

REPORT OF THE CHIEF LEGISLATIVE ANALYST

October 20, 2008

TO: The Los Angeles City Council

FROM: Gerry F. Miller 
Chief Legislative Analyst

Assignment No. 08-10-1982

MOTION (ALARCON-REYES) LUXURY TAX PROPOSAL

SUMMARY

Motion (Alarcon-Reyes) proposes to levy a 'luxury tax' on homes within the City of Los Angeles that exceed 5,000 square feet, with the levy beginning at \$1,000 and increasing to \$6,000 for homes of 10,000 square feet or more. A staff analysis of this proposal estimates that it could generate \$15M per year, but would likely be invalidated as an Ad Valorem tax that violates Article XIII A of the State Constitution. An alternative luxury tax that is not property-based, such as a levy on two categories of homes (above 5,000 square feet and above 10,000 square feet), could be feasible in that it would be less likely to be characterized as an Ad Valorem tax. Such an alternative proposal could generate \$9M per year.

Should the City Council wish to place a luxury tax proposal on the City's Primary Election Ballot in March 2009, the Council must instruct the City Attorney to draft such a proposal by the deadline of October 29, 2008. The City Attorney would need to finalize the draft resolution and present it to the Council for consideration by November 7, 2008. As currently proposed in the Motion (Alarcon-Reyes), any luxury tax proposal would require 2/3-voter approval to be ratified.

RECOMMENDATIONS

If the City Council wishes to proceed with placement of a luxury tax proposal on the next available ballot, pursuant to Motion (Alarcon-Reyes, CF 08-1125), the City Council should:

1. REQUEST the City Attorney, with the assistance of the Chief Legislative Analyst (CLA) and the City Administrative Officer (CAO), to prepare the necessary Ordinance and Resolution of Necessity to place a measure on the March 3, 2009 City Primary Election ballot to levy an annual luxury tax of \$1,000 on single family residences larger than 5,000 square feet and an annual \$6,000 levy on homes larger than 10,000 square feet, with said documents to be transmitted no later than November 5, 2008.
2. INSTRUCT the City Clerk to, upon submission of the Ordinance and Resolution of Necessity, to place them on the next available Council Agenda for consideration on or before November 7, 2008.

BUDGET & FINANCE

RULES & GOVERNMENT

OCT 21 2008



BACKGROUND

On May 2, 2008, the Motion (Alarcon-Reyes) was introduced instructing staff to develop and submit a 'luxury tax' proposal for placement on the next available Citywide ballot. The Motion proposed the following structure for this luxury tax levy:

<u>Square Feet</u>	<u>Tax</u>
5000-5999	\$1,000
6000-6999	\$2,000
7000-7999	\$3,000
8000-8999	\$4,000
9000-9999	\$5,000
10,000 or more	\$6,000

The assertion in the Motion (Alarcon-Reyes) is that larger homes 'utilize more City resources and services', such as water and electricity, in comparison to the citywide average usage of services, and should therefore pay their fair share for those excess services.

City staff from the Office of the CAO, CLA, City Attorney, and Building & Safety met to discuss this proposal, identify available data to analyze the projected impact of such a fee, and discuss its feasibility. The Planning Department and the County of Los Angeles provided the data required to complete this analysis.


In that staff meeting, the City Attorney immediately noted that extrapolating the proposed levy into increments of 1,000 square feet, as proposed in the Motion (Alarcon-Reyes) would likely trigger a legal interpretation that such a tax is an Ad Valorem tax. Article XIII A of the California State Constitution capped Ad Valorem property taxes at 1% of the assessed value of real property and Los Angeles County has reached that limitation. To reduce or eliminate the potential for such a legal interpretation, the City Attorney preliminarily recommended that the City consider other options, such as reducing the number of categories for this levy (e.g., above 5,000 square feet and above 10,000 square feet), applying a surcharge on energy or water usage, or revising the documentary transfer tax for homes in these same categories. The City Attorney cautions that any tax increase proposed by the City must not be characterized as relating to the value of the property being assessed to avoid legal interpretation as an Ad Valorem tax.

To estimate the revenues that would be generated from a luxury tax proposal, reliable data was made available by the City's Planning Department and the County of Los Angeles. According to the City Planning Department, there are 6,336 single family residences in the City of Los Angeles with a square footage exceeding 5,000 square feet, and 534 homes in the City that exceed 10,000 square feet. The County of Los Angeles Secured Tax Division calculated similar numbers for the City of Los Angeles, determining that there are 6,151 single-family homes, condos, and cooperatives with more than 5,000 square feet, and 445 exceeding 10,000 square feet. However, the County's data calculated the square footage of the main improvements on each lot, which does not include garages or guest houses. Also, unlike the Planning Department's data, the County of Los Angeles could not extrapolate data for each Council district or Community Planning Area, given that their data is based on Tax Rate Areas. For the

purposes of this analysis, therefore, we will use the Planning Department's data to estimate the impact of a luxury tax proposal in the City of Los Angeles. As a side note, the County of Los Angeles determined that there are 561,314 single-family homes, condos, and cooperatives of less than 5,000 square feet in the City of Los Angeles.

The attached chart shows the Community Planning District location of these residences based on the categories listed in the Motion(Alarcon-Reyes). Based on this data, a luxury tax levy applying the formula detailed in the Motion(Alarcon-Reyes) - which the City Attorney cautions will likely be challenged as an Ad Valorem tax - would generate approximately \$15.1M per year, if imposed as an annual levy. One alternative that the City Attorney believes would be less likely to be characterized as an Ad Valorem tax - above 5,000 square feet and above 10,000 square feet - would generate approximately \$9.5M per year, if levies of \$1,000 and \$6,000 were applied to each category, respectively. We note that there are numerous iterations of this type of an alternative proposal, and the categories and proposed levies presented in this report were chosen simply for the sake of illustration. Should the Council wish to explore other alternatives, such as different thresholds or revised levies, staff will be prepared to analyze those alternatives.

According to the City Attorney, any proposal to levy a "luxury tax" as proposed in the Motion(Alarcon-Reyes) or any other property-based tax, would be subject to Proposition 218 and require a 2/3-voter approval to be enacted. Should the City Council wish to proceed with this proposal, we would recommend that the City Attorney be instructed to draft a revised 'luxury tax' proposal that is less likely to be characterized as a Ad Valorem tax, such as the two category alternative. With regard to non-property-based tax alternatives, staff could explore the implementation of an increased documentary transfer tax on transactions involving homes in excess of 5,000 square feet. At this time, the potential revenues from a documentary transfer tax surcharge is unknown since it would be dependent on the number of sale transactions occurring in the future. It is possible, according to the City Attorney, that such a proposal may require a simple majority vote if the measure was structured as a general purpose tax and if the measure is placed on the City's primary or general election ballot. October 29, 2008 is the deadline for the City Council to request that the City Attorney prepare the necessary resolution to place a measure on March 3, 2009 City Primary Election ballot. January 14, 2009 is the deadline for the City Council to request drafting of a measure for placement on the May 19, 2009 City General Election ballot.


Roy R. Morales
Analyst

GFM:LMO:rrm

Attachments:

Motion (Alarcon-Reyes) - CF 08-1125

Chart - Homes 5000+ square feet by Community Plan Area

MOTION BUDGET & FINANCE

In the City of Los Angeles there is an increasing divide between the "haves" and the "have-nots." While a portion of our residents live luxurious lifestyles, the vast majority of Angelenos are bracing for a worsening economy. Currently, the number of residents who own homes in Los Angeles is declining, forcing less fortunate working families into the costly rental housing market. In addition to paying increasing rents, working families are being asked to pay higher utility fees, thereby further increasing the economic divide.

Fortunately many Angelinos have been incredibly blessed in the City of Los Angeles – and now they will have the opportunity to pay their fair share of the services that are provided to them. The more fortunate residents of the City occupy luxurious mansions, homes which were built well above the normal size in order to provide its inhabitants a comfortable and lavish lifestyle. These mansions often have features such as in-home movie theaters, extravagant heated pools and/or energy-intensive landscaping.

While Los Angeles provides so many opportunities for everyone, the City also endures many economic challenges. In order to improve public safety, provide clean-streets, create public spaces and encourage job creation the City needs to raise more revenue. A Luxury Tax is a fair way to provide an opportunity for those who are receiving a great benefit from our City to give back for the benefit of the greater public good. With this Luxury Tax, affluent residents who own mansions which meet or exceed 5,000 square feet and consume more city services will have a chance to give back to their communities as all of the revenue generated will be directed towards the City's general fund.

I THEREFORE MOVE that the City Council direct the CLA, CAO, Department of Building and Safety, Department of Planning, City Attorney's Office and the Los Angeles Department of Water and Power to research, calculate and report on a Luxury Tax which shall be levied on owners of mansions in Los Angeles who live in mansions which meet or exceed 5,000 square feet and utilize more City resources and services.

I FURTHER MOVE that the report include an assessment of the number of single-family dwelling units in single family zones in the City which meet or exceed 5,000 square feet as well as the communities in which these large-scale homes are most prevalent.

I FURTHER MOVE that the report include multiple alternatives with regards to the ways that the Luxury Tax can be assessed and a legal description of each type of tax. One alternative shall present a fee schedule for the Luxury Tax to be incrementally levied on owners of homes with excessive usage of City services as it relates to the size of the home and/or citywide average usage of services. A second alternative shall present a fee schedule which is levied incrementally according to an annual schedule on owners of mansions with an area of 5,000 square feet or more.

<u>Square Feet</u>	<u>Tax</u>
5000 – 5999	\$1,000.00
6000 – 6999	\$2,000.00
7000 – 7999	\$3,000.00
8000 – 8999	\$4,000.00
9000 – 9999	\$5,000.00
10,000 or more	\$6,000.00

W6

08-1125

BUDGET & FINANCE

I FURTHER MOVE that the report include information regarding possible exemptions from the Luxury Tax.

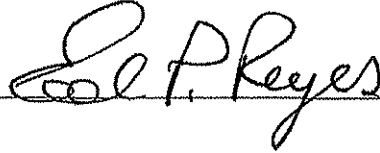
I FURTHER MOVE that the report be brought back to Budget and Finance Committee for review within 30 days and that the report outline the necessary steps required to place the measure on the ballot for the next municipal election.

PRESENTED BY



RICHARD ALARCÓN
Councilmember, 7th District

SECONDED BY



MAY 02 2008

Homes 5000+ Square Feet by Community Plan Area

As of MAY 22, 2008

Community Plan Area	Square Feet					
	5000-5999	6000-6999	7000-7999	8000-8999	9000-9999	Over 10000
Arleta - Pacoima	1	0	0	1	0	0
Bel Air - Beverly Crest	384	239	180	121	79	217
Boyle Heights	3	1	0	0	0	1
Brentwood - Pacific Palisades	683	388	188	91	57	89
Canoga Park - Winnetka - Woodland Hills - W	180	61	24	12	5	9
Central City	0	0	4	3	1	17
Central City North	0	1	0	0	0	2
Chatsworth - Porter Ranch	127	43	29	12	11	8
Encino - Tarzana	546	310	107	46	21	23
Granada Hills - Knollwood	34	7	8	1	3	2
Harbor Gateway	0	0	0	0	0	0
Hollywood	224	86	41	21	17	18
Los Angeles International Airport	0	0	0	0	0	0
Mission Hills - Panorama City - North Hills	5	1	0	0	0	4
North Hollywood - Valley Village	18	7	3	2	0	1
Northeast Los Angeles	14	8	0	0	1	3
Northridge	74	30	7	1	3	0
Palms - Mar Vista - Del Rey	11	1	0	1	0	2
Port of Los Angeles	0	0	0	0	0	0
Reseda - West Van Nuys	1	1	1	0	0	4
San Pedro	2	0	0	0	1	1
Sherman Oaks - Studio City - Toluca Lake - Ca	197	112	86	42	29	26
Silver Lake - Echo Park - Elysian Valley	5	0	1	1	1	3
South Los Angeles	21	7	4	1	1	5
Southeast Los Angeles	1	1	0	2	2	0
Sun Valley - La Tuna Canyon	4	1	1	0	0	2
Sunland - Tujunga - Lake View Terrace - :	7	1	1	1	0	2
Sylmar	7	3	0	0	0	1
Van Nuys - North Sherman Oaks	24	8	3	0	1	5
Venice	26	8	1	1	0	1
West Adams - Baldwin Hills - Leimert	23	11	3	0	0	3
West Los Angeles	70	16	8	2	0	1
Westchester - Playa del Rey	26	17	4	1	0	2
Westlake	5	3	5	1	2	7
Westwood	94	49	20	15	13	35
Wilmington - Harbor City	0	1	0	0	1	4
Wilshire	292	126	70	35	12	16
unknown	110	41	27	22	5	20
Subtotal	3219	1589	826	436	266	534

Motion (Alarcon-Reyes) proposal

@ \$1000 > 5K+	\$ 3,219,000					
@ \$2000 > 6K+		\$ 3,178,000				
@ \$3000 > 7K+			\$ 2,478,000			
@ \$4000 > 8K+				\$ 1,744,000		
@ \$5000 > 9K+					\$ 1,330,000	
@ \$6000 > 10K						\$ 3,204,000

Total \$ 15,153,000

Two Category Alternative

@\$1000 >5K <10K	\$6,336,000
@\$6000 >10K+	\$3,204,000
Total	\$9,540,000