



[AB 1868](#) (Friedman)

Date: January 18, 2024

Program: Property Taxes

Revenue and Taxation Code Section 402.1

Effective: Immediately/Upon Signature

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**Summary:** For purposes of valuing property by the County Assessor, establishes a rebuttable presumption that, at the time of purchase, the value of real property subject to a recorded contract that meets certain requirements is no greater than the sum of the value of the first mortgage and any applicable down payment.

**Fiscal Impact Summary:** Indeterminable.

**Existing Law: Purchase Price:** Under the California Constitution, all property is taxable unless otherwise provided for by the State Constitution or the laws of the United States.<sup>1</sup> Existing law requires that locally assessed real property subject to Proposition 13 is reassessed to its current fair market value upon a change in ownership or new construction.<sup>2</sup> Revenue and Taxation Code section 110 establishes a rebuttable presumption that after a change in ownership the 'fair market value' of the property is the purchase price paid, if the terms were negotiated under specified conditions reflecting an open market transaction. Section 110(b) 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.

**Land Use Restrictions.** When determining a property's fair market value, property tax law requires the Assessor to consider the effect of enforceable restrictions on a property's use.<sup>3</sup> Similarly, when assessing land, the law requires the assessor to consider the effect upon value of any enforceable restrictions to which the use of land may be subjected.<sup>4</sup>

**Homes on land with a 30-year use restriction as owner-occupied housing.** Relevant to this bill, RTC section 402.1(a)(10) currently requires an assessor to consider restrictions imposed by certain nonprofit corporations when determining the value of a home purchased at a below-market price from a nonprofit corporation housing program. Certain contractual conditions must exist in order for an assessor to consider the impact of these restrictions on land value:

- The contract must be with a nonprofit corporation organized pursuant to Internal Revenue Code section 501(c)(3) that has received a welfare exemption under RTC section 214.15 for properties intended to be sold to low-income families who participate in a special no-interest loan program.

<sup>1</sup> Cal. Const. art. XIII §1.

<sup>2</sup> Cal. Const. art. XIII A §2; Rev. & Tax. Code (RTC), § 60 et. seq.

<sup>3</sup> RTC § [110\(a\)](#).

<sup>4</sup> RTC § [402.1\(a\)](#)

*This staff analysis is provided to address various administrative, cost, revenue, and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.*

- The contract must restrict the use of the land for at least 30 years to owner-occupied housing available at affordable housing cost in accordance with Health and Safety Code section 50052.5.
- The contract must include a deed of trust on the property in favor of the nonprofit corporation to ensure compliance with the terms of the program, which has no value unless the owner fails to comply with the covenants and restrictions of the terms of the home sale.
- The local housing authority or an equivalent agency, or, if none exists, the city attorney or county counsel, has made a finding that the long-term deed restrictions in the contract serve a public purpose.
- The contract is recorded and provided to the assessor.

Typically, a nonprofit organization using this type of contractual restriction also uses a silent second mortgage that restricts its homebuyers' ability to sell, lease, refinance, encumber, or mortgage the home. The contract is recorded with these restrictions and could be legally enforced should the homebuyer violate contract terms.

**Proposed Law:** This bill provides that for real property subject to a contract that satisfies all of the above-described requirements, there shall be a rebuttable presumption that the value of the real property at the time of purchase is no greater than the sum of the value of the first mortgage and any applicable down payment.

**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>5</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 for tax purposes.

**Enforceable Restrictions.** When determining a property's fair market value, RTC section 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 section 402.1(a) requires the assessor to consider the effect of governmentally imposed restrictions on land use. Except for four specified exceptions,<sup>6</sup> the assessor may not consider a nonprofit-corporation imposed restriction that negatively impacts its value.

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.

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<sup>5</sup> RTC § 110(b)

<sup>6</sup> RTC § 402.1(a)(8) – (11).

**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<sup>7</sup> 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 on value of any imposed restrictions on use. Specifically, the assessor exercises their judgment under RTC section 402.1 to determine whether the property's value is equal to, more, or less than the purchase price as a result of the enforceable restrictions on the use of the land.

**Previous Legislation:** 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 AB 793.

In 2013, [SB 499](#) (Wyland) proposed legislation 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 assessor.

In 2016, [AB 668](#) (Gomez) became law to require County Assessors to consider a recorded contract with a tax-exempt non-profit corporation when valuing property for property tax assessment purposes. AB 668 attempted to address the issue by directing Assessors to consider the value of restrictions in affordable housing contracts to attempt to allow base value to consideration of the economic standing limited as a condition of buying the home. As each County Assessor values property in their county individually, the measure ensures that all Assessors consider these restrictions when determining value.

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<sup>7</sup> Property Tax [Annotation 535.0006](#).

**Commentary:**

1. **Sponsor - Habitat for Humanity (Habitat).** Habitat states that AB 1868 simply codifies a practice already in place by the majority of County Assessors. It further states that new home sales or new home assessments in California are approximately 100 properties annually. For non-Habitat new affordable home sales, the organization stated that sales are insignificant. This is based on the premise that there are very few affordable home developers compared to the total properties sold and assessed for each county. In conclusion, Habitat states that the tax or revenue impact will be minimal.
2. **This bill confines the value of the real property at the time of purchase to no greater than the sum of the value of the first mortgage and any applicable down payment.** The manner in which the proposal is described and presented does not provide a clear intent regarding what the value or the purchase price should be. Does this create a value standard other than fair market value as required by the California Constitution? BOE Staff assumes that the intent is to exclude the value of silent second mortgages from the purchase price. A better approach might be to provide language as to what should be excluded from the purchase price (for assessed valuation purposes) – in this case, silent second mortgages. The exclusion would be the amount stated in a trust deed that is recorded in conjunction with an affordable housing unit, when the trustor is the occupant and a non-profit or government agency selling authority is the beneficiary.
3. **Silent second mortgages: valuation.** 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.
4. **The BOE's current recommended assessment approach.**

First, the purchase price of the home must be determined by adding the sum of:

- a. the down payment,
- b. the face amount of the first mortgage, and
- c. 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 is for the Assessor to consider the effect upon value, if any, of enforceable restrictions on land use required under RTC section 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 section 402.1 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.

5. **Silent Seconds and Recorded Contracts Vary.** In past years when 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 original 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 remains payable regardless of 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.

**Costs:** The BOE would incur costs of approximately \$3,086 for fiscal year 2024-25, and \$187 for the years thereafter

**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 involved. The estimated 100 homes sold annually by Habitat for Humanity affiliates are sold across the state, where individual county approaches and practices vary. To determine an accurate revenue impact, BOE staff would need to know the fair market value of a property and the value of first mortgage plus the down payment. This would vary from property to property, thus making it difficult to estimate an accurate revenue impact.

Based on the factors above, staff estimates property tax revenue loss from application of a uniform deed restriction/valuation standard that could potentially exceed the high thousands of dollars per home built each year.