

The Market Value of Commercial Real Property in Los Angeles County in 2002

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Introduction

When Proposition 13 was passed by the voters in 1978, property assessments were rolled back to the values that prevailed in 1975. Subsequently, the assessed value of a property can be increased only by a maximum of 2% per year until the property is sold, at which time it is assessed at market value. Since property values have increased on average faster than 2% per year, the current assessed value of real property in California is significantly below market value and hence property tax revenues statewide are significantly less than what would be collected if property were assessed at market value.

The question of how much less is difficult to answer, since no attempt is made to track the market value of properties between sales. This report summarizes our estimate of this revenue differential for commercial and industrial property.

In our book *Property Taxes and Tax Revolts: The Legacy of Proposition 13* (Cambridge University Press: 1995) and our 1993 report to the California Policy Seminar,¹ *The Future of Proposition 13*, we (along with Arthur O'Sullivan) analyzed the economic and fiscal consequences of Proposition 13 in detail. In this work, we developed estimates of the 1991 market value of residential and commercial property so as to analyze the fiscal impacts of Proposition 13 on local governments. We subsequently updated this work in 1995–1996 after a period of declining property values in California. This research was funded and published by the Public Policy Institute of California in the 1998 monograph, *Proposition 13 in Recession and Recovery*.²

These estimates, however, are now outdated, as California property values have changed since 1996. This project replicates these earlier studies using current data but focusing on commercial and industrial property to provide guidance for possible reform efforts. We have chosen Los Angeles County because it contains roughly 25% of the entire statewide property tax base and because its large number of commercial properties increases the accuracy of our estimates.

In the next section we describe the methodology used to determine current disparity ratios (the ratio of market value to assessed value) for commercial properties in Los Angeles County. In the last section we use these disparity ratios to estimate the market value of commercial property in Los Angeles County and the subsequent difference in property tax revenues under the current versus a market value-based system for both Los Angeles County and the state.

Methodology

The current assessed value of a property may or may not reflect its current market value, depending upon how recently it was sold and how rapidly property values have risen since the last sale. The base year of a property is defined as the year of the most recent sale; however, for properties that were in existence in 1975 and have not sold since then, the base year is 1975. The base year for a newly constructed property will initially be the year in which it first appears on the property tax roll. Over time, provided property values increase at a rate in excess of 2%, the

¹ Now the California Policy Research Center

² Available at <http://www.ppic.org/publications/PPIC114/index.html>

disparity between market and assessed values grows and, hence, will be greater for properties with older base years.

A property can have multiple base years if it has been modified since its last sale. If a property owner adds additional square footage to an existing structure or an additional structure on an existing piece of land, the new part of the property will have a separate base year. Available data do not allow us to keep track of the precise number of modifications for each property; however, we do distinguish between properties with a single base year and properties known to have multiple base years. These are referred to as “non-modified” and “modified,” respectively.

Our first goal is to estimate the disparity ratio—defined as the ratio of market to assessed value—for modified and non-modified commercial and industrial properties. Since data on market values are not readily available, we develop measures based on the sale of properties. Our second goal is to estimate the market value of this class of property. These findings provide the basis for estimating the loss in property tax revenue experienced by Los Angeles County for 2002.

To estimate the disparity ratio, we first obtained data on all commercial/industrial properties in Los Angeles County for the two most recent years: 2000–2001 and 2001–2002. These data were purchased from CD-DATA, which had obtained the data from the Los Angeles County assessor’s property tax rolls for the relevant years. From these data it is possible to determine which properties sold between the two years.

We separate all sales into categories based on the prior base year and whether or not the property has been modified.³ The 2000–2001 and 2001–2002 data purchased from CD-DATA do not contain information on multiple base years or any indicator of modifications. Thus we rely on our previous dataset from 1995–1996 to identify whether properties that sold in 2001–2002 had been modified since their last sale. If the last sale was after 1995–1996 we have no way of knowing if the property has been modified or not. We include all such properties in the “non-modified” calculations.

When a property is sold, we know its new market value (generally the sale price) and we also know its assessed value from the prior year. For each sale, we calculate the ratio of market to assessed value—the disparity ratio for that property. Within each category, we calculate the median disparity ratio for all the properties that were sold. We use the median rather than the mean of the disparity ratios to minimize the influence of a few “outliers” with unusually high disparity ratios possibly caused by reporting errors. These median disparity ratios are our preferred measures of property tax disparities and are used in all subsequent calculations.

Figure 1 depicts the entire distribution of disparity ratios for 1975 base year commercial and industrial properties, both non-modified and modified, that were sold in the 2001–2002 period. It is clear from the figure that there is no single, unique disparity ratio and thus it is necessary to develop a summary measure. The median disparity ratio for non-modified properties is 4.0 and that for modified properties is 2.4. These seem quite reasonable, falling between our 1991 estimates of 5.7 and 4.2 and our 1996 estimates of 3.2 and 2.3. A disparity ratio of 4.0 means that the actual market value of non-modified properties that have not sold since 1975 is roughly four times higher than their assessed value for tax purposes.

³ Parcels consisting only of vacant land were omitted due to insufficient sales of such parcels.

Figure 1
Disparity Ratios for Non-Modified and Modified Commercial and Industrial Properties with 1975 Base Years: Los Angeles County 2002

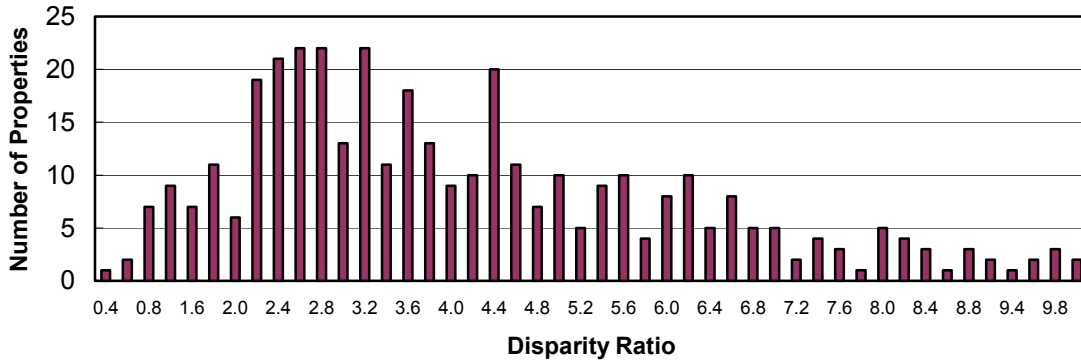


Table 1 reports 2002 median disparity ratios for modified and non-modified commercial and industrial properties in Los Angeles County broken down by base year. Table 1 also provides the total number of commercial and industrial properties on the secured roll⁴ and the number of properties sold in 2001–2002 by base year.

Market Value

The disparity ratios reported in Table 1, together with the breakdown of total assessed value of all commercial and industrial real estate by base year, allow us to estimate the market value of this class of property. For example, non-modified properties with 1975 base years have a total assessed value on the 2001–2002 roll of \$9,373,253,536. Multiplying this total assessed value by the disparity ratio of 4.0 yields an estimated market value of \$37,451,604,990.

Table 2 shows the results for both modified and non-modified properties by base year as well as the total estimated market value of commercial and industrial property in Los Angeles County. The current assessed value of commercial and industrial property in Los Angeles County is approximately \$147 billion while our estimate of actual market value is \$231 billion, an increase of nearly \$84 billion or 57%. This difference between assessed and market value leads to a loss in property tax revenue of roughly \$840 million per year in Los Angeles County alone.

Since Los Angeles County contains 25% of the statewide property tax base, simple extrapolation suggests that property tax losses statewide total approximately \$3.35 billion. Can we expect this revenue differential to remain constant over time? This depends on several factors.

⁴ The “secured roll” contains state and locally assessed property for which the taxes on the property are adequately secured by a lien on the property. The “unsecured roll” contains property for which the taxes are not adequately secured by a lien on real property. It consists mainly of business personal property owned by tenants, boats, and aircraft.

First, Table 2 shows that the vast majority (89%) of the estimated \$840 million dollars in additional property tax revenue that would result from a switch to market-value assessment would come from non-modified properties. Therefore, a change in the mix of modified to non-modified properties may affect this estimate.

Second, the fact that almost 40% of the increased revenue would come from 1975 base year properties is also significant. This is not surprising, since these properties have the highest disparity ratios. Over time, however, the number of 1975 base year properties will decline. We have observed a decrease from 36% in 1991 to 29% in 1996, and now to 18% in 2002, in the share of commercial and industrial properties in Los Angeles County with 1975 base years. As this trend continues, disparities will decline. Further uncertainty is associated with the rate of increase in property values. As long as property values grow faster than 2% each year, disparity ratios will increase, resulting in a corresponding increase in the revenue differential.

Third, although Los Angeles County contains one-fourth of the statewide property tax base, economic conditions may be sufficiently different elsewhere in the state that our Los Angeles estimates may not reflect the experience of other counties or the state as a whole. A more accurate estimate of the statewide revenue differential requires replicating this study for a larger sample of California counties.

**TABLE 1
NUMBER OF PROPERTIES, SALES, AND DISPARITY RATIOS FOR COMMERCIAL AND
INDUSTRIAL PROPERTY BY BASE YEAR IN LOS ANGELES COUNTY: 2002**

BASE YEAR	NON-MODIFIED PROPERTIES			MODIFIED PROPERTIES		
	NUMBER OF PROPERTIES	NUMBER OF SALES	MEDIAN DISPARITY RATIO	NUMBER OF PROPERTIES	NUMBER OF SALES	MEDIAN DISPARITY RATIO
1975	21,522	444	4.00	1,689	34	2.40
1976	1,740	28	3.23	275	4	2.83
1977	2,067	39	3.14	365	4	1.45
1978	2,456	47	3.78	524	7	1.67
1979	2,508	42	2.77	520	8	1.63
1980	2,447	51	1.92	506	11	1.26
1981	2,163	53	1.58	351	9	1.10
1982	2,181	59	1.66	276	3	1.15
1983	2,232	54	1.59	268	3	1.41
1984	2,679	54	1.30	304	2	1.24
1985	2,918	79	1.36	396	9	1.28
1986	4,119	92	1.31	400	6	2.15
1987	4,653	93	1.55	407	5	1.02
1988	3,367	89	1.27	294	4	1.18
1989	3,508	101	1.17	288	7	1.13
1990	3,245	79	1.16	208	4	0.87
1991	2,861	91	1.23	156	4	0.77
1992	2,623	79	1.14	83	2	1.19
1993	2,704	83	1.20	61	1	1.10
1994	3,093	92	1.21	39	2	2.64
1995	3,757	134	1.34	19		1.00
1996	5,359	201	1.41			
1997	5,628	183	1.31			
1998	6,210	202	1.31			
1999	6,876	204	1.25			
2000	7,408	294	1.23			
2001	6,846	150	1.28			
2002	3,494		1.00			
TOTAL	120,664	3117		7,429	129	

TABLE 2
MARKET VALUE OF COMMERCIAL/INDUSTRIAL PROPERTY IN LOS ANGELES COUNTY: 2002

NON-MODIFIED							
BASE YEAR	NUMBER OF PROPERTIES	NUMBER OF SALES	MEDIAN DISPARITY RATIO	TOTAL ASSESSED VALUE	TOTAL ESTIMATED MARKET VALUE	AVERAGE ASSESSED VALUE	AVERAGE ESTIMATED MARKET VALUE
				(\$)	(\$)	(\$)	(\$)
1975	21522	444	4.00	9,373,253,536	37,451,604,990	435,520	1,740,154
1976	1740	28	3.23	735,109,888	2,371,567,998	422,477	1,362,970
1977	2067	39	3.14	2,678,455,702	8,410,083,028	1,295,818	4,068,739
1978	2456	47	3.78	1,253,515,401	4,744,139,068	510,389	1,931,653
1979	2508	42	2.77	1,101,724,430	3,050,284,596	439,284	1,216,222
1980	2447	51	1.92	1,195,000,736	2,299,066,189	488,353	939,545
1981	2163	53	1.58	1,064,525,798	1,684,891,452	492,152	778,960
1982	2181	59	1.66	1,419,036,241	2,355,154,479	650,636	1,079,851
1983	2232	54	1.59	1,407,081,078	2,237,035,384	630,413	1,002,256
1984	2679	54	1.30	1,985,419,135	2,577,867,277	741,105	962,250
1985	2918	79	1.36	2,655,156,765	3,600,336,827	909,923	1,233,837
1986	4119	92	1.31	3,700,297,275	4,852,968,123	898,348	1,178,191
1987	4653	93	1.55	4,803,105,465	7,436,904,478	1,032,260	1,598,303
1988	3367	89	1.27	3,398,387,492	4,308,748,953	1,009,322	1,279,700
1989	3508	101	1.17	4,097,242,376	4,811,155,820	1,167,971	1,371,481
1990	3245	79	1.16	4,182,489,366	4,832,843,246	1,288,903	1,489,320
1991	2861	91	1.23	3,999,451,370	4,903,675,158	1,397,921	1,713,972
1992	2623	79	1.14	2,976,175,028	3,381,372,396	1,134,645	1,289,124
1993	2704	83	1.20	4,241,048,465	5,097,923,059	1,568,435	1,885,327
1994	3093	92	1.21	4,638,351,137	5,603,786,244	1,499,629	1,811,764
1995	3757	134	1.34	4,907,231,749	6,577,052,738	1,306,157	1,750,613
1996	5359	201	1.41	6,905,077,093	9,742,795,533	1,288,501	1,818,025
1997	5628	183	1.31	9,179,761,287	12,040,080,729	1,631,088	2,139,318
1998	6210	202	1.31	10,787,770,744	14,093,440,673	1,737,161	2,269,475
1999	6876	204	1.25	11,295,201,038	14,131,702,254	1,642,699	2,055,221
2000	7408	294	1.23	11,274,421,701	13,859,283,061	1,521,925	1,870,854
2001	6846	150	1.28	11,313,422,115	14,431,634,423	1,652,559	2,108,039
2002	3494		1.00	4,208,179,075	4,208,179,075	1,204,402	1,204,402
SUB	120664	3117		130,775,891,486	205,095,577,251	1,083,802	1,699,725
MODIFIED							
1975	1689	34	2.40	3,312,841,167	7,959,610,669	1,961,422	4,712,617
1976	275	4	2.83	237,260,287	671,320,373	862,765	2,441,165
1977	365	4	1.45	294,182,818	425,188,982	805,980	1,164,901
1978	524	7	1.67	510,634,948	850,672,069	974,494	1,623,420
1979	520	8	1.63	727,072,554	1,186,736,842	1,398,216	2,282,186
1980	506	11	1.26	1,030,230,313	1,302,327,347	2,036,028	2,573,769
1981	351	9	1.10	681,114,731	752,380,182	1,940,498	2,143,533
1982	276	3	1.15	906,352,998	1,045,791,921	3,283,888	3,789,101
1983	268	3	1.41	691,074,286	972,623,069	2,578,635	3,629,191
1984	304	2	1.24	807,421,057	998,810,359	2,655,990	3,285,560
1985	396	9	1.28	709,244,662	909,138,696	1,791,022	2,295,805
1986	400	6	2.15	1,750,678,751	3,771,873,401	4,376,697	9,429,684
1987	407	5	1.02	970,866,310	990,283,430	2,385,421	2,433,129
1988	294	4	1.18	829,937,341	979,372,761	2,822,916	3,331,200
1989	288	7	1.13	988,125,566	1,111,641,262	3,430,992	3,859,865
1990	208	4	0.87	818,624,951	710,147,782	3,935,697	3,414,172
1991	156	4	0.77	323,020,534	248,170,798	2,070,644	1,590,838
1992	83	2	1.19	190,222,739	226,607,413	2,291,840	2,730,210
1993	61	1	1.10	148,827,409	164,147,878	2,439,794	2,690,949
1994	39	2	2.64	130,158,745	343,635,094	3,337,404	8,811,156
1995	19		1.00	22,044,646	22,044,646	1,160,245	1,160,245
SUB	7429	129		16,079,936,813	25,642,524,974	2,164,482	3,451,679
TOTAL	128093	3246		146,855,828,299	230,738,102,224	1,146,478	1,801,333