WHAT PROPOSITION 13 DID

POLICY BRIEF | JANUARY 2013

KEY FACTS ABOUT PROPOSITION 13

- **Provides Certainty.** Removed much of the fluctuation of property tax revenue, creating a more stable revenue source for local government by using an acquisition-based assessment system.
- **Established New Base Year.** Rolled back locally assessed property values to 1975 lien date original base-year value, effective with the 1978-79 fiscal year.
- **Limits Assessments.** Limits property tax rate to 1 percent, plus the rate necessary to repay local voter-approved bond debt.
- **Restricts Rate Hikes.** Restricts annual increases in assessed value of locally assessed real property to the lesser of market value or an inflation factor, not to exceed 2 percent per year, except when there is a change in ownership or new construction.
- **Established Vote Thresholds.** Requires two-thirds vote of the Legislature to raise state taxes, and specifies that a vote of the people is needed to raise local taxes.

Proposition 13, the People's Initiative to Limit Property Taxation, has been law in California for more than three decades, meaning most people alive today either were not around when it was approved by voters in 1978, or were not old enough to have owned property. Since they never experienced the changes it made, they may not fully comprehend how Proposition 13 affected property taxes, and where those taxes would be without it.

Proposition 13 amended the California Constitution, and was the taxpayers' collective response to dramatic increases in property taxes, and a growing state revenue surplus of nearly $5 billion.

Proposition 13 set a maximum rate for the property tax; and removed guesswork, opinion and chance from the determination of a locally-assessed real property's assessed value - that is, the value upon which the tax rate is levied.

Set Maximum Property Tax Rate

In 1977, the average property tax rate in California was 2.67 percent. Proposition 13 fixed the rate at 1 percent, plus whatever additional rate is needed to cover voter-approved indebtedness, such as bonds. Although the additional rate varies around the state, it generally runs at about one-tenth of 1 percent, setting the overall Proposition 13 rate at 1.1 percent.

Eliminated Subjective Assessments

To understand how Proposition 13 removed guesswork from assessed values, some background is needed. Prior to Proposition 13, county assessors generally valued properties at their market value, according to the theory of "highest and best use." In some cases, instead of

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valuing a property based upon its actual use (as a home, for instance), assessors made subjective judgments based upon their opinion of the property's best use (by a developer, for instance). Or, if a subdivision sprang up near an existing home, the assessor might raise the older home's value because it now sat in a more expensive neighborhood. These practices often increased assessed values astronomically (there was no limit), forcing the owner to sell because the high property taxes were simply unaffordable.

Proposition 13 put a stop to the subjective approach by requiring that locally assessed real property be assessed objectively; that is, by the price paid. If the market value of a property declines in later years, it must be reassessed accordingly.

Controlling Assessment Growth

Proposition 13 dealt with the ups and downs of inflation. During the early 1970s, inflation rates were running in the 10 percent range and above, and assessors hiked property values accordingly. As a result, property owners could see their tax bills double within one year. Proposition 13 removed that hardship by allowing assessed values to increase no more than 2 percent annually. This leveling off stabilized revenue for local governments.

Prior to Proposition 13, property values not only were established subjectively, but also were established at various percentages of current market value. Pre-Proposition 13 data from the Board of Equalization found some properties within the same county being assessed at 2 percent, and others at 200 percent or more of current market value. An Assembly committee report found rural properties in El Dorado County being assessed at 10.7 percent and residential property at 23 percent.

Thus, assessed values told taxpayers nothing about the actual value of their property, nor did taxpayers know whether they were being assessed fairly in relation to others. But now, because Proposition 13 requires that all real property be assessed at its acquisition cost (except for business personal property and state-assessed property), there is far more uniformity around the state.

Stabilizing Local Revenue

Proposition 13 protects local government from major cyclical swings in revenue. If the pre-Proposition 13 system had been in place in recent years, property tax revenue would have plummeted, reflecting the decline in property values. This would have decimated local budgets.

Enhancing Local Revenue Growth

Proposition 13 opponents believe the 1 percent rate limit decimated local revenue. This is not the case. According to the Legislative Analyst's Office, "Since 1979, revenue from the 1 percent rate has exceeded growth in the state's economy" ("Understanding California's Property Taxes," November 29, 2012).

According to the Board of Equalization, property tax revenue has increased from $4.9 billion to $49 billion in the 30 years since voters approved Proposition 13. Adjusted for inflation and population growth, these figures indicate that property tax revenue in California was 89 percent higher in 2010-11 than in 1978-79, chiefly because of rising property values. Also, there has been a slow and steady growth in assessed values of locally assessed real property since the voters approved Proposition 13. See "Assessed Value of Locally Assessed Real Property Subject to Proposition 13" on next page.

Disparities in Assessed Value

Under Proposition 13, similar properties can have substantially different assessed values, based solely on the dates the properties were purchased.

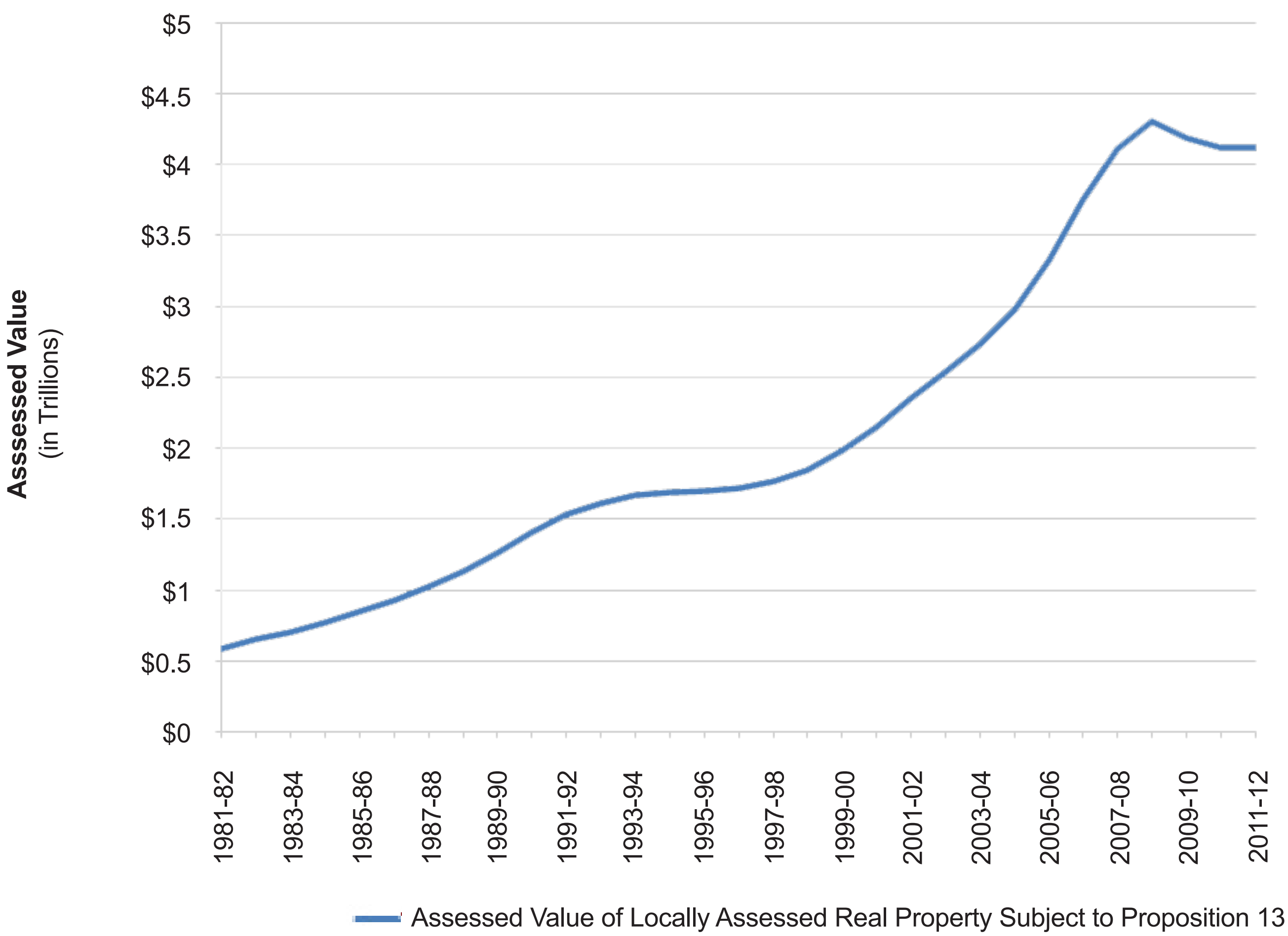
Disparities result wherever significant appreciation in property values has occurred over time. Longtime property owners, whose assessed values generally may not be increased more than 2 percent per year, tend to have markedly lower tax liabilities than recent purchasers, whose assessed values tend to approximate market levels. However, as noted in legislative reports, there were comparable disparities under the pre-Proposition 13 "ad valorem" assessment system.

Some say the disparities in assessed values are unfair, and that equivalent properties should pay an equivalent tax. But in return for these tax disparities, the state's property owners are granted the comfort of certainty, a key element in sound tax policy. Buyers know going in what the tax will be on their property (1 percent of the price) and that there will be no outlandish increases over the years. If the disparities were eliminated, property taxes would be much more regressive, increasing taxes on those with the least ability to pay (those on fixed incomes, for example).

Adam Smith, the father of modern economics, who wrote long ago: "The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a considerable degree of inequality ... is not near so great an evil as a very small degree of uncertainty."

In 1992, the U.S. Supreme Court, upheld Proposition 13 and the variation in assessments by an 8-1 vote in *Nordlinger v. Hahn* (1992) 505 U.S 1. The court produced a very strong opinion by Justice Harry Blackmun, who called the granting of certainty to a property owner an "exceedingly persuasive justification" for the disparities in assessed value.

ASSESSED VALUE OF LOCALLY ASSESSED REAL PROPERTY SUBJECT TO PROPOSITION 13



Source: Board of Equalization.

No Shift in Tax Burden to Homeowners

Proposition 13 has not shifted the property tax burden from business properties to homeowners, as some purport. Data from the Board of Equalization show that in 1979-80, homeowners paid 41.83 percent of the tax on properties subject to Proposition 13. The percentage is actually slightly lower, 39.77 percent in 2011-12.

Two-Thirds Vote Requirement

Some opponents of Proposition 13 are critical of the initiative's "two-thirds" requirement. Under Proposition 13, it takes a two-thirds vote of the Legislature to increase taxes. At the local level, taxes must be submitted to the electorate for approval (a majority vote is needed to approve taxes for general governmental purposes and a two-thirds vote is needed to approve taxes that are earmarked for a specific purpose). Over time, voters have continued to support Proposition 13. Most recently, in 2010, voters approved Proposition 26, the Supermajority Vote to Pass New Taxes and Fee Act, which expanded taxpayer protections.

The two-thirds vote requirement for legislative approval of taxes means that more than a majority of lawmakers must agree to raise taxes. Since passage of Proposition 13, several major tax hikes have been approved when lawmakers believed that new revenue was necessary. The two-thirds vote requirement forces policymakers to take a hard look at other ways to balance the budget, especially when revenue growth slows or declines.

Proposition 13's effects on local government are clear: more taxes may be levied now than ever before. Prior to Proposition 13, charter cities could levy some local taxes, such as utility user and hotel taxes by action of the city council, but general law cities and counties could not. Judicial and legislative interpretations of Proposition 13 allowed local government to impose additional local taxes, including parcel taxes. Now, all cities and counties can levy a wide variety of taxes, including local add-on sales taxes, with voter approval. (Historical note: The vote requirement for qualified school bonds is lower now (55 percent) than it was prior to Proposition 13. The two-thirds requirement for local bonds did not originate with Proposition 13. It was adopted in 1879 as Section 18 of Article XI of the California Constitution.)

Conclusion

Proposition 13 has protected taxpayers during its more than three decades of enactment, and at the same time, has ensured that there is a stable, yet growing budget base for local government.

More importantly, Proposition 13 did what it was supposed to do. Before Proposition 13, Californians would open their property tax bills and wonder if they could make ends meet. At that time, government revenue was directly tied to swings in real estate values. Today, homeowners still are the largest beneficiaries of Proposition 13, bearing the smallest share of the property tax burden.

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