

How the Texas Education Commissioner Decided to Give \$100 Million to Rich Homeowners in Rich School Districts

The effect of the local option homestead exemption

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Recently the Texas Education Commissioner changed the interpretation of a long-standing statute in order to give \$100 million to wealthy homeowners in wealthy school districts.

Key Takeaways:

- It's understandable that school districts have concerns about the underfunding of the Texas public school finance system and want state leaders to make changes.
- But a sudden, under-the-radar regulatory move that favors only wealthy school districts is not the solution.
- Lawmakers should step in and fix this provision so that all districts are treated equally and this inequitable exemption is subsidized only if the rest of the school finance system is funded adequately first.
- Real policy solutions – like increasing the per-student funding for all school districts in the school finance formulas – would help students, families, homeowners and employers while also ensuring more equity in the system.

As the public focuses attention on the level of local property taxes, it is important to remember that more than half of all property taxes go to support our schools. Homeowners can have their individual tax bills reduced through a variety of exemptions that reduce the taxable value of their house. But the best way to reduce pressure on local property taxes – not just for homeowners, but for renters and businesses, too – is to increase state aid to public education. That way schools don't have to raise tax rates on all property to cover increasing costs, reduce class size, and attract and retain the best teachers.

One of the exemptions in the Tax Code is called the local optional homestead exemption. It permits school districts to exempt up to 20 percent of the value of residential homesteads from school property taxes, in addition to the mandatory statewide exemption of \$25,000 applied to all homesteads. Recently the Texas Education Agency ruled that the state would replace one-half of property tax revenue lost to this exemption, but only for the small number of high-property-wealth school districts that both pay recapture and offer the optional exemption.

The total cost to the state of aiding these few districts is an astonishing **\$100 million for the first year**. This amount will grow as property values increase and if more property-wealthy districts take advantage of this change.

That \$100 million per year could instead pay for about 2,000 more public school teachers, which would create jobs, reduce crowded classrooms and improve student success.

What is the optional homestead exemption?

The optional homestead exemption (Tax Code, sec. 11.13(n)) allows 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 a wave of reform that created the current property-tax system. 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.

Which homeowners benefit from the exemption?

The optional homestead exemption is one of the least equitable exemptions in the Texas Tax Code. According to the comptroller’s [Tax Exemptions and Tax Incidence Study](#), more than half of the benefit of a percentage homestead exemption goes to households with an annual income of more than \$147,000. Less than one-quarter of the benefit of the exemption goes to families with an annual income of less than \$96,000. Since the optional exemption applies to a percentage of the value of a homestead, it reduces the taxable value of a higher-priced home by a larger dollar amount than it reduces the value of a lower-priced home. This means that wealthier homeowners benefit more from the exemption than lower- and middle-class homeowners.

In contrast, the mandatory statewide school tax exemption of \$25,000 of a homestead’s value is more equitable, reducing the tax bill for all homeowners in a school district by the same dollar amount. This has a greater impact on a low- or moderate-income family than on a higher-income family. Of course, families that rent their homes receive no benefit at all from a homestead exemption.

Why does a local property tax exemption cost the state money?

State expenditures are linked to local property tax revenue through the school-finance system, which – in general – guarantees each school district that it will generate a similar amount of revenue per student at similar tax rates. If local property values are too low to produce this amount of revenue, the state will make up the difference. If exemptions reduce property values, then the cost to the state of making up the difference can increase.

On the other hand, if local property values per student are above a certain amount, the district must share some of its revenue with the state through “recapture” payments. Exemptions that reduce property values will reduce recapture payments, allowing the district to retain more of its local taxes but reducing revenue available to the state to fund other school districts.

Until now, the state did not “recognize” the impact of the optional exemption, calculating state aid payments or recapture liability as if districts were collecting tax revenue without the optional exemption. Under the new ruling, recapture payments will be calculated as if districts were collecting revenue from these homesteads, but “recognizing” an exemption equal to half that actually granted. This has the effect of lowering that district’s apparent taxable value, thus reducing its recapture liability. Less wealthy districts that are not subject to recapture, and instead receive state aid, will not benefit from this change.

Which 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. School districts with high property wealth per student are more likely to offer the exemption, since they generally still have higher revenue per student than other districts, even after losing revenue to the exemption. Nearly 40 percent of wealthy districts provide the optional exemption, but only 15 percent of low-wealth districts do.

Houston ISD is by far the largest high-wealth school district that offers this exemption, so it garners by far the largest benefit of the recent TEA ruling. Other wealthy districts that will receive a significant subsidy include Spring Branch (Houston area), Highland Park (in Dallas County), Lake Travis (outside Austin), and Midland.

Why is this subsidy going only to property-wealthy school districts?

Under the provision that affects most school districts (Education Code, sec. 42.2522), the state replaces one-half of the revenue that school districts lose to the optional homestead exemption, but only if the education commissioner certifies that the state has appropriated more than enough to fully fund other school-finance formulas for that two-year period. This provision was inserted in the school-finance system in 1999 and activated several times in the succeeding years, when all districts offering the optional exemption received extra aid, regardless of local property wealth.

Earlier this year, without public notice or opportunity for public input, the Texas Education Agency ruled that other provisions of the Education Code (sec 41.001(2), 46.003(a), and 46.032(a)) required the state to subsidize the optional exemption, but only for high-wealth districts and those few lower-wealth districts receiving facilities aid. But, since there is no excess appropriation in the Foundation School Program, the broader provision (sec. 42.2522) prohibits state support for the large number of non-wealthy districts that offer the exemption.

Lawmakers should step in and fix this provision so that all districts are treated equally and this inequitable exemption is subsidized only if the rest of the school finance system is funded adequately first.

Going forward, it's critical that Texas leaders look to ways to lift all boats by remodeling the school finance system. Raising the base-level amount of state funding per student – known as the Basic Allotment – is the most equitable, effective way to do that.

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