PROPOSITION 15

"SPLIT ROLL" INITIATIVE ON NOVEMBER BALLOT
POTENTIAL IMPACT UPON CALIFORNIA'S GOLF COURSES

[Disclaimer: The following is an analysis of an initiative that proposes a number of amendments to the California Constitution that taken together would significantly alter the state's property tax paradigm – an analysis that given the subject matter necessarily skirts a number of legal issues; however, while what follows raises a number of legal questions, it does NOT constitute a legal opinion by any measure of that definition.]

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The "California Schools and Local Communities Funding Act of 2020" has qualified as "Proposition 15" on the November 3 ballot. Its passage would amount to the first significant change to California's property tax structure since 1978 by creating two classes of property for the purposes of reassessment – residential and "commercial/industrial" with residential property continuing to hew to all of the prescriptions and protocols of 1978's Proposition 13 for the purposes of reassessment (only upon sale) and with "commercial/industrial" property breaking therefrom by requiring reassessment at least once every three years. Proposition 13's constitutional provisions related to the 2% limitation on property taxes would remain intact for all categories of real property, albeit what that would mean in terms of limitations for properties reassessed "at least once every three years" would appear to be negligible – a mere sop.

There are four (4) basic types of golf properties in California: Private equity club; non-equity club; daily fee; municipal. The first and fourth categories are clear cut. The tax basis for private equity clubs is governed by ARTICLE XIII, Section 10 of the California Constitution. The tax basis for municipally owned golf courses is per dint of both Constitutional and legislative provisions exempt, although possessory interest taxes of a de minimis nature do apply to contracted-out (privatized) municipal golf courses.

Private Equity Golf Clubs

In 1960 California's voters approved Proposition 6. Its title: "Assessment of Golf Courses." The initiative set a basis for determining the taxes to be paid by private non-profit golf clubs [501 (c)(7) corporations] that remains in effect to this day and is enshrined in ARTICLE XIII, Section 10 of the California Constitution as follows:

> ***Real property in a parcel of 10 or more acres which, on the lien date and for 2 or more years immediately preceding, has been used exclusively for nonprofit golf course purposes shall be assessed***

for taxation on the basis of such use, plus any value attributable to mines, quarries, hydrocarbon substances, or other minerals in the property or the right to extract hydrocarbons or other minerals from the property. [ARTICLE XIII, Section 10]

Over the course of 60 years of interpretation by county assessors and boards of equalization, the standard enunciated in this initiative has resulted in tax bills calculated to incent golf clubs to remain what the initiative's proponents referred in their formal ballot argument as "privately paid-for parks." Most of the state's cities, including the City of Los Angeles, zone their private golf clubs "open space" in deference to the Constitutional provision, or as the ballot argument put forth by Proposition 6's backers much more boldly stated the matter in their introductory remarks:

How would you like the golf courses nearest your home to be converted into noisy factory layouts, clamorous supermarkets, traffic jammed shopping centers or brick and mortar apartment units? Proposition 6 is designed to save these courses and their benefits to you and your family as wooded, planted open space areas giving green belt breathing space to California's growing cities.

That ballot argument was co-authored by one of Proposition 6's biggest political backers, Augustus Hawkins, who the historians and political junkies among you will remember as one of the 20th Century's most prominent Democratic legislators (28 years in the California Assembly and 28 years in the U.S. House of Representatives). While a subject for another day, golf really does need to come to terms with its complete reversal of fortune in terms of the strong support it once had from the left side of the political aisle. Gus Hawkins, co-founder of the Congressional Black Caucus, represented inner city Los Angeles in the House from 1962-1990 and wrote this initiative to prevent California's "privately paid-for parks," as he defined country clubs, from "being taxed out of existence and taxed into overbuilt industrial and commercial developments."

The arguments in favor of 1960's Proposition 6 may be worth remembering should ARTICLE XIII, Section 10 come under scrutiny. It does come under fire periodically. The tax bills of Los Angeles' "metro" clubs have been the subjects of scrutiny over the years from various "progressive" tax organizations and are reported to have been the kindling for the firestorm that lit one Malcolm Gladwell's fuse in his Ted talk entitled, "why I hate golf and you should too."

Anything worth remembering is worth repeating. So, here are a few of Proposition 6's pro arguments excerpted from that 1960 ballot:

TAX REVENUE LOSS DUE TO DEPRECIATING VALUE OF SURROUNDING LAND WILL BE AVOIDED

Residential areas surrounding courses pay higher taxes because of scenic charm and prestige. Unfair taxes on the courses, forcing them to sell out and convert into commercial use, drops the value of the residential areas surrounding, erodes the tax base and throws a heavier tax burden on remaining taxpayers.

PROPOSITION 6 WILL HELP PROTECT OUR TOURIST AND CONVENTION INDUSTRY

These courses are a leading tourist and convention attraction. Tourists bring more than $1 billion in new outside money yearly into California. This means jobs for thousands. Fair taxation under Proposition 6 will help protect a major facility sustaining this source of employment.

TAX PRESSURE HURTS THE THOUSANDS WHO SEEK RECREATION ON PUBLIC LINKS

Courses cut down by the "tax ax" throw their membership into the public links, adding to the already great pressure there. Thus, thousands who cannot afford to belong to private golf clubs will be victimized.

OUR CITIES NEED OPEN AREAS AND "GREEN BELTS"

Civilian defense authorities say golf courses are indispensable facilities for use as mobilization areas in case of emergency. Parks and planted areas operated at private cost contribute to the beauty, health, and appeal of our growing metropolitan areas. Planted areas help decontaminate the air because plants absorb carbon dioxide and give off oxygen; thus, combatting air pollution.

Sixty (60) years later the arguments remain valid, although in 2020 we would need to predicate the value of golf courses as mobilization areas not for “civilian defense,” but rather firefighting. If anything, the relationship between maintenance of private equity clubs and public links access, and its companion affordability, is a much more visceral relationship today than it was in 1960.

Bottom line: So long as ARTICLE XIII, Section 10 of the California Constitution remains unchanged, and nothing about the “California Schools and Local Communities Funding Act of 2020” changes it, the golf course environs of the state’s 501(c)(7) private equity clubs would be affected by the initiative’s passage only to the degree to which they would be subject to reassessment “at least every three years.” The basis would remain benign, in most cases “open space,” but it would go up every three years more than the 2% cap that has prevailed since 1978. What that means in raw dollars would seem to be de minimis for the golf course proper; however, there would be no guarantee that those parts of a private golf club’s fixed structures (e.g., clubhouses, swimming pools, gyms, tennis courts) would be treated so benignly, particularly to the degree an assessor might deem that such “improvements” have added value to the price basis of an equity membership. Indeed, there are county assessors that have already done just that – reassess the basis of a private club’s property tax based upon the value added by fixed structure upgrades.

In addition, with the need to reassess/reevaluate all non-residential properties there will be a bevy of consultants and new assessors assigned to take fresh looks at how to value golf properties, and who knows where that could lead them once passage of these constitutional amendments signals popular support for “populist” tax policies. ARTICLE XIII, Section 10 may provide some comfort, but it does not guarantee full relief when the subject is as fraught with ambiguity as this one would necessarily be should Proposition 15 prevail at the ballot box.

MUNICIPAL GOLF PROPERTIES

This category is as simple as it is clear cut. The following definition is taken straight out of the “California Schools and Local Communities Funding Act of 2020” Initiative:

> ***For purposes of this section: (l) "Commercial and industrial real property" means any real property that is used as commercial or industrial property, or is vacant land not zoned for residential use and not used for commercial agricultural production. For purposes of this paragraph, vacant land shall not include real property that is used or protected for open space, a park, or the equivalent designation for land***

essentially free of structures, natural in character to provide opportunities for recreation and education, and intended to preserve scenic, cultural, or historic values.

California's municipally owned golf courses, whether managed by public employees or outsourced to the private sector, are parks. As such, the 1971 California Parkland Preservation Act prohibits them from being used for any purpose other than recreation; they cannot be developed or otherwise sold for commercial or residential purposes.

This 2020 initiative would continue California's longstanding property tax exemption for publicly owned golf properties, except to the degree to which a de minimis possessory interest tax would apply to the holders of long-term leases to operate them. As the management agreement has rapidly replaced the once dominant leasing model of municipal golf management as the preferred outsourcing model, this has become a rapidly declining feature of the municipal golf market.

NON-EQUITY CLUB AND DAILY FEE GOLF PROPERTIES

This is where all notions of "clear cut" and "simple" go by the wayside. This is also where considerably more knowledge on the subject than CAG possesses is necessary to speak in terms other than some of the questions the golf community needs answered before it can make informed judgments about both the impact of a successful "California Schools and Local Communities Funding Act of 2020" and the best course moving forward between now and November 3.

What we know for sure is that all golf properties have received full benefit of Proposition 13 since 1978, albeit that benefit may have from that inception been a more robust one for golf properties structured as 501 (c)(7) social clubs than for those structured otherwise. "May have been" because it may very well be true that between 1960 and 1978 it was standard operating procedure to assess all golf properties, save municipally owned ones parallel to the standard set by the voters in 1960 – "true" because California has never suffered the schisms among golf sectors (e.g., daily fee versus municipal) common in so many other states.

Indeed, a cursory review indicates that many of the state's daily fee courses or as the Assessors Handbook on the subject refers to them, "for-profit golf courses," are zoned open space much like their private equity brethren. The same holds true for most, if not all, of the state's non-equity private clubs. There are ways to structure them, so they are de facto private clubs for the purposes of property tax evaluation.

While there may be ways to structure the traditional non-equity club so that it qualifies more as social club than profit-making enterprise for the purposes of property tax assessments, that would not seem to be a possibility for the traditional daily fee or resort golf property. In either, or both, cases it's difficult to imagine a scenario in which they would be assessed anywhere near a "highest and best use" on some theory that they are amenable to commercial or industrial development; they are now zoned agricultural, open space, recreational, etc., and assessments are based in large part on the uses permitted by zoning. However, even a "highest and best use" definition that is restricted to the highest and best use within the confines of current zoning restrictions can mean significantly higher property tax bills for a golf course that is a for-profit operation – perhaps not significant when compared with actual commercial/industrial properties, but significant for a use like a golf course that produces substantially less net revenue than a traditional commercial/industrial parcel.

Whether a cleverly structured non-equity club or a traditional daily fee/resort property, the same caveat regarding the value of fixed structures that applies to private clubs applies just that much more so to daily fee/resort properties, as the basis for the valuation basis is not hidden in the price of an equity membership, but rather in the receipts of a profit-generating enterprise.
One wrinkle to consider is the ambiguity created by the definition of "commercial and industrial real property" in the Initiative:

> ***For purposes of this section: (l) "Commercial and industrial real property" means any real property that is used as commercial or industrial property, or is vacant land not zoned for residential use and not used for commercial agricultural production. For purposes of this paragraph, vacant land shall not include real property that is used or protected for open space, a park, or the equivalent designation for land essentially free of structures, natural in character to provide opportunities for recreation and education, and intended to preserve scenic, cultural, or historic values.***

Are non-equity private and daily fee golf properties "land(s) essentially free of structures, natural in character to provide opportunities for recreation" that would disqualify them as "commercial and industrial real property" for the purposes of the 3-year rolling reassessment that is the cornerstone of the Constitutional Amendment this initiative proposes? If the final, "and," in the definition were an, "or," the answer would clearly be yes. But because it is an "and," such golf properties would need to qualify as preserving "scenic, cultural, or historic values?" Scenic possibly; remember the arguments that helped sell Proposition 6 in 1960. But on both counts the answer would appear to be a resounding no; however there would seem to be some resonance in bifurcating daily fee properties into two classes of property for valuation purposes – golf courses proper considered as "open space" with fixed appurtenances assessed separately as contributors to the value of the property on a more traditional for-profit value added basis.

These are ambiguities that would fall to the assessors to interpret – that and the legislation and case law sure to issue in the years following the initiative's passage. That's cold comfort for daily fee facilities. Entirely dependent upon decisions rendered post passage, the financial impact of all this could be significant. On the other hand, the degree to which many of them are now zoned "open space," their zoning may well trump any such post Proposition 15 passage ambiguity on that count.

PRACTICAL CONSIDERATIONS

The "California Schools and Local Communities Funding Act of 2020" was polling poorly before COVID-19 struck – roughly 46% approval. However, in early April during the height of the economic shutdown, a credible poll indicated 53% approval. The common wisdom regarding initiatives is that their support trends downward over time irrespective of the campaigns for and against them, and this polling took place before any campaign against it had begun.

Polling circa Labor Day initially indicated support closer to 41%; however, at least one reliable poll one week later indicated a 51% level of support. Both were taken as the pro and con campaigns began their assaults upon one another. The most recent poll (September 26) indicated 49% support with 17% undecided. All polling seems to indicate that when the issue is framed as closing corporate loopholes to recalibrate tax burdens more equitably between residential and commercial property owners, Proposition 15 fares just above the 50% threshold required for passage. When the issue is framed as the largest property tax increase in California history, damaging to the small business community

already reeling under COVID-19 restrictions, and but the first step in unraveling Proposition 13 protections for homeowners, the initiative fares poorly.

What this means is anybody's guess, but it may well mean that Proposition 15 is a sufficiently close call that its fate may end up being decided by which of the above frames takes precedence between now and November 3. On one hand, an electorate that in 2018 began to reverse course regarding positive considerations of tax increases may be accelerated in that course by the recession we've just entered. On the other hand, COVID-19 and events surrounding the death of George Floyd may have shifted the body politic such that a plea for greater "tax fairness" is now much more resonant than it was just a few short months ago.

Consistent with what early polling has revealed, the pro campaign shot out of the box with a decidedly populist bent – a literal rant to make corporate "fat cats" and their "slick" lawyers and accountants pay their fair share of the property tax burden. The con campaign shot of the box citing Proposition 15's demonstrable failure to recognize that the small businesses supposedly exempted de jure are actually quite badly harmed de facto by virtue of the reality that 80% of them remit rentals to large commercial landlords per a triple net lease model that ties taxes to rents.

No matter which hand appeals to your sense of things, one thing is for sure; both sides are well funded, albeit it would appear that the pro side is better funded. Those groups (e.g., Howard Jarvis Taxpayers Association, California Chamber of Commerce, and others) that have scrupulously defended Proposition 13 have amassed a war chest cum campaign to ensure that California voters hear the following loudly and often before November:

- That this initiative is the slippery slope toward the erosion of Proposition 13's residential protections that have served California's homeowners so well for so long.
- That everyone pays through higher prices and rents when commercial/industrial owners are taxed.
- That California's businesses are already among the highest property tax remitters in the nation.
- That this will just accelerate California businesses fleeing the state and taking with them the jobs they now provide and the taxes they now pay.
- That raising taxes during a recession is a particularly counterproductive idea; and
- That the initiative fails miserably in protecting the small businesses that it purports to protect.

To that last point, it is one of many contained in a "white paper" re "split roll" that the California Assessors Association put out last year. The association of the state's county assessors billed it as a "white" as opposed to "position" paper, but it's clear from any reading of it where those who would be charged with executing the changes envisaged by the November 3 initiative stand with respect to its passage. Among the points the assessors make about a split roll:

- Without sufficient resources—including substantial increases in the appraisal staffing, training, and technology—implementation during the first five to ten years of a Split Roll system could have a devastating impact on the operations of California assessors and their ability to deliver quality customer service to taxpayers. A change in the law of such magnitude poses significant administrative problems for assessors, in addition to enormous start-up expenditures.
- Statewide, based upon the "BOE 2016-17 Budget Workload Report," there are 642,502 C&I properties that would require periodic re-assessment. Under current laws that drive assessments when change in ownership or new construction occurs, Santa Clara County,

reassesses approximately 2,000 C&I annually. Under a split roll, that number would increase 12-fold. It would be expected that similar increases would result in all counties.

- A split roll would also trigger significant downstream effects for Tax Collectors, Clerks of the Assessment Appeals Board, and County Counsels. Homeowners would probably experience declines in service levels as assessors reallocate staff resources to focus on the new commercial valuation and assessment appeal responsibilities triggered by a split roll.
- Adequate funding to resource assessor's offices through implementation and heightened workload moving forward. Initial analysis suggests $380-$470 million in funding for assessor's offices, as well as additional funding for upgrading technology systems to accommodate a split roll.
- As many as 900 new positions would need to be created statewide to manage the increase in workload. Practical administrative challenges would make it all but impossible to annually assess the massive increase in C&I properties to market value without significant and sustained investment in the county appraisal workforce. The most important impact would be the enormous amount of new staffing and training required to develop a workforce that is proficient in property appraisal. Training new appraisers and auditors to assess complex appraisal and business audits typically requires up to five years.

That's one of the most effective non-position positions in some time! Expect to see those points advertised widely in the campaign. Also, expect the points raised earlier this year by the California NAACP to be liberally employed as well, central among them the nation's oldest civil rights organization's firm conclusion that Proposition 15 would disproportionately harm communities of color. Alice Huffman, President of the California NAACP, is one of the authors of the formal ballot argument against Proposition 15.

Whether those points in conjunction with the points sure to be raised by the usual anti-tax suspects funded by the deep pockets that would suffer greatly in the wake of the initiative's passage are poised to combine to kill all hope of passage remains to be seen. Again, periodic polling over the coming weeks and months will tell.

CONCLUSIONS

This discussion enlightened up to a point – that point being sufficient information to understand some of the history and context of the issue as it pertains to the golf community, some of the matters that are already settled, and the many open questions it behooves the industry to close before it can discern its wisest course moving forward.

The "wisest course" is not always the most proactive course; indeed, it is often one characterized more by forbearance than action. And that may very well be the case here. To be clear, passage of the "split roll" initiative can only be characterized as a negative result for the California golf community. Even where its passage might only be minimally or partially impactful [501 (c)(7) clubs] or not impactful at all (municipal courses), there is plenty of interpretative ambiguity in one case and plenty of disruptive capacity in the other to be worried. And where its passage is impactful but to a degree not yet entirely known, that kind of uncertainty is cause for considerably more worry.

But "worry" is not the dispositive factor in determining whether to run the risk of incurring the public scrutiny sure to follow public engagement of this issue. "Progressive" tax groups understand the tax status of California's golf courses, but the general public has little knowledge and unless given reason,

no interest in knowing. In the current political atmosphere golf must consider whether it wants to expose the public to that knowledge.

On the other hand – there's that ubiquitous second hand again – California's golf community may not want to remain silent should the initiative begin to gain further traction.

If you have read this far it means three (3) things: 1) You care about the issue, 2) you understand the issue is as complicated as it is fraught, and 3) you recognize that the voluminous words you just read were no more than an introduction, an effort to stimulate interest in becoming sufficiently informed to render wise judgments.

Click here to read the split roll initiative in its entirety.

Click here to read the California Assessors Association's "white paper" re split roll.

Click here to read the California NAACP's defense of keeping Proposition 13 fully intact for both homeowners and commercial/industrial property owners.