

# The Empire's New Clothes: The Failure to Assess Commercial Property at Market Value

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Presented to COTCE, 2.12.09

# Policy failure at every level

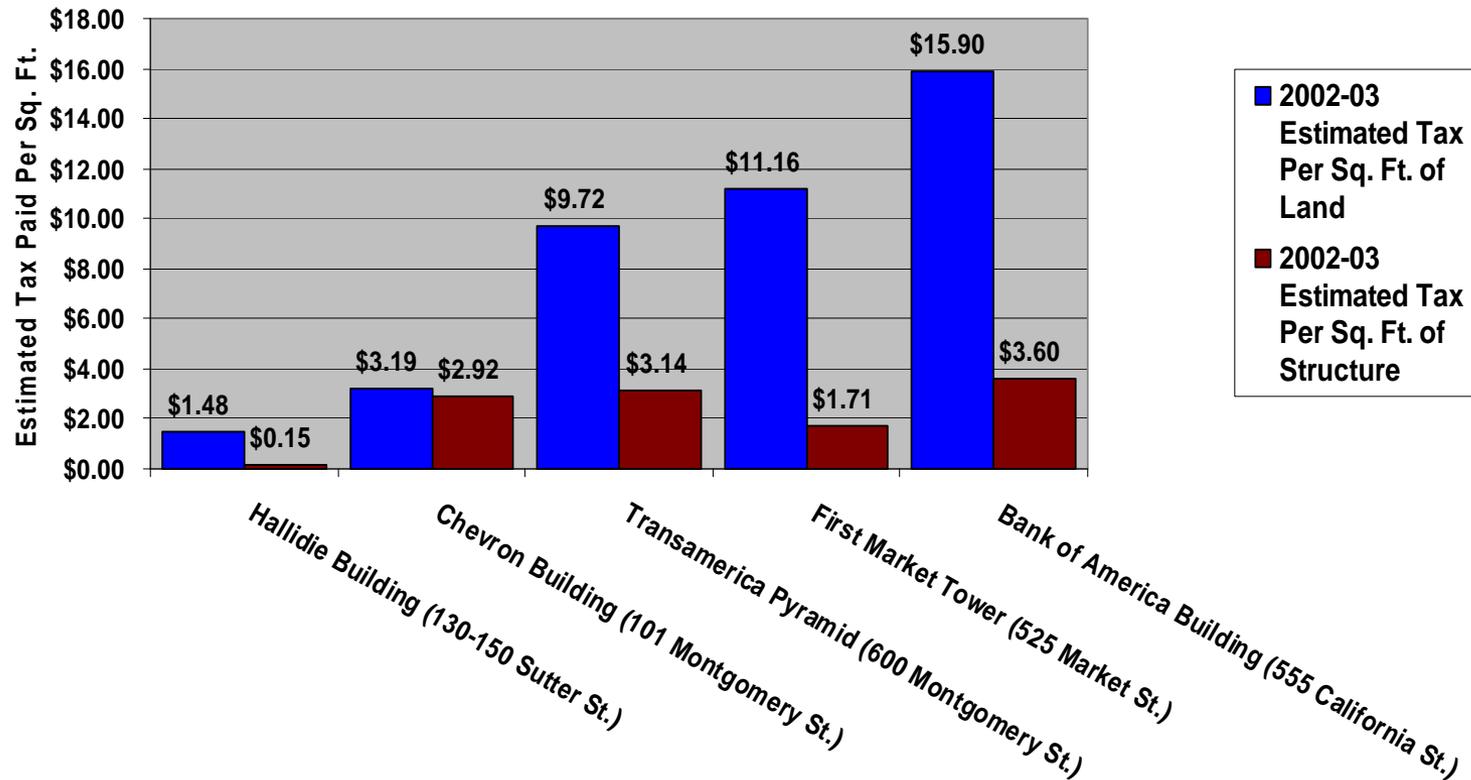
- The opposite of good economics
- Legal morass
- Fiscal policy failure
- Land use distortions

# Bad economics: taxing investment not land rents

- New investment: assessed at full market value, pays fees and exactions, sales and property tax on new equipment, inflated land values
- Land rents untaxed, i.e benefits accruing from the investment of others, private and public
- Competitors assessed at huge differentials, mostly on land

# SF: downtown office buildings

## Disparities in Property Taxes Paid for Select San Francisco Office Buildings



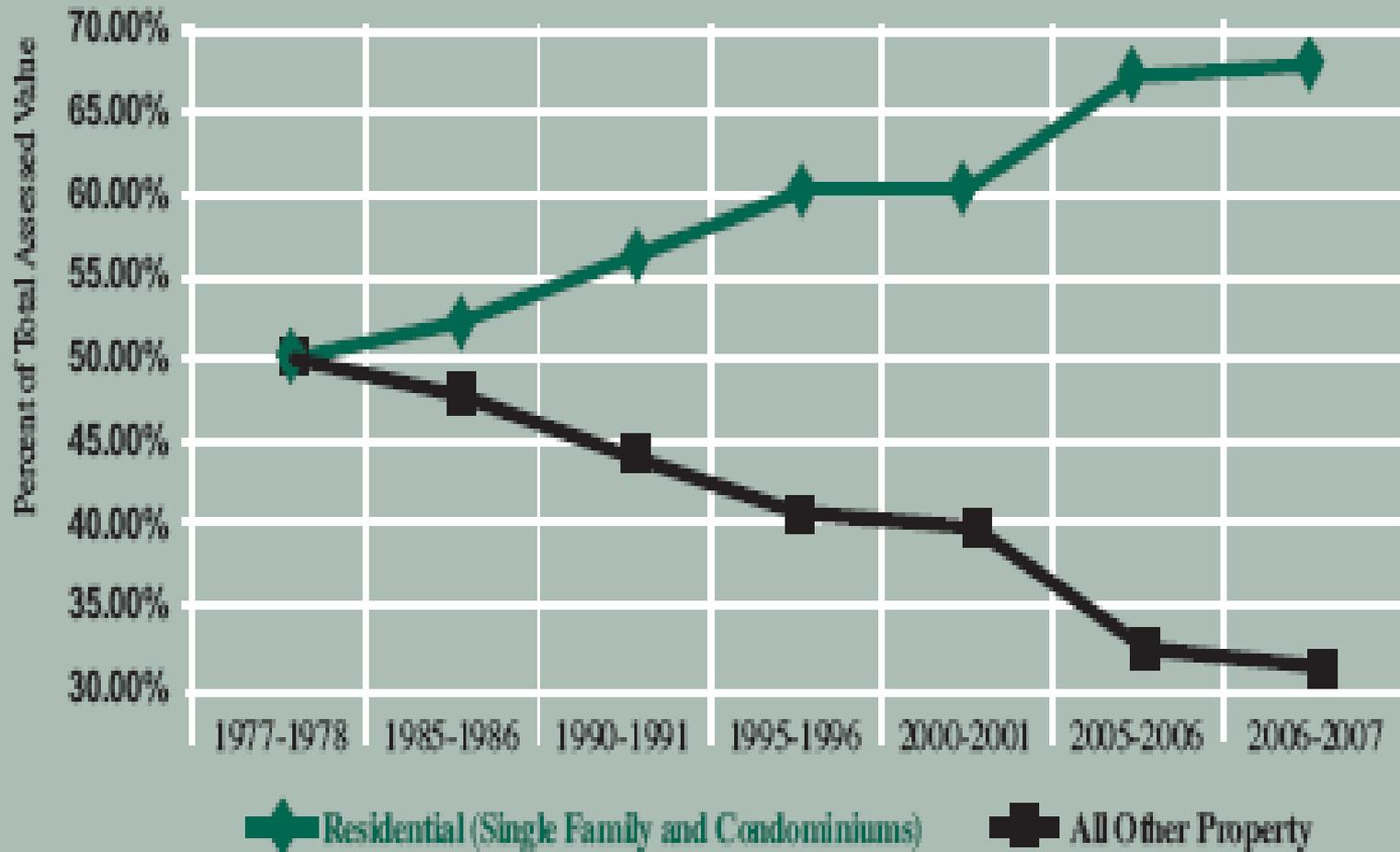
# Legal morass

- “Change of ownership” inapplicable to complex ways of holding property: publicly-traded corps, LLCs, Sub S, limited partnerships, REITs, etc.
- Martini to Gallo: 100% sold, partners to partners, no reassessment
- Changes easy to effectuate when values are low: downtown LA, early 90’s.
- Can be reformed statutorily but still messy

# Fiscal failure

- Economic growth does not pay for itself—generates land value increases but not local revenue increases=no-growth politics
- Virtuous cycle of infrastructure is short-circuited: public investment in land capacity gets insufficient return
- Burden shift to residential housing

## Historic Trend of Assessed Values in Santa Clara County



# 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
- “Highest and best use” avoided

# Simple policy solution

- “Non-residential property shall be periodically assessed at market value”
- Unlike housing, reflects stream of future earnings from land
- Allocated currently by Props 1A and 98
- Issues: rental residential, farms (Williamson Act), transition (assessors)
- Revenues: poor data: \$6 billion?

# Economic impacts

- Shefrin: “very close to the economists’ ideal of non-distorting taxes”
- Lower land costs
- Lower development costs, better approval climate
- Infrastructure finance significantly improved
- Competitors taxed equivalently
- Costs borne by those with locational advantages: retail, hotels, offices
- Potential trade-off: personal property relief (small business, relieves assessors)

# 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**