

[Assembly Bill 3050](#) (Quirk-Silva)

Date: May 4, 2020 (amended)

Program: Property Taxes

Sponsor: Southern California Association of Nonprofit Housing
Revenue and Taxation Code Section 214.2

Effective: Upon chaptering

Mark Durham (Chief) 916.274.3423

Glenna Schultz (Analyst) 916.274.3362

Ronil Dwarka (Revenue) 916.274.3391

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Summary: For purposes of the Welfare Exemption, for a five-year period, expands the phrase "facilities in the course of construction" to include a property that is acquired or a site that is controlled by a nonprofit organization with the intent of using that property for a low-income housing project eligible for partial exemption.

Fiscal Impact Summary: The estimated annual revenue loss at the basic 1 percent tax rate is \$7,000 per qualifying property.

Existing Law: Existing law provides that low-income rental housing owned and operated by a qualifying nonprofit organization¹ 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 statewide³ on low-income rental housing property owned by a nonprofit that does not receive government financing or low-income housing tax credits.

Vacant Land. Existing law⁴ provides a limited extension of the Welfare Exemption to vacant land. Under these provisions, the charitable purpose of the organization is acquiring and holding real property for the future construction/rehabilitation of single or multifamily residences for sale at cost to low-income families.

Under Construction. The California Constitution was amended to specifically provide that three exemptions can be granted to "buildings under construction," land required for their convenient use, and equipment in them, if the intended use would qualify the property for the exemption.⁵ Those exemptions are:

- **College Exemption.** Buildings, land, equipment, and securities used exclusively for educational purposes by a nonprofit institution of higher education. *Section 3(e) of article XIII*
- **Church Exemption.** Buildings, land on which they are situated, and equipment used exclusively for religious worship. *Section 3(f) of article XIII*
- **Welfare Exemption.** Property used exclusively for religious, hospital, or charitable purposes and owned or held in trust by corporations or other entities (1) that are organized and operating for

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 Revenue and Taxation Code (RTC) section [214\(g\)\(1\)\(A\)](#), section [214\(g\)\(1\)\(B\)](#), and section [\(g\)\(1\)\(D\)](#).

³ RTC section [214\(g\)\(1\)\(C\)](#).

⁴ RTC section [214.15](#).

⁵ California Constitution article XIII, section [5](#).

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.

those purposes, (2) that are nonprofit, and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual. *Section 4(b) of article XIII*

With respect to the Welfare Exemption, the provisions of article XIII, section 5 are statutorily embodied and expanded upon in RTC sections [214.1](#) and 214.2. RTC section 214.1 provides that the Welfare Exemption is available to **facilities in the course of construction**, together with the land on which the facilities are located as may be required for their convenient use and occupation.

RTC section 214.2 specifies that "facilities in the course of construction" require activity connected with the construction or rehabilitation of a new or existing building or improvement which **results in definite onsite physical activity that results in changes visible to any person inspecting the site** where the building or improvement is located. A court has held that the phrase, "in the course of construction," as used in RTC section 214.1, includes the digging of trenches for the foundation of a building prior to the lien date.⁶ As long as construction has commenced, the property will be considered "under construction" unless the construction is abandoned. However, if there is a delay in construction due to reasonable causes and circumstances beyond the property owner's control and that occurs notwithstanding the exercise of ordinary care and the absence of willful neglect, then the construction will not be considered "abandoned."

RTC section 214.2 also provides that "facilities in the course of construction" will include the demolition or razing of a building with the intent to replace the building with a facility to be used exclusively for religious, hospital, or charitable purposes.

Additionally, with respect to newly acquired property, RTC section [75.24](#) provides that a nonprofit organization has 180 days after the date of change in ownership to qualify for an exemption. This effectively provides a 180-day grace period before construction must commence.

Proposed Law: For a five-year period beginning with lien date January 1, 2021, this bill amends RTC section 214.2 to expand the phrase "facilities in the course of construction" to include property that is acquired or a site that is controlled by a nonprofit organization that qualifies for the Welfare Exemption and intends to use that property for a low-income housing project eligible for a partial exemption.

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 Exemption*, 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, *scientific*, was added to the three mentioned in the Constitution. RTC 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.

⁶ *National Charity League v. County of Los Angeles* (1958) 164 Cal.App.2d 241.

RTC 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.

The Board of Equalization (BOE) and the 58 county assessors jointly administer the Welfare Exemption. The BOE determines whether the organization is organized and operated for qualifying purposes and 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.

Vacant Land. [AB 1559](#) (Stats. 1999, ch. 927) added RTC section 214.15 to provide a limited extension of the Welfare Exemption to vacant land. In this case, the charitable purpose of the organization is acquiring and holding real property for the future construction/rehabilitation of single or multifamily residences for sale at cost to low-income families. RTC section 214.15 provides:

(a) Property is within the exemption provided by Sections 4 and 5 of Article XIII of the California Constitution if that property is owned and operated by a nonprofit corporation, otherwise qualifying for exemption under Section 214, that is organized and operated for the specific and primary purpose of building and rehabilitating single or multifamily residences for sale at cost to low-income families, with financing in the form of a zero interest rate loan and without regard to religion, race, national origin, or the sex of the head of household.

(b) (1) In the case of property not previously designated as open space, the exemption specified by subdivision (a) may not be denied to a property on the basis that the property does not currently include a single or multifamily residence as described in that subdivision, or a single or multifamily residence as so described that is in the course of construction.

* * *

(2) With regard to paragraph (1), the Legislature finds and declares all of the following:

(A) The **exempt activities** of a nonprofit corporation as described in subdivision (a) **qualitatively differ** from the exempt activities of other nonprofit entities that provide housing in that the exempt purpose of a nonprofit corporation as described in

subdivision (a) is **not to own and operate** a housing project on an ongoing basis, but is instead to make housing, and the land reasonably necessary for the use of that housing, available **for prompt sale** to low-income residents.

(B) **In light of this distinction, the holding of real property** by a nonprofit corporation as described in subdivision (a), for the future construction on that property of a single or multifamily residence as described in that same subdivision, **is central to that corporation's exempt purposes and activities.**

(C) In light of the factors set forth in subparagraphs (A) and (B), **the holding of real property** by a nonprofit corporation described in subdivision (a), for the future construction on that property of a single or multifamily residence as described in that same subdivision, **constitutes the exclusive use of that property** for a charitable purpose within the meaning of subdivision (b) of Section 4 of Article XIII of the California Constitution.

Background: Prior Legislation. [AB 1788](#) (Morrell, 2012) proposed allowing the Welfare Exemption to be granted on a retroactive basis for the period of time between the submission of an application for a building permit and the commencement of actual onsite physical construction if construction starts within 12 months of the building permit being approved by expanding the definition of the phrase "facilities in the course of construction."

[AB 722](#) (Emerson, 2005) proposed allowing the Welfare Exemption to be granted on a retroactive basis for the period of time between the submission of an application for a building permit and the commencement of actual onsite physical construction by expanding the definition of the phrase "facilities in the course of construction." Under this bill, the exemption would be granted only after actual construction commenced, but retroactively to the date of the building application. In its introductory form, the exemption would have been granted as soon as a building permit application was submitted.

[AB 783](#) (Maddox and Mountjoy, 2003) would have provided that the phrase "course of construction" includes the period subsequent to an owner filing a completed application for a building permit with an appropriate local agency for purposes of qualifying for the Welfare Exemption. As introduced, the bill would have expanded the phrase in the "course of construction" to include activities such as "seeking" permits, environmental studies, government entitlements and approvals, financing, and contractors.

[AB 2662](#) (Bogh, 2002) would have amended RTC section 214.1 to specify that property already in the course of construction will not be considered "abandoned," and therefore no longer eligible for exemption, if due to financing delays or delays in governmental approval. These provisions were removed from this bill by the May 17, 2002 amendments.

Commentary:

1. **Author's Comment.** Affordable housing projects should be eligible for the Welfare Exemption starting when they acquire the land for their project. This allows affordable housing projects to benefit from the Welfare Exemption from the start of the development process. This bill will make building affordable housing much more financially feasible and incentivize more affordable housing construction. Land is very expensive, and it is even more expensive if the Welfare Exemption is not yet in place. High carrying costs are made even higher due to property

taxes, which puts an additional burden on nonprofit projects when they already have high costs due to labor, materials, and construction.

2. **Generally, property is not eligible to receive the Welfare Exemption unless it is *used* by a nonprofit entity for exempt purposes and activities.** Vacant or unused property held for future construction does not qualify for the Welfare Exemption since it is not being “used” for an exempt purpose and activity. For example, a nonprofit organization may have enough funds to acquire land, but not enough to commence their construction project. Consequently, these properties are subject to property tax.
3. **The law allows the Welfare Exemption to commence as soon as the property is “under construction.”** A relatively minor preparatory activity that results in physical changes visible to any person inspecting the site, such as grading vacant land or tearing down a building, can be undertaken for the purpose of complying with the requirement that the property be in the course of construction for purposes of qualifying for the Welfare Exemption provided that such construction continues to proceed and is not abandoned.
4. **In addition, for new purchases, the law provides a 180-day window period before construction must commence.** With respect to a newly acquired property, an organization has up to 180 days from the date of purchase to begin demolition or construction on property designated for a future exempt use and qualify for a full exemption on a supplemental assessment pursuant to RTC section 75.24.
5. **Certain vacant property is eligible for the Welfare Exemption.** Specifically, RTC section 214.15 provides that vacant land acquired or donated to certain organizations, like Habitat for Humanity, for the future construction of a single or multifamily residence that will be sold at cost with zero interest loans constitutes the exclusive use of that property for a charitable purpose within the meaning of the California Constitution. However, in this situation, the charitable activity of the organization is the acquisition of vacant land to construct homes that will subsequently become subject to property taxation upon acquisition by low-income families. In contrast, most entities eligible for the Welfare Exemption are long-term owners of properties and the exemption from property taxation for their properties will likely apply indefinitely.
6. **Control of Site – Potential Constitutional Issue.** This bill applies the Welfare Exemption to the acquisition of property or control of a site. “Control of a site” is not a term used for property tax purposes and is undefined in this bill. We note that for income tax credit purposes, RTC section 17058 provides for “control of a site” by a housing sponsor that may be an S Corporation. However, an S corporation does not meet the qualifications of RTC section 214 and is not eligible for an Organizational Clearance Certificate.⁷

Under existing law, the Welfare Exemption applies to low-income rental housing owned by a nonprofit organization, other than a limited partnership with a qualifying managing general partner, that does not receive government financing or low-income housing tax credits, and 90 percent or more of the occupants are lower income households. Under these circumstances, when a nonprofit organization buys an existing building (no government financing) that does not

⁷ AB 1453 (2019, Chiu) would have extended the Welfare Exemption for property used exclusively for low-income rental housing to property owned by a limited partnership and leased to a limited partnership in which the managing general partner is an S corporation that is wholly owned by an exempt organization. This bill died when it did not make it out of its house of origin by January 31, 2020.

yet have the 90 percent required units available for low income tenants, but "intends" to meet that 90 percent as non-qualifying tenants move out, will the provisions of this bill apply? For instance, a nonprofit organization buys existing property with intention to eventually turn into all low income units but only 40 percent current tenants qualify. Does this statute trump the 90 percent requirement and they would be allowed 40 percent exemption because they eventually "intend" to use the other 50 percent + as a low income rental housing property?

If a contractor is constructing a building, would the contractor be considered "in control" of the site so to render the property ineligible for the Welfare Exemption because the contractor would not be a nonprofit organization? The author may want to consider clarifying what this term means.

The Welfare Exemption is authorized by the California Constitution, article XIII, section 4(b), which requires property to be owned or held in trust by a qualifying entity. To the extent "control of a site" does not require the nonprofit organization to own the property, a constitutional issue is raised.

7. **What if the intent never actually manifests in an exempt use?** This bill does not contain a time limit in which property must be put to an exempt use. For property owned by a community land trust (CLT), RTC section 214.18 provides that a CLT may claim the Welfare Exemption if all of the following conditions are met:

- The property is being or will be developed or rehabilitated as an owner-occupied single-family dwelling, owner-occupied unit in a multifamily dwelling, a member-occupied unit in a limited equity housing cooperative, or a rental housing development;
- Improvements are or will be available for use and ownership by qualified persons; and
- A deed restriction or other instrument serving as an enforceable restriction on the sale or resale value of owner-occupied units or the affordability of rental units is recorded.

Under these provisions, a CLT has five years to at least be in the process of developing or rehabilitating property. If the property was not developed or rehabilitated or in the process of being developed or rehabilitated by the end of the five-year exemption period, the CLT will be liable for property tax for the years for which the property was exempt.

Costs: The BOE would incur absorbable costs in informing and advising county assessors, the public, and staff of the change in law and addressing ongoing implementation questions and issues related to this new provision.

Revenue Impact: The revenue effect of expanding the definition of *facilities in the course of construction* to include *acquisition of property or control of a site by an organization* with the intent to use that property for a low-income housing project is difficult to estimate with any degree of certainty. This is due to the lack of predictability of the factors involved, specifically, forecasting which properties would be eligible for this treatment (acquiring property or control of a site between January 1, 2021 to January 1, 2026), the value of the properties, and the length of time between the date of acquiring property or control of a site and the start of onsite construction.

In 2019, BOE staff estimated that the average assessed value of a low-income housing property statewide was \$1.6 million. Statewide land assessed value is estimated to be 42 percent of overall assessments. Hence, staff estimates that assessed value of property considered under AB 3050 is \$0.7 million (42% X \$1.6 million). This amounts to an estimated annual revenue loss at the basic 1 percent tax rate of \$7,000 per qualifying property.

Revenue Summary. Expanding the definition of *facilities in the course of construction* to include *acquisition of property or control of a site by an organization* with the intent to use that property for a low-income housing project would reduce property tax revenues at the basic 1 percent property tax rate by an estimated \$7,000 per additional qualifying low-income property annually.