THE POLICY PAGE
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Center for Public Policy Priorities
900 Lydia Street, Austin, Texas, 78702 PH: 512.320.0222 www.cppp.org

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LOWER CAP ON APPRAISAL GROWTH WOULD BENEFIT MAINLY WEALTHY HOMEOWNERS, CREATE DANGEROUS IMBALANCES

Governor Rick Perry, in his State of the State address, proposed lowering the current cap on the annual growth in the taxable value of a homestead from ten percent to three percent. Bills already filed would bring all real property under the proposed lower cap. These changes would shift the burden of property taxes onto lower-income families, tax similar properties differently, and discourage the sale of real estate.

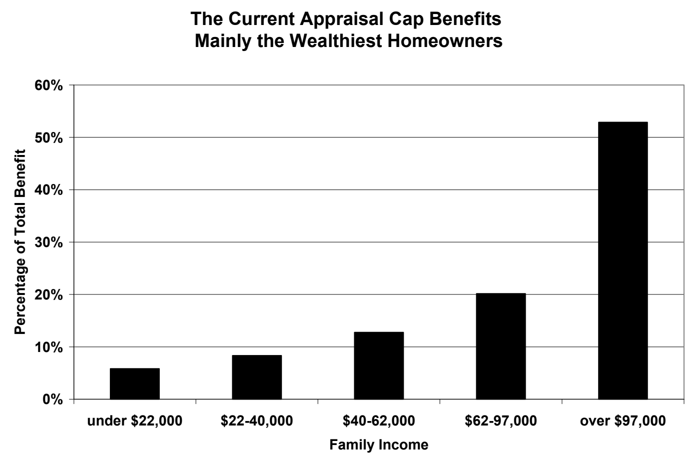
HOW A CAP ON APPRAISALS WORKS

In 1997 the voters approved a constitutional amendment, Proposition 2, to allow the legislature to limit the maximum annual increase in the taxable value (appraisal) of a residential homestead to 10 percent or more. A constitutional amendment was required because the cap is an exception to the basic requirement that taxation be equal and uniform (Art. 8, sec. 1-a, of the Texas Constitution) and that all taxable property be taxed in proportion to its value (sec. 1-b).

Appraisals in each county are made by central appraisal districts, which set the appraised property value used by all local taxing units – school districts, cities, counties, community colleges, and special districts – in taxing property within their jurisdictions. Appraisals must be done at least every three years.

LIMITING APPRAISALS FAVORS HIGHER-INCOME FAMILIES

More than half of the benefit of the current 10 percent cap goes to families with incomes over $97,000 a year, according to the comptroller's tax incidence study (http://www.window.state.tx.us/taxinfo/incidence05/, table 43), as shown in this chart. Higher-income families live in higher-priced homes, and higher-priced homes tend to gain in value more quickly than lower-priced homes. This tendency is so strong that the one-tenth of Texas families with incomes over $136,000 reap more than one-third of the benefit of the current cap.



The chief appraiser for Dallas, Foy Mitchell, calculated that the tax break received by the owner of the average million-dollar home in Dallas is 43 times greater than that received by the owner of a $50,000 home, even though the million-dollar home is only 20 times more valuable. He found even greater disparities in other counties, all due to the difference in how fast homes of different prices gain in value.

Mitchell also reported that, in just one neighborhood of 51 homes, over $25 million in property value remains untaxed because of the current cap – an average of $500,000 per home.

A cap of 3 percent would be expected to affect more homes than the current cap, but would probably not change the distribution of benefits. Even if most families were to see some limit on the growth of the taxable value of their home, the greatest tax break would still go to the homes with the fastest appreciation, which are generally higher-priced homes owned by higher-income families.

In 1992, Florida passed a 3-percent cap on appraisals, known as "Save Our Homes." But an analysis of the effect of the cap led some to refer to the measure as "Save Our Mansions," since expensive homes in areas with quickly rising real estates prices benefited much more than homes in slower growing parts of the state. A 1998 state study showed that 43 percent of the tax savings went to just 16 percent of homeowners; nearly a fifth of the savings went to people whose homes were worth more than $350,000. NBA star Shaquille O'Neal alone saved $65,000 in property taxes by claiming his lakefront mansion as his permanent address.

THE CURRENT CAP IS UNFAIR TO BUSINESSES AND RENTERS

One problem with the current cap is that, by limiting only the value of homesteads, businesses end up paying a greater share of local property taxes. The 36 percent of Texas families who rent their home also have to pick up an additional share of property taxes, since they pay the tax bill of their landlord, who passes it on to them in the form of higher rents. This problem is even worse in Houston, Dallas, and Austin, where more than half of households rent their houses or apartments.

EXPANDING THE CAP TO BUSINESS PROPERTY CREATES NEW PROBLEMS

But expanding the cap to cover business property just creates other problems. The value of business property is very sensitive to changes in the economy, so tends to rise and fall much more than the value of homes. If business property that was covered by an appraisal cap suffered a sharp fall in market value, even if the value of the property quickly recovered, the cap could hold the taxable value significantly below market value for many years.

Chief Appraiser Mitchell used three actual commercial properties in Dallas to demonstrate this effect. Each suffered a dramatic loss of market value, starting in the late 1980s. According to his calculations, even by 2003 these properties still had an appraised value as low as one-third of their actual market value – shifting the tax burden onto newer properties or those with less volatile values.

A CAP WOULD CREATE DANGEROUS IMBALANCES IN THE PROPERTY TAX SYSTEM

A lower cap on appraisal increases would create severe imbalances within the property tax system by weakening even more the link between the market value of a residential homestead and its taxable value.

An artificial cap creates the "Welcome, Stranger" phenomenon. The taxable value of a homestead would be raised to its true market value when it was sold. Two neighbors living in identical houses would pay the same amount in property taxes, as long as neither moved. But if one sold his home, the newcomer ("the stranger") would be charged taxes on the full market value of his home, while the person who did not move would pay on only a fraction of the true value. Needless to say, this would provide a real disincentive to moving into a nicer home and might discourage people from moving to Texas.

Warren Buffet, one of the world's richest men, has pointed out the consequences of a value cap, such as California's famous Prop 13. His home in Omaha, Nebraska, which is worth $500,000, has a tax bill of $14,410. His $4 million house in Laguna Beach, California, which is subject to Prop 13's value caps, is taxed at $2,264. But if Buffet were to sell his beach house, the new owner would face $40,000 a year in property taxes. Buffet's conclusion? "It makes no sense."

Another odd result of a cap on residential appraisals is a strong incentive for local governments to attract retail business, rather than new homeowners. Retail centers supply local governments with sales tax revenue, which would be unaffected by an appraisal cap and could exceed the cost of any additional demand for public services, such as police and fire protection and new roads. Local governments might also be tempted to resort to higher fees to pay for routine services such as garbage collection or street maintenance. Since fees are often collected on a per-household basis, they would further unfairly burden low- and moderate-income families

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This Policy Page was revised on February 4 to include updated data from the comptroller's just-released 2005 tax incidence study.