

[Senate Bill 1115](#) (Hill)

Date: 7/3/2018 (Amended)

Program: Property Taxes

Sponsor: Author

Revenue and Taxation Code Sections 214 and 214.18

Effective: January 1, 2019

Mark Durham (Chief) 916.319.9220

Glenna Schultz (Analyst) 916.274.3362

Chris Butler (Revenue) 916.323.3800

Summary: This bill removes the \$10,000,000 assessed value exemption cap applicable to certain low-income rental housing properties owned by nonprofit organizations under the welfare exemption and provides for the cancellation of taxes, interest, or penalties.

Summary of Amendments: Since our previous analysis, this bill has been amended to delete references to moderate income that were included in the non-codified statement of legislative intent.

Purpose: To provide an unlimited exemption for low-income rental housing owned by nonprofit organizations impacted by the cap.

Fiscal Impact Summary: Based on information provided by county assessors, the current revenue impact is zero as no organizations appear to be over the cap at the present time.

Existing Law: Existing law provides that low-income rental housing owned and operated by a qualifying nonprofit organization¹ may be exempt from property tax under the welfare exemption, provided various conditions and requirements are met. The law allows an unlimited exemption for rental housing owned by a nonprofit organization if it receives government financing or low-income housing tax credits.² However, the law limits the exemption to the first \$10,000,000 in assessed value statewide³ on any rental property owned by the nonprofit that does not receive government financing or tax credits.

Proposed Law:

Removes Exemption Cap. This bill removes the \$10,000,000 in assessed value exemption cap for non-government assisted low-income rental housing owned and operated by eligible nonprofit organizations. *RTC section 214(g)(1)(C)*

Cancellation of Outstanding Taxes. This bill authorizes the cancellation of any outstanding tax, interest, or penalty levied or imposed on these organizations from January 1, 2017 to January 1, 2019, inclusive, provided they were levied or imposed because of the exemption cap. *RTC section 214.18*

In General:

Government Financing or Tax Credits: Unlimited Exemption. When a nonprofit organization owns and operates a low-income rental housing property that receives government financing or low-income

¹ A qualified organization may also be an eligible limited liability company or a limited partnership in which the managing general partner is an eligible nonprofit corporation or eligible limited liability company.

² Revenue and Taxation Code (RTC) section [214\(g\)\(1\)\(A\)](#) and section 214(g)(1)(B).

³ RTC section 214(g)(1)(C).

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

housing tax credits, all of these properties may be exempt from property tax. Generally, a low-income rental housing property⁴ may qualify for the welfare exemption provided:

- **Occupancy.** While there is no minimum percentage of units that must be occupied by lower-income households, the exemption only extends to the units serving lower-income households. *§214(g)(1)*
- **Government Assistance.** The nonprofit organization owner receives low-income housing tax credits or government financing on the property. *§214(g)(1)(A) and (B)*
- **Use Restriction.** The property is subject to a recorded deed restriction, regulatory agreement, or "other legal document" restricting its use for low-income housing purposes at specified rents. *§214(g)(2)(A)(i) and Property Tax Rule [140](#)*
- **Rents Charged.** The rents charged to lower income household occupants do not exceed the rent prescribed by the deed restrictions or regulatory agreement. *§214(g)(1)(A) and §214(g)(2)(A)(i)*
- **Property Tax Savings.** The owner certifies that the funds otherwise spent to pay taxes are instead used to maintain affordability of, or reduce rents for, units occupied by the lower income households. *§214(g)(2)(B)*
- **Limited Partnership: Special Requirements.** In the case of housing owned by a limited partnership in which the managing general partner is an eligible nonprofit organization, use and rent restrictions must be contained in a recorded deed restriction or regulatory agreement. An "other legal document" is not allowed for a limited partnership. *§214(g)(2)(A)(ii) and Property Tax Rule 140*

No Government Assistance: Capped Exemption. When a nonprofit organization owns and operates a low-income housing property that does not receive any government financing or low-income housing tax credits, an exemption is available, but these properties are subject to a statewide cap. The exemption is capped at the first \$10,000,000 of assessed value. If it does not exceed the exemption cap, a particular low-income housing property may qualify for the welfare exemption provided:

- **Occupancy.** Ninety percent or more of the property's occupants are lower income households, as specified. With respect to the remaining occupancy, the law allows an exemption equal to the percentage of units serving lower-income households. For example, a 100 percent exemption would be allowed if all the units were occupied by low income households. *Sections 214(g)(1) and 214(g)(1)(C)*
- **Use Restriction.** The property is subject to an "other legal document" restricting the property's use to low-income housing. *Section 214(g)(2)(A)(i) and Property Tax Rule 140*
- **Rents Charged.** The rent charged does not exceed that prescribed in Health and Safety Code Section [50053](#). *Section 214(g)(1)(C)*
- **Property Tax Savings.** The owner certifies that the funds otherwise spent to pay taxes are instead used to maintain the affordability of, or reduce rents for, units occupied by the lower income households. *§214(g)(2)(B)*

⁴ Such property may include single-family residences, multifamily residences (e.g., duplex, triplex, fourplex), and apartment complexes.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

- **Limited Partnerships: Prohibited.** Limited partnerships with a nonprofit organization serving as the managing general partner are not eligible for exemption under this provision. *§214(g)(1)(C)*

Background: Historical Qualifications. Prior to January 1, 2000, nonprofit organizations could qualify for a property tax exemption for low-income rental housing by meeting *one* of the following requirements:

1. **Occupancy.** At least 20 percent of the occupants were persons with low income.
2. **Government Financing.** The project was financed with tax-exempt bonds, government loans, or grants.
3. **Tax Credits.** The nonprofit organization was eligible for and received low-income housing income tax credits.

More Stringent Qualifications. Beginning January 1, 2000, [Assembly Bill 1559](#) (Stats. 1999, Ch. 927) deleted mere "occupancy" by persons with low income as a qualifying condition for the welfare exemption. As a result, to receive a property tax exemption, the low-income housing property must either be financed with government funds or the owner must receive income tax credits on the property. Assembly Bill 1559 also imposed higher standards related to restrictive use documentation to substantiate that the property is dedicated to low-income housing. Accordingly, any deed restriction must be recorded, or a public agency must be a party to an enforceable and verifiable agreement regarding property use. Furthermore, "other legal documents" no longer sufficed to impose the necessary use restriction.

The Los Angeles Housing Law Project (Project) sponsored Assembly Bill 1559 to address welfare exemption abuse and misuse that permitted the owners of substandard housing properties to obtain a property tax exemption. In the course of investigating various substandard housing properties, this organization discovered that some properties were receiving the exemption under the provision that permits the property to qualify solely on the basis that the rents were low and the residents were low-income households. It was alleged that substandard housing owners were partnering with nonprofit organizations in a limited partnership as a ruse to obtain the welfare exemption or were themselves creating non-profit organizations. Presumably, the rationale for limiting the exemption to properties financed with tax-exempt bonds, government loans, or grants was that these properties would be subject to some level of government oversight, ensuring quality housing for the tenants and preventing creative property owners from obtaining the exemption to avoid paying any property tax.

Exemption Cap. Assembly Bill 1559's changes also revoked the exemption from charitable organizations providing adequate housing because they did not have government financing or tax credits. Consequently, the following year [Assembly Bill 659](#) (Stats. 2000, Ch. 601) reinstated exemption eligibility based on "occupancy" by low-income households with three changes:

1. **Occupancy Threshold.** The occupancy threshold was raised from 20 percent to 90 percent.
2. **Exemption Cap.** An exemption cap was created limiting the exemption amount applied to a taxpayer to \$20,000 of tax.⁵

⁵ \$20,000 of tax is equivalent to about \$2,000,000 in assessed value, using a 1 percent tax rate.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

3. **Exclude Limited Partnerships.** Limited partnerships in which the managing general partner is an eligible nonprofit corporation were specifically excluded.

Since the exemption cap was created, few nonprofit organizations that own low-income rental housing have exceeded the cap. Many projects use government financing or tax credits and thus are not impacted by the cap. The purpose of making public financing a key condition of receiving a property tax exemption was to help ensure that only legitimate operators were benefiting from the exemption. The purpose of excluding limited partnerships was to prevent the owners of substandard housing from partnering with a nonprofit organization in a ruse to obtain the welfare exemption. The purpose of imposing a \$20,000 of tax statewide cap when public financing does not apply was to limit the available exemption to owners that might misuse the exemption by creating a non-profit organization.

Consent Decree Property Exception. In 2004, the Long Beach Affordable Housing Coalition (LBAHC) unknowingly became impacted by the \$20,000 of tax exemption cap. It purchased 12 developments using conventional bank financing. Public subsidies were unnecessary to buy the properties because they were acquired from another nonprofit organization on favorable terms. These properties mitigated the loss of affordable housing related to the construction of the Century Freeway (I-105) in Los Angeles County and had always been exempt from property taxes. Because there were no public subsidies, the properties became taxable, with a maximum exemption cap not to exceed \$20,000 of tax. To remedy this issue, [Senate Bill 1284](#) (Stats. 2008, Ch. 524) modified the law to exclude the cap's application to these properties. Senate Bill 1284 also cancelled all outstanding taxes, including any related interest or penalties, on the properties.⁶ SB 1284 did not include refunds because at that time, it was believed that no taxes had yet been paid. However, the lender had paid taxes to avoid a property sale due to tax delinquency. In 2010, [Senate Bill 996](#) (Lowenthal) was introduced to allow the refund of taxes paid, but this bill was not enacted.⁷

In 2016, [Senate Bill 996](#) (Stats. 2016, ch. 836) increased the exemption cap from \$20,000 of tax to \$10,000,000 in assessed value statewide for lien dates occurring on and after January 1, 2017 and provided for the cancellation of any outstanding ad valorem tax in excess of the \$20,000 cap and any related penalties or interest imposed between January 1, 2013 and January 1, 2017.

Commentary:

1. **Summary of Amendments.** The **July 3, 2018** amendments modify the statement of legislative intent language to delete references to moderate income, which this bill does not address. No changes were made to either section 214 or 214.18.
2. **No other property eligible for the welfare exemption is subject to an exemption cap.** The cap was instituted to address the exemption's misuse as it applied to low-income housing. In addition to the cap, other restrictions were enacted to reduce exemption abuse, such as excluding limited partnerships, requiring recorded deed restrictions, and requiring regulatory agreements with a public agency.
3. **Few organizations have exceeded the cap.** Most projects require government subsidies to be economically viable, making the cap inapplicable. When the cap impacted Long Beach

⁶ RTC section 214(g)(1)(D).

⁷ RTC section 214.16.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Affordable Housing Coalition-owned properties, the Legislature enacted legislation to exclude the properties from any cap.

4. **The BOE requests and collects information on the statewide cap.** Nonprofit organizations report their holdings to the local assessor via the annual welfare exemption claim form, and the BOE requests that assessors annually provide the information to the BOE. For fiscal year 2016-17, 27 counties provided information. Of these 27 counties, 10 counties indicated that they granted exemptions to properties owned by organizations subject to the \$20,000 exemption cap. The other 17 counties reported that there were no such properties in their county.
5. **\$20,000 of Tax Exemption Cap.** For fiscal year 2016-17, according to information submitted to the BOE, 23 nonprofit organizations received exemptions on property that counted towards the \$20,000 cap. These 23 organizations owned 55 low-income rental housing properties of various types in 10 counties. Three organizations, located in Los Angeles, Marin, and Monterey Counties, exceeded the cap and were partially taxable.
6. **\$10,000,000 of Assessed Value Exemption Cap.** For fiscal year 2017-18, 18 counties submitted information to the BOE. This information indicates that 23 nonprofit organizations received exemptions on property that counted towards the \$10,000,000 exemption cap. These 23 organizations own low-income rental housing properties of various types in 8 counties. Of these 23 organizations, none of the organizations exceeded the \$10,000,000 cap.
7. **Related Legislation.** Assembly Bill [3152](#) proposes to also amend RTC section 214 to extend the welfare exemption to rental units serving moderate income households. AB 3152 was held in the Assembly Appropriations Committee.

Senate Bill [1056](#) proposes to also add section 214.18 to the Revenue and Taxation Code to extend the welfare exemption to property owned by a community land trust. Senate Bill 1056 passed the Assembly Revenue and Taxation Committee on July 2, 2018.

Costs: The BOE would incur absorbable costs to update claim forms (BOE-267-L and BOE-267-L2), Property Tax Rule 140, and Assessors' Handbook Section [267](#), *Welfare, Church, and Religious Exemptions*.

Revenue Impact: This bill effectively eliminates the exemption cap of \$10,000,000 in assessed value for non-government assisted low-income rental housing owned and operated by eligible nonprofit organizations.

Based on county assessor data collected by BOE Property Tax Department staff, no organizations appear to be over the \$10,000,000 cap at the present time. Consequently, the current revenue impact is zero.

Qualifying Remarks: The revenue impact could grow as organizations acquire more property subject to the \$10,000,000 cap, or if assessed values over time exceed \$10,000,000 due to the application of the annual inflation factor of up to 2 percent.

This revenue estimate doesn't account for any changes in economic activity that may or may not result from the enactment of the proposed law.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.