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

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Failure to reassess commercial property under Prop. 13

- **Economically indefensible**: Failure to capture economic rents, taxes new investment uncompetitively
- **Legally flawed**: “change of ownership” inapplicable to complexities of commercial property ownership, more loophole than tax
- **Environmentally damaging**: no cost to holding land off market, encourages speculation and sprawl, encourages big box retail
- **Fiscal policy failure**: 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

Disparities in Property Taxes Paid for Select Santa Clara County Properties

IB (555 Bailey Ave.)
Philips Electronics (811 E Arques Ave.)
Mitsubishi Electronics (1050 E Arques Ave.)
Microsoft (1065 La Avenida Ave.)
Applied Signal Tech. (400 W California Ave.)
Disparities in Property Taxes Paid for Select San Francisco Office Buildings

- Hallidie Building (130-150 Sutter St.)
  - 2002-03 Estimated Tax Per Sq. Ft.: $1.48
  - 2002-03 Estimated Tax Per Sq. Ft. of Land: $0.15

- Chevron Building (101 Montgomery St.)
  - 2002-03 Estimated Tax Per Sq. Ft.: $3.19
  - 2002-03 Estimated Tax Per Sq. Ft. of Land: $2.92

- Transamerica Pyramid (600 Montgomery St.)
  - 2002-03 Estimated Tax Per Sq. Ft.: $9.72
  - 2002-03 Estimated Tax Per Sq. Ft. of Land: $3.14

- First Market Tower (525 Market St.)
  - 2002-03 Estimated Tax Per Sq. Ft.: $11.16
  - 2002-03 Estimated Tax Per Sq. Ft. of Land: $3.60

- Bank of America Building (555 California St.)
  - 2002-03 Estimated Tax Per Sq. Ft.: $15.90

- 2002-03 Estimated Tax Per Sq. Ft. of Structure:

- 2002-03 Estimated Tax Per Sq. Ft. of Land:
Disparities in Property Taxes Paid for Select West Los Angeles Hotels

<table>
<thead>
<tr>
<th>Hotel Name</th>
<th>2002-03 Estimated Tax Paid Per Sq. Ft. of Land</th>
<th>2002-03 Estimated Tax Paid Per Sq. Ft. of Structure</th>
<th>Hotel Room Rates (per weeknight for 1 person)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hotel Bel Air (701 Stone Canyon Rd.)</td>
<td>$169</td>
<td>$1.31</td>
<td>$169</td>
</tr>
<tr>
<td>Luxe Summit Hotel Bel Air (11461 Sunset Blvd.)</td>
<td>$1.35</td>
<td>$0.79</td>
<td>$7.46</td>
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<tr>
<td>Beverly Marriot (1177 S Beverly Dr.)</td>
<td>$225</td>
<td>$0.90</td>
<td>$345</td>
</tr>
<tr>
<td>Beverly Hilton (9876 Wilshire Blvd.)</td>
<td>$250</td>
<td>$1.90</td>
<td>$225</td>
</tr>
<tr>
<td>Beverly Wilshire Hotel (9500 Wilshire Blvd.)</td>
<td>$310</td>
<td>$1.94</td>
<td>$169</td>
</tr>
<tr>
<td>Luxe Hotel Rodeo Drive (360 N Rodeo Dr.)</td>
<td>$3.36</td>
<td>$3.35</td>
<td>$310</td>
</tr>
<tr>
<td>Hotel Bel Air (701 Stone Canyon Rd.)</td>
<td>$3.36</td>
<td>$3.36</td>
<td>$310</td>
</tr>
</tbody>
</table>
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

- Residential (Single Family and Condominiums)
- All Other Property

Historical Trend of Property Tax Burden in Los Angeles County

<table>
<thead>
<tr>
<th>Year</th>
<th>Single-Family Residential</th>
<th>Residential Income</th>
<th>Commercial-Industrial</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>14%</td>
<td>14%</td>
<td>40%</td>
</tr>
<tr>
<td>1980</td>
<td>15%</td>
<td>15%</td>
<td>37%</td>
</tr>
<tr>
<td>1985</td>
<td>13%</td>
<td>13%</td>
<td>40%</td>
</tr>
<tr>
<td>1990</td>
<td>14%</td>
<td>14%</td>
<td>38%</td>
</tr>
<tr>
<td>1995</td>
<td>13%</td>
<td>13%</td>
<td>35%</td>
</tr>
<tr>
<td>2000</td>
<td>12%</td>
<td>12%</td>
<td>34%</td>
</tr>
<tr>
<td>2001</td>
<td>12%</td>
<td>12%</td>
<td>33%</td>
</tr>
</tbody>
</table>

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 49\textsuperscript{th} to 43\textsuperscript{rd} 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, they should nevertheless be amenable to an annual reassessment of business and commercial properties. 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