Legislative Enrolled Bill Analysis

Legislative, Research & Statistics Division

Senate Bill 294 (Hill)
Program: Property Taxes
Sponsor: Author
Revenue and Taxation Code Sections 214 and 214.20
Effective: January 1, 2020

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Summary: For a 10-year period, this bill decreases the percentage of occupants that are lower income households required to qualify for exemption from 90 percent to 50 percent. In addition, this bill increases the assessed value exemption limitation from $20,000,000 to $100,000,000 that is applicable to certain low-income rental housing properties owned by nonprofit organizations under the welfare exemption and provides for the cancellation of taxes, interest, or penalties.

Fiscal Impact Summary:

Reduction in low-income household percentage. The estimated revenue loss per new qualifying property on average at the basic 1 percent is $16,000 in tax per newly qualified property.

Increase in exemption limitation. Based on information provided by county assessors, the current revenue impact is zero as no organizations appear to be over the cap at the present time.

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 various 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 $20,000,000 in assessed value statewide[3] on low-income rental housing owned by a nonprofit that does not receive government financing or low-income housing tax credits, and 90 percent or more of the occupants are lower income households. This limitation is not per property but rather applies to all low-income rental housing owned by the nonprofit and located in California that does not receive government financing or low-income housing tax credits

Proposed Law:

Decreases Required Percentage of Qualifying Households. For claims filed for the 2020–21 fiscal year through the 2030–31 fiscal year, this bill reduces from 90 percent to 50 percent the percentage of occupants that are required to be lower income households whose rent does not exceed the rent prescribed by Health and Safety Code (HSC) section 50053. *RTC section 214(g)(1)(C)(i)(I)*

Increases Exemption Limit. This bill increases the assessed value exemption limit to $100,000,000 for non-government assisted low-income rental housing owned and operated by eligible nonprofit organizations. *RTC section 214(g)(1)(C)(ii)*

[1] A qualified organization may also be an eligible limited liability company or a limited partnership in which the managing general partner is an eligible nonprofit corporation or eligible limited liability company.
[2] Revenue and Taxation Code (RTC) section 214(g)(1)(A) and section 214(g)(1)(B).
[3] RTC section 214(g)(1)(C).

Cancellation of Outstanding Taxes. This bill authorizes the cancellation of any outstanding tax, interest, or penalty levied or imposed on these organizations from January 1, 2019 to January 1, 2020, inclusive, to the extent that the amount canceled does not result in a total assessed value exemption amount in excess of $100,000,000. *RTC section 214.20(b)(1)*

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 rental housing property[4] may qualify for the welfare exemption if they meet a number of conditions enumerated in RTC section 214(g).

No Government Assistance: Capped Exemption. When a nonprofit organization owns and operates a low-income rental 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 $20,000,000 of assessed value. A particular low-income rental housing property may qualify for the welfare exemption provided:

- **Occupancy.** 90 percent or more of the property's occupants are lower income households, which are described as those whose rent does not exceed the rent prescribed in HSC section 50053. *RTC sections 214(g)(1) and 214(g)(1)(C)*
- **Use Restriction.** The property is subject to an "other legal document" restricting the property's use to low-income housing. *RTC section 214(g)(2)(A)(i) and Property Tax Rule 140*
- **Rents Charged.** The rent charged does not exceed that prescribed in HSC section 50053. *RTC section 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 of, or reduce rents for, units occupied by the lower income households. *RTC section 214(g)(2)(B)*
- **Limited Partnerships: Prohibited.** Limited partnerships owning low-income rental housing with a nonprofit organization or LLC serving as the managing general partner are not eligible for exemption under this provision. *RTC section 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 percent 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 for and received low-income housing tax credits.

[4] Such property may include single-family residences, multi-family residences (e.g., duplex, triplex, fourplex), and apartment complexes.

More Stringent Qualifications. Beginning January 1, 2000, Assembly Bill 1559 (Stats. 1999, Ch. 927) 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 tax credits on the property. Assembly Bill 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 must be recorded, or 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 Assembly Bill 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. Assembly Bill 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) reinstated exemption eligibility based on "occupancy" by low-income households with three changes:

1. **Occupancy Threshold.** The occupancy threshold was raised from 20 percent to 90 percent.

2. **Exemption Cap.** An exemption cap was created limiting the exemption amount applied to a taxpayer to $20,000 of tax.[5]

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 have government financing or low-income housing 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 of tax statewide cap when public financing does not apply was to limit the available exemption to owners that might misuse the exemption by creating a nonprofit organization.

Consent Decree Property Exception. In 2004, the Long Beach Affordable Housing Coalition (LBAHC) unknowingly became impacted by the $20,000 of tax 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

[5] $20,000 of tax is equivalent to $2,000,000 in assessed value, using a 1 percent tax rate.

had always been exempt from property taxes. Because there were no public subsidies, the properties became taxable, but the maximum exemption could not exceed $20,000 of tax. To remedy this issue, Senate Bill 1284 (Stats. 2008, Ch. 524) modified the law to exclude the cap's application to these properties. Senate Bill 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.[7]

In 2016, Senate Bill 996 (Stats. 2016, ch. 836) increased the exemption cap from $20,000 of tax to $10,000,000 in assessed value statewide for lien dates occurring on and after January 1, 2017 and provided for the cancellation of any outstanding ad valorem tax in excess of the $10,000,000 cap and any related penalties or interest imposed between January 1, 2013 and January 1, 2017.

In 2018, Senate Bill 1115 (Stats. 2018, ch. 694) increased the exemption cap from $10,000,000 to $20,000,000 in assessed value statewide for lien dates occurring on and after January 1, 2019 and provided for the cancellation of any outstanding ad valorem tax in excess of the $20,000,000 cap and any related penalties or interest imposed between January 1, 2017 and January 1, 2019.

Commentary:

1. **Author's Statement.** Four out of the five least affordable rental markets nationwide continue to be in California. Nonprofits that do not receive any tax credits from the state or federal government, and that provide non-publicly financed affordable housing to low-income families, must pay property tax on affordable housing property with an assessed value of more than $20,000,000. SB 294 aids nonprofits and religious organizations by raising the cap for the property tax exemption on their affordable housing properties. Additionally, the bill lowers the percentage of low-income residents required in a given property from 90 percent to 50 percent in order to be eligible for tax relief on a pro rata basis.

2. **Summary of Amendments.** The **July 1, 2019** amendment (1) removes ambiguous language regarding prorating the exemption, and (2) reduces the proposed increase in the exemption limitation from $250,000,000 to $100,000,000.

3. **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 rental housing where the property did not receive government financing or low-income housing tax credits and, therefore, did not have oversight. 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.

4. **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.

[6] RTC section 214(g)(1)(D).
[7] RTC section 214.16.

5. **The BOE requests and collects information on the statewide cap.** Nonprofit organizations report their holdings to the local assessor via the annual welfare exemption claim form, and the BOE requests that assessors annually provide the information to the BOE. While three organizations exceeded the prior $10,000,000 cap, those properties are now exempt under the $20,000,000 cap. The BOE is not aware of any organizations exceeding the $20,000,000 cap.

Costs: The BOE would incur absorbable costs to update claim forms (BOE-267-L and BOE-267-L2), Property Tax Rule 140, and Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*.

Revenue Impact: SB 294 increases the number of properties qualifying for exemption for fiscal years 2020-21 through 2030-31. It reduces, from 90 percent to 50 percent, the ratio of lower income households required to occupy a property in order to receive the exemption. In each case, the exemption amount is uniquely prorated based on the percentage of lower income households occupying the property. Based on available data, we do not know how many additional properties might qualify. Of those newly qualified properties, we cannot estimate which ones might receive a full exemption and which will not, as each property receives a unique exemption amount.

Reducing the Low-income Household Provision. We can attempt to estimate the revenue impact per newly qualifying property by using county assessor data collected by the Board of Equalization's Property Tax Department. Staff estimates the average assessed value of property used exclusively for rental housing and related facilities, as specified, is $1,600,000. Estimated revenue loss per property on average at the basic 1 percent property tax rate can then be computed as:

$1,600,000 x 1% = $16,000 per newly qualified property on average

Increasing the Exemption Cap. While three organizations exceeded the $10,000,000 cap, all properties became exempt when the cap was increased to $20,000,000 for 2019-20. Increasing the exemption cap from $20,000,000 to $100,000,000 will not have a revenue impact as currently there are no organizations exceeding the cap.

Qualifying Remarks. The revenue impact could grow as organizations acquire more property subject to the cap or if assessed values over time exceed $100,000,000 due to the application of the annual inflation factor of up to 2 percent.

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.