DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**Enrolled**	Bill No:	**SB 1284**
Tax:	**Property**	Author:	**Lowenthal**
Related Bills:			

BILL SUMMARY

This bill would extend the welfare exemption to "consent decree" low-income rental housing properties, as specified, that are not receiving government financing or income tax credits. This bill would also cancel any outstanding property tax, including interest and penalties, due on these properties.

CURRENT LAW

Unlimited Exemption. Existing law provides that a low-income housing project owned and operated by a qualifying nonprofit organization may be exempt from property tax under the welfare exemption provided various conditions and requirements are met. Generally, a particular low-income housing property may qualify for the welfare exemption provided that:

- **Funding Source.** The nonprofit organization receives low-income housing tax credits or government financing for the property. *§214(g)(1)(A) and §214(g)(1)(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. For purposes of the welfare exemption, the property has low-income housing tax credits or government financing for the period of time that a regulatory agreement or recorded deed restriction restricts the use of all or any portion of the property for rental to lower income households even if the initial government financing has been refinanced or has been paid in full, or the allocation of the low-income housing tax credits has terminated or expired, provided that the government agency that is a party to the regulatory agreement continues to monitor and enforce compliance with the terms of the regulatory agreement. *§214(g)(2)(A)(i) and Property Tax Rule 140*
- **Property Tax Savings.** Savings are used to maintain affordability of, or reduce rents of units occupied by, the lower income households. *§214(g)(2)(B)*
- **Pro Rata Exemption.** If any of the individual units are not rented to low-income persons, then a partial exemption is available equal to the percentage of units serving lower-income households. *§214(g)(1)*
- **Limited Partnerships.** More strict provisions apply when a limited partnership owns the property in which a nonprofit organization is the managing general partner. §214(g)(2)(A)(ii)

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 may be available but it is limited. The exemption is limited to the first $20,000 of property tax – which at a 1% tax rate equates to $2,000,000 of assessed value. The $20,000 exemption cap is not per property. It applies to all properties owned by the nonprofit organization. Provided the exemption cap has not been exceeded, a particular low-income housing property may qualify for the welfare exemption provided that:

- **Funding Source**. Not relevant.
- **Occupancy.** Ninety percent or more of the occupants of the property are lower income residents as specified. *§214(g)(1)(C)*
- **Use Restriction.** The property is subject to a recorded deed restriction, regulatory agreement, or other legal document restricting the property's use to low-income housing. *§214(g)(2)(A)(i) and Property Tax Rule 140*
- **Property Tax Savings.** Savings are used to maintain affordability of, or reduce rents of units occupied by, the lower income households. *§214(g)(2)(B)*
- **Pro Rata Exemption.** The remaining 10% could be rented to persons that are not low-income in which case the exemption would not apply to those units. *§214(g)(1)*
- **Limited Partnerships.** Not allowed. Limited partnerships with a nonprofit organization serving as a managing general partner are not eligible under this provision. *§214(g)(1)(C)*

PROPOSED LAW

This bill would amend Section 214(g)(1) to add new subparagraph (D) to provide that the welfare exemption may be granted to property used exclusively for low-income rental housing that "was previously purchased and owned by the Department of Transportation pursuant to a consent decree requiring housing mitigation measures relating to the construction of a freeway and is now solely owned by an organization that qualifies as an exempt organization under Section 501(c)(3) of the Internal Revenue Code."

Creating a specific category for "consent decree" properties eliminates the requirement that the nonprofit organization receive low-income housing tax credits or government financing on the property. This, in turn, would effectively remove the $20,000 exemption cap for a nonprofit organization that owns consent decree properties in its portfolio of projects.

A "consent decree" low-income housing property may qualify for the welfare exemption provided that:

- **Property History.** It was once owned by the Department of Transportation and was related to the *Keith v. Volpe* consent decree and the Century Freeway Housing Program and its successors.
- **Funding Source**. Not relevant.
- **Use Restriction.** The property is subject to a recorded deed restriction, regulatory agreement, or other legal document. *§214(g)(2)(A)(i) and Property Tax Rule 140*
- **Property Tax Savings.** Funds not used to pay property taxes are used to maintain affordability of, or reduce rents of, units occupied by the lower income households. *§214(g)(2)(B)*

- **Pro Rata Exemption.** If any of the individual units are not rented to low-income persons, then a partial exemption is available equal to the percentage of units serving lower-income households. *§214(g)(1)*
- **Limited Partnerships.** Not allowed. Limited partnerships with a nonprofit organization serving as a managing general partner are not eligible under this provision. The property must be solely owned by the nonprofit organization. *§214(g)(1)(D)(ii)*

Cancels Outstanding Taxes. This bill would also add Section 214.16 to provide that any outstanding tax, interest, or penalty levied or imposed on a "consent decree" low-income property between January 1, 2002 and January 1, 2009 will be cancelled provided that the owner of the property certifies that certain conditions were met at the time the taxes were levied.

BACKGROUND

Prior to January 1, 2000, there were three possible ways to qualify for a property tax exemption on a low-income rental housing project owned by a nonprofit organization via the welfare exemption. These were:

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

Assembly Bill 1559 (Stats. 1999, Ch. 927, Wiggins), operative January 1, 2000, deleted mere "occupancy" by persons with low income as a qualifying condition for the welfare exemption. This meant that to receive a property tax exemption, the low-income housing project must either be financed with government funds or qualify for income tax credits.

The purpose of AB 1559 was to revoke the property tax exemption from properties owned by certain owners of substandard housing. The bill was sponsored by the Los Angeles Housing Project, which had, in the course of investigating various substandard housing projects, discovered that some properties were receiving a property tax exemption under a provision which permits the property to qualify solely on the basis that the rents were low and the residents were low-income households. Presumably, the rationale for limiting the exemption to properties that had been financed with tax-exempt bonds, government loans or grants was that such properties would be subject to some level of government overview, and thus, ensure quality housing for the tenants.

However, the changes made by AB 1559 also resulted in some quality housing projects losing their property tax exempt status because they did not have government financing or tax credits. Consequently, follow up legislation, Assembly Bill 659 (Stats. 2000, Ch. 601, Wiggins), was enacted the next year to reinstate the exemption based on "occupancy" but with three changes:

1. The 20% occupancy threshold was raised to 90%.
2. An exemption cap of $20,000 of "tax" was created.
3. The property must be solely owned by a nonprofit organization -- limited partnerships in which the managing general partner is an eligible nonprofit corporation were specifically excluded.

COMMENTS

1. **Sponsor and Purpose**. This bill is sponsored by the Long Beach Affordable Housing Coalition (LBAHC) to ensure the continued affordability of a portion of the Century Freeway affordable housing portfolio without the need for additional public subsidies. According to the author, LBAHC purchased 12 developments in 2004 that had always been exempt from property taxes. However, due to the fact that LBAHC was able to purchase them without a public subsidy, they do not qualify for a continued exemption under current law. The author states that if LBAHC is required to pay property taxes on this portfolio, the properties will operate in the red, and LBAHC's only option will be to sell the properties or refinance them with new public subsidy funds, in which case, ironically, the properties will qualify for a tax exemption again. This bill allows LBAHC to maintain ownership and the affordability of the units without having to use scarce affordable housing resources and without incurring large transaction costs to regain the exemption.

2. **Amendments.** The **August 8, 2008** amendments expressly provided that any interest or penalty associated with any outstanding taxes will also be cancelled. The **July 1, 2008** amendments expressly provided that the welfare exemption provisions for consent decree properties are not applicable to a property owned by a limited partnership in which a nonprofit organization is the managing partner. The **June 9, 2008** amendments effectively made the exemption retroactive to the date LBAHC purchased the properties by cancelling the outstanding taxes. The LBAHC, which had understood that the properties would continue to remain exempt from property tax under the welfare exemption, have not paid property taxes on these properties, which is currently delinquent.

3. **This bill would exempt the property from the ad valorem property tax, but not other special taxes or assessments.** Property eligible for various exemptions may still receive a property tax bill for other taxes, assessments, fees, or charges, related to the property that are imposed by local governments and collected via the property tax bill as direct levies. Thus, with respect to the provisions to cancel outstanding taxes, any outstanding direct levies on these properties would not be cancelled and payment would be required.

4. **The Consent Decree.** In 1972, a lawsuit, *Keith v. Volpe*, was filed in the United States District Court related to the then planned construction of the Century Freeway (I-105) in Los Angles County which was completed and opened to traffic in 1993. The lawsuit was eventually settled and a consent decree was issued in 1979 that, in part, required affordable housing be created to replace the housing that would need to be demolished to build the freeway. The Department of Transportation (CalTrans) was a party to the consent decree. The "Century Freeway Housing Program" was a state run program under the Department of Housing and Community Development (HCD) until 1995 when it was privatized and its assets transferred to the non-profit Century Housing Corporation.

5. **Consent Decree Properties**. The practical effect of creating a special category for qualified "consent decree" properties makes the funding source irrelevant by effectively eliminating the requirement that the nonprofit organization receive low-income housing tax credits or government financing on the property. All other conditions of the welfare exemption as it relates to low-income rental housing owned and operated by a nonprofit organization would continue to apply.

6. **The exemption cap has only been in place since 2000 and since then few nonprofit organizations that own low-income rental housing have exceeded the cap.** Most projects use government financing or tax credits and thus are not affected by the cap. The purpose of making public financing a key condition of receiving a property tax exemption was to prevent the owners of blighted and deteriorated housing for persons of limited means from receiving the welfare exemption by using a nonprofit organization as a front for the property owners in a limited partnership or by creating a non-profit organization on its own. The purpose of imposing a cap when public financing was not obtained was to ensure that if such owners were still able to qualify for the exemption by creating a nonprofit organization, the extent of the exemption would be limited to no more than $20,000 in tax.

7. **These properties were purchased with conventional financing from a bank.** Proponents note that the ability of a nonprofit organization to use conventional financing is rare. In the case of LBAHC, it was possible because the properties were acquired at a relatively low cost due to the unique circumstances of these properties. They were a product of the consent decree and as such the chain of ownership has been from Caltrans to subsequent nonprofit organizations each committed to providing affordable low-income housing to the public.

COST ESTIMATE

The Board would incur some minor absorbable costs in informing and advising county assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

The changes proposed by this bill would apply directly to property owned by the LBAHC. According to the Los Angeles County Assessor's Office, this bill would directly affect eleven parcels with a total assessed value of $16,772,000. Therefore, the local property tax revenue loss would be $16,772,000 x 1%, or $167,720.

This bill would reduce property tax revenues at the basic 1 percent tax rate by $167,720 annually.

In addition, this bill would result in the one time cancellation of outstanding taxes, including any related interest or penalties, on these properties which have not been collected. The amount of outstanding taxes for the years in question totals $931,572 ($660,164 for the original property assessment and $271,408 in associated penalties and interest related to the delinquency).

Qualifying Remarks. The LBAHC is the only known organization directly affected by this bill. However, its provisions could apply to other qualifying organizations with similar circumstances. At this time, we are not aware of any. Nonetheless, the local revenue impact for those yet unknown organizations would be determined by the number of properties and their assessed values. To date, we do not know of any additional revenue impact.

Analysis prepared by:	Rose Marie Kinnee	(916) 445-6777	8/21/08
Revenue estimate by:	Chris Butler	(916) 445-0840	
Contact:	Margaret S. Shedd	(916) 322-2376	

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