LAO

September 8, 2017

Hon. Xavier Becerra
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional and statutory initiative (A.G. File No. 17-0013, Amdt. #1) related to property tax assessment.

Background

Local Governments Levy Taxes on Property Owners. Local governments—cities, counties, schools, and special districts—in California levy property taxes on property owners based on the value of their property. Property taxes are a major revenue source for local governments, raising nearly $60 billion annually. Although the state receives no property tax revenue, property tax collections affect the state's budget. This is because state law guarantees schools and community colleges (schools) a minimum amount of funding each year through a combination of property taxes and state funds. If property taxes received by schools decrease (increase), state funding generally must increase (decrease).

Property Taxes Are Based on a Home's Purchase Price. Each property owner's annual property tax bill is equal to the taxable value of their property—or assessed value—multiplied by their property tax rate. Property tax rates are capped at 1 percent plus smaller voter-approved rates to finance local infrastructure. A property's assessed value is based on its purchase price. In the year a property is purchased, it is taxed at its purchase price. Each year thereafter, the property's taxable value increases by 2 percent or the rate of inflation, whichever is lower. This process continues until the property is sold and again is taxed at its purchase price.

Movers Often Face Increased Property Tax Bills. An existing homeowner often faces a higher property tax bill when she purchases a new home. Most homeowners who have lived in their homes for a few years or more pay taxes based on assessed values that are less than their homes' market values—what the homes could be sold for. This difference typically widens the longer a home is owned. This is because in most years the market value of most properties grows faster than 2 percent. When an existing homeowner purchases a new home, however, his or her assessed value is set to the market value of the new home. If the new home's market value is similar to or greater than the prior home, the new home's assessed value is likely to exceed the old home's assessed value. Even when the new home's market value is lower, the new home's assessed value can be higher than the prior home's if the prior home had been lived in for many years. A higher assessed value, in turn, leads to higher property tax payments for the home buyer.

Special Rules for Older Homeowners. While most homeowners face higher property taxes when buying a new home, in certain cases special rules apply to homeowners 55 and older. When moving within the same county, a homeowner who is 55 or older can transfer the assessed value of their existing home to a new home if the market value of the new home is equal to or less than their existing home. Further, counties may choose to allow homeowners 55 and older to transfer their assessed values from homes in different counties to new homes in their county. A county board of supervisors can permit such transfers by adopting a local ordinance. Currently, 11 counties (Alameda, El Dorado, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Mateo, Santa Clara, Tuolumne, and Ventura) allow these transfers. Whether within a county or across counties, a homeowner can transfer their assessed value only once in their lifetime.

Potential of Higher Property Taxes May Discourage Some Movers. Some research suggests that potential movers may be discouraged by the possibility of paying more property taxes. For example, homeowners 55 and older appear more likely to move in response to special rules allowing them to transfer their existing assessed value to a new home. California homeowners who were 55 years old were around 20 percent more likely to move in 2014 than 54 year old homeowners. This suggests that some homeowners who were interested in moving delayed doing so to avoid paying higher property taxes.

Other Taxes on Home Purchases. Cities and counties impose taxes on the transfer of homes and other real estate. These transfer taxes are based on the value of the property being transferred. Transfer taxes are equal to $1.10 per $1,000 of property value in most locations, but exceed $20 per $1,000 of property in some cities. Statewide, transfer taxes raise around $1.1 billion for cities and counties.

Counties Administer the Property Tax. County assessors determine the taxable value of property, county tax collectors bill property owners, and county auditors distribute the revenue among local governments. Statewide, county spending for assessors' offices totals around $550 million each year. County costs for property tax collectors and auditors are unknown but much smaller.

Proposal

Expands Special Rules for Older Homeowners. The measure expands the special rules applied to existing homeowners 55 and older who buy a new home. Under the measure, the assessed value of any home purchase by an existing homeowner 55 and older—including those moving across counties or to more expensive homes—would be tied to the assessed value of the buyer's prior home. If the new and old home have the *same* market value, the assessed value of the new home would be the assessed value of the prior home. If the market value of the new home is *higher than* the prior home, the assessed value of the prior home would be adjusted upward. This adjusted value would be greater than the prior home's assessed value but less than the new home's market value. Conversely, if the market value of the new home is *less than* the prior home, the assessed value of the prior home would be adjusted downward. The measure specifies a formula to be used to make these upward and downward adjustments. There also would be no limit on the number of moves by an individual homeowner. These changes would take effect January 1, 2019.

Examples. To see how the measure's formulas work, consider the options of a recently retired couple who is looking to move. The couple has lived in their suburban home for 30 years. The home's assessed value is $75,000 and could be sold for $600,000. They are looking at two options:

- ***Beach Home.*** The couple could buy a beach home for $700,000. Under the measure, the assessed value of the beach home would be $175,000: $75,000 (assessed value of their prior home) plus $100,000 ($700,000 [the new home's market value] minus $600,000 [the prior home's market value]).
- ***Small Downtown Condo.*** The couple also could buy a downtown condo for $500,000. Under the measure, the assessed value of the condo would be $62,500: $75,000 (assessed value of their prior home) multiplied by 0.8 ($500,000 [the new home's market value] divided by $600,000 [the prior home's market value]).

Fiscal Effect

Effects on Real Estate Markets. The measure would have a variety of effects on real estate markets throughout California. Most notably, the measure likely would change the number of homes bought and sold each year and the prices of those homes.

Increase Home Sales. Because the measure further reduces the property tax increases faced by older homeowners who purchase a new home, it likely would encourage more older homeowners to sell their existing homes and buy other homes. In recent years, between 350,000 and 450,000 homes have sold each year in California. Under the measure, home sales could increase by as much as tens of thousands per year.

Unclear Effect on Home Prices. The measure would increase the number of home buyers and sellers, as well as change how much home buyers are willing to pay for a home. The net effect of these changes on home prices is unclear.

Reduced Property Tax Revenues to Local Governments. By further reducing the increase in property taxes that typically accompanies home purchases by older homeowners, the measure would reduce property tax revenues for local governments. Additional property taxes created by an increase in home sales would partially offset these losses, but on net property taxes would decrease. In the first few years, property tax losses would be a few hundred million dollars per year, with schools and other local governments (cities, counties, and special districts) each losing around $150 million annually. Over time these losses would grow, likely reaching between $1 billion to a few billion dollars per year (in today's dollars) in the long term, with schools and other local governments each losing $1 billion or more annually.

More State Spending for Schools. Most schools' property tax losses would be offset by increased state funding. In the short term, annual state costs for schools would increase by around $150 million. In the long term, annual state costs for schools would grow by $1 billion or more (in today's dollars).

Increase in Property Transfer Taxes. As the measure likely would increase home sales, it also would increase property transfer taxes collected by cities and counties. This revenue increase likely would be in the tens of millions of dollars per year.

Higher Administrative Costs for Counties. The measure would require county assessors to make process, staffing, and information technology changes. These changes likely would result in one-time costs in the millions of dollars or more, with somewhat smaller ongoing cost increases.

Summary of Fiscal Effects.

- Annual property tax losses for cities, counties, and special districts of around $150 million in the near term, growing over time to $1 billion or more per year (in today's dollars).
- Annual property tax losses for schools of around $150 million per year in the near term, growing over time to $1 billion or more per year (in today's dollars). Increase in state costs for schools of an equivalent amount in most years.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance