California Commercial Property Tax Study, April 2004

From: California Tax Reform Association 2004 Study

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"…consistent evidence in the major counties that an increasing percentage of the tax burden has shifted to homeowners."

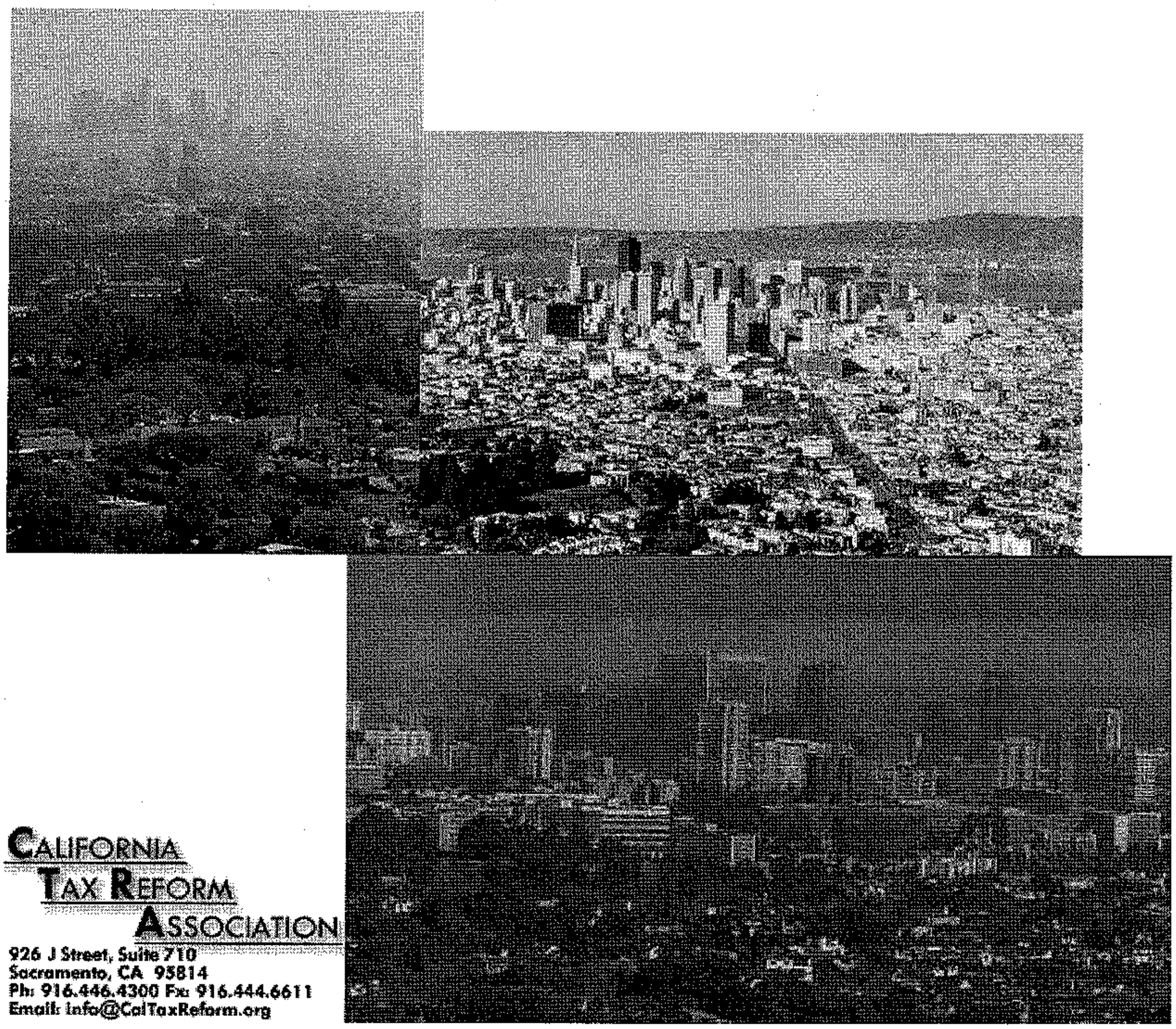
"…the percentage of the burden held by non-residential property has decreased"

"Data collected at the state level and several of the state's most developed counties…shows that the property tax burden has shifted from industrial properties to homeowners and other residential properties since the passage of Prop.13"

California Commercial Property Tax Study

Statewide Study Finds Huge Disparities in Property Taxes Paid for Similar Properties; Highlights Need to Reform System

April 2004



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About the California Tax Reform Association

The California Tax Reform Association (CTRA) is a non-profit organization based in Sacramento. CTRA has advocated for many years for fair taxes in the context of a healthy public sector. CTRA is primarily supported by labor, public interest, and education groups. CTRA has worked on most major tax policy issues since it was founded in 1976, with a focus on fairness and adequacy of the tax base. CTRA has been engaged in various ballot measures related to tax and fiscal policy, and has expertise in both the policy and political aspects of tax policy in California. For more information on CTRA projects visit our website at www.caltaxreform.org.

Acknowledgements

We would like to thank the PICO California Project for their financial support for this report and their commitment to legislation that seeks to reform the state's commercial property tax system. The PICO California project is a united effort of 20 California faith-based community organizations affiliated with the Pacific Institute for Community Organization, a national network of faith-based organizations.

We would also like to thank the county assessors and their staffs for providing the data that made this report possible as well as their input that made it a better study.

David Kersten of the California Tax Reform Association did the majority of the research which forms the basis of this report. It was written by Lenny Goldberg and David Kersten, with production assistance by Gina Lende.

The PICO California Project

CTRA

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I. <u>Executive Summary</u>

This study sought to examine the inequalities in property taxes paid by commercial property owners across the state in a post-Proposition 13 world. **The results show that huge disparities exist across the state among substantially similar properties and these disparities are likely to increase in the years ahead if Proposition 13, as it applies to commercial properties, remains unchanged.**

We also found consistent evidence in the major counties that an increasing percentage of the local property tax burden has shifted to homeowners. According to many assessors, the reason for this shift has been the significant rise in the value of single-family homes statewide, in part because of historically low long-term interest rates and the boom in the housing market. Whatever the reason, **the percentage of the burden held by non-residential property has decreased.**

In general, **we found that land values were far more disparate than building values**, for the high-value properties we studied. In many cases, particularly for hotels and for modern high-tech research and production facilities, the demands of competition required upgrading of the physical structures, which generated re-assessments to incorporate the value of the improvements. However, **the underlying land values continued to be grossly underassessed.** Depending on the timing of improvements, many similar buildings continued to have highly disparate values. The assessment disparities for older buildings were many times more than the disparities in rents between older and newer buildings.

One would expect the owners of more valuable properties to pay higher tax amounts but the results of this study show that the owners of substantially similar properties pay widely disparate amounts, with some disparities approaching multiples of **100 times** or more. And these disparities exist everywhere, from the streets of San Francisco's financial district to elite hotels in Beverly Hills and the sunny beaches of San Diego.

For example, the owners of the Luxe Summit Hotel in the Bel Air section of Los Angeles pay $0.22 cents per square foot of land in taxes while the owners of the Luxe Hotel Rodeo Drive—a nearby hotel—pay $7.46 cents per square foot of land in taxes, a disparity of **33.9x,** despite nightly room rates which are nearly identical. Another instructive example is the assessed value at Disneyland. There, land in the contiguous parcel but purchased at a later time is assessed at **12x** the adjoining land, with no discernible underlying differences.

To complete this study, the California Tax Reform Association gathered publicly available information from the county assessors' offices in Sacramento, San Francisco, Santa Clara, Los Angeles, Orange, and San Diego Counties. From this data, we were able to estimate the amount of property taxes that selected property owners pay per square foot of land and per square foot of structure. This information provided us with a standardized way to compare property tax amounts paid by property owners across the state.

These results highlight many of the problems we have long identified with the state's commercial property tax system. Specifically, the data shows that the current system:

1) Allows many business property owners to escape paying a fair property tax—that is, one which is commensurate with the market value of the property;
2) Puts many California business owners at a disadvantage relative to their competitors, who are paying far less for otherwise similar properties;
3) Taxes new investment, including improvements and equipment, at full market value while failing to tax the windfall land values which have accrued to longtime landowners whose property values benefit from the investment of others;
4) Costs state and local governments billions of dollars in revenues, while increasing the reliance of those governments on sales taxes and vehicle license fees.

Two bills, SB 17 (Senator Martha Escutia-D) and ACA 16 (Assemblymember Loni Hancock-D), introduced in the 2003-04 legislative session would reform the state's commercial property tax system and help ensure that businesses are once again competing on a level playing field.

II. Background for Study: "Change of Ownership" As the Basis For Reassessment

The state's current property tax system was created by Proposition 13—an initiative constitutional amendment approved by California voters in 1978. Prior to Prop. 13 property owners paid property taxes on the assessed value of their property at rate set by the counties. Properties were reassessed at market value on a periodic basis.

By the mid-1970s a booming real estate market, coupled with inflationary pressures, led to a situation where many homeowners, particularly elderly homeowners, complained that they were being taxed out of their homes and pressured the Legislature to act. Prop. 13 was designed to protect homeowners from huge annual increases in their annual property tax bills but also applies to commercial properties.

It rolled back the assessed values of properties to what their value was in 1975 and capped annual increases in the assessed value of properties at 2 percent a year unless "a change in ownership" occurs. Properties are reassessed and taxed on their full value of their property upon "a change in ownership." The initiative also capped county property tax rates at a maximum of 1 percent with an exception above the 1 percent rate for moneys needed to maintain voter-approved debt. (There have been other modifications and amendments since the passage of Prop. 13, in a variety of ways, but the basic system still functions as described.)

Tying the reassessment of property to a "change of ownership" has created a system where the owners of similar properties, whether residential or commercial, pay widely varying property taxes. Longtime property owners are locked in at a low base year (the last time the property was sold) and have their annual assessed values capped at an increase of no more than 2 percent a year. New market entrants, on the other hand, are taxed on the full market value of their properties. These disparities have grown over time.

While there is a plausible rationale for the homeowner protections Prop. 13 provides—namely, an explosive real estate market puts increasing burdens on homeowners which are not necessarily reflected in the income growth of the homeowner--the same cannot be said for its application to commercial properties.

III. **Problems with the Commercial Property Tax System**

In 1990, the California Tax Reform Association published a report, "Taxation with Representation: A citizen's guide to reforming Proposition 13" in which we argued that the major flaw in Proposition 13 is the way it treats non-residential property.

That flaw stems from two basic points which, as we have discovered from discussions and debates in the ensuing years, have never been refuted, nor has there even been a serious attempt to refute them. These flaws may be categorized as 1) economic, and 2) legal.

1. Economic Flaws. Commercial properties are investment properties whose purpose is to produce income for its owners. Offices, hotels, retail spaces, and industrial properties are owned for the generation of income in a competitive world. Given this, rational economics and sound tax policy demand a system where similarly-situated competitors pay similar taxes.

Because assessments are a function of the money to be earned from the property, the rationale for Prop. 13—protecting the taxpayer living in their home from unaffordable tax increases—does not hold true for investment properties. While there are numerous considerations that go into the assessment of commercial properties, they are generally assessed according to the value of the property and the stream of future earnings that the property is expected to generate. If assessments go up, it is because the stream of earnings from the property goes up, and therefore the tax is by definition affordable. If income from the property declines or the property becomes vacant, assessments go down based on potential earnings. By contrast, the homeowner's income has no necessary relationship to the assessment of their home, particularly for long-time homeowners and seniors.

Thus, when we observe in our study similarly-situated properties with a similar stream of revenues from rents paying widely differing taxes, we can infer that the level of taxation for the higher taxed property is not disproportionate in relation to income earned, and that the lower-taxed property bears a far less than proportionate burden. There can be no question of the affordability of the property tax for those properties which are closer to market value, and, for those receiving the tax windfall, no rationale for protecting them from assessment at market values.

In fact, land values are a function of the general conditions in the locale, including the investment of others than those of the landholder. Public sector infrastructure investment improves land values, as does the new investment of developers who contribute to the economic activity in the locale, and therefore the land values. Landholders thus accrue windfall land values, which go entirely untaxed. There is no justification in all of economic theory which holds that windfalls—called economic rents—should go untaxed while the burdens of taxation should fall more heavily on new investment.

We have also argued elsewhere (See "The Empire Has No Clothes", at www.caltaxreform.org) that the failure to appropriately tax land with development potential has the effect of distorting the land market and contributes to sprawl. This argument is based on the fact that there is no real cost of holding land off the market even when development is appropriate, and that such encouragement to speculation is an unfortunate result of our failure to capture rising land rents in our tax system. In fact, there are a substantial number of problems in the development process, including the ability of new investments to increase market values for old properties and therefore pay for new infrastructure, and the persistence of substantial development fees on new properties, which cannot be solved without rationalizing our irrational assessment system for commercial properties.

2. Legal Flaws. In summary, the concept of "a change of ownership" is highly inapplicable to the complexity of commercial property ownership. The complex ownership structure of many commercial properties allows many commercial property owners to exploit loopholes in the current property tax system that homeowners cannot take advantage of (See Appendix IV).

Ownership of commercial property is structured in many complex ways—publicly-traded corporations, partnerships, limited partnerships, limited liability corporations, family trusts, real estate investment trusts (publicly- or closely-held), and combinations thereof. When do such companies "change ownership"? It's difficult to determine and enforce, even with the tightest of laws.

A working group set up shortly after the passage of Prop. 13 drafted much of the state's current statutory laws defining what constitutes "a change in ownership"—the term Prop. 13 wrote into the state constitution but left up to the Legislature to define. After exploring many options, the group defined "a change in ownership" as a situation where one party takes control of more than 51 percent of the ownership interests in a property (Sections 61-64 et seq of the Revenue and Taxation Code). In addition, the law permits a property owner to reorganize its corporate form without reassessment (Section 62), provided the owners maintain the same ownership shares.

This statutory definition has remained in place ever since, despite growing evidence that a change of ownership, which triggers reassessment, can be easily avoided. For residential properties, changes in ownership can be easily tracked by county assessors because a new deed is recorded, and it is in the homeowners' legal and financial interest to transfer the deed and take ownership of the property.

Commercial properties, on the contrary, routinely change ownership without a deed being recorded. The vast complexity of the ownership structures and the many ways in which commercial properties can be held make it extremely difficult, if not impossible, for county assessors to enforce the law.

The law is also subject to endless manipulation by the taxpayer, which violates the basic precept of tax policy that tax laws should provide clear and known results to taxpayers. Buyers can avoid reassessment even if 100% of a property changes hands. Among egregious examples, in one transaction that took place in Napa County in 2001 where 12 shareholders of E & J Gallo Winery acquired the shares owned by approximately 20 shareholders of the Martini Winery, with the name changing and the deed changing, but since no shareholder bought over 50% no reassessment took place.

In addition, the Board of Equalization has reported ownership restructurings deliberately timed to coincide with periods of declining property values during recession so that a change in ownership was recorded, locking in the owners at a much lower base year value, in perpetuity. Properties owned by publicly-traded corporations never change ownership, even though their stock turns over many times, unless they are purchased outright and their stock is retired. Thus, many large corporations are assessed on what their property was worth in 1975 plus 2% a year—an extremely low amount compared to what the property is really worth. Since they have often made improvements in that time, it is the underlying land values which maintain their extremely low values, as the data presented below demonstrates.

Note on Residential Rental Property. We have excluded apartments and residential rental property from this analysis. Arguably, the same legal and economic concerns apply to residential rental property as to non-residential commercial/industrial property. Such property is held for investment purposes, and may have complex ownership structures not subject to easy application of change of ownership laws. However, many single family homes, units in a building, and condominiums may be rentals for some period and owned at other times, and would require reassessment upwards and downwards when owners move in and out.

Also, to the extent Prop. 13 is designed to protect residents, renters would receive a measure of protection from excluding residential rental housing from reassessment. Economic analysis would reflect that renters are already paying market value in rents, and therefore would not necessarily bear the burden of an increased property tax. However, major cities in the state—Los Angeles, San Francisco, San Jose, Oakland, and others—have rent controls in which increases could be passed on to at least some tenants.

IV. Summary of Data: Huge Disparities Found Across All Counties

(Note: For readers interested in detail on the methodology and data availability for this section see Appendix I, located after the conclusion)

The data collected from all counties studied demonstrate that that the owners of similar, and in some cases virtually identical properties, pay widely varying property tax amount on both the land and structure. The disparities in property taxes paid on the land are the most instructive, for reasons described above with regard to data availability.

Statewide, the disparities ranged between $0.004/sq. ft. of land for the IBM Silicon Valley Laboratory in San Jose to $16.55/sq. ft. of land for the Clift Hotel in San Francisco. Generally, we looked at disparities among similar properties, and across counties. The ranges of disparities are frequently on the order of 5x to 10x, with some comparable properties with far greater disparities, and others often in the difference range of 2x to 4x.

These differences bear little or no relationship to land values, or the value which investors receive from the property. In many, if not most, of these cases, land and property values may vary by as much as 50%. Office rents and hotel room rents vary far less than the tax differentials.

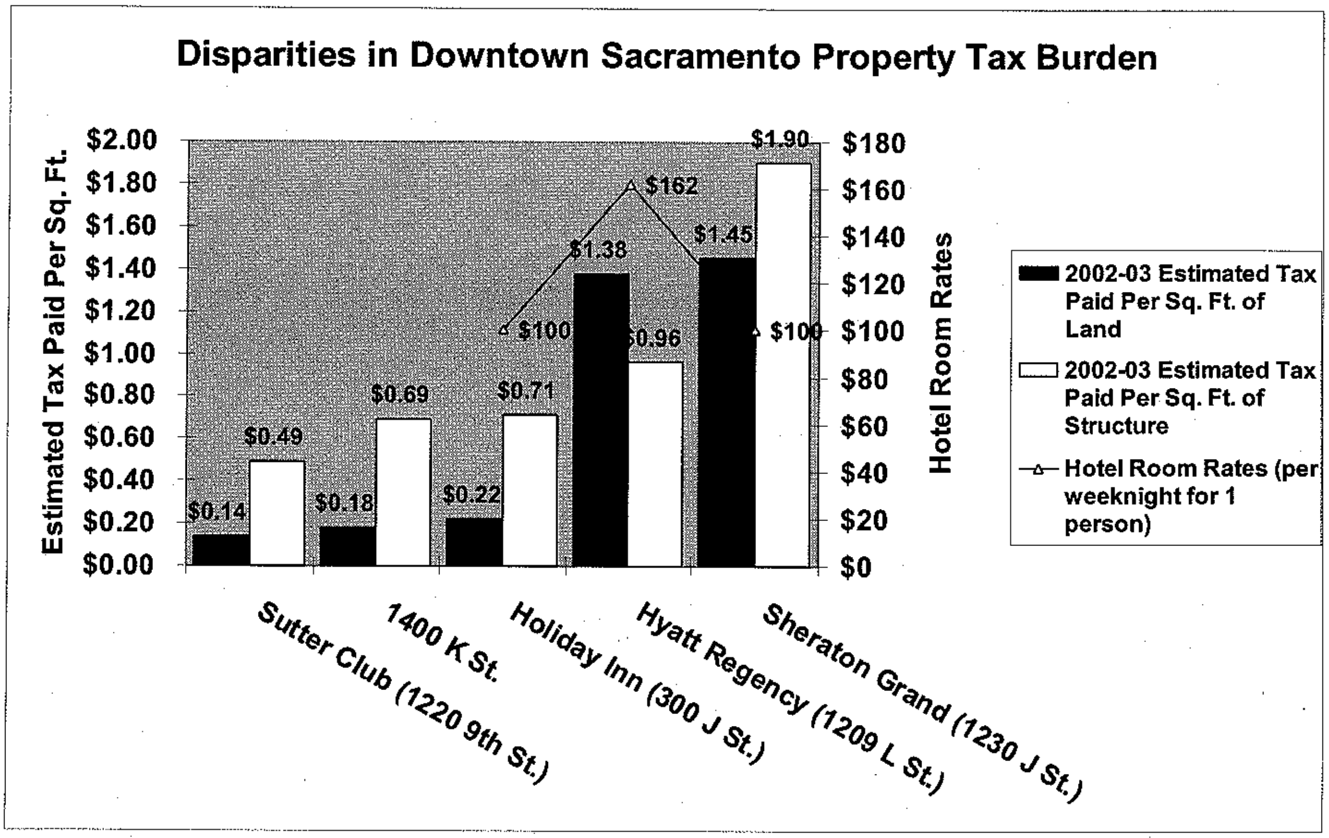
Let us now take a closer look at the county by county numbers.

Sacramento County

<u>Key findings</u>:

Downtown Sacramento was the first area studied and served as a pilot for the entire property tax study. Because of the relatively small downtown, we were able to identify clear disparities among similarly situationed properties and among competitors. Properties on Capitol Mall were paying widely disparate property taxes, as were hotels which clearly are competitive with one another. As our chart in Appendix II demonstrates, reassessment of just 6 undertaxed properties would bring in an estimated $548,000 to the county coffers.

Hotels: Three of the city's major hotels pay widely varying property taxes despite being in the same downtown area, with factors of **6.3x** and **6.6x** between the lowest and the other two.



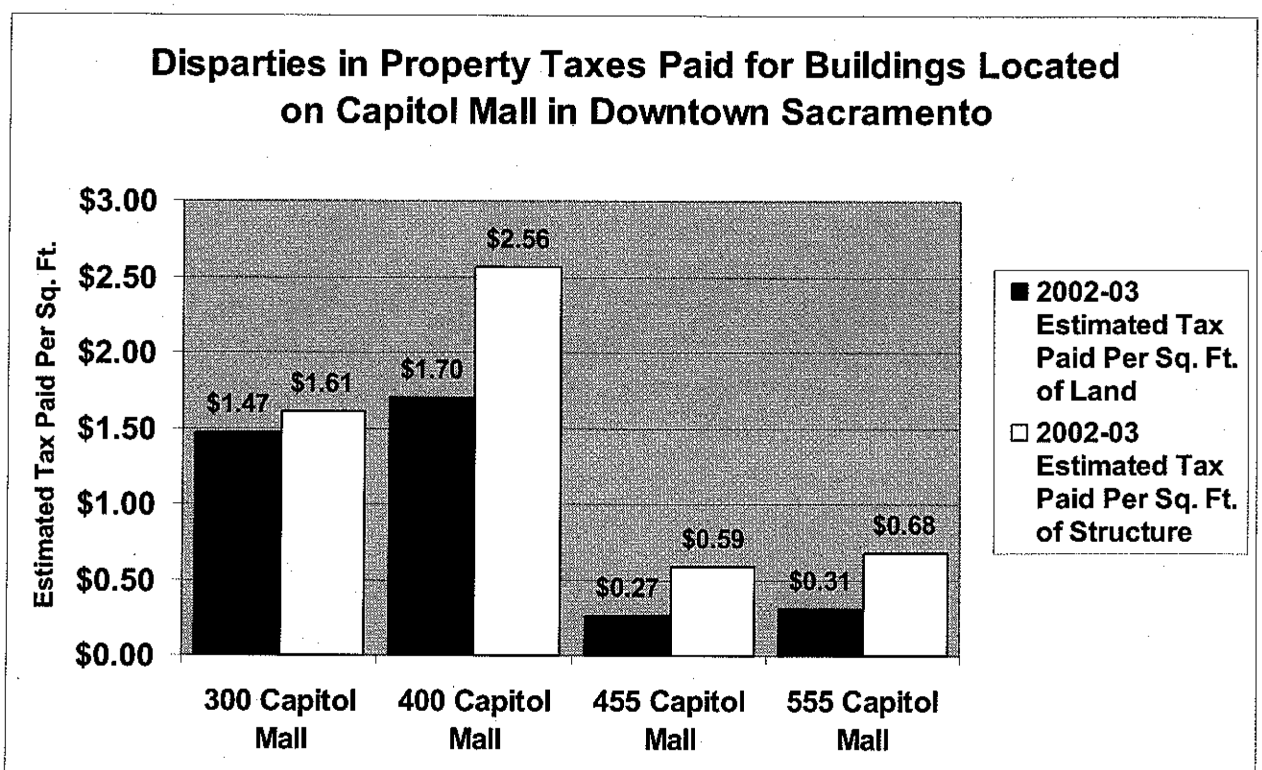
--The Holiday Inn Capitol Plaza (300 J St.) pays a mere $0.22/sq. ft. of land
--Hyatt Regency pays $1.38/sq. ft. (1209 L St.)
--Sheraton Grand pays $1.45/sq ft. (1230 J St.)

Property taxes on the hotel buildings were also found to vary by a factor of **2.7**, with the Holiday Inn paying $0.71/sq. ft., the Hyatt Regency paying $0.96/sq. ft. and the Sheraton Grand paying $1.90/sq. ft. These disparities stem from the fact that the Holiday Inn was last reassessed in 1978 compared to 1997 for the Hyatt and 1999 for the Sheraton.

The Hyatt, a relatively new hotel, was reassessed during a relatively deep recession in 1996, while the brand new Sheraton Hotel, was assessed during a booming economy in 2001. The room rates charged by the hotels do not appear to reflect the amount in property taxes paid on each hotel. A weekday room at the Holiday Inn and Sheraton Grand was found to charge $100/night compared to the $162/night at the Hyatt.

Downtown: The data confirms that similar disparities exist among various office buildings in the downtown area as well. The disparities on land reach **12.1x**. Values ranged between $0.14/sq. ft. paid by the Sutter Club (1220 9th St.) and $1.70/sq. ft. paid for the Wells Fargo Center (400 Capitol Mall). The Sutter Club is locked in at a 1975 base year while the Wells Fargo Center property was assessed at market value in 2000 (Note: the Sutter Club is "owned" by its members, mostly corporations, who have changed many times since 1975).

Taxes on the buildings ranged from $0.18/sq. ft. for an old office building located at 926 J Street and $2.56/sq. ft. for the Wells Fargo Center. The 926 J Street building has a 1975 base year value



for the main structure and a handful of other base year values for improvements to the building. Rents in these buildings vary by a factor of about **4x**, compared to the **14x** variation in tax.

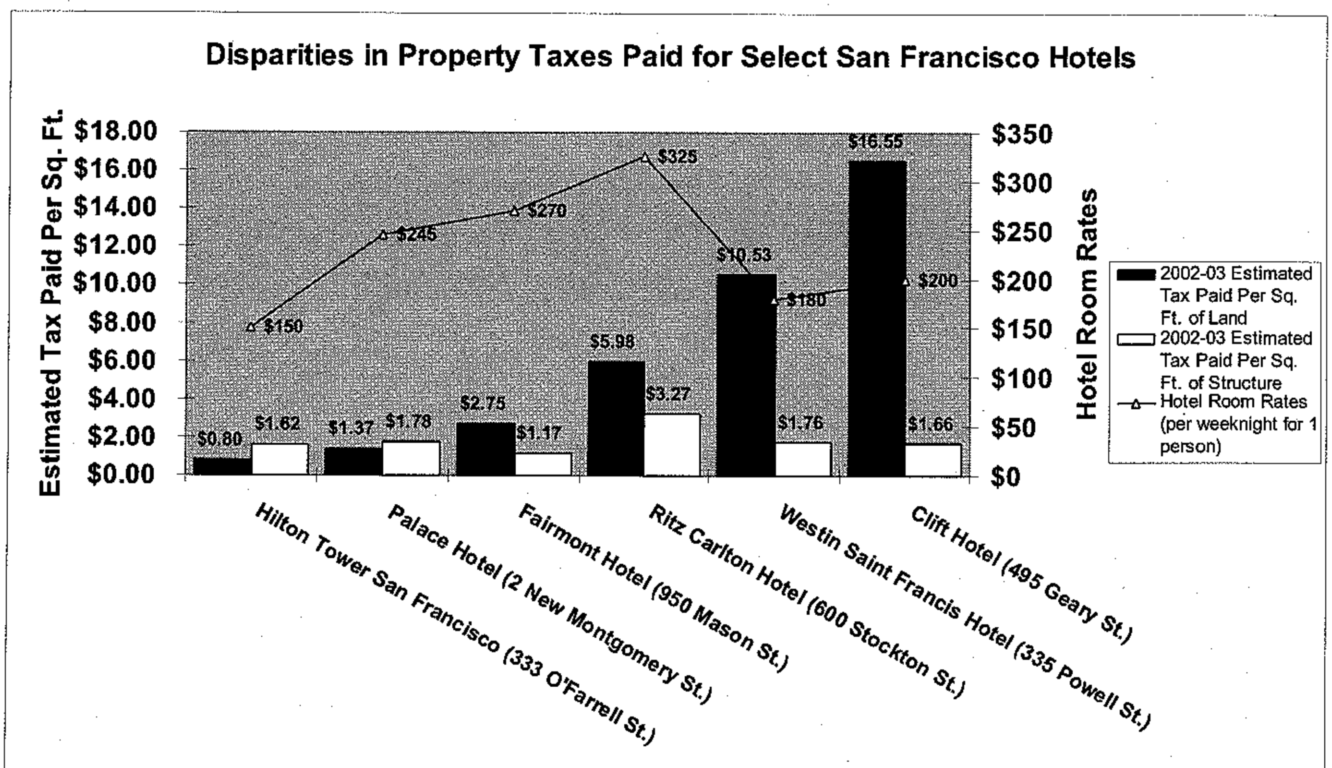
Properties very close in location varied by factors of **4.7x to 6.3x** on virtually identical land. On Capitol Mall, office buildings located at 455 and 555 Capitol Mall paid $0.27/sq. ft. and $0.31/sq. ft. of land respectively while two office buildings located just across the street at 300 Capitol Mall and the Wells Fargo Center at 400 Capitol Mall pay $1.47/sq. ft. and $1.70/sq. ft.

For the structures, the factors ranged from **2.7x to 4.3x**, with the office buildings at 455 and 555 Capitol Mall paying $0.59/sq. ft. and $0.68/sq. ft. of structure respectively compared to $1.61/ sq. ft. for 300 Capitol Mall and $2.56/sq. ft. for 400 Capitol Mall. The older buildings at 455 and 555 Capitol Mall have early base years, 1979 and 1975, while the new buildings at 300 and 400 Capitol Mall have 2002 and 2000 base years, respectively. Comparative rents for this office space are far closer than the differences in assessments.

San Francisco County

Key findings:

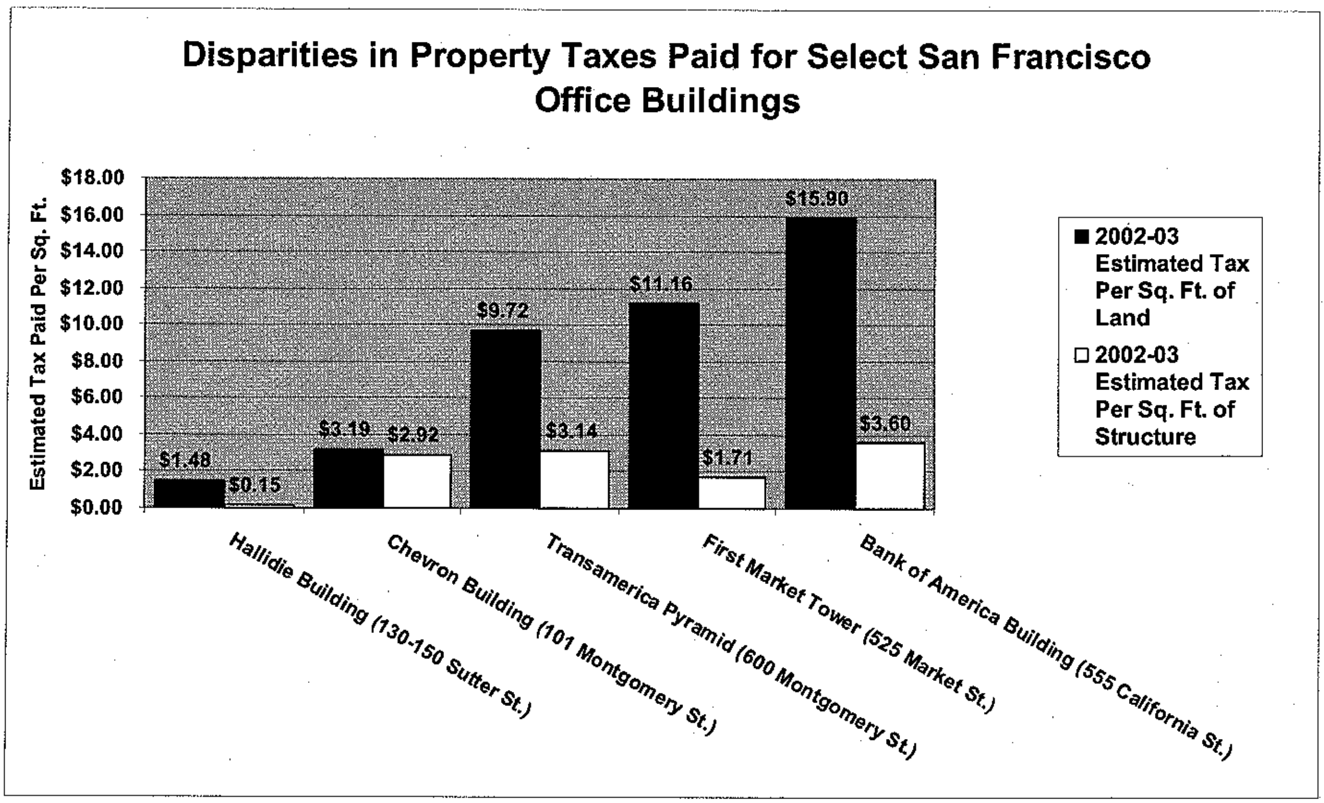
Of all the counties studied, San Francisco recorded some of the highest property taxes paid per square foot of land and structure, and some of the highest disparities. Some property owners paid as high as $16.00/sq. ft. of land while others paid less than a $1.00/sq. ft. By our rough estimates of just 6 undertaxed properties in the downtown area, San Francisco should recive $3.6 million in additional property taxes. Given the very high land values in the city, we would expect hundreds of



millions of dollars of additional revenue to the city and county from full reassessment of commercial property.

The Hilton Tower (333 O'Farrell St.) recorded the lowest value at $0.80/sq. ft. of land while the Clift Hotel (495 Geary St.) recorded the highest value at $16.55/sq. ft—an amount **20 times** that paid by the Hilton. The two hotels are located just around the corner from each other. The property taxes paid on the buildings were nearly identical with the Hilton paying $1.62/sq. ft. and the Clift paying $1.66/sq. ft. According to the San Francisco Assessor's office, the original hotel (completed in 1971) and most of land beneath the Hilton towers is locked into base years in the 1970s. Additional towers and structures were added to the hotel in the late 1980s and have corresponding base years. The Clift hotel, on the other hand, was completed in 1913 but reassessed upon a change in ownership in 2000. The room rates charged by the hotels are also similar with the Hilton charging $150/night and the Clift charging $200/night.

As for other hotel lots, the Palace Hotel (2 New Montgomery St.) paid $1.37/ sq. ft. of land followed by the Fairmont Hotel (950 Mason St.) at $2.75/sq. ft., the Ritz Carlton Hotel (600 Stockton St.) at $5.98/sq. ft., and the Westin Saint Francis Hotel (335 Powell St.) at $10.53/sq. ft., or differences of **7.39x** from lowest to highest. The room rates charged by each hotel did not correspond with the taxes paid on each property. The Palace Hotel charges $245/night compared to $270/night for the Fairmont, $325/night for the Ritz Carlton and $180/night for the Westin Saint Francis. As one can see by reviewing the graph, taxes on the structures did not vary nearly as much and did not correspond with the taxes paid per sq. ft of land (for example, property owners



paying high taxes per sq. ft. of land did not necessarily pay high taxes per sq. ft. of structure). Base years were only available for the Fairmont Hotel (1994) and Ritz Carlton Hotel (1999).

As for San Francisco office buildings, the historic Hallidie Building (130-150 Sutter St.) recorded the lowest tax amount at $1.48/sq. ft. of land followed by the Chevron Building (101 Montgomery St.) at $3.19/sq. ft., the Transamerica Pyramid (600 Montgomery St.) at $9.72/sq. ft., the First Market Tower (525 Market St.) at $11.16/sq. ft., and Bank of America Building (555 California Street) at $15.90/sq. ft. As with the hotels, the taxes per sq. ft. of structure did not vary as much and did not correspond with taxes paid per sq. ft. of land.

As expected, a property's base year is a good indicator of how much property tax is paid per sq. ft. of land. The historic Hallidie building has a 1975 base year compared to the Bank of America Building which has a 1994 base year. The base year for the land under the Chevron Building is unknown but must be pre-1984 because that is the base year of the structure. The Transamerica Pyramid has a 2000 base year, after recording a change in ownership in 1999. The first Market Tower has a 1998 base year, after being bought by Knickerbocker Properties Inc. in 1997. Among other examples, the disparity between the Chevron building and the Bank of America building is **10.7x.**

Santa Clara County

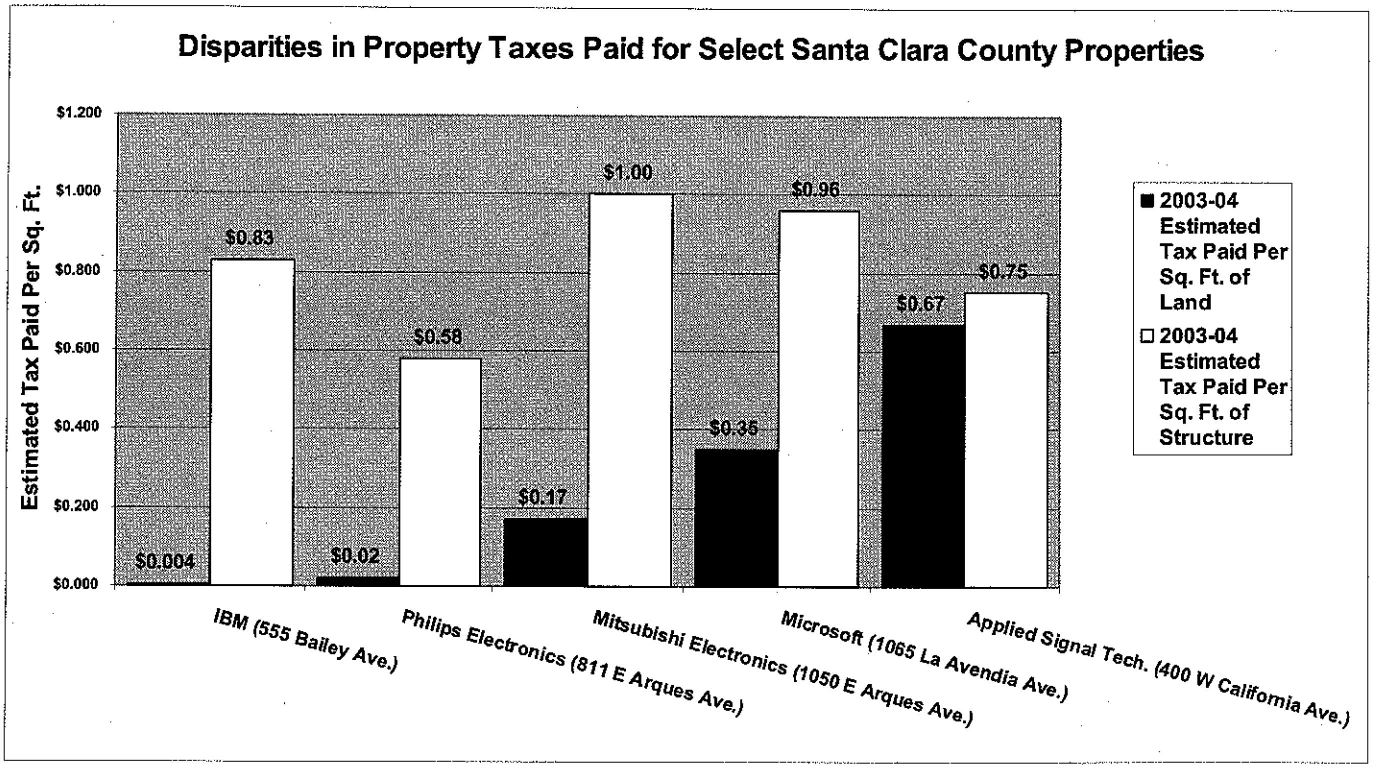
Key findings:

Despite recording far lower property taxes paid per sq. ft. of land than San Francisco, Santa Clara recorded greater disparities in property taxes paid with some property owners paying more than **487.5x** times the amount others pay. By our rough estimates, 14 properties, if brought to market value, would bring in about $4.9 million for Santa Clara county.

IBM Silicon Valley (555 Bailey Ave., San Jose) recorded one of the lowest property tax amounts of all the properties studied. The property, which has a 1975 base year, was taxed at a mere $0.004/sq. ft. of land compared to other Silicon Valley property owners who paid as much as $0.95/sq. ft. of land. Taxes on the structures ranged from $0.08/sq. ft. of structure for Storm Products (1400 Memorex Dr., Santa Clara) to $1.95/sq. ft. of structure for Nortel Networks (4655 Great America Parkway), or **487.5x** the amount paid by IBM.

A number of competing high-tech companies pay widely varying property taxes despite being located in close proximity to each other. Stanford University, one of the county's largest landholders, owns large tracts of land locked in at 1975 and 1976 base year values which are vastly underassessed. The University appears to lease the land to a number of companies, including the Epson Palo Alto Laboratory (3145 Porter Dr., Palo Alto), the Xerox Palo Alto Research Center (3333 Coyote Hill Rd., Palo Alto) and Hewlett-Packard (3000 Hanover St., Palo Alto). These properties are all taxed at between $0.02 and $0.10/sq. ft. of land. The structures were taxed at $0.22/sq. ft. for the Epson Palo Alto Laboratory, $1.46/ sq. ft. for the Xerox Palo Alto Research Center and $1.01/sq. ft. for the Hewlett-Packard facility (base years were not obtained for the structures).

The Philips Electronics property (811 East Arques Ave., Sunnyvale) is also taxed at a mere \$0.02/sq. ft. of land followed by the computer manufacturer Amdahl Corp. (1250 E Arques Ave., Sunnyvale) at \$0.09/sq. ft., Mitsubishi Electronics (1050 East Arques Ave., Sunnyvale) at \$0.17/sq. ft., Microsoft (1065 La Avendia Ave., Mt. View) at \$0.35/sq. ft. and Applied Signal Technology (400 West California Ave., Sunnyvale) at \$0.67/ sq. ft. The Philips Electronics land is at 1975 base



year. Base years were not obtained for the remaining properties. As one can see by looking at the graph, property taxes paid on the structures did not appear to correlate with property taxes paid on the land in most cases.

Similar disparities were recorded for the land beneath Silicon Valley hotels. Disparities ranged from \$0.05/sq. ft. of land for the Guesthouse Inn & Suites-Silicon Valley (2930 El Camino Real, Santa Clara) to \$0.95/sq. ft. for the Crowne Plaza Hotel (282 Almaden Blvd., San Jose), a differential of **19x.**

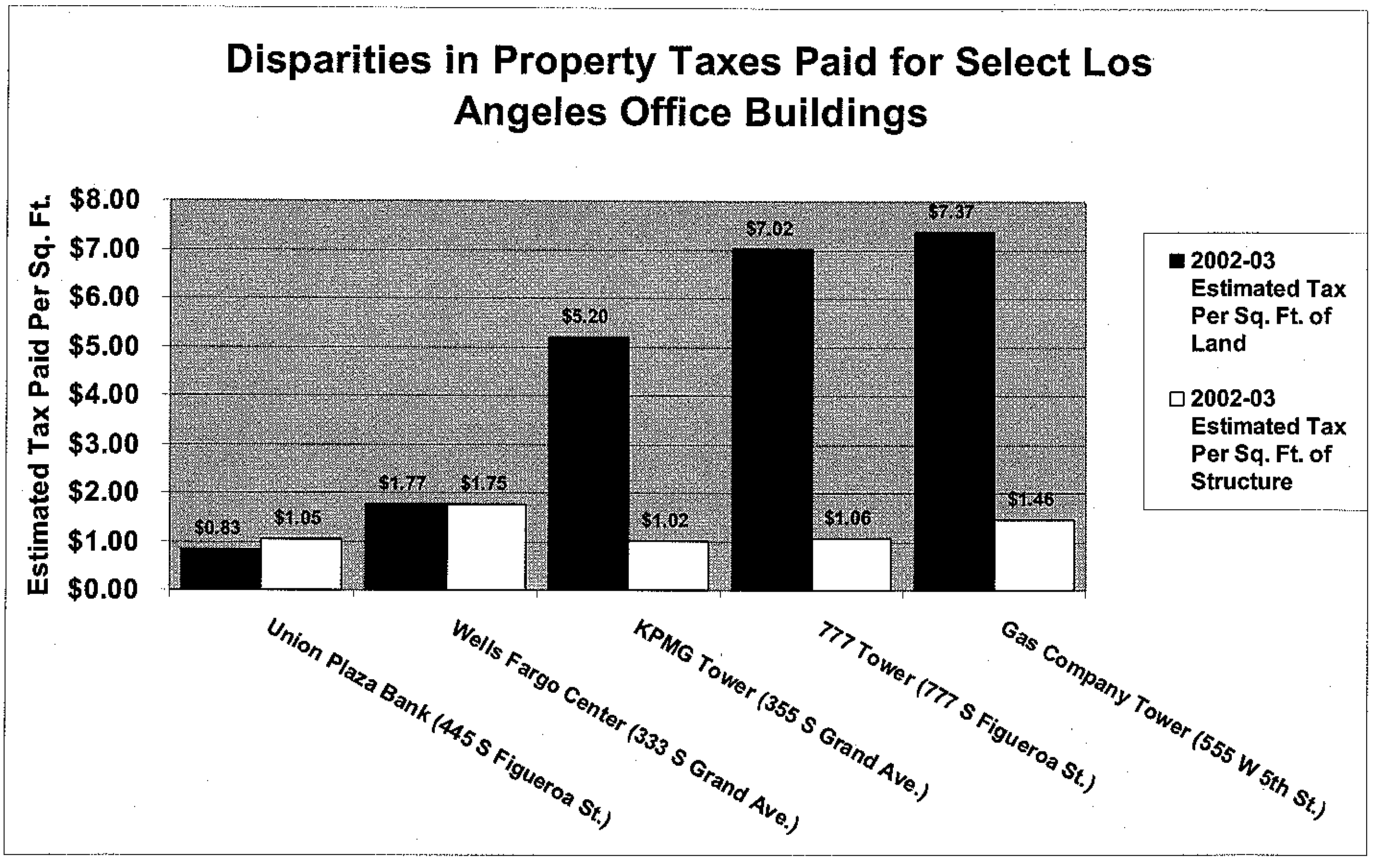
Los Angeles County

Key findings:

Highly similar properties in both downtown Los Angeles and among Westside hotel paid highly different tax amounts. We looked at similarly situated office building in the downtown, and relatively high-end hotels on the Westside. In-depth studies done by UC Davis and the Los Angelés

County Assessor identified property tax gains from non-residential reassessment in the range of $600 million (county assessor) to over $800 million (UC Davis).

For Los Angeles County as a whole, property taxes paid on the land varied from $0.22/ sq. ft. for the Capitol Records Building (1750 Vine St., Los Angeles) to $7.46/sq. ft. for the Luxe Hotel Rodeo Drive (360 North Rodeo Dr., Beverly Hills). Property taxes paid on the structures ranged from $0.26/sq. ft. for the Avalon Hotel (9400 West Olympic Blvd., Beverly Hills) to $3.36/sq. ft. for the Hotel Bel Air (701 Stone Canyon Rd., Los Angeles).



Based on our rough estimate of 18 undertaxed properties, we estimate that a market rate reassessment would generate about $17.7 million in additional property tax revenue.

In the downtown area, property taxes on the land varied from $0.51/sq. ft. for the Eastern Columbia Building (849 South Broadway) to $7.37/sq. ft. for the Gas Company Tower (555 W Fifth Street). In between these two extremes were the Union Plaza Bank (445 South Figueroa Street) at $0.83/sq. ft., Wells Fargo Center (333 South Grand Avenue) at $1.77/sq. ft., the KPMG Tower (355 South Grand Avenue) at $5.20/sq. ft., and 777 Tower (777 Figueroa Street) at $7.02/sq. ft. These office buildings are located just blocks from one another in the same real estate market, yet pay widely varying property taxes per sq. ft. of land. As for taxes on the structures, the historic Eastern

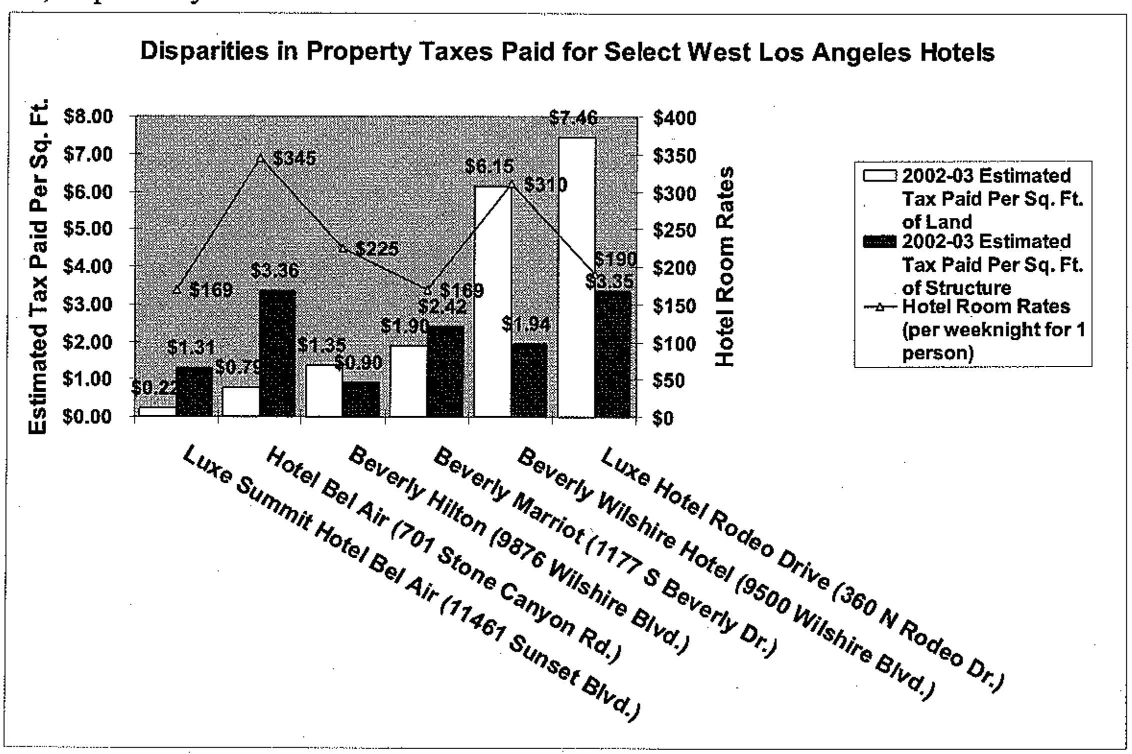
Columbia Building was the only real outlier at $0.04/sq. ft. of structure. Taxes on the remaining five downtown buildings ranged from $1.05/sq. ft. to $1.75/sq. ft. of structure.

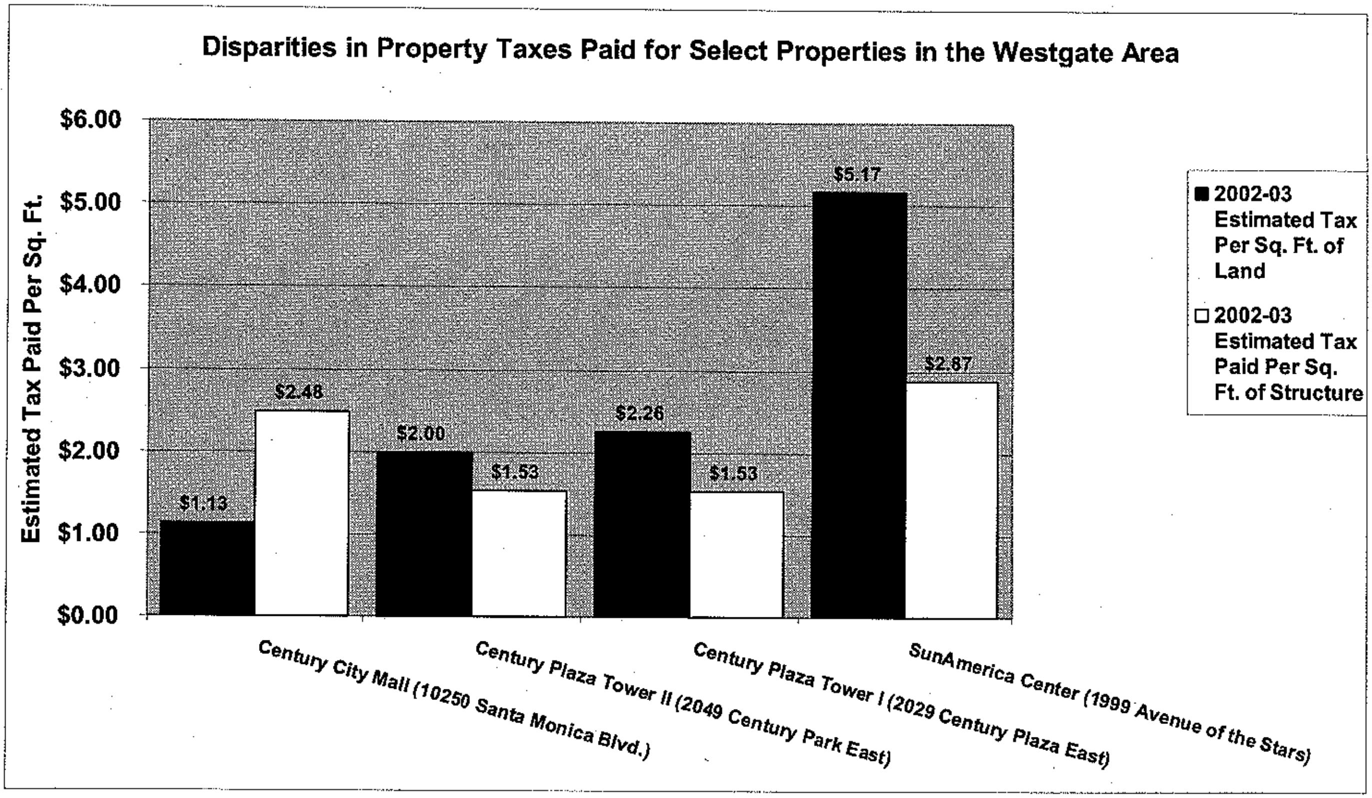
There were examples of properties located on the same street, even in the same block or within a few blocks of one another, that pay widely differing property taxes per sq. ft. Take South Figueroa Street for example. The Westin Bonaventure (404 South Figueroa), Union Plaza Bank (445 South Figueroa), and the TCW Tower (865 South Figueroa) paid $1.72, $0.83, and $1.33 a sq. ft. of land respectively, compared to the 777 Tower (777 South Figueroa) which paid $7.02/sq. ft. of land, a maximum differential of **8.5x**, and generally well over **4x**. Similar examples were found on South Broadway and South Grand Avenue.

In West Los Angeles, property taxes paid for hotels varied between $0.22/sq. ft. for the Luxe Summit Hotel Bel Air (11461 Sunset Blvd.) and $7.46/sq. ft. for the Luxe Hotel Rodeo Drive (360 North Rodeo Drive), a differential of **34x** more in property taxes/sq. ft. of land. In between these two extremes fell the Hotel Bel Air (701 Stone Canyon Road) at $0.79/sq. ft., the Beverly Hilton (9876 Wilshire Boulevard) at $1.35/sq. ft., Beverly Marriot (1177 South Beverly Drive) at $1.90/sq. ft., and the Beverly Wilshire Hotel (9504 Wilshire Boulevard) at $6.15/sq. ft. Most of these hotels are located in close proximity to each other, compete for the same clientele and have similar room rates.

Room rates ranged between $169/night for the Luxe Summit Hotel Bel Air and $345/night for the Hotel Bel Air. Taxes on the structures did not correlate with taxes on the land.

For properties located on the same block in the Westgate area, property taxes paid ranged from $1.13/sq. ft. of land for the Century City Mall (10250 Santa Monica Blvd.) and $5.17/sq. ft. for the Sun America Center (1999 Avenue of the Stars), a differential of **4.6x** for essentially the same land. The Century Plaza Towers I and II (2029 and 2046 Century Park East) paid $2.26 and $2.00/sq. ft. of land, respectively.





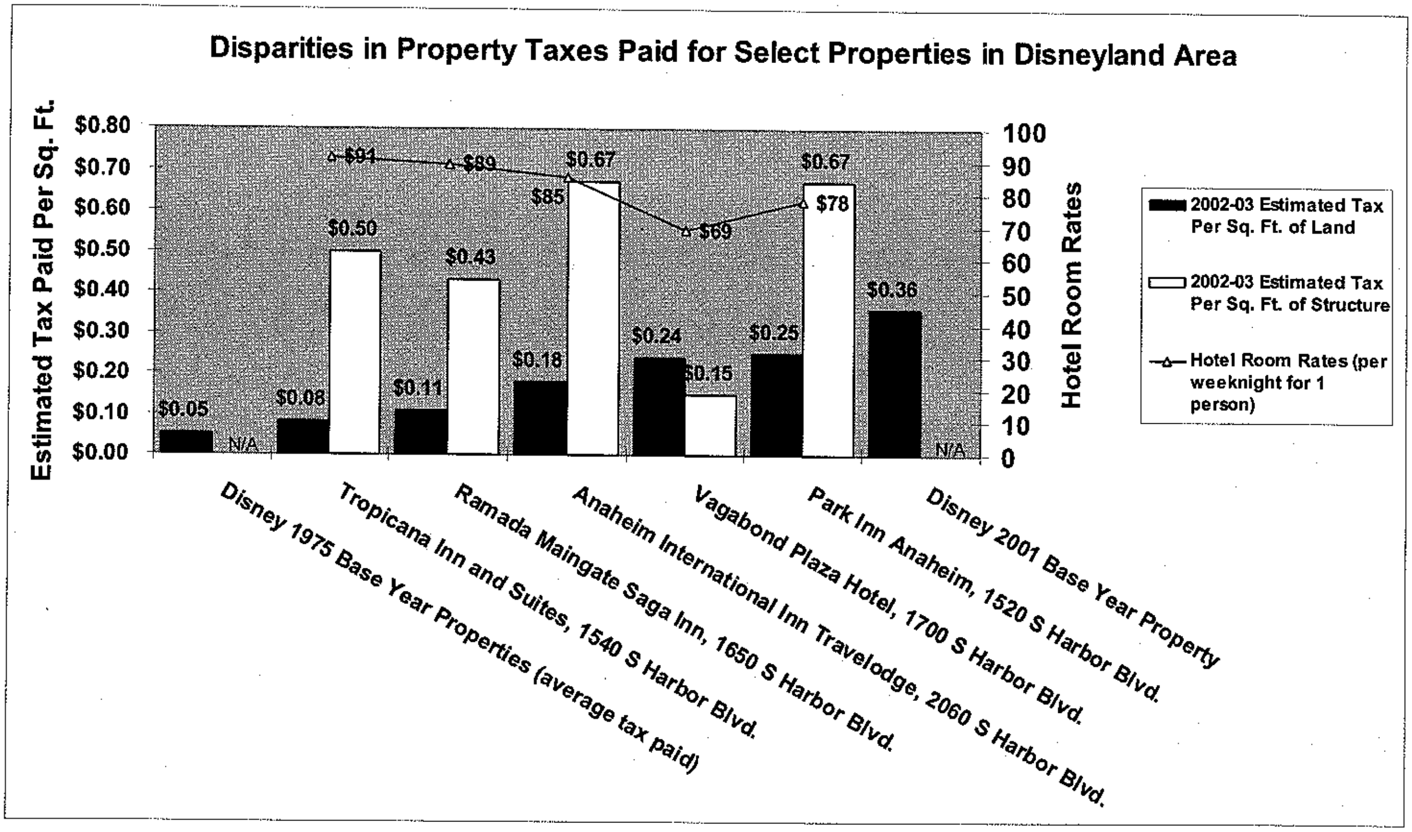
Orange County

Key findings:

Most of the properties studied in Orange County are located in the Disneyland area. Disney was found to be the largest landholder with property spanning more than 22 million square feet across some 50 different parcels. Rough estimates indicate that Disney would owe an additional $4.7 million in property taxes a year if all of the parcels were brought up to the current market value of other land in Disneyland.

The property was taxed at widely varying amounts per square foot with the differences tied to the year the property was purchased. Nearly one third of the land owned by Disney is locked in at 1975 base year values and therefore vastly underassessed. Taxes paid on the 1975 base year land generally range between $0.01 and $0.05/sq. ft. Recent parcels purchased by Disney are taxed from $0.36 to $0.37 a sq. ft, a difference of **36x**, and on average closer to **7x**. Assessed values of the improvements were collected but it does not make sense to break down the numbers into tax per sq. ft. of structure because most of the improvements are rides or some other unique structure.

A number of hotel properties in the Disneyland area were also studied. Property taxes paid on the hotel lots ranged from $0.08/sq. ft. of land for the Tropicana Inn at Suites (1940 South Harbor Blvd.) to $1.21/sq. ft. of land for the Anaheim Marriott (700 Convention Way), a difference of



15.1x. The Tropicana is locked in at a 1975 base year on the land while the Marriott was last reassessed in 2001.

In between these values came the Ramada Maingate Saga Inn (1650 South Harbor Blvd.) at $0.11/sq. ft., the Anaheim Ramada (1331 East Katella Ave.) at $0.17/sq. ft., the Crowne Plaza Resort (1201 Harbor Blvd.) at $0.24/sq. ft. and Park Inn Anaheim (1520 S Harbor Blvd.) at $0.25/sq. ft. As one can see, a property's base year on the land is a good indicator of its relative tax amount per sq. foot of land (Note: it is likely that the Park Inn is subject to a Prop. 8 assessment—see methodology section).

Property taxes paid on the structures in the Disneyland area ranged from $0.15/sq. ft. of structure for the Vagabond Plaza Hotel (1700 South Harbor Blvd.) to $1.09/sq. ft. of structure for the Anaheim Best Inn (1604 South Harbor Blvd.), a difference of **7x**. The Vagabond Plaza Hotel has a 1992 base year while the Anaheim Best Inn has a 1998 base year.

Room rates ranged from $66/night for the Anaheim Ramada and $139/night for the Anaheim Marriott. Mirroring results from other counties, the disparities in property taxes paid were far greater than the differences in room rates.

Greater property tax disparities were recorded in Newport Beach. Property taxes paid on the land ranged from $0.01/sq. ft. for the Palisades Tennis Club (1171 Jamboree Rd.) to $0.63/sq. ft. for the Best Western Newport Beach (6208 West Coast Highway), a difference of **63x**. The three Newport Center Medical buildings recorded different values with the oldest building (1441 Avocado Ave.)

logging $0.11/sq. ft. tax of land compared with two newer buildings (400 Newport Center Dr. and 360 San Miguel Dr.) which were taxed at $0.30/sq. ft. The older Newport Center Medical building has 1975 base year compared to the two newer buildings which both have a 1992 base year.

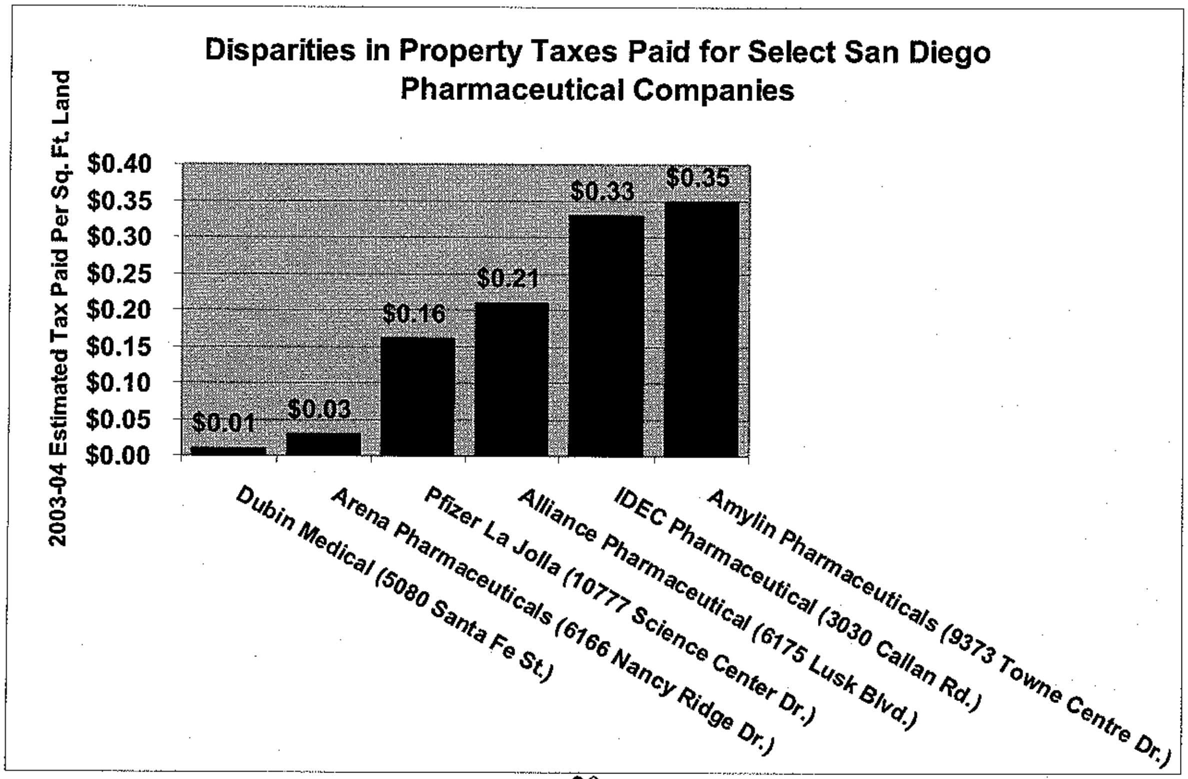
San Diego County

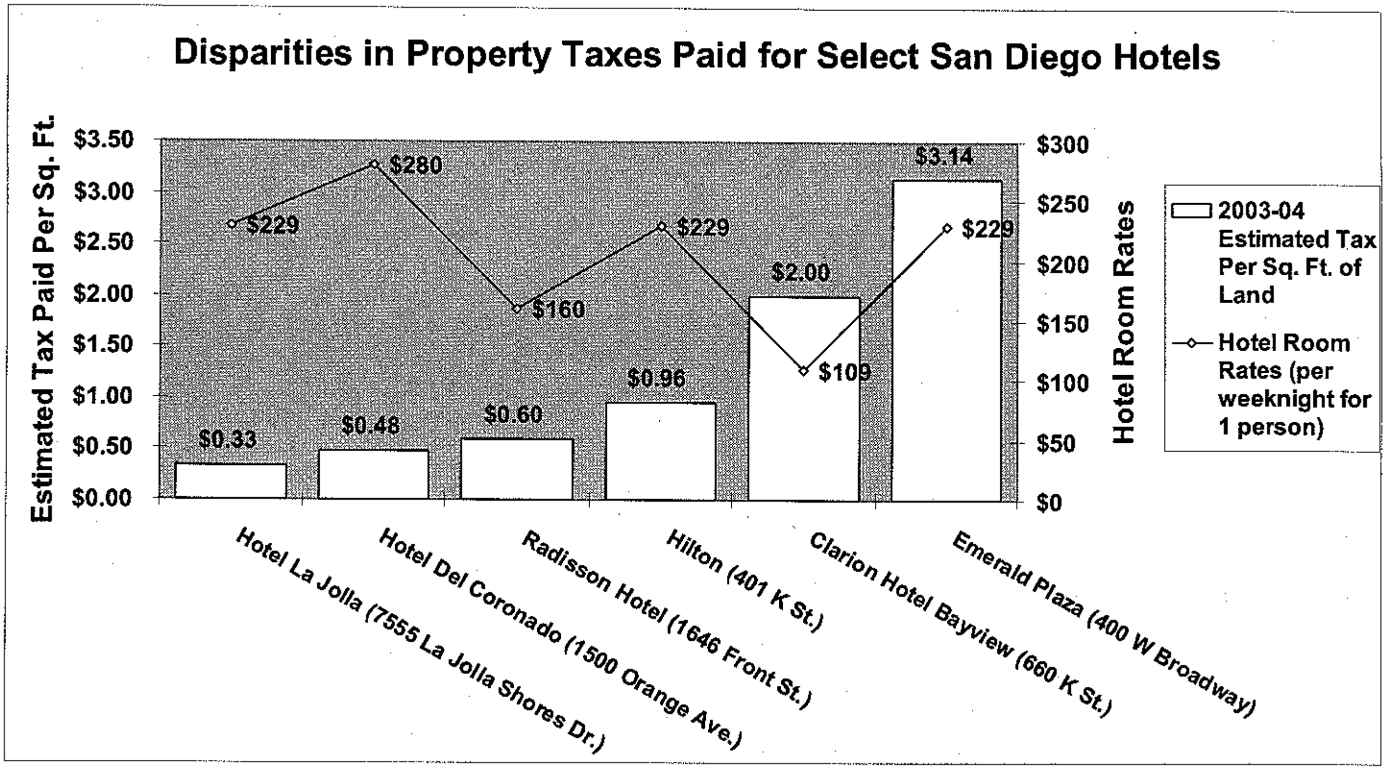
Key findings:

Data was collected for some 60 properties in San Diego County across an array of industry sectors, including pharmaceuticals, bio-technology, high-technology, telecommunications and hotels. Disparities ranged from $0.01/sq. ft. to $3.14/ sq. ft, a difference of **314x**. Our rough estimates indicate that 18 undertaxed properties in San Diego County would pay an addition $8.9 million, if brought to market value on the land alone.

Disparities in property taxes paid on properties occupied by pharmaceutical companies ranged from $0.01/sq. ft. for Dubin Medical (5080 Santa Fe St.) to $0.35/sq. ft. for Amylin Pharmaceuticals (9373 Town Centre Dr.). Other properties examined include Arena Pharamaceuticals (6166 Nancy Ridge Dr.) at $0.03/ sq. ft., Pfizer La Jolla (10777 Science Center Dr.) at $0.16/sq. ft., Alliance Pharmaceutical (6175 Lusk Blvd.) and IDEC Pharmaceutical (3030 Callan Rd.) at $0.33/sq. ft. Differences in the range of **19x to 35x** have no significant correlation with underlying uses or underlying values of the property.

For San Diego hotels, disparities ranged from $0.33/sq. ft. for Hotel La Jolla (7555 La Jolla Shores Dr.) to $3.14/sq. ft. for the Emerald Plaza Hotel (400 West Broadway). In between those two values fell the Radisson Hotel (1646 Front St.) at $0.60/sq. ft., the Hilton Hotel (401 K St.) $0.96/sq. ft., and the Clarion Hotel Bayview (660 K St.) at $2.00/sq. ft..





Again, differences as high as **9.5x** or even those in the range of **4-5x** have little to do with underlying values.

Room rates varied from $109/night for the Clarion Hotel Bayview to $280/night for the Hotel Del Coronado. Not surprisingly, some of the highest nightly room rates were recorded for hotels that paid the least property taxes.

A series of downtown office buildings examined did not reveal as much disparity. Values ranged from $0.76/sq. ft. for the Civic Center Plaza (1200 Third Ave.) to $2.01/sq. ft. for the John D. Spreckels Building (625 Broadway).

Other notable properties studied included Legoland (1 Lego Dr.) at $0.05/sq. ft., two Qualcomm-owned properties (5525-55 Morehouse Dr.) at $0.06/sq. ft., Sea World (500 Sea World Dr.) at $0.09/sq. ft. and the Mission Valley Center (1640 Camino Del Rio North) at $0.10/sq. ft..

V. Data Shows Property Tax Burden is Shifting More Heavily to Homeowners and Residential Properties

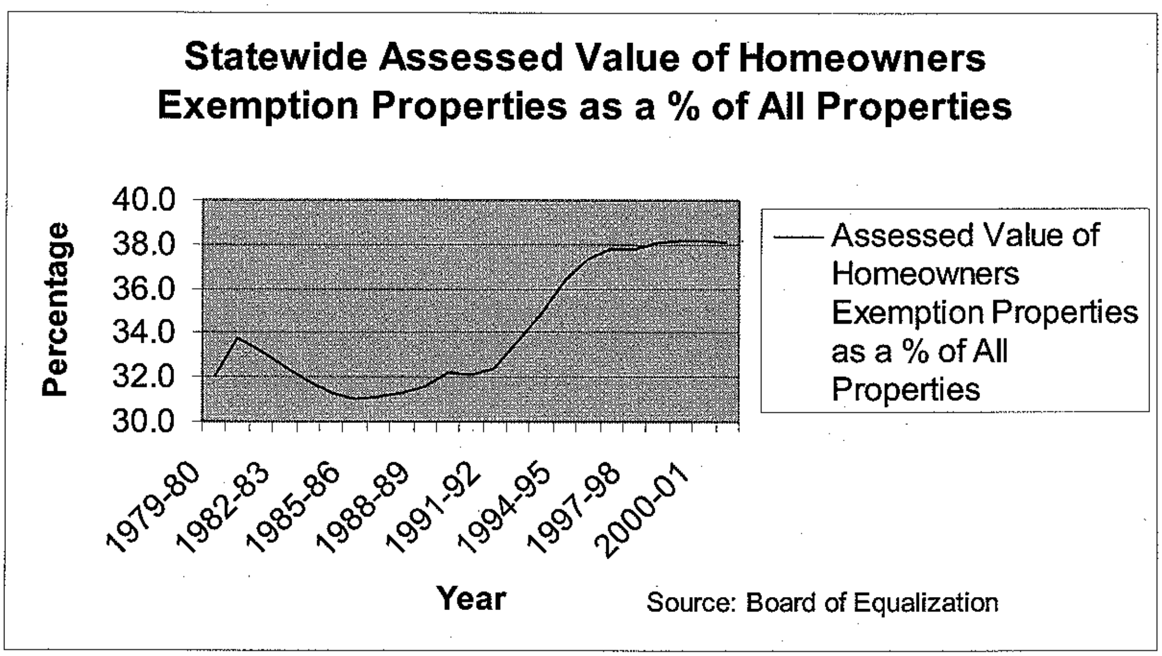
Data collected at the state level and several of the state's most developed counties, including Los Angeles, San Francisco, and Santa Clara, shows that the property tax burden has shifted from commercial and industrial properties to homeowners and other residential properties since the passage of Prop. 13. The reasons for this shift would appear to be varied, but the trends are relatively consistent.

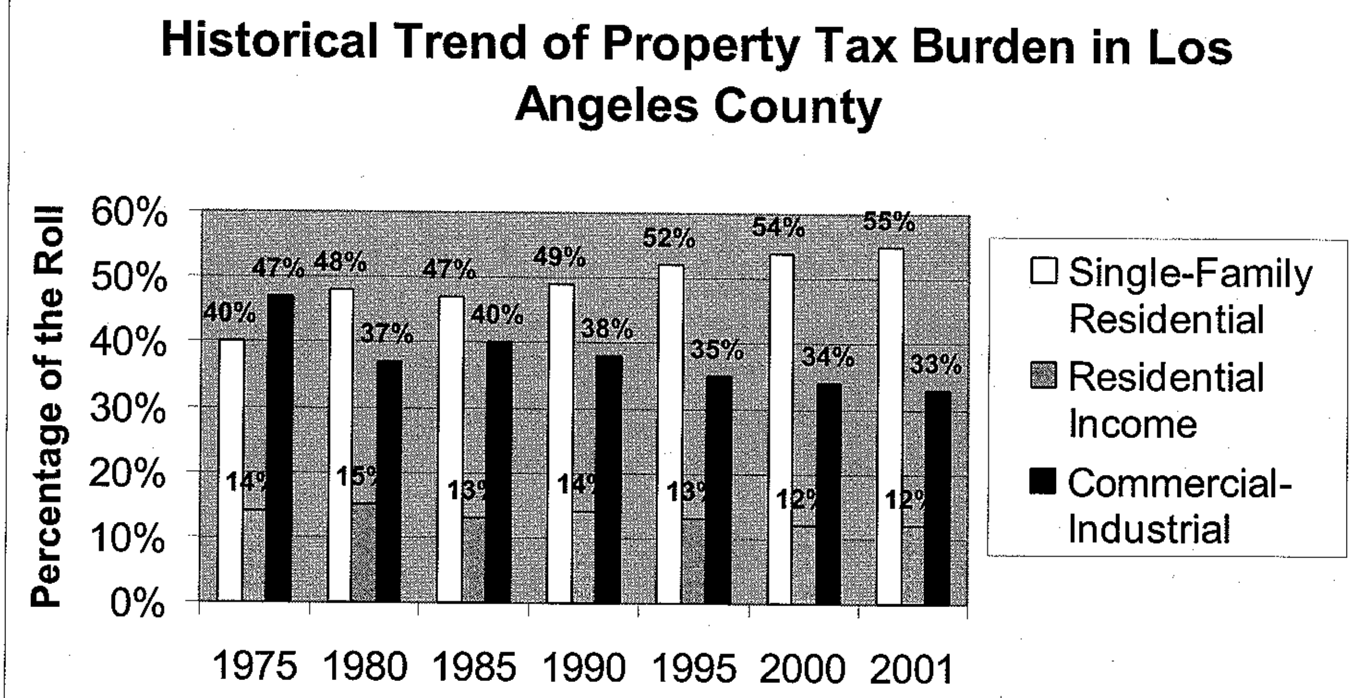
The available statewide data is limited but does show that homeowners are bearing a larger portion of the state property tax burden. Data collected by the State Board of Equalization shows that the homeowners' share of the state property tax roll has increased from 32% in the 1979-80 fiscal year to 38% in 2001-02. (Note: statewide data is only available for homeowner properties which claimed the homeowners exemption).

It would be helpful to have more detailed data at the state level that breaks down the property tax burden for single-family residential, multi-family and commercial and industrial property over time. Unfortunately, this data is only available for recent years.

However, many of the state's most developed counties keep this data, which dates back before Prop. 13 was passed in 1978.

In Los Angeles County, which composes one-quarter of the state's total property tax roll, the percentage of the county property tax roll borne by single-family residential homes has increased by 15 percentage points since 1975, jumping to 55% of the roll in 2001 from 40% of the roll in 1975. Over the same period, the percentage of the roll composed by commercial and industrial properties has fell by 14%, dropping from 47% of the roll in 1975 to 33% in 2001.

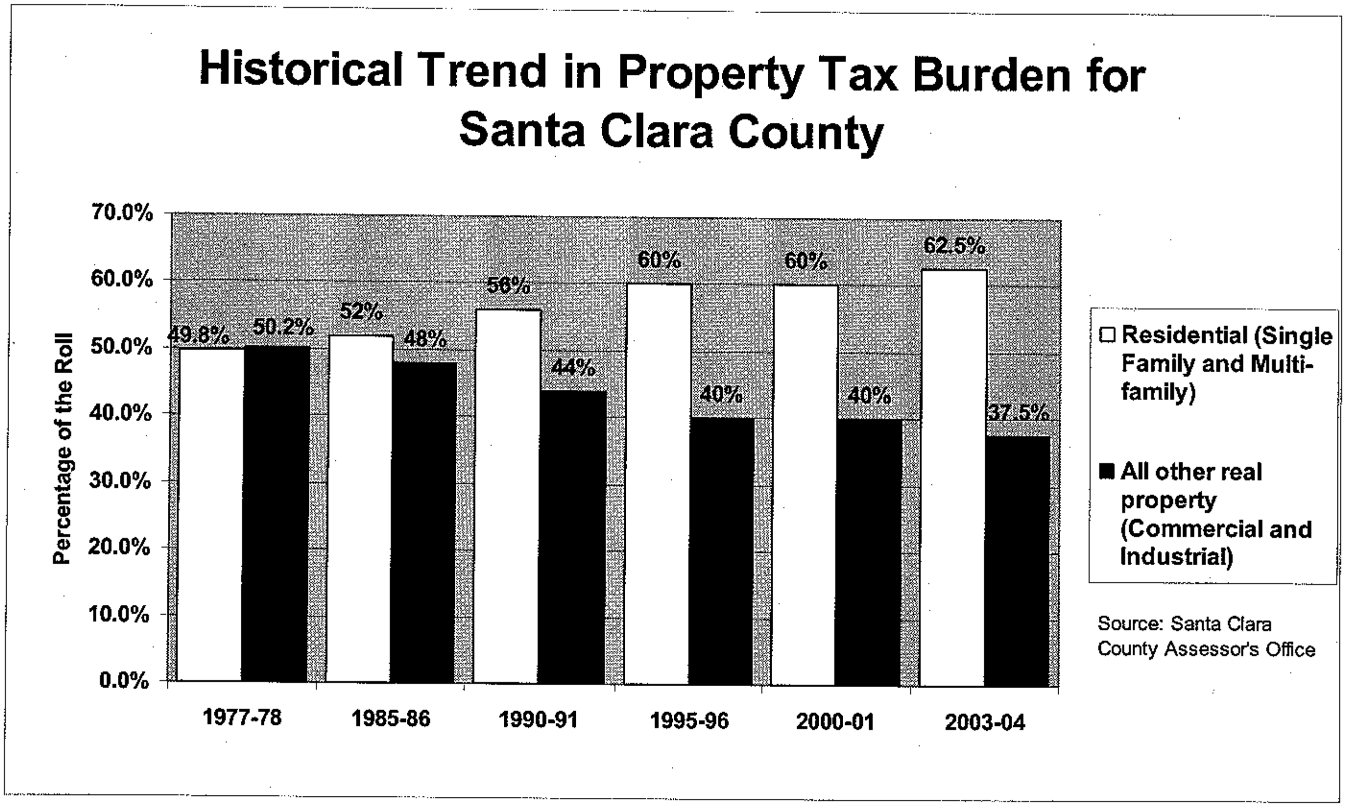




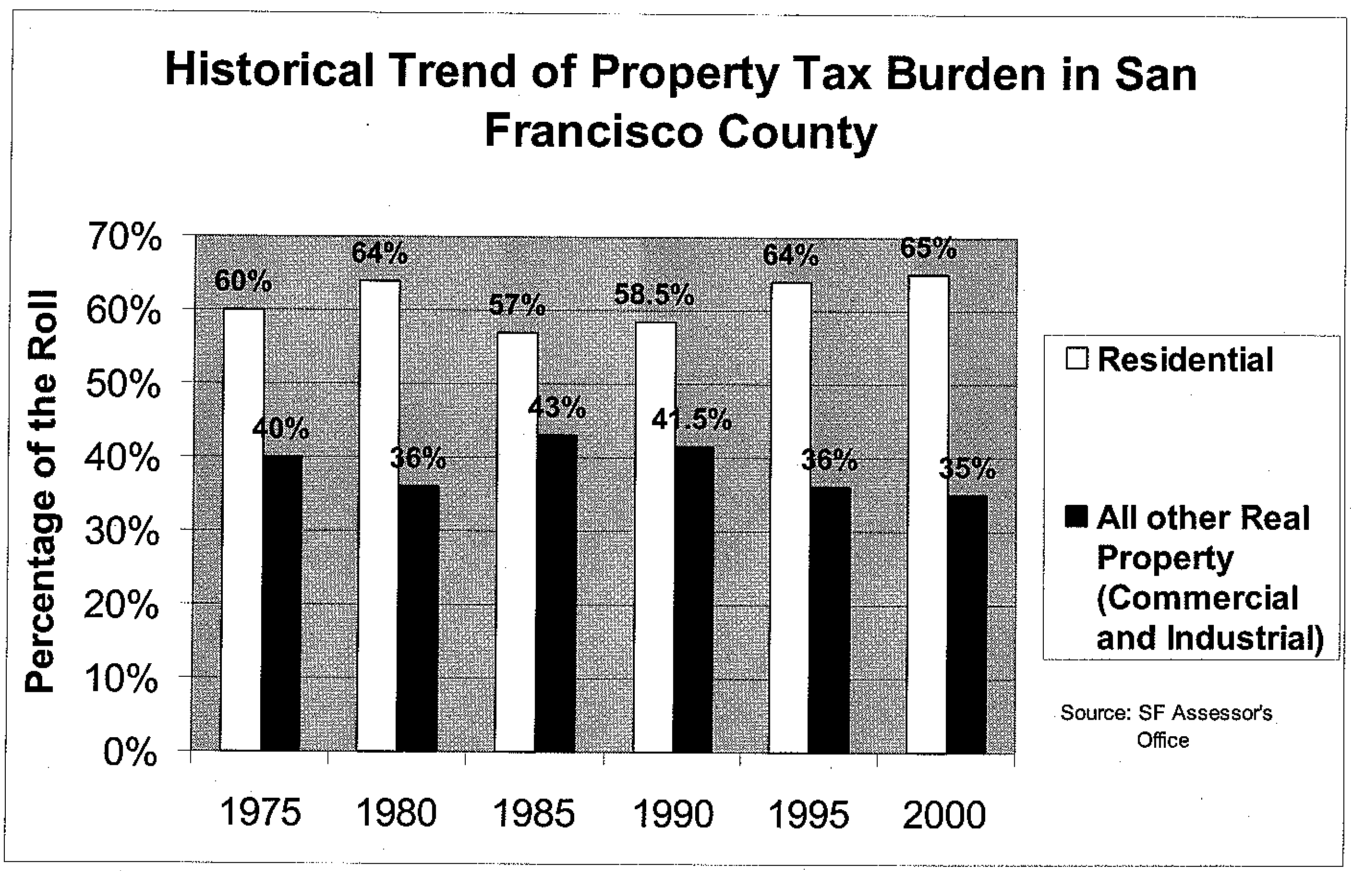
Source: Los Angeles County Assessor's Office

In Santa Clara County, the residential share of the property tax roll has increased by more than 12%, climbing from 49.8% in the 1977-78 fiscal year to 62.5% in the 2003-04 fiscal year. The share of the property tax roll composed by all other real property, namely commercial and industrial properties, has fallen by the same amount, dropping from 50.2% in the 1977-78 fiscal year to 37.5% in the 2003-04 fiscal year. The shift in the burden slowed in the second half of the 1990s and 2000-01 fiscal year during the high-tech boom but then resumed after the dot.com crash. We find it particularly compelling that, despite the massive commercial/industrial expansion in Santa Clara throughout this longer period, the homeowners' share of the property tax continued to rise.

Specifically, between 1990-91 and 1995-96 the residential share increased from 56% to 60% but then leveled off at 60% until 2000-01. Between 2000-01 and 2003-04 the residential share increased from 60% to 62.5%, arguably because of the drop-off in commercial activity and the sustained housing market. While this short-term fluctuation is to be expected, it is the long-term shift which is more surprising.



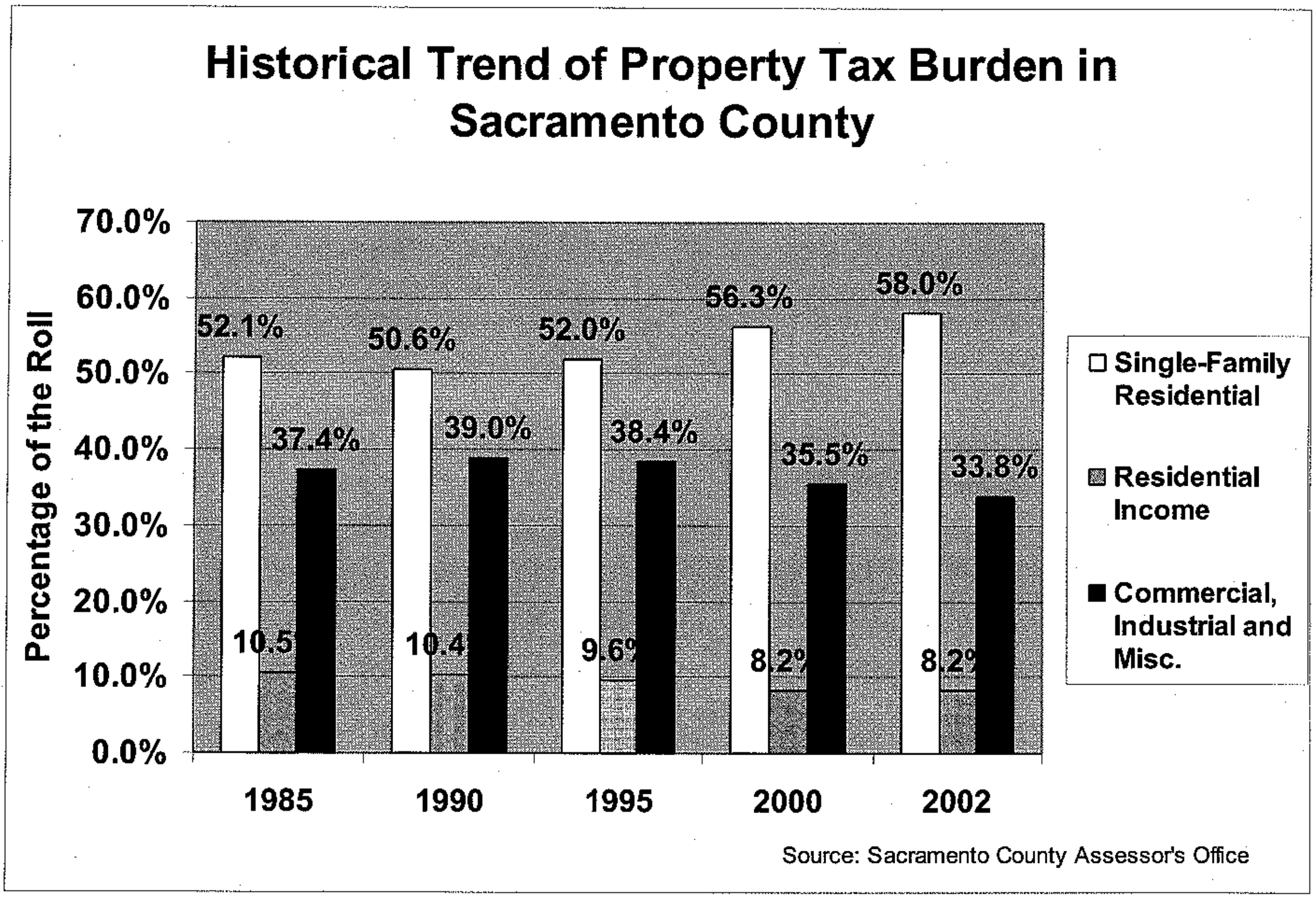
Historical Trend in Property Tax Burden for Santa Clara County
70.0%
60.0%
50.0%
40.0%
30.0%
20.0%
10.0%
0.0%
Percentage of the Roll
49.8%
50.2%
52%
48%
56%
44%
60%
40%
60%
40%
62.5%
37.5%
1977-78
1985-86
1990-91
1995-96
2000-01
2003-04
Residential (Single Family and Multi-family)
All other real property (Commercial and Industrial)
Source: Santa Clara County Assessor's Office

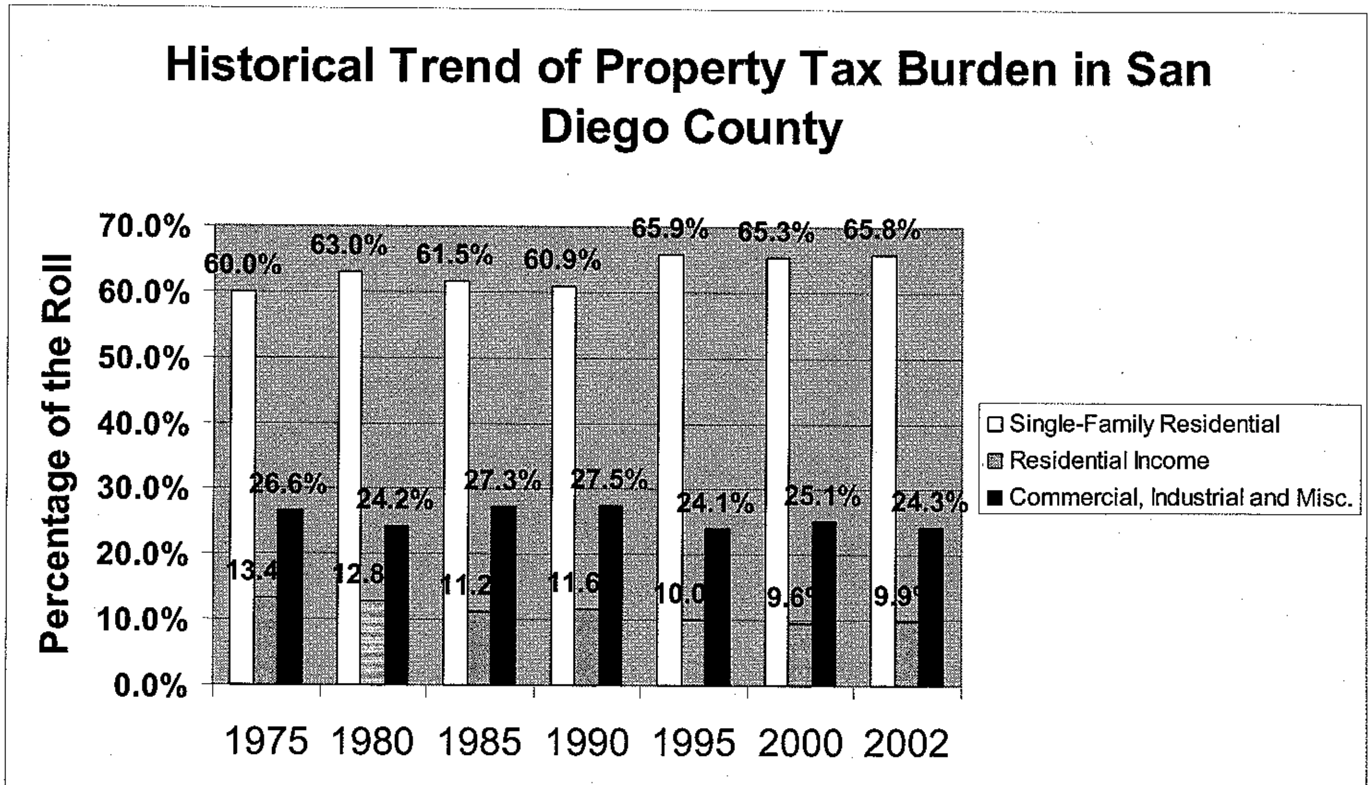


Historical Trend of Property Tax Burden in San Francisco County
70%
60%
50%
40%
30%
20%
10%
0%
Percentage of the Roll
60%
40%
64%
36%
57%
43%
58.5%
41.5%
64%
36%
65%
35%
1975
1980
1985
1990
1995
2000
Residential
All other Real Property (Commercial and Industrial)
Source: SF Assessor's Office

In Sacramento, it appeared that single family residential (not only homeowners) continued to bear a roughly constant share of the property tax burden, at about 50 to 52%, for a number of years, then their share of the burden rose after 1995 to 58% in 2002. Residential income property declined from 10.5% in 1985 to 8.2% in 2002. The share of the property tax burden for Commercial, industrial, vacant land, and other properties has declined by about 3.5 percentage since 1985, dropping from 37.4% in 1985 to 33.8% in 2002.

In San Diego, single-family residential property (which includes rented as well as homeowner property) rose from 60% of the county property tax burden to 65.8% of the role from 1975 to 2002. Residential income property declined from 13.4% to 9.9% of the roll during this period. Commercial industrial property declined slightly, from 26.6% to 24.3% during the same period.





Source: San Diego County Assessor's Office

How Should This Data Be Interpreted?

According to one county assessor, the difference is not so much in the assessment system as it is the relative values of single-family homes and other properties. Single-family homes have increased rapidly in value throughout the state over the long-term, while the market for other properties, including apartments, may not have been able to sustain the land value increases that homeowners have been able to carry, because non-homeowner property values are constrained by the ability of the property to generate immediate income.

Arguably, the benefit of Prop. 13 to homeowners has helped contribute to this shift by increasing the property values of residential homes. That is, stable and low levels of taxes capitalize into housing values as higher mortgage payments which a purchaser can make. The limited increases in property taxes on homeowners mean that homeowners can stay in their homes longer without selling in a rapidly rising market, thereby limiting supply on the margin and driving other home prices higher.

On the other hand, those effects should have been consistent over time, and would have affected the relative shares of the property tax in the early 1990s as well as the late 1990s. Ultimately, even if one could argue that it is the booming single-family market that caused more of the shift than lagging commercial/industrial assessments, the rationale for acquisition-based assessment is far stronger for homeowners than it is for income-producing property.

VI. Conclusion

A. The centrality of this problem to our current dilemma

If it were not all perfectly legal, California would have no greater scandal in its system of government than in its method of taxing commercial property. The systematic mis- and under-taxation of investment properties through our irrational assessment system contributes not only to numerous problems in our system of state and local finance. It is also harmful to the business climate itself, such that its reform should be positive for business investment in California.

Governor Schwarzenegger has promised to take a fresh look at every sacred cow in state government. This particular cow is hardly even sacred, insofar as, unlike most strongly held policy positions, no one has ever bothered to mount a rational defense of the current system. No economist can be found to defend the taxation of new investment more heavily than windfall land rents. And no lawyer can be found who will argue that the system makes any legal sense beyond the ability to manipulate it for loopholes.

Not surprisingly, the simple reform of the non-residential property tax speaks directly to the many concurrent fiscal problems facing California:

--the immediate need for local own-source revenues for local government. Local government needs a permanent replacement for lost Vehicle License Fees (VLF) and needs to eliminate the revenue shifts.

--the pressing need for revenues for the state's long-term structural deficit. Increased property tax would meet a share of the state's Proposition 98 obligation.

--the long-term need to address the infrastructure deficit. In a virtuous cycle, assessment increases would encourage infrastructure investment, which in turn would contribute to cumulative increases in commercial property values, which in turn would contribute to improving infrastructure. There would be a positive incentive for local government to invest in infrastructure.

--the need for incentives for local government to encourage high value-added development as opposed to retail development. Efforts made in the legislature to swap property and sales taxes must also address the failure in the property tax side of the equation in order to truly change the incentives.

--the need to address the threat of ever-increasing sprawl. A necessary step toward better land use is to eliminate the reward in the current system for land speculation, which drives land costs upwards and contributes to sprawl.

The amount of money to be raised from the periodic reassessment of non-residential property is currently estimated at $3 billion statewide. With all of the needs above—the local government deficit, the structural deficit and the infrastructure deficit—the money could be spoken for many times over. Yet at whatever the use of the new revenues, the system would spawn a number of improvements in government over time. And it's our view that as the incentives to invest both for the public and private sector improve, that number will rise far more rapidly than the dismal growth in commercial property values so far.

B. Improving the business climate?

It may seem counterintuitive to say that an increase of $3 billion in revenue through market value assessment of non-residential property would bring about an improvement in the state's business climate. But here's why that would be the case:

Fees: New investment already pays full market value on the land and buildings, and usually pays exactions, fees, mitigations, and easements as part of the permit process. Many of these fees are usually to pay for the burden on infrastructure, a burden which should be borne by all those who own property and benefit, through increasing land values, from the new investment. If the land value increases on current properties from new investment were to be captured, the fees on new investment would be likely to be diminished—a plus for new investment.

Local regulatory climate: Local government would view new commercial and industrial development far more favorably, because it would generate on-going land value increments. The revenues for of job-generating investment, as opposed to retail-generating investment, would improve, generating a much more favorable local regulatory climate for commercial and industrial development.

Competition: New investment pays at tax levels which their competitors don't pay. Economists talk about the ability to enter a market with a level playing field, and competing over quality and price with competitors. Yet in California, new entrants pay more in property taxes than those who already own property.

Land costs: One of the highest costs of new investment in California compared to other states is the high price of land. To an extent, that high price is a function of shortage of developable land and environmental restrictions on land use. But it is also a function of the distortions in the land market which permit speculation and holding of land off the market, at little or no cost to the speculator, as the result of their being no tax consequences to holding land. And, the price of land is inversely related to the holding costs, namely the tax consequences. Re-assessment would help rationalize the land market, and would make more land available at lower cost.

Location vs. cost-driven investment: Hotels, shopping centers, office buildings which require prime location would bear the costs far more than those manufacturing companies which are more likely to be mobile. These market or location-oriented businesses thrive on the most valuable land, (much of it in general proximity to the coast), yet many pay virtually nothing in taxes for their locational advantages. Manufacturing, by contrast, is in fact more mobile, and is generally located on less desirable land.

Infrastructure: One of the main constraints to investment in California is adequate infrastructure. In the late 1980's, the Bay Area Council, consisting of Bay Area business leaders, examined paying for infrastructure from the proceeds of re-assessment of commercial property. Not only could such funds be set aside for infrastructure, but the incentives of local government would undoubtedly be for investing in that infrastructure which improves property values, because they would get substantial returns on their investment through capturing 1% of the incremental value. Surely such an incentive would lead to property-value enhancing investments by local governments.

Finally, the business community—particularly the manufacturing sector--could come to the table and negotiate an agreement to reassess commercial property, in which case they would be sure to seek off-setting considerations to further improve their competitive position. To this point, however, they have always refused to engage and maintained vehement opposition to reassessment. In our view, the vehemence of their opposition is directly related to the lack of any substantive basis for their opposition to change.

C. Changing the system

How should the existing system be changed? The answer is relatively easy when one looks at how other states value commercial properties. No other state in the nation ties reassessment of commercial properties to a "change in ownership." As illustrated by the California case, the complex ownership structures of commercial properties and innumerable ways in which to structure "change of ownership" transactions render such a system unenforceable.

The most common method used by other states calls for the periodic reassessment of commercial properties at market value. This is the same method that was use in California prior to the passage of Prop. 13. Such an assessment method prevents commercial property owners from gaming the system to avoid reassessment and provides county assessors with clear guidelines about when properties should be reassessed. It would also guarantee that businesses compete on an equal playing field and ensure that California's property tax system captures billions of dollars in tax revenues from a real estate market that continues to increase in value. State and local governments need these property tax revenues to reinvest in state and local infrastructure, which will in turn benefit all property owners.

ACA 16 (Hancock) would amend the state constitution to require all nonresidential property that is not used for permanent or long-term commercial agricultural production to be assessed at market value on an annual basis. The State Board of Equalization estimates that the bill would raise about $3 billion in additional property tax revenues every year with approximately half going to local governments and half going to the state. The bill has received a hearing in the Assembly Revenue and Taxation Committee but faces an uphill battle because of the Legislature's 2/3 vote requirement for passage of bills that increase taxes or amend the constitution.

SB 17 (Escutia) would enact a number of statutory changes to help prevent changes of ownership from going undetected, and is intended to be amended to tighten the loophole-ridden system which legally permits changes of ownership to go recorded. We envision this as a first step which at least can be taken in the legislature, prior to a constitutional amendment which requires vote of the people. Under the current system, county assessors and the Board of Equalization are forced to rely on property owners to report changes of ownership but have no real way of checking to ensure that such changes are reported. Futhermore, the penalties are so low—capped at $2,500 even if the failure to report costs millions of dollars--that property owners have an incentive to avoid filing such reports.

Ultimately, this change will happen because the problems of the system of state and local finance can no longer be ignored. The state's major newspapers—the San Francisco Chronicle, the Sacramento Bee, the San Jose Mercury News, the Los Angeles Times, and the San Diego Union-Tribune--have already editorialized for this change. A recent poll by has demonstrated that voters prefer market value assessment of non-residential property by 60-34, as a solution to our structural problems. It remains for the appropriate political coalition to make this necessary reform a reality.

Appendix I: Methodology and Data Availability

The research undertaken for this study sought to examine property taxes paid on a number of different non-residential properties in several of the state's most developed counties. The counties studied include Sacramento, San Francisco, Santa Clara, Los Angeles, Orange County, and San Diego. A wide variety of properties were selected including hotels, office buildings, factories, warehouses, and amusement parks.

To complete the study we needed a way to objectively compare property taxes on properties that vary in size, value and use, without the resources to do site-by-site appraisals. Several recent analysis (for example, Professors Steve Sheffrin and Teri Sexton) have done broad computer analyses to compare commercial properties with those that changed ownership. Our approach was to seek out examples which would be instructive as indicators of the differences in property assessments. We utilized a methodology that made it possible to compare the property taxes paid per square foot of land and per square foot of structure for most of the properties studied.

Data. Unlike nearly all other state and local taxes such as the personal income tax and corporation tax, information on who pays property taxes and how much they pay is public information. All of the assessment and property information was obtained from county assessors' offices. Most of the information was contained in in-house or online databases maintained by the county assessors' offices. For each property, we obtained the square footage of the lot, assessed land value, square footage of the structure(s), and assessed structure value. All of the data collected is 2002-03 fiscal year data except for Santa Clara and San Diego counties, which is for the 2003-04 fiscal year. In addition, no data on structure square footage was publicly available for San Diego County.

From this assessed value and property information, we were able to estimate amount of tax paid per square foot of land and tax paid per square foot of structure. These values were found by multiplying the current assessed value of the land/structure by 1%, to find the total taxes paid on the land/structure, and then dividing by the square footage of the land/structure. We stress the fact that these are only estimates and are likely to be slightly different from the exact amounts paid for a number of reasons.

The actual tax rate on both the land and structure is slightly higher than 1% because special assessments and local bond debt may raise the property tax rate above one percent. These rates vary depending on which assessment district the property is located in. A 1% rate was used for all counties except San Francisco and Sacramento for standardization purposes. For Sacramento and San Francisco data, we used actual rate of the area in which the building was located, which is slightly over 1% (1.0897% for Sacramento and 1.117% for San Francisco).

We found that comparing tax paid per square foot of land makes for a much more objective comparison than comparing tax paid per square foot of structure. This is because the assessed value of a structure depends on many more factors than the assessed value of a lot. In general, the assessed value of a lot is basically a function of its square footage and the area in which it is located. This is not the case with a structure because appraisers take into account the condition of the building, age, potential for earning future income, as well as the area in which it is located. For example, older buildings are appraised at lower values because their potential for earning future income is lower. Nevertheless, buildings that are of similar age and similar amenities, and located in close proximity to each other, should be taxed at similar values per square foot. Despite property differences, relative property values should be reflected in rents or, in the case of hotels, room rates.

Base Year Information. A property's base year represents the last year the property was assessed at market value, which, in most cases reflects the last time the property changed ownership under Prop. 13. Prop. 13 passed in 1978 but rolled the assessed values of properties back to their 1975 values. Thus, the oldest possible base year is 1975 but properties with 1975 base years may not have changed ownership since the early 1970s or earlier.

It is common for the land and structure to have different base years. Many property owners own land long before they develop it, or improvements on the building would provide a different base year than on the land. Additionally, it is also not uncommon for a structure to have multiple base years. A new building is given a base year upon its completion and a new base year for every year improvements are made to the structure. For example, the Sutter Club building in downtown Sacramento was assessed at $440,000 in 1975. Subsequently, the building owners recorded the following improvements: $13,000 in 1981, $620,000 in 1983, $10,000 in 1993 and $208,800 in 1995. Under Prop. 13, the property owner pays property taxes on the sum of these values which are commonly referred to as factored values because they cannot increase by more than 2% a year after they are established.

Unfortunately, base years were only readily available for some of the properties studied. The databases in the Sacramento and Orange County Assessors' offices contained base years for all of the properties reviewed in those counties. Base year information for the remaining counties was more limited. This data has not been included on the data spreadsheets but is discussed in the county-by-county summaries depending on availability. All of the assessment databases tracked the last date the ownership information for the property was amended (i.e. the names of the persons or legal entities that own the property, and the mailing address for the bill).

This date does not necessarily correspond to the last time a change of ownership was triggered under Prop. 13. For example, the owners of a property could merely swap out a few ownership shares and change the name of the holding company. A change of ownership is not recorded as long as no one partner takes control of 51% of the new ownership structure. This ownership amendment date is helpful in that one can determine that the property has not changed hands since that date. To illustrate, many of the properties have ownership dates in the early 1980s or 1970s. One could therefore infer that these properties have early base years.

Proposition 8. Generally speaking, properties which are taxed at lower amounts per sq. ft. of land are also taxed relatively less per sq. ft. of structure because properties with earlier base years on the land tend to contain older structures. There are, however, a number of cases where a property with an older building is taxed at full market value on both the land and structure. Proposition 8 requires assessors to assess a property at its Prop. 13 value, namely its base year value plus a maximum of 2% a year, or its market value, whichever is less (Prop. 8 was approved by California voters in 1978, the same year that Prop. 13 passed). For example, many properties with older buildings that have undergone a number of improvements are assessed at market value. This is because improvements to older buildings are given a new base year and assessed at full market value the first year (increases in assessed values are limited to 2% a year). In these cases, it makes sense for property owners to have their properties assessed at the market value because it is not worth paying taxes on the original value of a building, plus any number of expensive improvements. The only catch is that the land is also assessed at full market value. So property owners in this position typically save a significant amount in taxes on the structure(s) and lose a modest amount on the land, for a hefty overall tax saving. It is possible for a property to be assessed under Prop. 8 one year then revert back to a Prop. 13 assessment the next year.

Additional Considerations. As mentioned previously, the data estimating the taxes paid per square foot of land and structure is a good approximation of the actual taxes paid but should not be regarded as an exact figure.

Property owners do not receive separate tax bills for the land and structures that they own. Property owners receive two bills a year, with each bill asking them to pay half of the total amount of property taxes they owe for a given year. Property owners are also taxed on fixtures and personal property and face a variety of other special assessments and fees in addition to the taxes they pay on the land and structures they own. We were able to separate out the taxes paid on the land and structures from a property owners' total tax bill because the publicly available databases maintained by county assessors' offices list separate values for the assessed value of a parcel of land and the assessed value of any structures, pursuant to the California Constitution which requires separate assessment of land and buildings.

Another consideration when analyzing the structure figures is that we were not always able to separate out the portion of a building's square footage that is used for parking or some other use (i.e. catwalks, utility sheds, attics, basements). We separated the amount used for parking in most cases and did not include it in the total structure square footage. For other structures, we could only use the entire square footage of the facility. In addition, for certain properties, namely industrial and manufacturing facilities, there is a fine line between what is considered part of the structure (subject to Prop. 13) and what is considered personal property (not subject to Prop. 13 and therefore taxed at market value every year). Examples include cranes, machinery, and other equipment that could be argued to be part of the building or separate from the building. This determination is made by the county assessors' offices and is frequently challenged on appeal by the taxpayer.

The Los Angeles County Assessor's office also noted that the assessed values allocated to the land and structures are not exact in all cases. They try to allocate the exact amount but focus on getting the combined total right. The office also noted that smaller lots are generally assessed at higher values than larger lots because they tend to be more densely developed and have the capacity to bring in more revenue. Thus, smaller lots would be taxed a higher amount per square foot than larger lots, all other considerations aside. Nevertheless, one would expect a 200,000 square foot lot in downtown Los Angeles to be taxed at the same or similar amount per square foot that a 50,000 square foot in the same location would be (assuming the parcels have the same base year).

It should also be noted that some of the properties for which data was collected may have been part of a multi-parcel sale. Such parcels are likely to be assessed at a value different than if they were sold as a single parcel because Prop. 13 requires county assessors to appraise a property at the lesser of its sale price or true market value as determined by the county assessor. One would expect properties that are part of a multi-parcel sale to be assessed at lower values than if the parcels were sold separately because one commonly gets a better price for buying more property.

Room Rates. For hotel properties, nightly room rates were also collected to give one an idea about the relative room rents collected by hotel owners. Room rates were collected for one person on a weeknight. These rates vary based on room availability and the number of special discounts available at the time.

Ownership Information and Additional Information. Ownership information was also obtained for nearly all of the properties studied. For the majority of cases it is impossible to tell if the property is owned by the same owners that own the business at the property's listed address. For example, the Chevron Building in San Francisco is owned by the 101 Montgomery Street Company.

Most properties are owned by a limited liability company, limited partnership, holding company or some other legal entity set up specifically for purposes of holding the property. The names of these entities do not necessarily have to correspond to the individuals or entities who own them and information about ownership interests is not public record. Many of the properties are owned by either the same entity that owns the business at the property's listed address or an entity that has a name that closely resembles the business name. For example, the Transamerica Pyramid in San Francisco is owned by Transamerica Insurance Corp. of California.

This is the reason why county assessors have such a difficult time tracking changes of ownership. Unless a new deed is recorded, nobody, including the county assessor's office, would be aware of changes in a legal entity's ownership structure. Even when a deed is recorded, all the deed records is the new name of the legal entity that owns the property. Information documenting what individuals or companies own parts of a legal entity is confidential information and not available. Property owners are supposed to file a change of ownership statement with a county assessor's office upon a change in ownership but there is no way for a county assessor to check to make sure that this form is filed. Improving reporting requirements and increasing penalties for failure to file this information are proposed in SB 17 (Escutia).

A variety of other property characteristics, including the number of floors, number of rooms and year built, and use of the property, were also obtained for most of the properties studied.

Appendix II: Undertaxed Properties by County

Using data collected from each county, we estimated the additional amounts that select property owners should be paying in annual property taxes beyond what they currently pay. While these are only rough estimates, they do indicate that a significant amount of money could be raise by bringing the following properties up to market value. We used conservative estimates in making these calculations.

Sacramento County Properties

Property Name	Address	2002-03 Total Estimated Additional Tax Amount	2002-03 Estimated Tax Paid on Land	2002-03 Estimated Market Value Tax on Land	2002-03 Estimated Tax Paid on Structure	2002-03 Estimated Market Value Tax on Structure	Lot Sq. Ft.	Structure Sq. Ft.
Holiday Inn Capitol Plaza	300 J St.	$110,000	$0.22	$1.40	$0.71	Same	91,703	212,000
California Fruit Bldg.	1000 4th St.	$45,000	$0.16	$1.40	$0.21	$0.70	10,800	64,266
Hyatt Regency	1209 L St.	$220,000	$1.38	$1.40	$0.96	$1.50	136,323	405,000
Sutter Club	1220 9th St.	$18,000	$0.14	$1.40	$0.49	Same	14,400	42,161
	555 Capitol Mall	$115,000	$0.31	$1.40	$0.68	Same	104,980	397,069
	455 Capitol Mall	$40,000	$0.27	$1.40	$0.59	$0.70	25,600	98,000

San Francisco County Properties

Property Name	Address	2002-03 Total Estimated Additional Tax Amount	2002-03 Estimated Tax Paid on Land	2002-03 Estimated Market Value Tax on Land	2002-03 Estimated Tax Paid on Structure	2002-03 Estimated Market Value Tax on Structure	Lot Sq. Ft.	Structure Sq. Ft.
Chevron Building	101 Montgomery St.	$85,000	$3.19	$10.00	$2.92	Same	12,438	277,895
Hallidie Building	130-150 Sutter St.	$285,000	$1.48	$10.00	$0.15	$1.50	16,169	108,432
Hilton Tower San Francisco	333 O'Farrell St.	$1,045,000	$0.80	$10.00	$1.62	Same	113,436	1,424,230
Fairmont Hotel	950 Mason St.	$800,000	$2.75	$6.00	$1.17	$1.70	113,437	804,136
Mark Hopkins Hotel	1 Nob Hill	$450,000	$2.95	$6.00	$0.80	$1.70	56,715	310,000
Renaissance Hotel	55 Cyril Magnin St.	$270,000	$3.65	$10.00	$2.02	Same	42,077	696,431

Santa Clara County Properties

Property Name	Address	2003-04 Total Estimated Additional Tax Amount	2003-04 Estimated Tax Paid on Land	2003-04 Estimated Market Value Tax on Land	2003-04 Estimated Tax Paid on Structure	2003-04 Estimated Market Value Tax on Structure	Lot Sq. Ft.	Structure Sq. Ft.
Epson Palo Alto	3145 Porter Dr., Palo Alto	$360,000	$0.03	$0.30	$0.22	$1.00	323,215	348,829
Xerox Palo Alto Research Center	3333 Coyote Hill Rd., Palo Alto	$175,000	$0.02	$0.30	$1.46	Same	617,245	210,557
Hewlett-Packard	3000 Hanover St., Palo Alto	$320,000	$0.10	$0.30	$1.01	Same	1,588,198	466,000
IBM Silicon Valley Laboratory	555 Bailey Ave., San Jose	$2,700,000	$0.004	$0.30	$0.83	$1.00	8,717,277	600,000
Candor Systems	18705 Madrone Pky, Morgan Hill	$110,000	$0.05	$0.30	$1.11	Same	434,729	160,000
Sony Electronics	3300 Zanker Rd., San Jose	$180,000	$0.19	$0.30	$1.22	Same	1,640,034	500,000
Mitsubishi Electronics America Inc.	1050 E Arques Ave., Sunnyvale	$80,000	$0.17	$0.30	$1.00	Same	614,196	215,852
Philips Electronics	811 E Arques Ave., Sunnyvale	$310,000	$0.02	$0.30	$0.58	$1.00	656,449	300,844

Property Name	Address	2003-04 Total Estimated Additional Tax Amount	2003-04 Estimated Tax Paid on Land	2003-04 Estimated Market Value Tax on Land	2003-04 Estimated Tax Paid on Structure	2003-04 Estimated Market Value Tax on Structure	Lot Sq. Ft.	Structure Sq. Ft.
Amdahl Corp.	1250 E Arques Ave., Sunnyvale	$350,000	$0.09	$0.30	$0.47	$1.00	997,960	258,550
Applied Materials	3050 Bowers Ave., Santa Clara	$60,000	$0.02	$0.30	$1.12	Same	215,622	80,690
California Eastern Laboratories, Inc.	4590 Patrick Henry Dr., Santa Clara	$33,000	$0.20	$0.30	$0.52	$1.00	121,532	42,826
Excelics Semiconductor, Inc.	310 De Guigne Dr., Sunnyvale	$52,000	$0.19	$0.30	$0.75	$1.00	260,053	93,380
Integrated Device Technology, Inc.	2975 Stender Way, Santa Clara	$37,000	$0.05	$0.30	$0.67	$1.00	91,040	41,936
Storm Products	1400 Memorex Dr., Santa Clara	$150,000	$0.05	$0.30	$0.08	$1.00	229,561	98,961

Los Angeles County Properties

Property Name	Address	2002-03 Total Estimated Additional Tax Amount	2002-03 Estimated Tax Paid on Land	2002-03 Estimated Market Value Tax on Land	2002-03 Estimated Tax Paid on Structure	2002-03 Estimated Market Value Tax on Structure	Lot Sq. Ft.	Structure Sq. Ft.
Beverly Hilton	9876 Wilshire Blvd., Beverly Hills	$2,065,000	$1.35	$5.00	$0.90	$1.95	388,120	617,814
Avalon Hotel	9400 W Olympic Blvd., Beverly Hills	$150,000	$0.90	$5.00	$0.26	$2.00	24,054	28,586
Beverly Marriott	1177 S Beverly Dr., Los Angeles	$72,000	$1.90	$5.00	$2.42	Same	23,120	111,051
Four Season's Los Angeles	300 S Doheny Dr., Los Angeles	$275,000	$1.64	$5.00	$2.79	Same	81,457	302,978
Hotel Bel Air	701 Stone Canyon Rd., Los Angeles	$1,680,000	$0.79	$5.00	$3.36	Same	399,445	85,599
Luxe Summit Hotel Bel Air	11461 Sunset Blvd., Los Angeles	$1,403,000	$0.22	$5.00	$1.31	$2.00	278,784	102,510
Broadway Spring Arcade	540 S Broadway, Los Angeles	$246,000	$1.28	$5.00	$0.04	$0.50	38,800	220,512
Aon Center/First Interstate Tower	707 Wilshire Blvd., Los Angeles	$573,000	$1.85	$5.00	$0.64	$1.00	43,996	1,207,589

Property Name	Address	2002-03 Total Estimated Additional Tax Amount	2002-03 Estimated Tax Paid on Land	2002-03 Estimated Market Value Tax on Land	2002-03 Estimated Tax Paid on Structure	2002-03 Estimated Market Value Tax on Structure	Lot Sq. Ft.	Structure Sq. Ft.
One Wilshire Bldg.	624 S Grand Ave., Los Angeles	$150,684	$1.51	$5.00	$1.55	Same	43,176	717,065
Westin Bonaventure	404 S Figueroa St., Los Angeles	$3,000,000	$1.72	$5.00	$0.13	$2.00	154,202	1,333,377
Union Plaza Bank	445 S Figueroa St., Los Angeles	$1,000,000	$0.83	$5.00	$1.05	$1.50	159,430	737,598
Century City Mall	10250 Santa Monica Blvd., Los Angeles	$3,150,000	$1.13	$5.00	$2.48	Same	814,572	747,690
Century Plaza Tower I	2029 Century Park East, Los Angeles	$765,000	$2.26	$5.00	$1.53	Same	279,220	1,226,598
Century Plaza Tower II	2049 Century Park East, Los Angeles	$950,000	$2.00	$5.00	$1.53	Same	316,246	1,226,598
KPMG Tower	355 S Grand Ave.,Los Angeles	$557,000	$5.20	Same	$1.02	$1.50	58,440	1,160,728
777 Tower	777 S Figueroa St., Los Angeles	$482,000	$7.02	Same	$1.06	$1.50	31,064	1,094,768
611 Place	611 W 6th St., Los Angeles	$840,000	$2.11	$5.00	$0.60	$1.50	48,274	832,049
Capitol Records Bldg.	1750 Vine St.,LA	$322,000	$0.22	$4.00	$0.42	$1.50	52,030	116,097

Orange County Properties

Property Name	Address	2002-03 Total Estimated Additional Tax Amount	2002-03 Estimated Tax Paid on Land	2002-03 Estimated Market Value Tax on Land	2002-03 Estimated Tax Paid on Structure	2002-03 Estimated Market Value Tax on Structure	Lot Sq. Ft.	Structure Sq. Ft.
Disneyland	S Harbor Blvd., Anaheim	$4,700,000	$0.01-$0.37	$0.36	N/A	N/A	22.1 million sq. ft.	N/A
Anaheim International Inn Travelodge	2060 S Harbor Blvd., Anaheim	$27,000	$0.18	$0.35	$0.67	$1.00	60,722	50,688
Hilton Suites Anaheim	400 N State College Blvd., Anaheim	$53,000	$0.28	$0.35	$0.80	$1.00	130,680	220,445
Anaheim Ramada	1331 E Katella Ave., Anaheim	$100,000	$0.17	$0.35	$0.42	$1.00	212,573	106,886
Park Inn Anaheim	1520 S Harbor Blvd., Anaheim	$30,000	$0.25	$0.35	$0.67	$1.00	51,905	71,668
Tropicana Inn and Suites	1540 S Harbor Blvd., Anaheim	$70,000	$0.08	$0.35	$0.50	$1.00	100,928	82,656
Ramada Maingate Saga Inn	1650 S Harbor Blvd., Anaheim	$34,000	$0.11	$0.35	$0.43	$1.00	44,998	40,474
Vagabond Plaza Hotel	1700 S Harbor Blvd., Anaheim	$95,000	$0.24	$0.35	$0.15	$1.00	368,866	156,387
Villager Lodge	1441 S Manchester Ave., Anaheim	$29,000	$0.13	$0.35	$0.94	$1.00	116,305	49,209

Property Name	Address	2002-03 Total Estimated Additional Tax Amount	2002-03 Estimated Tax Paid on Land	2002-03 Estimated Market Value Tax on Land	2002-03 Estimated Tax Paid on Structure	2002-03 Estimated Market Value Tax on Structure	Lot Sq. Ft.	Structure Sq. Ft.
Homestead Studio Suites	30 Technology Drive, Irvine	$35,000	$0.17	$0.35	$0.67	$1.00	143,530	50,502
Hyatt Regency Irvine	17900 Jamboree Rd., Irvine	$52,000	$0.18	$0.30	$1.25	Same	432,512	397,199
Palisades Tennis Club	1171 Jamboree Rd., Newport Beach	$30,000	$0.01	$0.40	N/A	N/A	77,972	N/A
Newport Beach Marriott	900 Newport Center Dr., Newport Beach	$144,000	$0.16	$0.40	Not Avail.		600,692	Not Avail.

San Diego County Properties

Property Name	Address	2003-04 Total Estimated Additional Tax Amount	2003-04 Estimated Tax Paid on Land	2003-04 Estimated Market Value Tax on Land	Lot Sq. Ft.
Sea World	500 Sea World Dr.	$7,503,776	$0.09	$1.00	8,245,908
Executive Complex	1010 Second Ave.	$14,000	$1.49	$2.00	27,007
Imperial Bank Tower	701 B St.	$32,000	$0.94	$2.00	30,056
Union Bank of California Bldg.	530 B St.	$32,000	$0.92	$2.00	30,056
Westin Horton Plaza San Diego	910 Broadway Cir.	$56,000	$1.13	$2.00	64,904
Chamber Building	110 W C St.	$19,000	$0.76	$2.00	15,000
Civic Center Plaza	1200 Third Ave.	$37,000	$0.76	$2.00	30,056
Westgate Hotel	1055 Second Ave.	$40,000	$0.67	$2.00	30,056
Ligand Pharmaceuticals, Inc.	10275 Science Center Dr.	$36,000	$0.13	$0.30	214,315
Elan Pharmaceuticals Inc.	7473 Lusk Blvd.	$58,000	$0.11	$0.20	649,915
Arena Pharmaceuticals, Inc.	6166 Nancy Ridge Dr.	$45,000	$0.03	$0.20	262,667
Dubin Medical, Inc.	5080 Santa Fe St.	$29,000	$0.01	$0.20	151,589

Property Name	Address	2003-04 Total Estimated Additional Tax Amount	2003-04 Estimated Tax Paid on Land	2003-04 Estimated Market Value Tax on Land	Lot Sq. Ft.
Raytheon Systems Co.	8680 Balboa Ave.	$89,000	$0.08	$0.20	743,569
Qualcomm Inc.	5525-55 Morehouse Dr.	$118,000	$0.06	$0.15	1,312,027
SkyRiver Communications, Inc.	4810 Eastgate Mall	$142,000	$0.09	$0.20	1,291,554
Kyocera Wireless Corp.	10300 Campus Point Dr.	$255,000	$0.06	$0.20	1,814,710
Mission Valley Center	826-1640 Camino Del Rio North	$224,000	$0.10-$0.18	$0.20	2,932,459
Gen-Probe Inc.	10210 Genetic Center Dr.	$166,000	$0.05	$0.20	1,108,602

Appendix III: New Study Ranks California In Bottom Ten for Commercial and Industrial Property Taxes

But the State Really Ranks in Bottom Five Because Study Fails to Account for Loopholes in the System Which Lead to Huge Underassessment of Properties

A May 2003 study completed by the Minnesota Taxpayers Association has found that only eight states have lower commercial and industrial property taxes than California.

The state is estimated to really rank in the bottom five because the study fails to account for the fact that California's commercial and industrial properties are only assessed at only 2/3 of their market value (according to a recent UC Davis study). The study assumed that California commercial and industrial properties were assessed at 100%. Loopholes in current law and the fact that California is the only state that ties the reassessment of commercial and industrial properties a "change in ownership" ensure that the state's roll is vastly underassessed.

<u>Other Notable Facts:</u>

♦ None of the states with lower property taxes are large industrial states like California. Large industrial states are in the top 15, not the bottom 10.

♦ The state ranked much lower in property taxes on commercial and industrial property owners than on homeowners (30th) because homeowners cannot take advantage of the same loopholes in the law available to commercial and industrial property owners.

<u>Here's a brief look at the data:</u>

States Whose Commercial and Industrial Property Taxes Rank Among the Bottom (largest city in each state)

State	Tax on $1 million Commercial Property	Rank
Wyoming	$8,664	51st
Hawaii	$9,269	50th
Kentucky	$11,228	49th
Delaware	$11,622	48th
Washington	$11,728	47th
Nevada	$13,344	46th
North Carolina	$14,515	45th
Oklahoma	$14,892	44th
California	**$15,000**	**43rd**
Arkansas	$15,228	42nd
Alabama	$16,663	41st
New Mexico	$16,715	40th

State	Tax on $1 million Industrial Property	Rank
Hawaii	$9,409	51st
Delaware	$11,621	50th
Kentucky	$13,618	49th
Wyoming	$13,984	48th
Washington	$16,054	47th
Nevada	$17,900	46th
Virginia	$19,741	45th
North Carolina	$19,742	44th
California	**$20,000**	**43rd**
North Dakota	$21,273	42nd
Utah	$22,550	41st
New Mexico	$22,748	40th

Source: "50-State Property Tax Comparison Study," May 2003. Completed by the Minnesota Center for Public Finance Research in Cooperation with the Minnesota Taxpayers Association and National Taxpayers Conference.

Notes: The study used the largest city in each state to compare the amount that property owners would pay in each state for comparable properties. The City of Los Angeles was used for California, assuming a 100% market rate assessment.

Appendix IV: Brief Summary of What's Wrong with the Commercial Property Tax

1. **Change of ownership is more loophole than tax, with endless ways for owners to transfer property without re-assessment. (see II, below)**

2. **Windfall land rents, precisely what should be taxed, go untaxed.**

3. **New investment/development is heavily taxed (full market value, fees, exactions, mitigation, dedications and easements)—where tax burden should be minimized.**

4. **Business personal property—that is, capital investment in technology—is taxed at full market value—again, where tax burden should be minimized**

5. **Anti-competitive: new entrants are taxed more heavily than current landholders**

6. **Mal-distributes the tax burden among property owners: the new investor/developer pays more, while the landholder who benefits from the new investment/development pays less.**

7. **No ability to invest in infrastructure, since there is no ability to capture tax increments for capital outlay from the landholding beneficiaries of other people's new investment.**

8. **Rewards land speculation, with no penalty for holding high-value land off the market.**

9. **Diminishes intensity of land use by encouraging speculation, thereby promoting sprawl and leapfrog development.**

10. **New investment does not generate revenues for local government to pay for itself over long term.**

11. **Thus, politics becomes anti-growth, since growth causes problems and does not pay for infrastructure or improvements, let alone amenities.**

12. **The burden shifts to homeowners, who cannot exploit loopholes.**

13. **Land becomes more costly since the tax inversely affects its values.**

14. **Thus, it increases returns to land ownership instead of productive investment.**

15. **Because it fails to pay for the costs of growth, it increases reliance on sales taxes.**

Part II: Loopholes in Commercial Change of Ownership Law

1. **Publicly-traded companies continually change ownership, but reassessments are not recorded.**

2. **100% of the property can sell in one transaction, but no one owner takes 50+ percent—for example, 3 owners each take 33% shares.**

3. **100% of the company, whether publicly-traded or private, can change ownership over time but no reassessment is recorded because ownership is dispersed.**

4. **Two partners—even a husband and wife—can buy 50% each, with no reassessment.**

5. **Business can be sold, but a long-term land-lease can be held by the owner, with no reassessment.**

6. **Change of ownership can be established when property goes down in value, thereby preventing reassessment when property values recover.**

7. **No information requirements for reporting changes in ownership—untrackable by assessor, thereby damaging the long-standing credibility of the honorable profession of assessor.**

8. **Ownership by Real Estate Investment Trusts, which own property widely, never changes ownership although the shareholders/partners in REIT's change continually.**

9. **Additional ways of avoiding change of ownership can be discovered as they are needed—the assessment is subject to endless manipulation.**