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Key Facts About Proposition 15, California's Commercial Property Taxes, and Revenue for Schools and Local Communities

Local tax revenue reflects a community's shared effort to support vital public services that all Californians need to thrive in our cities and counties. This ranges from education for students in K-12 schools and community colleges to access to housing, health care, public parks, and libraries. These vital public services are supported by tax revenues from commercial and industrial properties – many of which are still taxed based on purchase prices that are more than four decades old. California voters will be asked in fall 2020 to vote on a measure known as Proposition 15, an amendment to the state Constitution that would change how commercial and industrial properties are taxed and provide more revenue for schools and local communities to support services Californians rely upon. This report outlines key facts about how Prop. 15 would change taxes for commercial and industrial properties and increase revenue for local communities.

Proposition 15 Would Only Affect Commercial and Industrial Properties, Not Residential or Agricultural Properties

Proposition 15 would only change property taxes for properties used for commercial and industrial purposes and would not change property taxes for residential or agricultural properties. All residential property, including rental properties, would continue to be assessed (valued for tax purposes) based on their purchase price plus an annual inflation adjustment of up to 2%, as the state Constitution currently provides. Properties that are mixed-use – that is, they contain both commercial and residential uses – would only be reassessed on the share of the property that has a commercial or industrial use. Further, the measure allows the Legislature to exempt mixed-use properties from reassessment if at least 75% of the property is used for residential purposes. Additionally, the measure exempts agricultural land from its new assessment rules.

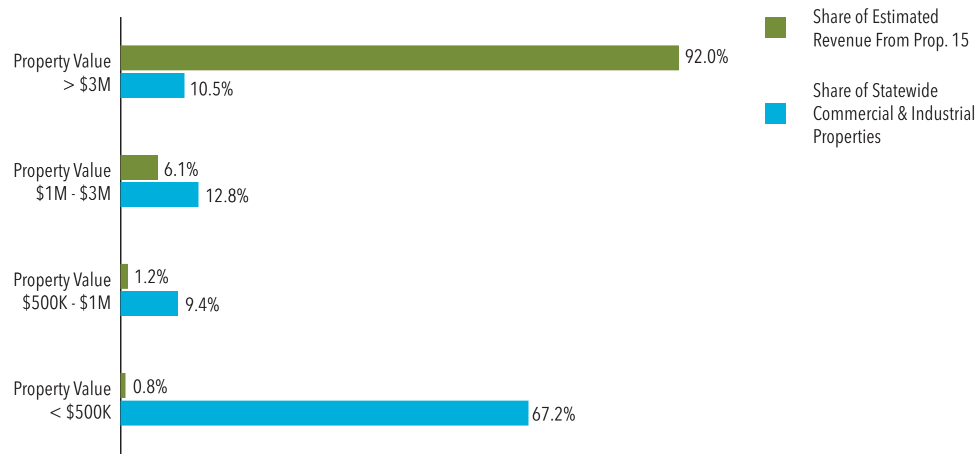
Proposition 15 Would Raise Most of its Revenue From a Small Share of Very Valuable Commercial and Industrial Properties

The new revenue raised from reassessing commercial and industrial properties to market value would be highly concentrated among a small share of high-value properties. An estimated 92% of the revenue raised would come from 10.5% of all commercial and industrial properties in the state, according to an estimate produced for the measure's proponents (Figure 1).[1] This is because a small portion of the commercial and industrial properties are very valuable but have not been reassessed in decades, so their assessed values under current law are much lower than their market values. On average, the properties that would be reassessed under Prop. 15 are currently under-assessed by 50% or more – meaning that the market value of an average property subject to reassessment is at least twice the assessed value.

FIGURE 1

Vast Majority of Proposition 15 Revenue Would Come From a Small Share of High-Value Properties

Share of Estimated Prop. 15 Revenue by Estimated Market Value, 2021-22



Note: Revenue estimates include only properties where property owner has $3M or more in total commercial property holdings; share of all commercial properties includes all commercial properties statewide, including those exempt from the tax. Totals do not sum to 100% due to rounding.
Source: Blue Sky Consulting Group and USC Equity Research Institute

Proposition 15 Contains A Series of Protections for Small Businesses

Prop. 15 includes a series of provisions that would protect many small businesses from property tax increases while also providing them with new property tax *cuts*.[2] Taken together, these provisions could result in tax *reductions* for more than 4 in 5 of California's small businesses, according to estimates produced for the measure's proponents.[3] Prop. 15's protections for small businesses include:

- Exemption for home-based businesses. Home-based businesses and other limited commercial uses of residential property would not be subject to reassessment to market value. This would exempt about 54% of the state's small businesses – including about 56% of minority-owned small businesses.[4]
- All properties that are worth $3 million or less and have owners with no more than $3 million in statewide commercial and industrial property would be exempt from the new system of assessment based on market value. It is estimated that 30% of the state's small businesses own or rent property qualifying for this exemption.[5]
- The measure would establish a new property tax exemption for up to $500,000 in personal property and fixtures, such as office equipment and furniture.[6] Small businesses would be fully exempt from taxation on their personal property.

As a result of these provisions, the majority of small businesses would *not* be affected by the measure's reassessment provisions but *would* benefit from the new personal property tax exemptions. Additionally, the measure provides that the first reassessment for properties where at least half of the space is occupied by small businesses would not occur until 2025-26 at the earliest. This delay would allow affected businesses time to make adjustments to minimize the impacts of the measure (for instance, those renting their premises would have time to renegotiate their leases or enter into new agreements).

Proposition 15 Would Supplement Current Funding for K-12 Schools and Community Colleges

The dollars Prop. 15 raises for K-12 school and community college districts could not replace other funding for K-14 education. Prop. 15 dollars would not be part of the calculations used to determine the annual funding level for K-14 education required by the state constitution – also known as the Proposition 98 guarantee. Prop. 15 would also prohibit the state from using the measure's revenue to fulfill any of its current Prop. 98 obligations, including those related to the state's rainy day fund for K-12 schools and community colleges.

Proposition 15 Would Equitably Distribute the Revenue It Raises for K-12 Schools and Community Colleges

Prop. 15 would distribute the dollars it raises for K-12 school and community college districts according to the state's equity-based formulas. Currently, counties distribute local property tax dollars among K-12 school and community college districts within their county. Under Prop. 15, counties would instead transfer the property tax revenue the measure raises for K-14 districts to a new statewide fund – the Local School and Community College Property Tax Fund ("K-14 Education Fund"). Dollars in the K-14 Education Fund would then be allocated to K-12 school and community college districts based on the share of funding they receive from the state's equity-based funding formulas.

For K-12 school districts, charter schools, and county offices of education this means Prop. 15 revenues would be allocated according to the state's Local Control Funding Formula (LCFF), the state's main K-12 education funding formula. The LCFF provides K-12 school districts a base grant per student and additional grants for the costs of educating English learners, students from low-income families, and foster youth.

For California's community colleges, Prop. 15 revenues would be allocated primarily through the Student Centered Funding Formula (SCFF), which includes a supplemental grant for community colleges based on their number of low-income students whose enrollment fees are waived due to financial need or students who receive financial aid.

Proposition 15 Would Protect Revenue Raised for Schools and Local Communities

Prop. 15 would prohibit using the dollars the measure raises to support entities other than school districts, community college districts, cities, counties and special districts.[7] Moreover, Prop. 15 expressly prohibits loaning the dollars it raises for K-14 education to any state or local fund or using that revenue for any purpose other than supporting K-12 schools and community colleges.

California is One of a Handful of States With Commercial Property Assessment Caps

Most other states do not limit the growth in the assessed – or taxable – value of commercial and industrial properties. In fact, only eight states have such a limit – and California's limit is the most restrictive. California limits the annual increase in assessed value of commercial properties to 2%, whereas other states with such laws limit the annual increase to between 3% and 10%.[8] Additionally, while California currently requires commercial and residential properties to be taxed the same, half of all states already allow different types of properties to be taxed differently – for instance, by setting higher tax rates or higher assessment ratios (the ratio of the assessed value to market value) for commercial properties.[9]

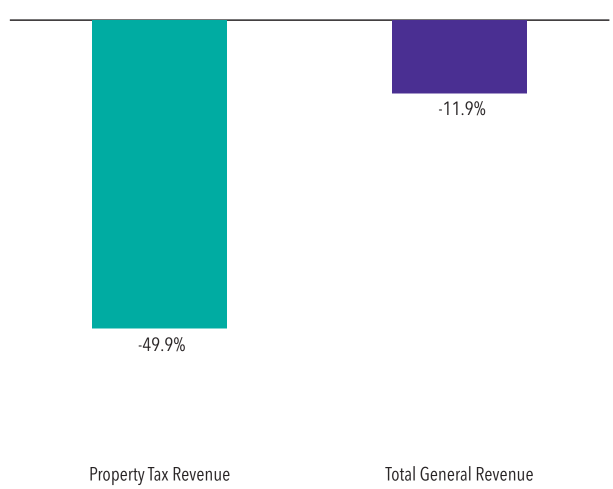
California's Local Property Tax Revenues Have Plunged as a Share of the State's Economy Since the Late 1970s

In the 40 years after voters put into place Proposition 13's limits on property tax rates and the growth in taxable value – property tax revenues for local communities as a share of state personal income fell by half, from 5.2% in 1976-77 to 2.6% in 2016-17 (Figure 2). To make up for this loss of property tax revenue, local governments have come to rely more heavily on other revenue sources, such as service charges and other taxes. However, even with increases in other revenues, overall general revenue collected at all levels of local government in California has fallen nearly 12% relative to personal income. In other words, even as California grew more prosperous during this time period, the resources that support critical services for California's local communities – such as education for students in K-12 schools and community colleges, housing, health care, public parks, and libraries – have not kept pace.

FIGURE 2

Since Prop. 13, California's Property Tax Revenue Has Dropped By Half as a Share of the State's Economy

Change in Revenue as a Share of State Personal Income, 1977-78 to 2016-17



Note: Total general revenue includes property tax revenue, other tax revenue, intergovernmental revenue, and charges and miscellaneous general revenue.
Source: Budget Center Analysis of data from US Bureau of Economic Analysis and US Census Bureau

California Businesses Contribute Less in Taxes Than Businesses in Many Other States by Several Measures

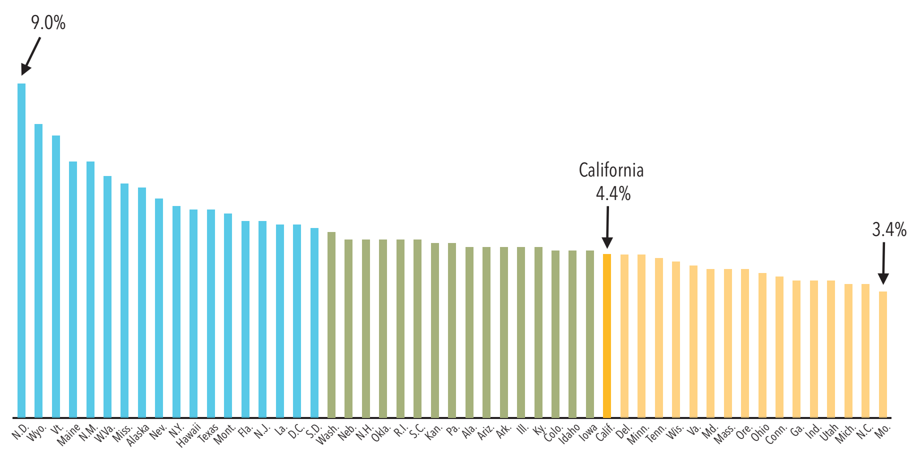
California's limits on the assessment of commercial and industrial properties means businesses in the state pay less in property taxes as a share of the property's market value than businesses in many other states. When comparing taxes on commercial and industrial properties relative to market value across the nation's 50 largest cities, the eight California cities on the list all rank in the bottom half.[10] California ranks in the bottom third of states when ranking *all* state and local taxes paid by businesses as a share of the state's private-sector economy (Figure 3).[11]

Additionally, the state income taxes that corporations are paying in California as a share of their profits in the state are now only about half of what they were in the early 1980s (having fallen from 9.5% in 1981 to 4.2% in 2017). This is due to both reductions in the corporate tax rate in 1987 and 1997 and the introduction of new tax breaks benefiting corporations over the last several decades.[12]

FIGURE 3

California Ranks in Bottom Third of States on a Measure of State and Local Business Taxes as a Share of the Economy

Estimated State and Local Taxes Paid by Businesses as Share of Private-Sector State GDP



Note: GDP = Gross Domestic Product. Analysis includes the District of Columbia. Measure includes property taxes, sales and excise taxes, corporate taxes, individual income taxes on business income, unemployment insurance taxes, and other taxes paid by businesses.
Source: Ernst & Young

Proposition 15 Would Increase Local Funds Available to Support Housing Production and Could Incentivize Some Private Landowners to Use Land for Housing Development

Prop. 15 could enhance housing production and affordability in three ways:

- First, local governments would gain new revenues from Prop. 15, with cities, counties, and special districts gaining roughly $4 billion to $7 billion in new property taxes each year, according to analysis by the Legislative Analyst's Office.[13] These new revenues could be used by cities and counties to support production of affordable housing or development of infrastructure needed to facilitate more housing production, and to leverage additional funding for affordable housing and infrastructure projects through grants and loans that require or award competitive points for local matching funds.
- Second, by providing local governments with new ongoing annual revenues, Prop. 15 would reduce the need for local governments to rely on revenue raised through fees charged to developers of new housing. These fees have increased over time, particularly in the years after Prop. 13 was approved in 1978, as local governments faced more limited funding to support the costs of infrastructure development.[14] Developer fees raise the costs and risks of housing production and may be passed on to homebuyers and renters in the form of higher prices and rents, particularly in areas with strong housing markets.[15]
- Finally, for private owners of vacant or underutilized real estate, Prop. 15 would create an incentive to seek to develop housing rather than retail or office or industrial facilities on their land, because the long-term costs of property taxes would be lower for residential development compared to commercial development. This new incentive could cause private owners of land zoned for mixed use to choose to develop more housing, and could cause private owners of land zoned for commercial or mixed use to pursue housing uses or seek zoning changes to allow for housing development. A study by the Urban Institute identified about 8,100 privately owned vacant or aging commercial or industrial parcels in the City of Los Angeles, for example, where owners would have a financial incentive to shift the land use to housing.[16]

Kayla Kitson, Jonathan Kaplan, and Sara Kimberlin prepared this *Key Facts*. The Budget Center was established in 1995 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The Budget Center engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the Budget Center is provided by foundation grants, subscriptions, and individual contributions. Please visit the Budget Center's website at calbudgetcenter.org.

Endnotes

1 Blue Sky Consulting Group, *Concentration of Revenue Generated by Proposition 15: Analysis of the Share of Properties Responsible for the Majority of Revenues Generated by Commercial Property Tax Reform* (July 2020)), pp. 1-2, downloaded September 24, 2020 from https://www.documentcloud.org/documents/6988869-Proposition-15-Analysis-1.html.

2 The measure defines a small business as an independently-owned business with less than 50 full-time equivalent employees that owns real property – such as land or buildings – in California.

3 Blue Sky Consulting Group, *Impact of Proposition 15 on Small Business: Analysis of the Percentage of Small Businesses Affected by Commercial Property Tax Reform* (August 2020), p. 1, downloaded September 24, 2020 from http://www.blueskyconsultinggroup.com/storage/SCF_Small_Business_Report_20200804.pdf.

4 Blue Sky Consulting Group, *Impact of Proposition 15 on Small Business: Analysis of the Percentage of Small Businesses Affected by Commercial Property Tax Reform* (August 2020), p. 3, downloaded September 24, 2020 from http://www.blueskyconsultinggroup.com/storage/SCF_Small_Business_Report_20200804.pdf.

5 Blue Sky Consulting Group, *Impact of Proposition 15 on Small Business: Analysis of the Percentage of Small Businesses Affected by Commercial Property Tax Reform* (August 2020), p. 3, downloaded September 24, 2020 from http://www.blueskyconsultinggroup.com/storage/SCF_Small_Business_Report_20200804.pdf. Prop. 15 requires a property to be reassessed if *any* of its owners – direct or indirect – have ownership interests in commercial and/or industrial property throughout the state that has an aggregate value of more than $3 million. The estimate that 30% of small businesses would benefit from this exemption is based on an analysis of county assessor data, and properties were considered to have the same owner if the listed mailing addresses for the properties matched. The assessor data do not contain enough detail to identify all owners of a single property, so this estimate could overstate or understate the number of businesses that would qualify for the exemption to some degree.

6 This exemption does not include aircraft and boats.

7 The measure would reimburse the state for reductions in corporate and personal income tax revenues that would result from larger deductions due to higher property tax liabilities and for start-up costs the state would pay to begin its implementation.

8 Isaac William Martin, *Commercial Assessment Limitation and Income Inequality Among Racial Groups* (August 12, 2020), p. 6, downloaded September 24, 2020 from https://www.siliconvalleycf.org/sites/default/files/documents/scf/scf-martin-report.pdf.

9 Richard C. Auxier, Tracy Gordon, and Kim Reuben, *California's State and Local Revenue System* (Urban Institute: July 2020), p. 8, downloaded September 24, 2020 from https://www.urban.org/sites/default/files/publication/102584/californias-state-and-local-revenue-system_1.pdf.

10 Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence, *50-State Property Tax Comparison Study for Taxes Paid in 2019* (June 2020), pp. 78, 86, and 88, downloaded September 24, 2020 from https://www.lincolninst.edu/sites/default/files/pubfiles/50-state-property-tax-comparison-for-2019_full.pdf.

11 This includes property, sales, income, unemployment, and other taxes paid by businesses. Andrew Phillipps and Caroline Sallee, *Total State and Local Business Taxes: State-by-State Estimates for FY18* (Ernst and Young: October 2019), pp. 11-12, downloaded September 24, 2020 from https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/news/2019/10/ey-total-state-and-local-business-taxes-october-2019.pdf.

12 Jonathan Kaplan, *Corporations Pay Far Less of Their California Income in State Taxes Than a Generation Ago – Even Amid COVID-19* (California Budget & Policy Center: May 2020).

13 Legislative Analyst's Office. *Proposition 15. Increases Funding for Public Schools, Community Colleges, and Local Government Services by Changing Tax Assessment of Commercial and Industrial Property. Initiative Constitutional Amendment. Analysis by the Legislative Analyst* (July 2020), downloaded August 24, 2020 from https://lao.ca.gov/ballot/2020/Prop15-110320.pdf.

14 John Landis, et al. *Pay to Play: Residential Development Fees in California Cities and Counties, 1999.* California Department of Housing and Community Development and University of California Berkeley Institute of Urban and Regional Development (August 2001), p. 12, downloaded September 15, 2020 from https://www.novoco.com/sites/default/files/atoms/files/pay2play.pdf.

15 Hayley Raetz, et al. *Residential Impact Fees in California: Current Practices and Policy Considerations to Improve Implementation of Fees Governed by the Mitigation Fee Act* (Terner Center for Housing Innovation at UC Berkeley: August 5, 2019), pp. 21-22, downloaded September 15, 2020 from http://ternercenter.berkeley.edu/uploads/Residential_Impact_Fees_in_California_August_2019.pdf.

16 Solomon Greene, et al., *Housing and Land-Use Implications of Split-Roll Property Tax Reform in California* (Urban Institute: September 2020), downloaded September 23, 2020 from https://www.urban.org/research/publication/housing-and-land-use-implications-split-roll-property-tax-reform-california. Theoretically, local governments might consider attempting to zone more parcels for commercial use rather than residential use because of higher long-term property tax revenues from commercial or industrial properties – but the same Urban Institute study found that the number of residential parcels that might be at risk of rezoning to commercial or industrial use would be substantially smaller – in Los Angeles, less than half as many – compared to the number of parcels where private landowners would have a new incentive to seek to develop housing. Moreover, state law through the Regional Housing Needs Allocation (RHNA) process and various provisions of Housing Element law requires that local jurisdictions maintain at all times an adequate supply of sites zoned for housing to meet each jurisdiction's fair share of the state's total need for new housing production across all income levels. The most recent RHNA cycle has included larger allocations for the number of new housing units that must be accommodated, and recent changes to Housing Element law have closed loopholes and increased accountability and incentives for local jurisdictions to meet their obligations to zone adequate sites for housing. As a result, local governments would have limited realistic opportunities and would face substantial legal barriers and counter-incentives to significantly increasing "fiscalization of land use" and converting residential land to commercial use in response to Prop.15.