

California Commercial Property Split Property Tax Roll Proposals

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THE CHALLENGE

Unquestionably, commercial property owners are under increasing attack to pay a substantially higher property tax. Legislators, powerful labor unions, and many academics are at the helm of these proposals.

CALIFORNIA STATE LEGISLATIVE PROPOSALS

AB 2492 (Ammiano) is a bill that would mandate commercial property tax reassessment when 100% of the ownership interest in a corporation, limited liability company (LLC), partnership, or other legal entity holding the property is sold or transferred in either single or multiple transactions. The California State Board of Equalization claims that tax collections will increase by "hundreds of millions of dollars per year" should the Ammiano measure become law.

That measure is pending on the floor of the Assembly and will not be able to move due to the rules of the Legislature. However, this does NOT rule out the right of the author to "gut" another bill pending in the Senate and "amend" it by incorporating the split roll measure in order to address that issue this year. This has been a regular practice in the California legislature.

Ammiano and many Democratic members of the California legislature are actively supporting a split roll property tax because this would ultimately line the pockets of government with billions of dollars in new revenue.

CALIFORNIA STATE BALLOT INITIATIVES

A prominent law firm that has consistently represented the financially well-heeled and politically motivated California Teachers Association (CTA) submitted not one, but two ballot initiatives to the State Attorney General's office for titling and summary.

The first initiative would:

- Require commercial property owners to pay 1.55% to the full cash value (versus 1% under current law).
- Double the homeowner property tax exemption from \$7,000 to \$14,000.
- Double the renter's tax credit.
- Exempt the first \$1 million of personal property tax to "protect small business."
- Subvene new property taxes directly to public schools.

The second initiative would:

- Mandate immediate reassessment of all non-exempt and non-residential property (commercial property). All commercial property would be assessed to "fair market value."
- Exempt property that is zoned for agricultural production.
- Exempt the first \$1 million of personal property tax to "protect small business."
- Double the homeowner property tax exemption.
- Double the renter's tax credit.

CA commercial property owners should expect rents to fall and property values decline by 5-8%.

- Dedicate all raised funds to the state general fund. Counties would be reimbursed for new administrative costs associated with the new split roll initiative.

Luckily, the CTA decided to abandon a costly state initiative drive to qualify one of the ballot measures

and then to advocate for the measure once the Secretary of State certified it for the year. Now that the skeleton has been designed,

the union will have less work to do when it is ready to take the measure and run with it in the not too distant future.

FINANCIAL IMPACT

The increase in property tax won't just affect tenants' bottom lines when the time comes to write the check for each installment (for net leases)— it will also negatively affect property value by decreasing the amount of rent tenants are willing to pay on triple net leases and net operating income on gross leases.

In today's commercial real estate market, due to increased vacancies, anemic tenant demand, falling rents and increasing economic concessions, tenants signing new or renewing existing leases ("active tenants") are not allowing increased costs operating in their real estate to be pushed to their side of the bargaining table.

Most importantly, if a split roll property tax becomes reality, active tenants will not be willing to increase their gross rent to cover this increased cost to the landlord. For example, we have analyzed the direct financial impact of the FIRST SPLIT ROLL INITIATIVE that would increase commercial property taxes to 1.55%.

While we have analyzed the impact of that initiative in Los Angeles, San Francisco and San Jose, we focus our attention in this article to the Los Angeles commercial market.

The Los Angeles' average net operating income (NOI) for **industrial and flex properties** is approximately \$6.71 per square foot per year for properties sold in the first quarter of 2010 (according to Real Capital Analytics). The tenant currently pays an additional \$.87 per square foot per year in property taxes. If approved by the voters, the split roll tax would change this amount to \$1.33: an increase of \$.464 per square foot per year. Given the state of the market, as tenants' leases roll, this increase in property tax will get indirectly shifted to the landlord, as active tenants will be unwilling to pay more in gross rent. **This will be translated into a direct drop in property value, as the decreased NOI gets capitalized at a similar rate (7.80% as of the 1Q2010).**

Property values could drop by approximately \$5.94 per square

foot (from \$86 to 80 per square foot) for industrial and flex buildings in the Los Angeles area, or approximately 6.9% of their total value. Accordingly, the **retail sector** would see similar declines. As active tenants renew or sign new leases, property values would drop more than \$15.04 per square foot (from \$212 to \$197 – a decline of 7.1%). **The office market would be exposed as well – with active tenants driving down property values more than \$13.44 per square foot (from \$222 to \$209 – a decline of 6.1%).** (See Chart)

These estimations make it abundantly clear that if tenant demand persists anemic, and negotiating leverage remains on

ACADEMIC COMMUNITY ADVOCATES FOR SPLIT ROLL

The unions are not the only ones interested in splitting the property tax roll. Academics are now coming out of the woodwork. Professors such as Steven M. Sheffrin, University of California at Davis, are advocating for a split roll property tax. Academics' support lends weight and intellectual credence to the split roll tax initiative of which can be said to be supported by all educators in the state.

CALIFORNIA GOVERNOR CONSIDERS SPLIT ROLL

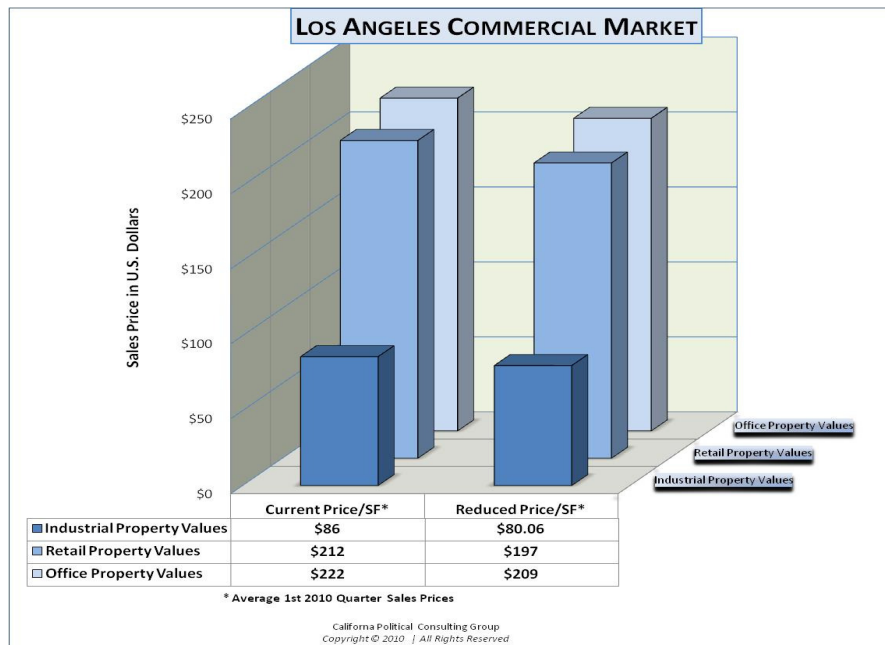
Finally, the *Governor's Commission on the 21st Century* came extremely close to adopting a resolution last year that would have advocated for

the current property tax and revenue structure to include a split roll property tax.

SUMMARY

If there is anything that we have learned from the events over the past 18 months, it is that there will be a state ballot initiative and a serious push by state Democratic legislators to totally revise the amount of property tax revenue commercial property

owners will pay to government.



their side of the table, property values will decline substantially, ranging from 5% to over 8%.

Let's face it:

- Government coffers are near empty.
- Government is looking to increase revenues instead of cutting government programs.
- Teachers and public labor unions will be at the forefront of advocating a split roll initiative. Progressives, tax groups, and many more are expected to join this most certain battle that the California electorate has not faced since the passage of Proposition 13 in 1978.

So, what does the commercial real estate sector have to lose? **BILLIONS OF DOLLARS.**

The California Political Consulting Group provides lobbying, legal and consulting services for business and trade associations.

Ronald M. Kingston is an accomplished lobbyist in California. He has successfully written numerous legislative measures relating to housing, building, real estate finance, real estate disclosure, environmental hazards and new construction standards. He has a long and accomplished track record representing landlords, REALTORS®, the finance industry, judicial council, homeowner associations and many other interest groups and businesses.

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