

Pasadena Sub Rosa

Latin sub rosā, under the rose; from the Roman practice of hanging a rose over a meeting as a symbol of secrecy

April 13, 2009

AN OPEN LETTER ON CALIFORNIA PROP 13

AN OPEN LETTER TO GERALD PARSKY, CHAIRMAN, CALIFORNIA COMMISSION ON THE 21ST CENTURY ECONOMY - SPLIT COMMERCIAL/RESIDENTIAL PROPERTY TAX ROLL UNDER PROPOSITION 13

April 13, 2009

The Honorable Gerald Parsky, Chairman
Commission on the 21st Century Economy
C/O Mark Ibele, PhD, Staff Director

<http://www.cotce.ca.gov/>

Re: Split Property Tax Roll – State of California

Dear Chairman Parsky:

I read with consternation that the Commission for the 21st Century has convened with the apparent agenda to undo the protections of Proposition 13 for commercial properties in California -

<http://www.venturacountystar.com/news/2009/apr/09/tax-panel-promises-to-think-boldly/>

A split commercial/residential property tax roll would spell personal and financial ruination for me and many other small commercial property owners across California. What befell widows in 1975 when Proposition 13 was passed by the voters would happen to me – I would be forced to sell my property at likely a fire sale price in a depressed market and lose my place of residence as well as the revenue stream from the income it generates for my retirement.

I am a real estate appraiser by training and have authored a number of articles in professional real estate journals. Please consider the following in any deliberations by your blue ribbon Commission to sanction a split commercial/residential property tax roll in California .

1. A split tax roll would force many small commercial property owners across the state to fire sale their properties in a depressed market which would lead to collapsing commercial property values. Predator buying would be in vogue in such a market. Commercial property owners would not have recourse to compensation as a regulatory taking even though they would be forced by government to sell their commercial properties at the worst time.
2. Lifting the property tax on commercial properties would place at risk an uncountable number of home equity loans and Small Business Administration loans that small business owners have taken out to finance their small businesses. In other words, a split property tax roll would not only affect commercial properties, it would have a ripple effect on residential properties across the state. This would add even more properties to the growing default list from sub-prime residential property loans.

As far back as October 2008, the website smSmallBiz.com reported that lenders were wary of making more SBA loans because of declining collateral value, particularly the value of homes in California .

http://www.smsmallbiz.com/capital/SBA_Backed_Loans_Dry_Up.html

The February 24, 2009 issue of the Wall Street Journal entitled "**Defaults by Franchisees Soar as Recession**

Deepens," addressed the growing defaults on business franchisees – See:

<http://online.wsj.com/article/SB123544165161055467.html> . I quote:

From ice-cream parlors to tanning salons, franchisees' defaults on loans guaranteed by the U.S. Small Business Administration are piling up in amounts unseen in years. A list of loans at 500 franchises shows the number of defaults by franchisees increased 52% in the fiscal year ended Sept. 30, 2008, from fiscal 2007. Loan losses totaled \$93.3 million, a 167% jump from \$35 million just 12 months earlier

The annual list, which shows the number of loan failures for the year and failure rates over eight years, is compiled by the SBA and published by the Coleman Report, a lending-industry trade publication based in La Canada, Calif.

The franchise brands where at least 11 franchisees defaulted on loans during the 2008 fiscal year were: Aamco Transmissions, Carvel Ice Cream, CiCi's Pizza, Cold Stone Creamery, Curves for Women, Domino's Pizza, Dream Dinners, Planet Beach tanning salons, Quiznos, Subway and Taco Del Mar.

The above does not even consider the countless number of small mom and pop businesses and mixed residential/commercial properties that would be negatively affected by a split property tax roll.

3. A split tax roll would subject houses and apartments on commercial-zoned land to large tax increases resulting in displacements and rent increases beyond monetary inflation.
4. It is likely there would be a mass breach in commercial and gross office and retail building leases as many landlords and tenants could not afford to pay for the huge tax increase. Landlords would be sandwiched between increased property taxes and leases which only provide for rent increases based on the Consumer Price Index. Passing the increased tax onto landlords would result in landlords seeking to void leases at the slightest breach of a commercial lease. Imagine commercial strips in your home town with 20% vacancies or more while this tax chaos is sorted out.
5. A split tax roll would likely force many historical structures on commercial land to be demolished as they would no longer be economically viable. Such properties would quickly have to be put to higher and better uses just to pay the property tax load.
6. A split tax roll would especially hit auto dealerships hard during an historic depression in the new and used car sales business as the land on which their dealerships sit would be taxed to the hilt. This would result in even more vacant and abandoned auto dealerships.
7. A split tax roll would send commercial property values into a downward spiral in a process called "tax capitalization." Although this hypothetically and ultimately would compensate property owners for the higher taxes, the transition would wipe out many small businesses and family fortunes in the process.
8. Under a split tax roll many small businesspersons would end up having to let go hired employees and run a larger part their daily business operations themselves to make up for the increased tax load. Higher unemployment at the bottom end of the employment food chain would result.
9. A split commercial-residential property tax roll would take about 2 to 3 years to derive any revenue from such a commercial property tax increase as assessors would have to be hired and trained and reassessment appeals processed. Today, California tax assessors mainly do not have to annually re-appraise commercial properties. The deployment of staff to accomplish this function would be costly and involve a lag time. Any such tax reassessments in a collapsing commercial real estate market would be problematic and politically risky, especially for newer

mixed use developments on commercial-zoned land.

10. Supporters of the split property tax contend that businesses don't pay their "fair share" of taxes. Under the proposed initiative wealth would be transferred from small and large businesses, mom-and-pop owned stores and businesses, small manufacturers, and vacant commercial and industrial landowners to teachers, law enforcement, firefighters, senior citizens, and CalTrans engineers. Under the banner of "fairness" many small businesses and industries would be asked to pay for medical insurance and retirement plans for government employees that they can not afford for themselves or their employees. This is not fairness.

11. The relatively low level of property taxation on high profile large commercial properties like "Disneyland" are typically pointed to by supporters of a split property tax roll to show how "unfair" the current system of taxation is. But the mainstream media usually ignores the hardships and collateral damage this tax increase would impose on small businesses and commercial landowners. And most commercial properties in California are owned or rented by small businesses not shopping centers and amusement parks. A split property tax roll in California would be a regressive tax on small businesses and property owners and not something progressive for the 21st Century.

12. Contrary to the notion that commercial properties are not paying their fair share of property taxes, a study conducted in 1996 estimated that commercial properties were assessed at 82% of their fair market value while residential properties were only assessed at 71% (<http://www.caltax.org/member/digest/may2000/may00-6.htm>)

Another irony is that between 1977 (the year before Prop. 13) and 1999 (before the current real estate "bubble"), inflation and population grew at a combined rate of 235 percent. State revenues grew 448 percent, California city revenues grew 333 percent and county revenues grew 326 percent. There was no "tax gap" created by Proposition 13, as governments merely shifted to other taxes (see: <http://www.tommeclintock.com/columns/defenprophirteenApr7-03.htm>).

13. Another often neglected aspect of Proposition 13 needs to be pointed out – contrary to popular misconceptions Prop 13 leads to more stable tax revenue streams for state and local governments. Let me give you an example.

Under Prop 13 the current value of a building goes up and down as the market changes. As the value goes up, the reassessments would drive up the costs of taxes. The state gets used to the new amount of taxes and buys 10 widgets with the money. When the market goes down, the building value goes down and the owner gets another reassessment. The taxes decrease and the government no longer has the tax money to pay for 10 widgets. It can only buy 5 widgets. A 'shortage' of 5 widgets is created.

On the other hand, with Prop 13, the current value of a building goes up by 2% annually as long as the owner does not change. The state buys 3 widgets with the money. (The amount gradually increases but is fairly constant.) When the market goes down, the building value goes down and the owner gets another reassessment. The taxes decrease and the government no longer has the tax money to pay for 3 widgets. It can only buy 2 widgets. A 'shortage' of 1 widget is created. This may be much more easily handled than a 5 widget 'shortage'.

The difference is that in the first case the state government spent the higher amount and expected it. When the market downturn came around, there was a huge deficit. In the second case, the government does not experience a severe shortage. This second way is the way to more stable government funding, not raising taxes through the roof by a split tax roll. By and large, the California legislature has lost the ability to understand this simple concept.

14. Allow me to share yet another often unapparent aspect of Proposition 13. I kept my mother in nursing homes

for 20-years without burdening the Medi-Cal system by renovating the family home on commercial-zoned land and using the rents for my mother's medical needs. Without the low property tax basis this would not have been possible. If a split roll is passed how many other people would be forced to either sell their commercial properties to take care of elderly parents? And once the sales proceeds are exhausted how many more people will then be dependent on Medi-Cal, only increasing the State budget deficit?

For a multitude of sound financial and moral reasons I implore you not to consider a split property tax roll as a way to fund the current and ongoing state budget deficit. Politicians should also be made aware of the political repercussions that would ensue from such a reckless change in taxation policy.

Respectfully submitted,
WAYNE LUSVARDI
Pasadena , California

Posted at 10:47 PM | [Permalink](#)

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Comments

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William G. Hamm, PhD, has authored a study for the California Commission on the 21st Century Economy that misses the impacts on small commercial property owners and fails to consider the spillover effects on residential property loan defaults. For his flawed study see here:

<http://www.cotce.ca.gov/meetings/testimony/documents/WILLIAMHAMM-COTCE-21stCenturyEconomypresentation-4909.pdf>

Posted by: Wayne Lusvardi | [April 14, 2009 at 01:30 PM](#)

What you didn't speak to was fairness.

Why should new companies be penalized for being new?

You seek to minimize the competition for long-established entrants to the business community. Not only must they pay a seller exhorbitant amounts to buy a site, and a mortgage lender, with interest. THEN they have to pay multiples of the property tax paid by their long-established competitors.

Please tell us what is fair about that.

I hope this sees the light of day.

Small commercial property landlords? Or small business? Or consumers? Or potential entrepreneurs? Whose interests do you have at heart?

Posted by: [lvtfan](#) | [April 14, 2009 at 05:13 PM](#)

Please explain, while you're at it, why entities like the Los Angeles Country Club should be subsidized by poor homeowners who struggled to buy a home in the last 2, 5, 10 or even 20 years?

Grandfathering longterm owners -- be they real estate operators, country clubs, so-called "small businesses" which mostly exist to collect the economic rent while the owners wait for the land to appreciate or their grandchildren to reach college age -- is

just plain wrong and indefensible.

Posted by: [lvtfan](#) | [April 14, 2009 at 05:16 PM](#)

To lvtfan:

Your argument that new business entrants are penalized is only logical by half. To extend your logic out, it would be better that all businesses and landowners suffer from high taxation. Prop 13 is no different than paying capital gains on stocks. You don't pay the gain until you realize it. What you argue for is for small businesses to have taxes raised before they are in a position to sell their properties or businesses; before they realize a gain. That is a taking when coerced by government action.

Posted by: Wayne Lusvardi | [April 14, 2009 at 09:21 PM](#)

To lvtfan:

There is no evidence that Prop 13 has shifted the tax burden to residential properties. In fact it has been shown that residential properties are taxed at about 53% of market value and commercial properties at 60% of market value. So commercial properties typically pay more pro rata taxes than residential properties. But I don't think that data or logic will persuade you. Nonetheless, thanks for your comments.

Posted by: Wayne Lusvardi | [April 14, 2009 at 09:34 PM](#)

To my readers:

The comments posted by "lvtfan" are from the website lvtfan's blog here: <http://lvtfan.typepad.com/>

LVT is an acronym for Land Value Tax originally propounded by land economist Henry George.

I thank lvtfan for his challenging questions.

Posted by: Wayne Lusvardi | [April 14, 2009 at 09:42 PM](#)

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