DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date:	**04/08/14**	Bill No:	**Senate Bill 1216**
Tax Program:	**Property**	Author:	**Morrell**
Sponsor:	**Author**	Code Section:	**RTC 218**
Related Bills:	**AB 2097 (Morrell)**	Effective Date:	**Operative for 2015 lien date**

BILL SUMMARY

In part, this bill increases the property tax homeowners' exemption from $7,000 to $20,000 of assessed value and allows an annual inflation adjustment thereafter.

ANALYSIS

CURRENT LAW

For owner-occupied principal places of residence, the California Constitution[1] exempts from property tax the first $7,000 of assessed value. Commonly known as the "homeowners' exemption," the Constitution[2] requires the state to reimburse local government for the property tax revenue loss.

The Constitution authorizes the Legislature to increase the homeowners' exemption amount if the state:

- reimburses local governments for the revenue loss; and,
- increases the benefits provided to renters (i.e., the renters' income tax credit) by a comparable amount.[3]

Implementing statutes specify exemption amounts,[4] eligibility requirements, and filing requirements.

PROPOSED LAW

Homeowners' Exemption. Beginning with the January 1, 2015 lien date, this bill increases the homeowners' exemption amount from $7,000 to $20,000. Thereafter, this bill provides an annual adjustment based on the percentage change in the Federal Housing Finance Agency's published House Price Index (HPI) for California for the first three quarters of the prior calendar year.[5]

Renters' Credit. This bill also increases the renters' income tax credit, as specified. This analysis does not address this bill's provision, since the Franchise Tax Board administers the renters' credit.

[1] Article XIII, Sec. 3(k)
[2] Article XIII, Sec. 25
[3] Article XIII, Sec. 3(k)
[4] Revenue and Taxation Code Section 218
[5] The HPI is a weighted, repeat-sales index. It measures average price changes in recent sales or refinancing on the same properties.

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 Board's formal position.

BACKGROUND

Homeowners' Exemption Enactment. Prior to Proposition 13's[6] enactment in 1978, property tax reform advocates in the 1960's and 1970's put forth various reform proposals that departed from a market value based property tax system. At that time, the law required the assessor to cyclically reassess property to its current market value. These periodic reassessments resulted in substantial property tax increases due to escalating real estate values during that time period. In 1968, voters enacted the homeowners' exemption to provide some property tax relief.[7] Initially, the exemption amount was $3,000[8] of assessed value. In 1972, legislation increased the exemption amount to its current level of $7,000 beginning in 1974.[9]

Between 1972 and 1978, legislative members introduced numerous bills to increase the exemption amount. All were rejected. The prevailing view was that continuous increases in the homeowners' exemption would, at best, only provide temporary property tax relief in inflationary times. Thus, those holding this view argued that fundamentally changing the property tax system to contain rapidly increasing property taxes was the better approach. Ultimately, voters adopted Proposition 13.

Property Tax System Reform. Voters changed California's property tax system with Proposition 13, which replaced a current market value based system with an acquisition value based system. Under the new law, real property assessed values were rolled back to 1975 market value levels and future assessed value increases were limited to the inflation rate, not to exceed 2%, for as long as the property's ownership remains unchanged and the property is not substantively improved (i.e., new construction). In addition, it limited the basic property tax rate to 1%. Previously, the statewide average tax rate had been 2.67% as each taxing agency could set and levy its own rate to cover its budgetary needs.

The current system provides certainty to property owners regarding future property tax liability. The 2% maximum inflation adjustment ensures only modest assessed value increases, assuming no ownership changes or substantive property improvements.

RELATED LEGISLATION

The Legislature and initiative proponents have considered numerous ways to increase the homeowners' property tax exemption, including:

- one-time flat increase for all homeowners,
- increase limited to certain homeowner class (age, disabled, first-time buyer)
- variable exemption amount according to the purchase year, and
- annual inflation adjustment.

The following table summarizes these attempts.

---

[6] Article XIII A of the California Constitution

[7] Proposition 1-A; SCA 1 and SB 8, Stats. 1968.

[8] The actual exemption amount was $750 of assessed value; however, at that time, property was assessed at 25%, rather than 100%, of market value. To compare the exemption amounts on the same mathematical basis, the "equivalent" amount of $3,000 is referenced ($750 x 4 = $3,000).

[9] SB 90, Stats.1972. SB 90 provided for a $1,750 exemption amount. But assessments were set at 25% of market value. To compare the exemption amounts on the same mathematical basis, the equivalent amount of $7,000 is referenced ($1,750 x 4 = $7,000).

Bill Number	Legislative Session	Author	Type
SB 1430	2009-10	Walters	Increase to $27,000 for over 62; inflation index
AB 293	2007-08	Strickland	Increase to $22,000; inflation index
AB 351	2007-08	Symth	Increase to $27,000 for over 62
AB 388	2007-08	Gaines	Increase to $25,000
AB 968	2007-08	Walters	25% exemption for 1st time homebuyers
AB 972	2007-08	Walters	25% exemption
AB 457	2007-08	Tran	Increase to $25,000 for over 62; inflation index
AB 1922	2005-06	Walters	25% exemption, no assessed value cap
AB 2738	2005-06	Wyland	Increase to $27,000 for over 62
AB 185	2005-06	Plescia	Increase to $15,000 for over 62
AB 62	2005-06	Strickland	Increase to 25% for 1st time homebuyers
AB 2357	2003-04	Plescia	Increase to $10,000 for over 62
AB 211	2003-04	Maze	Increase to $17,000 for over 62, disabled, blind
AB 82	2003-04	Dutton	Increase to $32,000, inflation index
Initiative	Signature drive ended 11/6/02 – Not Pursued	Howard-Jarvis Taxpayers Assoc. & Bill Simon	Increase to $32,000, inflation index
AB 1844	2001-2002	Mountjoy	Increase to $17,000 for over 62, disabled, blind
SB 48	2001-2002	McClintock	Inflation Index by California CPI
SB 48	2001-2002	McClintock	Increase to $25,000, inflation index
AB 218	2000-2001	Dutra	Increase for 1st time homebuyers
AB 2288	1999-2000	Dutra	Increase for 1st time homebuyers
AB 2158	1999-2000	Strickland	Increase to $8,750 for persons over 62
SCA 8	1999-2000	Johannessen	Increase to $20,000; delete renters' credit parity
AB 2060	1997-1998	Granlund	Increase to $20,000
ACA 43	1997-1998	Granlund	Increase to $20,000
ACA 5	1991-1992	Elder	Variable, according to assessed value
ACA 31	1991-1992	Frizzelle	Index for inflation by California CPI
ACA 47	1991-1992	Jones	25% exemption; no assessed value cap
ACA 3	1989-1990	Elder	Variable, depending on year acquired
ACA 9	1989-1990	D. Brown	25% exemption; $250,000 assessed value cap
ACA 31	1989-1990	Hannigan	15% exemption; $150,000 assessed value cap
ACA 55	1989-1990	Wright	Increase to $48,000
ACA 1	1987-1988	Elder	Increased to $25,000, inflation index
ACA 25	1987-1988	D. Brown	25% exemption; $250,000 assessed value cap
AB 2141	1985-1986	Klehs	20% exemption; $50,000 exemption cap
AB 2496	1985-1986	Cortese	Increase in years with General Fund Reserves
AB 3086	1985-1986	Elder	Variable, depending on year acquired
AB 3982	1985-1986	La Follette	Increase for 1st time home buyers
ACA 49	1985-1986	Elder	Variable, depending on year acquired

COMMENTS

1. **Sponsor and Purpose.** This author-sponsored measure intends to provide increased property tax savings to homeowners on an ongoing basis.

2. **The Constitution specifies the minimum exemption amount.** The $7,000 amount specified in the Constitution is the *minimum* exemption amount. The Constitution provides that the homeowners' exemption can be statutorily increased, if the Legislature provides an equivalent increase in the renters' credit and the state reimburses local governments for the property tax revenue loss. This bill provides the required renters' credit increase; existing law (Article XIII, Section 25) requires the state to reimburse local governments for the property tax revenue loss.

DRAFT

3. **Exemption amount unchanged since Proposition 13's enactment.** First enacted in 1968, the homeowners' exemption has only increased one time (in 1974) to its current level. Despite many attempts, the exemption amount has not changed in 40 years. Historically, opponents of increasing the exemption generally argue that California property tax law provides sufficient property tax relief and protections for homeowners, via Proposition 13. Additionally, they cite the negative fiscal impact due to the requirement that the state both (1) reimburse local governments for the revenue loss and (2) provide a comparable increase in benefits to renters via the renters' state income tax credit.

4. **Adjustments: Negative housing price index changes**? On occasion, the change in the housing price index is negative. This bill provides that the assessor is to "adjust" the exemption amount. Thus, it appears that assessors would be required to reduce the exemption amount previously provided when the HPI is negative.

5. **Rounding exemption amounts**. The proposed annual exemption amount should be rounded to the nearest dollar. The bill's language requires rounding the HPI index change to the nearest one-thousandth of a percent (language based on the annual CPI adjustment in RTC Section 51). However, in addition, the annual exemption amount should be rounded to the nearest whole dollar. Assessed values are rounded to the nearest dollar rather than cents.

6. **Should the BOE announce and post the annual exemption amount to ensure statewide uniformity and avoid duplicate efforts**? This eliminates the need for each county assessor to calculate the adjustment.

7. **The State subvenes homeowners' exemption property tax revenue loss.** The homeowners' exemption is the only property tax exemption for which the state fully reimburses local governments. The state also makes subvention payments to offset property tax reductions for open space and agricultural property that receives preferential assessment treatment under the Williamson Act. These rates are $1 per acre for non-prime land and $5 per acre for prime land. However, in recent years Williamson Act subventions have not been fully funded.

8. **Related legislation.** This bill is identical to Assembly Bill 2097, which the same author introduced when he was a Member of the Assembly. He has since been elected to the Senate.

COST ESTIMATE

Counties administer the homeowners' exemption and would incur costs to modify their systems to reflect a variable homeowners' exemption. The BOE would incur some minor absorbable costs to inform and advise county assessors, the public, and staff of the law changes and address ongoing implementation issues and questions. These costs are estimated to be under $10,000.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Existing property tax law provides for a homeowners' exemption of $7,000 of the full value of a "dwelling," as specified. The state is required to pay subventions to counties for homeowners' exemptions to offset resulting local property tax loss. The 2012-13 state reimbursements totaled $427,284,000 on 5.3 million claims.

The total exempt value on these properties was $36,848,478,000. Therefore, the average tax rate for properties receiving the homeowners' exemption is:

$427,284,000 / $36,848,478,000, or 1.16%.

Initially, the homeowners' exemption would increase by $13,000, from $7,000 to $20,000 for a full exemption. The initial increase in the homeowners' exemption reimbursement is computed as follows:

$13,000 x 1.16%, or $150.80.

The estimated initial increase in the homeowners' exemption reimbursement is then:

5.3 million claims x $150.80 = $799.2 million

Under this bill, the exemption amount would be adjusted annually to reflect the California HPI year-to-year change for the first three quarters of the calendar year. The average annual third-quarter change in the California HPI since 1991 is a 3.282% increase.

REVENUE SUMMARY

This bill would initially increase the state reimbursement for the homeowners' exemption by approximately $799.2 million annually. Due to the proposed annual California HPI adjustment, we expect the reimbursement to grow significantly over time due to the compounding effect of the adjustment.

Qualifying Remarks. While the 22-year average change in the California HPI is a 3.282% increase, the index is also subject to sustained year-to-year decreases. From 1992 to 1996, and between 2007 and 2011, the California HPI averaged a negative year-to-year percentage change.

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

Analysis prepared by:	Rose Marie Kinnee	916-445-6777	04/11/14
Revenue estimate by:	Chris Butler	916-445-0840	
Contact:	Michele Pielsticker	916-322-2376	

ls 1216sb040814rmk.docx

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 Board's formal position.