Senate Bill 378 /Senate Constitutional Amendment 9 (Beall)
Date: 8/17/15 and 08/18/15
Program: Property Taxes
Sponsor: California Association of Realtors
California Constitution Article XIII A, Section 2
Revenue and Taxation Code Section 69.5
Effective: If approved by voters.

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Summary: Subject to voter approval, allows homeowners 55 and older to qualify for a base year value transfer if they buy a home of greater value.

Purpose: To allow partial benefits if a replacement home is not of equal or lesser value.

Fiscal Impact Summary: Annual revenue loss of $7,000,000.

Existing Law: For property tax purposes, real property is reassessed from its Proposition 13 protected value (called a "base year value") to its current market value whenever a change in ownership occurs.[1] Subject to many conditions, the law allows homeowners 55 years and older or qualified disabled persons to sell their home, and buy or build a new one, and transfer their base year value to the new home.[2] This benefit gives homeowners property tax relief by allowing property taxes to remain essentially the same[3] after the move, provided they purchase a home of equal or lesser value that is located in the same county.[4] The replacement home must be purchased within 2 years, before or after the sale of the original home.

Relevant to this bill, to qualify for this benefit, the replacement property's market value as of the date of purchase must be equal to or less than the original property's market value on the date of its sale. If the replacement home does not satisfy the "equal or lesser value" test, then no benefit is available. The meaning of "equal or lesser value" depends on when the replacement property is purchased. In general, equal or lesser value means:

- 100% or less of the market value of the original property if a replacement property was purchased or newly constructed *before* the sale of the original property, or
- 105% or less of the market value of the original property if a replacement property was purchased or newly constructed within the first year after the sale of the original property, or
- 110% or less of the market value of the original property if a replacement property was purchased or newly constructed within the second year after the sale of the original property.

New Construction. Under existing law, after a base year value transfer, additional new construction to a replacement home will not be subject to assessment provided that (1) the construction is completed within two years of the sale of the original property and (2) the full cash value of the new construction plus the market value of the replacement home when purchased does not exceed the market value of the original property as determined for the original base year value transfer claim.

[1] California Constitution Article XIII A, Sec. 2.
[2] California Constitution Article XIII A, Sec. 2 (a), Revenue and Taxation Code (RTC) Section 69.5.
[3] The property tax payment will not be exactly the same because the precise tax rate and direct levies (special assessments, parcel taxes, etc.) typically vary by location.
[4] In addition, ten counties offer this property tax benefit to new county residents. Each county has the discretion to accept intercounty transfers. Counties with active enabling ordinances include: Alameda, El Dorado, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Mateo, Santa Clara, and Ventura.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Proposed Law:

Homes of Greater Value. If voter-approved, SCA 9 authorizes the Legislature to allow a partial benefit for a replacement home that is of greater value. The replacement property's base year value would be calculated by adding the difference between the original property's market value and the replacement dwelling's market value to the original property's base year value. The bill provides the necessary implementing provisions. *RTC §69.5(a)(1)(B)*

Value Comparison. SB 378 modifies the value comparison test when the market value of the replacement property has decreased and the replacement property is purchased before the original property is sold. In this situation, to determine whether the "equal or lesser" value requirement is met the assessor looks to the market value of replacement property on the date the original property sells. *RTC §69.5(g)(6)(A)*

New Construction. SB 378 provides that new construction on a home of greater value will not be subject to assessment if it is completed within two years of the sale of the original property. *RTC §69.5(h)(4)(B)*

Contingent Enactment. SB 378 becomes operative only if SCA 9 is enacted.

In General:

Property Tax System. In 1978, voters changed California's property tax system by the approval of Proposition 13. Under this system, property is reassessed to its current market value only after a change in ownership or new construction. Generally, the sales price of a property is used to set the property's assessed value, and annual increases to that value are limited to the rate of inflation up to 2%.

Base Year Values. At the time of the ownership change, the value for property tax purposes is redetermined based on current market value. This established value is described as the "base year value." Thereafter, the base year value is subject to annual increases for inflation limited to 2% per year. This value is described as the "factored base year value." This system, established by Proposition 13, can result in substantial property tax savings for long-term property owners.

Base Year Value Transfers. Voters have approved three constitutional amendments permitting persons to "transfer" their Proposition 13 base year value from one home to another that is of equal or lesser value. The base year value transfer avoids reassessment of the newly purchased home to its fair market value.

- **Intracounty.** In 1986, Proposition 60[5] amended the constitution to allow persons over the age of 55 to sell a principal residence and transfer its base year value to a replacement principal residence within the same county.
- **Intercounty.** In 1988, Proposition 90[6] amended the constitution to extend these provisions to a replacement residence located in another county on a county-optional basis. Currently, ten counties accept transfers from homes located in another county.
- **Disabled Persons**. In 1990, Proposition 110[7] amended the constitution to extend these provisions to any severely and permanently disabled person regardless of age.

RTC Section 69.5 implements all three propositions.

[5] Proposition 60, approved November 4, 1986.
[6] Proposition 90, approved November 8, 1988.
[7] Proposition 110, approved June 5, 1990.

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Legislative Background: Similar legislation to allow a partial benefit for replacement homes of greater value include:

- SCA 11/SB 274 (2009, Dutton). This bill additionally would have expanded the window to purchase from two to three years from the sale of the original property.
- SCA 24/SB 1610 (2008, Dutton).

Neither bill passed out of Senate Revenue and Taxation Committee.

Commentary:

1. **Base year value transfers allow homeowners to keep their Proposition 13 tax savings if they move to a home of equal or lesser value.** A "base year value transfer" allows eligible homeowners to keep their prior home's Proposition 13 protected value by transferring it to a new home of equal or lesser value. With the transfer, homeowners pay essentially the same amount of property tax if they move within the county or to one of ten other participating counties.

2. **Base year value transfers are not permitted if a person moves to a home that costs more.** Some persons may choose not to purchase a new home because of the resulting increase in property taxes. Generally, the property taxes on the new home would be 1% of its current market value. With this constitutional amendment, if a qualified person buys a new home that is worth $75,000 more than the home they sold, then they would pay an additional $750 ($75,000 x 1% tax rate) over the amount of property taxes they paid for the original home.

3. **This bill allows homeowners to keep their Proposition 13 tax savings if they move to a home of greater value by allowing a partial benefit.** Homeowners over the age of 55 and qualifying disabled persons would only pay additional property taxes based on the difference in market value between the two homes.

4. **How would the new base year value be set when a home of greater value is purchased?** The replacement dwelling's base year value would be calculated by adding the original home's base year value to the difference in market value of each home as of the date each was sold. Thus, the new "combined" base year value would be:

   Replacement dwelling's base year value = Original property's base year value + (Replacement dwelling's market value on date purchased - Original property's market value on date sold)

5. **The possible tax savings depends on a number of variables that are specific to the facts of each case.** The following table shows the variable tax savings if a person sells a home for $500,000 and buys a new home for $600,000. Without a base year value transfer, the taxes on the new home at the basic 1% tax rate would be $6,000.

Original Property's Assessed Value	Market Value Difference Between Homes	Replacement Dwelling's Assessed Value with Partial Transfer	Taxes Under Current Law	Taxes Under Proposed Law	Tax Savings
$100,000	$100,000	$200,000	$6,000	$2,000	$4,000
$200,000	$100,000	$300,000	$6,000	$3,000	$3,000
$300,000	$100,000	$400,000	$6,000	$4,000	$2,000
$400,000	$100,000	$500,000	$6,000	$5,000	$1,000

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6. **The value comparison test is problematic when a homeowner purchases the replacement property before selling the original property and real estate values are declining.** This bill appears to address a situation where there is a downturn in the housing market in the period between the acquisition of a replacement home and the subsequent sale of the original home. The original property may be of greater value than the replacement property on any given day (as is currently required for a base year value), but the comparison value test uses different valuation dates for each home: the date of purchase for the replacement home and the date of sale for the original property. Because of this, in a declining market, by the time the original home is sold (up to two years later) the value of the replacement home may be greater than the value of the original property on the date sold and the homeowner cannot qualify for a base year value transfer. However, if this is the bill's intent, additional amendments are needed to correct the terms used. (The terms used are incorrect because a market value reduction does not change a property's underlying base year value. While a property's assessed value may be temporarily reduced to reflect a market value decline, its base year value does not change.) The intent appears to be to allow a same day fair market value to fair market value comparison, but only if the homeowner purchased the replacement property before selling the original property and the factored base year value of the replacement property is greater than its current fair market value on the day the homeowner finally sells his or her original home. The following amendments are suggested to reflect intent:

   (g) (6) Full cash value of the replacement dwelling" means <u>either of the following:</u>
   <u>(A)</u> Its full cash value, determined in accordance with Section 110.1, as of the date on which it was purchased or new construction was completed, and after the purchase or the completion of new construction.
   <u>(B) In the case where the replacement dwelling is purchased or newly constructed prior to the date of the sale of the original property and the full cash of the replacement dwelling as determined in accordance with subparagraph (A) exceeds its full cash value as determined in accordance with Section 110 as of the date the original property is sold, its full cash value means its full cash value as determined in accordance with Section 110 as of the date the original property is sold.</u>

7. **Changes in the value comparison test require assessors to make an additional appraisal of the replacement property.** Under the current value comparison test, assessors must already appraise property to determine market value for date of sale or date of purchase for change in ownership purposes. This is necessary to evaluate whether the purchase price reflects market value. Additionally, for decline in value purposes, the assessor may also appraise the replacement property to determine market value as of January 1. This bill requires assessors also to appraise the replacement property on the date the original property is sold. This additional appraisal will require staffing resources.

8. **Extends the base year value transfer to include new construction on homes of greater value**. Existing law grandfathers certain new construction when a replacement home of equal or lesser value is purchased. This bill unnecessarily proposes similar treatment for replacement homes of greater value. (See Section 69.5(h)(4)(B).) Homes of greater value will receive the full property tax benefit of a base year value transfer on a market value basis. The inclusion of any new construction completed within two years of the sale of the original property, and without any conditions, appears to be an unintentional error. If so, these provisions should be stricken.

9. **Operative date of amendments to Section 69.5.** At page 18, Line 3 the operative date has not been changed to the lien date for the 2017-18 fiscal year. Also on page 18, Line 18, the operative date has not been changed to January 1, 2017.

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Administrative Costs: If enacted, the BOE would incur absorbable costs to update its publications and website and address ongoing implementation issues that will result from these new provisions.

Revenue Impact:

Background, Methodology, and Assumptions. BOE property tax statistics indicate 5,200 base year value transfer claims are granted on average each year. BOE historical claims data also suggests that as real estate values increase, the number of claimants increase. While determining the immediate impact of this bill is difficult, based on the recovering housing market and a growing senior population, staff assumes a 100% increase in the number of base year value transfers granted, or 5,200 additional claims granted annually. The number of additional claims that will be filed is an assumption as data is unavailable. This estimate of 5,200 claims assumes that the existing number of base year value transfers granted annually will double, as the equal or lesser requirement is a significant limiting condition that this bill removes.

According to the California Association of Realtors, the median home price in November 2015 was $475,000. The 2014-15 average assessed value of a property receiving the homeowners' exemption was about $340,000. Therefore, where the transfer is granted, the estimated amount of assessed value difference per home is about $135,000.

The total revenue loss is computed by multiplying the estimated number of qualified transfers by the assessed value difference at the basic 1% property tax rate:

5,200 qualified transfers x $135,000 x 1% = $7 million

Summary. This bill would reduce property tax revenues at the basic 1% tax rate by $7 million annually.

Qualifying remarks. Generally, for a claimant to be eligible for the property tax relief described a previous transfer of the original property, i.e. a change in ownership subjecting the original property to reappraisal at its current fair market value, must have occurred. In addition, the revenue impact may be greater to the extent that market values return to previous peak levels.

This bill also provides relief for a claimant's purchases of a replacement dwelling before selling the original property where the claimant no longer qualifies for a base year value transfer due to a subsequent decline of real estate market values. Staff estimates these limited cases would have a minor revenue impact (given that real estate values are not currently declining). However, each claim granted in these limited cases is calculated at $1,350 ($135,000 x 1%) per qualified transfer.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.