percent of the burden), cities (16 percent), special-purpose districts such as hospital and utility districts, community college districts, water districts, development/improvement districts and emergency-services districts.

Multiple Local Entities

All told, more than 4,000 local government entities collect property taxes in Texas. By law, payments must be based on the current assessed value of property, though there are exceptions for property owners’ primary residence (homestead exemptions), land used for designated purposes (such as agriculture, which is sometimes eligible to be taxed at a lower rate) and property owned by certain people (such as seniors, who are sometimes eligible to freeze their payment levels).²

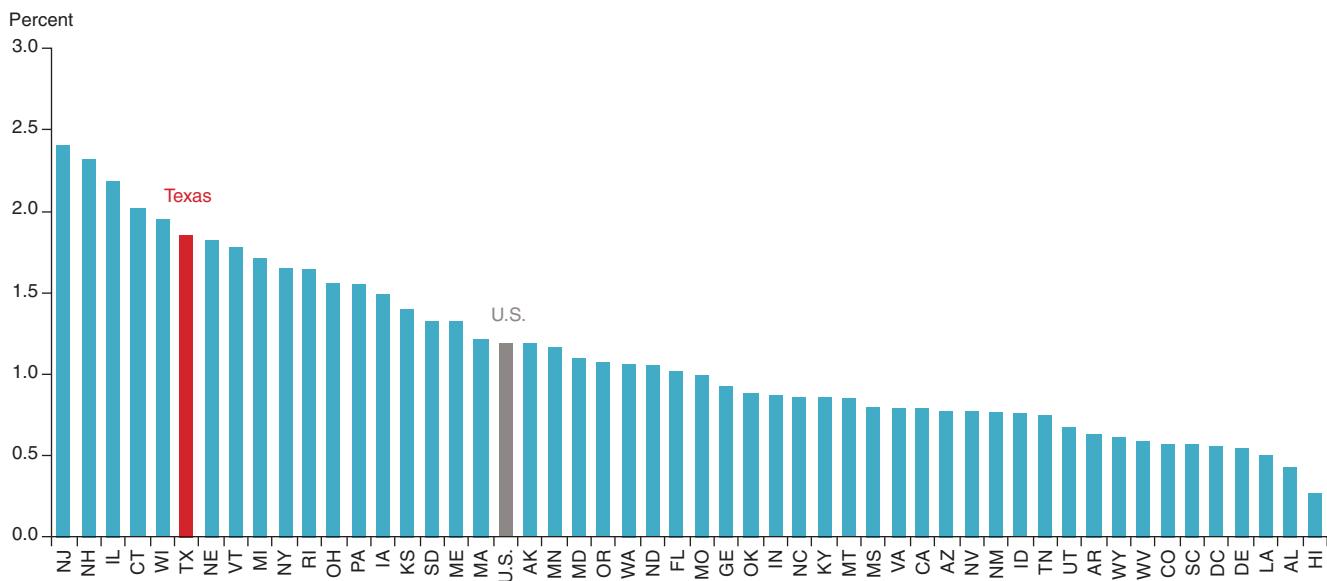
Single-family homes represent 51 percent of the state’s total property tax base, with commercial and industrial businesses composing another 35 percent and multifamily residences 6 percent.

In fiscal 2015, property taxes made up about 42 percent of Texans’ total state and local tax burden.³ While less than the 50 percent for sales and use taxes, it is significant (*Chart 2B*).

Property taxes are not only high, but also rapidly rising in the state. Following

**CHART
1**

Median Property Tax Rate in Texas Exceeds National Average



NOTE: Property tax is calculated by dividing the median real estate taxes paid by the median home price.

SOURCE: Census Bureau, 2012–16 American Community Survey 5-year estimates.

a three-year lull during and immediately after the Great Recession, property tax revenue has grown at a 6.9 percent annual rate since 2012, with the proceeds distributed fairly evenly among schools, counties, cities and other taxing districts (*Table 1*).

While the available data stop at 2015, anecdotal evidence suggests the trend continued in subsequent years. By comparison, household income grew at a 2.7 percent annualized rate in 2012–15 and a 2.9 percent rate in 2016–17, adding to the perception that Texans are increasingly burdened by property taxes.

Rising Property Values

Property tax burdens have increased rapidly in recent years. While it's possible that tax authorities have raised rates so quickly that revenue growth has outstripped home prices, in reality overall property tax revenue growth for Texas jurisdictions has actually trailed real estate price appreciation in recent years. Annual tax revenue growth trailed appreciation by 0.9 percentage points in 2012–15 (and the trend has likely continued). Some jurisdictions no doubt markedly raised their rates, but a better

explanation is needed for why property tax revenue increased so quickly.

If higher rates can't fully explain rising property taxes, perhaps increased home valuations can. Chart 3 suggests home values have, indeed, risen rapidly. Over the past six years, the Texas median home price has jumped nearly 40 percent, in line with trends at the national level. But because Texas has historically relied more heavily on property taxes than the national average, Texans are more directly affected than their counterparts who have low or no property taxes.

One other factor of note is that recent home-price movements in Texas have been unusual. Typically, large swings in national home prices yield only modest changes in Texas because the state's lax zoning, plentiful land, flat geography and robust economy have tended to ensure enough supply will be built to keep pace with demand.

The boom-bust cycle of 2002–08 illustrates this phenomenon. Texas home prices barely budged as national home prices appreciated 30 percent in the first few years of the period and then fell about 40 percent. Texas' high

property tax rates didn't attract a lot of attention over the period because assessments weren't growing rapidly.

For reasons not fully understood, this pattern has been broken in the aftermath of the Great Recession, with both state and national home prices rising 30 to 40 percent. Does this unusual Texas home-price appreciation signify a change in fundamentals, such that the state will experience boom-bust cycles from which it had been excluded? Or do the housing data simply reflect other, secular forces that are temporarily prompting a rise in Texas home prices that just happens to coincide with the current national housing boom?

Factors such as the Dodd-Frank Wall Street Reform and Consumer Protection Act that affect lending for housing development, the gradual de-localization of housing finance and the appearance of lot-availability constraints in major Texas metros suggest housing markets may more closely follow national home price trends than they once did. Still, it remains far from certain to what degree the next national housing bust might impact Texas real estate prices.⁴

Ranking Texas Taxes

Whatever the long-term outlook, the current cycle of home-price appreciation has dramatically boosted property tax revenue. And with property taxes growing at a rapid pace that is faster than income, it may be tempting to conclude that Texas' low-tax reputation is now more myth than fact. Such a conclusion would be premature, though.

In the last year for which full data are available, Texas' state and local tax burden was 15 percent below the national average, 30 percent below California's and 55 percent below New York's on a per capita basis (*Chart 4*). The differences are even starker when only the state portion of the burden is considered.

However, the local portion of that tax burden tells a different story. Texas' per capita local tax burden (\$2,116 per year) is actually slightly higher than the national average and, perhaps surprisingly, higher than that in high-tax California. Measuring the total local tax burden rather than median property taxes alone, as seen in Chart 1, reveals that Texas property taxes are indeed high by comparison with other states that may levy other types of local taxes. This comparative Texas burden may be why property taxes have become a focal point of attention in recent years.

Why, then, are there so many types of local jurisdictions in Texas and why do they need to raise so much revenue?

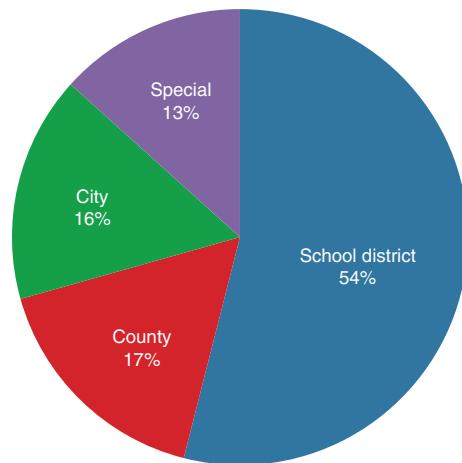
There are a couple of reasons. First, Texas has historically delegated significantly more responsibilities to localities than other states, allowing cities, counties and school districts to provide services that are elsewhere handled at the state level. Such decentralization stems from a historic distrust of any single center of power. This is visible in requirements that are unnecessary in other states, such as the election (versus appointment) of executive branch officials and public referendums to ratify some legislative measures.

As a corollary, Texas transfers a relatively small amount of state revenue to localities, requiring local jurisdictions to raise revenue themselves. In Texas, local governments receive only 23 percent of their revenue from the state;

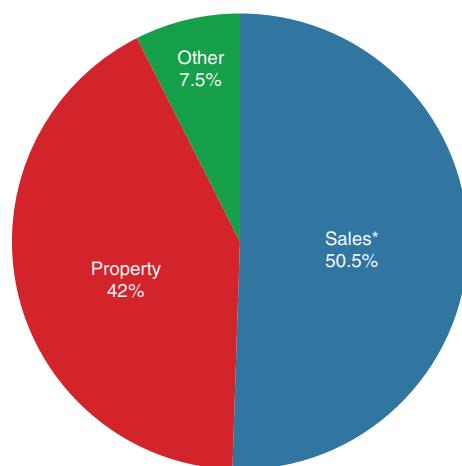
CHART 2

School Districts Receive Half of Texas Property Tax Revenue; Property Tax Share Large for Individual Taxpayers

A. Recipients by Taxing Authority



B. Taxpayer Outlays by Tax Type



NOTES: Property tax data are from fiscal year 2015. Shares are based on the taxable value assigned.

SOURCE: Texas Comptroller of Public Accounts.

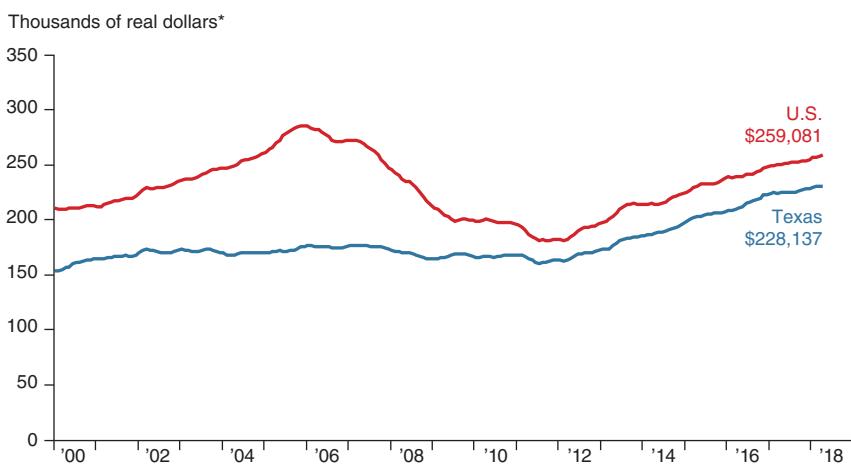
in only six other states do localities receive a smaller percentage (*Chart 5*). The U.S. average is 30 percent. Buffeted by the combination of more responsibility and less state support, the local tax burden in Texas is relatively high.

Local Property Taxation

This doesn't mean the property tax specifically should be the vehicle through which local revenue is raised, though some economic arguments favor locally administered property

taxes. A central argument from the economic literature is that houses can't readily be moved from one jurisdiction to another, which makes tax avoidance less of an issue than it would be for, say, a locally imposed income tax.

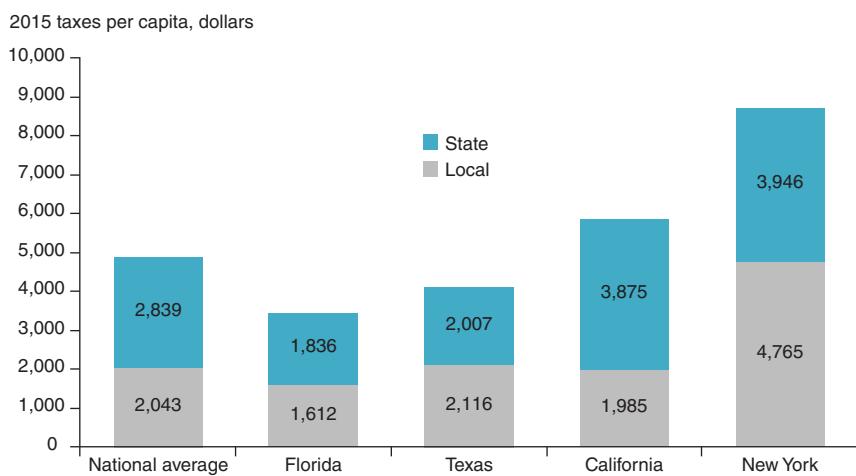
Another argument is that property taxes don't directly discourage productive activity as income taxes sometimes do. This by no means implies it is impossible to have a dynamic local area with such taxes in place, as California's Silicon Valley demonstrates. Neverthe-

**CHART
3****Texas Median Home Values Have Risen Dramatically Since 2012, in Sync with Nation**

*Four-month moving average; seasonally adjusted.

NOTE: Data are through April 2018.

SOURCES: Multiple Listing Service; Texas A&M Real Estate Center.

**CHART
4****Total Texas Tax Burden Below U.S. Average; Local Taxes Alone Tell a Different Story**

SOURCES: Census Bureau; Bureau of Economic Analysis.

less, efficiency arguments suggest income taxes are more appropriate at the federal level, while property taxes may be more effectively assessed locally.

Nonetheless, property taxes hit only one type of asset—housing wealth—and therefore discriminate against people who choose to spend their money on a larger house rather than,

for example, better cars or travel. Is it fair to tax the one person more heavily than the other just because their housing preferences are different? It's also possible that property taxes discourage housing consumption to some degree, though this effect is likely much smaller when it comes to housing than it would be for, say, a tax on stamp/coin collec-

tions. There are tax benefits associated with homeownership, after all, and people cannot easily do without housing.

Local property taxes also enable some jurisdictions to spend more than others on public services, if they so choose. To be sure, it is efficient for individuals to be able to compare jurisdictions and live in the one whose mix of taxes and services best matches their own preferences.

However, when applied to K-12 education in particular—the largest local program—large differences in spending per student could potentially perpetuate patterns of inequality, leaving the children of poor parents with less human capital (and lower future salaries) than their wealthier peers. Texas mitigates this issue to some degree with its so-called Robin Hood system, under which a portion of school property tax revenue is redistributed to poorer jurisdictions, though that system is itself controversial.⁵

A final issue is that an individual's property tax burden can rise dramatically when neighborhood property values spike, leading to a sudden unwelcome increase in tax liability for which the homeowner may be unprepared. People who cannot pay may be forced to sell their homes.

These surges can be dealt with by "circuit breakers" that phase in appreciation over several years, though phases inevitably reduce revenue available to local jurisdictions and may, depending on the circumstance, make it more difficult for those jurisdictions to provide the services residents expect.

Texas also limits annual tax rate increases by allowing voters to hold a rollback election. While these rules are complicated and vary depending on the taxing authority, if the tax rate increase exceeds a certain percentage, property owners may elect to reduce the rate increase in a given year.

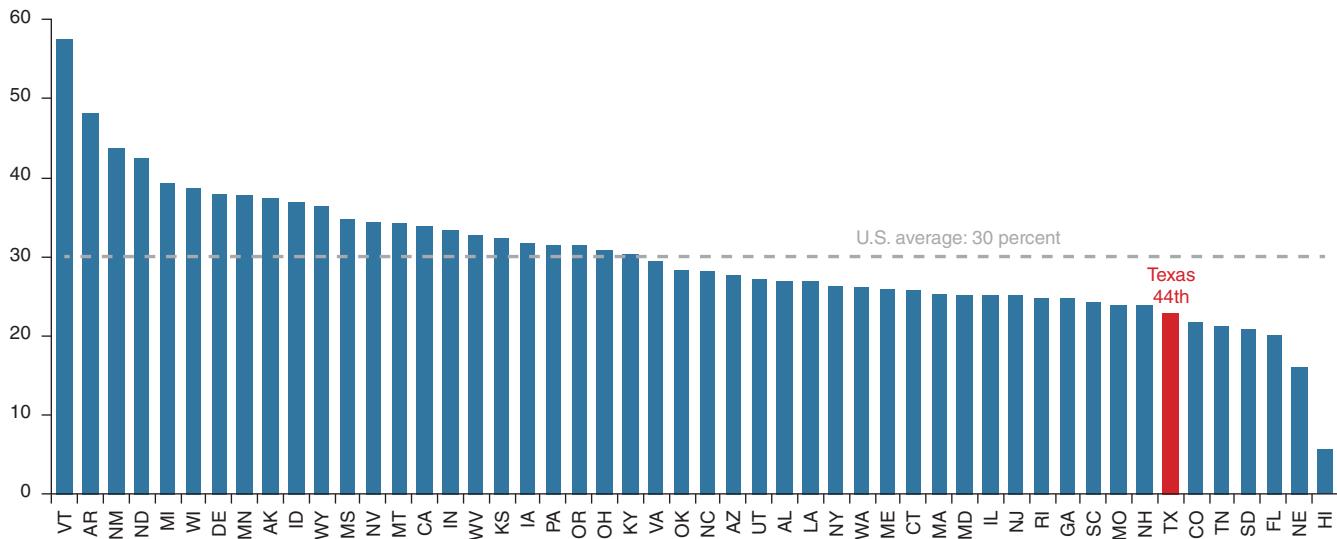
Imperfect Funding Method

The bottom line: Property taxes are an imperfect way to raise revenue. For this reason, some states emphasize sales and income taxes over property taxes. However, Texas' sales tax rate

CHART 5

State Transfers Provide Relatively Low Share of Local Revenue in Texas

Percent of revenue from home state



NOTE: Texas localities received 22.9 percent of total revenue from the state in fiscal year 2015.

SOURCE: Census Bureau.

is already among the highest in the country and has been shown to disproportionately burden the poor, while an income tax is constitutionally prohibited in Texas and would risk discouraging work and investment were it somehow implemented.⁶ Any taxing system comes with its own set of advantages and disadvantages.

Alternatively, property taxes could be cut without raising taxes elsewhere. However, significant property-tax-funded functions such as K-12 education, already well below the national average in terms of per capita funding, would fall further, potentially reducing the quality and quantity of those services.

One solution might be to pair local property tax cuts with increased state transfers, though those transfers would themselves have to be funded through service reductions or higher taxes at the state level. This doesn't automatically make efforts to rein in property tax growth a "bad" thing, but it does reinforce the need to carefully weigh the economic arguments, fully cognizant of both residential tax burdens and desired levels of government services.

It is eminently possible to address Texas' relatively high property tax burden, but doing so inevitably imposes sacrifices on some, while potentially affecting state and local tax progressivity and perhaps even future growth rates. It is also possible that the market-place will address the issue through a housing contraction, but that would dramatically lower home valuations across the state. Were that to happen, today's higher property taxes caused by soaring home valuations might not seem like such a bad thing.

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Notes

¹ Based on the Census Bureau's American Community Survey 5-year estimate for 2016.

² Government-owned facilities are also generally exempt from property taxation.

³ Texas fiscal years begin Sept. 1. Thus, fiscal 2015 began Sept. 1, 2014.

⁴ See "Texas Housing Market Soars to New Heights, Pricing Out Many," by Laila Assanie, Federal Reserve

Bank of Dallas *Southwest Economy*, First Quarter, 2017.

⁵ For example, the Robin Hood system partially but not fully equalizes per-student funding across jurisdictions, leaving both donor and recipient districts unsatisfied with the outcome. Many also argue the system amounts to a de facto statewide property tax, though the state Supreme Court ended a lengthy legal battle last year by affirming its constitutionality. For a more thorough discussion of these and other economic issues, see "Improving School Finance in Texas," by Jason Saving, Fiona Sigalla and Lori L. Taylor, Federal Reserve Bank of Dallas *Southwest Economy*, no. 6, 2001.

⁶ See "Texas Taxes: Who Bears the Burden," by Jason Saving, Federal Reserve Bank of Dallas *Southwest Economy*, Third Quarter, 2017.