

Winners and Losers in School Tax Reform

Any school finance reform that changes tax rates changes property values. Thus, as Texas reforms school finance under the direction of its Supreme Court, property values will change throughout the state.

Property values reflect both property taxes and the quality of local services, such as education. However, changes in tax rates are more immediate and certain than changes in school quality. Therefore, the housing market will respond faster to changes in taxes than to changes in quality. In the near term, changes in property taxes will determine the changes in property values.

Property taxes represent a series of obligations that buyers assume when they purchase a property. Therefore, the greater the tax obligation, the less a buyer would be willing to pay for any property, all other factors being equal. Research indicates that with a market interest rate of 8 percent, every \$100 increase in property taxes reduces property values by approximately \$1,150.¹ If taxes increase with inflation, the effect on property values is even greater.

The actual changes in school property taxes depend on the details of the Texas Legislature's finance reform proposal. As an example, we consider the effect of a law that equates tax rates across the 1,065 school districts in Texas. For this example we use data from the 1988–89 school year from the Texas Research League. School districts with tax rates above the state average of 88.1 cents per \$100 of taxable valuation would lower their tax rates, while school districts

with tax rates below the state average would increase their tax rates. This example corresponds closely to the effect of a statewide property tax for education.

Of the school districts that would increase their tax rates to the average rate, 345 would experience a decline of at least 1 percent in property values. Property values would fall by at least 7 percent in the five school districts with the lowest tax rates—Juno Consolidated School District (CSD), Allamoore CSD, Iraan–Sheffield Independent School District (ISD), Seminole ISD and Glen Rose ISD. An \$80,000 home in these school districts would lose roughly \$6,000 in value.

Of the school districts that would decrease their rates to the state average, 385 would experience increases in property values of at least 1 percent. Properties in the Coahoma ISD, which has the highest tax rate in the state, would appreciate by almost 12 percent, causing an \$80,000 home to gain \$9,200 in value. Fifteen other school districts would experience at least a 7-percent increase in home values.

The six largest school districts in the state, which educate 18 percent of the student population, already have tax rates that are close to the state average and would experience little change in their property values. Austin and San Antonio, with tax rates above the state average, would experience small gains in property values. Dallas, El Paso, Fort Worth and Houston have below-average tax rates and would see small losses in property values.

Changes in property taxes should induce swift changes in property values. Although changes in school quality will also alter property values, the effect may not be obvious for years. At least in the near term, the winners and losers in finance reform will be clear. School districts that must increase property taxes following reform should experience losses in property values, while school districts that can decrease property taxes should experience gains.

—Lori L. Taylor
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¹ Rosen, H. S., and D.J. Fullerton (1977), "A Note on Local Tax Rates, Public Benefit Levels, and Property Values," *Journal of Political Economy* Vol. 85, No. 2, pp. 433–40.

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