

[Assembly Bill 668](#) (Gomez)

Date: 03/26/15

Program: Property

Sponsor: Habitat for Humanity

Revenue & Taxation Code 402.1

Effective: January 1, 2016

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**Summary:** Requires assessors to consider the value impact on property purchased with a 30-year affordable housing use restriction imposed by a nonprofit organization.

**Purpose:** To allow nonprofit organization imposed restrictions to be considered when setting property tax value for a home purchased at a below market price from a nonprofit organization housing program.

**Fiscal Impact Summary:** Indeterminable.

**Existing Law:** When determining a property's fair market value, property tax law requires the assessor to consider the effect of restrictions on a property's use, such as zoning or environmental constraints, that can be legally enforced.<sup>1</sup> Similarly, when determining land value, the law requires the assessor to consider the effect of *government-imposed* restrictions on land use.<sup>2</sup> Except for certain easements granted to nonprofit organizations to preserve and protect land in its natural state,<sup>3</sup> the law does not allow the assessor to consider the effect of a nonprofit's *organization-imposed* restriction that negatively impacts value.<sup>4</sup>

**Proposed Law:** This bill requires the assessor to consider the effect upon value of a recorded contract with a nonprofit corporation that has as its primary purpose the advancement of affordable housing to the list of enforceable restrictions when valuing land for assessment purposes.<sup>5</sup> To qualify:

- The contract must restrict the land's use for at least 30 years to affordable housing or affordable rent,<sup>6</sup> and
- The nonprofit organization must (1) have as its primary purpose the advancement of affordable housing and (2) provide funding or land for affordable housing.

**In General: Purchase Price.** Existing property tax law requires the assessor to reassess property to its fair market value when it is sold. The law provides that the property's "purchase price" is rebuttably presumed to be its "fair market value."<sup>7</sup> It also provides that "purchase price" means the *total consideration* provided by the purchaser or on the purchaser's behalf, valued in money, whether paid in money or otherwise.

Relevant to this bill, some government and nonprofit organizations' affordable housing programs use silent second mortgages (silent second) to assist low-income home buyers to purchase homes they could not otherwise afford. Typically, the silent second has no, or a deferred, repayment obligation.

When a home is purchased through an affordable housing program, "purchase price" may include more than the nominal sales price when the silent second is considered since "total consideration" is the measure of value.

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<sup>1</sup> Revenue and Taxation Code (RTC) [Section 110\(a\)](#)

<sup>2</sup> RTC Section [402.1\(a\)](#)

<sup>3</sup> RTC Section 402.1(a)(8)

<sup>4</sup> *Carlson v. Assessment Appeals Board No. 1* (1985) 167 Cal.App.3d 1004

<sup>5</sup> For purposes of this analysis, "nonprofit corporation" and "nonprofit organization" have the same meaning.

<sup>6</sup> Health and Safety Code Sections [50052.5](#) and [50053](#) define "affordable housing cost" and "affordable rent," respectively.

<sup>7</sup> RTC Section 110(b)

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**Enforceable Restrictions.** When determining a property's fair market value, RTC §110(a) requires the assessor to consider the effect of restrictions on a property's use, such as zoning or environmental constraints, that can be legally enforced. Similarly, when determining the value of land, RTC §402.1(a) requires the assessor to consider the effect of governmentally-imposed restrictions on land use. Except for certain easements granted to nonprofit organizations to preserve and protect land,<sup>8</sup> the assessor may not consider a nonprofit-organization imposed restriction that negatively impacts its value.<sup>9</sup>

Relevant to this bill, a nonprofit organization typically requires its home buyers to enter into a contract that limits the homeowner's ability to sell, lease, refinance, encumber, or mortgage the home. The contract is recorded and could be legally enforced should the home buyer violate contract terms.

**Determining Fair Market Value – Silent Second Mortgages.** Property tax law does not address how to determine value when the total consideration for a property includes a silent second mortgage. Relevant to this bill, in the case of silent seconds that involve a governmental agency, the BOE advises assessors to estimate the property's purchase price by adding the sum of:

- the down payment,
- the first mortgage face amount, and
- the assessor's estimate of the *present economic value* of the silent second reflecting all the agreement's terms and conditions. Such terms include whether the silent second will have to be repaid, repaid at the time of sale, or assumed by the next buyer.

After determining the purchase price, the assessor is required to consider the effect of any government-imposed restrictions on value. Specifically, the assessor exercises his or her judgment under RTC §402.1 to determine whether the property's value is equal to, or more or less than, the purchase price as a result of the enforceable government restrictions.

**Previous Legislation:** In 2013, [SB 499](#) (Wyland) proposed legislation identical to this bill, which was held in the Senate Appropriations Committee. The bill's sponsor, Habitat for Humanity, surveyed 22 counties in 2007 regarding how affordable homes built, financed, and sold by Habitat for Humanity affiliates were assessed after the sale. The assessment treatment varied. In some areas, the assessed value is based on whether or not the construction involved city or county funds, and in others, the value is based on verbal agreements with the local assessor.

In 2007, [AB 793](#) (Strickland), related to a home purchased under an affordable housing program, would have:

- Excluded from the calculation of purchase price the amount of any "silent second mortgage" if payment is not required for at least 30 years.
- Expressly provided that resale price restrictions on homes purchased through a program operated by a governmental agency must be considered when determining property value.
- Allowed resale price restrictions on homes purchased through a program operated by a nonprofit organization to be treated as an enforceable restriction that must be considered when determining property value.

The Senate Appropriations Committee held that bill.

## Commentary:

1. **This bill allows assessors to consider the effect upon value when nonprofit organizations impose restrictions on land use to affordable housing or affordable rent for at least 30 years.** When determining value for property tax purposes, the assessor may not consider any privately imposed use restrictions that negatively impact values. But, the assessor must consider the effect upon value

<sup>8</sup> RTC 402.1(a)(8)

<sup>9</sup> *Carlson v. Assessment Appeals Board No. 1* (1985) 167 Cal.App.3d 1004

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of any government-imposed restriction or any recorded contract involving a government agency. For nonprofit organization-imposed restrictions, the law provides one exception: an easement entered into between a private land owner and a nonprofit organization for an open space, scenic, or trail easement. This bill adds a second exception for affordable housing use restrictions.

2. **Habitat for Humanity reports that county practices vary.** In 2015, the organization surveyed 15 counties and found that assessment practices varied on homes their affiliates sold. The organization states that in some areas the assessed value is based on whether or not the construction involved city or county funds, and in others, the value is based on verbal agreements with the local assessor.
3. **This bill allows assessors to reduce the property tax value for homes sold in affordable housing programs run by nonprofits.** Without this bill, the assessor may assess the same home at different amounts depending on whether or not the buyer purchased the home from a nonprofit affordable housing program or a city affordable housing program. For example, if the total consideration for a home was determined to be \$100,000, and, in the assessor's judgment, the enforceable restriction negatively impacted land value by \$20,000, then the property tax value would be:
  - \$100,000 if purchased from a nonprofit organization, or
  - \$80,000 if purchased from a city's affordable housing program.
4. **This analysis focuses on homes sold with silent second mortgages because this has been an area causing concern.** Some argue that a home's "purchase price" should not take into account the silent second mortgage. However, because the law requires *total consideration*, whether paid in money or otherwise, to be the assessment basis, it must be considered. A mitigating factor is that the face amount of the silent second, which can be substantial, will be discounted. Once the assessor analyzes the silent second terms, it is possible that no amount, or a negligible sum, is added to the nominal sales price to calculate the statutory "purchase price" definition.
5. **Assessment of affordable housing sold when encumbered with silent second mortgages.** In 2007, BOE published Property Tax Annotation [460.0004](#) and [535.0006](#), to set forth a recommended approach for homes sold by *government* agencies (in this case a city's affordable housing program). The approach has two steps, as explained in comment 6. Without this bill, the approach's second step, which can result in a value reduction, cannot be used for homes sold by affordable housing programs operated by nonprofit organizations. This is because the restriction limiting use of the property is imposed by a nonprofit organization and not by a government agency.
6. **The BOE recommends the following assessment approach.** First, the purchase price of the home must be determined 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 terms would include whether, if at all, the silent second will have to be repaid at the time of sale, or must be assumed by the next buyer.

In practical application, the discount on a silent second, which may have a delayed payment as long as 30, 45, or an indefinite number of years, may be a negligible sum.

The second step in the process, which is the subject of this bill, is for the assessor to consider the effect upon value, if any, of enforceable restrictions on land use required under RTC §402.1.

This approach is administratively complex. The assessor must calculate a discount period and discount rate appropriate for the terms of the silent second mortgage. After determining the purchase price, the assessor is required to consider the effect of the government-imposed restrictions on value. Specifically, the assessor must exercise judgment under the RTC §402.1

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requirement to determine whether the value of the property is equal to, or more or less than, the purchase price due to the use restriction.

7. **Silent Seconds and Recorded Contracts Vary.** When the BOE reviewed this issue, it didn't find a standard or pro forma "silent second." The specific terms and conditions of each silent second must be analyzed separately and independently to determine their respective property tax implications. Some silent seconds may only take effect if the purchaser violates the agreement, and are forgiven if the agreement is fulfilled. Such silent seconds operate primarily as an enforcement mechanism to encourage compliance with the enforceable restrictions. In these cases, the BOE generally does not regard the silent second as part of the purchase price. In other cases, while the silent second may or may not have some enforcement goal, it nevertheless is payable whether or not the purchaser breaches the enforceable government restrictions. In such cases, where the purchaser has unconditionally committed to pay the silent second under its terms and conditions, the assessor must consider the silent second in the determination of the purchase price. Moreover, regulatory agreements related to the resale of affordable housing units also vary. Therefore, to determine whether enforceable restrictions have an effect on value, the assessor must review and analyze the agreement's specific restrictions and conditions, as well as take into consideration the local marketplace for homes subject to similar or identical enforceable restrictions.
8. **It should be noted that the provisions of this bill are not specific to silent seconds.** The bill applies to any recorded contract restricting the land use for affordable housing for at least 30 years. Additionally, the bill is not limited to housing that is sold; it also could apply to rental housing. Thus, this bill treats a nonprofit organization-imposed restriction on affordable housing using a recorded contract the same as if the restriction was imposed by a government agency.

**Administrative Costs:** The BOE's costs to update its documents, website materials, and provide guidance to assessors are absorbable.

**Revenue Impact:** It is not possible to determine the revenue impact of this measure with any degree of certainty due to the number of variables. Each assessor must exercise his or her judgment to determine whether the value of the property at that particular location is equal to, or more or less than, the purchase price as a result of the impact of the enforceable restriction placed by the nonprofit organization.