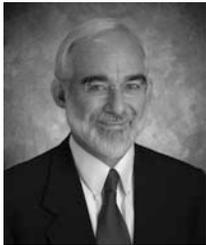




April 20, 2010

Texas House Ways & Means

Senior Fiscal Analyst Dick Lavine testified before the Texas House Ways and Means Committee about the optional homestead exemption.



“Because the benefit of state recognition of the optional homestead exemption goes to only a small minority of Texas school districts and primarily to higher-income homeowners within those districts:

The Center for Public Policy Priorities recommends that the Legislature repeal the provision allowing state aid to replace revenue lost to the optional homestead exemption.”

Dick Lavine
Senior Fiscal Analyst
Center for Public Policy Priorities

What You Need to Know

The optional homestead exemption permits Texas school districts to exempt up to 20 percent of the value of a residential home from property taxes. This is in addition to the statewide \$15,000 homestead exemption all homeowners receive. Under current school-finance rules, the state may cover half of the revenue that school districts lose to the exemption.

The Facts

- **This provision could cost the state an estimated \$180 million in 2011.**
- **Fewer than one-quarter of school districts offer this exemption.**
- **More than half of the benefit of the exemption goes to homeowners with a family income of more than \$118,000 per year.**

Where Does the Money Go?

WHAT IS THE OPTIONAL HOMESTEAD EXEMPTION?

The optional homestead exemption (Tax Code, sec. 11.13(n)) permits a school district to exempt up to 20 percent of the value of a residential homestead from school property taxes.

The exemption was enacted in 1981 as part of reform to the state’s property-tax system established in the late 1970s. Because the new system required all homes to be taxed at their full market value—rather than at some fraction of the total value—homeowners were facing rapid increases in their values. The optional exemption, along with other statewide mandatory exemptions, were intended to ease the “sticker shock” faced by homeowners.

WHY DOES A LOCAL PROPERTY TAX EXEMPTION COST THE STATE MONEY?

The state’s school-finance system guarantees each school district a certain “target revenue” per student. If local property values are too low to produce this amount of revenue, the state makes up the difference. If property values are reduced by exemptions, the cost to the state increases.

Under current law, the state may replace half of the revenue that school districts lose to the optional homestead exemption, provided the education commissioner certifies that the state has appropriated more than enough to fully fund other school-finance formulas. Since being enacted in 1999, this

provision has resulted in extra payments to school districts with the optional exemption in fiscal 1999, 2001, 2003, and 2009. (The commissioner can be sure there will be enough money only in the second year of each two-year budget cycle.) In these years, higher-than-expected property values or lower-than-expected student enrollment statewide created a small surplus in state appropriations to fund school finance formulas.

WHAT DISTRICTS OFFER THE EXEMPTION?

The optional homestead exemption is currently offered by less than one-quarter of the 1,000-plus school districts in Texas. Most of these districts are concentrated in certain areas of the state, probably because the exemptions were adopted in response to competitive pressures within these regions. For instance, none of the school districts in Bexar County offer the exemption, while nine of the 21 districts in Harris County provide the exemption.

Houston ISD, which offers the full optional exemption, accounts for more than one-quarter of the total cost to the state of the exemption. Just three districts —Houston, Cypress-Fairbanks (11 percent of the total cost) and Dallas (10 percent)—receive nearly half of the statewide benefit. Other major beneficiaries include Spring Branch, Highland Park, Comal, Richardson, Lake Travis, and Ysleta.

A district with little reliance on residential property in its tax base is more likely to offer the exemption than a district that consists primarily of homes—the exemption has less effect on its total taxable value. Two-thirds of the districts granting the exemption have less than 30 percent of their property wealth in residential homesteads; only 35 districts that consist primarily of homes give the exemption.

Among the few largely residential districts that exercise the option, the optional homestead exemption reduces total property value by more than 10 percent—Highland Park exempts 14 percent of total value, and Spring Branch and Lake Travis exempt more than 11 percent.

WHICH HOMEOWNERS BENEFIT FROM THE EXEMPTION?

The optional homestead exemption is one of the most regressive exemptions in the tax code. According to the comptroller's Tax Exemptions and Tax Incidence study, more than half of the benefits received by Texas homeowners goes to households with an annual income of more than \$117,900. Only 13.5 percent of the benefit of the exemption goes to families with an income of less than \$49,100 per year, who account for 40 percent of households.

Since the optional exemption applies to a percentage of the value of a homestead, it reduces the taxable value of a higher-priced home more than the value of a lower-priced home. In contrast, the mandatory statewide exemption of the first \$15,000 of a homestead's value is progressive, since it has a greater impact on a low-value home than on a higher-value home.

And families that rent their homes receive no benefit at all from a homestead exemption, which goes only to homeowners. Homestead exemptions also burden business property owners, since a school district must levy a higher tax rate to make up for the value lost to homestead exemptions.