



# Understanding the Impact of Proposition 15 on Small Businesses in California

---

September 2020



This report was prepared by Beacon Economics LLC with research costs covered by the Silicon Valley Community Foundation, Stupski Foundation, and others. All findings, conclusions, and opinions are solely and exclusively those of Beacon Economics.

## ABOUT BEACON ECONOMICS LLC

Founded in 2007, Beacon Economics, an LLC and certified Small Business Enterprise with the state of California, is an independent research and consulting firm dedicated to delivering accurate, insightful, and objectively based economic analysis. Leveraging unique proprietary models, vast databases, and sophisticated data processing, the company's specialized practice areas include sustainable growth and development, real estate market analysis, economic forecasting, industry analysis, economic policy analysis, and economic impact studies. Beacon Economics equips its clients with the data and analysis required to understand the significance of on-the-ground realities and to make informed business and policy decisions.

## PROJECT TEAM

### **CHRISTOPHER THORNBERG, PhD**

Founding Partner  
Chris@beaconecon.com

### **TANER OSMAN, PhD**

Manager, Regional and Sub-Regional Analysis  
Taner@beaconecon.com

### **BRIAN VANDERPLAS**

Senior Research Associate  
Brian@beaconecon.com

### **JOHN MACKE**

Research Associate, Regional  
and Sub-Regional Analysis  
John@beaconecon.com

### **JAMES MCKEEVER**

Research Associate, Regional  
and Sub-Regional Analysis  
James@beaconecon.com

For further information about this report, or to learn more about Beacon Economics' practice areas, please contact:

### **SHERIF HANNA**

Managing Partner  
Sherif@beaconecon.com

### **VICTORIA PIKE BOND**

Director of Communications  
Victoria@beaconecon.com

### **RICK SMITH**

Director of Business Development  
Rick@beaconecon.com

Or visit our website at [www.BeaconEcon.com](http://www.BeaconEcon.com)



## KEY FINDINGS

- This report examines the factors that determine commercial rents in 12 California counties. It explores the relationship between commercial and industrial rents and the reassessment of commercial property values, accounting for other factors that shape rents.
- Commercial rents are driven by location, local market conditions, the nature of a local economy (high-wage areas are associated with higher rents), and building age and size.
- For average commercial properties, reassessments do not increase rents. Office buildings have a small relationship between reassessments and rents. Reassessing a 20-year-old office building to current market value could lead to a one-time rent increase of roughly 2%.

## CONTEXT

- On Nov. 3, the state’s voters will be asked to vote on Proposition 15, formally known as the “Increases Funding for Public Schools, Community Colleges, and Local Government Services by Changing Tax Assessment of Commercial and Industrial Property. Initiative Constitutional Amendment,”<sup>1</sup> and commonly called the “Schools and Communities First Initiative” or the “Split Roll” initiative.
- The initiative would amend the California Constitution to require commercial and industrial properties, except those zoned as commercial agriculture, to be taxed on market value rather than purchase price, while continuing to tax residential properties on their purchase price.
- The revenue generated from Prop. 15 would be directed to K-12 public schools, community colleges, and local governments.
- At present, property taxes are determined by the purchase price, under the provisions of Prop. 13. The tax is limited to no more than 1% of the purchase price, with an annual adjustment equal to the rate of inflation or 2%, whichever is lower. The assessed value of a property resets once a property is sold. The changes under Prop. 15 would be phased in beginning in fiscal year 2022-23.
- The initiative exempts properties whose owners have \$3 million or less in holdings in California. These properties would continue to be taxed on their purchase price.
- Prop. 15 contains other protections for small businesses, including an exemption for home-based businesses; deferred reassessment until the 2025-26 lien date for properties in which small businesses account for 50% or more of the occupied spaces; and the elimination of the business tangible personal property tax on equipment and fixtures for small firms.
- Supporters of Prop. 15 argue that it would generate billions of dollars for education and local services without affecting the property taxes of homeowners and small businesses; close loopholes that allow corporations to avoid property tax reassessment; and create greater parity in property tax revenue generation, which increasingly relies on taxes from households.
- Opponents argue that it would create a substantial tax increase (roughly \$12.5 billion per annum) on commercial and industrial property owners and would increase the rents paid by their tenants. They say these cost increases would eliminate jobs, suppress new business activity, and prompt firms to move out of state.

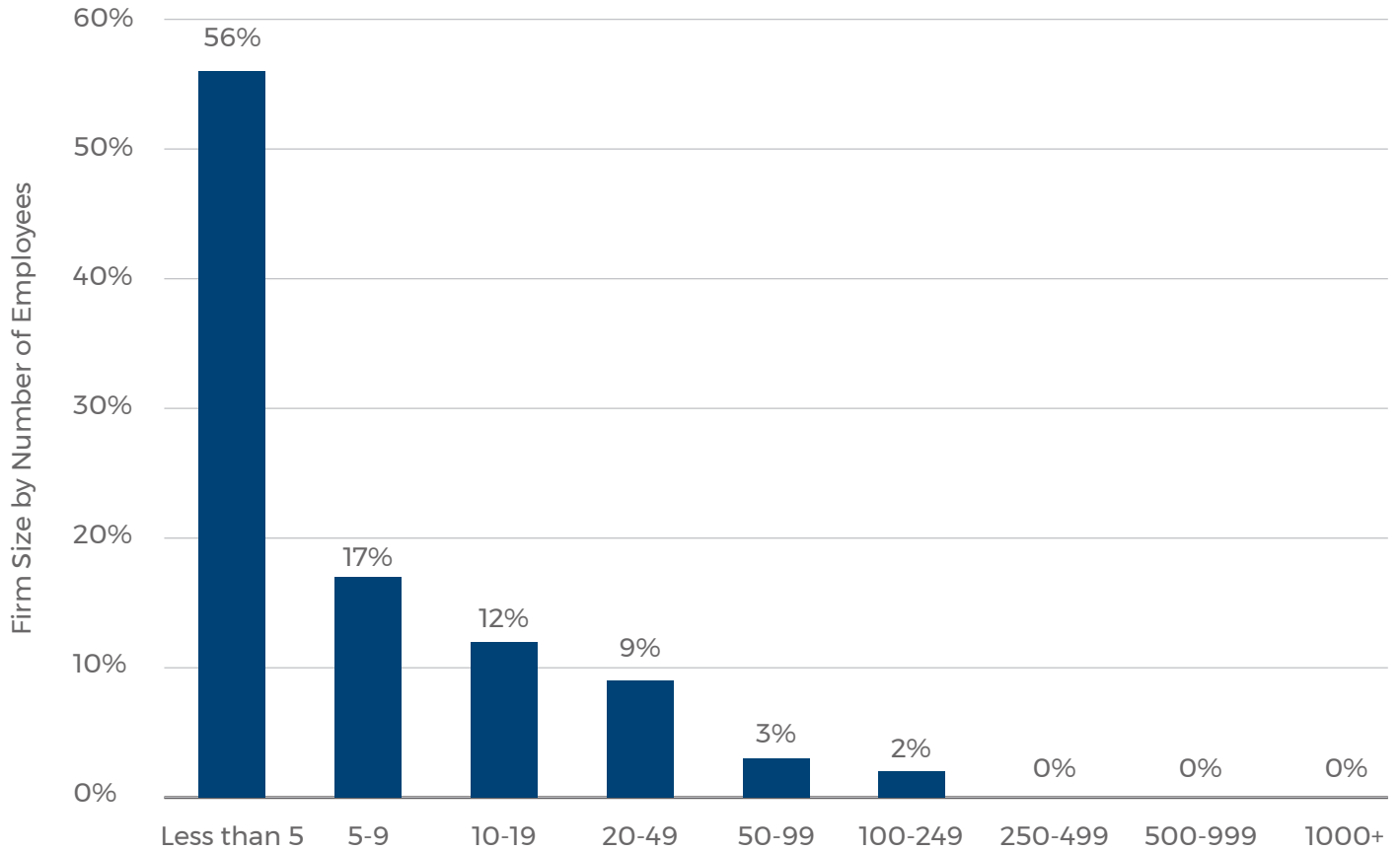
---

<sup>1</sup> <https://www.sos.ca.gov/elections/ballot-measures/qualified-ballot-measures/>

# THE SMALL-BUSINESS LANDSCAPE IN CALIFORNIA

- California has more than 1 million businesses, the overwhelming majority of which are small. Fifty-six percent have fewer than five employees, and 17% have five to nine. Altogether, 85% of all businesses in the state have fewer than 20 employees.

## Distribution of Firms by Employee Size



Source: County Business Patterns; Analysis by Beacon Economics, LLC

- Prop. 15 could affect business costs in two primary ways. First, it would raise property taxes of commercial landowners with properties valued at greater than \$3 million, especially long-standing property owners. Second, these increases could be passed through to commercial renters. A number of provisions in Prop. 15 protect small businesses from such increases.

## SMALL-BUSINESS PROPERTY OWNERS

- Properties owned by most small businesses are low-value and therefore shielded by the Prop. 15 exemptions.
- A random sample of about 22,000 commercial property transactions in California's major population centers from 2018 to 2020 found that two-thirds sold for less than \$3 million. The median price was \$1.6 million.
- Based on this sample, most properties in California be exempt from Prop. 15. In general, small businesses require less space and operate in relatively small and inexpensive properties.
- This finding is consistent with studies that show that the burden of Prop. 15 would fall on the state's largest corporations and highest-value properties.
- But many small businesses rent their places of business. Small-business renters could suffer if increased property tax bills are passed through to them.

## SMALL-BUSINESS RENTERS

- Commercial rents are primarily determined by location, market conditions, building type, building age, and taxes.
- The findings in this report are based on a statistical analysis of the factors that influence commercial and industrial rents in California.
- The study analyzes nearly 12,000 properties in the counties of Alameda, Contra Costa, Fresno, Los Angeles, Orange, Sacramento, San Bernardino, San Diego, San Francisco, San Joaquin, San Mateo and Santa Clara.

The analysis determines whether rents are higher in recently sold properties than in those sold earlier. If property tax reassessments under Prop. 15 lead to rent increases, rents would be higher in recently sold properties than in those sold earlier.

- Factors that determine rents include building age, property type (office, warehouse, retail, etc.), location (city), size, the year a building was sold or renovated, the prevailing local rent, a building's vacancy rate, how much local commercial activity is found in professional and business services, and local economic conditions, such as wages.

- Report Findings:
  - ▶ Rent is mostly determined by local market conditions, such as the average rent of other local properties
  - ▶ Rents rise in tandem with the number of Professional and Business Services in the building or area.
  - ▶ In high-wage areas, rents are relatively high.
  - ▶ Larger buildings command higher rents per square foot.
  - ▶ Older buildings command lower rents.
  - ▶ The length of time since a property was sold or renovated does not have a statistically significant relationship with commercial rents. For most property types, if an assessed value is lower than market value, this does not influence rent. In other words, if under Prop. 15 many properties are reassessed to current market value, this would not affect rents, based on the properties studied.
  
- To place these figures in context, imagine identical properties side by side. One's taxes are based on the purchase price of the building 10 years ago. The other's taxes are based on today's market value. The property taxes paid by the first building owner are lower than those paid by the second owner, but Beacon Economics' analysis shows that the rents are not driven by the property taxes paid, but by other factors as described above.
  
- In a triple net lease, the tenant or lessee is responsible for the ongoing expenses of the property, including real estate taxes, building insurance, and maintenance, in addition to rent and utilities. Opponents of Prop. 15 say small businesses subject to such leases would be adversely affected.
  
- But if triple net leases were affected by property tax reassessment in some wholesale manner, it would show in this report's analysis. If thousands of renters routinely had their rents increase each time properties were reassessed, evidence would be seen.
  
- Ultimately, this analysis shows that rents are determined by what the market is willing to pay. That is, in some of the most desirable commercial markets, rent differences in neighboring properties are not based on the sale date. A property owner charges the highest rent that tenants are willing to pay, regardless of the purchase price.
  
- These findings hold for retail, warehouse, and research and development properties. For office properties, the year of sale does have an effect on rents. In two identical neighboring properties, one would yield a rent 0.014% lower than its neighbor bought a year later. This means that reassessing a property bought 20 years ago to current market conditions could lead to a one-time 2% rent increase.
  
- In sum, Prop. 15 could affect costs for small businesses in two primary ways. First, small-business property owners could see higher taxes. But this analysis reveals that most commercial properties would not have their assessed value changed under Prop. 15. Second, increased property taxes could be passed on to small businesses through higher rents. This analysis suggests that recently purchased properties, which should command higher taxes, do not have higher rents. Based on this analysis, it seems unlikely that small-business owners would be hurt by Prop. 15.



## INTRODUCTION

1978's Proposition 13 lowered property taxes by assessing values at their 1976 levels and restricting annual increases of assessed value to a maximum of 2%. It prohibits reassessment of a new base-year value except after a change in ownership or completion of new construction. These rules apply equally to all real estate, residential and commercial, whether owned by individuals or corporations. Before Prop. 13, property taxes were largely determined by the market value of homes and commercial properties. Prop. 13 passed with 64% voter approval.

From 1970 to 1980, the median property value in the state increased 250% while median household income growth remained flat. This meant that property tax payments were increasing as a share of Californians' incomes. Households' increasing property tax bills were a primary driver of Prop. 13. The law has affected local budgets and the types of development that communities have permitted. Despite its perceived negative impacts, Prop. 13 remains popular with voters.

Prop. 13 was intended to reduce taxes for homeowners, not commercial property owners. But over time, the relative tax for commercial property owners has fallen. In 1975, commercial properties paid 46% of the property tax roll in L.A. County; by 2017, such properties paid just 28%.<sup>2</sup> This is because homes are reassessed more frequently than commercial properties because unlike corporations, homeowners move or die. Corporations can hold properties longer than people and so reap greater benefits from the reassessment rule. At some blue-chip companies, personnel changes occur regularly but the corporate entity lives for generations.

<sup>2</sup> [https://assessor.lacounty.gov/wp-content/uploads/2017/10/LACountyAssessor\\_AnnualReport\\_Digital.pdf](https://assessor.lacounty.gov/wp-content/uploads/2017/10/LACountyAssessor_AnnualReport_Digital.pdf)



Furthermore, a property transfer loophole in Prop. 13 limits what constitutes a change in property ownership, therefore reducing the reassessment of commercial properties. Usually when a property changes hands, the assessed value (which determines the taxable value) resets to the market rate. But the use of limited liability corporations and complex partnerships enable certain corporations to avoid reassessment.

Legislative attempts have been made to close such loopholes (in 2014, 2015, 2018, and 2020), but none have succeeded. Prop. 15 aims to tax commercial and industrial property on current market value as opposed to the purchase price. The initiative includes exemptions for agricultural land, residential properties, and commercial and industrial properties that have a combined value of \$3 million or less.

Small businesses would be exempt from personal property tax, and non-small businesses would receive a \$500,000 exemption on personal property tax. The ballot initiative would provide \$6.5 billion to \$11.5 billion in new funding to local governments,<sup>3</sup> public schools, and community colleges based on the revenue from the increased property taxes.<sup>4</sup>

The ballot measure preserves Prop. 13's protections for homeowners and residential rental properties while providing increased and stable revenue for schools and local governments; new revenue is not intended to be allocated to the state government.

The key provisions of Prop. 15:

- Commercial and industrial properties are to be taxed at market value instead of purchase price.
- Commercial and industrial properties with a combined value at or below \$3 million are exempt and will continue to pay property tax based on purchase price.
- Home-based businesses are exempt.
- No changes are made to Prop. 13's provision limiting property tax rates for all taxable real property to 1%.
- All residential property is exempt.
- Agricultural land is exempt and will continue to be taxed under existing laws.
- For properties in which small businesses account for 50% or more of the occupied space, reassessments of tax will be deferred until the 2025-26 lien date.
- The business tangible personal property tax on equipment and fixtures for small businesses is eliminated.
- A \$500,000 annual tax exemption on equipment and fixtures to non-small businesses is included.
- Legislatures must provide, by statute, for the phase-in of reassessments of under-assessed commercial and industrial real properties to implement the new law beginning with the lien date of 2022-23.
- Affected owners will be required to pay the new taxes only from the lien date for the fiscal year when the assessor has completed the assessment.
- Legislatures must provide reasonable time to pay any increase in tax obligations resulting from this measure.
- The Board of Equalization's oversight over the property tax system is maintained to assure the public that the assessment of commercial and industrial property in every county is equitable and uniform.

---

<sup>3</sup> <https://lao.ca.gov/BallotAnalysis/Proposition?number=15&year=2020>

<sup>4</sup> California Secretary of State. (2020, July 3). Official title and summary prepared by the attorney general. Retrieved from <https://elections.cdn.sos.ca.gov/statewide-elections/2020-general/prop-15-title-summary.pdf>

## PROPOSERS OF PROP. 15 ARGUE THAT THE LEGISLATION WOULD:

- **Close corporate loopholes:** Commercial and industrial property owners exploit loopholes in the current law to avoid property reassessment.
- **Have no impact on homeowners and renters:** The initiative exempts residential properties.
- **Reduce taxes for small businesses:** Small businesses that operate from their residences and those that own nonresidential commercial property valued at \$3 million or less would be exempt.
- **Restore equity to property taxes:** Over the years, residential property tax revenue has increased from 55% to 72% relative to commercial tax revenue. Prop. 15 would reduce this inequity.
- **Increase funding for public services (schools and community colleges):** Property tax revenue would go directly to schools and community colleges instead of being redirected by intermediary bodies.
- **Protect farmland:** The legislation exempts agricultural land.<sup>5</sup>

## OPPOSERS ARGUE THAT THE LEGISLATION WOULD:

- **Be the largest property tax increase in the state's history:** The legislation would lead to a substantial tax increase (\$12.5 billion per annum) on commercial and industrial entities. This would hurt small businesses, the agricultural industry, residential homeowners, and consumers.
- **Raise the cost of living:** The tax increases would cause businesses to increase the cost of groceries, health-care, energy, and other products and services. Some residents would be priced out of their communities, and the legislation would have detrimental impacts on low-income communities.
- **Destroy jobs and small businesses:** The legislation does not prevent increased taxes from being passed on to small businesses.
- **Increase taxes on farms:** The legislation would increase property taxes on the farming sector (barns, dairies, food processing plants, and cultivation sites), which would raise food prices.
- **Enable the legislature to increase homeowners' property taxes:** Business owners who operate from their homes would pay higher taxes.

The merits of these claims notwithstanding, both sides agree that Prop. 15 would increase property tax revenue. The key difference centers on who would bear the cost of the increases. Although the crafters of Prop. 15 have taken steps to protect small businesses from property tax increases, opponents argue costs for small businesses would increase substantially. The remainder of this report considers how Prop. 15 could affect small businesses.

---

<sup>5</sup> California Secretary of State. Retrieved from <https://elections.cdn.sos.ca.gov/statewide-elections/2020-general/prop-15-arg-in-favor.pdf>

# LITERATURE REVIEW

After considering studies of the potential impact of Prop. 15, this report discusses research that measures the effect of taxes on business location.

## THE POTENTIAL IMPACT OF PROP. 15

Surprisingly, given the potential magnitude of Prop. 15, few analyses have been done on its potential effects. A study by Blue Sky Consulting Group found that more than 90% of the additional property tax revenue Prop. 15 would generate would come from just 10% of high-value properties.<sup>6</sup> These findings are consistent with those from researchers at UC Santa Cruz who found that 8% of properties gain 80% of the benefits under Prop. 13.<sup>7</sup>

According to the Legislative Analyst's Office, increased property taxes on commercial properties worth more than \$3 million would provide \$6.5 billion to \$11.5 billion in new funding to local governments and schools.<sup>8</sup> Similarly, USC researchers found that \$10.3 billion to \$12.6 billion in revenue would be generated in 2021-22.<sup>9</sup>

According to research by the Berkeley Research Group, the property tax increases would cause the loss of 120,000 private-sector jobs, which would be partially or fully offset by job gains in the public sector.<sup>10</sup> Both the Berkeley and UC Santa Cruz studies found that Prop. 15 would have a negligible impact on the state's output.

These studies have merits and deficiencies, but none address the relationship between Prop. 15 and commercial rents, which is the focus of this study.

## BUSINESS LOCATION

The opponents of Prop. 15 say the law would prompt many companies to leave the state. Business location is a well-explored area of inquiry,<sup>11</sup> and our understanding continues to evolve as changes in industry, markets, and globalization have altered decision-making and business strategies.<sup>12</sup> The following section explores some of the most-discussed factors that businesses consider when choosing locations.

Access to workers, consumers, infrastructure, land and natural resources is key to business location. The regulatory climate is also a consideration, but labor and market access are the most important factors.

---

<sup>6</sup> <https://www.documentcloud.org/documents/6988869-Proposition-15-Analysis-1.html>

<sup>7</sup> [http://www.everettprogram.org/main/wp-content/uploads/Market-Value\\_Final.pdf](http://www.everettprogram.org/main/wp-content/uploads/Market-Value_Final.pdf)

<sup>8</sup> <https://lao.ca.gov/BallotAnalysis/Proposition?number=15&year=2020>

<sup>9</sup> [https://dornsife.usc.edu/assets/sites/242/docs/Updated\\_2019\\_Rev\\_Est\\_memo\\_Design\\_v5.pdf](https://dornsife.usc.edu/assets/sites/242/docs/Updated_2019_Rev_Est_memo_Design_v5.pdf)

<sup>10</sup> <https://www.politico.com/f/?id=00000171-5087-d6b1-a3f1-d4d7be430000>

<sup>11</sup> Dunning J. (1998). "Location and the Multinational Enterprise: A Neglected Factor?" *Journal of International Business Studies*, 29, 45-66

<sup>12</sup> Vlachou C. & Iakovidou O. (2015). "The Evolution of Studies on Business Location Factors." *Journal of Developmental Entrepreneurship*, 20, 04

## LABOR

Industries are “traded” or “nontraded.” Traded industries are those whose good or service is transported and exchanged between locations. Movies produced in Hollywood are consumed throughout the world. By contrast, nontraded industries’ production and consumption occur in proximity. Restaurants and hairdressers, for example, serve local markets rather than being “traded” in distant locations.

Traded industries are typically more sensitive to labor considerations. With respect to labor market access, businesses in these industries consider skill and cost. The importance of each of these factors varies by industry. In some industries, business success is determined by innovation and creation. The key considerations for these industries are knowledge and worker skill. Access to skilled workers is why tech firms pay a high cost to cluster in Silicon Valley. These firms compete on their ability to innovate and bear high costs to access certain workers.

Other industries compete on cost. Take clothing. Although branding and marketing are important, a pair of jeans today is not fundamentally different from jeans of 100 years ago. For most such businesses, success is determined not by worker knowledge or innovation but by the ability to produce goods in high volume at low cost. For these companies, competitive strategy centers on reducing labor costs, so they locate where payroll costs are relatively cheap.

## CONSUMER ACCESS

For nontraded industries (goods that are consumed in the place of production), business location is determined by the ability to access consumers. A hairdresser has more market potential in a city than in a rural location, and better access to consumers in some parts of a city than others. Many companies, such as Trader Joe’s, employ location strategists who use algorithms to help the grocer access the preferred type of consumer.

For traded industries, market access can also be important. Ford Motor Co., for example, locates many manufacturing plants overseas to cut the cost of shipping cars and trucks to final consumers. Likewise, suppliers locate close to their business consumers to cut transportation costs and facilitate coordination. Hence many intellectual property lawyers are in the Bay Area and costume designers in Los Angeles.

## INFRASTRUCTURE

Businesses’ infrastructure requirements depend on the nature of their activities. Infrastructure typically refers to transportation (roads, freeways, airports, ports) telecommunications (cellphone coverage, broadband), and energy and utilities (electricity, water, sewage systems), and soft infrastructure, such as education. Exporting companies require good access to airports, freeways, ports, and railroads. Firms typically favor locations with good infrastructure because it lowers operating costs.

## ENVIRONMENT/LAND AND NATURAL RESOURCES

Businesses consume land and resources differently. Manufacturing facilities are land-intensive; given the nature of their machinery and output, they are better suited to single-story operations. The same is true of distribution facilities. Large facilities consume a large amount of land and typically locate where it is relatively cheap. Other industries can overcome high land costs by building upward. Land is scarce in Manhattan, so companies that locate there are either not land-intensive or consume land in a more efficient way through the use of tall buildings.

In some industries, natural resources are a key input of production. The classic examples are the steel mills in Pittsburgh, which located there to benefit from proximity to iron ore deposits. The same is true of oil companies. For such extraction industries, proximity to natural resources is a key location consideration to reduce transportation costs.

## REGULATORY ENVIRONMENT

Local business climates and the region's soft infrastructure, which includes governance (government, law enforcement, and emergency services), also are key to business location.

The role of taxes is the most commonly discussed business climate metric. Taxes are typically applied to income, profits, property, and sales. The largest taxes, which are equal across states, are applied by the Federal government. There are myriad local taxes, however, with which a business must contend. Again, the extent to which taxes shape the location of operations depends on the nature of the business. If cost were the only determinant of business location, tech firms would not be found in Silicon Valley and entertainment firms would not be found in Hollywood — two of the costliest real estate markets in the world. Clearly cost is not the key driver of decisions for some firms, as described above. For other firms, cost-cutting is the primary driver of location, and they will be more sensitive to lower taxes and tax incentives.

Recourse to the law is another key determinant of business location. Consider technology and creative firms that rely on intellectual property protection. The inability to protect against intellectual property theft can be a key factor in decisions about location.

As the next section will demonstrate, firms do not locate in California because it is a cheap place to do business. It is because it has unique attributes: skilled labor, an ecosystem of tech and entertainment firms, and a high quality of life for workers. Low taxes and a low cost of doing business are not relevant factors.

## STATE RANKINGS

The previous section outlined factors that influence firm location. One of the key points was that firms in some industries are more sensitive to high costs. As a high-cost state with a historically active government, California is the target of constant refrains: "It's too costly and its businesses are at a competitive disadvantage compared with those in other states." "Taxes are too high, regulations are too strict, and land is too expensive." "California is at a competitive disadvantage compared with other states."

To Prop. 15 opponents, the cost of doing business in California is already high compared with other places, and the proposed ballot initiative would only increase it. This section compares the cost of doing business in California with other states'. This will include rankings of income tax rates, business tax rates, housing costs, commercial rents, and measures of regulation, such as the Wharton national survey of land use regulation. Focus will be placed on rankings of business climate and the key metrics and data that are used to determine the rankings.

Many organizations compile and publish state-level business climate rankings. These are based on measures of state policies and other factors that are thought to affect the health of businesses, and therefore the ability for states to attract new or expanding businesses. The rankings usually fall into two groups: those that consider the business climate in terms of productivity (including measures of quality of life, human capital, and growth potential), and those that emphasize taxes, regulation, and other costs of doing business.

California ranks poorly on many indexes, particularly those focusing on taxes and costs. At the same time, the state's employment, wages, and output continue to grow at or above the national average, raising the question of why California's economic performance is often better than its business climate rankings suggest it should be, and what this implies for the usefulness of these rankings.

## TAX AND COST BASED INDEXES

### TAX FOUNDATION: 2020 STATE BUSINESS TAX CLIMATE INDEX

Taxes are an inevitable part of the business climate. The State Business Tax Climate Index, produced by the Tax Foundation, distills the many complexities of states' tax systems down to a single metric of overall tax efficiency.

The index is a hierarchical structure built from five components that each focus on a major area of state taxation. The five components and their weighting in the index are individual income tax (30.2%), sales tax (24.0%), corporate income tax (19.7%), property tax (16.6%), and unemployment insurance tax (9.5%). The weighting is based on the degree of variability in tax rates across states, with more weight placed on components with greater variability. Businesses that are comparing states for new or expanded operations will give greater emphasis to tax components when the differences among states are large. Conversely, tax components with little variation among states are likely the areas that businesses deemphasize in their location decisions.

California ranks 48th in the overall index for 2020, with the subcomponent rankings as follows:

- Individual income tax (ranks 49th)
- Sales tax (45th)
- Corporate income tax (28th)
- Property tax (16th)
- Unemployment insurance tax (22nd)

# PACIFIC RESEARCH INSTITUTE: SMALL-BUSINESS REGULATION INDEX

This ranking enables the comparison of regulatory requirements among states. The index measures 14 regulatory components that are either positively or negatively associated with small-business economic burdens and relates these to the alternative growth performance of small businesses across states. Each regulatory component is included because of its impact on small-businesses' costs. The regulations will raise the cost of hiring workers, increase operation costs, reduce profit-making options, or create operational uncertainty. When relating the index rankings to small-business performance across states, the study found a strong relationship between the index rankings and small-business economic performance, and further argues that state policymakers who ignore regulatory concerns of small-business owners do so at the expense of a robust small-business economy.<sup>13</sup>

California ranked 50th overall in 2015, with these subcomponent scores:

- State Labor Regulations
  - Workers compensation insurance (ranked 50th)
  - Unemployment insurance (21st)
  - Short-term disability insurance requirements (one of five states that require disability insurance)
  - Minimum wage laws (44th)
  - Expanded Family Medical Leave Act (50th)
  - “Right to work” laws (Not a “right to work” state)
  - Occupational licensing laws (35th)
- Other Business Regulations
  - Land use (42nd)
  - Energy (49th)
  - Tort liability costs (47th)
  - Regulatory flexibility (32nd)
  - Telecommunication (40th)
  - Start-up and filing costs (35th)
  - Alcohol Control States (Not an alcoholic beverage control state)

---

<sup>13</sup> Wayne Winegarden, “The 50-State Small Business Regulation Index,” Pacific Research Institute, July 2015, [https://www.pacificresearch.org/wp-content/uploads/2017/04/SmBusinessIndex\\_UpdatedVersion2\\_web.pdf](https://www.pacificresearch.org/wp-content/uploads/2017/04/SmBusinessIndex_UpdatedVersion2_web.pdf)

# WHARTON RESIDENTIAL LAND USE REGULATORY INDEX

This index compares local regulatory environments through factor analysis, which combines component parts into a single index that measures regulatory constraints on development. This index enables comparison of the degree of control over residential land use in each state. California ranks among the most restrictive regulatory environments (ninth-most restrictive state).

Key insights from the data:

- Strong positive correlation across the subcomponents of the index.
  - This means that highly regulated places tend to be highly regulated on all dimensions included in the index, while less regulated places tend to be less regulated on all dimensions.
  - This suggests that regions do not target specific items or issues to regulate.
- Strictness of regulation is positively correlated with measure of community wealth.
  - Richer and more educated places have the highest-regulated land use environments.
- Strictness of regulation is negatively correlated with population density.
  - This suggests that motivation for land use controls is not a fundamental scarcity issue.

Characteristics of regions with the average ranking:

- Two distinct entities such as a zoning commission, city council, or environmental review board that must approve any project requiring a zoning change
- Some density control such as a minimum lot size requirement, but is highly unlikely to be as stringent as a one acre minimum
- Some exactions requirements on developers, with a six-month lag on average between permit application and issuance on standard developments.

More-regulated regions have more intense community and political involvement in the land use control process, are likely to have a one-acre lot size minimum in at least one neighborhood, and some type of open-space requirement, and have much longer permit review times. Most include some type of direct democracy, such as town meetings at which zoning changes are voted on by citizens.

Less-regulated regions have some controls in place, but their density restrictions are much more forgiving, open-space requirements are unlikely to be imposed, and the lag between permit requests and issuance for standard projects is about 90 days.

This aggregate measure comprises 11 subindexes that summarize aspects of the regulatory environment. Nine pertain to local characteristics, and two reflect state court and state legislative/executive branch behavior. In each index, a low value indicates a less restrictive or more laissez faire approach to regulating local housing. Factor analysis is used to create the aggregate index, which then is standardized so that the sample mean is 0 and the standard deviation equals 1.



# PRODUCTIVITY AND ECONOMIC GROWTH POTENTIAL INDEXES

## FORBES: BEST STATES FOR BUSINESS

Forbes' Best States for Business ranking takes a more holistic approach to rating states' business-friendliness. Rather than focusing strictly on tax structure, the ranking is based on six measures of the overall business climate: business costs, labor supply, regulatory environment, current economic climate, growth prospects, and quality of life. This approach considers the many factors businesses weigh when determining where to expand or develop new business. The ranking uses 40 metrics that together represent the six main areas of consideration.

California ranked 31st overall in 2019, with these subcomponent scores:

- Business cost (ranked 47th)
- Labor supply (25th)
- Regulatory environment (40th)
- Economic climate (1st)
- Growth prospects (10th)
- Quality of life (27th)

The Moody's Analytics Cost of Doing Business Index focuses on the cost of labor, energy, and taxes on business operations. One of the most important factors in determining an area's ability to attract capital and labor is its cost structure. For example, China's cheap labor and subsidized energy costs have enabled it to attract manufacturers from around the globe.<sup>14</sup> Also considered in the business cost ranking is the Tax Foundation's State Business Climate Tax Index.

The ranking of labor supply accounts for the rates of college and high school achievement, using figures from the U.S. Census Bureau. Also considered is net migration and projected population growth over the next five years. In this way, the labor supply ranking accounts for the size, growth and skill level of the available pool. Other factors include the share of the workforce represented by a union and the share of the population age 25 to 34, both of which are collected from the U.S. Census Bureau.

The regulatory environment ranking includes metrics influenced by government policy. The Cato Institute's regulatory component of the Freedom in the 50 States report is used; it incorporates a range of metrics including state taxes, land use regulation, and social policies. Additionally, the regulatory environment ranking includes Moody's bond rating on the state's general obligation debt and metrics on the transportation infrastructure of the state. Another factor in the regulatory component is a measure of the best and worst legal climates for businesses compiled by the U.S. Chamber Institute for Legal Reform. According to the institute, 70% of general counsels who participate in the survey say that a state's lawsuit environment impacts business decisions to expand or locate to an area. The survey focuses on the perceptions of the state's liability system by asking respondents to grade treatment of class action lawsuits, trial judges' impartiality, etc.<sup>15</sup>

The economic climate category gauges jobs, income, gross state product growth, and the average unemployment rate over the past five years. This component also incorporates the 1,000 biggest public and private companies by revenue that are headquartered in the state.

---

<sup>14</sup> Tyler Case, "U.S. Cost of Doing Business: Costs Fall in 2010," Moody's Analytics, DATE, SOURCE

<sup>15</sup> "Legal Climate: Overall Rankings by State," U.S. Chamber Institute for Legal Reform, DATE, <https://www.instituteforlegalreform.com/states>

The economic climate component is backward looking, and the growth prospects component looks forward, incorporating job, income, and gross state product growth forecasts over the next five years from Moody's Analytics. This category also looks at venture capital activity from the PWC MoneyTree survey and entrepreneurial activity tracked by the Kauffman Foundation.

Finally, the quality of life component measures the cost of living via Emsi, school test performance via the Department of Education, and crime rates from the FBI. Also considered is the number of top-ranked four-year colleges in the state from Forbes' annual college rankings, the culture and recreational opportunities based on an index created as part of the Best Places for Business and Careers list, commute times from the Census Bureau, and the United Health Foundation's America's Health Rankings.

## WHERE DOES CALIFORNIA STAND?

- California has the eighth-highest corporate income tax rate at 8.84%. California does not have tax brackets, so the 8.84% rate applies to all corporate income, other than that of banks and financials.
- It has the highest individual marginal income tax rate, 13.3%. California does have tax brackets for individuals.
- It has the highest state-level sales tax rate, 7.25%.
- It ranks as one of the worst regulatory environments for land use, based on the Wharton Land Use index (ninth-most restrictive land use environment).
- It ranks 15th in the share of population 25 and older with at least a bachelor's degree.
- It ranks sixth in median household income.
- It ranks second in median home value.
- It ranks 49th in affordability (measured as median home value/median household income).
- It ranks 50th in Pacific Research Institute's Small Business Regulation Index.
- It ranks 31st in Forbes' Best States for Business.

## CALIFORNIA'S SECRET SAUCE

Other studies cast California's business climate in a more favorable light. With respect to property taxes, these studies suggest that California has a lower amount because, unlike nearly every other state, its taxes do not apply to the market value of most properties. When this factor is taken into account, many California communities rank better (meaning the amount is lower) than communities in what are considered low-tax states, like Texas.<sup>16</sup>

Similarly, research by Ernst & Young, the Council on State Taxation, and the State Tax Research Institute reveals that the total effective business tax rate — measured as the ratio of state and local business taxes to private-sector Gross State Product (the total value of a state's annual production of goods and services by the private sector) — is 4.4%, lower than the national average of 4.7%.<sup>17</sup>

---

<sup>16</sup> [https://www.lincolnst.edu/sites/default/files/pubfiles/50-state-property-tax-comparison-for-2019\\_full.pdf](https://www.lincolnst.edu/sites/default/files/pubfiles/50-state-property-tax-comparison-for-2019_full.pdf)

<sup>17</sup> <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/fy18-state-and-local-business-tax-burden-study.pdf>

A study by the Public Policy Institute of California found that business climate indexes that focus on productivity and growth potential exhibit no relationship to actual economic growth.<sup>18</sup> In contrast, some of the indexes that focus on taxes and costs demonstrate a clear relationship with employment growth, and a less significant relationship with wage and Gross State Product growth. In particular, they found that a few subindexes, each capturing a narrower set of policies than the overall business index they belong to, exhibit a stronger relationship with economic growth than the broader indexes do.

But factors beyond the control of policy, such as weather, population density, and industry mix, have a stronger relationship with economic growth than the measures included in the indexes, including the tax- and cost-based indexes. California's poor ranking in many business climate indexes focusing on taxes and costs is offset by advantages outside of policy control. The study argues that many concerns about the business climate in California are overstated, because factors beyond the control of policymakers matter more in determining why some states have stronger economic gains than others. They caution, however, that the policies captured in these indexes and subindexes may promote economic growth as well as respond to economic growth, and it is difficult to draw definitive conclusions about the causal relationship between policy changes and faster economic growth.

A study by the Kauffman Foundation further argues that business climate indexes are not informative regarding the actual economic performance of a state. The study argues that many academic studies have uncovered that state rankings had little correlation with economic growth-related indicators at the state level. In other words, high scores in those ranking reports do not reflect better economic performance. The study argues that comparing ranking indexes with aggregate state-level indicators is not appropriate for two reasons. First, the business climate is not an objective reality but people's subjective perceptions. Second, a business climate can be case-specific; that is, the same condition can indicate different business climates depending on types of industries and size of businesses even in the same state.

The study proposes a different approach to examining rankings and business climate by decentralizing the measurement of business climate as much as possible. The study uses a survey of small-business owners to analyze the perception of business climate at the individual level, and also conducts hierarchical models to incorporate, both among and within states, covariates controls for statewide economic performance indicators. Ultimately, the study tests how individual perceptions about business climate are linked with state rankings. The study finds that corporate, individual, and sales taxes are not significant in the perception of the business climate, but property tax is positively correlated (that is, the lower the property tax rate, the better the perception of business climate). The study hypothesizes that only property tax is significant because companies pay property taxes regardless of company size or profits, which could harm small businesses that are not profitable in their first few years of operation.

The results of the study for indexes related to taxes are counterintuitive and go against conventional economics, which assumes that anything that lowers production costs is good for companies. They note that caution needs to be exercised on this subject. If business owners are asked whether lower taxes would help them, we already know the answer will be yes. But the real issue is whether the need represents a significant obstacle to the entrepreneur's success and development. The survey results indicate that corporate and individual income tax rates are not an obstacle, at least not with regard to shaping the perception of business climate. At the same time, regulations and the complexity of the tax code were important. These results indicate that policymakers should consider creating a simpler regulatory environment for businesses, but not necessarily lower taxes.<sup>19</sup>

---

<sup>18</sup> "Business Climate Rankings and the California Economy," Public Policy Institute of California, DATE, [https://www.ppic.org/content/pubs/report/R\\_411JKR.pdf](https://www.ppic.org/content/pubs/report/R_411JKR.pdf)

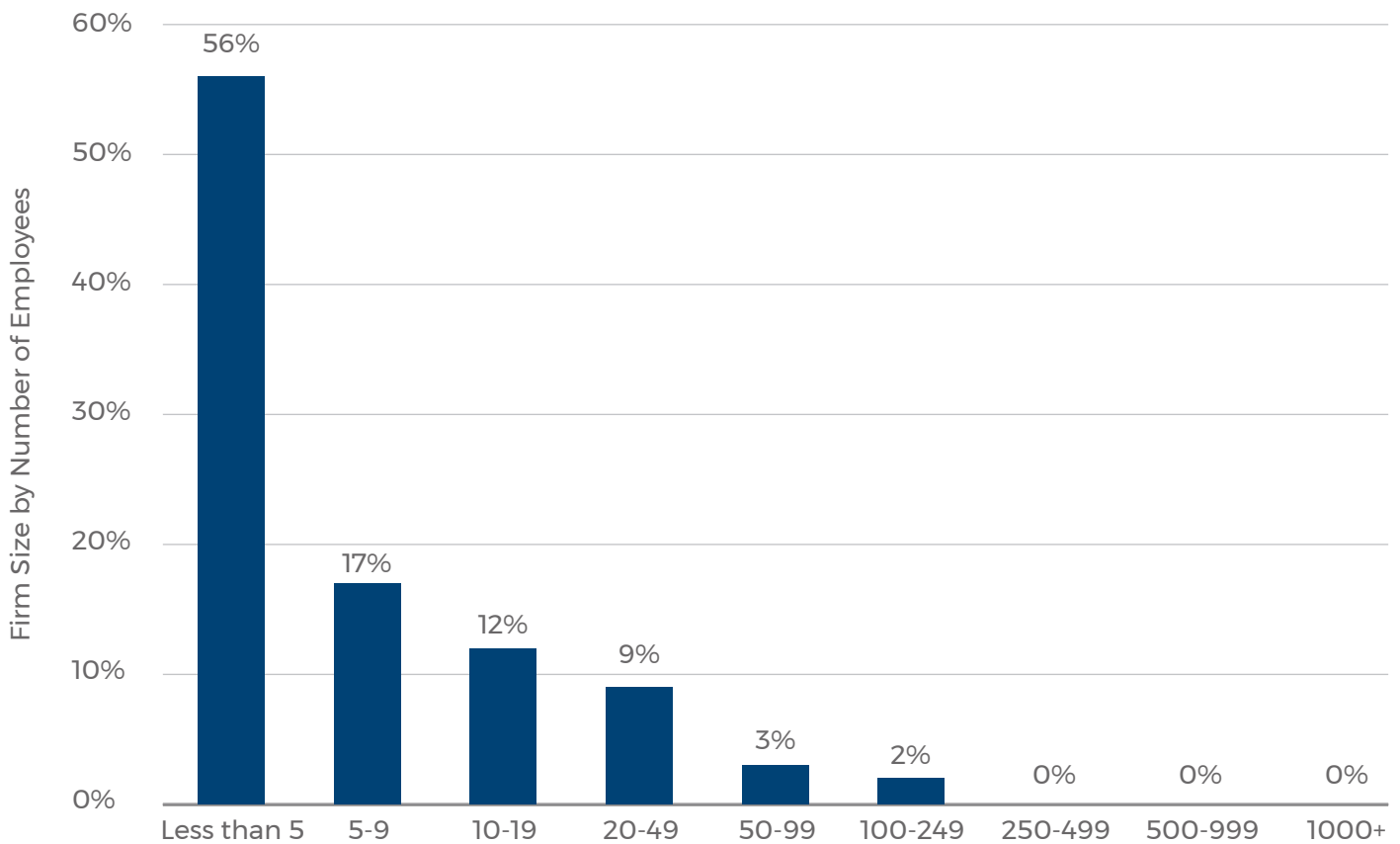
<sup>19</sup> "How Do Business Owners Perceive the State Business Climate?" Kauffman Foundation, DATE, [https://www.kauffman.org/wp-content/uploads/2019/12/how\\_do\\_business\\_owners\\_perceive\\_state\\_business\\_climate.pdf](https://www.kauffman.org/wp-content/uploads/2019/12/how_do_business_owners_perceive_state_business_climate.pdf)

# SMALL BUSINESSES IN CALIFORNIA

One of the central debates surrounding Prop. 15 concerns its potential impact on small businesses. This section describes the small-business landscape in California. There is no universal definition of “small business.” For example, the U.S. Small Business Administration defines a small business in the Manufacturing sector as one with fewer than 500 employees. In California, this definition covers 99.9% of manufacturing firms.

When most observers think of small businesses, they distinguish based on size. California has more than 1 million businesses, and the overwhelming majority are much smaller than the Federal definition suggests. Fifty-six percent of establishments have fewer than five employees, and 17% have five to nine. Altogether, 85% of all California businesses have fewer than 20 employees.

## Distribution of Firms by Employee Size



Source: County Business Patterns; Analysis by Beacon Economics, LLC

The following table shows the concentration of business establishments across sectors. The table breaks establishments into size categories. In the first column, all establishments, regardless of size, are divided across sectors. In columns two and three, establishments with one to 20 employees and one to 50 employees are divided across sectors. The patterns are similar across each size category. There is a slightly higher share of Finance and Insurance and Real Estate and Rental Leasing firms in the smaller establishment categories, and a slightly lower share of Accommodation and Food Services firms in the smaller establishment categories.

### Distribution of Firms by Sector

	All Establishments	1-20 Employees	1-50 Employees
Agriculture, Forestry, Fishing and Hunting	0.3%	0.3%	0.2%
Mining, Quarrying, and Oil and Gas Extraction	0.1%	0.0%	0.0%
Utilities	0.1%	0.0%	0.0%
Construction	9.1%	9.6%	9.3%
Manufacturing	3.8%	3.2%	3.4%
Wholesale Trade	5.9%	5.9%	5.9%
Retail Trade	11.1%	10.9%	11.2%
Transportation and Warehousing	2.7%	2.5%	2.5%
Information	2.7%	2.5%	2.5%
Finance and Insurance	5.7%	6.1%	5.8%
Real Estate and Rental and Leasing	6.0%	6.8%	6.3%
Professional, Scientific, and Technical Services	13.1%	14.2%	13.6%
Management of Companies and Enterprises	0.5%	0.3%	0.3%
Administrative, Support, Waste Management and Remediation Services	5.2%	4.9%	4.9%
Educational Services	1.5%	1.2%	1.3%
Health Care and Social Assistance	11.8%	12.1%	12.1%
Arts, Entertainment, and Recreation	2.5%	2.5%	2.3%
Accommodation and Food Services	9.5%	7.8%	9.5%
Other Services (except Public Administration)	8.2%	9.0%	8.6%
Public Administration	0.1%	0.1%	0.1%

Source: County Business Patterns; Analysis by Beacon Economics, LLC

The following table displays the share of small-business establishments across each industry category. Establishments with one to five employees account for 58% of all establishments in the state. Those with one to 20 employees account for 89% of all establishments, 94% of Real Estate and Rental Leasing firms, 92% of Other Services companies — a category that includes hair and nail salons — and 37% of Utilities companies.

### Small Firms Share of Total by Sector

	1-5 Employee Establishments Share of Total	1-20 Employee Establishments Share of Total
All Establishments	58%	89%
Agriculture, Forestry, Fishing and Hunting	63%	69%
Mining, Quarrying, and Oil and Gas Extraction	31%	47%
Utilities	32%	37%
Construction	64%	89%
Manufacturing	40%	70%
Wholesale Trade	53%	83%
Retail Trade	43%	82%
Transportation and Warehousing	57%	77%
Information	58%	78%
Finance and Insurance	60%	89%
Real Estate and Rental and Leasing	77%	94%
Professional, Scientific, and Technical Services	71%	91%
Management of Companies and Enterprises	29%	44%
Administrative, Support, Waste Management and Remediation Services	57%	79%
Educational Services	46%	69%
Health Care and Social Assistance	52%	86%
Arts, Entertainment, and Recreation	71%	81%
Accommodation and Food Services	28%	69%
Other Services (except Public Administration)	62%	92%
Public Administration	89%	89%

Source: County Business Patterns; Analysis by Beacon Economics, LLC

Establishments with one to five employees account for about 9% of all employment. Those with one to 19 employees account for 27%.

Prop. 15 could impact business costs in two primary ways. First, it would lead to higher property tax payments for commercial landowners with properties valued at greater than \$3 million, especially longtime owners. Second, increases in property taxes for landlords could be passed through to commercial renters.

But as mentioned, Prop. 15 contains protections for small businesses, including an exemption for commercial and industrial properties with a combined value at or below \$3 million; an exemption for home-based businesses; deferred reassessment until the 2025-26 lien date of properties in which small businesses account for 50% or more of the occupied spaces; and the elimination of the business tangible personal property tax on equipment and fixtures for small businesses.

Opponents of Prop. 15 say small businesses subject to triple net leases will be adversely affected by Prop. 15, because such leases are not protected by some of the initiative's provisions. A triple net lease is one in which the tenant or lessee is responsible for the ongoing expenses of the property, including real estate taxes, building insurance, and maintenance, in addition to paying the rent and utilities. The following analysis considers the impact of the law on triple net lease holders.



# METHODS AND DATA

This analysis uses Real Estate Information Services (REIS) Network data from Moody's Analytics. The data set provides property level statistics covering a range of variables. Beacon Economics used these data to estimate factors determining commercial rents in California, focusing on the counties of Alameda, Contra Costa, Fresno, Los Angeles, Orange, Sacramento, San Bernardino, San Diego, San Francisco, San Joaquin, San Mateo, and Santa Clara. These counties include those that form the state's core economic hubs on the coast and inland counties that have a different type of economy.

From these 12 counties, a list of 371,163 properties was generated. A number of data fields for certain properties were missing; for example, no rent value was listed for most properties. When each property with missing data was removed from the variables of interest, 12,325 properties remained. Alameda County had 8% of the properties in the sample, Contra Costa 3%, Fresno 2%, Los Angeles 27%, Orange 11%, Sacramento 9%, San Bernardino 8%, San Diego 15%, San Francisco 3%, San Joaquin 2%, San Mateo 3% and Santa Clara 9%. Moody's Analytics confirmed that the remaining properties in the data represented a random sample of the properties in Moody's data set.

To analyze these data, Beacon Economics employed an ordinary least squares hedonic regression, which measures how various factors contribute to the per-square-foot rent of units in a given commercial property. The dependent variable, therefore, is the log of per-square-foot rent for a given property. The natural logarithm of rents and other variables are used to normalize the distribution of the data.

In regression analysis, the goal is to include as many variables (controls) as possible that might account for differences in rent among buildings. As mentioned, a number of factors could affect the rent of a given commercial property. Beacon Economics' primary relationship of interest is between the year a building was sold and the rent charged. Because property taxes are determined by the date of sale, how the year of sale affects rents is important to understand. Property taxes can also be reassessed after construction or renovations. The REIS data set identifies the year a property was last renovated. For the year-of-reassessment variable, therefore, the most recent year that either a sale or renovation occurred is used. The year of sale or renovation is subtracted from 2020 to yield the number of years since a sale or renovation occurred. If the time of sale or renovation affects a property's rents, the higher the number of years since each occurred should be associated with lower per-square-foot rents. Again, Beacon Economics takes the natural logarithm of this variable.

Location also affects rent. Those with better access to freeways, customers, or specialized workers can command a premium. Indeed, companies pay a premium to locate in San Francisco and the Silicon Valley to access tech workers. For each property, the extent to which rents are determined by the property's city and submarket is controlled for. The 12 counties are further divided into 159 submarkets, which are a distinct part or neighborhood of a larger market. In commercial real estate, a market is typically a city or a metropolitan area, and a submarket is a smaller area within the market, such as a commercial district. The logic for including submarket rents is that rent of a given property is largely shaped by the prevailing area rent. Each of these location variables are included to account for the fact that rents are higher in some locations because of higher demand.

Rent is also determined by the type of activity that occurs on a given property. Beacon Economics allows for the fact that rent could be determined by whether a property is devoted to office, warehouse, retail, or research and development activities by including a dummy variable for each of these activities.



Property-specific factors, such as age, size, and vacancy rate, also influence rent. The higher a building’s vacancy rate, the lower the rent; vacancy rates are a measure of demand. Older properties command lower rents, after accounting for other factors. Larger buildings, because they are more inclined to be land-intensive, also command higher rents. This analysis includes a variable for each of these factors.

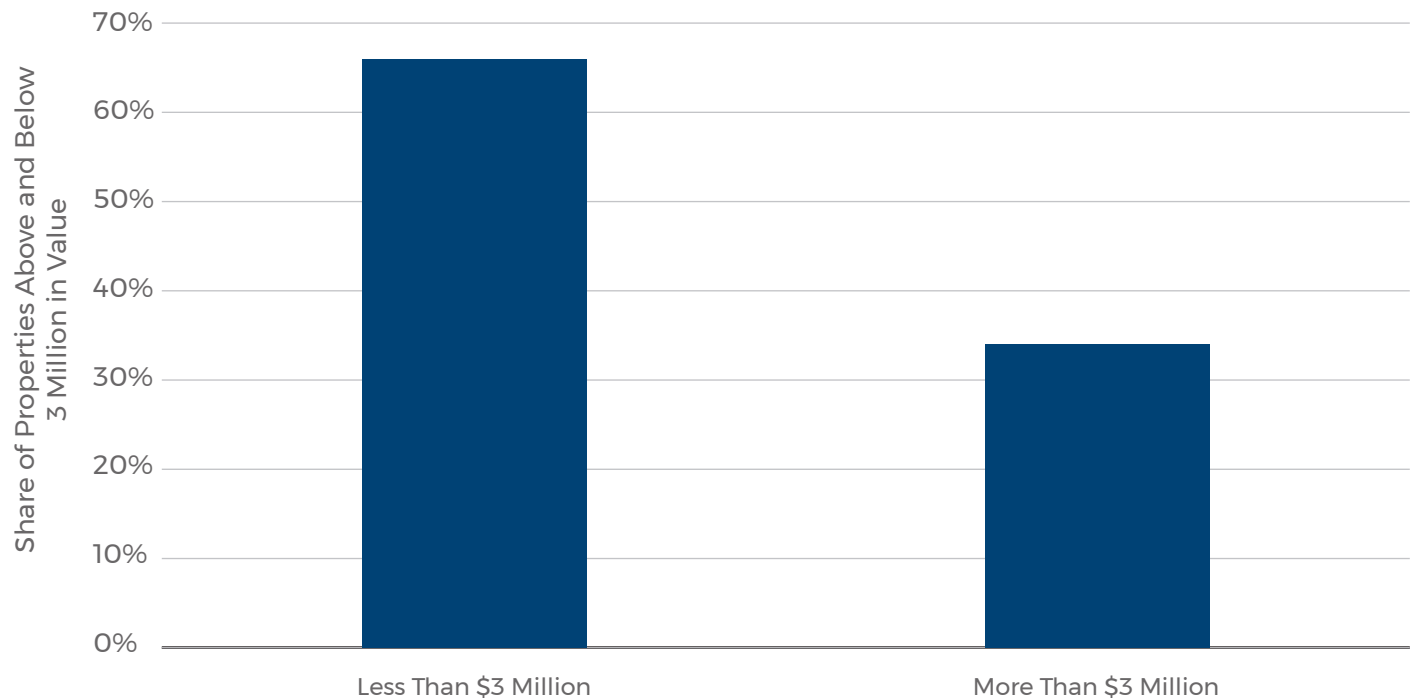
Two final predictors of rents are employed. The first is the wages paid in a given location. The idea is that locations where companies pay higher wages are “premium,” containing advanced economic activities, and that firms pay a premium to locate there. Finally, the nature of activities in a given area is controlled for. Rents are affected, for example, by whether an area has a high concentration of heavy industry rather than a lot of office space. To assess this, a variable measuring the share of firms in a location in the Professional Services sector of the economy is included. Data for each variable are drawn the Census Bureau’s Zip Business Patterns.

## THE NUMBER OF PROPERTIES SUBJECT TO PROP. 15

Recall that Prop. 15 doesn’t apply to properties of less than \$3 million in value. Using the REIS data for the 12 counties, properties for which a sale price is not identified are removed. The data are restricted to properties that were sold in 2018, 2019 and 2020 to get a sense of relatively current property valuations. This leaves a sample of 22,005 properties. In this sample of the data, the median property sold for \$1.6 million.

Furthermore, 66% of these properties sold for less than \$3 million. These figures show that most properties in California would be exempt from Prop. 15.

### California Property Sales by Value 2018-2020



Source: Reis; Analysis by Beacon Economics, LLC

## STATISTICAL FINDINGS

Below are the results of the regression analysis. The results from five models are displayed. The first estimates the determinants of rent for all commercial properties in the dataset. The other models divide properties across sector type: Office, Retail, Warehouse and Distribution, and Flex R&D properties.

	All Commercial Properties		Office		Retail		Warehouse and Distribution		Flex R&D	
	Coefficient	T-Statistic	Coefficient	T-Statistic	Coefficient	T-Statistic	Coefficient	T-Statistic	Coefficient	T-Statistic
Years Since Sale or Renovation	-0.0006	-1.21	-0.0018	-3.31	0.0005	0.48	0.0011	1.64	0.0011	1.64
Building Age	-0.0826	-16.58	-0.0012	-5.03	-0.0042	-6.49	-0.0034	-9.26	-0.0034	-9.26
Ratio of Property Assessed Value to Average Submarket Property Assessed Value	0.1608	12.31	0.1703	8.92	0.1265	3.82	0.0681	2.54	0.0681	2.54
Log of Size of Building (square feet)	0.0426	13.46	0.0881	18.94	0.0351	3.87	-0.0147	-2.54	-0.0147	-2.54
Vacancy Rate	-0.0061	-0.54	-0.0046	-0.26	-0.3060	-5.05	0.0159	0.94	0.0159	0.94
Log of Average Submarket Rent (per sq. ft)	0.3000	18.34	0.5298	15.84	0.1999	2.17	-0.1782	-2.27	-0.1782	-2.27
Share of Local Businesses in Professional Services	0.0118	14.5	0.0045	3.94	0.0109	3.89	0.0078	4.21	0.0078	4.21
Log of Submarket Wages	0.0875	6.47	0.0693	3.78	0.0212	0.57	0.0728	2.04	0.0728	2.04
Number of Observations	11,301		4,290		1,353		2,575		1,911	
R-squared	0.8501		0.7179		0.573		0.5037		0.6207	

T-statistics with values of greater than 1.96 or less than -1.96 are statistically significant, with a 95% level of confidence, meaning the observed results are real and not an error caused by anomalies in the data.

R-squared (R2) represents the proportion of the dependent variable that's explained by an independent variable or variables in a regression model.

The results reveal that factors other than the year a property was sold or renovated are the primary drivers of rent.

- O Local rents are the biggest determinant of a given commercial property's rent per square foot. That is, rent is determined by local market conditions, specifically, the average rent per square foot in the property's submarket. This relationship is statistically significant, with a 95% level of confidence. As commercial rents in a given submarket increase 1%, the rent of a given property increases 0.3%. This shows that "hot" commercial property markets have higher rents.
- O Increased Professional and Business Services economic activity is positively associated with rent in a given building. This relationship is statistically significant, with a 95% level of confidence. As the share of jobs in Professional and Business Services increases 10%, rents increase 0.1%.
- O In higher-wage areas, rents are higher. This relationship is statistically significant, with a 95% level of confidence. As wages in a community increase 10%, rents increase 1%.
- O Building size is a determinant; as building size increases 10%, rent increases 3%. This relationship is statistically significant, with a 95% level of confidence.
- O Older buildings command lower rents. A building 10 years older than another has rents 0.8% lower, other variables constant. This relationship is statistically significant, with a 95% level of confidence.
- O The length of time since a property was sold or renovated does not have a statistically significant relationship with commercial rents. For most property types, if assessed value is lower than market value, rent is not influenced. In other words, if under Prop. 15 many properties are reassessed to current market value, this would not influence rents, based on the properties studied in this analysis.

If triple net leases were affected by property tax reassessment in some wholesale manner, this should show up in the results. That is, if rents increased for thousands of tenants each time properties were reassessed, it would be revealed in the findings.

For the most part, these findings hold across all property types except for office properties. For office properties, the length of time since a property was sold does have a positive and statistically significant impact on rents: The further back a property is sold or renovated, the lower the rent. For each year in the past that a property is sold, rents increase 0.1%. To place this figure in context, if a property that was last sold 10 years ago were revalued for the current period, this would be associated with a one-time 1% increase in rent.

To expand on the findings of this analysis, imagine identical properties side by side. Opponents of Prop. 15 contend that because rents are driven by property taxes paid by landowners, one property would command lower rents because it was bought before the other property. This analysis reveals that rents are driven by other factors.



## DISCUSSION AND CONCLUSION

This paper has considered a number of ways in which small businesses in California could be affected by Prop. 15. Based on the sample of properties in this analysis, most properties would not be affected. The report includes a comprehensive statistical analysis of the factors that determine commercial rents in the state. Recall that one of the key arguments against Prop. 15 is that, if older properties are reassessed to current market values, rents will increase, leading to job losses and business displacement. The analysis in this report reveals that the year of purchase is not a key determinant of rents. In fact, in most instances, the year a property was bought has little impact on rents. Rather, rents are determined by local economic conditions, local real estate market conditions, and property-specific characteristics, such as size and age.

# APPENDIX

The following tables display California's position in various business ranking indexes.

## State Tax Rankings

### Corporate Income Tax

State	Top Margin at Rate (%)	Brackets	State	Top Margin at Rate (%)	Brackets
Nevada	0.000	No	New York	6.500	No
Ohio	0.000	No	Tennessee	6.500	No
South Dakota	0.000	No	West Virginia	6.500	No
Texas	0.000	No	Montana	6.750	No
Washington	0.000	No	Idaho	6.925	No
Wyoming	0.000	No	Kansas	7.000	Yes
North Carolina	2.500	No	Rhode Island	7.000	No
Missouri	4.000	No	Connecticut	7.500	No
North Dakota	4.310	Yes	Oregon	7.600	Yes
Florida	4.450	No	New Hampshire	7.700	No
Colorado	4.630	No	Nebraska	7.810	Yes
Arizona	4.900	No	Wisconsin	7.900	No
Utah	4.950	No	Louisiana	8.000	Yes
Kentucky	5.000	no	Massachusetts	8.000	No
Mississippi	5.000	Yes	Maryland	8.250	No
South Carolina	5.000	No	Vermont	8.500	Yes
Indiana	5.500	No	Delaware	8.700	No
Georgia	5.750	No	<b>California</b>	<b>8.840</b>	<b>No</b>
New Mexico	5.900	Yes	Maine	8.930	Yes
Michigan	6.000	No	Alaska	9.400	Yes
Oklahoma	6.000	No	Illinois	9.500	No
Virginia	6.000	No	Minnesota	9.800	No
Hawaii	6.400	Yes	Pennsylvania	9.990	No
Alabama	6.500	No	New Jersey	10.500	Yes
Arkansas	6.500	Yes	Iowa	12.000	Yes

Source: Tax Foundation; Analysis by Beacon Economics, LLC

## State Tax Rankings

### Individual Income Tax

State	Top Margin at Rate (%)	Brackets	State	Top Margin at Rate (%)	Brackets
Alaska	0.00	No	Missouri	5.40	Yes
Florida	0.00	No	Kansas	5.70	Yes
Nevada	0.00	No	Georgia	5.75	Yes
South Dakota	0.00	No	Maryland	5.75	Yes
Texas	0.00	No	Virginia	5.75	Yes
Washington	0.00	No	Rhode Island	5.99	Yes
Wyoming	0.00	No	Louisiana	6.00	Yes
Tennessee	1.00	No	West Virginia	6.50	Yes
North Dakota	2.90	Yes	Arkansas	6.60	Yes
Pennsylvania	3.07	No	Delaware	6.60	Yes
Indiana	3.23	No	Nebraska	6.84	Yes
Michigan	4.25	No	Montana	6.90	Yes
Arizona	4.50	Yes	Idaho	6.93	Yes
Colorado	4.63	No	Connecticut	6.99	Yes
Ohio	4.80	Yes	South Carolina	7.00	Yes
New Mexico	4.90	Yes	Maine	7.15	Yes
Illinois	4.95	No	Wisconsin	7.65	Yes
Utah	4.95	No	Iowa	8.53	Yes
Alabama	5.00	Yes	Vermont	8.75	Yes
Kentucky	5.00	No	New York	8.82	Yes
Massachusetts	5.00	No	Minnesota	9.85	Yes
Mississippi	5.00	Yes	Oregon	9.90	Yes
New Hampshire	5.00	No	New Jersey	10.75	Yes
Oklahoma	5.00	Yes	Hawaii	11.00	Yes
North Carolina	5.25	No	<b>California</b>	<b>13.30</b>	<b>Yes</b>

Source: Tax Foundation; Analysis by Beacon Economics, LLC

## State Tax Rankings

### State-Level Sales Tax

State	Rate (%)	State	Rate (%)
Alaska	0.00	Idaho	6.00
Delaware	0.00	Iowa	6.00
Montana	0.00	Kentucky	6.00
New Hampshire	0.00	Maryland	6.00
Oregon	0.00	Michigan	6.00
Colorado	2.90	Pennsylvania	6.00
Alabama	4.00	South Carolina	6.00
Georgia	4.00	Vermont	6.00
Hawaii	4.00	West Virginia	6.00
New York	4.00	Utah	6.10
Wyoming	4.00	Illinois	6.25
Missouri	4.23	Massachusetts	6.25
Louisiana	4.45	Texas	6.25
Oklahoma	4.50	Connecticut	6.35
South Dakota	4.50	Arkansas	6.50
North Carolina	4.75	Kansas	6.50
North Dakota	5.00	Washington	6.50
Wisconsin	5.00	New Jersey	6.63
New Mexico	5.13	Nevada	6.85
Virginia	5.30	Minnesota	6.88
Maine	5.50	Indiana	7.00
Nebraska	5.50	Mississippi	7.00
Arizona	5.60	Rhode Island	7.00
Ohio	5.75	Tennessee	7.00
Florida	6.00	<b>California</b>	<b>7.25</b>

Source: Tax Foundation; Analysis by Beacon Economics, LLC

## Tax Foundation's Business Climate Tax Index Rankings

State	Overall Rank	Corporate Tax Rank	Individual Income Tax Rank	Sales Tax Rank	Property Tax Rank	Unemployment Insurance Tax Rank
Wyoming	1	1	1	6	39	27
South Dakota	2	1	1	35	22	44
Alaska	3	26	1	5	25	46
Florida	4	9	1	23	13	2
Montana	5	21	25	3	12	20
New Hampshire	6	43	9	1	44	45
Nevada	7	25	5	44	10	47
Oregon	8	33	38	4	18	36
Utah	9	12	10	22	5	15
Indiana	10	11	15	20	2	25
Delaware	11	50	41	2	6	3
Michigan	12	18	12	9	24	17
Texas	13	47	6	36	38	12
Missouri	14	5	24	24	7	9
North Carolina	15	3	16	21	34	10
North Dakota	16	19	20	27	3	13
Colorado	17	7	14	37	14	43
Tennessee	18	24	8	47	31	24
Washington	19	41	6	49	27	19
Arizona	20	22	17	40	8	6
Idaho	21	29	26	12	4	48
New Mexico	22	20	31	41	1	8
West Virginia	23	15	28	18	17	29
Kentucky	24	17	18	14	36	49
Virginia	25	14	35	11	32	41
Wisconsin	26	30	37	7	23	37
Oklahoma	27	8	33	39	19	1
Nebraska	28	31	21	10	41	11
Pennsylvania	29	46	19	17	21	42
South Carolina	30	4	34	31	30	26
Mississippi	31	10	27	34	37	5
Georgia	32	6	36	29	28	39
Maine	33	38	22	8	43	32
Kansas	34	35	23	38	20	14
Illinois	35	36	13	33	40	40
Massachusetts	36	39	11	13	48	50
Hawaii	37	16	47	30	11	28
Ohio	38	42	44	32	9	7
Rhode Island	39	40	29	25	45	31
Alabama	40	23	30	50	15	18
Louisiana	41	37	32	48	33	4
Iowa	42	48	42	15	35	35
Maryland	43	32	45	19	42	33
Vermont	44	45	39	16	49	16
Minnesota	45	44	46	28	26	34
Arkansas	46	34	40	46	29	23
Connecticut	47	27	43	26	50	21
California	48	28	49	45	16	22
New York	49	13	48	43	46	38
New Jersey	50	49	50	42	47	30

Source: Tax Foundation; Analysis by Beacon Economics, LLC



## Forbes' Best States for Business Ranking

State	Overall Rank	Business Cost Rank	Labor Supply Rank	Regulatory Environment Rank	Economic Climate Rank	Growth Prospects Rank	Quality of Life Rank
North Carolina	1	4	9	1	13	13	16
Texas	2	3	10	21	4	1	15
Utah	3	23	2	6	8	7	9
Virginia	4	30	3	3	20	24	1
Florida	5	31	11	7	3	5	18
Georgia	6	19	15	9	7	11	23
Tennessee	7	10	27	4	11	14	29
Washington	8	15	4	29	6	8	30
Colorado	9	39	1	19	2	4	21
Idaho	10	28	19	8	10	2	24
Nebraska	11	10	18	2	28	36	19
Indiana	12	7	40	5	25	25	7
Nevada	13	5	26	14	14	6	48
South Dakota	14	1	22	13	39	20	28
Minnesota	15	40	7	16	16	27	3
South Carolina	16	21	20	17	15	12	39
Iowa	17	6	36	11	36	35	10
Arizona	18	38	12	18	12	3	35
Massachusetts	19	48	5	37	5	15	4
Oregon	20	27	6	36	9	9	38
Wisconsin	21	33	30	10	19	37	8
Missouri	22	20	37	25	26	18	17
Delaware	23	2	13	42	37	19	43
Oklahoma	24	8	38	15	31	33	31
New Hampshire	25	41	8	32	21	22	22
North Dakota	26	16	14	22	45	26	42
Pennsylvania	27	14	33	35	23	40	12
New York	28	29	34	34	18	21	14
Ohio	29	25	41	26	22	44	2
Montana	30	24	17	28	35	17	45
California	31	47	25	40	1	10	27
Wyoming	32	22	39	12	49	23	36
Arkansas	33	12	42	20	33	39	41
Maryland	34	36	16	41	27	29	26
Michigan	35	37	44	22	17	41	13
Kansas	36	35	24	24	32	42	32
Illinois	37	26	35	39	30	45	11
Kentucky	38	18	47	33	41	34	25
New Jersey	39	49	23	49	29	30	5
Alabama	40	32	43	27	38	31	44
Rhode Island	41	44	29	44	40	32	20
Mississippi	42	17	49	30	46	47	37
Connecticut	43	45	31	43	42	48	6
Maine	44	43	27	48	34	28	34
Vermont	45	46	21	45	43	38	33
Louisiana	46	9	48	47	47	46	47
Hawaii	47	50	32	38	24	49	40
New Mexico	48	34	46	46	44	15	49
West Virginia	49	13	50	50	48	50	46
Alaska	50	42	45	31	50	43	50

Source: Forbes; Analysis by Beacon Economics, LLC

## Wharton Residential Land Use Regulation Index

State	Rank	Index Value	State	Rank	Index Value
Kansas	1	-1.11	Virginia	26	-0.2
Louisiana	2	-1.07	Illinois	27	-0.17
Indiana	3	-1.02	New York	28	-0.12
Missouri	4	-1.02	New Mexico	29	-0.08
Alaska	5	-1.01	Utah	30	-0.05
South Dakota	6	-1.01	Michigan	31	0.03
Iowa	7	-0.99	Oregon	32	0.09
Alabama	8	-0.94	Wisconsin	33	0.09
West Virginia	9	-0.93	Minnesota	34	0.1
Arkansas	10	-0.87	Vermont	35	0.33
Mississippi	11	-0.83	Connecticut	36	0.35
South Carolina	12	-0.75	Pennsylvania	37	0.36
Oklahoma	13	-0.7	Florida	38	0.38
Nebraska	14	-0.67	Colorado	39	0.51
Tennessee	15	-0.67	Delaware	40	0.51
Idaho	16	-0.62	Arizona	41	0.6
Kentucky	17	-0.58	<b>California</b>	<b>42</b>	<b>0.62</b>
North Dakota	18	-0.55	Maine	43	0.64
Nevada	19	-0.45	Washington	44	0.71
Texas	20	-0.45	Maryland	45	0.81
Wyoming	21	-0.43	New Jersey	46	0.89
Ohio	22	-0.37	New Hampshire	47	1.37
Montana	23	-0.33	Massachusetts	48	1.52
North Carolina	24	-0.33	Rhode Island	49	1.56
Georgia	25	-0.2	Hawaii	50	2.34

Source: University of Pennsylvania Wharton Business School, Samuel Zell Rober Lurie Real Estate Center

Note: A lower index value reflects a less restrictive regulatory environment. Index values have been standardized with mean 0 and standard deviation 1.

## Housing Affordability

State	Median Household Income (\$)	Median Home Value (\$)	Affordability	State	Median Household Income (\$)	Median Home Value (\$)	Affordability
West Virginia	44,097	107,789	2.4	Maryland	83,242	309,182	3.7
Oklahoma	51,924	130,001	2.5	North Carolina	53,855	203,661	3.8
Iowa	59,955	153,281	2.6	New Hampshire	74,991	291,293	3.9
Kansas	58,218	151,212	2.6	Delaware	64,805	254,717	3.9
Ohio	56,111	150,835	2.7	Virginia	72,577	285,587	3.9
Arkansas	47,062	128,777	2.7	Alaska	74,346	301,660	4.1
Indiana	55,746	156,102	2.8	Wyoming	61,584	252,310	4.1
Alabama	49,861	140,030	2.8	New Jersey	81,740	336,389	4.1
Mississippi	44,717	126,788	2.8	Vermont	60,782	259,920	4.3
Kentucky	50,247	147,685	2.9	New Mexico	47,169	204,856	4.3
Nebraska	59,566	176,239	3.0	Maine	55,602	244,413	4.4
Missouri	54,478	162,980	3.0	Florida	55,462	246,107	4.4
Michigan	56,697	173,481	3.1	Arizona	59,246	270,320	4.6
Illinois	65,030	202,609	3.1	Rhode Island	64,340	301,867	4.7
Pennsylvania	60,905	195,178	3.2	New York	67,844	328,397	4.8
Wisconsin	60,773	202,523	3.3	Utah	71,414	350,841	4.9
Connecticut	76,348	255,746	3.3	Montana	55,328	279,288	5.0
Texas	60,629	207,829	3.4	Nevada	58,646	302,437	5.2
Georgia	58,756	201,713	3.4	Idaho	55,583	288,029	5.2
Louisiana	47,905	167,376	3.5	Massachusetts	79,835	423,344	5.3
Tennessee	52,375	186,747	3.6	Colorado	71,953	398,753	5.5
South Carolina	52,306	187,337	3.6	Washington	74,073	412,988	5.6
Minnesota	70,315	257,609	3.7	Oregon	63,426	364,382	5.7
South Dakota	56,274	206,437	3.7	<b>California</b>	<b>75,277</b>	<b>556,815</b>	<b>7.4</b>
North Dakota	63,837	235,722	3.7	Hawaii	80,212	638,007	8.0

Source: Zillow, U.S. Census Bureau

Note: Affordability = median home value / median household income (that is, a lower affordability number implies a more affordable state)

## Education of Workforce

State	Share (%)	State	Share (%)
Massachusetts	44.5	Florida	30.4
Colorado	41.7	Texas	30.3
Maryland	40.8	Alaska	30.2
New Jersey	40.8	Wisconsin	30.0
Connecticut	39.6	Arizona	29.7
Virginia	39.3	North Dakota	29.7
Vermont	38.7	Michigan	29.6
New York	37.2	Missouri	29.5
New Hampshire	36.8	South Dakota	29.2
Minnesota	36.7	Iowa	29.0
Washington	36.7	Ohio	29.0
Illinois	35.1	South Carolina	28.3
Utah	34.9	Idaho	27.7
Rhode Island	34.4	New Mexico	27.7
<b>California</b>	<b>34.2</b>	Tennessee	27.5
Oregon	34.0	Indiana	27.1
Kansas	33.8	Wyoming	26.9
Hawaii	33.5	Oklahoma	25.6
Nebraska	32.4	Alabama	25.5
Georgia	31.9	Nevada	24.9
North Carolina	31.9	Kentucky	24.8
Pennsylvania	31.8	Louisiana	24.3
Montana	31.7	Arkansas	23.3
Maine	31.5	Mississippi	23.2
Delaware	31.3	West Virginia	21.3

Source: U.S. Census Bureau



# Understanding the Impact of Proposition 15 on Small Businesses in California

---

September 2020