



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date:	05/22/14	Bill No:	<a href="#">Senate Bill 1203</a>
Tax Program:	Property	Author:	Jackson
Sponsor:	BOE Chairman Horton	Code Section:	RTC Section 214 GC Section 66009
Related Bills:	AB 1760 (Chau)	Effective Date:	01/01/15

*This analysis is limited in scope to the property tax provisions.*

**BILL SUMMARY**

Related to a property tax exemption for low-income rental housing projects, this bill:

- deletes a certification requirement related to the use of property tax savings;
- prohibits unlevied escape assessments related to the certification and payment in lieu of taxes agreements (PILOT);
- cancels outstanding tax liabilities related to PILOT agreements; and
- defines “related facilities.”

**Summary of Amendments**

The amendments since the previous analysis modify the types of fees and charges a local agency may impose on a low-income rental housing development project pursuant to an agreement with the project’s owner.

**ANALYSIS**

**CURRENT LAW**

**PILOT Agreements.** Existing property tax law is silent on the issue of PILOT agreements related to low-income rental housing projects.<sup>1</sup>

**Property Tax Exemption.** The law provides that the welfare exemption applies to certain low-income rental housing properties.<sup>2</sup> One exemption requirement is that the property owner must be able to certify the following:

- That an enforceable and verifiable agreement exists restricting the development to appropriate lower income household usage and rents.
- That the property tax savings from the exemption are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households.

The question has been raised whether a property owner can properly make the property tax certification when a PILOT agreement exists with local government. The BOE issued a non-binding [legal opinion](#) that a property owner can make the required certification in good faith if rents actually meet or are lower than the restrictions set forth in the enforceable agreement, and if the property owner has a reasonable belief that its PILOT payment will go directly to support or benefit the low-income household units.

<sup>1</sup> Revenue and Taxation Code (RTC) [§237\(b\)](#) addresses payments that an Indian tribe may make related to a low-income housing project owned and operated by the tribe.

<sup>2</sup> RTC §214(g)

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**Exemption revocation.** The exemption has been revoked and escape assessments issued in at least one county which deemed payments made under a PILOT agreement to disqualify the property owner's certification for property tax savings. Other counties are considering this issue.

**Related Facilities.** The exemption applies to rental housing and "related facilities." When the rental housing also serves non-lower income households, the property is entitled to a partial exemption. Existing law does not define the term related facilities.

#### PROPOSED LAW

**PILOT Agreements.** This bill prohibits a local agency from entering into an agreement to charge, or newly impose, a charge or fee on a housing development project as described in property tax exemption law for low-income rental housing unless the charge or fee meets certain conditions. These are:

- The charge or fee is imposed under the Mitigation Fee Act.<sup>3</sup>
- The charge or fee does not prohibit or discriminate against the housing development project, as specified.
- The charge or fee is for a specific service or product provided directly to the housing development project that does not exceed the actual cost to provide the service or product. The service or product must not be provided to other properties not similarly charged.

**Property Tax Exemption.** This bill deletes the certification eligibility requirement that the property tax savings from the exemption are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households.

**Escape Assessments.** This bill prohibits escape assessments not yet levied if they relate to the (1) property owner's certification concerning the use of funds and (2) a PILOT agreement with a local government, for which an assessor did not, prior to January 1, 2015, levy any assessment.<sup>4</sup> For escape assessments already levied, this bill requires any outstanding taxes, penalty, and interest be canceled. Any payments previously made towards those escape assessments would not be refunded.

**Legislative Declaration.** Related to the property tax exemption available to low-income housing projects, Legislative findings and declarations state that:

[I]n enacting subdivision (g) of Section 214 of the Revenue and Taxation Code in 1987, [the Legislature] determined that the funds that were being paid in property taxes could better be used in furtherance of the goals of providing low-income housing and that a property tax exemption was necessary to ensure that low-income housing properties with restricted rents would be able to provide the residents with a liveable community and remain financially feasible over the life of the deed restrictions, generally 55 years.

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<sup>3</sup> Government Code Chapter 5 (commencing with Section 66000), Chapter 6 (commencing with Section 66010), Chapter 7 (commencing with Section 66012), Chapter 8 (commencing with Section 66016), and Chapter 9 (commencing with Section 66020).

<sup>4</sup> And any supplemental assessment, as well, in the case of a change in ownership for completion of new construction.

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**Related Facilities.** This bill defines related facilities for purposes of the low-income rental housing exemption. The definition for related facilities means:

- any manager's units
- any and all common area spaces that are included within the physical boundaries of the low-income apartment development, including, but not limited to, common area space, walkways, balconies, patios, clubhouse space, meeting rooms, and parking areas.

Any portions of the overall project that are nonexempt commercial structures are excluded from the related facilities definition.

#### IN GENERAL

Under authority granted by the California Constitution, the Legislature has chosen to exempt from property taxation property used exclusively for religious, hospital, or charitable purposes. The exemption's main provisions, known as the "welfare exemption," are set forth in RTC Section 214(a), which enumerates many eligibility requirements.

In addition to the RTC Section 214(a) requirements, low-income housing projects must meet criteria set forth in RTC Section 214(g). Specifically, under RTC Section 214(g)(2)(B), the low-income housing property owner must certify that:

[T]he funds that would have been necessary to pay property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income individuals.

When claimants cannot make this certification, they may not receive a welfare exemption.

#### BACKGROUND

Recently the Ventura County Assessor's Office sent notification of possible welfare exemption revocation to five nonprofit housing developments that have PILOTs with various cities. The assessor took this action after the office received a courtesy copy of a December 23, 2011 BOE legal opinion letter (never annotated). The legal opinion concluded that the required RTC Section 214(g)(2)(B) certification could not be made with respect to a certain PILOT agreement calling for in-lieu payments to the local government. Thereafter, the assessor's office investigated other low-income housing projects with PILOTs, and a statewide discussion commenced to reexamine this issue.

**BOE Legal Memo.** On March 20, 2013, the BOE's Legal Department issued a memo reviewing the December 14, 2011 letter and an earlier annotated letter dated September 29, 2003, (former Property Tax Annotation 880.0155). and concluded that the certification could be made under certain circumstances even when a PILOT agreement was in place.

**BOE Town Hall Meeting.** On November 6, 2013, the BOE held a [panel discussion](#) and some attendees noted the need to pursue legislative action. A video of the town hall meeting is available [online](#).

**BOE Publishes New Annotation.** On November 19, 2013, the BOE Members took [action](#) to publish a new Annotation [880.0155.005](#) based on the March 20, 2013 memo and deleted the prior annotated letter.

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Property Tax Annotation 880.0155.005 now states:

RTC §214(g)(2)(B) requires a developer to certify that property tax savings be used to "maintain the affordability of" or "reduce rents otherwise necessary for" low-income housing units. A Payment In Lieu of Tax (PILOT) Agreement between a local government and an owner of a low-income housing project does not disqualify a developer from making the certification if rents have been maintained in accord with those required by section 214(g)(2)(A), and the developer has a reasonable belief that the PILOT payment will be used to support or benefit the low-income housing development.

**Assembly Joint Informational Hearing.** On February 3, 2014, the Assembly Committees on Housing and Community Development, Local Government, and Revenue and Taxation held a hearing entitled "Understanding the Scope of Payment in Lieu of Taxes (PILOTs) and Their Impact on the Welfare Property Tax Exemption." A video of the hearing and agenda is available [online](#) via the Cal Channel website.

**Legislative Analyst's Office Report.** The LAO issued a report for this hearing entitled "[Nonprofits and the Property Tax.](#)"

## COMMENTS

1. **Sponsor and Purpose.** BOE Chairman Jerome Horton is sponsoring this measure to address this emerging property tax issue in statute. According to the author, "as a condition of project approval, some local governments have required affordable housing developers to agree to annual PILOT payments, often equal to the share of the jurisdiction's share of the property tax. Most recently, some county assessors are threatening certain affordable housing projects that make PILOT payments with the cancellation of their welfare exemption and the imposition of back taxes for past years when PILOT payments were made. Back taxes on PILOT agreements are often in the hundreds of thousands of dollars. These assessments threaten to bankrupt the affordable housing developments, which would result in the loss of precious affordable housing. Affordable housing developments provide critical opportunities for our low-income residents. Often, these units can be their last resort before becoming homeless. As confirmed by Legislative Counsel in 2012, there is no legal authority to charge these PILOT fees. Affordable housing developments should be protected by the welfare exemption, not burdened by local governments requiring PILOT fees."
2. **The May 22, 2014 amendments** relate to the prohibition on PILOT agreements. The amendments modify the types of fees and charges a local agency may impose on a low-income rental housing development project pursuant to an agreement with the project's owner. **The April 21, 2014 amendments** rewrote the bill as introduced and deleted the property tax savings use certification found in existing law. As introduced, the bill provided that a PILOT agreement, as defined, did not make a low-income housing project ineligible for the property tax welfare exemption. It also voided all PILOT agreements except those with fees that are (1) consistent with other residential development fees; or (2) for services that do not exceed actual costs, including services tied to bond issuance and project monitoring. The introduced version stated that its provisions were declaratory of existing law but did not address escapement assessments already issued to retroactively revoke the exemption on property with PILOT agreements. The amendments also added the definition of "related facilities."

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3. **PILOT issue simplified.** Low-income housing property may be exempt from property taxation under the Welfare Exemption. Since the local government will not receive its portion of property tax if the property is exempt, low-income housing developers or owners sometimes enter into agreements (often called PILOT agreements) to compensate local government for costs associated with the property. For property tax purposes, some concern exists regarding the effect of a PILOT on a low-income housing property's eligibility for the Welfare Exemption.
4. **Financial implications of retroactively revoking a property tax exemption.** The low-income housing project owners are very concerned about the prospect of losing the welfare exemption for prior years in which they made PILOT payments. Since they did not anticipate such liabilities, they have insufficient funds to pay back taxes and associated penalties.
5. **This bill will provide certainty regarding this issue and related escape assessments.** The BOE, assessors, local governments, nonprofit organizations, and project financiers have an interest in clear and consistent treatment of properties subject to PILOT agreements when the welfare exemption eligibility is at stake. This bill cancels outstanding property taxes liabilities on those projects where the welfare exemption was retroactively revoked due to a PILOT agreement. The bill expressly provides that refunds will not be provided for any payments already made.
6. **Property tax savings use requirement.** This bill deletes the provision in law that requires owners to make a certification that property tax savings are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households. The Senate Revenue and Taxation Committee analysis of AB 2144 (Stats. 1987, Ch. 1469) which added RTC 214 (g), and included the certification requirement from inception, noted the enforcement difficulty of this particular provision. The analysis stated: "[i]n order to claim the exemption the operator must demonstrate that the property tax saved goes toward furthering the low-income aspects of the project. It will be impossible, operationally, to make an unambiguous demonstration, or for the assessor, in most cases, to effectively challenge the demonstration. Enforcing this requirement will prove very difficult, and will cause much administrative difficulty both for the assessors and the assesse."

The bill deletes the certification requirement in light of its unenforceability and in recognition that it is duplicative due to the deed restrictions, regulatory agreements, and tax credit oversight upon which such property already operates.

7. **Suggested amendments for internal consistency.** The related facilities definition uses the phrase "low-income apartment development," which is not otherwise used in the statute. Further, a project development may not be limited to occupancy only by "low-income" households; hence the authorization to allow a partial exemption to such properties. The following amendments are suggested to better integrate the new definition with the existing statute. However, this bill does not address an uncertainty that exists concerning the formula to use to calculate the percentage of value when providing a partial exemption.

214(g)(3)(B) "Related facilities" means any manager's units and any and all common area spaces that are included within the physical boundaries of the ~~low-income apartment~~ rental housing development, including, but not limited to, common area space, walkways, balconies, patios, clubhouse space, meeting

rooms, and parking areas, except any portions of the overall project development that are nonexempt commercial structures.

8. **Related legislation.** AB 1760 (Chau and Bocanegra) also relates to low-income rental housing projects subject to PILOT agreements. That bill creates a presumption that any PILOT payments made under a PILOT agreement entered into before January 1, 2015, are used to maintain the affordability of, or reduce rents otherwise necessary for, lower income household occupied units. Thus, allowing a property owner to make the required certification that SB 1203 proposes to delete.

### **COST ESTIMATE**

The BOE and counties co-administer the welfare exemption. The BOE would incur some minor absorbable costs to inform and advise county assessors, the public, and staff of the law changes, revise claim forms, and address ongoing implementation issues and questions. These costs are estimated to be under \$10,000.

### **REVENUE ESTIMATE**

Information on the number of PILOT agreements has proven difficult to obtain and is unknown, making it impossible to assess the full fiscal impact of this proposal. To date, the identified property tax revenues at stake relate to four low-income housing projects that have received escape assessments for prior years' taxes related to PILOT agreements. Two projects have entered into five-year payment plans and have paid a total of \$450,000 toward outstanding liabilities of over \$6.1 million. In other projects where PILOT agreements became an issue, the city dropped the PILOT payment requirement to ensure the project would remain eligible for the property tax exemption. Thus, those properties do not impact this revenue estimate.

Exemption eligibility status is uncertain regarding projects located in California, pending the outcome of this issue. The intent of this bill is to maintain eligibility for all other projects currently receiving the exemption, regardless of whether they have entered into a PILOT agreement. According to the author's office, the intent of this bill is to require the cancellation of outstanding taxes related to escape assessments for prior years' taxes. But, those property taxes already collected (\$450,000) would not be subject to refund.

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