Draft

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**04/10/07**	Bill No:	**AB 793**
Tax:	**Property**	Author:	**Strickland**
Related Bills:			

BILL SUMMARY

Related to homes purchased by a homeowner under an affordable housing program, this bill would:

- Exclude from the calculation of purchase price the amount of any "silent second mortgage" if payment is not required for at least 20 years.
- Expressly provide that restrictions on the resale price of homes purchased through a program operated by a governmental agency must be considered in determining the value of the property.
- Allow restrictions on the resale price of homes purchased through a program operated by a nonprofit organization to be treated as an enforceable restriction that must be considered in determining the value of the property.

ANALYSIS

CURRENT LAW

Purchase Price. Existing law requires that whenever property changes ownership, the property must be reassessed to its current fair market value for property tax purposes. Revenue and Taxation Code Section 110(b) provides a rebuttable presumption that after a change in ownership the "fair market value" of the property is the purchase price paid. It further defines "purchase price" to mean the **total consideration** provided by the purchaser **or on the purchaser's behalf**, valued in money, **whether paid in money or otherwise**.

Enforceable Restrictions. Revenue and Taxation Code Section 110(a) provides that in determining a property's fair market value the effect of enforceable restrictions must be considered. Additionally, Section 402.1 provides that in the assessment of land, the assessor must consider the effect upon the value of any enforceable restrictions to which the use of the land may be subjected. Section 402.1 expressly lists specific types of restrictions that must be considered. One type of restriction listed is a recorded contract with a governmental agency. The list of restrictions delineated in Section 402.1 is not all inclusive. However, with respect to this bill, restrictions imposed by nonprofit organizations (rather than a governmental entity) are generally not considered enforceable restrictions.

PROPOSED LAW

Purchase Price – Silent Second Mortgages. This bill would amend Section 110 to provide that "purchase price" does not include the amount stated in a trust deed, recorded in conjunction with an affordable housing unit purchased by its occupant, for which that occupant is the trustor and a nonprofit or governmental agency selling authority is the beneficiary, and both have contracted that a periodic payment of

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principal and interest will **not** be required for at least 20 years. These provisions would apply beginning with the 2008-09 fiscal year.

Enforceable Restrictions – Resale Restrictions. In addition, this bill would amend Section 402.1 to add to the list of specific types of restrictions that must be considered in determining the value of property to expressly include restrictions on the resale price of real property in a recorded real property deed or other recorded real property transfer document for real property that was purchased by its occupant through an affordable housing program operated by a city, a county, the state, or a nonprofit organization.

This amendment would allow a resale restriction imposed by a nonprofit organization to be considered as an enforceable restriction affecting the value of the property. Resale restrictions imposed by a government agency are already required to be considered under existing law.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author. As noted in the uncodified statement of intent, the purpose of this bill is to ensure that homes purchased under an affordable housing program are valued for property taxation purposes in a manner that reflects the restrictions on the homes.

2. **Inclusionary affordable housing units are offered for sale within new subdivisions at below market prices.** In order to increase the supply of affordable housing some cities require developers seeking approval to build a new residential project to sell a portion of the dwelling units (affordable units) to low or moderate income purchasers at a specified affordable price. Typically, these specially designated units are dispersed within the development and are developed concurrently. In addition, they are often architecturally similar and are of comparable quality and size.

   For example, a person approved as eligible by the governmental agency that runs an affordable housing program is able to purchase an affordable housing unit within a new residential development from the developer for $158,000. Other homes in the subdivision sell for $450,000. The developer is required to sell these homes at this price to low-income buyers in order to build out the subdivision "inclusionary housing units." In addition to buying the home from the developer for $158,000, the purchaser signs a promissory note or deed of trust, which are also sometimes referred to as a “silent second mortgage” or a “silent second” with the city in the amount of $251,000. Neither the developer nor the property owner actually receive any funds from the silent second mortgage. The developer only receives $158,000 for the property. While the purchaser only pays $158,000, they must also agree to and sign the silent second mortgage, with a deferred payment of any interest or principal payments on this mortgage. The silent second mortgage is typically used as enforcement mechanism to ensure that the purchaser complies with restrictions imposed on the property and may never have to be repaid until the property is subsequently sold. Therefore, for property tax purposes what should the assessed value of the home be: $158,000, $409,000 ($158,000 + 251,000), or $450,000?

3. **The issue of the proper assessment of affordable housing units with a silent second is an emerging property tax issue.** How to treat these promissory notes and deeds of trust has come into question. Based upon the Board’s review of

various silent second agreements, it appears that there is no standard or pro forma silent second. There are many kinds and variations.

4. **Lack of uniformity.** As property tax administrators have struggled with this new assessment question, given the lack of express statutory provisions, and the many variables in the programs, there is inconsistency in tax treatment of these properties across the state.

5. **This bill creates a bright line test for some silent second mortgages.** This bill provides that "purchase price" does not include the amount stated in a trust deed, recorded in conjunction with an affordable housing unit purchased by its occupant, for which that occupant is the trustor and a nonprofit or governmental agency selling authority is the beneficiary, and both have contracted that a periodic payment of principal and interest will **not** be required for at least 20 years.

6. **This bill would provide both tax administrators and agencies that develop affordable housing programs with some certainty as to the property tax treatment of these units.** This would provide guidance for those agencies for which minimizing the annual property taxes for the purchaser of a home is a consideration in the structure of the type of silent second used.

7. **What is the "purchase price" a home sold with a silent second?** The Board has recently reviewed a few sales of inclusionary affordable housing units and in those particular instances has opined that, absent other evidence, the value of the home is its purchase price, which should be estimated by adding the sum of:

   - the down payment,
   - the face amount of the first mortgage and
   - the *present economic value* of the silent second reflecting all the terms and conditions of the agreements such as when, if ever, the silent second will have to be repaid such as at the time of sale or must be assumed by the next buyer.

   Determining the purchase price is the first step. Thereafter, a second step in the process, would be for the assessor to consider the effect upon value, if any, of the enforceable government restrictions.

8. **Discounting silent seconds.** In practical application, the discounted value of the silent second, which may have a delayed payment as long as 30, 45 or an indefinite number of years, may be a negligible sum.

9. **Silent seconds and regulatory agreements generally**. The specific terms and conditions of a particular silent second agreement must be analyzed separately and independently by the assessor to determine its respective property tax implications. As with the specific terms of silent seconds, regulatory agreements for sales of affordable units also vary. Therefore, to determine the effect, if any, of enforceable government restrictions upon value, the specific restrictions and conditions contained in the agreement must be reviewed in the context of the local marketplace for properties subject to the same or similar restrictions.

10. **The approach recommended, within the context of existing law is administratively complex.** As inclusionary affordable housing units become more commonplace, the recommended approach may not be administratively practicable within the mass appraisal system that assessors operate. Given limited resources, the property tax system must be operated in a cost effective manner. Acquiring and

reviewing the silent second agreements and regulatory agreements is time consuming and complex. The assessor must exercise his or her discretion to calculate an appropriate discount period and discount rate to account for the fact, depending on the terms of the particular silent second in question, and in some cases the silent second may never be payable during the entire term of the regulatory agreement as long as the purchaser is not in breach of the agreements. In this case, what term would the assessor use? This bill would provide a bright line test that would address some of the difficult assessment issues that allow for the efficient taxation of these properties.

11. **Should the amendment to Section 401.2 be limited to nonprofit organizations to avoid unintended consequences?** Resale restrictions imposed by a government agency are already required to be considered under existing law. Specifically adding them to the list, but specifying an effective date could raise questions about whether they should have been considered prior to the 2008-09 fiscal year.

12. **Should the purchase price provisions be placed in a separate section of code?** It may be preferable to create a separate section of code outlining the definition of "purchase price" where a silent second is involved rather than incorporating these limited situations within the foundational section that defines fair market value. Additionally, this would also allow the nonprofit organizations provisions to be fully developed such as with language similar to that found in Section 401.2 to specify the types of nonprofit organizations that a property owner may contract with in order to reduce unintended abuse of these benefits.

13. **Should property owners, affordable housing programs, and nonprofit organizations be required to identify properties subject to silent seconds?** This would aid in the efficient administration of these provisions and ensure purchasers receive the benefits of this bill.

14. **Clarification on the principal and interest provisions is needed.** Must both principal <u>and</u> interest be deferred or could only the principal payments be deferred?

COST ESTIMATE

The Board would incur insignificant costs (less than $10,000) to inform and advise county assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

With state and federal funds, the California Housing Financing Agency (CalFHA) and the California Department of Housing and Community Development (HCD) have partnered with more than 250 cities, counties, redevelopment agencies, housing authorities, and non-profit housing organizations to promote affordable housing by providing financial assistance to eligible homebuyers purchasing a home in California. First-time low-, and, in many cases, moderate-income homebuyers may obtain deferred payment loans from these organizations to be used for assistance.

The amount of the deferred payment loan would not be included in "purchase price" under this bill. CalFHA and HCD, through their affordable housing financial assistance

partners, provided about $103 million in assistance in 2005-06.

The annual revenue impact at the basic 1 percent property tax rate can be calculated as follows:

$103 million x 1% = $1.03 million

REVENUE SUMMARY

This bill would reduce property tax revenues at the basic 1 percent property tax rate by about $1.03 million annually.

QUALIFYING REMARKS

Adjustments were not made for deferred payment loans where the periodic payment is required sooner than 20 years, or where the term is less than 20 years, or for assistance provided in grants, instead of loans. However, no adjustments were made for any funding provided in addition to that provided by CalFHA and HCD.

This bill would have no effect in those cases under current practice where the adjustment to purchase price for deferred payment loans is already being made.

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