LEAGUE OF CALIFORNIA CITIES

REVENUE AND TAXATION POLICY COMMITTEE
Thursday, June 4, 2020
1:30 p.m. – 4:30 p.m.

To join the meeting, please register here:
https://zoom.us/meeting/register/tJItdeGhrToiGtK90v6b5wNYTUIUpDK3Gnfk
Once you register, you will immediately receive a link to join the meeting.

AGENDA

I. Welcome

Speakers: Chair, Olivia Valentine, Council Member, City of Hawthorne
Vice-Chair, Lisa Middleton, Council Member, City of Palm Springs

II. Public Comment

III. General Briefing *Informational*

IV. COVID-19 & Budget Update *Informational*

- **LAO Comments on the Governor's May Revision**

V. Legislative Update *Informational*

VI. Ballot Measures *Action*

- The California Schools and Local Communities Funding Act of 2020 ("Split-Roll") *(Attachment A)*
- Family Home Protection and Fairness in Property Tax Reassessments Act *(Attachment B)*

Next Meeting (tent.): Annual Conference, Long Beach, October 7
Staff will notify committee members after August 17 if the policy committee will be meeting in October.

NOTE: Policy committee members should be aware that lunch is served at these meetings. The state's Fair Political Practices Commission takes the position that the value of the lunch should be reported on city officials' statement of economic interests form. Because of the service you provide at these meetings, the League takes the position that the value of the lunch should be reported as income (in return for your service to the committee) as opposed to a gift (note that this is not income for state or federal income tax purposes—just Political Reform Act reporting purposes). If you would prefer not to have to report the value of the lunches as income, we will let you know the amount so you may reimburse the League.

Brown Act Reminder: The League of California Cities' Board of Directors has a policy of complying with the spirit of open meeting laws. Generally, off-agenda items may be taken up only if:

1. Two-thirds of the policy committee members find a need for immediate action exists and the need to take action came to the attention of the policy committee after the agenda was prepared (Note: If fewer than two-thirds of policy committee members are present, taking up an off-agenda item requires a unanimous vote); or
2. A majority of the policy committee finds an emergency (for example: work stoppage or disaster) exists.

A majority of a city council may not, consistent with the Brown Act, discuss specific substantive issues among themselves at League meetings. Any such discussion is subject to the Brown Act and must occur in a meeting that complies with its requirements.
Informational Items: Any agenda item listed for information purposes may be acted upon by the Policy Committee if the Chair determines such action is warranted and conforms with current League policy. If the committee wishes to revise League policy or adopt new policy for an item listed as informational, committees are encouraged to delay action until the next meeting to allow for preparation of a full analysis of the item.

ATTACHMENT A

REVENUE AND TAXATION POLICY COMMITTEE
Ballot Measure Agenda
June 4, 2020

Staff: Nick Romo, Legislative Representative, (916) 658-8200
Johnnie Pina, Legislative Policy Analyst (916) 658-8200

1. The California Schools and Local Communities Funding Act of 2020

Initiative Summary

The California Schools and Local Communities Funding Act of 2020, also known as the "Split Roll Initiative", qualified for the November 2020 ballot. This measure would increase funding for K-12 public schools, community colleges, and local governments by requiring that certain commercial and industrial real property be taxed based on current market value.

There are several exemptions from this change, including:

- Residential properties;
- Agricultural properties; and
- Owners of commercial and industrial properties with combined value of $3 million or less.

The Legislative Analyst's Office (LAO) and Director of Finance estimate a net increase in annual property tax revenues of $7.5 billion to $12 billion in most years, depending on the strength of real estate markets. After backfilling state income tax losses (decreased taxable personal and corporate income) and county administrative costs, the remaining $6.5 billion to $11.5 billion would be allocated to schools (40 percent) and other local governments (60 percent). For local government, this means a low of $3.9 billion and a high of $ 6.9 billion per year.

Initiative Description

The measure would require commercial and industrial properties, as well as vacant land not intended for housing, commercial agriculture, or protected open space to be taxed based on their market value. A property's market value is what it could be sold for today. The measure would shift to market value assessment over a number of years beginning in 2022-23. Notably, commercial properties would still be taxed at one percent of their value.

(Under existing law, these properties are protected by Proposition 13. Under Proposition 13, all real property has established base year values, restricted rates of increase on assessment no greater than two percent each year and a one percent limit on property taxes on the current assessed value.)

Small Business Exemptions and Delayed Implementation

For properties in which the majority of space is occupied by small businesses, the transition to market value assessment would not begin until 2025-26 or a later date set by the Legislature.

Properties owned either by individuals or businesses with value less than $3 million (adjusted for inflation biannually beginning in 2025) are exempt from the proposed market value tax assessment.

The measure would exempt the first $500,000 in value of a business's personal property and would exempt from taxation all personal property of small businesses.

For the purposes of this measure, a small business is defined as a business that owns California property and has 50 or fewer employees.

Allocation of Revenues

Before allocating funds to local governments, the measure would require a portion of the new revenues be allocated to:

- The state general fund to compensate for any reductions in income tax revenue resulting decreased taxable personal and corporate income; and

- Counties to cover their costs of administering the split roll.

Of the remaining funds, roughly 60 percent is allocated to cities, counties, and special district, with each entity receiving an amount proportional to the share of property tax revenues in their county that they receive under existing law.

The remaining roughly 40 percent would be allocated to schools and community colleges to supplement the existing funds schools and community colleges receive under the state's constitutional minimum funding requirement.

Market Value Reassessment Phase-In

The Legislature will be required to provide by statute for the phase-in of the reassessment of commercial and industrial real property commencing with the lien date for the 2022-23 fiscal year and extending over two or more lien dates. Property owners will be required to pay taxes based on the new assessed value beginning with the lien date for the fiscal year when the county assessor has completed the reassessment. For properties in which the majority of space is occupied by small businesses the transition to market value assessment would not begin until 2025-26 or a later date set by the Legislature.

After the initial reassessment of a commercial or industrial property, the property shall be periodically reassessed no less frequently than every three years as determined by the Legislature.

Background
California local governments levy property taxes on real property and business personal property based on the value of their property; resulting in a key discretionary revenue source for local governments. Property taxes raise around $65 billion annually for local governments, about $2 billion of which is attributable to business personal property.

Specifically, cities receive about $13 billion in property tax revenues yearly. For the average city, property taxes are about 15 percent of total city revenues, and about 40 percent of general revenue (varies widely). For cities, property tax remains amongst the most stable local and discretionary revenue sources. Cities also depend to varying degrees on locally imposed taxes such as the transient occupancy tax, business license tax, and utility user tax.

Passed in June 1978, Proposition 13 capped local property taxes levied by cities, counties, schools, and special districts at one percent of full cash value which is based on the full cash value at the time a property is sold. The sale of the property establishes a base-year, and the property tax assessment cannot increase by more than two percent annually. Since property values often increase by more than two percent annually, property owners receive an additional benefit when they hold their properties for a longer period. Proposition 13 also treats commercial property the same as residential property.

Additional information about Proposition 13 can be found here:

- CaliforniaCityFinance.com
- CalMatters: Prop 13
- The Block that Prop 13 Built

Fiscal Impact
According to the Legislative Analyst's Office (LAO) analysis:

> Upon full implementation, the net increase in annual property tax revenues as a result of this initiative would be $7.5 billion to $12 billion in most years, depending on the strength of real estate markets. After backfilling state income tax losses related to the measure and paying for county administrative costs, the remaining $6.5 billion to $11.5 billion would be allocated to schools (40 percent) and other local governments (60 percent). As a result, this new revenue stream would fluctuate more from year to year than property tax revenues have historically.
>
> The increase in revenue for individual cities will depend on the number of commercial businesses in the city and gap between the market value and the base value of that property.
>
> The measure's new business personal property exemptions likely would reduce property tax revenues by several hundred million dollars per year.

From this revenue, the measure first allocates funding to cover:

- Decreased Income Tax Revenues.
  By increasing property tax payments for commercial and industrial properties, the initiative would decrease taxable personal and corporate income and, in turn, decrease state Personal Income Tax (PIT) and corporate tax revenues. This decrease in PIT and corporate tax revenues could be as much as several hundred million dollars annually.

- Increased County Costs for Property Tax Administration.
  The initiative creates significant new administrative responsibilities for counties, particularly county assessors. These new responsibilities could increase county property tax administration costs by hundreds of millions of dollars per year ongoing.

- Short-Term State General Fund Costs.
  Counties likely will incur administrative costs related to the measure before new revenue is available to cover their costs. The initiative requires the state to provide loans to counties to cover these initial costs—possibly in the hundreds of millions of dollars—until new revenue is available, at which time the state loans would be repaid.

Studies

The Schools and Communities First campaign released a report on May 4, 2020 of estimated new revenues for cities. This report gives the revenue estimates for the following counties and the cities and special districts within those counties: Alameda, Fresno, Kern, Los Angeles, Merced, Orange, Riverside, Sacramento, San Bernardino, San Francisco, San Joaquin, San Diego, Santa Barbra, Santa Clara, and Ventura.

According to the University of Southern California study titled, "Getting Real about Reform II: Estimating Revenue Gains from Changes to California's System of Assessing Commercial Real Estate", if commercial and industrial property were assessed at market value, it would provide an additional $11.4 billion in property tax revenues. This study also has a breakdown of how the revenue would be allocated by county.

A 2012 study by Pepperdine University School of Public Policy titled, *An Analysis Of Split Roll Property Tax Issues And Impacts* details the following key findings*:*

- Increasing the taxes of businesses…would result in lost economic output and decreased employment. The cost to the California economy of this property tax increase would total $71.8 billion dollars of lost output and 396,345 lost jobs over the first five years of a split roll property tax regime. These losses would be even greater in succeeding years.

- The introduction of a split roll property tax valuation system would result in increased instability for local government finances, as they would become more directly susceptible to the value gyrations of the real estate market. For example, in 2008-09 when California property values faced the traumatic decline in the wake of the sub-prime crisis and the market collapse (industrial and commercial values fell 6.5 percent), property taxes collected from these same properties actually rose 5.0 percent.

- A split roll property tax valuation system would also further undermine the attractiveness of the business climate in California. Because small businesses typically lease properties where the cost of property taxes is passed through to the lessee, this research concludes that the employment losses described above would be disproportionately concentrated in small businesses, and especially those owned by women and minorities.

According to the LAO's analysis of the first version of the split roll ballot measure in 2018,

> "The measure could have indirect effects on the state's economy. For example, the measure would increase taxes paid by many businesses, thereby increasing their costs of operating in California relative to other states. This would influence some businesses' decisions about whether to expand in or move to California. Overall, the measure's effect on the health of the state's economy is uncertain."

Existing League Policy

Related League Revenue and Taxation policies and principles include:

- Additional revenue is required in the state/local revenue structure. There is not enough money generated by the current system or allocated to the local level by the current system to meet the requirements of a growing population and deteriorating services and facilities.

- Meaningful fiscal reform should allow each level of government to adequately finance its service responsibilities, with each being accountable to taxpayers for its own programs.

- Cities require a greater share of the property tax and other reliable, discretionary revenues in order to finance local services to property.

- Counties require additional funding if they are to fulfill their state-mandated and traditional roles.

Related League Housing, Community and Economic Development policy:

- Support the establishment of a secure, balanced, and discretionary local revenue base necessary to provide the full range of needed services and quality land use decisions.

Comments

Supporter Comments

The Schools and Communities First Fact Sheet describes the measure by stating: It closes commercial property tax loopholes benefiting a fraction of corporations and wealthy investors, without affecting homeowners or renters, and reclaims $12 billion every year to fund world-class schools and strengthen local economies to lift up all Californians. The campaign website states:

> "The Schools & Communities First initiative, which recently submitted a historic 1.7 million signatures of support, will reclaim $12 billion every year for essential local services and schools by closing corporate tax loopholes – all while protecting homeowners and renters, small businesses, and agriculture from any changes. Recent polling, both internally and from PPIC, have consistently shown that Schools & Communities First is supported by a majority of likely California voters. According to research conducted by the University of Southern California, **78% of the revenue would come from only 6% of commercial and industrial properties**."

More information and additional statements of support can be found on their website.

Opposition Comments

Californians to Save Prop 13 and Stop Higher Property Taxes are leading the campaign against this ballot measure. Opponents of this measure state that "special interests qualified a measure for the November 2020 statewide ballot that will destroy Proposition 13's property tax protections. The measure has too many flaws and will increase the cost of living for all Californians."

They state that with the increased property tax small businesses would have to absorb the costs and pass them to the customer. They state that the ballot measure has the following flaws:

- "Most food items will face higher property taxes not just once, but several times, as they travel from the farm to processing, packaging, distribution, and the grocery store ultimately driving up the cost of living for all Californians;

- The property tax hike will eliminate the incentive to build solar energy systems which will endanger California's goal of 100 percent renewable energy by 2045 and increase utility bills for families – ultimately driving our cost of living even higher; and

- The property tax hike will make it even more difficult for small businesses to reopen their doors and stay in business as a result of this economic crisis."

In this Op-Ed, Willie Brown, former San Francisco mayor and Speaker of the California Assembly, states that while the proponents of this measure claim that this ballot measure is small business friendly, in reality it is not. Brown goes on to say, "This demonstrates a general lack of awareness of how most small businesses operate. Most small businesses rent the property where they operate and have what's called a "triple net lease," where property taxes, insurance and maintenance costs are passed directly onto tenants."

Additional Comments

- According to the Legislative Analyst's Office (LAO), long-tenured properties are less likely to be developed, which Proposition 13 may have played in part in explaining this pattern. The split-roll measure can encourage California's under-assessed commercial lands such as car lots, strip malls, and sprawls to be made available for more intensive use.

  This measure may benefit startup companies in California. In the 1992 case, *Nordlinger v. Hahn*, Supreme Court Justice John Stevens said "as Proposition 13 controls the taxation of commercial property as well as residential property, the regime greatly favors the commercial enterprises of the [wealthiest], placing new businesses at a substantial disadvantage."

- There is raised concern that increasing the tax revenue generation of commercial property would further the 'fiscalization of land use' towards incentivizing commercial development over residential development. However, existing laws governing the zoning and approval of housing development may limit this effect.

- Large corporations residing in California have highly benefited from Prop 13. For example, according to an article entitled, *Should Businesses Pay More?*, Intel's plot of land in the heart of Silicon Valley has a current value of about $2.50 per square foot, while a professional office center just across the street was recently assessed with a value of roughly $126 per square foot.

Key Policy Questions for the Committee to Consider

- Does the proposed measure provide a more *equitable* property tax structure?

- Does the increased revenue for cities, schools, and other local governments outweigh/offset potential impacts on California businesses?

- Does this measure advance the League's strategic priorities, particularly in the areas of fiscal sustainability, housing supply/affordability, and supporting individuals experiencing homelessness?

- Timing and context matter - given the phase-in provisions and legislative controls, does this measure properly balance concerns regarding the current economic outlook with potential long-term benefits for local governments?

Support-Opposition: (as of May 25, 2020)

Support
A full list of supporters can be found on The Schools and Community First Coalition website.

Opposition
A full list of supporters can be found the on the Californians to Save Prop 13 and Stop Higher Property Taxes website.

Staff Recommendation:

Committee Recommendation:

Board Action:

ATTACHMENT B

REVENUE AND TAXATION POLICY COMMITTEE
Ballot Measure Agenda
June 4, 2020

Staff: Nick Romo, Legislative Representative
Johnnie Pina, Legislative Policy Analyst

2. Family Home Protection and Fairness in Property Tax Reassessments Act

Initiative Summary:
The measure would make the following changes:
1. This measure would allow those over 55 years old, severely disabled, displaced by a natural disaster, or moving from contaminated housing to take their base year property value with them when moving to a home of equal or lesser value and would give them a property tax break when moving to a replacement dwelling of greater value.
2. This measure would narrow the tax breaks on inherited properties.
3. This measure would amend the law to clarify when commercial property has a "change in ownership" in order to reassess the commercial property.

The Legislative Analyst's Office (LAO) and Department of Finance specify that the fiscal impact on state and local governments is as follows:

> Local governments could gain tens of millions of dollars of property tax revenue per year, likely growing over time to a few hundred million dollars per year. Schools could receive similar property tax revenue gains. Other local and state revenues each could increase by tens of millions of dollars per year. County property tax administration costs likely would increase by tens of millions of dollars per year.

Initiative Description:

1. **This measure would allow those over 55 years old, severely disabled, displaced by a natural disaster, or moving from contaminated housing to:**
   - Take their base year property value with them when moving to a home of equal or lesser value; and
   - Receive property tax break when moving to a replacement dwelling of greater value.
     - These tax breaks would be allowed in all counties; and
     - Individuals would be allowed to make such a transfer up to three times a year.

   Below are examples of how the property base value transfer would work in both possible scenarios.

   - Moving to a home of equal or lesser value:
     For the purposes of this example:
     - *Full Cash Value of Replacement Property = $600,000*
     - *Full Cash Value of Original Property = $700,000*
     - *Base Year Value of Original Property = $300,000*

In this example, a qualified homeowner who transfers their base year of $300,000 to a replacement property, would keep their base year value of $300,000. In this example for purposes of calculating their new property tax, they would be assessed at half of what they would have otherwise been assessed on.

- Formula applicable to moving to a home of greater value:
  (Full cash value of replacement property – Full cash value of original property) + Base year of original property = the base year value of the replacement dwelling

  For the purposes of this example:
  - *Full Cash Value of Replacement Property = $8000,000*
  - *Full Cash Value of Original Property = $600,000*
  - *Base Year Value of Original Property = $300,000*

  ($800,000 – $600,000) + $300,000 = $500,000.

  The base year value of the replacement dwelling = $500,000

  In this example, the qualified homeowner would be now be paying a property tax based on a value that is $300,000 less than the current market value of the replacement home.

2. **Narrows the Special Rules for Inherited Properties.**
   The measure would narrow the special rules for inherited properties. Specifically, effective January 1, 2021, the measure would:

- **Eliminate Exclusion for Properties Not Used as Primary Residence*.***
  The inheritance exclusion would apply *only* to properties used as the *inheritor's primary residence*. Inherited property used for any other purpose than the inheritor's primary residence—such as rental homes or business properties—would be reassessed to market value.

- **Cap Amount of the Tax Benefit for Primary Residences.**
  The assessor would exclude only the first $1 million of value that would be added upon reassessment. If a property is inherited by a child or a grandchild in certain circumstances, the person inheriting the property would also inherit the taxable value.

  Under existing law if a home with a taxable value of $500,000 was sold for $2 million its taxable value would have increased by $1.5 million if the home were reassessed.

  Under this measure, $1 million of this increase would be excluded. Upon inheritance, the home's taxable value in this example would be $1 million.

  For example:

  - Market Value of the Property = $2,000,000
  - Original Taxable Value of the Property = $500,000
  - (Original taxable value) + [gap between original taxable value and market value] - $1 million (inheritance exclusion) = New Taxable Value).
    - $500,000 + [$2,000,000 - $500,000] - $1,000,000 =

    - New Taxable Value for the Inherited Property used as a Primary Residence = $1,000,000
- **Increases the Annual Adjustment to an Inherited Property's Taxable Value.** The taxable value of an inherited property would increase each year at the same rate as the price of a typical California home. This rate will be based on the House Price Index for California (HPI) for the first three quarters of the prior calendar year, as determined by the Federal Housing Finance Agency (FHFA). The intent and impact of this provision remains ambiguous. The committee may wish to question the supporters and opponents of this measure about how this provision would impact the existing Proposition 13 protections for homeowners and what the rationale may be for loosening these protections on inherited property by children or grandchildren used as a principal residence. The Committee may also wish to consider whether this change should apply to all homeowners who primarily reside in an inherited home indiscriminate of income level or home value.

3. **Broadens Scope of Legal Entity Ownership Changes.**
   In addition to the existing circumstances defined in current law, the measure would broaden the types of legal entity ownership changes that trigger reassessment. Specifically, effective January 1, 2021, the measure would require properties owned by a legal entity to be reassessed if 90 percent or more of the ownership of the legal entity is transferred, *even if no single person or entity gains more than 50 percent ownership*. The transfer of 90 percent of the ownership could occur in a single transaction or over time as part of multiple transactions. The sale of stock in a publicly traded company through an established stock market would not count as a change of ownership.

Background
Property taxes are a major revenue source for local governments, raising nearly $60 billion annually. Although the state receives no property tax revenue, property tax collections also affect the state's budget, because state law guarantees schools and community colleges (schools) a minimum amount of funding each year through a combination of property taxes and state funds. If property taxes received by schools decrease, state funding generally must increase.

Specifically, cities receive about $13 billion in property tax revenues yearly. For the average city, property taxes are about 15 percent of total city revenues, and about 40 percent of general revenue (varies widely). For cities, property tax remains amongst the most stable local and discretionary revenue sources. Cities also depend to varying degrees on locally imposed taxes such as the transient occupancy tax, business license tax, and utility user tax.

Proposition 13 of 1978 capped local property taxes levied by cities, counties, schools, and special districts at one percent of full cash value which is based on the full cash value at the time a property is sold. The sale of the property establishes a base year, and the property tax assessment cannot increase by more than two percent annually. Since home values often increase by more than two percent annually, homeowners and other property owners receive an additional benefit when they hold their properties for a longer period. Examples of these scenarios can be drastic in regions like the Bay Area where homes purchased years ago for $100,000 are now valued in the millions.

The California Constitution offers a one-time property tax saving opportunity for four categories of homeowners (those over 55 years old, the severely disabled, individuals displaced by a natural disaster, or moving from contaminated housing) who move to another home. All of these individuals have the ability to transfer their Proposition 13 property tax base year value from their current dwelling to a replacement dwelling of equal or lesser value within the same county. Transfers to other counties are prohibited unless the county agrees to allow such transfers.

The policy rationale behind this subsidy is to assist seniors looking to downsize because they are retiring and living on lower incomes, assist the disabled and others who have had homes destroyed by disaster or had to move from a contaminated property. The policy rationale in letting counties decide whether to accept out-of-county transfers is in recognition of the potential financial impacts on "destination" counties where retirees may move to because local services, including medical, library, parks, and other services that support retirees, must be paid for. Currently, 11 counties (Alameda, El Dorado, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Mateo, Santa Clara, Tuolumne, and Ventura) allow these transfers. Whether within a county or across counties, a homeowner can transfer their assessed value only once in their lifetime.

Some cities and counties also impose taxes on the transfer of homes and other real estate. These transfer taxes are based on the value of the property being transferred. Transfer taxes are equal to $1.10 per $1,000 of property value in most locations but exceed $20 per $1,000 of property in some cities. Statewide, transfer taxes raise around $1.1 billion for cities and counties. Additionally, the state collects a personal income tax on income earned within the state, which includes profits from selling real estate. The personal income tax raises over $90 billion each year.

Inherited Properties
According to the LAO:

> Under existing law… "Special rules also exclude from reassessment certain property transfers between parents and children. These rules also apply to grandparents and grandchildren if the grandchildren's parents are deceased. The rules apply to all types of property including primary residences, vacation homes, and business properties."

This was highlighted in an L.A. Times article titled, *California homeowners get to pass low property taxes to their kids. It's proved highly profitable to an elite group*.

Change in Ownership of a Business Property
Under existing law, properties owned by a legal entity are not always reassessed when ownership of the legal entity changes. This is because while the owners of the legal entity change, the legal entity remains the owner of the property. Reassessment can occur, however, if any person or entity obtains more than 50 percent ownership of the legal entity, the legal entity's properties are reassessed. Currently,

Fiscal Impact:
In 2017, the LAO estimated that Proposition 5 would decrease revenue for local governments and school districts by $2 billion or more per year in the long-term. However, this year's measure would have a net positive increase on local and school revenue.

According to the LAO Analysis of this measure, this measure would have the following major impacts on state and local governments:

- Local governments could gain tens of millions of dollars of property tax revenue per year, likely growing over time to a few hundred million dollars per year. Schools could receive similar property tax revenue gains.
- Other local and state revenues each could increase by tens of millions of dollars per year.
- County property tax administration costs likely would increase by tens of millions of dollars per year.

The analysis continues by stating the following:

> "Potentially Higher Revenues from Higher Home Prices and More Home Building
> The measure could cause more people to sell their homes and buy different homes because it gives them a tax break to do so. More people being interested in buying and selling homes would have some effect on home prices and home building. Increases in home prices and home building would lead to more property tax revenue.
>
> Inherited Property Rules***.***
> As the measure would narrow the inheritance reassessment exclusion, it would result in more properties being reassessed at the time of inheritance. Under current law, between 60,000 and 80,000 inherited properties statewide are excluded from reassessment each year. Somewhere around two-thirds of these properties are not used as primary residences. Further, it appears that roughly one-fifth of the tax benefit on inherited primary residences went to those who received a benefit greater than $1 million. Both of these types of inherited properties would see an increase in their taxable value under the measure. This suggests the measure could lead to increases in property tax payments for 40,000 to 60,000 properties each year. This, in turn, would increase property tax revenues for local governments. In the first few years, schools and other local governments each probably would gain over $100 million per year. Over time, these gains would grow resulting in schools and other local governments each gaining about $1 billion per year (in today's dollars).
>
> Legal Entity Ownership Change Rules
> By expanding the scope of legal entities ownership changes that can result in reassessment, the measure would result in more legal entities' properties being reassessed each year. This, in turn, would increase property tax payments by legal entities. Very little information is available about ownership changes of legal entities throughout the state. Because of this, the magnitude of the potential increase in property taxes paid by legal entities is unclear."

SB 2 (Atkins) Building Jobs and Homes Act Funding
If there are increased real estate transactions there will be an increase in the number of $75 recording fees on real estate documents. This would lead to an increase in the SB 2 pot of money allocated to cities to increase the supply of affordable homes in California.

Because the number of real estate transactions recorded in each county will vary from year to year, the revenues collected will fluctuate.

Existing League Policy:
Over recent years the League has joined with the California State Association of Counties in opposing similar proposals to this one when they have been proposed in the Legislature, primarily out of a concern for the impacts on local revenue.

Related League Revenue and Taxation policies and principles include:

- Additional revenue is required in the state/local revenue structure. There is not enough money generated by the current system or allocated to the local level by the current system to meet the requirements of a growing population and deteriorating services and facilities.
- Meaningful fiscal reform should allow each level of government to adequately finance its service responsibilities, with each being accountable to taxpayers for its own programs.
- Cities require a greater share of the property tax and other reliable, discretionary revenues in order to finance local services to property.
- Counties require additional funding if they are to fulfill their state-mandated and traditional roles.

Related League Housing, Community and Economic Development policy:

- Support the establishment of a secure, balanced, and discretionary local revenue base necessary to provide the full range of needed services and quality land use decisions.

Comments:

- In 2018, in support of the "The People's Initiative to Protect Proposition 13 Savings", the California Association of Realtors (Realtors) stated that existing law results in the following problems:
  - Seniors cannot afford to move, because they would face increases in their property taxes compared to what they currently pay.
  - Many disabled people are trapped in inadequate homes and efforts to move to a more suitable property are often impossible due to the prospect of paying increased property taxes.
  - Disaster victims are penalized when they seek to move out of their disaster-stricken county, because many counties have opted to not accept out-of-county transfers.
  - The existing process results arbitrary and limited property tax protections from a confusing patchwork of county laws (where only 11 out of 58 counties have opted to accept out-of-county transfers).

The Realtors maintained that is measure will produce the following benefits:

- Seniors will have the freedom to downsize and move closer to family.
- The severely disabled can move to more practical homes.
- Disaster victims will have an opportunity to move anywhere in the state.

They also stated that additional policy benefits include:

- Unlocking the existing housing market by providing more opportunities for home ownership when seniors and others sell their existing properties.
- Increased property taxes to jurisdictions where the properties are sold.
- Increased economic activity and additional local revenue triggered by other actions that occur in conjunction with a home sale, including additional household spending like building renovations, new furniture, carpeting and other purchases.

According to a 2017 Legislative Analyst's Office (LAO) Analysis:

> "Some research suggests that the existing property tax benefit does affect the timing of when seniors may move. For example, California homeowners who were 55 years old were around 20 percent more likely to move in 2014 than 54-year-old homeowners. This

suggests that some homeowners who were interested in moving delayed doing so to avoid paying higher property taxes."

- The League currently supports SB 1319 (Bates), which would further clarify a "change in ownership" of commercial property to include when at least 90 percent of direct or indirect ownership interests in a legal entity are sold or transferred in a single transaction, similarly to what this ballot measure seeks to do.

- When the League has opposed similar property tax base transfer proposals in the Legislature, the following additional policy arguments were made:

    - Prop. 13 already gives all Californian's a significant property tax break by capping property taxes at one percent of assessed value. Thirty-three other states have higher property tax levels. Also, most other states also annually reassess property values, but in California increases cannot exceed two percent.

    - Local governments already do not receive enough property tax revenue from housing to offset service costs, this would make it even harder for housing to "pencil out" for cities.

    - Property taxes are not the only financial reason affecting a decision to move. Other costs associated with selling and buying property need to be factored in. Property tax is capped at one percent of home value, but Realtor fees associated with the same transaction average six times that (six percent).

In 2018, the League remained neutral on "The People's Initiative to Protect Proposition 13 Savings" which would have expanded property tax breaks for certain categories of individual homeowners when they move. In their analysis of the 2018 measure, the LAO projected that while the reassessments from more homes sold could offset some impacts—overall property taxes would decrease for local governments. In the first few years, property tax losses would be a few hundred million dollars per year, with schools and other local governments (cities, counties, and special districts) each losing around $150 million annually. Over time these losses would grow, likely reaching between $1 billion to a few billion dollars per year (in today's dollars) in the long term, with schools and other local governments each losing $1 billion or more annually. That is why League staff recommended the committee take an oppose position. A caveat to that is that the 2018 went further in reducing the taxable value of a replacement property if the value was less than the assessed value of the original property, resulting in a larger property tax loss for the jurisdiction in which the replacement house is located.

<u>Legislative Discussions</u>
If there is a legislative compromise on this measure, the Legislature has until June 25 to place measures on the ballot.

<u>Other Considerations</u>
Even if the net fiscal impact to cities will be a gain in revenue, the real fiscal impact to individual cities will likely be uneven and challenging to determine.

The policy argument that likely resonates the most with this proposal is whether it would help free up housing stock by providing additional incentives to seniors to sell and move. This proposal will likely trigger some activity, but how much it tips the balance is debatable. It's also debatable whether it is worth the uneven revenue loss or gain to find out. In today's tight housing market, having more homes for sale may moderate price increases in areas where seniors are selling, but perhaps increase prices in areas where seniors are moving to. Since this incentive is not limited to lower income individuals or those seeking to downsize it could create additional challenges for first-time homebuyers who may be competing with seniors able to make cash offers with accumulated equity and have an additional advantage of paying lower property taxes.

Policy Questions:

- Other initiatives and efforts may be considered in the Legislature and on the November 2020 ballot that meticulously avoid changes to residential property tax assessment – should changes be made to residential assessments in this manner?

- The LAO states that there will be gains and losses but the net increase in funding to local governments will increase. However, the net increase will not be evenly distributed to all cities. Given the potentially unknown impact to individual cities, should the League of California Cities position?

Support-Opposition: (as of 05/26/2020):

Support: The Association of California Realtors

Opposition: Howard Jarvis Tax Payers Association

Staff Recommendation:

Committee Recommendation:

Board Action: