California State Conference of the National
Association for the Advancement of Colored People

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To: Interested Parties

From: California State Conference of the National Association for the Advancement of Colored People

Re: CA HI NAACP Social Justice Impact Study of Split Roll

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Introduction

Some political battles never die. Passed overwhelmingly by voters in 1978, Proposition 13 has never seen its opposition go away. Largely the same groups and political interests who opposed this measure when it passed have sought to chip away at its underlying base of support ever since. The latest comes in the form of a Split Roll measure qualified for the 2020 ballot, which would remove much of the measure's cost protections from businesses in this state.

In their 4-decade campaign against Proposition 13, opponents have tried to misconstrue this measure in the public's mind. They have tried to portray it as only a benefit to persons who bought their homes long ago, generally more wealthy, older, and whiter than the state's rapidly evolving diverse population. This portrayal ignores the much broader provisions in Proposition 13, which remains as the only constitutional provision providing some relief from the rising costs of living in California.

Why Social Justice Groups Should Be Concerned about Weakening Proposition 13—It Is the Only Constitutional Measure that Helps Control Rising Costs in California

Prior to Proposition 13, there were no controls over how much property tax bills could change each year, whether paid directly by homeowners or as pass-through cost increases to renters. The 6,300 cities, counties, and special districts throughout the state separately determined how much each one wanted, and taxpayers learned how much more they owed only after opening up their annual bills. If Proposition 13 had not passed, the average property tax rate is estimated to have been 2.67% of market value in 1978-79. For someone buying the median priced single-family home in California today, the difference between that and the current average rate under Proposition 13 would mean paying over $9,200 more a year. Based on present value over the 30-year life of a mortgage, this additional annual housing payment would be the same as tacking on almost $160,000 to the price of an already too-costly California home.

Much like today's conditions, home prices and rents were also rising rapidly. In the four years prior to Proposition 13, assessed values grew an average of 12.5% a year, meaning the average homeowner saw their tax bill grow by 60% in this period even if they did nothing but live in the same house and if somehow the rates had stayed the same. Many homeowners saw their costs spike even more.

Proposition 13 provides certainty to homeowners, renters, and employers by removing these types of financial surprises from the costs coming from annual tax bills:

- Assessed value for real property (land, buildings, and other improvements) was changed from market value (which can vary widely from year to year) to acquisition value (the price paid at the time a property is purchased or for major improvements). In years property values are rising, the assessed value can rise, but no more than 2% annually.

- These provisions mean that someone buying a home, starting a new business, or entering into a lease has some certainty of this cost component over time. There are no surprises, and the actual annual costs can be known with some certainty at the time the buying decision is made. And while the benefits are higher for someone who has now been in the same property for a longer period of time, comparable benefits are also available over time to anyone buying or entering into a lease today.

  This aspect of Proposition 13 was cited by Justice Blackmun in the Supreme Court's *Nordlinger v. Hahn (1992)* ruling that acquisition value is a constitutional assessment method:

  > **"The State therefore legitimately can decide to structure its tax system to discourage rapid turnover in ownership of homes and businesses, for example, in order to inhibit displacement of lower income families by the forces of gentrification or of established, "mom-and-pop" businesses by newer chain operations . . . A new owner has full information about the scope of future tax liability before acquiring the property, and if he thinks the future tax burden is too demanding, he can decide not to complete the purchase at all. By contrast, the existing owner, already saddled with his purchase, does not have the option of deciding not to buy his home if taxes become prohibitively high. To meet his tax obligations, he might be forced to sell his home or to divert his income away from the purchase of food, clothing, and other necessities. In short, the State may decide that it is worse to have owned and lost, than never to have owned at all."**
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  > *Nordlinger v. Hahn*

- The general real property tax rate was capped at 1%. The rate can be increased to pay off certain general obligation debt, but the agencies cannot decide to do so on their own as in the past. Any such increases must be approved by the voters, and they have where local agencies have made a convincing case for additional funds. As a result, the Board of Equalization shows the 2018-19 average rate has risen to 1.153% primarily to support bonds issued by the school districts, but varies widely by county and city. Using prior estimates by the Legislative Analysts' Office (LAO), the current effective property tax rate likely averages around 1.3% if voter-approved parcel taxes, Mello-Roos taxes, and assessments shown on annual property tax bills are included.

- New taxes approved by the legislature require a 2/3 vote, as was the case with the recent fuel/vehicle tax increases and the Cap and Trade program passed in 2017. Voters can approve new state taxes directly through ballot measures by a majority vote, as was the case with the income tax increases contained in Proposition 30 (2012) and Proposition 55 (2016).

- In order to ensure state and local governments were unable to hike costs by creating a new tax but simply call it something else, they are prohibited from imposing new *ad valorem* taxes on real property. But new taxes for a designated or special purpose can be approved at the local level through a 2/3 approval by the voters. General taxes for general fund purposes are approved by a majority of the voters.

- The legislature was given the responsibility to determine how property tax revenues are distributed to local agencies. While Board of Equalization (BOE) data shows schools receive

54% of the property tax allocations, this distribution is primarily the result of decisions by the legislature rather Proposition 13 itself.

Viewed from this broader perspective, Proposition 13 set a base on how much Californians should be paying in taxes—state and local agencies were no longer able to decide these amounts on their own. Tax revenues can be raised—and they have been—but only where there is a clear consensus or after getting approval from the voters who in the end will end up paying them directly or indirectly through higher costs.

Home Ownership Remains the Primary Path to Wealth Creation and Generational Economic Mobility—Proposition 13 Helps Preserve and Promote Home Ownership by Reducing Annual Housing Costs

Although still recovering to levels seen prior to 2008, home ownership remains the primary means of wealth accumulation and thereby upward income mobility for lower and moderate-income households in the state. The 2007 Survey of Consumer Finances showed nationally that principal residences constituted 54.0% of all household wealth for African-Americans and 52.5% for Latinos, compared to 30.8% for non-Latino Whites. Policies that make housing less expensive to buy and own, therefore, have a far greater effect on the ability of these demographics to move up the economic scale.

The most recent American Community Survey (ACS) data for 2018 shows California home ownership still at significant levels for all income groups: 27% for households with incomes below poverty, to 48% for households with incomes at 200-299% of poverty, to 72% for those earning 500% or more. By race/ethnicity, home ownership was 34% for African-American households (compared to 42% in the rest of the US), 44% for Latinos (48% in rest of US), and 63% for non-Latino Whites (73% in rest of US). These lower rates largely reflect the significantly higher housing costs in California. But by reducing the annual cost of owning a home and providing long-term certainty to home buyers on what these costs will be, Proposition 13's savings have helped keep these ownership rates from falling lower in face of the state's rapidly rising costs and still assist households seeking to move from being renters to owners.

Split Roll Would Begin to Dismantle the Proposition 13 Cost Protections

The concept behind Split Roll is to treat and tax different classes of property differently. Under the split roll initiative that has qualified for the November 2020 ballot, commercial and industrial properties would be assessed at current market values as determined by the local County Assessors. The proponents claim that residential property—both homeowners and rentals—along with agricultural properties would continue to be assessed based on acquisition value. But anyone using their home for business purposes—whether to operate their own business or as a home office—would see their assessments and property tax rising under the split roll treatment. Various exemptions and inconsistencies in the measure mean in practice many farms and other agricultural operations would see rising taxes as well. Rather than attempt a direct repeal of Proposition 13 in its entirety, the current initiative instead attempts to break off groups of Californians currently relying on those cost protections.

Split Roll Would Increase Business Costs by up to $10.5 Billion a Year, Likely Paid by Consumers through Higher Costs

The LAO estimates that the current 2020 ballot measure will increase taxes by $6.5 to $10.5 billion annually, while the proponents estimate taxes on businesses will go up an average of $9 billion annually. The LAO estimate for revised measure the proponents are now seeking to qualify as well is even higher—$7.5 to $12 billion. These amounts would be imposed on most businesses in California and likely as well many homeowners using their homes for business purposes, paid directly as higher taxes or indirectly as higher lease costs. These costs in turn generally would be passed on to customers including both consumers and small businesses through higher prices.

At these levels, Split-Roll would be the largest single tax increase in California's history, exceeding even the Proposition 55 income tax increases approved in 2016 or the recently enacted increases to fuel and vehicle taxes.

The Proposed Provisions to Protect Small Business Owners Are Not Real

The current ballot measure attempts to portray itself as "small business friendly" by containing an exemption for business owners owning and operating on property worth less than $2 million—an amount that gets whittled down quickly by the market value of their homes and other property they own in the state. This is a meaningless provision based on the simple fact that many businesses—especially small businesses and minority-owned businesses—don't own their stores, offices, and shops. They lease, and they generally do so under a "triple net" lease that means they are responsible for paying all real estate taxes, building insurance, and maintenance in addition to the normal components such as rent and utilities. Any increase in property tax such as under the proposed initiative will immediately be passed on to these small business owners, further cutting into their ability to stay in business at a time they are also facing rapidly rising costs for energy, fuel, rent, salaries, and worker benefits.

Split Roll Will Accelerate Gentrification

Split roll will produce rapid hikes in property tax bills in areas with the highest rising property values. In practice, split roll will consequently serve as an accelerant in gentrifying neighborhoods. As new businesses able to afford rising rents move into an area to serve higher income new residents, long time neighborhood businesses—as the result of simply being located where they are—will suddenly face added cost pressures from property taxes as well. And just as homeowners prior to Proposition 13 faced rising tax bills that threatened their financial ability to stay in the homes, these rising costs will be coming out of already tight operating profits, threatening their ability to continue and accelerating the turnover of locally operated businesses.

Under split roll, local governments will also gain a significant financial incentive to approve commercial and mixed-use projects to replace existing housing. The combined effect will be to intensify the gentrification processes now underway throughout much of the Bay Area and coastal counties in Southern California, that have made the costs of living too expensive for historic minority, low income, and increasingly as well middle-income communities.

Split Roll Will Affect Minority-Owned Firms the Hardest

Five percent of all businesses in the state are owned by African-Americans and nearly one-quarter of are owned by Latinos. In the latest available data, African-American-owned businesses grew by 29% between 2007 and 2012 and Latino-owned businesses by 44%, compared to the growth rate for all California businesses combined at 4% in this period. African-American owned firms (9.0%) were nearly twice as likely to fail because they had insufficient cash flow or sales to cover their costs than US businesses as a whole (4.6%), while Latino-owned firms (6.6%) were about 50% more likely. The additional costs from Split Roll would reduce cash flow even further, especially for minority-owned firms who tend to be smaller and family operated.

Moreover, Latino-owned firms tend to start small and stay small. In 2016, only 3% of Latino-owned firms nationally generated sales of more than $1 million. As smaller firms, they will tend to rent their facilities and thereby be subject to pass-through payments coming from higher property taxes. And as smaller firms, they will have a smaller profit base that will be more affected by cost increases of this type.

Split Roll Will Reduce California's Already Too-Low Pace of Homebuilding and Lead to Even Higher Housing Costs

A frequent criticism of Proposition 13 is that it has led to a fiscalization of land use decisions, under which local governments are said to favor commercial and industrial projects over residential due to additional tax revenues such as from sales tax that would come from this land use preference. This reluctance to approve new housing has contributed to the severe housing shortage that has produced rising home prices and rents that ever fewer Californians can afford. By shifting the fiscal balance by another $10.5 to $12.0 billion a year, split roll will only intensify this situation. Californians already face high housing costs because the supply has not kept up with demand. Split Roll would only increase the financial pressures on local governments to reduce future supply even more.

Reduced Homebuilding will Worsen California's Burgeoning Homelessness Problem

As fewer homes are built for California's growing population, more households will face the risk of becoming homeless. In 2019, California continued to lead the states, with US Housing & Urban Development data showing the state with over one-quarter of nation's homeless. Individual counties saw dramatic increases, with Los Angeles County's homeless population growing 13%, San Francisco 17%, Alameda County 46%, and Santa Clara County 34%.

Split Roll Will Increase the Volatility of School and Local Government Revenues

Property tax revenues currently are a sustainable component of school and local government finances, generating revenues that are generally predictable from year to year. State revenues, in sharp contrast, have become increasingly volatile as they have become dependent on taxes paid by a small number of wealthy taxpayers. As a result, the state budget has gone through wide fluctuations over the past two decades, inducing new spending commitments in flush years only to be followed by drastic cuts—including to schools and safety net programs—in the down years.

Shifting the property tax burden to a portion of property owners would have much the same effect to school and local budgets. As shown in the drastic drops during the recent recession, market values don't always go up, they can also go down and force major cuts in revenues based on market valuations. Using Board of Equalization data, if commercial and industrial properties had been assessed based on market rather than acquisition value, property tax revenues from this portion of taxpayers would have grown 65% between 2003-04 and 2007-08, but then would have plunged 23% in the following two years. Increasing revenue volatility at this level would add essential local services to the mix of state services to lower income communities that have seen major cuts in recent budget crisis years.

Split Roll Will Be a Regressive Tax, Giving Greater Benefits to High Income Areas

Shifting to market value assessments means that any new property tax revenues will go more to those parts of California that have the strongest economic growth. The coastal cities that have benefited the most from growth in jobs, income, and property values will secure a far larger share of any potential revenues than lower income communities that still face high unemployment and relatively few higher wage job opportunities.

Again using Board of Equalization data, if commercial/industrial assessed values had been based on market rather than acquisition value in 2016-17, a split roll tax system would have sent 86% of the additional revenues to the urban coastal counties and only 14% to everywhere else. The higher income Bay Area would have gotten 32% of any new funds, while the Central Valley with its lower property values and lower incomes would have gotten only 3%.

The Full Effect on School Funding Is Uncertain

As with other measures before it, the current ballot proposal covers only one part of the full school financing system in the state. It is a piecemeal approach that assumes everything else will stay the same. That businesses will simply pay the higher costs and pass them on to their customers. That the legislature will continue funding schools at the level they are supposed to do even as they see new revenues bypassing the state and going to the schools. The fiscal estimates of up to $10.5 to $12.0 billion a year in new funds with about 40%—or more precisely 40% of what's left over after the state and counties have taken their shares—going to schools depends on no changes in behavior.

But we already know that California is a costly place to do business just as it is a costly place to live. Many manufacturers have not been able to continue operating here as a result of these costs, with employment in this blue-collar industry already dropping by a third between 1990 and 2018, meaning there are far fewer of these high-value establishments to tax in the first place. These are jobs that once offered the promise of middle-class incomes to minority communities, and they still do. The most recent US Census data shows that in 2018, 42% of employment in California manufacturing was Latino or African-American, earning an average of $56,300 a year. If more of these jobs go, few of these workers—especially those with a high school or less education—will be able to find jobs paying this much.

We also know the legislature can become very creative at budget time, especially during budget crisis years when their other favored programs are on the chopping block. In 2017, the legislature made a last-minute change to the estimate of how much schools would be getting from local property taxes, in order to redirect $300 million from schools to their own budget priorities. In 2011 during an extreme budget crisis, the legislature reduced the amount of state funds owed to the schools under Proposition 98 by $2.1 billion just by reclassifying a portion of sales tax revenues from general funds to special funds as part of the 2011 Realignment. These funds were backfilled only after the threat of these cuts was used to convince the voters to approve Proposition 30 and raise income taxes on higher wage earners and sales taxes on all consumers.

California's Disadvantaged Communities Need Tax Reform, Not Just More of the Same

The past two decades have shown the weakness of California's current public revenues structure. The budget's ups and downs have seen promises of new programs to improve the wellbeing of disadvantaged communities in the up years, only to see them yanked away in the bad. And the response of both state and local governments has continued to be the same—trying to shore up their finances by passing new taxes and new fees that land on the poor, the working poor, and those struggling to keep in place in the middle class just when they can afford them the least.

Split roll is just another proposal to do the same. It does not help reform the whole of public finances to a more sustainable and fair system to ensure essential services will not again go through the cuts we've seen in the recent past. It instead increases the complexity of the tax system, introduces new sources of financial volatility to the schools and local programs, and increases the economic divide in the state by a tax that will benefit the wealthy communities of our state more than the areas that need it the most.

References/Citations

If Proposition 13 had not passed, the average property tax rate is estimated to have been 2.67% of market value in 1978-79. . . In the four years prior to Proposition 13, assessed values grew an average of 12.5% a year . . . *Board of Equalization, Annual Reports and California Senate, Report of the Senate Commission on Property Tax Equity and Revenue, 1991.*

For someone buying the median priced single-family home in California today, the difference between that and the current average rate would mean paying over $9,200 more a year. *Calculated from the California Association of Realtors, median price of an existing single-family home at $538,690 in January 2019 and the current average tax rate of 1.143% from Board of Equalization data.*

Based on present value over the 30-year life of a mortgage, this additional annual housing payment would be the same as tacking on almost $160,000 to the price of an already too-costly California home. *Calculated as present value of annuity growing at 1% a year and February 2019 average mortgage rate of 4.3% over 30 years.*

As stated by Justice Blackmun in the Supreme Court's ruling that acquisition value is a constitutional assessment method . . . *Nordlinger v. Hahn (1992).*

Using prior estimates by the Legislative Analysts' Office, the current effective property tax rate likely averages around 1.3% if voter-approved parcel taxes, Mello-Roos taxes, and other assessments on annual property tax bills are included. *Calculated from data in Legislative Analyst's Office, Understanding California's Property Taxes, November 2012.*

The 2007 Survey of Consumer Finances showed nationally that principal residences constituted 54.0% of all household wealth for African-Americans and 52.5% for Latinos, compared to 30.8% for non-Latino Whites. *Wolff, Edward N., Household Wealth Trends in the United States, 1962-2013: What Happened Over the Great Recession? NBER Working Paper Series, December 2014.*

The most recent American Community Survey (ACS) data for 2018 shows California home ownership still at significant levels for all income groups: 27% for households with incomes below poverty, to 48% for households with incomes at 200-299% of poverty, to 72% for those earning 500% or more. *Analysis of ACS PUMS data from IPUMS-USA, University of Minnesota.*

By race/ethnicity, home ownership was 34% for African-American households (compared to 42% in the rest of the US), 44% for Latinos (48% in rest of US), and 63% for non-Latino Whites (73% in rest of US). *US Census Bureau, 2018 American Community Survey.*

Using Board of Equalization data, if commercial and industrial properties had been assessed based on market rather than acquisition value, property tax revenues from this portion of taxpayers would have grown 65% between 2003-04 and 2007-08, then would have plunged 23% in the following two years. *Calculated from the BOE 4-R commercial/industrial assessment ratio data and average property tax rates.*

Again using Board of Equalization data, if commercial/industrial assessed values had been based on market rather than acquisition value in 2016-17, a split roll taxation would have sent 86% of the additional revenues to the urban coastal counties and only 14% to everywhere else. The higher income Bay Area would have gotten 32% of any new funds, while the Central Valley with its lower property values would have gotten only 3%. *Calculated from the BOE 4-R commercial/industrial assessment ratio data and average property tax rates.*

Many manufacturers have not been able to continue operating here as a result of these costs, with employment in this blue-collar industry already dropping by a third between 1990 and 2018, meaning there are far fewer of these high-value establishments to tax in the first place. *Calculated from EDD Current Employment Survey data.*

The most recent US Census data shows that in 2018, 42% of employment in California manufacturing was Latino or African-American, earning an average of $56,300 a year. *Calculated from Census, Quarterly Workforce Indicator data.*

In 2017, the legislature made a last-minute change to the estimate of how much schools would be getting from local property taxes, in order to redirect $300 million from schools to their own budget priorities. *Governor Brown, Legislative Democrats Strike State Budget Deal, KQED News, June 13, 2017.*

In 2011 during an extreme budget crisis, the legislature reduced the amount of state funds owed to the schools under Proposition 98 by $2.1 billion just by reclassifying a portion of sales tax revenues from general funds to special funds as part of the 2011 Realignment. *LAO, 2011 Realignment: Addressing Issues to Promote Its Long-Term Success.*

Nearly one-quarter of all businesses in the state are owned by Latinos, and they are the fastest growing component of the state's economy. In the latest available data, Latino-owned businesses grew by 43.9% between 2007 and 2012, compared to the growth rate for all California businesses combined at 5% in this period. The additional costs from Split Roll would raise cost barriers faced by Latino firms. *California Latino Economic Institute, The State of Latino Economic Well-Being in California: Employment & Entrepreneurship, May 2019.*

Moreover, Latino-owned firms tend to start small and stay small. In 2016, only 3% of Latino-owned firms nationally generated sales of more than $1 million. *Stanford Graduate School of Business, Latino Entrepreneurship Initiative, State of Latino Entrepreneurship, 2018 Research Report.*

In 2019, California continued to lead the states, with US Housing & Urban Development data showing the state with over one-quarter of nation's homeless. Individual counties saw dramatic increases, with Los Angeles County's homeless population growing 13%, San Francisco 17%, Alameda County 46%, and Santa Clara County 34%. *HUD Exchange, 2019 AHAR: Part 1 - PIT Estimates of Homelessness in the U.S., December 2019.*