



# City of Culver City

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## Staff Report Details (With Text)

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**Title:** CC - (1) Discussion of Whether to Place a Measure on the November 3, 2020 General Municipal Election Ballot to Submit to the Voters an Amendment to Culver City Municipal Code Section 3.08.400 to Increase the Real Property Transfer Tax; (2) (If Desired) Creation of an Ad Hoc Real Property Transfer Tax Ballot Measure City Council Subcommittee; and (3) Direction to the City Manager as Deemed Appropriate.

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Date	Ver.	Action By	Action	Result
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**CC - (1) Discussion of Whether to Place a Measure on the November 3, 2020 General Municipal Election Ballot to Submit to the Voters an Amendment to Culver City Municipal Code Section 3.08.400 to Increase the Real Property Transfer Tax; (2) (If Desired) Creation of an Ad Hoc Real Property Transfer Tax Ballot Measure City Council Subcommittee; and (3) Direction to the City Manager as Deemed Appropriate.**

**Meeting Date:** July 27, 2020

**Contact Person/Dept:** Jesse Mays, Assistant City Manager  
**Phone Number:** (310) 253-6000

**Fiscal Impact:** Yes ☒ No ☐      **General Fund:** Yes ☒ No ☐

**Public Hearing:** ☒      **Action Item:** ☒      **Attachments:** ☒

**Commission Action Required:** Yes ☐ No ☒      **Date:**

**Public Notification:** (E-Mail) Meetings and Agendas - City Council, Culver City News and Events, Chamber of Commerce, Fiscal and Budget Issues, Public Notifications, Finance Authority, Ballot Measure Updates, Press Organizations, Media Organizations (07/20/2020)

**Department Approval:** John Nachbar, City Manager, (07/23/2020)

## **RECOMMENDATION**

Staff recommends the City Council: (1) discuss whether to place a Measure on the November 3, 2020 General Municipal Election Ballot to submit to the voters an amendment to Culver City Municipal Code Section 3.08.400 to increase the real property transfer tax; (2) (if desired) create an Ad Hoc Real Property Transfer Tax Ballot Measure City Council Subcommittee; and (3) direction to the City Manager as deemed appropriate.

## **BACKGROUND**

Charter cities, such as Culver City, may enact a real property transfer tax, which is imposed during the sale of real property, based on the value of the property. Courts have determined that such a tax, enacted by a charter city, does not violate either the California Constitution Article XIII A or Government Code §53725, which prohibits a transaction tax on the sale of real property, but applies to only general law cities.

Any sale of real estate in Culver City over \$100 is currently subject to the City's Real Property Transfer Tax ("transfer tax") of \$2.25 per \$500 (0.45%) (see Attachment 1, Culver City Municipal Code Section 3.08.400 - 3.08.470). The seller and buyer are jointly liable for the payment of the tax. Historically, sellers have paid transfer taxes in California, although in recent years it has become something that is negotiated between buyer and seller, during the course of a real estate sales transaction.

In Fiscal Year 2018-2019, the transfer tax generated revenue of \$3,634,569. In Fiscal Year 2019/2020 the unaudited transfer tax revenue is \$3,962,081. The proposed Fiscal Year 2020/2021 budget anticipates the transfer tax will generate \$3,210,000.

At its July 13, 2020 meeting, at least three Council Members requested that the City Council place on a future agenda a discussion of whether to place a measure on the November 3, 2020 ballot submitting an amendment to the Culver City Municipal Code to increase the transfer tax. At the July 27<sup>th</sup> Special Meeting, if City Council votes to place such a transfer tax increase on the November 3<sup>rd</sup> ballot, staff would return to City Council with a draft proposed ordinance and ballot measure language on Monday, August 3, 2020 to meet the August 7<sup>th</sup> deadline to place measures on the November 3, 2020 ballot.

## **DISCUSSION**

### ***Rate***

Five cities in Los Angeles County, including Culver City, as well as Los Angeles County, levy a documentary transfer tax or property transfer tax. Rates range from 0.11% to 0.45% in these jurisdictions. Examples of transfer tax rates throughout California are shown in Attachment 2.

A recent white paper by Shane Phillips at the UCLA Luskin School (Attachment 3) argues that transfer taxes in Los Angeles County are relatively low. In comparison, the City of San Francisco has transfer tax rates that range from 0.5% to 3.0%, depending on the sale price (see Attachment 3, page 3, Table 1). The cities of Alameda, Albany, Emeryville, and Piedmont have flat rates of over 1%. Oakland has a range of transfer tax rates from 1-3%. Berkeley has a rate of 1.5% for properties sold for \$1.5 million or less and 2.5% on those sold for over \$1.5 million. The Phillips white paper details

reasons why City Council may wish to consider increasing the transfer tax, as well as disadvantages of transfer taxes.

Staff recommends that the City Council keep in mind the *effective* rate when deciding on what rate to use, as discussed further below in the section on marginal versus flat tax rates.

### ***Tiered Tax Rate Structure***

Culver City's existing transfer tax has a flat rate structure, as do all other jurisdictions in Los Angeles County. In other words, this means that the sale of a single-family home is taxed at the same rate as the sale of a large commercial property. Four jurisdictions in California (San Francisco, Oakland, Richmond, and Berkeley) have progressive, tiered tax rate structures which tax the sale of more expensive properties at a higher rate than the sale of lower priced properties. This type of tax structure generates more revenue from those who can most afford it while shielding owners of relatively lower-priced properties (such as single-family homes) from higher rates. San Francisco has five tiers, Oakland and Richmond each have four tiers, and Berkeley has two tiers.

An example of a tiered rate structure is shown as Attachment 4. Three different scenarios are shown: increasing transfer tax rates (1) a limited amount, (2) a moderate amount, or (3) a robust amount.

### ***Marginal vs Flat Tax Rate Structure***

When reviewing whether to include a tiered rate structure in a proposed measure, consideration should also be given as to whether rate tiers are "marginal" or flat. There are significant differences between the two types of tax structures:

- A marginal tax structure prevents large discrepancies in tax payments for sales of a similar dollar amount that happen to fall into different tiers. By way of example, under a flat tax, a \$99 sale might pay 1% while a \$100 sale would pay 2% if they happened to fall into different tax rate tiers. The effective tax on the \$99 sale is 1% and on the \$100 sale is 2%. With a flat tax, the tax and effective tax are equal. On the other hand, with a marginal tax rate structure, *each sale* pays 1% of the first \$99; then, the \$100 sale pays 2% of the *additional* \$1 of the sales price. The effective tax on the \$99 sale is 1% and on the \$100 sale is 1.01%.
- For any given tax rate imposed on a taxpayer (except for those in the lowest bracket), a flat tax will result in a higher effective tax rate, and raise more revenue, than a marginal tax; a marginal tax rate will result in a lower effective tax rate and raise less revenue than a flat tax.

Attachment 4 shows the range of effective tax rates for each of the tax rate tiers in each of the three different tax scenarios, if a marginal tax rate were used. (As stated above, the effective tax rate is equal to the flat tax rate if a flat tax rate is used.) Attachment 4 also shows the difference between a flat tax and a marginal tax in the range of taxes paid/revenue generated per property transfer.

Staff recommends the City Council consider the difference between a marginal and flat tax rate when deciding on tax rates. While the marginal or flat tax rates are what voters will see on the ballot, the effective rate is what taxpayers will pay and what the City will receive in revenue. In general, the City Council should consider using lower flat rates than it would if it were to use marginal rates, since that will result in similar effective rates.

Three of the four California cities with tiered rate structures use flat taxes (Berkeley, Oakland, and San Francisco), while one city uses a marginal tax (Richmond).

One reason more California cities may have chosen to use a flat tax is that with a marginal tax ballot measure, voters are asked to approve tax rates that appear on paper higher than the effective tax rates that most taxpayers will actually pay. Additionally, if Culver City were to adopt a marginal tax rate structure for transfer taxes, it might increase the frequency of taxpayer error in calculating the correct tax, which might increase the cost of compliance and collection.

### ***How Tiered Tax Rate Brackets are Modified Over Time***

If a tiered rate structure is used, the City Council may determine whether to allow for the tier ranges to be adjusted over time to account for inflation. One of many several strategies could be used:

- *Periodic City Council Action Based on CPI:* Oakland's Measure X allows the City Council, no more than once every five years, to modify the two middle tiers of its four-tier structure by amounts no more than the Consumer Price Index, and places a cap on the maximum allowable increase.
- *Automatic Annual Increase Based on Sale Price Distribution:* Berkeley's Measure P automatically adjusts the tier threshold annually on January 1 of every subsequent year, to a number equal to the value of consideration for the transaction at the 67th percentile of transactions during the 12 months preceding September 1 of the preceding year, as recorded by the Alameda County Assessor. This would be rounded to the nearest \$100,000 increment, provided that in no case shall any adjustment lower the threshold below \$1,500,000. In other words, Berkeley ensures that the higher tax rate applies to the highest 33% of sale prices.
- *Automatic Increase Based on the Consumer Price Index Increase.*

Other jurisdictions, such as San Francisco and Richmond, do not have a process to adjust tiers. If City Council were to select this option, and not provide for a mechanism to adjust the tiers, the tiers would remain in place unless modified by voters in the future.

### ***Exemptions***

The City Council may wish to consider whether to exempt certain types of real property transfers from a transfer tax increase to achieve a variety of policy goals. Exempted properties would retain the existing 0.45% tax rate or another rate. Types of properties City Council may wish to consider exempting include:

- First transfer of new multifamily construction (to avoid disincentivizing construction of new housing)
- 100% affordable residential properties (to avoid disincentivizing affordable housing)
- Properties below a certain sale price

### ***Potential New Revenues Generated***

A preliminary analysis by HdL Coren & Cone of marginal rates from the Example Tiered Rate Structure applied to calendar year 2019 Culver City actual transactions (Attachment 5) shows the increased transfer tax would have generated \$12.1 million in the Limited Scenario, \$16.5 million in the Moderate Scenario, and \$19.6 million in the Robust Scenario, compared to actual unaudited FY19/20 transfer tax returns of \$3.96 million. If the tax were applied as a flat tax instead of a marginal tax, the increased transfer tax would have generated \$14.8 million in the Limited Scenario, \$20.0

million in the Moderate Scenario, and \$24.2 million in the Robust Scenario.

A similar analysis performed by Shane Phillips at the UCLA Luskin School of marginal rates from the Example Tiered Rate Structure applied to calendar year 2019 Culver City actual transactions (Attachment 6) shows that the increased transfer tax would have generated \$8.1 million in the Limited Scenario, \$11.2 million in the Moderate Scenario, and \$13.1 million in the Robust Scenario. If applied as a flat tax, the increased transfer tax would have generated \$10.3 million in the Limited Scenario, \$14.1 million in the Moderate Scenario, and \$17.0 million in the Robust Scenario.

It is important to note that these estimates are derived using one year's real estate transaction data, which may not necessarily be typical. The COVID-19 pandemic and current recession will likely reduce the amount of revenue generated by this tax. Ultimately, the amount of additional revenue generated will depend on the number and size of real estate transactions that take place in any given year. Should the City Council desire to move forward with a ballot measure, further analysis would be performed to project anticipated new revenues.

### ***Additional Considerations***

As a tax program increases in complexity (e.g. more tiers and exemptions), it becomes increasingly more difficult for taxpayers to calculate and pay the correct amount. In addition, it becomes more difficult and thus more expensive for the City to monitor. Both issues may lower compliance and collection rates. The complexity is something City Council should consider when designing a tax program.

Transfer taxes are collected by the County and remitted to the City. The City will be engaging in conversations with the Los Angeles County Recorder about how they collect the tax, although those discussions will not be concluded before the ballot measure deadline. Should the City Council choose to use a tiered rate, the Los Angeles County Recorder may not have the technical capability to collect more than one tax rate. Therefore, the County may only be able to collect the revenue generated by the first marginal rate. The City would have to collect the remaining tax on its own. The City would likely engage a contractor to identify sales, calculate and collect remaining taxes. This would come at an unknown cost. The City would also engage in an education campaign to inform local real estate agents and brokers about how to advise their clients to pay the correct amount of transfer tax.

### ***Liability for Payment of the Tax***

The existing transfer tax ordinance makes the seller and buyer jointly liable for payment of the transfer tax. City Council should consider whether to indicate in the ordinance whether the buyer, seller, or both are liable for payment of the transfer tax. Naming who is responsible for the tax will make it clear who owes it, which will reduce confusion and difficulty in collection. This will be especially important if the County is not able to collect the tax and the City must collect the tax. If the buyer is ultimately responsible, the City will not only have contact information for the person responsible for payment of the tax, but the City will be able to put a lien on the property for non-payment, if necessary. If the seller is responsible, the City may not be able to find the seller once they sell the property and leave. In any event, the seller and buyer may privately work out between themselves how the tax is paid.

## ***Legal Review***

Culver City's Transfer Tax ordinance was last substantially updated in 1965, so staff along with the City Attorney's office is currently reviewing the entire ordinance to ensure the tax language is up to date. If modifications are needed, staff will bring that language back to City Council when it returns with a draft proposed ordinance, if the Council determines to place the matter on the November 3<sup>rd</sup> ballot.

## ***Case Studies***

### **Berkeley**

On November 6, 2018, voters in the City of Berkeley approved Measure P, Real Property Transfer Tax Increase, with 72% voting "yes" and 28% voting "no". Measure P increased the real property transfer tax from 1.5% to 2.5% for property sales and transfers over \$1.5 million, adjusted annually to capture the top approximately 33% of transfers. The tax is a flat tax. The measure was put into place for a period of 10 years. It is expected to raise an estimated \$6 million to \$8 million annually for general municipal purposes such as navigation centers, mental health support, rehousing and other services for the homeless, including homeless seniors.

Additionally, the Berkeley measure also established a Homeless Service Panel of experts. Property sales or transfers up to \$1.5 million maintain the historic tax rate of 1.5%. Property sales or transfers over \$1.5 million have a new transfer tax rate of 2.5%. Applicants may claim up to 1/3 of the base 1.5% transfer tax rate on a dollar-for-dollar basis for all voluntary seismic upgrades to residential property.

### **Oakland**

On November 6, 2018, voters in the City of Oakland approved Measure X, Graduated Real Estate Transfer Tax, with 70% voting "yes" and 30% voting "no". Measure X changed the city's transfer tax from a flat 1.5% rate to the following tiered rates based on sale price: 1% for up to \$300,000; 1.5% from \$300,000 to \$2 million; 1.75% from \$2 million to \$5 million; 2.5% for over \$5 million. The tax is a flat tax. The City previously reduced the 1.5% transfer tax to 1.25% for qualified low- and moderate-income first-time homebuyers. The measure reduced the tax rate for low- and moderate-income first-time homebuyers by one-half of a percentage point below the applicable rate, for property transfers for \$2 million or less. The measure also reduced the tax by up to one-third (1/3) for seismic retrofit work or the installation of a solar energy system costs if the work is completed within one year of the transfer. Only transfers for \$2 million or less to low- and moderate-income homebuyers are eligible for the reduction. The tax reduction is refunded to homebuyers for the costs they incur for qualified seismic retrofit or solar energy installation work.

### **San Francisco**

On November 8, 2016, voters in the City and County of San Francisco approved Proposition W, Real Estate Transfer Tax Increase, with 62% voting "yes" and 38% voting "no". The measure increased the property transfer tax rate on transactions between \$5 million and \$10 million from 2% to 2.25%, the tax rate on transactions between \$10 million up to \$25 million from 2.5% to 2.75%, and the rate on transactions valued at least \$25 million from 2.5% to 3%. The tax is a flat tax.

### Santa Monica

On November 4, 2014, voters in the City of Santa Monica rejected Measure H, Real Estate Transfer Tax, with 58% voting “no” and 42% voting “yes”. The measure would have increased the transfer tax on residential and commercial real estate valued at \$1 million or more from \$3 per \$1,000 of sale price (0.3%) to \$9 per \$1,000 of real estate sale value (0.9%). Transfers for less than \$1 million would have been continued to be taxed at the existing \$3 per \$1,000 sale price (0.3%).

On June 9, 2020, the Santa Monica City Council voted to place a measure on the November 3, 2020 ballot that would increase its transfer tax to \$6 per \$1,000 of sales price (0.6%) for all real estate sales over \$5 million. Sales under \$5 million would remain at \$3 per \$1,000 of sales price (0.3%). A research firm commissioned by Santa Monica found that more than 60% of Santa Monica voters support raising the real estate transfer tax on luxury properties. Santa Monica estimates that in a healthy economy the measure would raise \$3 million annually, but due to the impact of COVID-19 on the economy it would only be expected to raise half of that amount.

### Emeryville

On November 4, 2014, voters in the City of Emeryville approved Measure V, Real Property Transfer Tax, with 60% voting “yes” and 40% voting “no”. Previously, the City did not have a transfer tax. The measure imposed a flat transfer tax of \$12 per \$1,000 of real estate sale value (1.2%).

### ***Policy Considerations***

If a ballot measure is desired to increase the transfer tax, staff seeks guidance from the City Council on the following policy issues:

- 1) Should the City maintain the existing flat tax rate or change to a progressive, tiered rate tax?
- 2) How many tiers should there be and at what dollar amount should the tiers begin and end?
- 3) Should the tax rates be marginal or flat?
- 4) What should the tax rate be for each tier?
- 5) Should the dollar amount ranges of the tiers be modified over time? If so, how? Examples include City Council action based on CPI, automatic annual increase based on sale price distribution, or automatic increase based on CPI.
- 6) Which types of property sales should be exempt from the tax rate increase, if any?
- 7) Who is liable for the payment of the tax? Buyer, seller, or both?

### ***Ad Hoc Transfer Tax Ballot Measure Subcommittee***

If desired, the City Council may create an Ad Hoc Subcommittee and appoint two City Council Members thereto to work with staff on the draft ordinance and ballot measure before it comes back to City Council for consideration. Additionally, the Subcommittee could be tasked with writing the arguments in favor of the Measure, if the City Council votes to place it on the ballot. Voters will receive the ballot arguments, as well as an Impartial Analysis by the City Attorney, in their Voter Pamphlet.

### **FISCAL ANALYSIS**

If approved, the ballot measure will increase the City's cost to hold the General Municipal Election on November 3, 2020 by approximately \$13,200. That additional cost includes Los Angeles County's costs to print and provide the measure on the ballot. A public education program to inform the public about the ballot measure, if desired, is estimated to cost approximately \$30,000. These expenses will be paid from the General Fund's Non-Departmental Acct #10116100.619800.

If approved by voters, depending on the tax structure selected by City Council and the number and size of real estate transactions, the transfer tax increase could have a positive impact of \$5 - \$10 million annually to the General Fund, although taxes raised through this type of tax are volatile. The COVID-19 pandemic and recession would likely have a significant negative impact on the amount of revenue generated by a transfer tax measure.

### **ATTACHMENTS**

1. 2020-07-27\_ATT\_CCMC Sections
2. 2020-07-27\_ATT\_Transfer Taxes in Other California Jurisdictions
3. 2020-07-27\_ATT\_UCLA Luskin School White Paper
4. 2020-07-27\_ATT\_Example Tiered Rate Structure
5. 2020-07-27\_ATT\_Preliminary Annual Revenue Projections HdL
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### **MOTION**

That the City Council:

1. (If Desired) Place a Measure on the November 3, 2020 General Municipal Election Ballot to submit to the voters an amendment to Culver City Municipal Code Section 3.08.400 to increase the real property transfer tax;
2. (If Desired) Create an Ad Hoc Real Property Transfer Tax Ballot Measure City Council Subcommittee; and
3. Direction to the City Manager as deemed appropriate.