

[Senate Bill 996](#) (Hill)

Date: 02/10/16

Program: Property Tax

Sponsor: Author

Revenue and Taxation Code Sections 214 and 214.17

Effective January 1, 2017

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Summary: Increases from \$20,000 to \$100,000 the exemption cap applicable to certain low-income rental housing owned by nonprofit organizations under the welfare exemption. Also allows refunds and cancellations of taxes imposed between 01/01/13 and 01/01/17 as a result of the exemption cap.

Purpose: To exempt low-income rental housing owned by nonprofit organizations impacted by the cap.

Fiscal Impact Summary: Annual \$240,000 revenue loss and one-time property tax refund or cancellations of about \$400,000.

Existing Law: Existing law provides that low-income rental housing 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. The law allows an unlimited exemption for rental housing owned by a nonprofit organization if it is financed with government loans or grants, or is receiving other governmental financial assistance or government low-income housing tax credits.¹ However, the law limits the exemption to the first \$20,000 of tax paid statewide² on any rental property owned by the nonprofit that does not receive these loans, grants, or tax credits.

Proposed Law:

Increases Exemption Cap. This bill increases the exemption cap from \$20,000 to \$100,000 of tax for non-government assisted low-income rental housing owned and operated by eligible nonprofit organizations.

Refunds Taxes. This bill authorizes the refund or cancellation of any tax, interest, or penalty between \$20,000 and \$100,000 levied or imposed on these organizations from January 1, 2013 to January 1, 2017, inclusive, provided they were levied or imposed because of the exemption cap.

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

- **Government Assistance.** The nonprofit organization owner receives low-income housing tax credits or government financing on the property.³ *§214(g)(1)(A) and (B)*
- **Use Restriction.** The property is subject to a recorded deed restriction, regulatory agreement, or other legal document⁴ restricting its use for low-income housing purposes at specified rents. *§214(g)(2)(A)(i) and Property Tax Rule 140*

¹ RTC §214(g)(1)(A) and §214(g)(1)(B)

² RTC §214 (g)(1)(C)

³ The exemption continues to apply if the government financing has been refinanced or paid in full or if the allocation of the low-income housing tax credits has terminated or expired, during the period of restricted use and rent levels provided that the government agency that is a party to the regulatory agreement continues to monitor and enforce compliance with the regulatory agreement. Property Tax Rule 140(c).

⁴ An "other legal document" is not permissible if a limited partnership owns the property with a managing general partner that is a nonprofit organization. RTC §214(g)(2)(A)(ii).

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- **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 of units occupied by, the lower income households. *§214(g)(2)(B)*
- **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)*
- **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 an enforceable and verifiable agreement with a public agency or in a recorded deed restriction. An “other legal document” is insufficient. *§214(g)(2)(A)(ii)*

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 \$20,000 of property tax which, at a 1% tax rate, equates to \$2,000,000 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% exemption would be allowed if all the units were occupied by low income households. *§214(g)(1) and §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*
- **Rents Charged.** The rent charged does not exceed that prescribed in Health and Safety Code Section 50053. *§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 for, or reduce rents of units occupied by, the lower income households. *§214(g)(2)(B)*
- **Limited Partnerships: Prohibited.** Limited partnerships with a nonprofit organization serving as a managing general partner are not eligible for any 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% 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 and received low-income housing income tax credits.

More Stringent Qualifications. Beginning January 1, 2000, [Assembly Bill 1559](#) (Stats. 1999, Ch. 927, Wiggins) 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. AB 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

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must be recorded, and 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 AB 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. AB 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, Wiggins) reinstated exemption eligibility based on "occupancy" by low-income households with three changes:

1. **Occupancy Threshold.** The occupancy threshold was raised from 20% to 90%.
2. **Exemption Cap.** An exemption cap was created limiting the exemption to \$20,000 of "tax" statewide.
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 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 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, except for the first \$20,000 in tax. To remedy this issue, [Senate Bill 1284](#) (Stats. 2008, Ch. 524, Lowenthal) modified the law to exclude the cap's application to these properties.⁵ SB 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.

Earlier this year, [Senate Bill 678](#) (Hill) proposed an identical increase but added one more assessment year open to refund or cancellation. The bill was held in Senate Appropriations.

⁵ RTC §214(g)(1)(D).

⁶ RTC §214.16.

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Commentary:

1. **The cap has not increased since its inception over 15 years ago.** Twenty thousand dollars in tax is equivalent to about \$2 million in assessed value at the 1% tax rate. Three nonprofit organizations in San Mateo County currently own low-income rental housing that is partially taxable due to the exemption cap. Increasing the cap to \$100,000 in tax (about \$10 million in assessed value) would allow the low-income housing properties owned by these organizations to be exempt under the welfare exemption.
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 Affordable Housing Coalition-owned properties, the Legislature enacted legislation to exclude the properties from any cap.
4. **Currently, 26 nonprofit organizations receive exemptions on property that count towards the cap, with three organizations exceeding the cap.** The 26 organizations own 76 properties of various types: single-family residences, multifamily residences (e.g., duplex, triplex, fourplex), and apartment complexes. The properties are located in 11 counties, but only the three noted organizations in San Mateo County are known to exceed the cap and are partially taxable.
5. **The BOE monitors the statewide cap.** Nonprofit organizations report their holdings to the local assessor via the annual welfare exemption claim form, and assessors annually transmit the information to the BOE. Only 11 counties report that they have granted exemptions to properties owned by a nonprofit organization, and the tax savings granted must be counted towards the statewide exemption cap of \$20,000 in tax. The other 39 counties report that there are no such properties in their county.

Administrative Costs: The BOE would incur absorbable costs to update claim forms (BOE-267-L), Property Tax Rule 140, and the Assessors' Handbook.

Revenue Impact: Three organizations located in San Mateo County would be immediately impacted by this bill and would reduce property tax revenues by up to \$240,000 annually.

$$\text{Three organizations} \times \$80,000 (\$100,000 - \$20,000) = \$240,000$$

Additionally, there would be a one-time property tax refund or cancellation of approximately \$100,000 per year for four years for a total of \$400,000.

Qualifying Remarks: Other than the three known organizations in San Mateo County, according to information county assessors annually report to the BOE, no other organizations appear to be over the cap at the present time. Five other organizations are near, but have not yet exceeded the cap. This bill could apply to other qualifying organizations under similar circumstances currently not reported to the BOE for statewide monitoring purposes. At this time staff is not aware of any. The revenue impact could grow if other organizations acquire more property subject to the cap or if assessed values over time exceed \$20,000 in tax due to the application of the annual inflation factor of up to 2%. 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.

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