Title

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Addressing California's Housing Crisis Through Municipal Finance Reform

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Issue

California has a historic shortage of affordable housing. Statewide median rents have increased by 35% since 2000 with median renter household income increasing only 6%. Meanwhile, the statewide median sales price of a single-family home was $827,940 in 2021. Nearly 80% of low-income renter households are severely cost burdened, meaning they spend more than half of their income on housing. Over 1 million affordable units were lost due to conversion, demolition, or abandonment between 1997 and 2007.

Additionally, the state's ability to invest in housing is limited. Proposition 13 caps annual property taxes to 1% of assessed value and limited yearly property value increases at 2% or the California Consumer Price Index, whichever is less. In 2020, California voters narrowly rejected Proposition 15, requiring owners of commercial and industrial properties valued at $3 million or greater to pay property taxes based on market value rather than purchase price. Lastly, California municipalities discourage development of denser housing through burdensome permitting procedures and zoning restrictions. Given these problems, how can reform of public finance models in California improve local and state governments' ability to invest in affordable housing construction?

Research Discussion

Land Value Tax

A land value tax (LVT) imposes taxes either solely on land itself or on land and improvements at different rates. Doing so minimizes perverse incentives to leave properties in disrepair and disincentivizes land speculation via higher taxes on undeveloped land. The LVT also has income equity merit; property owners pay taxes in proportion to infrastructure benefits they receive.

An LVT faces significant political and technical hurdles in California. Proposition 13, for example, requires a two-thirds legislative vote to pass new taxes. Additionally, a land value tax is not currently legal under California law. However, an LVT provides ample revenue generation potential for affordable housing development. Data from county assessors' offices and from Redfin demonstrate that an LVT of 1.86% (average LVT rates hover at 4.5%) placed on only California's 13 most-populated cities generates revenue equivalent to that of California's total 2019 property tax receipts. Further, an LVT could generate both more sites for affordable housing development and rent savings as the benefits of land ownership decrease with LVT implementation.

Real Estate Transfer Tax (RETT) Reform

A comprehensive reassessment of California's real estate transfer taxes (RETT), which occur when property is sold or otherwise transferred, can also raise additional revenue for affordable housing. Most California municipalities stick to the baseline tax allowed by state law of ~0.1% of a property's sale price. Creating more progressive RETT measures and earmarking a portion of funds for affordable housing can be a more effective and equitable revenue source than sales taxes or impact fees on developers. Many California cities have passed RETT reform, including Oakland, Culver City, and Emeryville. Table 1 shows our revenue generation calculations for a progressive RETT in California's 13 most-populated cities.

Proposition 13 Reform

Reform of Proposition 13 also provides pathways for revenue generation for affordable housing. Before its passage in 1978, property tax rates were set at the local level, with the average property tax rate in the state 2.67%, based on a home's market value rather than sale price. These changes greatly limit the amount of eligible tax revenue California can collect via property taxes. Our research shows enactment of Proposition 13 has resulted in roughly $262 billion in lost tax revenue. Additionally, Proposition 13 is most beneficial to older, white property owners who have owned their property for many years and have benefited from artificially low tax rates.

Property Value	Low	Medium	High
Under $1.5 Million	(1%) $132 M	(1%) $132 M	(1%) $132 M
$1.5 Million to $2,999,999	(1.25%) $238 M	(1.5%) $285 M	(1.5%) $285 M
$3 Million to $4,999,999	(2%) $331 M	(3%) $497 M	(3%) $497 M
Above $5 Million	(3%) $4.746 B	(4%) $6.328 B	(5%) $7.91 B
Total	$5.447 B	$7.284 B	$8.824 B

Table 1.

Case Study City Property Tax Revenue Projection

Recommendations

Implement a Land Value Tax for maximum revenue generation. The LVT's potential for revenue generation is undeniable. In this sense, however, implementation of a land value tax exemplifies the perennial tension between revenue generation and political feasibility.

Implement Real Estate Transfer Tax reform for maximum feasibility. Given the legal, political, and technical obstacles for other alternatives, a citizen-based property transfer tax reform measure earmarking funds for greater affordable housing stock maximizes feasibility. The initiative process now allows California cities the ability to pass a special tax by a simple majority.

Implement Proposition 13 reform for maximum equity. Proposition 13's multifaceted nature allows for policy reform geared towards affordable housing revenue while still benefiting homeowners. Proposition 13 reform is ambitious, but the growing recognition of the affordable housing crisis in California and the near success of Proposition 15 may allow for reform of Proposition 13 soon.

For More Information

Arredondo, A., Green, N., Hussain, R. & Parker, M. (2022). Building for the Future: Alternatives to Address California's Housing Crisis Through Municipal Finance Reform (Master's capstone, UCLA). Retrieved from: https://escholarship.org/uc/item/3532t8bs.