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Housing and Land-Use Implications of Split-Roll Property Tax Reform in California

Summary of Findings

Solomon Greene, Laurie Goodman, Sarah Strochak, Daniel Teles, and Patrick Spauster

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Background

Proposition 15 is a statewide ballot measure that, if passed, would change the way local governments assess property values for calculating and collecting property taxes in California. Since the passage of Proposition 13 in 1978, tax rates and increases in California have been subject to strict limits, and property assessments have been tied to a property's purchase price instead of its current market value. If passed, Proposition 15 would require California jurisdictions to reassess most commercial and industrial properties at current market value at least every three years (residential property would continue to be taxed under the rules of Proposition 13). Proposition 15 is often referred to as the "split-roll" ballot measure because it would split the assessment rolls for commercial and industrial properties from residential properties in California.

Municipal Incentives to Rezone

Several critics of the ballot initiative argue that Proposition 15 could exacerbate California's housing shortage by encouraging municipalities to rezone properties from residential use to commercial or industrial use to capture new tax revenue from a split-roll assessment scheme. A city's fiscal incentive to rezone away from residential use is limited by the number of parcels that could plausibly be converted (we call these "at-risk" properties) and the amount of revenue it retains from property taxes. We assume cities will not rezone new residential properties or lots in the middle of a purely residential development, and we therefore identify at-risk parcels as either vacant parcels or those with aging residential structures that are near commercial or industrial areas.

Owner Incentives to Redevelop

If passed, Proposition 15 would create incentives for private owners of vacant parcels or those with aging commercial or industrial structures to covert those properties to residential use (we call these "opportunity" properties). Residential properties can increase in their assessed value by only 2 percent a year, while commercial and industrial properties will be taxed at their market value. The incentive to private owners and developers varies with expected property value increases. The greater the increase in property values, the bigger the difference in the tax liability between a commercial or industrial use and a residential use.

Four Case Study Cities

After screening based on data quality, we selected four cities that represent a diversity of size, zoning regimes, real estate markets, position within a regional housing market (core cities versus suburban or satellite cities), and property tax apportionment (table 1). The cities also vary in the number of at-risk and opportunity parcels.

TABLE 1
Characteristics of Selected Cities

City	Population	Residential permitted in commercial zones?	At-risk parcels	Opportunity parcels	Median home value	Current (2019) implicit tax rate
Los Angeles	3,959,657	Yes	3,830	8,104	$599,700	0.265%
Fresno	522,277	No	19	291	$224,600	0.232%
Berkeley	120,926	Yes	23	88	$938,400	0.382%
Chula Vista	266,468	No	5	91	$465,000	0.117%

Sources: Authors' calculations using data from First American property records, the 2018 American Community Survey, and the California State Controller's Office.
Note: The implicit tax rate is the city's share of the 1 percent property tax plus local levies and fees.

In all four cities, private owners stand to gain more in tax savings by converting opportunity properties to residential use than jurisdictions could gain by rezoning at-risk parcels. Table 2 displays our estimates of increased revenue if each city aggressively rezoned at-risk properties and potential savings to owners who convert opportunity properties.

TABLE 2

Comparison of Annual Monetary Incentives

Millions of dollars

	Los Angeles		Fresno		Berkeley		Chula Vista	
	Municipal incentive to rezone	Owner incentive to convert	Municipal incentive to rezone	Owner incentive to convert	Municipal incentive to rezone	Owner incentive to convert	Municipal incentive to rezone	Owner incentive to convert
Short term	$3.77	n/a	$0.14	n/a	$0.01	n/a	minimal	n/a
Year 5	$4.02	$51.34	$0.05	$4.58	$0.04	$0.29	minimal	$0.49
Year 10	$10.36	$132.37	$0.13	$11.80	$0.10	$0.75	minimal	$1.25
Year 20	$28.76	$367.40	$0.35	$32.76	$0.27	$2.09	minimal	$3.48

Source: Authors' calculations using data from First American property records and the California State Controller's Office.

Notes: n/a = not available. Dollar values are nominal. Our calculations of monetary incentives assume a medium-growth scenario of a 3.5 percent appreciation rate, the average rate from 2002 to the present. We do not estimate city incentives in Chula Vista because there were only five at-risk properties.

Main Findings

Cities have few opportunities to rezone residential land for commercial or industrial use. Across all four case study cities, there are very few at-risk parcels. We expect that Los Angeles represents the upper end of at-risk parcels, with less than 4,000. Cities in which residential, commercial, and industrial zones rarely overlap and cities that are almost entirely residential will, like Chula Vista, have little or no incentive to rezone no matter where they are located or how much tax revenue is apportioned to the city.

City incentives to rezone to capture additional property tax revenue are reduced significantly by statewide property tax limits. All the cities we examined have an implicit property tax rate (the city's share of the 1 percent property tax plus local levies and fees) between 0.1 percent and 0.4 percent. Other cities in that range will have similarly few incentives to rezone away from residential use.

In every city, private owners stand to gain more in tax savings by converting opportunity properties to residential use than jurisdictions could gain by rezoning at-risk parcels. This is partly because cities receive only a fraction of the revenue generated from properties within their boundaries. The rest goes to schools, the county government, or special districts. Cities in California that receive a far smaller share of the property tax have even less incentive to rezone than our four case studies.

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500 L'Enfant Plaza SW
Washington, DC 20024

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