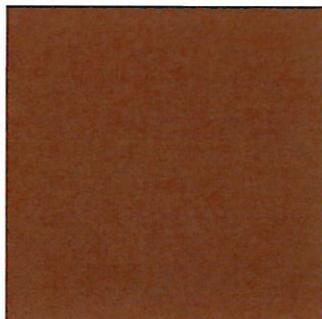
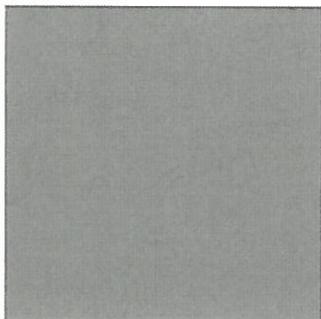


**The Economic
Effects of Adopting a
Spilt-Roll Property
Tax**



LECG

A global expert services company providing expert testimony, authoritative studies, and strategic advisory services to clients including Fortune Global 500 corporations, major law firms, and governments worldwide. www.lecg.com

INTRODUCTION

About LECG

- **International economics consulting firm headquartered in California**
- **Offices throughout the U.S., and in Canada, Mexico, Europe, Australia, New Zealand, & China**
- **340 Experts**
- **700 Staff**

**The Economic Effects of
California Adopting a Split
Roll Property Tax**

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William G. Hamm, Ph.D.

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Caveats

- **Authors take no position on the merits of a split-roll**
- **Findings and conclusions do not necessarily reflect views of either LECG or the organizations that sponsored the study**

About the Study

- **Commissioned by a coalition of business groups and Cal-Tax**
- **Co-authors:**
 - **Jose Alberro, Ph.D. (LECG)**
 - **William Hamm, Ph.D. (LECG)**
- **Purpose: assist interested parties determine the likely economic effects of adopting a split-roll in California**

Research Questions

1. How would a split-roll affect jobs and income in California?
2. How would a split-roll affect
 - Workers?
 - Consumers?
 - Renters?
3. How would a split-roll affect small businesses?
4. Would a split-roll have a disproportionate impact on racial minorities?
5. How would a split-roll affect public retirement funds?

THE ECONOMICS OF PROPERTY TAXES

What do we mean by a “Split-Roll”?

Today (Unified Roll)

Residential property (where Californians live) is taxed according to the same rules as commercial property (where Californians work)

Split-Roll

Commercial property is taxed more heavily than residential property

- Different rules for assessing **value** for tax purposes and/or
- Higher tax **rate**

Bedrock Economics Principles

- Land is fixed; capital is **mobile**
- Business behavior is shaped by **expectations** about the future
- Investment decisions are based on expected **after-tax** returns
- A change in taxes will lead to **changes in behavior**

Business Response to an Increase in Taxes

1. **Pass it on to others**
 - a. **Consumers (via higher prices)**
 - b. **Renters (via higher rents)**
 - c. **Workers (via reduced wages/benefits)**
2. **Change operations to reduce tax exposure**
E.g., Reduce investment in capital equipment
3. **Shift operations out of state**
 - a. **Relocate existing operations**
 - b. **Expand out of state**
4. **Forego supra-competitive profits**
5. **Close the business (when after-tax return on investment is less than the cost of capital)**

LOOKING BACKWARDS

Has Proposition 13 shifted the property tax burden in California away from business and toward homeowners?

Has Proposition 13 shifted the property tax burden from businesses to homeowners?

- **Hypothesis: Business property changes ownership less often than owner-occupied property, and therefore the gap between assessed value and market value will be wider for business property**
- **If valid, the hypothesis means that, over time, more of the property tax burden would shift from business to owner-occupied housing**

Has Proposition 13 shifted the property tax burden from businesses to homeowners?

- **Methodology:** calculate the ratio of assessed value (AV) to market value for owner-occupied and commercial property (“disparity ratio”).
- **Data source**
 - California State Board of Equalization
 - US Census Bureau
- **Finding:** No evidence that Proposition 13 has shifted the property tax burden from businesses to homeowners.

Has Proposition 13 shifted the property tax burden from businesses to homeowners?

Property Type	Assessed Value ^b (\$M)	Percent of Assessed Value	Market Value (\$M)	Disparity Ratio
Homeowners' exemption	\$1,559,370	38.3%	\$2,930,877	53.2%
Veterans' exemption	\$2,303	0.1%	\$13,532	17.0%
Non-exempt residential ^a	\$858,564	21.1%	N/A	N/A
Commercial/industrial	\$1,349,662	33.1%	\$2,251,541	59.9%
Nonprofit/other exempt	\$99,532	2.4%	N/A	N/A
Other	\$203,654	5.0%	N/A	N/A
Total	\$4,073,086			

^a This category includes rental property and vacation homes.

^b California State Board of Equalization. Data obtained via personal communications.

LOOKING FORWARD

How would adoption of a split-roll affect the California economy?

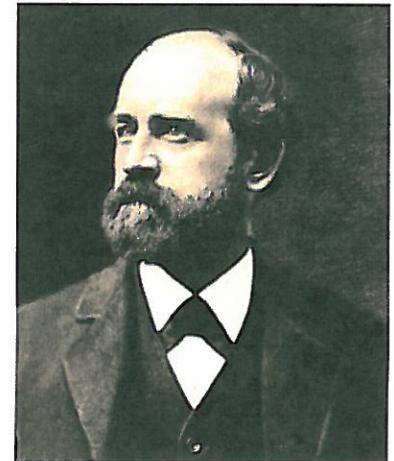
1. How would a split-roll affect jobs and income in California?

- To what extent do property taxes matter?

- Taxes on **unimproved** land generally do not affect investment decisions because they do not change expected **after-tax** returns from new investments

- Henry George (1839-1897)

- In contrast, taxes on improvements and capital equipment tend to discourage investment by reducing expected **after-tax** returns



1. **How would a split-roll affect jobs and income in California? (cont'd)**
 - **Why the differential impact?**
 - Land is fixed – it cannot be exported
 - Capital is highly mobile – it can go anywhere
 - **Estimates of tax elasticity of economic activity from meta-regression analysis:**
 - Bartik: 0.25%
 - Phillips & Goss: 0.32%

1. How would a split-roll affect jobs and income in California? (cont'd)

- Implications of meta-regression analysis for a split-roll in California:
 - A 1% rise in taxes on business will result in the loss of about 43,000 jobs in California

1. How would a split-roll affect jobs and income in California? (cont'd)

Dynamic estimates of a split-roll's economic impact in California

- Economic model: DRAM (developed jointly by the Dept of Finance and UC/Berkeley)
- Key assumptions:
 - AV of business property = property's market **value** (+67%)
 - No change in property tax **rate**
 - Increased revenues used to reduce the structural deficit
 - Of total business property AV, 45% represents land values
 - Portion of capital that cannot migrate out of state ranges from 25% to 33%

1. How would a split-roll affect jobs and income in California? (cont'd)

Estimated Impact of a Split-Roll On the California Economy

Variable

Jobs Loss	152,400
Migration (number of families)	(48,700)
Change in the Wage Rate (%)	-0.4%
Return to Capital	-0.7%
Net Private Investment (billions)	(2.0)

Source: DRAM (1999).

2. Other Economic Consequences of a Split-Roll

- **Higher rents on apartment dwellers**
- **Higher rents on small businesses that lease facilities (e.g., “triple net”)**
- **Lower wages (due to decline in worker productivity caused by reduced investment)**

2. Other Economic Consequences of a Split-Roll (cont'd)

- **Increased consumer prices (where competitive forces allow/require)**
- **Decline in value of financial assets held by CalPERS and STRS**
 - Both retirement systems have large holdings of California real estate
 - Increased property taxes will be capitalized, thereby reducing property values
- **If increased property taxes are used to improve the business environment in California, some of the adverse effects may be mitigated**

3. Impact of a Split-Roll on Investor Psychology

- Splitting business/commercial property from owner-occupied property will greatly weaken businesses' perceived ability to resist **further** increases in property taxes