Cities Association Board of Director's Meeting
February 10, 2011
7:00 p.m., speak for 20 minutes, incl. Q & A
Sunnyvale City Hall, West Conference Room
No Podium – Table Presentation
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Lawrence E. Stone, Assessor

As a former Mayor and Councilmember, I assume that like me you know little about the Assessor's Office. So, first I'm going to provide an overview of the Assessor's Office. Then, talk about the current real estate market and its impact on the assessment roll and property tax revenue. Then, Governor's proposal to eliminate R & D's and finally, what cities can do to help streamline the assessment process to benefit your city.

OVERVIEW OF THE ASSESSOR'S OFFICE

SCC is the 6th largest county in California, but the 4th largest assessment roll.

243 employees in the Assessor's Office - <u>$29.6</u> million base budget (wow!)

- 117 (48%) professionals
- 42 Auditors in Business Division
- 69 Appraisers in Real Property Division
- Higher caliber of bureaucrat, w/degree requirements

Shameless self promotion

- 2% fewer employees than when I took office in 1995. Assessment roll has nearly tripled from $115 billion to $296 billion.
- Over 16 years returned $7.8 million of budget back to the general fund.

OFFICE OVERVIEW

- 75,000 title documents & 28,000 transfers of ownership requiring reassessment.
- 23,000 building permits (new construction) received from 15 cities,4,400 permits requiring appraisals
- 55,000 businesses file business property statements
- 3,500 boats
- 909 airplanes

- 10,027 mobile homes on property tax roll (18,000 total spaces)
- 66,000 phone calls
- 4.2 million hits to the Assessor's website (second most popular website)

Major corporations loosely defined as more than $400k assets; must be audited every four years. Our Business Division auditors conduct 1,000-1,200 audits of major corporations annually 25% of them out of state. Total property tax revenue in S.C.C. – over $3 billion. Property tax is the largest source of discretionary revenue for local governments.

How it is allocated? Where does the money go?

44% State Public Education, K-12 (schools)
14% Cities
18% County
11% RDA's
7% Community Colleges
6% Special Districts

ROLE OF ASSESSOR

Assessor is **not** a revenue agent for local government! I'm a taxpayer, voter and a citizen. I care about public education, healthcare and roads, but as Assessor my legal obligation is to enroll accurate values, whatever they are.

Why is the Assessor elected? Only one good reason—to ensure the Assessor is independent of the Board of Supervisors who spend the property tax revenue that assessments generate.

NOT A FORECASTER

I know local governments are anxious to know my projections about the direction of the local economy, and how it will impact them this year. There is always a danger to asking the Assessor to look into the future. After all, the Assessor's Office, by the nature of what we do, is always looking backward at transactions that have <u>actually</u> occurred in the market place.

BOARD OF EQUALIZATION OVERSIGHT

Who oversees the Assessors? The State Board of Equalization is constitutionally charged with that responsibility.

Every five years, a team of the State Board of Equalization's most seasoned assessment professionals perform a comprehensive assessment practices survey and audit of my office. Over a six-month period, a team of 12 or so SBE employees perform their own appraisals of real property, and review audits of major corporations. They do this for several hundred randomly selected properties that are representative of all property types in the entire assessment roll.

The SBE's value conclusions are compared to my staff's conclusions, and the sum of the differences are calculated and statistically applied to the entire assessment roll.

Since I have been elected, we have been audited three times. The most recent audit of the 2008 assessment roll resulted in a total compliance ratio of 99.81 percent, a new record. That means we are less than 2/10ths of one percent from perfect! That's a pretty high quality standard.

MAJOR COMPONENTS OF ROLL GROWTH

As I mentioned, the roll in SCC was negative last year. What exactly caused this reduction? The answer….several major factors. For only the fourth time since the Great Depression, has economic conditions resulted in a decline in total assessed values in Santa Clara County. As we know, the national economy tanked, and neither Santa Clara County nor California was immune.

The result was a dramatic diminution of arm's length, real estate transactions, an equally dramatic increase in foreclosures and bankruptcies, and a significant drop in consumer optimism and spending, lenders tightened credit requirements so tight that most borrowing ceased, and unemployment skyrocketed to levels not seen in 50 years. What you want to know is what does it have to do with the local assessment roll?

- When the inventory of unsold real estate expands, and the number buyers that qualify for loans shrink, prices drop.
- As the Assessor, I am required to value each change in ownership at that property's market value as of the date of the change in ownership.
- When a significant number of available properties for sale are not arm's length transactions, that is, when the preponderance of available properties are owned by banks or mortgage companies,

(foreclosures) or by sellers a half a step in front of foreclosure – prices of all transactions are driven down.

- When consumer confidence declines and unemployment increases, new construction, purchase of machinery, equipment, computers etc., the expansion of businesses declines.

ROLL GROWTH FACTORS

What are the major components that trigger changes to the assessment roll? These factors include changes in ownership, new construction; application of the California Consumer Price Index (CCPI), assessment appeals, the annual assessment of business personal property and Proposition 8 reductions.

CHANGES IN OWNERSHIP

In prior years, major increases to the assessment roll were triggered by changes in ownership. Real property is assessed at market value when a change in ownership or new construction occurs.

Historically, substantial roll growth was derived from real estate changes in ownership at increased sales prices. Last year, instead of properties with assessments transferring at higher values, purchase prices were frequently below existing assessments, triggering a reduction in assessed value.

NEW CONSTRUCTION

New Construction is another major factor. New construction hit historic lows in 2010, one quarter of that recorded in 2001. Countywide, the total number of building permits dropped by 25.7 percent.

CCPI

Another major negative impact on the assessment roll is the change of the California Consumer Price Index (CCPI). As you know Proposition 13 requires an annual adjustment of the assessed value of all real property by the amount of change in the CCPI, not to exceed 2%.

In the 33 years since Proposition 13 passed in 1978, the CCPI has been lower than two percent only six times. Last year, the CCPI was actually negative at -0.237% for the first time.

As a result, 350,000 property owners with assessed values already lower than market value, received a further reduction! In my case, my home is assessed at one-fifth what I could sell it for, yet I received a $50 reduction in property taxes! There is a ceiling, but no floor. It makes no sense, but it's the law.

The collective impact of the negative CCPI on schools, cities, the county, community colleges, redevelopment agencies and special districts is huge, and likely exceeded $6 billion, compared to what it would have been if it had remained at 2%.

This year the CCPI will be 0.753%. That's good news because it at least positive, but far below the 2% cap.

BUSINESS PERSONAL PROPERTY

Another major impact last year was an unexpected countywide 8% decline in the value of business property which includes machinery, equipment, computers and fixtures.

This decline was in part, a direct result of the decrease in the number of businesses, which fell by 8.2 percent from 46,000 businesses to 42,000 in one year.

ASSESSMENT APPEALS

Another factor is assessment appeals.

Historically, Santa Clara County has a relatively low number of appeals compared to other major counties. Currently, there are approximately 11,650 active appeals. In 2009, we experienced a 400 percent increase, the highest number ever recorded. It is truly a "tsunami" of assessment appeals.

Those 11,650 appeals reflect $37 billion in assessed value at risk (difference between the assessed value on the roll and the taxpayer's opinion of value). This translates into a potential property tax refund liability of $400 million.

While residential appeals comprise the greatest number of appeals, three quarters of all value in dispute, involve some of the valley's biggest corporations. We currently have 86 corporate appeals in which the tax refund liability exceeds $500,000 each.

It is comforting however, that we historically retain over 90% of the value in dispute. How successful are appellants?

1. 43% of all appeals are withdrawn by the appellant
2. 35% are resolved by stipulation or agreement with some adjustment
3. Only 2% actually go to formal appeals hearing

PROPOSITION 8

Finally, and certainly the issue that has attracted so much interest, is our implementation of Proposition 8.

When the market value of a property declines below the factored base year value (i.e., usually the purchase price increased by no more than two percent annually) the assessor is required by Proposition 8 passed six months after Proposition 13 in 1978, to "temporarily" reduce the assessed value to reflect actual market value for one year.

Just as I am required to reduce the assessed value when market value drops below assessed value, I am also required to restore assessed values when the market improves.

In 2010, the number of properties receiving a temporary assessed value reduction as a consequence of the declining real estate market climbed 31 percent to 118,690 properties, further reducing the assessment roll by a total of $23.8 billion.

CURRENT ECONOMY

Now, the topic I'm asked most about, the current economy.

Let me try and answer the fundamental question on everyone's mind: has Silicon Valley hit bottom? It is my opinion that the worst is behind us, and there are reasons for some limited optimism.

Have we dodged the "D" bullet? I believe a depression has been avoided.

One thing is clear, while thankfully this was not the “Great Depression,” it certainly was the “Great Recession.”

I firmly believe we have hit bottom, and, there are serious signs of movement in the positive direction.

Even job growth, while awful, is showing meager signs of improving. In December, unemployment in Silicon Valley dropped to 10.6%, a big change from last January when it hit 12.1%. However, it still remains above the national average of 9.4%. Nationally, private employers have recorded 11 consecutive months of modest job gains. However, at the current rate it would take six years to regain the jobs lost during the recession. California’s unemployment remains unchanged at 12.5%.

Another indicator that holds out promise in Silicon Valley is that according to the Bureau of Labor Statistics, our County saw the largest increase in weekly wages, 10%, during the second quarter of 2010. That means there is greater competition for employees, and a higher likelihood that companies are on the brink of adding employees. In January, Google announced plans to add 6,000 employees in 2011, a 20% increase. 2,000 of these in Silicon Valley.

This is important because employment is a key factor for this to be more than just a jobless recovery. Other critical factors include:

- Corporate profits are beginning to recover led by Apple, Google, E-Bay, Facebook and others.
- Credit liquidity must be more available(fuel of economy)
- We must liquidate foreclosure product
- Public confidence must return (most important element)

Employment is also critical to driving the real estate market. As companies expand, they lease office space, purchase equipment, computers, fixtures, and in turn new employees often need places to live.

Unfortunately, revenue for schools and local government typically lag 12-18 months behind an economic turnaround.

ELIMINATE REDEVELOPMENT AGENCIES

As a part of this budget reform package, Governor Brown is proposing to eliminate redevelopment agencies. This is a very popular idea with the voters and is polling nearly 70% in favor of the Governor's proposal.

I believe it would be a mistake to categorically eliminate redevelopment agencies.

It's true there have been major abuses in RDA's in California. The worse cases of abuse are in Southern California. RDA funds were not used for legal RDA purposes.

Even the creation of the RDA district areas have been inconsistent with the law, including San Jose's RDA. RDA district areas should only include area of blight in which property tax revenue is declining or not keeping pace with property tax assessments in the community at large.

Downtown San Jose in the 70's certainly qualified as a blighted area. Commercial vacancies were high and property values were stressed.

In designating the RDA boundaries, San Jose included properties along North First Street to Highway 237 and extended the district boundaries south to the IBM plant on Cottle Road.

Neither North First Street nor Cottle Road could be classified as blight. The only blight on North First Street was "Prune Rot." That was an abuse. It was a classic "ends justify the means."

The tax incremented generated from development along North First Street was diverted and invested in properties downtown, including Fairmont Hotel, Adobe World Headquarters, several hotels and office buildings. The HP Pavilion and the Convention Center would never have been built without the San Jose RDA. Mountain View did the same, extending their redevelopment agency from Downtown (blight) to Shoreline area (rural).

My solution: amend it - don't end it! Eliminate the abuses and punish and prosecute if necessary, the abusers. Tighten the regulations and increase the oversight of RDA's.

The Governor claims that if RDA's are eliminated all property tax increment could then flow the State to fund public education, and to the cities to balance local budgets.

However, many RDA's are so leveraged, have such a debt service liability that there is no excess funds available. The San Jose RDA is a perfect example. They are concerned that they will be unable to meet next year's debt service. There's no money available for the State or local agencies, for cities and schools for several years in San Jose.

In fact, the San Jose RDA owes the Santa Clara County $40 million which will grow to $60 million in July, that they can't pay now.

Why? Because of the significant decline in property values caused by the "Great Recession." I think the amount of revenue the Governor is projecting from his proposal is grossly overstated.

One benefit of RDA's that is practically ignored in the debate, is affordable housing. State law requires 20% of the tax increment from RDA's be used to subsidized affordable housing.

The San Jose RDA through San Jose Housing has financed 128 affordable housing developments consisting of 10,630 affordable housing units. That's $516 million in City funding, generating $2 billion in City and RDA bond funding. None of that could happen without the San Jose RDA. Without RDA's you can kiss the development most affordable housing goodbye, particularly in cities in which the cost of living is very high.

HOW CAN CITIES HELP MY OFFICE?
While the economy is not doing well, there are things you can do to help expedite revenue for your city. As I mentioned earlier, one of the main components of roll growth is new construction.

Unfortunately, we are not processing permits as fast we would like and several cities are part of the problem. It's hard to believe but a few cities remain, that still do not provide us with building permits electronically.

Those cities are: Gilroy, Los Altos (provides in excel but of little use), Los Altos Hills, Los Gatos and Monte Sereno. So, if a permit is processed by the city staff in Los Gatos and San Jose on the same day, it could take a lot longer for us to process that permit in Los Gatos, ultimately delaying when Los Gatos receives the appropriate property tax revenue from that transaction.

We need all the cities to help us by electronically transmitting building permits to the Assessor. In addition, once we have the permit in our system, we can further expedite the assessment if we receive the building plans electronically.

Currently, only San Jose and Santa Clara provide building plans electronically, which means they are getting their property tax revenue from new construction quicker than other cities. Even my beloved Sunnyvale has been slow to provide us with plans electronically! I urge you to go back to your city managers and get this fixed. It's costing you money!

There are lots more I could discuss. We have a few minutes more. I'd be happy to take questions concerning RDA, public pension reform or split roll or anything else on your mind.