



DATE: September 29, 2020

TO: Mayor and City Council

FROM: City Manager

SUBJECT: Adopt a Resolution in Support of California Proposition 15, Tax on Commercial and Industrial Properties for Education and Local Government Funding Initiative

RECOMMENDATION

That Council adopts a Resolution (Attachment II) in support of Proposition 15, which is on the November 2020 ballot.

SUMMARY

Staff requests that Council consider adopting a resolution supporting California Proposition 15 (Proposition 15), the 2020 constitutional amendment to increase funding for K-12 public schools, community colleges, and local governments by requiring that commercial and industrial real property be taxed based on current market value.

BACKGROUND

California local governments levy property taxes on real property and business personal property based on the value of their property, resulting in a key discretionary revenue source for local governments. Property taxes raise around \$65 billion annually for local governments, about \$2 billion of which is attributable to business personal property. Specifically, cities receive about \$13 billion in property tax revenues yearly. For the average city, property taxes are about 15 percent of total city revenues, and about 40 percent of general fund revenue (varies widely). For cities, property tax remains amongst the most stable local and discretionary revenue sources. Cities also depend to varying degrees on locally imposed taxes such as the transient occupancy tax, business license tax, and utility user tax.

Passed in June 1978, Proposition 13 capped local property taxes levied by cities, counties, schools, and special districts at one percent of full cash value which is based on the full cash value at the time a property is sold. The sale of the property establishes a base-year, and the property tax assessment cannot increase by more than two percent annually. Since property values often increase by more than two percent

annually, property owners receive an additional benefit when they hold their properties for a longer period. Proposition 13 treats commercial property the same as residential property.

DISCUSSION

Under Proposition 15, most owners of commercial land and buildings with a market value of \$3 million or more would be subject to higher property taxes, phased in over the first four years of implementation, which would begin on January 1, 2022. The change from the purchase price to market value would be phased-in beginning in fiscal year 2023.

Overall, estimates indicate that property taxes generated as a result of Proposition 15 will range from an additional \$6 billion to \$11.5 billion annually after full implementation has taken place beginning in 2025. With 60 percent allocated to local agencies (cities, counties, and special districts), an agency's share will depend on several factors including the amount of new taxes paid by commercial properties in their jurisdiction and will be tied directly to assessed (market) valuation. The remaining funds would be distributed 11 percent to community colleges and 89 percent to public schools, charter schools, and county education offices.

There are some known potential challenges and/or unintended impacts:

1. The Alameda County Assessor's Office has stated that there are not enough licensed and qualified assessors in the state to implement this change over the stated period of implementation.
2. It is truly unknown and unquantifiable the impacts this could have on corporations potentially coming to or leaving the state after this change.
3. Properties, such as retail centers, whose occupants are 50 percent or more small businesses would be taxed based on market value beginning in fiscal year 2026. Proposition 15 would define small businesses as those that are independently owned and operated, own California property, and have 50 or fewer employees.

Additionally, Council is aware that there are drawbacks and loopholes that are exploited in Proposition 13; these will not go away in the residential area and there will likely be loopholes found in the proposed Proposition 15.

The League of California Cities has not taken a position on the Proposition 15, which is likely because of potential negative impacts this change could have on funding for schools in communities that do not have a significant commercial and industrial property tax base subject to the proposed Proposition 15.

Support of Proposition 15 is consistent with the Council's adopted legislative goals as it helps to secure and increase the City's tax base.

FISCAL IMPACT

Estimating the impacts of potential increases to revenue for the City should voters approve Proposition 15 is difficult. Blue Sky Consulting Group made an estimation of over \$15 million in additional revenues annually for the City. This estimation, however, is based solely on estimates published in a report from the USC Dornsife College of Letters, Arts & Sciences in February 2020 called *Getting Real about Reform II: Estimating Revenue Gains from Changes to California's System of Assessing Commercial Real Estate*. Staff does not feel that this is an accurate estimation based on many factors that are either not being taken into consideration or are currently unknown.

First, this does not consider the potential impacts to other City revenue sources such as Vehicle License Fees, for which the growth used to calculate the annual change in this revenue source shall not include the additional assessed valuation that results from the application of Proposition 15. This means this source will likely stay tied to Proposition 13 assessed valuations. Potential impacts to properties inside former redevelopment areas, for which incremental growth shall not be factored into any division of taxes or calculation of growth for treatment of tax increment and shall not be diverted in any manner whatsoever means that tax increment in these areas will not change from 2020 levels under Proposition 15 as they would normally grow up to 2% annually. Additionally, committees from the State Legislative Analyst's Office, State legislative committees, and State auditor will need to be formed to develop the methodology for allocation of the additional revenue. All of these factors make it very difficult to estimate the fiscal impact to Hayward.

Property Taxes are the single largest source of revenue to the City's General Fund, currently accounting for over 33 percent of budgeted revenues in FY 2021, even an incremental change could have a great impact on the City's General Fund.

NEXT STEPS

If Council adopts the attached resolution, staff will distribute the signed resolution to the appropriate bodies, as well as post a copy of the resolution on the Legislative Program website.

Prepared by: Terence Candell, Management Fellow

Recommended by: Laurel James, Management Analyst

Approved by:



Kelly McAdoo, City Manager