July 2018

Policy Brief:
Impacts on the 5-County Bay Area from Commercial Property Tax Reform

THE SAN FRANCISCO FOUNDATION

MAKE IT FAIR

July 2018

THE CALIFORNIA SCHOOLS AND LOCAL COMMUNITIES FUNDING ACT

How to Raise Billions for Schools and Services by Reforming the Commercial Property Tax System

Policy Brief Summary

Nearly $2.4 billion in new revenues are estimated for the 5-County Bay Area (Alameda, Contra Costa, Marin, San Francisco and San Mateo) from reforming Prop 13's commercial property tax system according to USC/PERE's extensive multi-year study.[1] These funds, which are estimated at $11 billion statewide, will be allocated for cities, counties, schools and special districts, with additional revenue paying off the bonds for school construction and infrastructure. The primary impact of market-value reassessment will be on the underassessed land and buildings belonging to companies and investors who purchased their properties a long time ago. Commercial property tax reform will also reassess underutilized land in sprawling commercial strips, auto malls and underassessed retail areas. In addition to strengthening local governments, it will also lead to far more efficient land use, including likely sparking higher-density housing along commercial strips in Alameda, Contra Costa and San Mateo Counties and more intensive use of land currently held vacant or in low-level uses across the region.

Key findings and patterns from the data and analysis:

1. **Revenues for local government and schools:** Revenues in San Francisco County top the list and are estimated to be at $836 million from reassessment of commercial/industrial property for schools, cities, counties and special districts. For San Mateo, it would be $587 million annually, and for Alameda $553 million. Those amounts are at the 1% current property tax rate, and property tax debt incurred for infrastructure would be higher. This revenue is local property tax revenue, which can be used for all local purposes including infrastructure, public safety, parks and libraries, affordable housing, health care and homelessness services (about 55% of total or $6 billion statewide annually). It will improve local service delivery and strengthen the finances of local governments, while also providing significant new revenues for K-12 schools and community colleges (about 45% of total or $5 billion statewide annually, over and above the current funding guarantees).

2. **Long-held properties:** The majority of revenues from reassessment will come from properties held for long periods of time. On a regional basis, 56% of all Bay Area commercial properties have not been reassessed for nearly 20 years, while 22% still have assessments based on property values dating back to 1975-1979.

NEW REVENUE PROJECTIONS FOR BAY AREA:
$2.4 billion for the 5-County region and $11 billion statewide

Source: USC Program for Environmental and Regional Equity

Data analysis by USC/PERE shows that Contra Costa County has the largest share of old assessments, with 75% of properties assessed nearly 20 years ago, including over one-third (35%) that were assessed pre-1979. Alameda, Marin and San Mateo are all in the middle range with 55%, 59% and 58% of properties assessed before 1999, while San Francisco County's real estate boom of the last decade now shows that under half (48%) of all commercial properties were last reassessed pre-1999. *(See accompanying charts in Appendix)*

3. **Wide disparities:** Assessed commercial land values throughout the Bay Area can vary by factors of 50x and even 100x or more.[2] They not only vary widely from company to company, they can vary within one company which leases or owns long-held land and also has recently bought land for expansion. We also see large variations in the same industry located on similar properties, even while they charge the same prices for products and services.

   For example, in downtown San Francisco's Union Square, the Grand Hyatt San Francisco is assessed at $1,562 per square foot, while the nearby Handlery Hotel sits on land assessed at $161. The Handlery Hotel's underassessment results in a $356,000 annual loss for the City on the land alone, even while they charge their customers similar room rates.

4. **Commercial renters:** The tax advantages afforded by the current system accrue to long-term landholders, not new companies. Rents for companies that lease their property in industrial/office parks are at market rates and will continue at market, with the benefits providing a windfall to landowners. For example, in Redwood City in San Mateo County, two neighboring industrial business parks are assessed at very different rates: HCP, a publicly-traded Real Estate Investment Trust (REIT), is assessed at $109/square foot, while Met Life, a global financial company, is assessed at an average rate of $21. Rents, however, are similar, since they are primarily set by market conditions. This results in a loss of $1.6 million for San Mateo County's schools and local governments. Rents are equivalent for buildings with both higher and lower assessments; there is no indication that any rents are below market because of low assessed values.

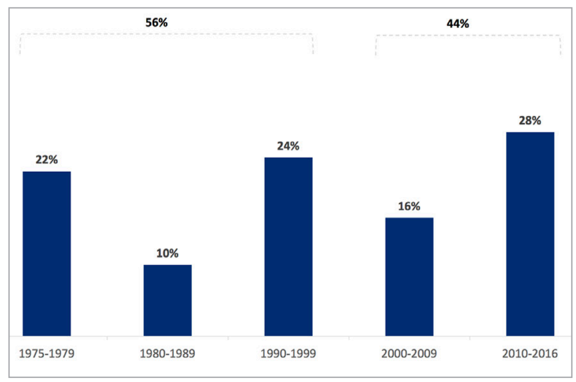
5. **High value-added per square foot:** Technology and pharmaceutical companies hold such high value-added per square foot that the 1% property tax is not a significant cost, as it might be for auto lots or big box retail. New equipment is already taxed at full market value, and buildings are reassessed when remodeled. High-tech companies have built expensive new properties, assessed at full market value, with the tax at 1% representing a miniscule part of their revenue stream (also still fully deductible under the new federal tax law just passed). For example, Genentech in South San Francisco is owned by the multinational company, Hoffman-LaRoche Pharmaceuticals. Its 3.83 million square foot campus is paying taxes based on assessed values of only $34/sf while others in the area are assessed at

PROJECTED NEW REVENUES FOR BAY AREA (in millions)

COUNTY	ESTIMATED RANGE	MID-ESTIMATE
Alameda	523.9 - 583.9	553.4
Contra Costa	329.5 - 366.7	347.8
Marin	67.1 - 75.1	71.0
San Francisco	795.4 - 877.7	835.9
San Mateo	559.5 - 615.7	587.2
Total Bay Area New Revenues	2,275.4-2,519.1	2,395.3

Source: USC Program for Environmental and Regional Equity

DISTRIBUTION OF AVERAGE REVENUE GAINS by Base Year, 5-County Bay Area, 2019



Source: USC PERE analysis of disparity ratios of commercial and industrial properties based on CoreLogic assessor roll data for 2015-16. 5-County Bay Area includes Alameda, Contra Costa, Marin, San Francisco, and San Mateo.

SAN FRANCISCO COUNTY: GRAND HYATT SAN FRANCISCO AND THE HANDLERY HOTELS

GRAND HYATT

HANDLERY UNION SQUARE SAN FRANCISCO

For example, in downtown San Francisco's Union Square, the Grand Hyatt San Francisco is assessed at $1,562 per square foot, while the nearby Handlery Hotel sits on land assessed at $161. The Handlery Hotel's underassessment results in a $356,000 annual loss for the City, even while they charge their customers similar room rates.

3 times this rate. Yet, compared to the company's value of $29 billion, a reassessment to fair market value would add a very insignificant and negligible cost to overall business operations.

6. **Most revenue from largest properties:** In the 5-County Bay Area region, 85% of the new revenue will come from only 16% of all properties worth over $5 million. In other words, the impact of increased property tax revenues due to reassessment will be concentrated in the very top-tier of property owners. Conversely, a tiny proportion, just 2.5% of all new revenues, will come from the 49% of small commercial properties that are valued at under $1 million. Even for the 34% share of somewhat larger commercial properties valued between $1 million and $5 million, the data show that they will provide just 12% of the new revenues overall. Assessors will be able to focus on the largest properties for the bulk of the revenue while allowing a longer transition for the smaller properties.

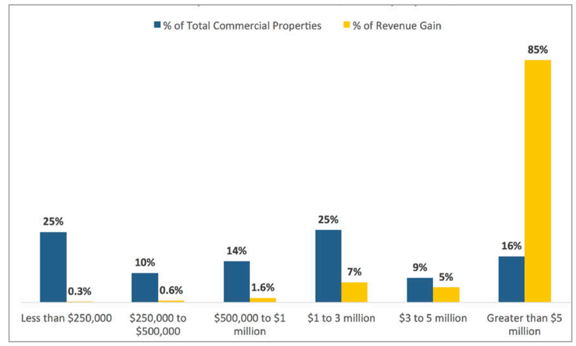
7. **Export of tax:** A not-insignificant amount of the tax increase will be exported from California, since many of these highly-valuable properties are owned by national and international investors through REITs and other mechanisms and as shareholders of corporate-owned property who are worldwide as well. The recent federal tax bill gives even greater benefits to these investors. For example, MetLife, a global financial company, owns a greatly underassessed office park in Redwood City. PS Business Parks is a publicly-traded REIT with underassessed property in San Mateo. The impact of reassessment will be borne by shareholders and investors all over the world.

8. **Competitive impact:** With full market value reassessment, property taxes in Oakland will still rank 35th and San Francisco 43rd among the largest 50 cities in the nation, due to the low rates of 1% plus overrides, property tax debt incurred for infrastructure.[3]

9. **Infrastructure will benefit greatly:** Oakland has .3492 in overrides for debt, including BART, schools, parks, city and community colleges, which means that the additional revenue will either pay off current bonded indebtedness more quickly or, if payment is a fixed amount, will lower the rates to generate the same amount of revenue. A greater degree of infrastructure can and will be supported, particularly since infrastructure investment raises property values, which in turn helps finance more infrastructure.

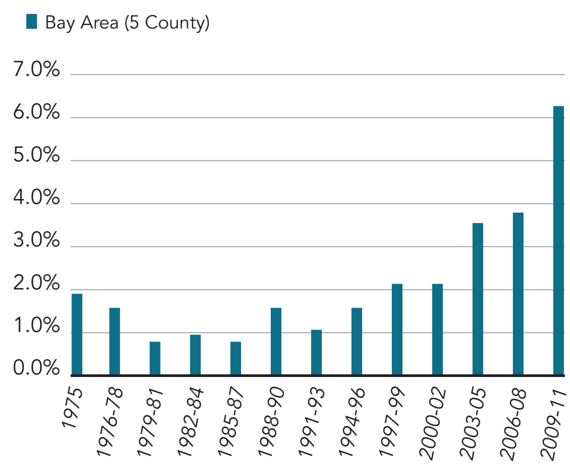
10. **Commercial strips, housing and land use:** Research has shown that underassessed land is more likely to be vacant.[4] [5] Underutilized commercial land for car lots, strip malls and sprawl are often greatly underassessed, with much of it passed on for generations in trusts. A June 2018 study by UC Santa Cruz

SHARE OF TOTAL COMMERCIAL/INDUSTRIAL PROPERTIES AND SHARE OF REVENUE GAIN
by Estimated Market Value, 5-County Bay Area, 2019



Source: USC PERE analysis of disparity ratios of commercial and industrial properties based on CoreLogic assessor roll data for 2015-16. 5-County Bay Area includes Alameda, Contra Costa, Marin, San Francisco, and San Mateo.

BAY AREA PERCENT OF VACANT LOTS DEVELOPED 2011-2016,
by Tax Base Year: Bay Area



In the Bay Area, of all vacant lots with a tax base year of 1993 or earlier, only 1.3% were developed by 2016, while 6.2% of vacant lots with a tax base year of 2009-11 were developed by 2016. This strongly suggests that lack of regular assessment to fair market value contributes to holding land off the market and keeping it vacant.

analyzes this problem carefully and clearly shows the current system encourages holding land off the market and inflates its value. With market value taxation, much of this land will be released and made available for more intensive use, including much-needed high-density housing.

REFERENCES

(1) USC Program for Environmental & Regional Equity analysis based on CoreLogic assessor roll data for 2015-16.

(2) California Tax Reform Association has provided the specific data for individual properties and trends referenced in this document, from CoreLogic and assessor data.

(3) Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence, *50 State Property Tax Comparison Study For Taxes Paid in 2017*, April 2018.

(4) Legislative Analyst's Office/State of California, *Common Claims About Proposition 13*, September 2016.

(5) Chris Benner and Gabriela Giusta, Everett Program, University of California-Santa Cruz, *Market Value: How Fair Assessment of California's Commercial Property Values Would Likely Affect Land Use, Urban Development and The Economy,* June 2018.

MARIN COUNTY – MALLS IN CORTE MADERA (COMMERCIAL)

Marin County is a suburban area whose residents have some of the nation's greatest purchasing power as income per capita is one of the highest. Yet a few landowners who own retail space are not paying their fair share in local property taxes.

In the City of Corte Madera, two neighboring malls of the same size serve the same consumers, but one is assessed radically less than its competitor. The Town Center at Corte Madera, a 1.3 million square foot property owned by Heitman, a real estate management firm from Chicago, is assessed between \$13 and \$249. Its neighbor, the Village at Corte Madera, a 1.3 million square foot property partly owned by Macerich, a publicly traded company from Santa Monica, is assessed between \$12 and \$46 per square foot. If The Village at Corte Madera was assessed like its competitor at \$249, it would pay \$3.6 million more in property taxes every year. If the Town Center was entirely taxed at \$249 it would also pay \$3.6 million more in property taxes.

Chevron Oil Refinery, Richmond, California (photo: Scott Hess)

ALAMEDA COUNTY– PROLOGIS AND PS IN HAYWARD (INDUSTRIAL-LOGISTICS)

Alameda County, with its proximity to major airports, the Port of Oakland, and multiple highways and freight lines, helps make the San Francisco Bay Area a key distribution hub for the region and the country. Yet a few owners of logistics real estate are not paying their fair share.

In the City of Hayward, Prologis, a publicly traded company from San Francisco, owns 2.9 million square feet of industrial land taxed at between \$7 and \$25. However, its competitor, PS Business Parks, a publicly traded company from Glendale, CA, owns 411,640 square feet of industrial land assessed at \$11. If PS Business Parks was taxed like its neighbor, it would pay an additional \$69,000 in property taxes every year. If Prologis' properties, which were acquired in 1993 and 2015, were taxed based on the more current value, it would pay an additional \$529,000 in property taxes every year.

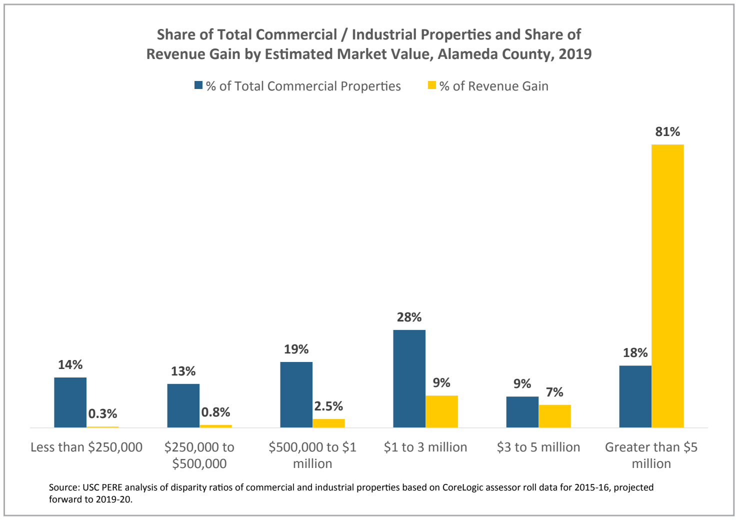
THE SPECIAL CASE OF CHEVRON OIL

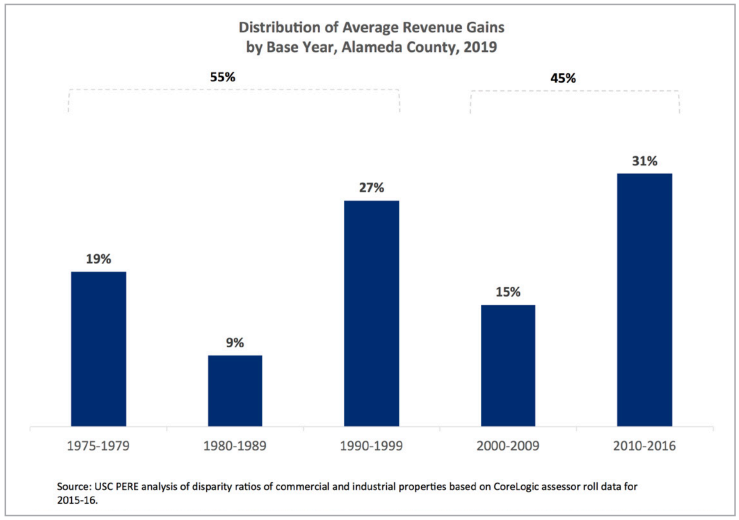
Chevron

Contra Costa County is home to four oil refineries which represent over a quarter of the state's daily capacity to process petroleum, equal to 23.8 million gallons a day.

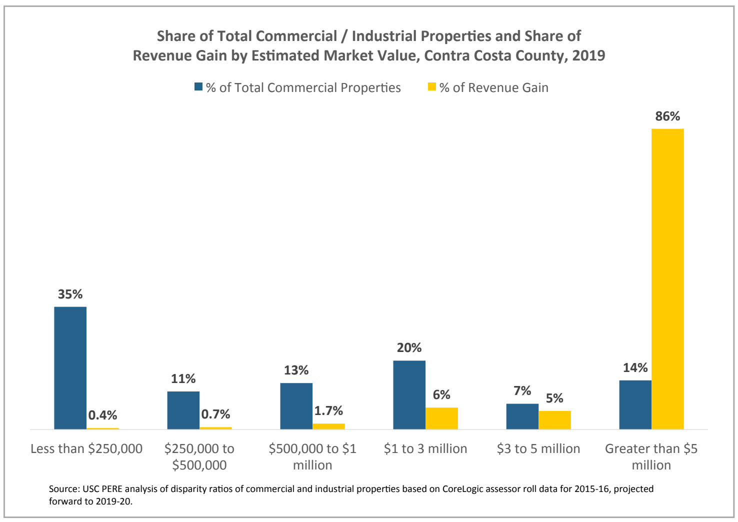
Under Proposition 13, Chevron saves \$100 million or more annually on its property taxes statewide due to underassessed properties, including gas stations, oil properties, and refineries. If the land beneath the Chevron Richmond Refinery were assessed like comparable refineries, such as the Phillips 66 Refinery in the City of Rodeo or the Tesoro Refinery in the City of Martinez, Chevron would pay from \$3.1 to \$3.5 million in additional property taxes every year on their land alone.

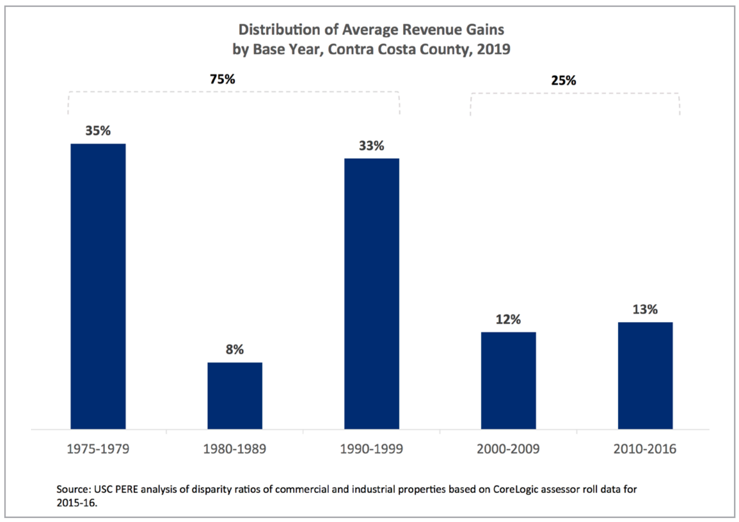
ALAMEDA COUNTY



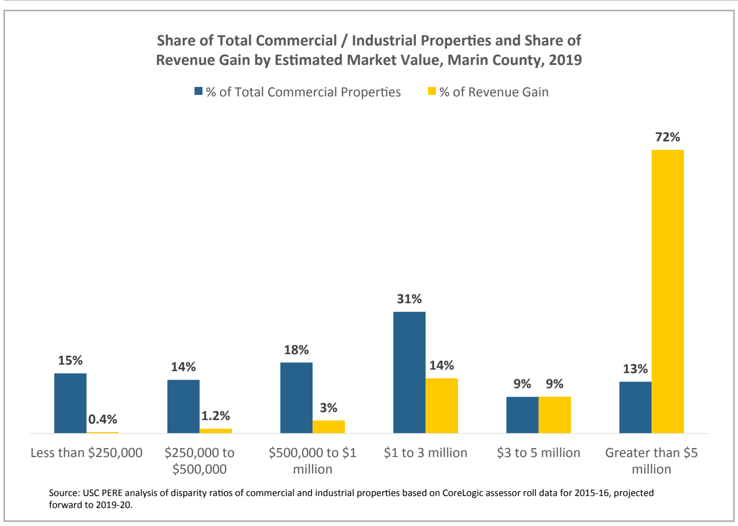


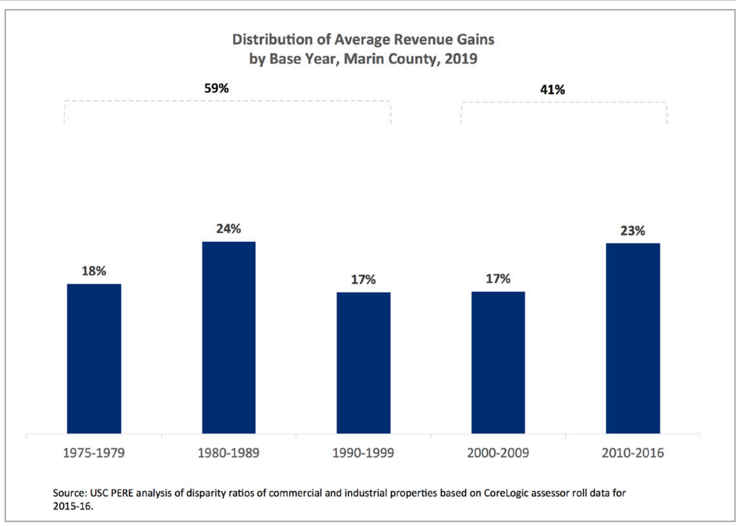
CONTRA COSTA COUNTY





MARIN COUNTY



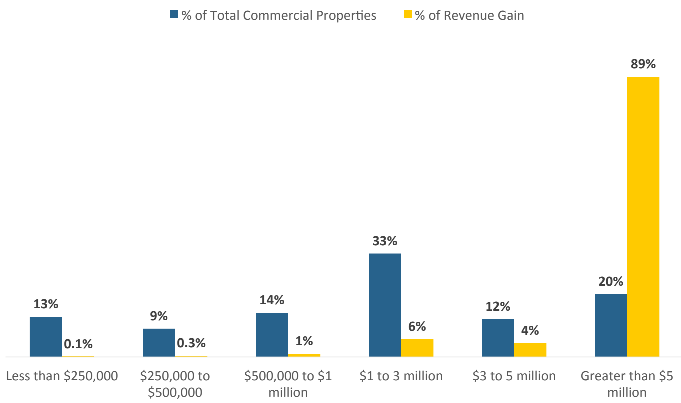


Appendices *continued*

BAY AREA DATA

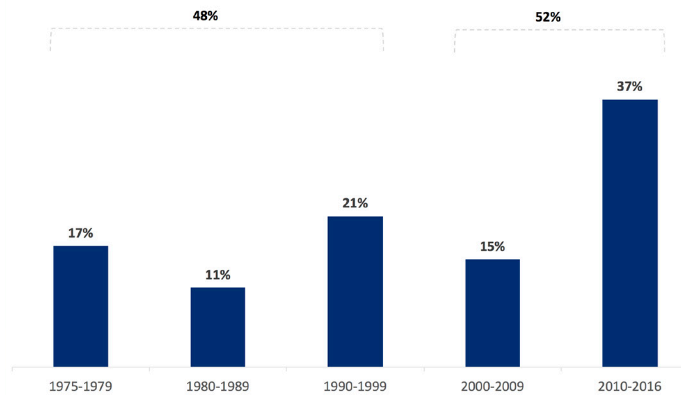
SAN FRANCISCO

Share of Total Commercial / Industrial Properties and Share of Revenue Gain by Estimated Market Value, San Francisco, 2019



Source: USC PERE analysis of disparity ratios of commercial and industrial properties based on CoreLogic assessor roll data for 2015-16, projected forward to 2019-20.

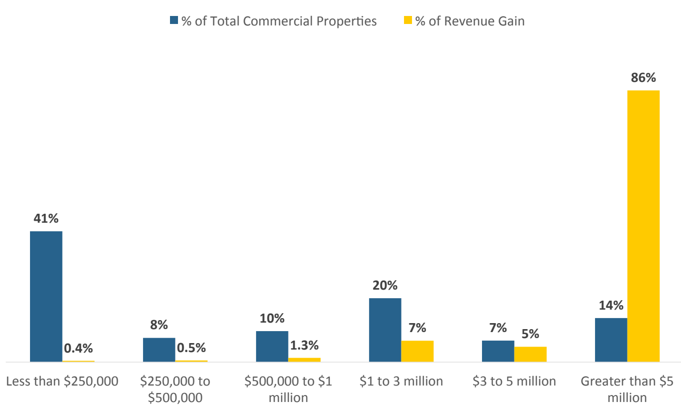
Distribution of Average Revenue Gains by Base Year, San Francisco, 2019



Source: USC PERE analysis of disparity ratios of commercial and industrial properties based on CoreLogic assessor roll data for 2015-16.

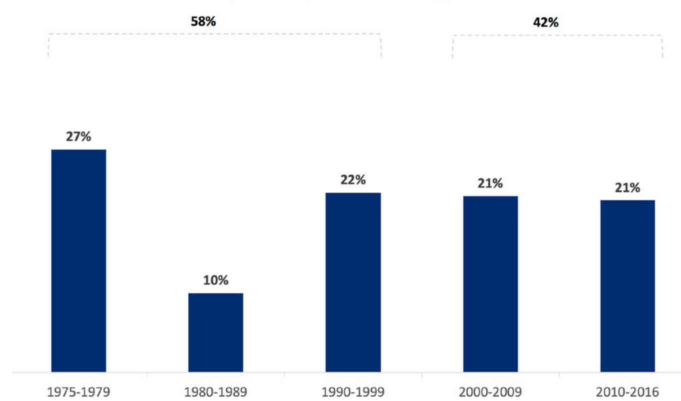
SAN MATEO COUNTY

Share of Total Commercial / Industrial Properties and Share of Revenue Gain by Estimated Market Value, San Mateo, 2019



Source: USC PERE analysis of disparity ratios of commercial and industrial properties based on CoreLogic assessor roll data for 2015-16, projected forward to 2019-20.

Distribution of Average Revenue Gains by Base Year, San Mateo County, 2019



Source: USC PERE analysis of disparity ratios of commercial and industrial properties based on CoreLogic assessor roll data for 2015-16.

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Steering Committee