TEXAS TAXPAYERS AND RESEARCH ASSOCIATION

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The Price of Appraisal Caps: Higher Taxes for Everyone Else

Many Texas homeowners have come to fear their property tax appraisal because they connect rising values to higher tax bills. In response, several bills have been filed recently to further limit how much a homeowner's tax appraisal may increase. But in fact, appraisal caps are a false promise of tax relief. They force higher tax rates, offsetting a portion of the benefit for existing homeowners and raising taxes on everyone else. In 2022, **Texas' 10% appraisal cap saved homeowners $4 billion in property taxes, but it moved that $4 billion to the tax bills of rental property, new homebuyers, and Texas businesses.** The appraisal cap did not cut taxes, it simply shifted them.

Texas' Appraisal Cap. In 1997 the Legislature proposed and voters approved a limit on the growth of the taxable value of a homestead of 10% from one year to the next. The appraisal cap was designed as a circuit breaker for existing homeowners caught in a red-hot real estate market. It would provide temporary relief against a short-term appraisal shock. But property tax is a zero-sum game – one property owner's relief is another's higher tax bill.

How Appraisal Caps Shift Taxes. Appraisal caps simply shift taxes from one taxpayer to another. Texas' appraisal cap does not constrain the amount of revenue a jurisdiction can raise; instead jurisdictions simply adjust their tax rate to raise the desired amount of revenue.

A $4 Billion Tax Shift

In 2022, Texas' appraisal cap protected homeowners from skyrocketing appraisals, but it added $4 billion to the tax bills on rental property, new home buyers, and businesses.

In Figure 1, the small hypothetical city of Azul, Texas has 4 properties: 2 identical homes (one owned by Bob, another owned by his neighbor Eva), a rental property (with property taxes incorporated into the rent Tom pays), and the Widget Store. In Year 1, both owner-occupied homes are valued at $250,000, Tom's apartment at $100,000, and the Widget Store at $400,000. The City of Azul's total tax base is $1 million. Azul needs $10,000 in property taxes to fund its budget, so it levies a property tax rate of $1.00 (per $100 of value), to raise the needed funds. Let's look at how these taxpayers would fare with and without appraisal caps.

Year 2, No Appraisal Cap. The market is hot, and all properties increase in value by 20%. Eva decides to move and sells her house to Zoe,

Figure 1

How Appraisal Caps *Shift*, rather than *Cut*, Property Taxes

Property	Year 1		Year 2, No Cap		Year 2, 10% Homeowner Cap		
	Taxable Value	Tax Due	Taxable Value	Tax Due	Taxable Value	Tax Due	Impact of Cap
Bob Homeowner	$250,000	$2,500	$300,000	$2,588	$275,000	$2,422	-$165
Eva/Zoe Homebuyer	$250,000	$2,500	$300,000	$2,588	$300,000	$2,643	$55
Tom Renter	$100,000	$1,000	$120,000	$1,035	$120,000	$1,057	$22
Widget Store	$400,000	$4,000	$480,000	$4,140	$480,000	$4,228	$88
Value/Azul City Tax	**$1,000,000**	**$10,000**	**$1,200,000**	**$10,350**	**$1,175,000**	**$10,350**	**$0**
Tax Rate (per $100)	$1.00		$0.86		$0.88		

Note: For simplicity of presentation no other exemptions apply other than the 10% appraisal cap.

who pays the new market price of $300,000. Overall, Azul's tax base is now $1.2 million. The city has growing budget needs, so it decides to increase taxes by 3.5%,[1] which raises $350 in new money, for total property tax revenues of $10,350. The city then calculates the tax rate it needs to levy to raise that revenue: $10,350/$1,200,000, or $0.86. Even though appraisals were up 20%, everyone's tax bill only grew by 3.5% because, absent voter approval, the city could not raise taxes above that – a provision of 2019's SB 2 (with similar provisions for schools in HB 3).

Year 2, Homeowner Appraisal Cap. How do the numbers change if existing property owners enjoyed a 10% appraisal cap, as currently provided for in Texas law? Even though Bob's home value is up $50,000 in Year 2, for tax purposes his value can only increase by $10%, or to $275,000. Zoe just bought her house from Eva, though. Since she didn't own the property a year ago, the appraisal cap does not apply. Zoe is taxed on the home's full market value – the $300,000 she paid for it. Tom's rental unit and the Widget Store aren't eligible for an appraisal cap, so their taxable value is up 20% from Year 1. Azul's overall tax roll is $1,175,000, reflecting lower growth because of Bob's appraisal cap. Azul now calculates the tax rate it needs to raise $350: $10,350/ $1,175,000, or $0.88 per $100 of value.

Comparing the Year 2 scenarios with and without appraisal caps illustrates their impact. Bob did see a lower tax bill with the cap. His taxable value increased less than everyone else's, and his share of Azul's taxes shrank, as did his actual tax bill, even though the city raised taxes by 3.5%. Bob's appraisal cap didn't cost the city any revenue, as they raised the $10,350 needed regardless of what was going on with the tax base. Because the appraisal cap reduced growth in the city's tax roll, a higher tax rate was needed to fund its budget – $0.88 with appraisal caps versus $0.86 without**. Even though the city promised it was only raising property taxes by 3.5%, Bob's tax bill dropped by 3.1% while everyone else's taxes went up 5.7%!** They paid for Bob's lower tax bill, not the city. Bob's appraisal cap in no way reduced the amount of property taxes Azul levied. It simply shifted who paid them.

Texas' Appraisal Cap *Raises* Rates and Taxes. Data on 2022 school district property values documents one of the hottest real estate markets in Texas history. The market value of single-family homes increased by 28% over 2021,

[1] For simplicity, we use 3.5%, which is the highest increase many cities can raise without voter approval. In fact, SB 2 allows small towns more flexibility.

Figure 2
Shifting Taxes Under Texas' Appraisal Cap ($ Billions)

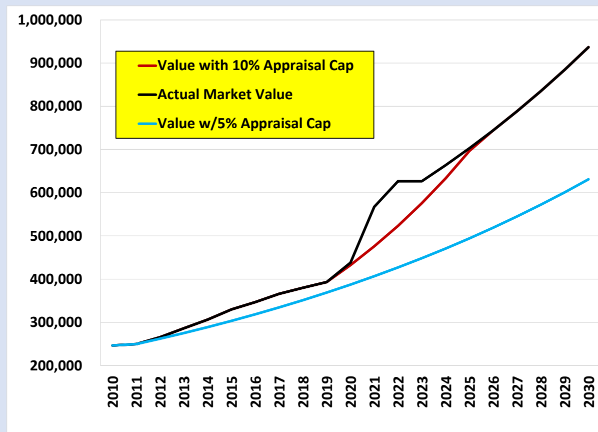
Tax Due	Actual School Taxes Paid			2022 Impact of Appraisal Cap		
	2021	2022	Increase	School Taxes w/o Cap	School Tax Shift	2022 All Juris Shift
New Home Buyers	$3.2	$3.9	22.1%	$3.6	$0.3	$0.5
Single Family Rental	$5.1	$6.2	22.1%	$5.8	$0.4	$0.8
Multi Family Rental	$3.2	$3.8	17.2%	$3.5	$0.3	$0.5
Business	$15.6	$18.1	15.7%	$16.8	$1.2	$2.2
Total Taxes	**$38.9**	**$44.3**	**13.7%**	**$44.3**	**$2.2**	**$4.0**

Source: Texas Taxpayers and Research Association.

but the 10% appraisal cap kept a whopping $272 billion of the increase off the tax rolls (versus $60 billion in 2021). The total school tax rate averaged $1.18 (per $100 of taxable value); however, absent the 10% appraisal cap, the same amount of revenue could have been raised with only a $1.10 tax rate. Existing homeowners did see a modest 4% average increase in their school tax bills, but saved $2.2 billion in school taxes they would have paid otherwise. Those savings grew to $4 billion factoring in city, county, and special district taxes. However, other property owners and renters only saw *higher rates* than they would have otherwise. For them, that translated into $4 billion of *higher tax bills*.

Lower Cap, Greater the Distortion. Texas' 10% appraisal cap was intended to be a circuit breaker protecting against short term market upheavals, and it has worked well in that regard. Figure 3 illustrates the concept, drawing from actual and projected median home prices in the Austin metro area.[2] Austin prices have generally grown near a 6% annual clip since 2010; however, from 2020 to 2022 the market was red hot and values increased 11%, 30%, and 10%, respectively (black line). Assuming a return to historic growth, Texas' 10% appraisal cap works as intended, providing temporary protection against the post-pandemic appraisal shock. Had a 5% appraisal cap been in place, it would have limited appraisals during times of normal market growth, effectively creating a split roll, with some homes arbitrarily and consistently valued well below the market rate.

Figure 3
Tax Appraisals at 10% and 5% Cap
Median Priced Home: Austin, Texas



Note: Austin median home value through 2022 from the Texas Real Estate Research Center; 2023 and beyond it TTARA projection.

The Economic Impact of Appraisal Caps. California is a textbook example of the distortionary impacts of low appraisal caps. In 1979, Cali-

[2] In this example, actual median home values as reported by the Texas Real Estate Research Center are used through 2022. Prices are assumed to be flat in 2023, with growth returning to historic norms in 2024 and beyond.

fornia voters approved Proposition 13, which sets the appraised value of a property at the price paid by the current owner, and limits future assessment increases to no more than 2% per year. Further, property taxes may not exceed 1% of the assessed value.

Studies have revealed a number of consequences from appraisal caps:

- **Slower real estate market**. Appraisal caps incentivize homeowners to stay longer in their homes, as purchasing a new property resets their tax bill. Studies reveal that California homeowners stay in their homes a year longer as a result of Prop 13.[3] Housing mobility has been reduced by 17%.[4]
- **Higher home prices.** A University of Notre Dame study found that California's appraisal cap drove up home prices by 18%, as a result of fewer homes on the market.
- **Welcome stranger!** California appraisal caps have essentially turned the property tax into a tax based on homeowner longevity.[5] Neighbors can pay vastly different tax bills depending on when they bought their homes rather than the value of the property.
- **Harm to renters**. Appraisal caps drive up rent costs (as taxes are shifted to rental properties) and home prices, making it harder for renters to save for and afford their first home.[6]
- **Urban/Rural Shift**. Texas' 10% appraisal cap mostly benefits urban homeowners where real estate markets tend to run hotter. For school finance purposes, those big city homeowners benefit with lower proportionate tax bills over those in cooler housing markets – typically rural and small-town Texas.

Appraisal Caps on All Property? Would the tax shift be resolved by extending a cap to all properties? No, it would simply work differently, shifting taxes from those properties with rapidly increasing values to those with lesser increases, especially business property. In addition to real estate, Texas' property tax applies to tangible personal property businesses use – such as machinery and equipment (as well as inventories and supplies). Unlike real estate, machinery and equipment tends to depreciate in value from year to year. Property declining in value would not benefit from a cap, and instead would see substantially higher tax rates. Further, Texas oil and gas valuations are extremely sensitive to oil and gas prices. The cap would shift more taxes to oil and gas when prices are declining, while providing a huge benefit when prices rebound, arbitrarily locking in low values for years to come.

Appraisal Caps are a False Promise of Tax Relief. Property taxes are essentially a zero-sum game – jurisdictions can raise certain amounts of new revenue without regard to their tax base. All values do is determine each individual taxpayer's share of that total. Appraisal caps don't change the size of the pie, they simply determine who gets a bigger or smaller piece. For some taxpayers, appraisal caps can be sweet, but for others, they are a sure cause of tax indigestion.

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[3] *Property Tax Limitations and Mobility: The Lock-in Effect of California's Proposition 13*, Nada Wasi and Michelle J. White, National Bureau of Economic Research, Working Paper 11108, February 2005.
[4] Proposition 13: An Equilibrium Analysis, Ayse Imrohoroglu, Kyle Matoba, and Selale Tusel.
[5] *Similar Home, Different Taxes*, Matt Levin, CALmatters.
[6] *Unjust Legacy: How Proposition 13 Has Contributed to Intergenerational, Economic, and Racial Inequalities in Schools and Communities*, Carrie Hahnel, Arun Ramanathan, Jacopo Bassetto, and Andrea Cerrato, The Opportunity Institute, June 2022.