CITY OF PACIFIC GROVE

300 Forest Avenue, Pacific Grove, California 93950

AGENDA REPORT

TO:	Honorable Mayor and Members of City Council
FROM:	Thomas Frutchey, City Manager
MEETING DATE:	August 6, 2014
SUBJECT:	Resolution supporting commercial property tax reform to lessen adverse impacts of Proposition 13 on the City's financial stability
CEQA:	Does not Constitute a "Project" per California Environmental Quality Act (CEQA) Guidelines

RECOMMENDATION

Adopt a resolution supporting commercial property tax reform to lessen adverse impacts of Proposition 13 on the City's financial stability.

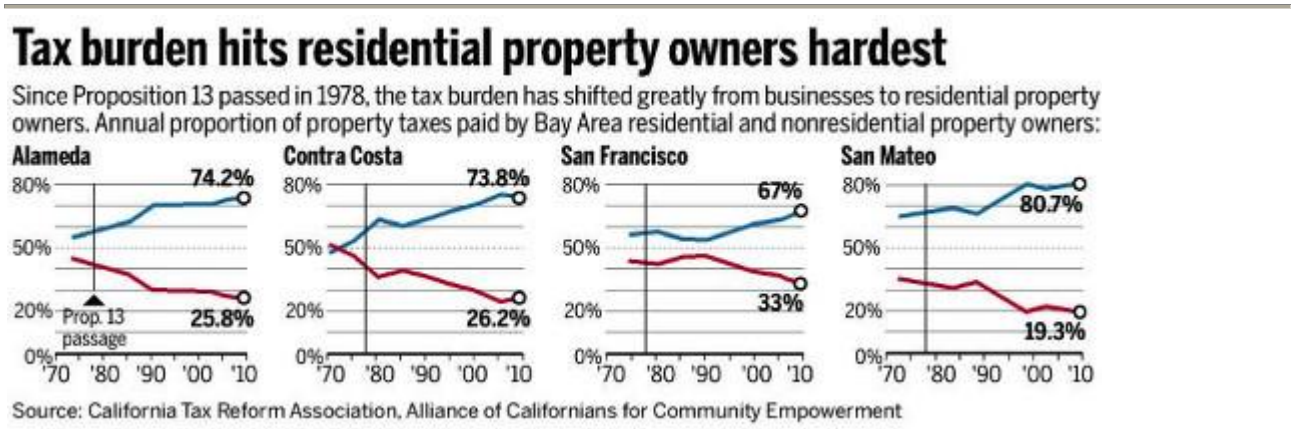
DISCUSSION

Property taxes are one of the primary sources of revenue for local governments. Property taxes statewide account for 30% of discretionary spending used for such local government services as public safety and infrastructure. In Pacific Grove, property taxes account for 25% of City General Fund revenues.

Proposition 13 was intended to prevent increases in property taxes that outpaced increases in wages. In the 36 years since 1978, it has made progress towards achieving that goal but has also increased the inequities in the State's overall property tax structure. Two inequities are primary:

The first inequity is between similar homes that receive similar City services but that have had qualifying events (such as a sale or issuance of a building permit) in differing years. Thus, two homes of equal value, occupied by families utilizing the same City services, can have markedly different assessed values and property taxes.

The second inequity is between residential and commercial properties. Before Proposition 13, 40% of local property tax revenue in California came from non-residential commercial property. Today, commercial property accounts for only 28% of California's property tax revenue, while home and apartment owners contribute 72% of total property taxes. (Because property taxes from commercial properties are accounted for separately from property taxes from residential properties, this is called a "split [tax] roll.")



Since commercial properties rarely change hands, they are rarely reassessed. For example, Disneyland is still paying property taxes based on a 1975 assessment.

Equity is one of the five basic criteria for evaluating a tax (along with stability, simplicity, neutrality, and ability to grow along with the economy and the responsibilities it is expected to fund.) Proposition 13 was fueled by the lack of stability in property taxes in the 1970s. Since local governments at that time could set their property taxes as they saw fit, voters were increasingly unhappy with the rapid rise in property taxes in many jurisdictions throughout the state.

Since 1978, however, for those residential and commercial properties not being reassessed, the revenues generated are falling behind the cost of the services the City provides. This was documented in the Fiscal Health Evaluation Report generated recently for the City by Magis Advisors (Attachment 2). In constant dollars, property taxes have declined from $3.5 to $3.3 million in the last three years alone.

With the passage of time, the two major inequities in property tax structure in the City are likely to further increase. Thus, although property taxes in the pre-Proposition era failed 1 of the 5 basic criteria (stability), they are now also failing 1 of the 5 basic criteria (equity). In solving one problem, the Howard Jarvis-inspired reforms have caused another. In addition, under Prop. 13, two identical businesses can pay very different property taxes. This puts certain businesses at a competitive disadvantage. It also inhibits growing businesses from moving to quarters more suitable to their size, thus stifling the growth of dynamic businesses.

Although Proposition 13 is generally considered the “third rail” of California politics, the City and the State need to acknowledge the problems that Proposition 13 and subsequent tax measures have caused, and seek to find solutions acceptable to the voters.

As part of the budget process this year and in subsequent years, the City needs to continue to emphasize that:

- property taxes are one of City’s three primary revenue sources (along with sales taxes and transient occupancy taxes);
- property taxes are designed to pay for basic services, including maintaining City streets, community amenities such as the Library, and providing public safety;
- as a result of Proposition 13 and subsequent tax measures, the system of property taxes in California has introduced several inequities into the tax code;

- only the voters can change Proposition 13; and
- it may be time in Pacific Grove to start considering measures that can address these inequities.

It should be noted that the City receives only a small portion of each parcel's property taxes. The failings associated with the current property tax system fall on each of the other local entities that are funded through property taxes, primarily the Pacific Grove Unified School System.

OPTIONS

1. Do nothing.
2. Direct staff to return to Council with additional steps that can be taken

FISCAL IMPACT

No impact from this action. Failing to address the problems associated with the current property tax system will continue to have a negative fiscal impact on the City.

ATTACHMENTS

1. Resolution
2. 2014 Pacific Grove Fiscal Health Evaluation regarding property taxes
3. Property Tax Fact Sheet
4. Los Angeles Times Article
5. Chamber of Commerce Letter opposing the Resolution

RESPECTFULLY SUBMITTED,

Thomas Frutchey
City Manager

RESOLUTION NO. 14-xxx

A RESOLUTION OF THE CITY OF PACIFIC GROVE REGARDING THE SPLIT PROPERTY TAX ROLL AND CALLING FOR THE REGULAR REASSESSMENT OF NON-RESIDENTIAL PROPERTY

WHEREAS, Proposition 13, passed in 1978, allows reassessment of properties for property tax purposes only upon change in ownership or significant remodeling;

WHEREAS, commercial properties in the state are sold, on average, much less frequently than residential properties;

WHEREAS, over time, this means the property tax burden is continually shifting from commercial properties to residential properties;

WHEREAS, in 1978, 40% of local property tax revenue in California came from non-residential commercial property and today, commercial property accounts for only 28% of California's property tax revenue, while home and apartment owners contribute 72% of total property taxes;

WHEREAS, this trend is only going to worsen if it is not addressed;

WHEREAS, cities throughout the state of California continue to face chronic budget crises in large part because Proposition 13 has forced them to rely on more volatile revenue sources than the property tax, like sales taxes paid by working families that move in tandem with economic cycles, causing deficits and requiring cuts to vital services that grow our economy and thereby worsening economic downturns; and

WHEREAS, regularly reassessing non-residential property would, according to an analysis of data provided by the California Board of Equalization, generate at least $6 billion in additional revenue for California, and better balance the tax burden between homeowners, renters, and working families with corporations and commercial landholders.

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF PACIFIC GROVE:

1. The foregoing findings are adopted by the City Council as though set forth in full.

2. The City Council supports commercial property tax reform that will require non-residential commercial properties to be reassessed regularly while maintaining Proposition 13 protections for residential property and small business owners; and

3. The City will communicate this position to locally elected officials in other jurisdictions and at the state level.

4. This Resolution shall take effect immediately upon passage.

PASSED AND ADOPTED by the council of the City of Pacific Grove this 16th day of July, 2014, by the following vote:

AYES:

NOES:

ABSENT:

APPROVED:

_____
BILL KAMPE, Mayor

ATTEST:

_____
ANN CAMEL, Interim City Clerk

APPROVED AS TO FORM:

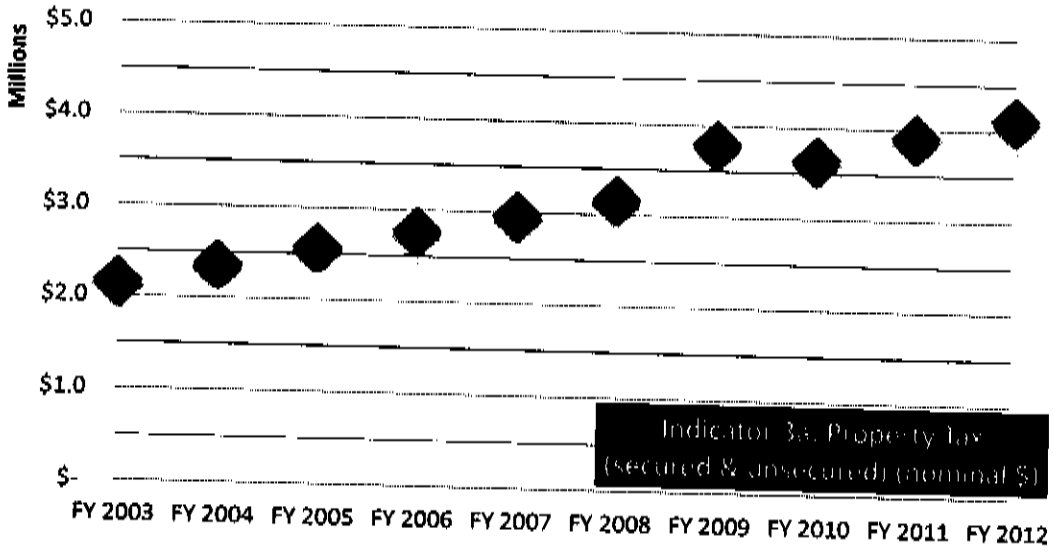
_____
DAVID C. LAREDO, City Attorney

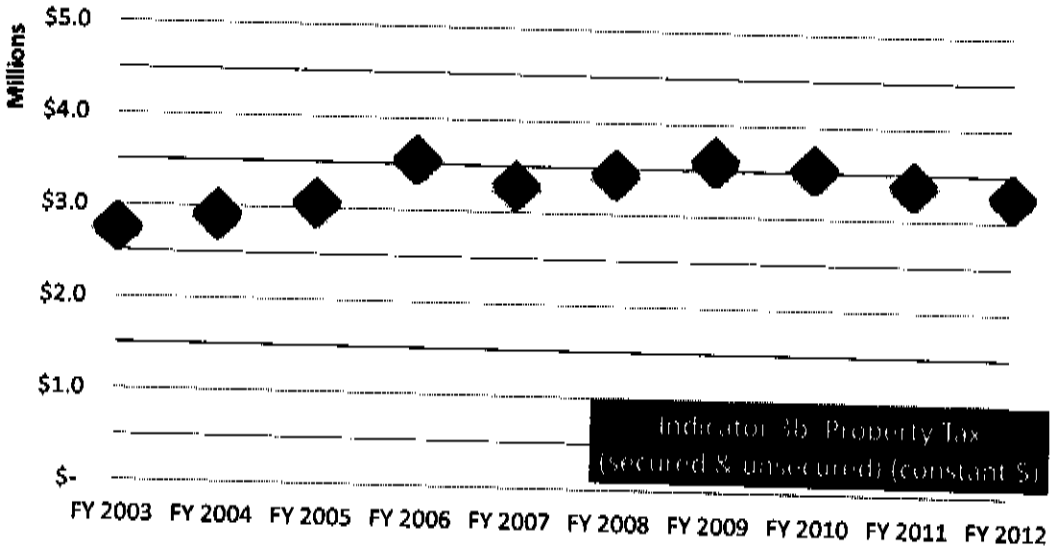
CITY OF PACIFIC GROVE

INDICATOR 3: PROPERTY TAXES

Explanation

Property taxes accounted for an average of 24% of the City's general fund revenues over the measurement period. The City's real estate transfer tax is included in this measure. The data is shown in both nominal dollars and constant dollars over the measurement period. The constraints imposed by Proposition 13 reduce the volatility of this measure. However, a population that skews older tends to be less mobile and property turns over less frequently, with the result that property tax growth occurs more slowly than in younger communities.





CITY OF PACIFIC GROVE

Property Tax Trend

After reaching a peak of $4.07 million in FY 2009, this measure declined to $3.9 million in FY 2012. This source averaged about $4.05 million (nominal) over the past three years. However, we observe that the measure has declined slightly (from $3.5 million to $3.3 million, constant dollars) over the past three years.

For further consideration:

The City may wish to consider investigating augmented property tax measures for services it provides that are clearly "property-related." Such augmented measures might include citywide Mello-Roos taxes, parcel taxes, and similar levies. These measures should be considered for those projects or services that have a clear "nexus" to property ownership.

Property Tax Funds Local Government

- Property tax revenue remains within the county it was collected and is used exclusively by local governments.

- Property taxes are a critical source for local discretionary spending. Statewide 30% of cities' discretionary revenue (public safety and infrastructure) come from property taxes.

- Prior to Prop 13 commercial real estate accounted for 40% of property tax revenue in California. Today only 28% of property taxes come from non-residential property.

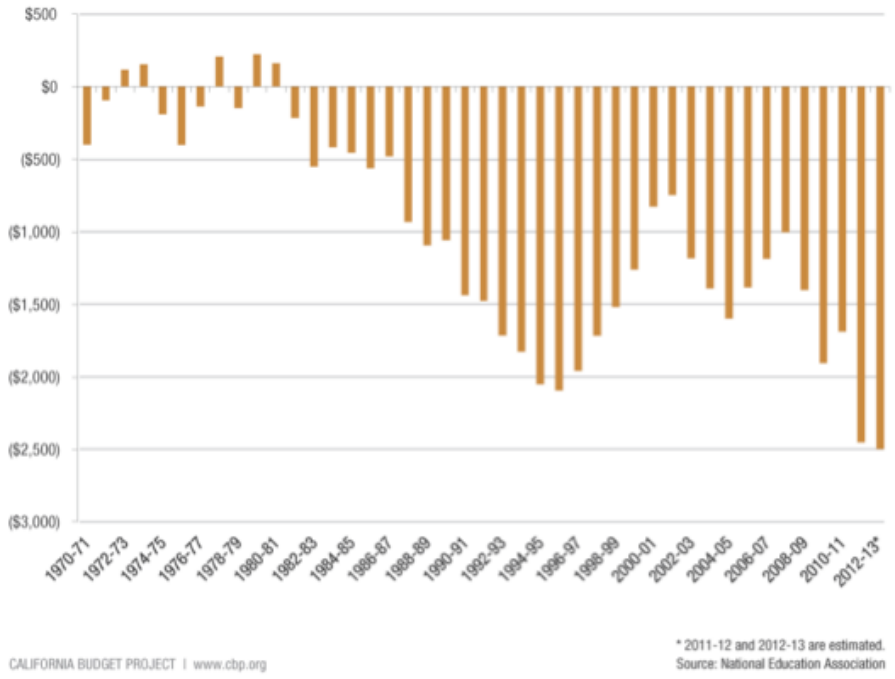
- Between 2001-2012 voters approved about 180 regressive parcel tax measures to fund cities, counties, and special districts. This negatively impacts working families.

Lack of Property Tax Revenue Hurts Schools

- California is 49th in the nation in per pupil spending as a share of income.

- From 2008-2012 Sacramento cut $2.65 billion from higher education funding. Tuition at UC doubled from 2007-2011 and doubled at CSU from 2005-2011.

CA K-12 Spending Per Student Minus K-12 Spending in Rest of US (2012-13 Dollars)



Los Angeles Times

Corporations get big edge in Prop. 13 quirk

May 05, 2013 -- Jason Felch and Jack Dolan

In 2006, billionaire computer magnate Michael Dell, one of the world's richest men, agreed to pay $200 million for the Fairmont Miramar Hotel, a beachfront landmark in Santa Monica that long has been a retreat for Hollywood starlets and U.S. presidents.

A few months later, Dell tore up the contract. He still wanted the hotel. But his attorneys had found a simple way to reshuffle the deal to avoid a legal change in ownership.

The maneuver saved about $1 million a year in property taxes -- an option available only to businesses, not homeowners, under the arcane rules governing Proposition 13.

The Miramar deal illustrates how businesses can easily -- and legally -- avoid property tax hikes under the California ballot initiative passed in 1978. As a result, the state loses tens of millions of dollars in revenue each year, officials estimate.

Voters overwhelmingly approved Proposition 13 out of a concern that homeowners, particularly the elderly, would be forced from their houses by rising tax bills during a real estate boom. The law ensured that property taxes were pegged at 1% of purchase price, assessed value could rise no more than 2% per year, and property was reassessed to full market value only when sold.

But large corporate property owners have been among the law's biggest beneficiaries, thanks in part to loopholes such as the one Dell used.

Essentially, the law allows businesses to sidestep reassessment if no one acquires a majority stake in a company that owns the property. Dell did that by bringing in his wife and two of his investment advisors as partners -- with no one taking more than 49% control of the hotel company. With no change in ownership, it continued to be taxed based on the 1999 property value of $86 million.

Los Angeles County assessors concluded it was a blatant tax dodge and raised taxes on the property.

A Superior Court judge disagreed, finding last December that the deal met the letter of the law. The county has filed an appeal.

Dell declined to comment. If he prevails, he will save more than $1 million a year, and taxpayers will probably also owe him more than $2 million in tax refunds and legal fees.

Christopher Thornberg, founder of research firm Beacon Economics and a former economist at UCLA Anderson Forecast, says the state has only itself to blame: "He didn't do anything wrong. He's saying to California: Look, idiots, I just robbed you blind, and it's your own fault."

Shifting tax burden

Passed 35 years ago by more than 65% of voters, Proposition 13 remains highly popular among property owners.

But during that period, the tax burden has steadily shifted from businesses to homeowners. In Los Angeles County, for instance, homeowners have gone from paying a 40% share of the total in 1975 to 57% today.

That shift is fueling efforts by some Democrats to tinker with Proposition 13. Eight separate measures were introduced this session. One, intended to close the loophole used by Dell, was recently tabled amid complaints by businesses that it was "a job killer." The others remain long shots.

Public support is growing, however, for a more sweeping change. A December poll by the Public Policy Institute of California found that 58% of likely voters favor a so-called split roll, in which commercial properties would be reassessed periodically regardless of their ownership.

The change would require a popular vote to amend Proposition 13, which is enshrined in the state Constitution, and would probably meet a wall of opposition from business owners, who complain they are overtaxed in California as it is.

For now, state and local officials are bound by rules that even some architects of Proposition 13 warned were ripe for abuse.

A year after Proposition 13 passed, state leaders began to grapple with the meaning of three words in the initiative: "change of ownership."

In the case of a single-family home, the change is obvious: A new deed is filed with the county recorder, triggering a reassessment. The property is then taxed based on its current market value.

But the transfer of business properties is more complex. What changes hands often is not the property but control of the legal entity -- a corporation, limited liability company or limited partnership -- that owns the real estate. In those cases, no new deed is filed.

A legislative task force searched for a bright line signaling a transfer and concluded that there were only two choices.

One was to require reassessment when a new company bought the property outright. The limitation of that was that it would capture too few transactions. The other method would require it when a single person or entity took control of more than 50% of a company that owned the property -- the majority-ownership rule.

Adopting the majority-ownership rule would lead to "monumental" enforcement problems, the task force warned: "No one, no matter how skilled and imaginative, can foresee ... every possible form of real property transfer."

But the Legislature adopted it anyway, concluding it was the better of two imperfect solutions.

Today, the Board of Equalization relies on businesses to accurately disclose changes in majority ownership. Assessors sometimes scan newspapers for big deals the board might have missed.

Often, buyers take majority ownership because other business advantages outweigh the tax benefit.

But the Miramar deal is not the only instance in which a wealthy buyer has used the majority-ownership loophole to save millions.

In 2002, E&J Gallo, the world's biggest winemaker, purchased Louis M. Martini, which owned more than 1,000 acres of prime Napa and Sonoma County vineyards. None of the property was reassessed because Martini was divided among 12 Gallo family members, none of whom acquired more than 50%.

Some of that property today is worth more than $150,000 an acre but continues to be taxed based on its 1975 value of a few thousand dollars an acre, according to Napa County assessor John Tuteur.

In 1998, a Canadian skiing conglomerate bought 58% of Mammoth Mountain resort, which had been family-owned for years.

The new owner, Intrawest Corp., argued that the property should not be reassessed because the deal did not give it a majority of the voting rights in the company.

The county assessor concluded that challenging the ski resort in court would be too costly.

In 2005, it changed hands again. This time, the buyer bought majority control and paid for it in property taxes: The assessed value almost doubled, bringing in an additional $1 million in annual revenue for Mono County.

Texas tax fight

At the time Dell bid for the Miramar hotel with its 10-story tower and poolside bungalows, Forbes listed him as the 12th-wealthiest person in the world. His fortune was estimated at $17 billion.

He had never been a fan of property taxes. In the 1990s, Dell had a protracted fight with the city of Austin over the value of his 22,000-square-foot mansion.

The county appraised its value at $22.5 million, but Dell appealed, arguing it was worth $6 million at most. Eventually the two sides settled upon a value of $12 million.

In 2006, Dell reduced the annual tax bill on his Texas ranch from $580,000 to $1,300 by qualifying for a wildlife exemption, which required him to feed wild turkeys and hunt white-tailed deer on the 1,700-acre property outside Austin.

He bid that same year for the Santa Monica hotel.

After discarding the first contract, Dell arranged for three partners to buy Ocean Avenue LLC, the holding company that owned the hotel. A firm owned by Dell acquired 42.5%. His wife Susan's trust acquired 49%. And a company set up by two of Dell's investment managers acquired the remaining 8.5%.

Dell reported to state tax officials that there had been no change in ownership. The Los Angeles County assessor's office learned of the deal after reading about it in The Times.

Staff members asked a lawyer at the Board of Equalization whether they could consider the deal a change in ownership. When the answer was no, the county decided to reassess anyway and raised the hotel's taxes.

In a hearing before the Assessment Appeals board, county counsel Albert Ramseyer argued that the Dells plainly took control of the property from the seller. He urged the board to "use common sense."

Dell lawyer Christopher Matarese responded that common sense is not the standard. He pointed to Revenue and Taxation Code section 462.180(d)(s), which says that a husband and wife can acquire 100% control of a property with no change of ownership as long as they split it 50-50.

"This court should not undo almost 40 years of change in ownership legislation because the assessor thinks the law is 'too good to be true,'" argued Matarese.

In December 2010, the Assessment Appeals Board ruled for the county, concluding Dell retained "ultimate control" of the hotel and had concocted the partnership to avoid reassessment.

Dell took the county to Superior Court. Five months ago, Judge Joanne B. O'Donnell struck down each of the assessor's arguments and ordered the county to refund his taxes and pay Dell's legal fees.

As Los Angeles County pursues its appeal, Dell's team has announced new plans for the Miramar: a massive remodel that would a dd a 21-story tower, making it Santa Monica's second-tallest building.

Local activists flooded a recent City Council meeting to object, saying it would turn Santa Monica into Miami Beach.

To bring neighbors around, Dell's team has touted the economic benefits of the plan, saying it would "generate important new revenue for Santa Monica ... money that will support our police, fire, schools and parks."

PACIFIC GROVE
CHAMBER OF COMMERCE
& TOURIST CENTERS

July 15, 2014

To: Pacific Grove City Council
From: Moe Ammar - Pacific Grove Chamber of Commerce
Subject: City Council Agenda Item No. 6A Commercial Property Tax Reform - Proposition 13

Introduction
Based on input from chamber members, this is the first time that the chamber is pulling an item from the consent agenda.

Discussion
On behalf of our members and the business community we are requesting the City Council to consider the below facts in the decision making process:

1. Commercial properties generate a lot more than property taxes. Sales tax, business license tax, and transient occupancy taxes are generated by commercial properties. A total of 27 commercial properties of inns, lodges, motels generate almost 3 million dollars in transient tax. It is not fair to evaluate commercial property taxes without considering the total taxes generated.

2. Commercial properties create jobs in the local community which are the driver of our economy

3. According to retired Senior Planner at City Hall Judy McLeland, only 6% of the City is zoned commercial. When considering inequities, please realize that 6% of the City zoning is responsible for producing an estimated 50% of the City's General Fund revenue.

4. Lack of growth in property taxes is directly related to zoning. For at least the past 25 years, the City of Pacific Grove has not expanded the commercial zone. Whereas the residential zone is influenced by new construction and remodel, the commercial zoning has remained stagnant.

5. All commercial property leases that we have encountered or handled, allow the property owner to charge the business owner for any and all taxes and fees levied by the State or City. Property owners will increase rent of small businesses.

6. Changes in the market as well as technology, encouraged home-based businesses that operate from residential properties. Annually, over 400 home-based business licenses are issued by the City. This reduced the demand for office space and devalued commercial properties. Are home-based business properties commercial or residential?

7. Five years ago the City approved vacation rentals of residential properties. Are the properties considered commercial or residential?

Valid Questions

We request the Council to ask the following questions

1. How will this resolution impact the City's overall economy?

2. How will this resolution impact future investments in the commercial sector? What is the impact on progress?

3. Who has studied the specifics and data of the impact?

4. What is the position of the City's appointed boards and commissions such as the Economic Development Commission, Business Improvement District or Hospitality Improvement District Advisory Boards?

5. Page 1 of the resolution, section 2, item 2 states that: "Non-residential commercial properties need to be reassessed regularly while maintaining Proposition 13 protections for small business owners". How will an increase in taxes and ultimately rent protect small business owners?

Closing

In the next few weeks, the chamber and City will be reaching out to the commercial property owners in order to seek support of downtown enhancements. We need the cooperation of the owners to further improve the business climate. Additional taxation is not an option. Residents and business owners are hopeful that State elected officials would reform the public employee retirement system before seeking taxation regardless of the source.

Thank you for your consideration and service to the people of Pacific Grove.

Sincerely,

Moe Ammar