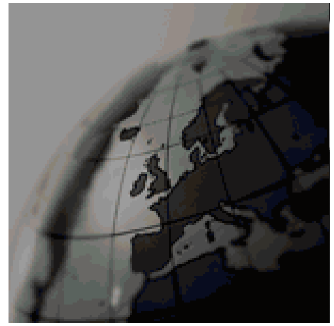

The Economic Effects of Adopting a Spilt-Roll Property Tax

LECG

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INTRODUCTION

What do we mean by a “Split-Roll”?

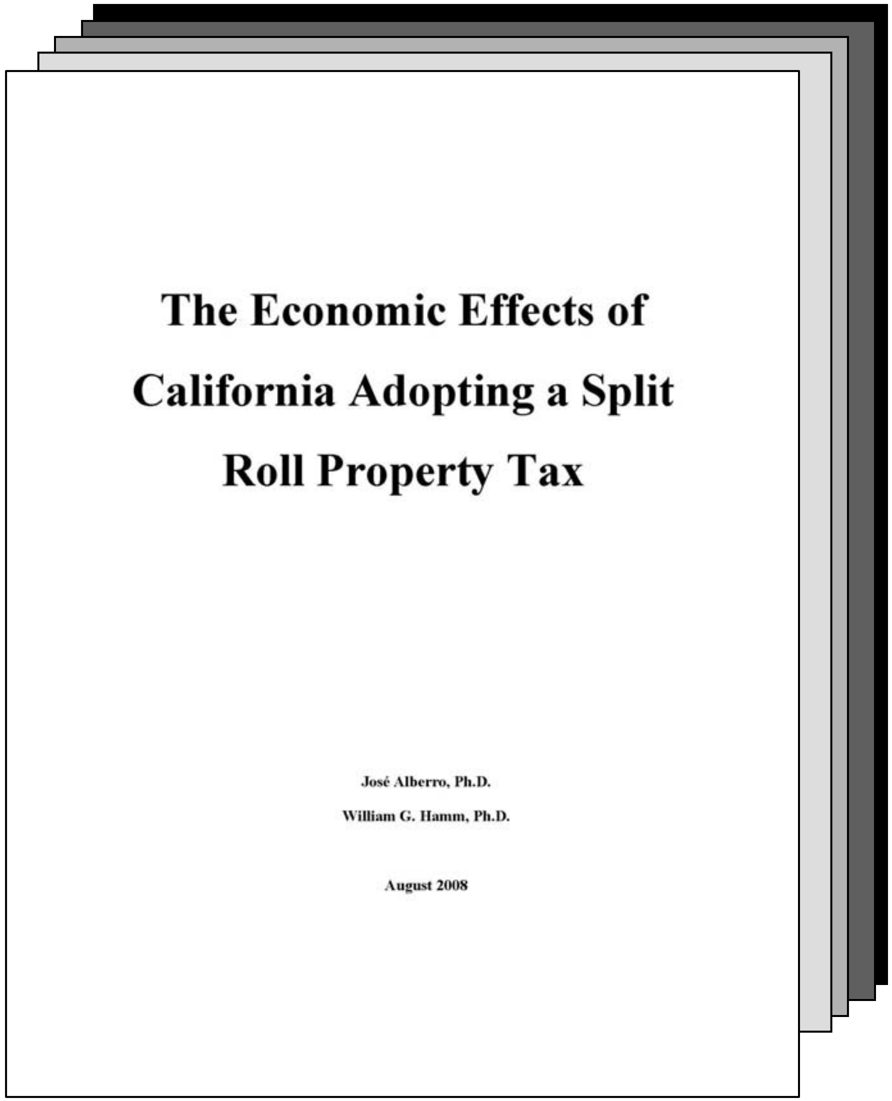
Today (Unified Roll)

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



The Economic Effects of California Adopting a Split Roll Property Tax

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August 2008

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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?

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

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

THE ECONOMICS OF PROPERTY TAXES

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)

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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.

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LOOKING FORWARD

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

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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**

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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%

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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).

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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

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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**