The FISCAL REPORT an informational update

Volume 29 For Publication Date: November 13, 2009 No. 23

Property Taxes Could Fall in 2010-11

Based on data that determines the change in base property tax values from one year to the next, property tax collections in 2010-11 could drop below current-year levels. As a result, a little known provision of Proposition 13 may come into play in the next few months, which could place significant pressure on the budgets of basic aid districts and the state General Fund in 2010-11 as property is assessed for tax purposes under the constitutional provision.

Given the developing news on the California Consumer Price Index (CPI), basic aid districts are encouraged to reexamine their projections of property tax revenues for the budget year. Should the CPI come in either flat or negative and reassessments and new construction fall below local projections, basic aid districts could experience a shortfall in revenues. This may in turn either reduce a district's ending fund balance or prompt the need for changes to the district's expenditure plan.

Background

Proposition 13, the landmark property tax limitation initiative of 1978, set the property tax rate at 1% of assessed value and limited the growth in assessed values from one year to the next to 2% annually. The constitutional amendment further specified that the full cash value base for purposes of taxation could be reduced "as shown in the consumer price index or comparable data for the area under taxing jurisdiction . . ."

To give meaning to this provision, the Legislature enacted Section 51 of the Revenue and Taxation Code and the Board of Equalization (BOE) promulgated Rule 460. Together, these measures specify that the consumer price index would be the California Consumer Price Index for All Urban Consumers, comparing the change in this index from the month of October of the prior fiscal year to October of the current fiscal year. The CPI is determined by the state's Department of Industrial Relations (DIR), based on data compiled by the U.S. Bureau of Labor Statistics. The state index is a weighted average for the southern California region (Los Angeles, Anaheim, and Riverside) and the northern California region (San Francisco, Oakland, and San Jose).

According to the BOE, since the passage of Proposition 13, there have been only five years in which the CPI has been less than 2%, and it has never been less than zero. The most recent data for the ten-month period from October 2008 to August 2009 shows a change of -0.501%. The October 2009 data is expected to be available at the end of this month or early December.

Why is This an Issue?

It is important to note that, while Proposition 13 and Revenue and Taxation Code Section 51 prohibit year-to-year increases in base-year property values from exceeding 2% annually, these provisions are silent on decreases. The BOE has, therefore, concluded that reductions in base- year values will be determined by the change in the CPI, regardless of how low this index should fall.

A negative CPI could, therefore, have a significant impact on the funding of basic aid districts whose general purpose funding is derived solely from the property tax and for the state General Fund under Proposition 98 and revenue limit statutes. For the state, a shortfall in the property tax would require a dollar-for-dollar increase from the General Fund. For basic aid districts, a shortfall would require them to draw down their reserves or reduce operational expenditures.

It is important to note that the change in a school district's property tax income will be influenced by the CPI for purposes of determining base year values, but will also be influenced by reassessments and new additions to the property tax roll. Reassessments occur when a property is sold—setting the new base value at the sales price of the property. In most cases, these reassessments could significantly increase property tax revenues, depending upon the difference between the sale price of the property and its base value prior to the sale. Similarly, new construction adds significant value to a parcel, thus increasing property tax revenues associated with that parcel. These two factors can mitigate the negative effects of a flat or negative CPI.

Within approximately the next six weeks, we will know if the CPI is negative for the October 2008 to October 2009 period, thus setting the change in base values for 2010-11. Anything less than 2% growth puts pressure on the state and basic aid districts, but a negative CPI will be charting new territory. We will report on this little known, but important, index as soon as the data are available.

—Robert Miyashiro and Michele Huntoon, CPA

posted 11/02/2009