California State
Board *of* Equalization

Legislative Bill Analysis

Legislative, Research & Statistics Division

Assembly Bill 2829 (Ting)
Date: February 20, 2020 (Introduced)
Program: Property Taxes
Sponsor: BRIDGE Housing and City of San Diego
Revenue and Taxation Code Section 214
Effective: Upon chaptering

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Summary: For a 20-year period, this bill extends the Welfare Exemption to rental housing owned by nonprofit organizations and occupied by moderate-income households.

Fiscal Impact Summary: The estimated annual revenue loss is $16,000 per newly qualified property.

Existing Law: Existing law provides that low-income rental housing owned and operated by a qualifying nonprofit organization[1] may be exempt from property tax under the Welfare Exemption, provided certain conditions and requirements are met. The law allows an unlimited exemption for rental housing owned by a nonprofit organization if it receives government financing or low-income housing tax credits.[2] However, the law limits the exemption to the first $20 million in assessed value statewide[3] on low-income rental housing property owned by a nonprofit that does not receive government financing or low-income housing tax credits.

Lower Income Household Definition. Property tax law defines lower income households by cross reference to the Health and Safety Code.[4] In general, lower income households are those households with incomes that do not exceed 80 percent of the Area Median Income (AMI) adjusted for family size; income limits are established for all geographic areas of the state. The law also requires the California Department of Housing and Community Development (HCD) to annually publish these income limits based on data by the U.S. Department of Housing and Urban Development (HUD). Existing law[5] allows owners of low-income rental housing properties receiving federal low-income housing tax credits to continue to claim the property tax exemption on units occupied by tenants whose household income increases after move-in to a level above the lower income limit up to the federal law related limit of 140 percent of AMI (over-income tenant), provided that the units remain rent-restricted.

Joint Administration. The BOE and the 58 county assessors jointly administer the Welfare Exemption.[6] The BOE determines whether the organization is eligible to receive the Welfare Exemption; and if eligible, issues an Organizational Clearance Certificate for the claimant to provide with claim forms filed in any of the 58 counties. The county assessor determines whether the use of the property is eligible for the exemption. Applications for exemption of property are filed with the county assessor where the property is located. The assessor is responsible for granting or denying the exemption.

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[1] A qualified organization may also be an eligible limited liability company (LLC) or a limited partnership in which the managing general partner is an eligible nonprofit corporation or eligible LLC.
[2] RTC section 214(g)(1)(A) and section 214(g)(1)(B).
[3] RTC section 214(g)(1)(C).
[4] Health and Safety Code (HSC) section 50079.5. Additionally, the BOE annually reports the household income limits to assessors.
[5] RTC sections 214(g)(2)(A)(iii). See Letter To Assessors No. 2017/055.
[6] RTC section 214(o).

Proposed Law: Until January 1, 2041, this bill extends the Welfare Exemption to qualified rental housing and related facilities owned by certain nonprofit organizations that are occupied by moderate-income households.

Qualified Property. This bill specifies a qualified property is real property that is a rental housing development of three or more units. In addition, the property must meet either of the following:

- Constructed on public land receiving or that has received funding from a local or state agency, including, but not limited to, the California Housing Finance Agency or the California Tax Credit Allocation Committee, or
- Subject to a recorded regulatory agreement with a local agency, securing at least 20 percent of the units in the project as available only to moderate-income households or households with housing incomes below the level of a moderate-income household, as defined, and that sets moderate-income rent at a rate at least 20 percent below the fair market rent for comparable newly constructed units in the county, as defined. *RTC section 214(h)(4)(B)*

In addition, the property owner must certify all of the following:

- **Property Restriction.** There is an agreement with a public agency or a recorded deed restriction that restricts the property's use and that the units designated for use by moderate-income households are continuously available to, or occupied by, moderate-income households. *RTC section 214(h)(2)(A)(i)*
- **Property Tax Savings.** The funds that would have been necessary to pay property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by moderate-income households. *RTC section 214(h)(2)(B)*
- **Rents Charged.** The rents to be charged are set by a regulatory agreement with the local agency that confirms that moderate-income rents are at least 20 percent below the fair market rent for comparable newly constructed units in the county at that time, as determined by a market study prepared in accordance with the market study guidelines established by the California Tax Credit Allocation Committee that are in effect at the time of execution of the agreement or deed restriction. This bill also limits annual rent increases to the percentage increase in the area median income, as determined by HUD, applicable to the county in which the property is located. *RTC sections 214(h)(2)(C) and (D)*

Moderate-Income Household. "Moderate-income households" means households whose incomes are between 80 percent and 120 percent of AMI, as defined by HSC section 50093. *RTC section 214(h)(4)(A)*

This bill also requires that a unit continue to be treated as occupied by a moderate-income household if the occupants were moderate-income households on the lien date in the fiscal year in which their occupancy of the unit commenced and the unit continues to be rent restricted, notwithstanding any increase in the income of the occupants of the unit to 140 percent of AMI, adjusted for family size. However, the unit shall cease to be treated as a moderate-income unit if the income of the occupants of the unit increases above 140 percent of the AMI, adjusted for family size. *RTC section 214(h)(2)(A)(iii)*

Related Facilities. This bill provides that "related facilities" means any manager's unit and any and all common area spaces that are included within the physical boundaries of the rental housing development, including, but not limited to, common area space, walkways, balconies, patios, clubhouse space, meeting rooms, laundry facilities, and parking areas, except any portions of the overall development that are nonexempt commercial space. *RTC section 214(h)(4)(C)*

Termination of Exemption. This bill provides that the exemption ceases when a qualified property is sold. A purchaser will be eligible for the exemption if they independently satisfy the requirements. *RTC section 214(h)(3)*

Effective Date. This bill would go into immediate effect. However, its provisions are operative beginning with lien date January 1, 2021 and ending before January 1, 2041. In addition, this bill provides that a qualified property will continue to receive the exemption on or after the sunset date of these provision, until either of the following occur:

- There is a subsequent change in ownership of the qualified property.
- The qualified property ceases to include any units that are available to and occupied by moderate-income households at rents that are at least 20 percent below the fair market rent for comparable newly constructed units in the county. A unit will continue to be treated as occupied by a moderate-income household, as defined. If the tenancy of a current moderate-income household is terminated, the unit will continue to be treated as a moderate-income unit if it is occupied by another qualified moderate-income household. *RTC section 214(h)(5)*

Report to Legislature. Uncodified language in section 2 of this bill requires the Legislative Analyst, in collaboration with the BOE, to annually review the effectiveness of the exemption for moderate-income households and report its findings to the Legislature. The bill requires the BOE to provide any data requested by the Legislative Analyst and requires the county assessor to provide any data requested by the BOE.

In General: Under section 4(b) of article XIII of the California Constitution, the Legislature has the authority to exempt property (1) used exclusively for religious, hospital, or charitable purposes, and (2) owned or held in trust by nonprofit organizations operating for those purposes. This exemption from property taxation, popularly known as the *Welfare Exemptio*n, was first adopted by voters as a constitutional amendment on November 7, 1944.

When the Legislature enacted RTC section 214 to implement this constitutional provision in 1945, a fourth purpose, *scientifi*c, was added to the three mentioned in the Constitution. Section 214 parallels and expands upon the Constitutional provision by exempting property used exclusively for the stated purposes (religious, hospital, scientific, or charitable), owned by qualifying nonprofit organizations if certain requirements are met. An organization's *primary* purpose must be either religious, hospital, scientific, or charitable. Whether its operations are for one of these purposes is determined by its activities. A qualifying organization's property may be exempted fully or partially from property taxes, depending on how much of the property is used for qualifying purposes and activities.

Section 214 is the primary Welfare Exemption statute in a statutory scheme that consists of more than 20 additional provisions. Over the years, the scope of the Welfare Exemption has been expanded by both legislation and numerous judicial decisions. In general, the following requirements must be met before property is eligible for exemption:

- The property must be irrevocably dedicated to religious, hospital, scientific, or charitable purposes.

- The owner must not be organized or operated for profit and must be qualified as an exempt organization, under a specific federal or state statute, by the Internal Revenue Service or the Franchise Tax Board.
- No part of the net earnings of the owner may inure to the benefit of any private shareholder or individual.
- The property must be used for the actual operation of the exempt activity.

Property with Government Financing or Tax Credits: Unlimited Exemption. Under existing law, when a nonprofit organization owns and operates a low-income rental housing property that receives government financing or low-income housing tax credits, these properties may be exempt from property tax. Generally, a low-income rental housing property[7] may qualify for the Welfare Exemption provided:

- **Government Financing or Tax Credits.** The property owner receives low-income housing tax credits or government financing on the property. *RTC section 214(g)(1)(A) and (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 at specified rents. *RTC section 214(g)(2)(A)(i) and Property Tax Rule 140*
- **Rents Charged.** The rents charged to lower income household occupants do not exceed the rent prescribed by the deed restrictions or regulatory agreement. *RTC sections 214(g)(1)(A) and 214(g)(2)(A)(i)*
- **Property Tax Savings.** The owner certifies that the funds otherwise necessary to pay property taxes are instead used to maintain the affordability of, or reduce rents for, units occupied by the lower income households. *RTC section 214(g)(2)(B)*
- **Limited Partnership: Special Requirements.** In the case of housing owned by a limited partnership in which the managing general partner is an eligible nonprofit corporation or an eligible LLC,[8] use and rent restrictions must be contained in an enforceable and verifiable agreement with a public agency or in a recorded deed restriction. *RTC section 214(g)(2)(A)(ii) and Property Tax Rule 140*

An "other legal document" is a document that restricts the property's use to low-income housing, such that a minimum of 90 percent of the units are made continuously available to or occupied by lower income households. A "recorded restriction" is a deed recorded as an encumbrance against title to the property; the recorded restriction specifies that all or a portion of the property's usage is restricted to rental to lower income households and identifies the number of units restricted to use as low-income housing. While the minimum percentage of units that must be occupied by lower-income households will vary for each project, the exemption only extends to the units serving lower-income households.[9]

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[7] Such property may include single-family residences, multifamily residences (e.g., duplex, triplex, fourplex), and apartment complexes.
[8] See Property Tax Rule 136.
[9] RTC section 214(g)(1); Property Tax Rule 140(a)(3) and (a)(5).

Current law requires property owners to annually file a claim to receive the exemption. The claim must state the number of units serving low-income households, including temporarily vacant units that are held for such households, and requires an attachment that lists qualified households.[10]

Property *without* Government Financing or Tax Credits: Limited Exemption. For nonprofit organizations that own and operate low-income rental housing properties that do *not* receive government financing or tax credits, the exemption is limited to $20 million in assessed value.

Background: Commencing with the 2018-19 fiscal year, Assembly Bill 1193 (Stats. 2017, Ch. 756) extended the low-income housing property tax exemption to a rent-restricted unit occupied by an over-income tenant (up to 140 percent of AMI), who was income-qualified at first occupancy, as long as the property receives federal low-income housing tax credits. Proponents of AB 1193 stated that deed or regulatory restrictions generally prohibited the owner of these properties from evicting tenants for being over-income or increasing the over-income tenants' rent. Additionally, units with over-income tenants continued to qualify as lower income units for tax credit purposes; however, owners would lose their property tax exemption on them, creating a financial hardship.

Previous Legislation – Moderate Income Households. In 2018, Assembly Bill 3152 (Chiu) proposed to extend the Welfare Exemption for rental housing owned by nonprofit organizations that were occupied by moderate-income households in certain counties in the state. AB 3152 was held in the Assembly Appropriations Committee. In 2019, Assembly Bill 1734 (Chiu) proposed to extend the Welfare Exemption to rental housing owned by nonprofit organizations and occupied by moderate-income households for a five-year period. AB 1734 was held in the Assembly Appropriations Committee.

Commentary:

1. **Author's Statement.** California is facing an unprecedented housing crisis that is pushing more and more Californians at all income levels to the brink of displacement. AB 2829 will create more housing affordable to the middle class by providing a property tax abatement for rental units set aside for middle-income earners and made available at below market rate.

2. **Moderate-Income Elderly and Handicapped Families.** Existing law provides an exemption for properties that are used for housing and related facilities for low- and moderate-income elderly or handicapped families.[11] The law allows a partial exemption equal to the percentage that the number of low- and moderate-income elderly and handicapped families represents of the total number of families occupying the property. This bill would extend the Welfare Exemption to units rented by occupants with moderate income who are not elderly or handicapped.

3. **Filing Requirements.** Owners of low-income rental housing property that receive government financing or low-income housing tax credits[12] must annually file a claim[13] to receive the exemption ensuring that certain criteria are met to qualify for exemption, including identification of a list of qualified households. As drafted, Assembly Bill 2829 requires property owners to certify under penalty of perjury as to the property's use restriction and units

[10] RTC section 214(g)(3)(C). Vacant units in elderly and handicapped unit that qualify under moderate income under RTC section 214(g) are not eligible for exemption.
[11] RTC section 214(f).
[12] RTC section 214(g)(2)(A)(i) and Property Tax Rule 140.
[13] RTC section 214(g)(2).

designated for use by moderate-income households, but does not indicate that any other information be furnished as to qualification.[14] The BOE would have to develop new forms or revise existing forms to include moderate-income household reporting.

4. **Loss of Low-Income Housing?** If owners choose to rent to more moderate-income tenants and fewer low-income tenants, this may reduce the number units available for low-income households.

5. **Property Usage Restriction.** Unlike the exemption provisions for low-income rental housing property that receives government financing or low-income housing tax credits, the proposed language for exemption of units for moderate-income households does not allow any other documents to restrict property, other than an agreement with a public agency or recorded deed restriction.

6. **Related Legislation.**

   - For nonprofit organizations that own and operate low-income rental housing properties and do *not* receive government financing or tax credits, Assembly Bill 2063 proposes to extend the $20 million exemption limitation to $250 million and decrease the percentage of occupants that are lower income households required to qualify for exemption from 90 percent to 50 percent.
   - Senate Bill 1371, the Maintenance of the Codes bill, proposes nonsubstantial changes to various parts of section 214.

Costs: The BOE would incur absorbable costs to either create new forms or update existing claim forms (BOE-267-L, BOE-267-L2, BOE-277-L1, BOE-277-LLC, and BOE-277), amend Property Tax Rules 140 and 140.1, and revise Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*.

The BOE already receives quite a few claims for low income housing and anticipates that this bill will create an influx of claims for moderate income housing that cannot be accommodated with existing staff. The BOE estimates that additional staffing of one Associate Auditor Property Appraiser will be needed, resulting in an estimated annual cost of $99,000. The BOE will also incur costs of about $23,600 to make changes to the Welfare and Veterans' Organization Exemptions application if this bill is enacted.

Revenue Impact: **Background, Methodology and Assumptions.** Existing law allows an unlimited exemption for rental housing owned by a nonprofit organization if the property receives government financing or low-income housing tax credits. For nonprofit organizations that own and operate low-income rental housing properties that do *not* receive government financing or tax credits, the exemption is limited to $20 million in assessed value. An exemption is also provided for properties rented to low- and moderate-income elderly or handicapped families. The law allows a partial exemption equal to the percentage that the number of low- and moderate-income elderly and handicapped families that represent the total number of families occupying the property.

It is difficult to determine the number of additional rental properties that will qualify under this bill. After a survey of several counties, staff found over 400 qualified properties with units rented to elderly and/or handicapped occupants. These properties already receive the Welfare Exemption and would, therefore, not be affected by this change. While we do not know the number of properties that would

[14] RTC section 214(h)(2).

be affected by this bill, we can estimate the revenue impact per newly qualified property using the average assessed value obtained in the results of the county survey. This will, at minimum, provide an order of magnitude of the effect of AB 2829.

The average assessed value of a qualifying property is about $1.6 million. Under AB 2829, the estimated annual revenue loss is:

$1.6 million x 1%, or $16,000 per newly qualified property.

Qualifying Remarks. Under existing law, affordable low-income housing nonprofit owners are subject to exemption limits on a property unless the property has government financing or low-income housing tax credits. AB 2829 allows an unlimited exemption if property is rented to moderate-income persons. Additionally, the possibility exists that owners may choose to rent to more moderate-income tenants and fewer low-income tenants, resulting in fewer units available for low-income households.

Currently, in the case of low-income housing property without government financing, 90 percent or more of the property's occupants must be lower income households. This bill provides for qualification with an "other legal document" that restricts the project's usage to use by moderate-income households, but provides no minimum number of units that must be rented to tenants at or below the moderate-income limit.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.