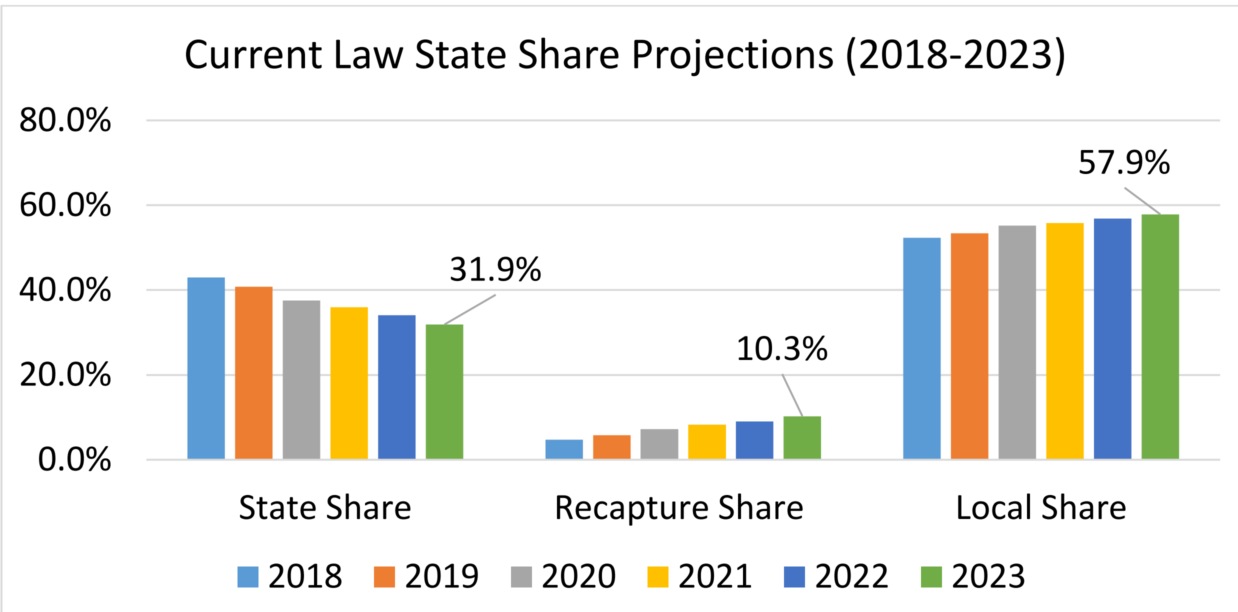
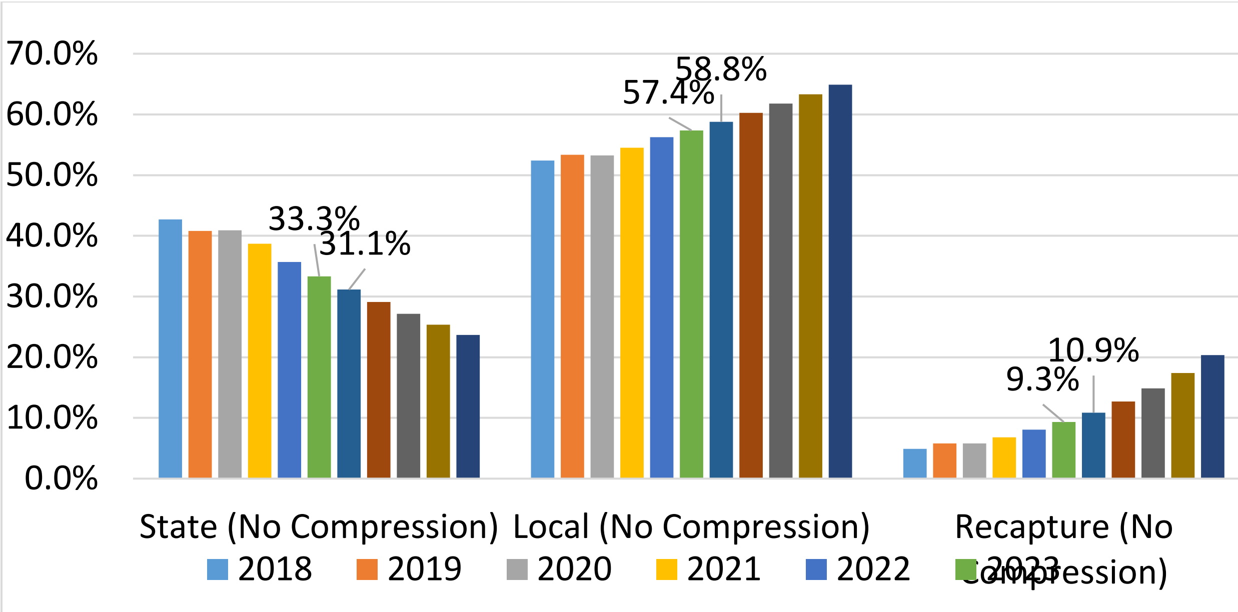
Proposal J: Slowing Recapture and Property Tax Growth

While most of the recommendations in this report have focused on how to improve student outcomes for all of Texas' public school students, the Commission was also tasked with developing recommendations related to the "relationship between state and local funding" and "the appropriate levels of local maintenance and operations and interest and sinking fund tax effort."

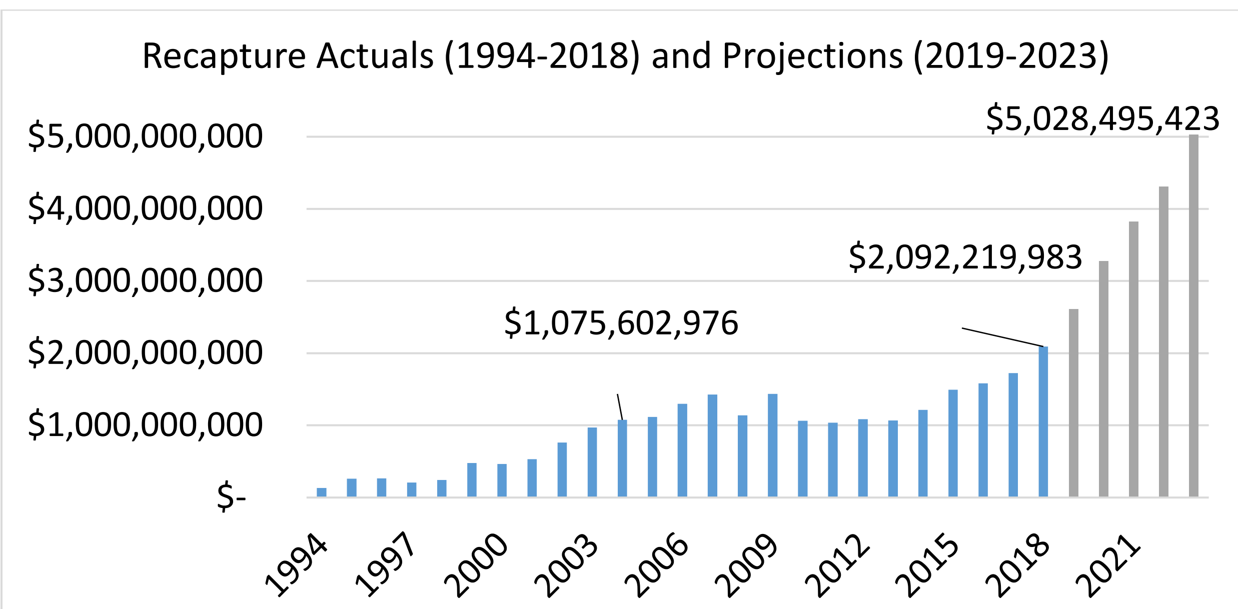
The Commission believes that the current school finance system's reliance on property tax growth and recapture is unsustainable. For fiscal year 2018, just 43% of maintenance and operations funding for Texas public schools comes from state tax revenues. The balance comes from the local share (52.3%) and "Robin Hood" recapture payments (4.7%), which are both generated by local property taxes. If left the system is left unchanged, the decline in the state's share will continue its negative trajectory. By 2023, the state share would be 31.9%, the local share 57.9%, and 10.3% would be funded by recapture payments, meaning that 68.2% of the system is funded property taxes.



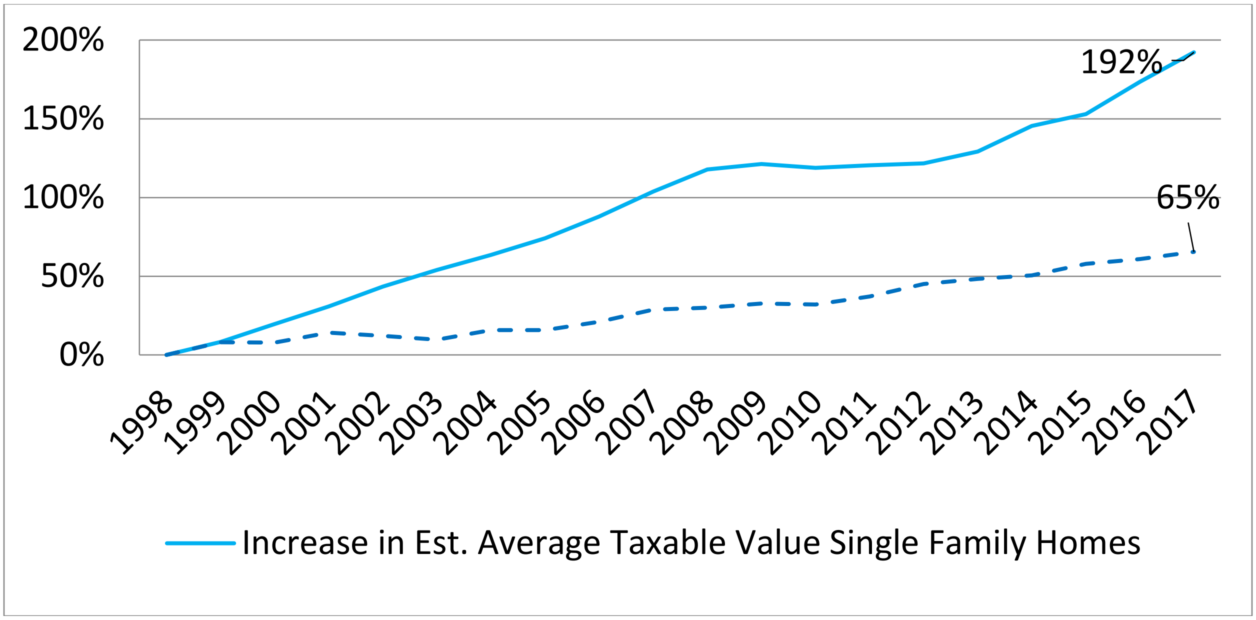
Additional state education spending, which is contemplated in this report, will not resolve these trends without addressing the underlying property tax problems. As shown below, a hypothetical increase of more than $2 billion in additional state spending, put into the current, broken system, does not materially change the negative trend lines. The state must pair the education reforms with property tax reforms to have any hope of resolving state/local share issues without massive tax increases.



The growth of recapture under current law is perhaps most alarming. When originally implemented, only a handful of school districts paid into recapture and total collections were $131 million. It took a decade before total collections eclipsed $1 billion annually, and other 14 years before the state crossed $2 billion. If the system is left unchanged, 375 school districts are projected to pay a total of $5 billion per year by 2023. This rapid and unchecked growth in recapture demonstrates that, just as the state cannot afford to wait before pursuing critical education reforms, it likewise cannot wait to reform its current property tax system.



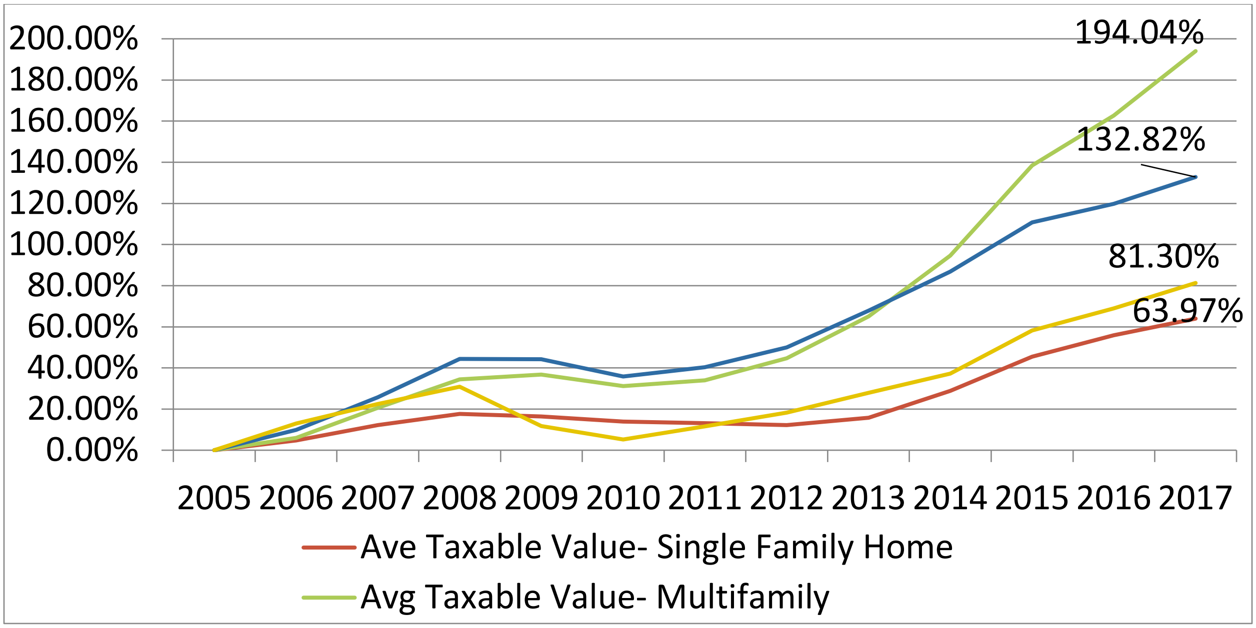
Property value increases, paired with fixed tax rates, cause tax bills to increase rapidly across the state, pushing more and more districts into recapture. As the chart below shows, the average taxable value of single family homes has risen steadily over the past 20 years, nearly tripling over this time, rising far faster than median household income. Significant efforts by the Legislature to address these issues, including the 2015 increase of the homestead exemption, only served to briefly slow these increases.



In 2006, the Legislature passed significant property tax relief, buying down M&O tax rates by 33%. Since 2008, Tier 1 tax rates have been functionally fixed at the Tier 1 compression ratio (which, for most districts, is $1.00). During this same time, property values across the state have increased rapidly. With a fixed tax rate, increases in appraised values directly cause increases in a taxpayer's total tax bill. Valuations are rising statewide, and five of the nation's ten fastest growth home markets over the past decade are located in Texas.

Metro Area	Percent Change in Home Prices
Austin-Round Rock	72.55%
Dallas-Plano-Irving	68.51%
Fort Worth-Arlington	59.85%
Houston-The Woodlands-Sugar Land	57.05%
San Antonio-New Braunfels	44.47%

These tax increases don't just harm homeowners – they directly impact businesses and renters, neither of which benefit from homestead exemptions or appraisal limits. (See the chart below, which shows Harris County data from 2005-2017). Many areas of the state are entering into housing affordability crises, with gentrification and migration effects already underway. The Commission heard testimony from representatives of small business and Habitat for Humanity – both of which stressed the unsustainability of these increases if the state wishes to remain a viable option for entrepreneurs and middle-income families. Future economic development faces risk if total tax levies continue to rise unchecked.



The Commission heard multiple proposals to target these concerns, two of which are discussed below.

Option A – The Governor's Comprehensive Property Tax and Recapture Reform: *The state should compress districts' Tier 1 tax rates as local property tax values rise, which will significantly slow the growth of property tax bills. If property tax levy increases are capped at 2.5% per year, with state tax revenues making up any balance to ensure school districts are fully funded, the state can structurally prevent the collapse in the state share and slow the rapid growth in recapture. Further investments in education, discussed elsewhere in this report, could allow for the state share to increase. According to TEA estimates, The Governors model gives the greatest tax relief over the long term with a 12 cent reduction in M&O taxes forecast by 2023, which would continue to grow over time as property values rise. The Governors model also costs the most in additional state aid, gives the most relief to recapture, and produces the greatest reduction in future local property tax increases. In addition, some districts will receive net increases in revenue due to reforms to the calculation of recapture. Under this proposal, recapture and traditional school districts are treated equally, and districts only pay Tier 1 recapture on the amount above their formula entitlement.*

Option B – TTARA's Recapture Funded Tax Compression: *The state should use future recapture growth as a revenue source to fund statewide compression of tax rates. This proposal is projected to reduce Tier 1 tax rates by $0.07 over four years, and prevent nearly $600 million in annual recapture growth by 2023. The TTARA proposal gives taxpayers more relief in the FY 2020-21 biennium, but the rate of growth for that relief slows in future years due to reliance on recapture as a funding stream.*

Section L: Revenue Options

The Commission received reports suggesting a high likelihood that the state would receive a significant influx of additional revenues from existing revenue streams (including the sales tax and severance tax) for the upcoming biennium. To ensure long-term funding stability for the education and tax reforms contemplated herein, the Legislature should ensure that any revenue streams dedicated toward these goals are sufficiently stable to meet the anticipated cost growth in future biennia.

Recommendation X – Prioritize Projected Revenue Growth to Fund Education and Property Tax Reforms. *The Comptroller will be releasing the Biennial Revenue Report (BRE) in January 2019 that will provide the exact amount of revenue available for allocation in the next biennium. While no official estimates are available at the time of this report's drafting, informal estimates suggest substantial increases in available revenue since publication of the 2017 BRE. Since January 2017, the Comptroller has increased the revenue estimate from $104.9 billion to $110.2 billion in July 2018, a $5.3 billion increase. Sales tax revenue represents 58% of all state tax collections, and have been trending in a positive direction during the last two fiscal years. Historically state general revenue has grown an average of 10% every biennium since 2004-05, and current trends indicate an increase of General Revenue available for budgeting for the next biennium.*

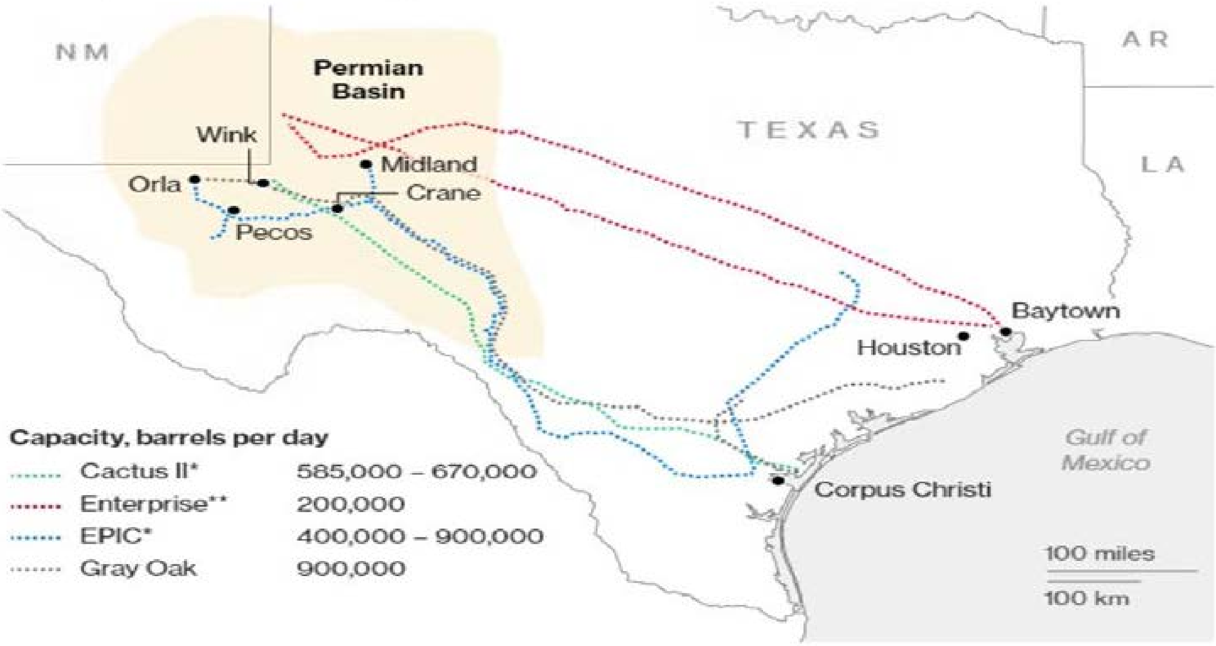
The charts below show the amount of sales tax growth over past two full fiscal years and the beginning months of the current fiscal year:

	2016-17	2017-18	% Change
Septemeber	$ 2,128,221,000	$ 2,356,666,000	10.41%
October	$ 2,290,300,000	$ 2,458,543,000	6.94%
November	$ 2,499,590,000	$ 2,784,661,000	11.12%
December	$ 2,437,750,000	$ 2,745,041,000	12.30%
January	$ 2,439,299,000	$ 2,672,488,000	9.06%
February	$ 2,397,932,000	$ 2,612,239,000	8.56%
March	$ 2,229,512,000	$ 2,400,001,000	7.19%
April	$ 2,427,420,000	$ 2,766,470,000	13.45%
May	$ 2,494,191,000	$ 2,758,373,000	10.18%
June	$ 2,426,348,000	$ 2,769,213,000	13.74%
July	$ 2,553,076,000	$ 2,741,744,000	6.93%
August	$ 2,473,082,000	$ 2,871,796,000	15.81%
Total	$ 28,796,721,000	$ 31,937,235,000	10.51%

	2017-18	2018-19	% Change
Septemeber	$ 2,356,666,000	$ 2,706,622,000	14.85%
October	$ 2,458,543,000	$ 2,637,335,000	7.27%
November	$ 2,784,661,000	$ 2,997,742,000	7.65%
December	$ 2,745,041,000		
January	$ 2,672,488,000		
February	$ 2,612,239,000		
March	$ 2,400,001,000		
April	$ 2,766,470,000		
May	$ 2,758,373,000		
June	$ 2,769,213,000		
July	$ 2,741,744,000		
August	$ 2,871,796,000		
Total	$ 31,937,235,000	$ 8,341,699,000	9.76%

Recommendation Y: *Redirect a portion of severance taxes currently designated for the Economic Stability Fund (also known as the "Rainy Day Fund") given the growing size of the ESF due to unprecedented energy activity in the state, particularly in the Permian Basin. While oil prices may fluctuate, the rate of growth in the Permian Basin is stable and will provide increased revenues for years to come as new pipeline capacity in 2019 will bring 2 million barrels per day, followed by an additional 2 plus million barrels per day pipeline capacity in 2020.*

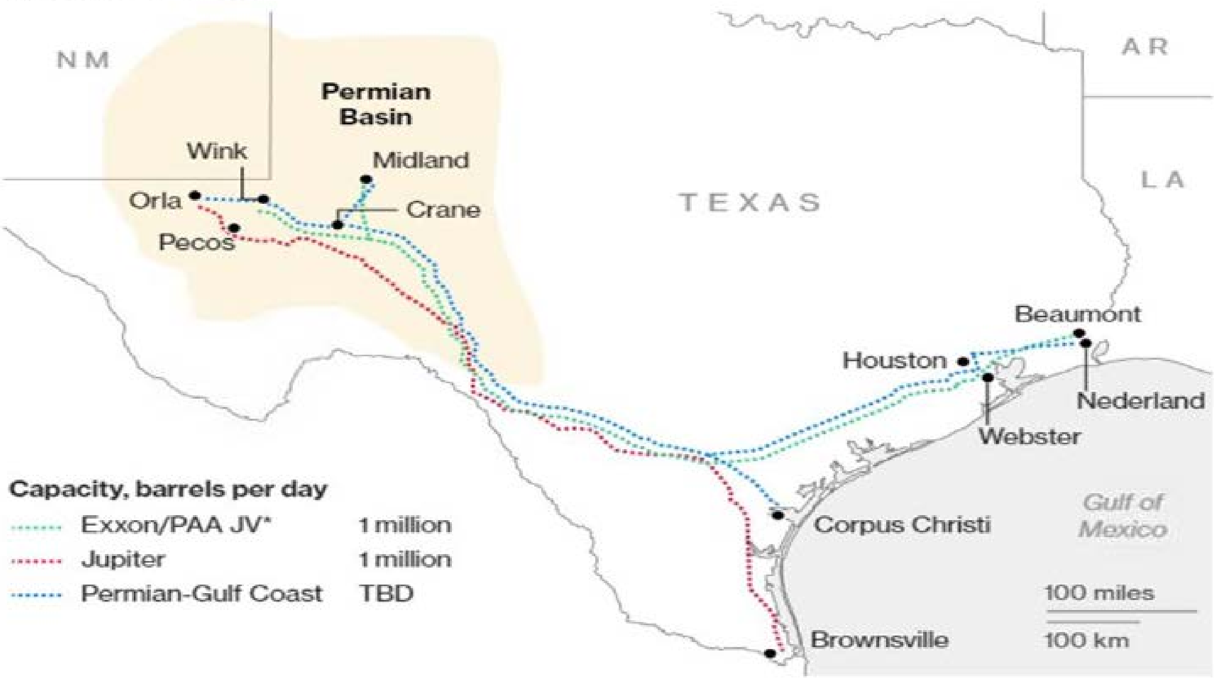
Oil Pipelines Set to Open in 2019...



Source: Pipeline companies

* Early flows to start in 2019, with full service planned for 2020. ** Enterprise Products Partners plans to convert one of the NGL pipes in those two routes

...And in 2020



Source: Pipeline companies

* Exxon Plains All American joint venture pipeline path is notional. No route has been announced

Items for Consideration: If the Legislature determines that the currently-identified revenues do not fully cover projected costs for outcomes improvements or property tax reform, the Legislature may need to consider additional revenue options. While the following proposals were discussed by the Commission; inclusion in this report is for reference purposes only:

[[INSERT ADDITIONAL PROPOSALS]]