

July 27, 2016

Office of the Governor
P.O. Box 12428
Austin, Texas 78711-2428

Dear Governor Abbott:

As the House Appropriations and Public Education Committees investigate Speaker Strauss' Interim Charge to "recommend ways to reverse the increasing reliance on recapture payments to fund public education statewide," I would like to share the following impact statement on behalf of the Plano Independent School District. The following describes the impact of increasing property values upon school districts that are subject to and must submit recapture payments.

A common argument is that taxing authorities should reduce tax rates in areas where property values grow. The logic states that if a taxing authority's tax revenues grow due to increased property values to an amount exceeding its spending needs, taxes should be reduced. While this logic works in a vacuum, the reality for school districts is that the impact of rising property values is not the same as compared to other taxing authorities, and the impact of rising property values on certain school districts is not the same as compared to other school districts.

We would like to share with you the specific impact of increasing property values on Plano ISD using three illustrative scenarios. As you are aware, Plano ISD is a "Chapter 41" district and is subject to paying recapture taxes to the State of Texas under Chapter 41 of the Education Code. Out of 1,019 independent school districts in Texas, there are 251 districts that fit into this category that submit collectively about \$1.5 billion per year in recaptured property taxes. Within Collin County, the school districts that fit into this category are Allen, Frisco, McKinney, Plano and Prosper ISDs. These neighboring districts would each have similar results as those demonstrated below.

As a starting point, let me demonstrate the impact of the Robin Hood system on Plano ISD using last year's tax information. Plano ISD's gross operating revenues from local property taxes were \$470.2 million. As a result of the State's current funding formula, Plano ISD paid \$52.6 million in recapture taxes to the State, resulting in a net formula funding for Plano ISD of \$417.6 million. In other words, while Plano ISD collected \$470.2 million from local taxpayers, the District realized only 88.8% of that amount, delivering the remaining 11.2% to the State.

Year	M&O Tax Rate	M&O Local Tax Collections	State Recapture Tax	Effective State Tax Rate	M&O Net Local Tax Revenue
2015-2016	\$1.17	\$470.2 million	\$52.6 million <i>11.2% of total collections</i>	\$0.131	\$417.6 million

Under that rubric, let me address the impact of increasing property values on Plano ISD taxpayers. Unfortunately, under the State’s existing funding formula, additional tax revenues resulting from increasing property values does not always stay with local school districts to educate local students. In fact, for Chapter 41 districts like Plano ISD, those increased values simply result in a higher recapture tax payment to the State. As noted above, while it may seem logical for a taxing authority to reduce its tax rate to compensate for the higher property values, the shocking result for a Chapter 41 district like Plano ISD is that reducing the tax rate actually results in a net loss of operating revenue.

As noted above, we think walking through three illustrative scenarios will provide valuable context for you. Each of the three scenarios demonstrates what would happen if Plano ISD took action to create the stated outcome.

Scenario 1

OBJECTIVE: KEEP THE M&O¹ TAX RATE THE SAME

Maintain the current M&O tax rate of \$1.17.

POTENTIAL ACTIONS: KEEP THE M&O TAX RATE AT \$1.17

Adopt an M&O tax rate of \$1.17.

NET OUTCOME: LOSS OF \$5.2 MILLION IN NET OPERATING REVENUES.

Should Plano ISD retain its M&O tax rate at \$1.17, the District would generate an increase of \$38.4 million in additional M&O tax collections as compared to the previous year as a result of increased property values. Due to the prior year property value increase, however, the recapture tax payment to the State would increase by \$43.6 million as compared to the previous year. This \$43.6 million increase to the State more than offsets the increase in additional property taxes collected of \$38.4 million, leaving Plano ISD with a loss in net operating revenues of (\$5.2 million). Stated as a percentage of local tax revenue, this increased recapture payment represents 18.9% of the total amount collected by Plano ISD, as compared to the 11.2% of total collections in the previous year. Stated more plainly, notwithstanding increased property values resulting in increased taxes paid by Plano ISD taxpayers, under the State’s current formula, Plano ISD would receive less net operating revenue than in the previous year.

Year	M&O Tax Rate	M&O Local Tax Collections	State Recapture Tax	Effective State Tax Rate	M&O Net Local Tax Revenue
2016-2017	\$1.17	\$508.6 million	\$96.2 million <i>18.9% of total collections</i>	\$0.221	\$412.4 million

¹ As a reminder, school districts tax using two separate tax rates: (1) the maintenance and operations (“M&O”) rate, which funds operational costs, and (2) the interest and sinking (“I&S”) rate, which funds debt service. This letter addresses only Plano ISD’s M&O rate. Increased property values could have an impact on the I&S tax rate, as Plano ISD levies only the amount necessary to meet its debt service needs for the upcoming year. Increases in property values allow for a reduction in the I&S rate.

Scenario 2

OBJECTIVE: PRODUCE THE SAME AMOUNT OF M&O TAX COLLECTIONS AS IN 2015-16.

Keep the M&O property tax collections the same as the previous year (\$470.2 million) by reducing the M&O tax rate in order to neutralize the impact of the increased property values of approximately 9%.

POTENTIAL ACTIONS: REDUCE THE TAX RATE BY APPROXIMATELY 10 CENTS.

Plano ISD could reduce its M&O tax rate from \$1.17 to \$1.0755² and still produce the same amount of M&O tax collections as it did in the 2015-16 school year.

NET OUTCOME: LOSS OF \$25.6 MILLION IN NET OPERATING REVENUES

As noted above, a common argument is that increased revenues to a taxing authority due to increased property values should theoretically allow such taxing authority to reduce its tax rate while still generating the same amount as required in the previous year. For Plano ISD, however, this is not the case. Lowering the M&O tax rate to \$1.0755 would actually result in a net loss in operating revenues of \$25.6 as compared to the previous year. Under the State's funding formula, because of increased property values, and notwithstanding the District offsetting the impact on its taxpayers by reducing the tax rate, the District's recapture tax payment to the State would actually increase year over year by \$25.6 million (from \$52.6 million to \$78.2 million). In other words, while lowering the tax rate to \$1.0755 would result in the same tax revenues generated locally, the State increases the amount of its recapture tax payment because of the increase in local property values.

Year	M&O Tax Rate	M&O Local Tax Collections	State Recapture Tax	Effective State Tax Rate	M&O Net Local Tax Revenue
2016-2017	\$1.0755	\$470.2 million	\$78.2 million <i>16.6% of total collections</i>	\$0.179	\$392 million

Scenario 3

In Scenario 1 we see that taxpayers feel the impact of increased property values and experience a larger tax bill, the State receives a windfall, and Plano ISD loses net operating revenue. In Scenario 2 taxpayers have roughly the same tax bill, the State receives a windfall, and Plano ISD loses even more net operating revenue. Not to be deterred, we thought outside of the box and explored increasing the homestead exemption in an effort to minimize a homeowner's impact of increasing property values and generate the same amount of net operating revenue.

² Note that although a district could theoretically reduce its tax rate, current Texas law disincentivizes districts from doing so, but that is for another discussion.

OBJECTIVE: REDUCE THE IMPACT OF RISING VALUES ON HOMEOWNERS BY ADDING A LOCAL OPTION HOMESTEAD EXEMPTION

The state-mandated homestead exemption is \$25,000. School districts are allowed to adopt a local option homestead exemption as well.

POTENTIAL ACTIONS: SET A NEW LOCAL HOMESTEAD EXEMPTION AT \$35,000

Increase the homestead exemption by \$10,000 to \$35,000.

OUTCOME: LOSS OF \$13.4 MILLION IN NET OPERATING REVENUE

The District has explored the possibility of increasing the amount of the homestead exemption by \$10,000 to \$35,000. While this action would reduce the burden to some – but not all – Plano ISD taxpayers (i.e. homestead homeowners), the State does not recognize new local homestead exemptions in its school finance formula. As a result, the increased homestead exemption would result in a loss of \$8.2 million in M&O tax collections, but Plano ISD’s recapture tax payment to the State would remain unchanged as compared to Scenario 1 (an increase of \$43.6 million compared to 2015-16).³ Due to the reduction in local tax collections, the State’s recapture tax as a percentage of local M&O property taxes would be 19.2% (as opposed to 18.9% in Scenario 1).

Year	M&O Tax Rate	M&O Local Tax Collections	State Recapture Tax	Effective State Tax Rate	M&O Net Local Tax Revenue
2016-2017	\$1.17	\$500.4 million	\$96.2 million <i>19.2% of total collections</i>	\$0.225	\$404.2 million

While these three scenarios are not the only scenarios studied by the District, other scenarios yield similar results. The breathtaking conclusion remains the same – notwithstanding phenomenal property value growth recognized by Plano ISD taxpayers (due in no small part to Plano ISD being the district of choice for many families moving to this area), because of the State’s byzantine funding formula, Plano ISD will actually *lose* revenue in 2016-17. While the pie may be getting bigger, this growth cannot outpace the State’s appetite. In the State of Texas, increased property values do not generate a positive net operating impact upon school districts like Plano ISD.

Looking forward, if no changes are made in the state funding formula during the upcoming legislative session, Plano residents will likely see at least another \$37.4 million added to our State recapture tax bill in 2017-18. If so, Plano taxpayers will then be paying a property tax rate equivalent of \$.294 for the State’s recapture tax. Compare that to the first year of our \$1.17 M&O rate when the State’s recapture tax rate equivalent was \$.082 cents. You can only imagine the outcry if the District had silently raised its tax rate by \$.212 cents over a four year period, yet that is exactly the impact of the increase in the State’s recapture tax since 2014.

³ An increase in the local homestead exemption would also reduce I&S tax collections by \$1.9 million, which could possibly result in an increase to the I&S tax rate to meet the District’s debt service needs.

Year	M&O Tax Rate	M&O Local Tax Collections	State Recapture Tax	Effective State Tax Rate	M&O Net Local Tax Revenue
2017-2018	\$1.17	\$532.2 million	\$133.6 million <i>25.1% of total collections</i>	\$0.294	\$398.6 million

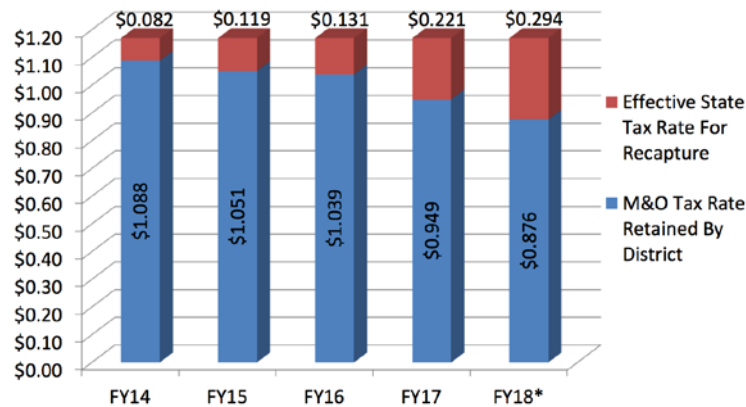
For full disclosure purposes, non-Chapter 41 districts realize the same net impact. The only difference is that when their property values grow, the state benefits by reducing their state funding rather than sending them a bigger State recapture tax bill.

Either way, when property values increase, the true beneficiary of additional operating revenue is the State of Texas – not local school districts.

We too would love to see meaningful reductions in school property taxes, but that can only occur if the funding formula in general, and the recapture tax in particular, are addressed. If not, that \$.294 cent tax rate equivalent that the State will collect via the recapture tax will continue to silently grow every year as demonstrated in the following chart.

Breakout of M&O Tax Rate – State vs. Local

(Rate Being Constant at \$1.17 per \$100 of Taxable Assessed Value)



* Assumes additional property value growth of 5%.

We invite dialogue with you on this issue and welcome any questions that you have. We ask for your leadership on this opportunity and would be delighted to learn more about the ideas that you have that would allow Chapter 41 school districts that pay recapture tax, like Plano ISD, to reduce or eliminate the recapture tax and/or reduce its tax rate without a net operating revenue reduction.

We look forward to sharing our ideas with you and talking about solutions that can position us to minimize taxpayer impact during periods of property value escalation.

Sincerely,

Missy Bender
President
Plano ISD Board of Trustees

cc: Dr. Brian Binggeli
Plano ISD Board of Trustees
Steve Fortenberry