Commercial property assessment in California: Bad law, bad economics, bad fiscal policy, bad land use

Lenny Goldberg
California Tax Reform Association
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www.caltaxreform.org

Failure to reassess commercial property under Prop. 13

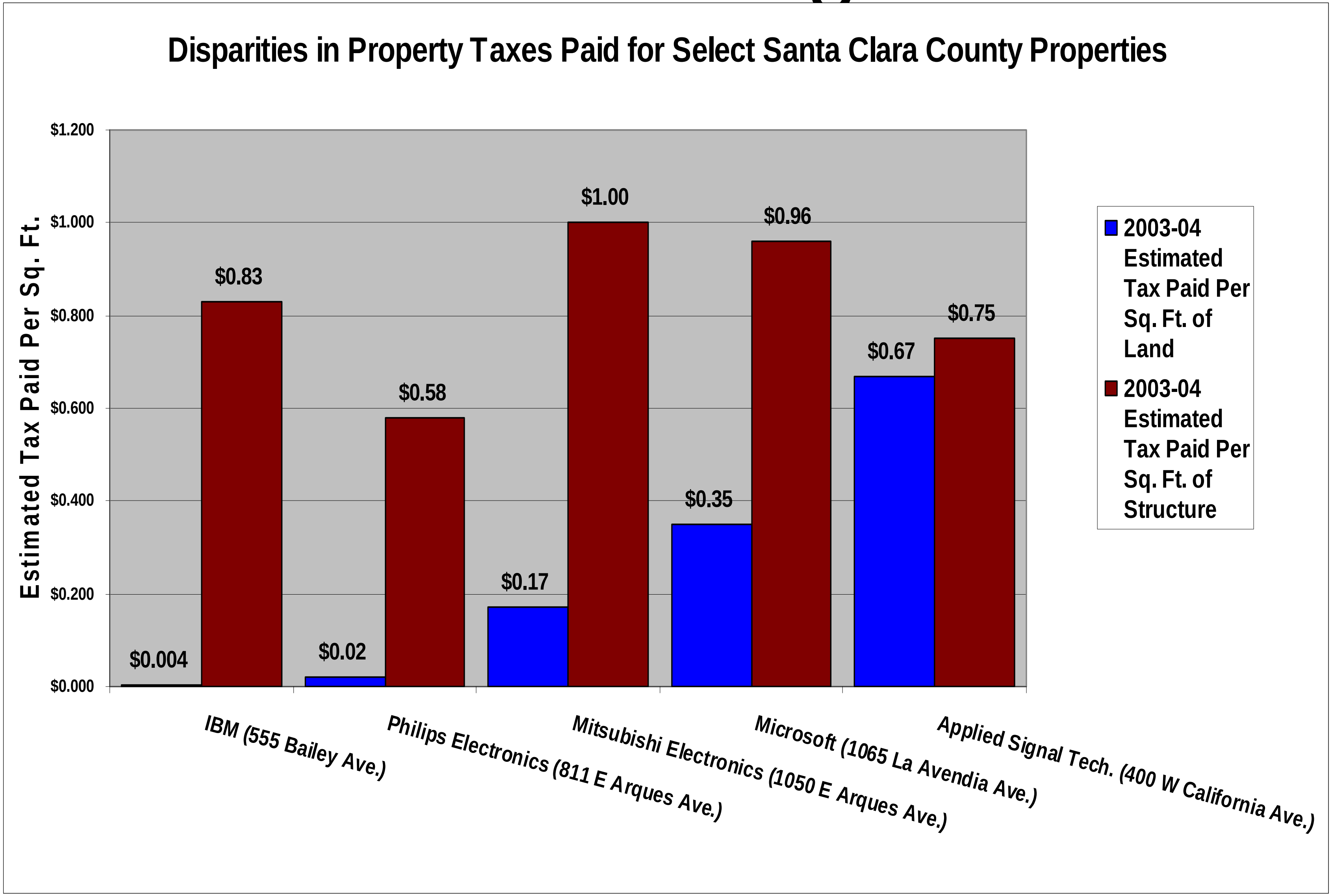
- <u>Economically indefensible</u>: Failure to capture economic rents, taxes new investment uncompetitively
- <u>Legally flawed</u>: “change of ownership” inapplicable to complexities of commercial property ownership, more loophole than tax
- <u>Environmentally damaging</u>: no cost to holding land off market, encourages speculation and sprawl, encourages big box retail
- <u>Fiscal policy failure</u>: no public returns from non-retail commercial growth, no virtuous cycle of infrastructure investment, burden shift to homeowners

The reverse of good economics

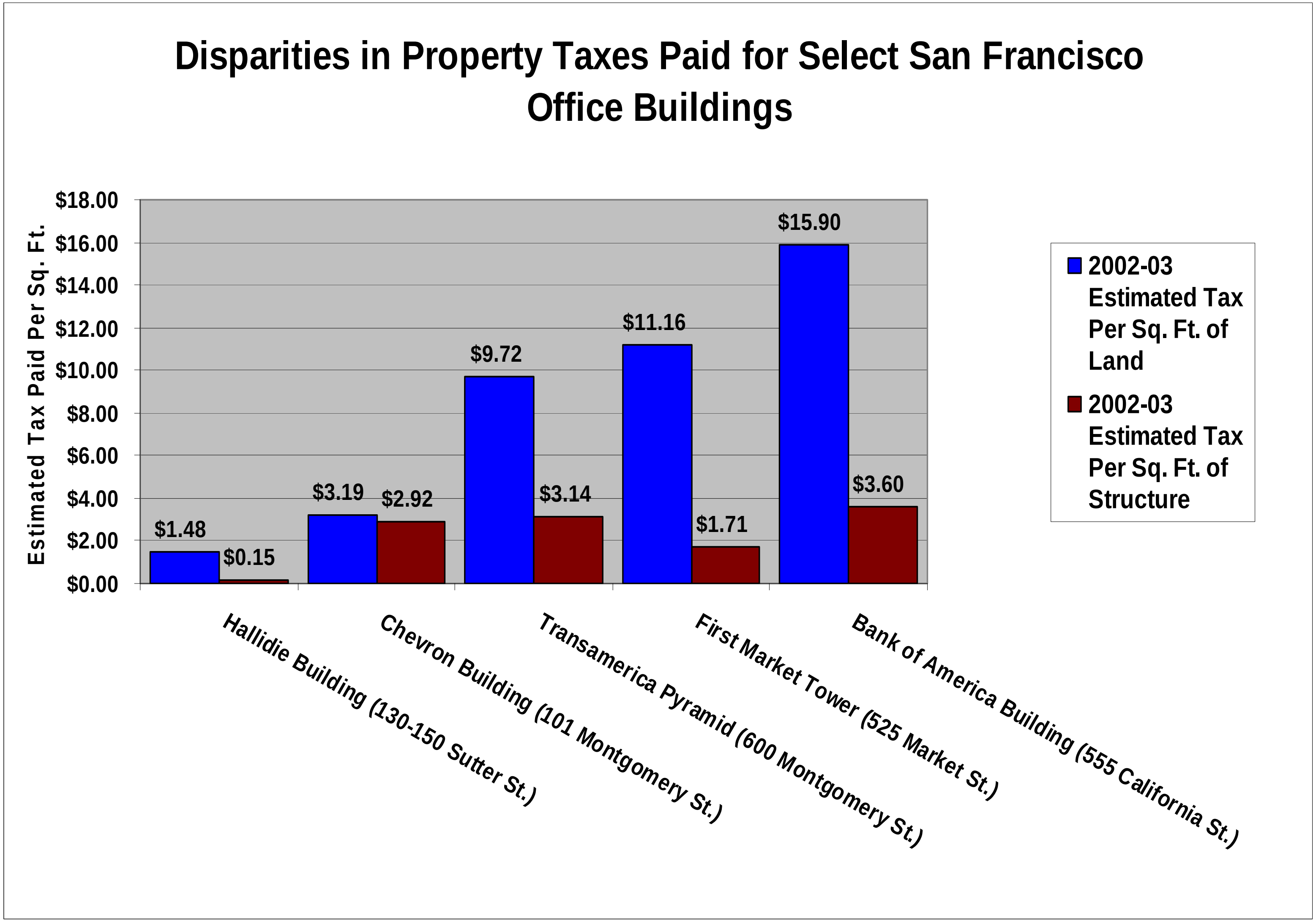
--Windfalls accruing as the result of investment by others (private or public) are untaxed

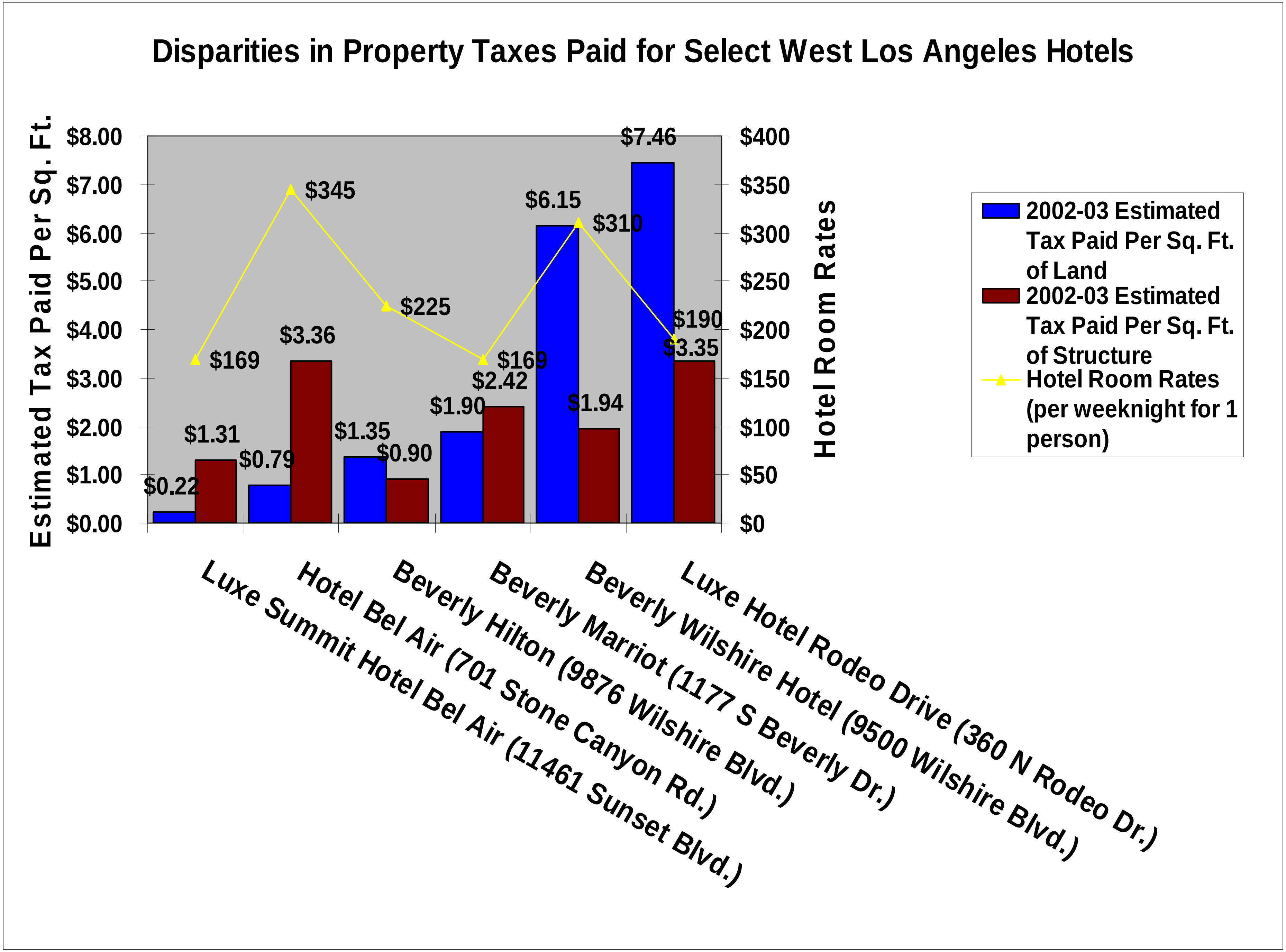
- New investment taxed heavily to pay for inability to capture land values (buildings, not land, fees and exactions)
- Competitors taxed wildly differently
- Land values are function of stream of income—no rationale for lock-in effect
- Job-generating investments do not pay for itself, compared to alternatives

Santa Clara: high tech



SF: downtown office buildings





Disparities in Property Taxes Paid for Select West Los Angeles Hotels
Estimated Tax Paid Per Sq. Ft.
Hotel Room Rates
$8.00
$7.00
$6.00
$5.00
$4.00
$3.00
$2.00
$1.00
$0.00
$400
$350
$300
$250
$200
$150
$100
$50
$0
$0.22
$1.31
$169
$0.79
$3.36
$345
$1.35
$0.90
$225
$1.90
$2.42
$169
$6.15
$1.94
$310
$7.46
$3.35
$190
2002-03 Estimated Tax Paid Per Sq. Ft. of Land
2002-03 Estimated Tax Paid Per Sq. Ft. of Structure
Hotel Room Rates (per weeknight for 1 person)
Luxe Summit Hotel Bel Air (11461 Sunset Blvd.)
Hotel Bel Air (701 Stone Canyon Rd.)
Beverly Hilton (9876 Wilshire Blvd.)
Beverly Marriot (1177 S Beverly Dr.)
Beverly Wilshire Hotel (9500 Wilshire Blvd.)
Luxe Hotel Rodeo Drive (360 N Rodeo Dr.)

Taxing new investment

- New manufacturing/research facility:
  - pays full market value on inflated land value
  - pays sales tax on installed equipment
  - pays yearly property tax on equipment
  - Increases apportionment factors if multi-state
  - pays exactions, mitigations, fees, easements to cover infrastructure and growth costs
  - Still doesn’t generate sufficient local revenue over time (at least comparatively)

Legal morass

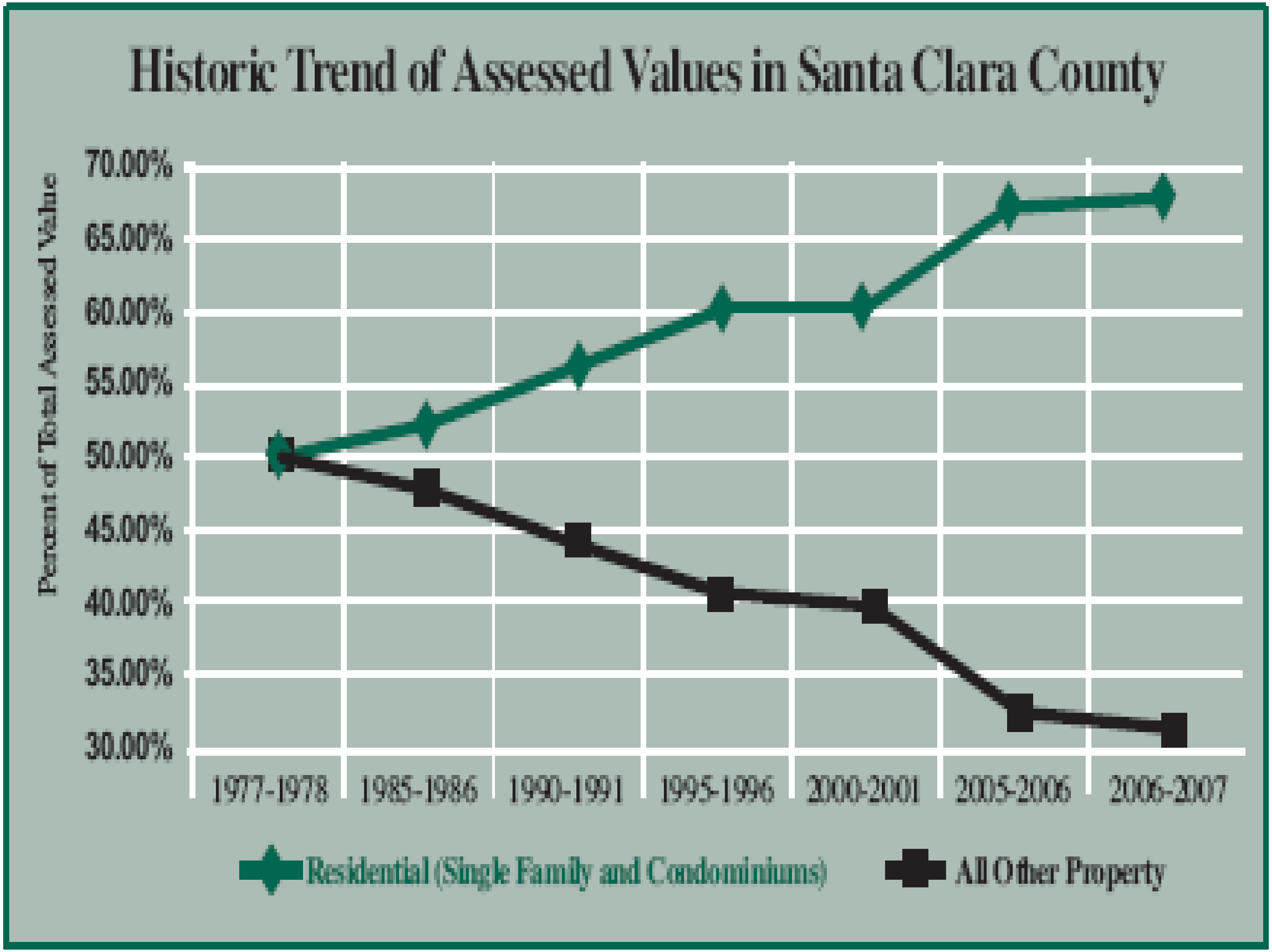
Complexity of holdings makes change of ownership impossible to define and/or track (REIT's, publicly-traded corps, limited partnerships, Sub S corps, LLC's, etc)

E.g. Martini to Gallo partners, 100% sale,no change of ownership

Can manipulate change or no change as matter of convenience/tax savings

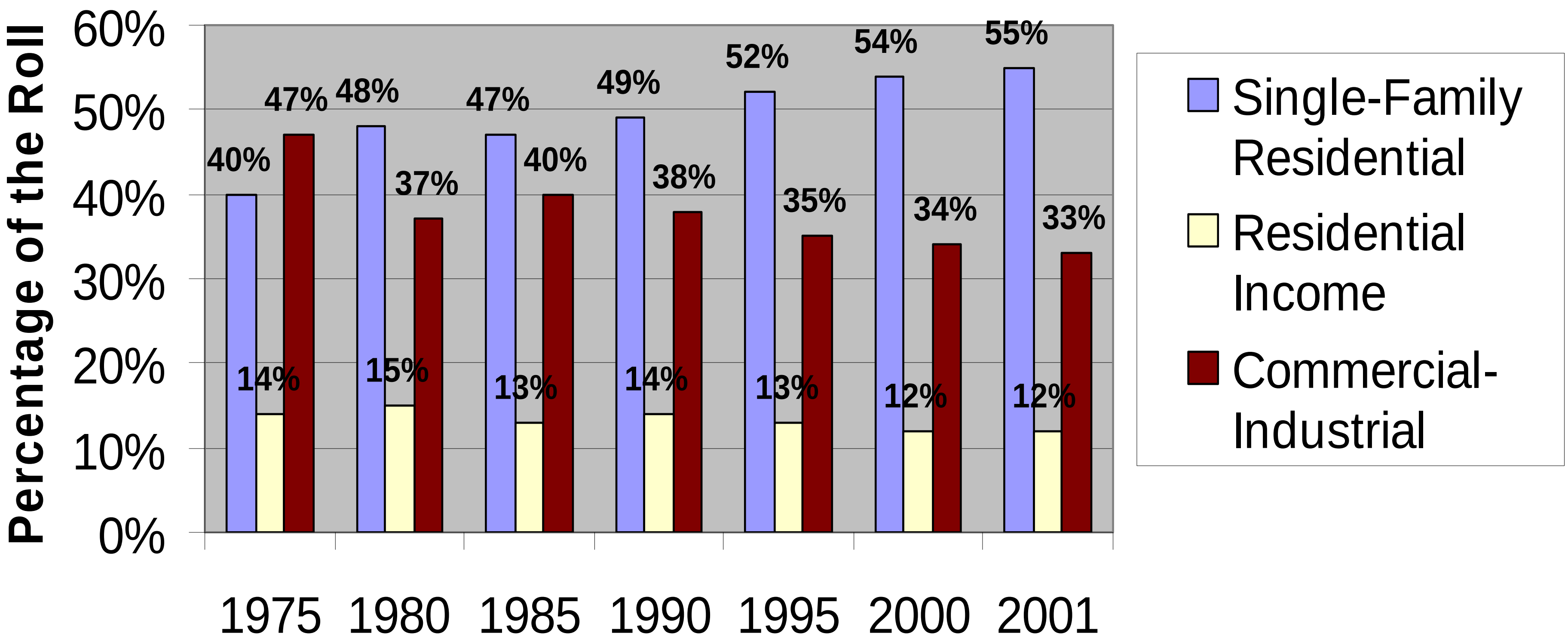
Fiscal failure

- Inability to pay for infrastructure—short-circuits virtuous cycle of infrastructure investment
- Growth does not generate sufficient revenues, because no spillover impacts, leading to anti-growth local politics
- Burden shift to homeowners: statewide, from 32% to 40%



Historic Trend of Assessed Values in Santa Clara County
Percent of Total Assessed Value
70.00%
65.00%
60.00%
55.00%
50.00%
45.00%
40.00%
35.00%
30.00%
1977-1978
1985-1986
1990-1991
1995-1996
2000-2001
2005-2006
2006-2007
Residential (Single Family and Condominiums)
All Other Property

Historical Trend of Property Tax Burden in Los Angeles County



Source: Los Angeles County Assessor's Office

Environmentally unsound land economics

- No penalty for withholding land from market, promotes speculation and sprawl
- Land values inversely related to tax burden, thus land value inflation
- Low-value infill uses maintained
- Big box retailing: best fiscally, worst land-use
- Insufficient returns to growth

Simple policy solution

- Reassess non-residential property to market value, on a periodic basis = $4-5 billion annually (or more).
- Allocating the revenue: cities and counties (Prop 1A) and schools (Prop. 98)
- Other issues:
  - Why not statutory change?
  - Why not apartments?
  - Farms and open space
  - Trade-offs with small business: personal property

Business impacts

- Burden on business as % of land value moves from 49th to 43rd in nation
- Lower land costs—land values inversely related to tax burden on land, and increased by market distortions
- Lower development costs, better development climate—better land market, potential relief in fees because of on-going tax benefits
- Infrastructure investment—local government incentive to improve property values, reinvest
- Level playing field w.r.t. taxes among competitors
- Costs borne by those with untaxed windfall land values, particularly hotels, retail, offices—not manufacturing
- Potential trade-offs on other taxes, other burdens—major, but so far ignored opportunity by business

The Empire's New Clothes

- SD Union-Trib: "Even Prop. 13 Must be on the table": "While Democrats and Republicans cower before this iconic restriction on property taxes, **<u>they should nevertheless be amenable to an annual reassessment of business and commercial properties</u>**<u>.</u> There can be no sacred cows in confronting California's catastrophic budget".
- PPIC Polling: Should commercial property be taxed on the basis of market value?

Yes 60, no 34