

How to Raise Billions for Schools and Services by Reforming the Commercial Property Tax System

Policy Brief Summary

The California Schools and Local Communities Funding Act proposes a constitutional amendment that will:

- ▶ Reclaim \$12 billion for schools and local government by closing a huge property tax loophole that benefits large corporations and wealthy investors.
- ▶ Require the regular reassessment of some commercial and industrial properties at fair market value for property tax purposes and keep the 1% cap on the property tax rate to ensure that property taxes will continue to be among the lowest in the country.
- ▶ Maintain all Prop 13 protections for homeowners, rental properties and agricultural land.
- ▶ Protect small business property owners by excluding from reassessment properties under \$3 million in market value when these properties are owned independently.
- ▶ Provide relief from the business personal property tax for ALL businesses by exempting the first \$500,000 of fixtures and equipment, significantly benefiting small businesses.
- ▶ Direct at least \$4.6 billion for schools toward all students, with a focus on high-need students, improving our educational system everywhere in the state.
- ▶ Provide cities with substantially increased revenue to spend on critical municipal services, including homeless services, parks and libraries, roads, infrastructure, and business improvements.
- ▶ Help counties to provide improved health and human services, emergency response services, roads and infrastructure, and have a stable source of their own revenue, controlled locally.
- ▶ Improve land use greatly, including increased housing and transit, reduced urban sprawl and decreased carbon footprint.

The Problem

The system for assessment of commercial and industrial property is loophole-ridden, harmful to sound land use, housing, and new investment, and negatively impacts revenue for cities, counties, and schools. Not even the largest beneficiaries of the system—wealthy property owners and large corporations—can provide a rationale for its continuation.

A. Failed Fiscal Policy

Even with massive economic growth and a proliferation of new local taxes, tax revenue per capita for cities and counties has fallen from \$790 per person to \$640 since 1978, according to the Legislative Analyst's Office (LAO), generating fiscal stress on most local governments in the state. The property tax has shifted away from the commercial/industrial sector to residential in virtually every county. Our infrastructure investment has declined because local governments cannot generate the revenue needed from the growth in land values, while fees and other taxes have gone up on ordinary citizens.

Public schools continue to struggle and still lag behind much of the nation despite new state revenue streams since 2012. Over the past 40 years, California has disinvested from public education, sliding from one of the top states to one that now ranks near the bottom. In 1977 before Proposition 13 passed, California ranked 7th out of 50 states in per student spending nationally. Yet, California now ranks 39th among all states in per student spending for K-12 education relative to the cost of living in California.

B. Loophole-Ridden System

Property tax assessment under Proposition 13 is based on a "change of ownership", which locks in assessment at the purchase price (plus 2% per year) and limits the tax rate for all properties to 1%. Intended to help homeowners, change of ownership is easily avoided by corporations and wealthy investors because of the complex ways commercial and industrial property is legally held, and cannot be reformed without

maintaining loopholes and inequities. For publicly-traded corporations, whose stock turns over regularly, change of ownership fails to trigger reassessment, unless those companies are fully bought out. For example, Chevron, Intel and IBM own land still assessed at 1975 values while nearby land is assessed at 50 times the value or more. For investor-owned property, complex ownership patterns using real estate investment trusts, LLCs, land leases, trusts and partnerships allow wealthy investors to avoid reassessment in many ways, on everything from industrial parks, offices, shopping centers and hotels to parking lots and mini-malls. Many of these investors are out of state or foreign.

C. Unfair to New Investment

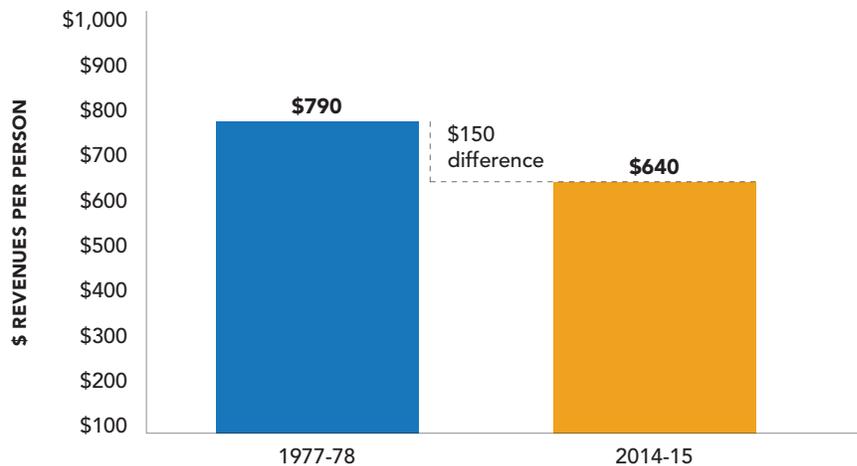
The current system taxes new investment heavily while failing to tax windfalls, the opposite of good economics. It holds land off the market, inflating land prices, which is bad for housing affordability and new investment. It is

anti-competitive, as new businesses have to pay higher property taxes than their competitors, even though they are charging the same prices for their rents, products and/or services. Newer investors pay taxes on inflated market values and substantial fees and mitigations, while older commercial property owners who benefit from infrastructure growth and rising markets continue to pay on the old, outdated property values.

D. Works Against “Smart Growth” Land Use

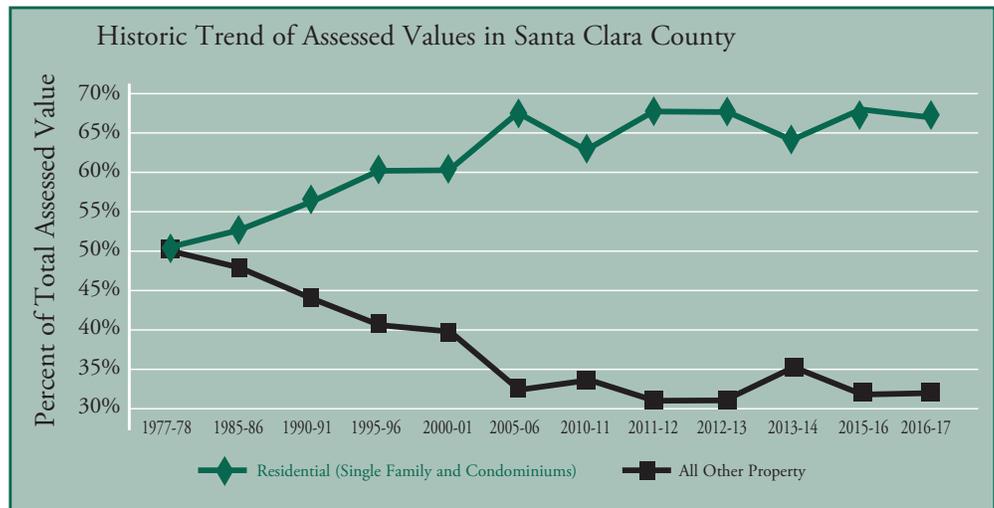
The system has negative impacts on land use and the environment. The LAO and academic research shows that the system promotes keeping urban land vacant. It increases speculation and sprawl, the opposite of “Smart Growth”. It drives up land prices that make housing less affordable. Important approaches to climate change and livability—increased density and transit—are discouraged by the current failure to tax commercial land appropriately.

Decline in Cities/Counties Per Person Revenues, 1977 to 2014



Legislative Analyst’s Office. September 2016. *Common Claims about Proposition 13*. <http://lao.ca.gov/reports/2016/3497/common-claims-prop13-091916.pdf>.

Property Tax Shift in 55 of 58 Counties



Office of the County Assessor. September 2016. *2016-2017 Assessor’s Annual Report*. https://www.sccassessor.org/edocman/AnnualReport2016_2017.pdf

E. Regional Examples

FAIRMONT MIRAMAR HOTEL

in Santa Monica

“Large corporate property owners have been among the law’s biggest beneficiaries, thanks in part to loopholes such as the one Dell used... the tax burden has steadily shifted from businesses to homeowners.”¹

For the past 40 years, large corporate property owners have taken advantage of California’s property tax system by exploiting loopholes and underpaying local schools and communities in needed tax revenue. One prominent example is that of billionaire Michael Dell’s use of a loophole in the 2006 purchase of the Fairmont Miramar Hotel in Santa Monica, resulting in a \$1.14 million per year tax avoidance—totaling \$16.8 million since 2006.

Here’s how Michael Dell and his associates exploited the commercial property tax loophole:

- 1 Michael Dell paid \$200 million for the Fairmont Miramar Hotel in Santa Monica hotel.
- 2 The deal is reshuffled to avoid a legal change in ownership by buying the company that owns the hotel, rather than the Miramar itself—avoiding reassessment and corresponding property tax change.

Fairmont Miramar Hotel ownership

Susan Dell 49.0%

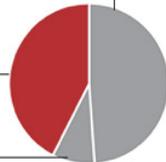
Susan Lieberman Dell Separate Property Trust, a legal entity 100% controlled by Susan Dell

Michael Dell 42.5%

MSD Portfolio LP Investments, an investment portfolio 99% controlled by Michael Dell

Miramar Hotel LLC 8.5%

Miramar Hotel LLC, a holding company created and controlled by Dell’s investment managers Glenn Fuhrman and John Phelan



- 3 Michael Dell reduced tax bill by \$1.14 million/year.

Purchase price: \$200 million

Assessed value: \$86 million

Estimated property tax under original deal

\$2 million

Estimated property tax under reshuffled deal

\$860,000

Estimated tax benefit per year for Dell

\$1,140,000

¹LA Times, “Opinion: Michael Dell: Poster boy for a Proposition 13 tweak”, May 15, 2014.

- 4 2006-18: Dell’s tax avoidance scheme has kept \$16.8 million in total tax revenue from funding local schools and communities.

This tax avoidance scheme, which was ruled to be perfectly legal by a judge, is just one example of how corporations and wealthy land-owners have been taking advantage of California’s unique commercial property tax system that has resulted in \$12 billion per year in lost funding for our local schools and communities.



SHELL OIL COMPANY
in Carson



Oil extraction and production have played a pivotal role in the development of Southern California. The Shell Carson Distribution Complex, which was originally built in 1924 as a refinery, 44 years before the City of Carson was established, is greatly underassessed and illustrates how oil companies with a long legacy in California benefit from the current system.

Shell Oil owns over 400 acres of industrial land in Carson assessed between \$3.40 and 3.60 per square foot. This property was last reassessed in 1975. Much of the land is vacant, and large sections are used for yard and warehouse storage. Recently purchased industrial land in the surrounding area is assessed as high as \$50 per square foot, with other properties in the range of \$25-40 per square foot. Even assuming the mid-point (approximately \$25 per square foot for vacant land) between their current assessment and the highest in the area, Shell Oil would pay nearly \$4 million more. If it were reassessed to the highest rate of similar industrial land in the area, Shell would pay \$8 million more each year to benefit schools, parks and local services in Carson and LA County.

E. Regional Examples *continued*



THE WALT DISNEY AND BURBANK STUDIOS
in Burbank

Los Angeles’ unique history as the home to major movie studios also places them in the spotlight with regard to commercial property tax disparity. Most of these multi-national companies are also multi-billion dollar enterprises, yet most pay property taxes based on old land values.

The Walt Disney Studios in Burbank sit on 43 acres of land assessed at 1975 land values, resulting in the loss of millions each year. The Disney Studios are assessed at \$5 per square foot, while the nearby Burbank Studios are assessed at \$180. If the Disney Studios and the Burbank Studios were similarly assessed, the owners would compete on a level playing field and restore \$3.5 million in additional revenue every year for schools and local services.



MALLS IN CORTE MADERA
in Marin County

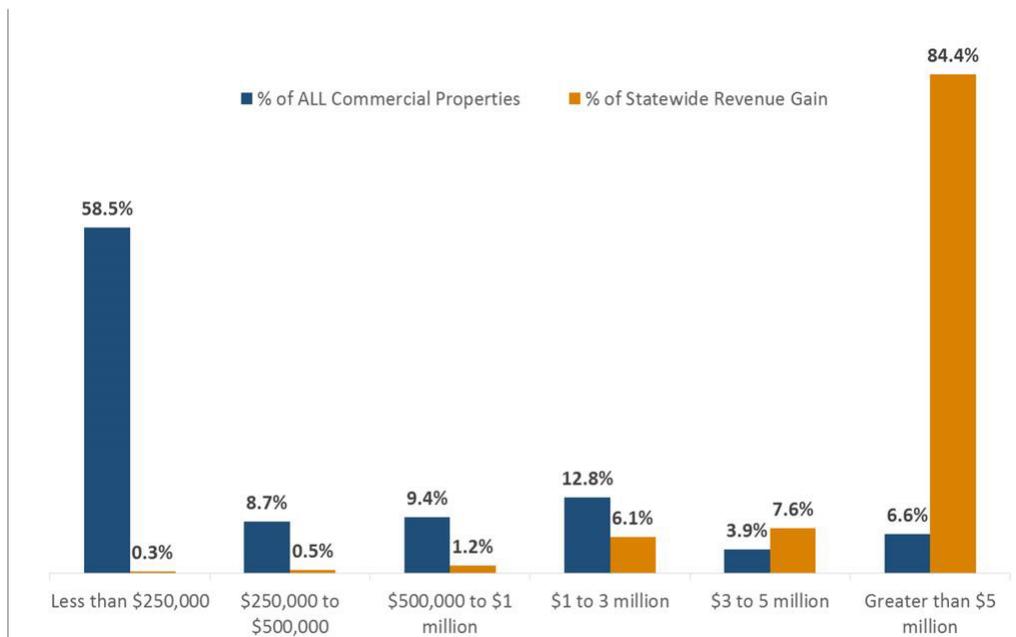
Marin County is a suburban area whose residents have some of the nation’s greatest purchasing power as income per capita is one of the highest. Yet a few landowners who own retail space are not paying their fair share in local property taxes. In the City of Corte Madera, two neighboring malls of the same size serve the same consumers, but one is assessed radically less than its competitor.

The Town Center at Corte Madera, a 1.3 million square foot property owned by Heitman, a real estate management firm from Chicago, is assessed between \$13 and \$249 per square foot. Its neighbor, the Village at Corte Madera, a 1.3 million square foot property partly owned by Macerich, a publicly traded company from Santa Monica, is assessed between \$12 and \$46 per square foot. If The Village at Corte Madera was assessed like its competitor at \$249, it would pay \$3.6 million more in property taxes every year. If the Town Center was entirely taxed at \$249 it would also pay \$3.6 million more in property taxes.

Share of Total Commercial/Industrial Properties and Share of Statewide Revenue Gain by Estimated Market Value, 2021-22

About 92% of the new property tax revenue would come from just 10% of all properties that are worth over \$3 million.

Source: USC PERE analysis of disparity ratios of commercial and industrial properties based on CoreLogic assessor roll data for 2017-2018.



The Solution

This policy proposal will require a constitutional amendment to be approved by California voters in order to reform the system for assessment of commercial and industrial property.

A. Reassessment

The core component of this proposal is the reassessment of commercial and industrial property to market value on a periodic basis, as occurs nearly everywhere else in the country. **The current constitutionally mandated rate of 1% would remain unchanged.**

B. Protecting Residential and Agricultural Property

Periodic reassessment will only affect commercial and industrial property, NOT residential and agricultural property. The measure makes sure that no residential property will be impacted, using current use to protect residential and agriculture property from reassessment, and zoning for vacant land. No residential properties will be reassessed, whether rental residential (apartments and rental homes), homeowner or condominium owner, or mobile home. To the extent that any definitional questions are raised, the legislature is **required** to make certain by statute that no residential property will ever be affected. Mixed-use property is to be assessed based on proportion of commercial to residential footage and is likely to be exempt if it is predominantly residential. Open space and natural and scenic properties are explicitly protected.

C. Phasing-In the New System

Since the system has not been changed in 40 years, a transition period will be necessary. The measure creates a task force to implement a phase-in timetable and process, working with assessors and the Board of Equalization, and requires that all start up and on-going costs shall be provided, to ensure a reasonable workload and implementation period for assessors. It then requires on-going assessment on a periodic basis, but no less than every three years, after initial reassessment is completed. There are many ways for the assessors to approach this work. For example, assessing the oldest properties and the largest properties first would generate substantial revenue while allowing smaller properties to be phased-in over a longer period.

D. Small Business Protections

1. Business Personal Property Tax Relief: The measure provides relief from the business personal property tax, providing an exemption of the first \$500,000 for California businesses. This exemption helps the vast

majority of businesses that lease but do not own their property, providing significant relief from a nuisance tax as well as financial relief to small businesses.

2. Small properties: Properties with value of \$3 million or less will be excluded if they are independently owned and not part of chains or owned by larger investors.

E. Revenue Allocation

1. Local Government Share of Revenue: The proposal calls for revenue in each county to be allocated based on the current proportions of the property tax which go to the cities, counties, schools, and special districts. Except for the schools, the local jurisdictions in each county will receive the new revenue based on the share of the local property tax they currently receive. The measure leaves property tax allocation unchanged, because a combination of Proposition 13 (which puts property tax allocation in the hands of the legislature) and a subsequent constitutional measure (Prop 1A) control allocation.

2. School Share of Revenue: Because of the potentially great fiscal differences among school districts in richer vs. poorer areas, the school revenue generated in each county from the share of the property tax in each school district will be pooled statewide and protected for use solely by K-12 schools and community colleges. This incremental revenue will be over and above Prop. 98 formulas, so will not lower any state support for schools. To further address equity, it will be distributed based on the current Local Control Funding Formula. Basic aid districts, which are typically in the wealthiest communities, will receive what they previously would have received, plus at least \$100 per student, a minimum that all districts will receive over and above current revenue.

3. Revenue Reimbursements: The state General Fund will be reimbursed against any losses resulting from an increase in commercial property tax deductions caused by reassessment, with the Franchise Tax Board to provide an estimate yearly. And assessors will be reimbursed from the new revenue for any increased costs of implementation. Revenue will be allocated to the newly-created school fund and to local districts after these General Fund reimbursements, which amount to very small percentage of total revenue.

F. Accountability to Taxpayers

All school districts and local governments receiving revenue from the measure will be required to prepare reports to provide accountability to taxpayers for the use of the incremental revenue from collections. The legislature shall develop a consistent method to calculate the incremental revenues received.

Impact

A. Projected Revenue

1. *Statewide Revenue:* The Legislative Analyst Office (LAO) estimates that the initiative will generate up to \$12 billion every year. This amount will grow with economic growth. The reform will generate substantial revenue increases for all counties.
2. *Schools:* Schools and community colleges will receive 40% of the \$12 billion in increased revenue yearly. This translates into between \$15,000-\$20,000 per classroom when fully implemented. Every school district will receive increased revenue for students in need based on the Local Control Funding Formula applied statewide, and Basic Aid districts that already meet their target funding level will also receive a minimum of \$100 per student in additional revenues. All revenue will be in addition to and on top of current revenue guaranteed by Proposition 98.
3. *Local Government:* Cities, counties, and special districts will receive 60% of the \$12 billion in increased revenues. Like all property taxes, revenues will be spent at local government discretion, for parks, libraries, capital outlay, health and social services, etc.

B. Who Pays?

1. *Highest-Value Properties Pay the Most:* The highest-value properties provide most of the revenue. 92% of the revenue comes from a small share of properties—that is, from properties estimated worth over \$3 million, or about 10% of commercial and industrial properties. These are mostly corporate-owned and wealthy investor-owned and have the lowest current assessment compared to market value. In contrast, nearly 77% of properties are worth under \$1 million and generate only 2% of the total revenue.
2. *Many Properties See Little Change:* Many properties will see little or no impact. 45% of all commercial/industrial properties are currently assessed at 60% or more of market value, with many of those close to or at market, and will pay little or no additional taxes as the measure phases in.
3. *Oldest Properties Pay:* Nearly 50% of the revenue comes from properties which were last reassessed before 2000. These include large corporate and investor-owned properties, many of which have not been reassessed since the 1970s and 1980s.
4. *Most Value in Land, Not Buildings:* Sixty percent (60%) of the revenue comes from the reassessment of land as compared to buildings and improvements. Buildings which are improved are currently reassessed while land may still be held at very old values. The differences in building values are nowhere near the disparities in land values, which can be as high as

100 to 1 in places where values have grown rapidly, such as Silicon Valley, San Francisco, and west Los Angeles.

5. *Out of State Investors:* Substantial amounts of the new tax revenue will be paid by out-of-state and foreign investors and the very wealthy. Large properties are often owned by Real Estate Investment Trusts and are publicly-traded on national and international exchanges, and foreign investors have seen California commercial property as a safe long-term investment. Corporate shareholders are widely distributed nationally and internationally and would pay much of the property tax. Owners of commercial property are far wealthier than most citizens, generally within the top 1% of earners.

C. Broader Benefits and Impacts

1. *Relief from Fees and Local Tax Pressures:* Increasing revenue from commercial property taxes eliminates pressures for additional local taxes and fees, which have grown considerably as a portion of local government expenses. Over time, citizens and businesses have borne many of these new taxes and fees because large property owners have paid so little.
2. *Infrastructure Benefits:* Because rising land values will be captured, the ability to finance infrastructure is greatly improved, particularly for transit, where new investments can recover costs from rising land values. The measure will increase the rate of payment of bonded indebtedness by expanding the tax base.
3. *“Smart Growth” Benefits:* Development which concentrates urban land use instead of promoting suburban sprawl and big-box retail will increase as underutilized, in-fill properties with high value but low assessments will be brought onto the market. Smart growth is a necessary part of combating climate change.
4. *Regulatory Climate Will Improve for Business:* The regulatory burden of fees and exactions put on new economic development will diminish, as cities have stronger fiscal incentives for new development and will be able to finance the costs of economic growth.
5. *Affordable Housing:* Low-density commercial strips will be available for higher-density housing. Local revenues from reassessment will enable cities to meet their local affordable housing obligations and address their homeless problems. The heavy fee burden on new housing development is likely to diminish. And the land use benefits will improve affordability for all types of housing.
6. *Small Business Benefits:* Every small business will benefit from the exemption of the first \$500,000 of the business personal property tax, and for most, this tax will be completely eliminated. The exclusion of properties of \$3 million or less also will provide significant relief to small business. Since many properties will face little or no increases, many businesses will have net benefits due to the elimination and/or reduction of the business personal property tax.

SCHOOLS & COMMUNITIES FIRST

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