California State
Board of Equalization

Legislative Bill Analysis

Assembly Bill 84 (Ward)
Date: March 7, 2023 (Amended)
Program: Property Taxes
Revenue and Taxation Code section 214 and 259.15
Effective: July 1, 2024

Lisa Renati (Chief Deputy Director) 916-274.3563
Laurel Williams (Analyst) 916-274-3565
Ronil Dwarka (Revenue) 916-274-3391
Analysis Date: April 12, 2023

Summary: This bill amends Revenue and Taxation Code (RTC) section 214 to expand the welfare exemption to property acquired, rehabilitated, developed, or operated, or any combination of these factors, with financing from qualified 501(c)(3) bonds, as defined. This bill also expands the certification requirement as it relates to unoccupied land and improvement and properties under construction. This bill requires the Assessor conditionally grant the exemption within 30 days of application. Lastly, this bill changes the eligibility requirement for over-income tenant of 140 percent Area Median Income (AMI) for the welfare exemption.

Fiscal Impact Summary: This bill expands the welfare exemption in several ways. The exact impact is difficult to determine, however, each of the expansions will result in a revenue loss to schools and local governments. The estimated loss for the expansion for an exemption to allow properties to qualify when acquired versus under construction is $11 million. The sections of the bill enabling properties with tenants up to 140 percent of AMI and properties with financing from 501(c)(3) bonds is an indeterminable loss.

Existing Law: Under the California Constitution, all property is taxable unless otherwise provided for by the State Constitution or the laws of the United States.[1] The Legislature may exempt from property taxation in whole or in part property used exclusively for religious, hospital, scientific, or charitable purposes and owned or held in trust by nonprofit corporations or other entities if specific criteria are met.[2]

This exemption is known as the "welfare exemption" and is implemented according to RTC[3] section 214.

Section 214 generally exempts from taxation, subject to certain conditions and qualifications, property (1) owned by nonprofit organizations organized and operated for charitable purposes and (2) used exclusively for those purposes.

Section 214(g)(1) generally provides that property used exclusively for low-income rental housing owned and operated by nonprofit organizations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation, shall be deemed within the exemption authorized by section 214.

The State Board of Equalization (BOE) and 58 County Assessors jointly administer the welfare exemption. The BOE is responsible for determining whether an organization is organized and operating for exempt purposes, which qualifies the organization for either an Organizational Clearance Certificate (OCC) or a Supplemental Clearance Certificate (SCC). The County Assessor is responsible for determining whether using a qualifying organization's property is eligible for the welfare exemption. The County Assessor shall

[1] California Constitution, article XIII, section 1.
[2] California Constitution, article XIII, section 4(b).
[3] All statutory references are to the Revenue and Taxation Code, unless otherwise provided.

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.

not grant the welfare exemption for an organization's property unless the organization holds either a valid OCC or SCC issued by the BOE. However, the County Assessor may deny a welfare exemption claim based on non-qualifying use of the property, notwithstanding that the BOE has issued the organization an OCC or SCC. The BOE tracks eligible nonprofit organizations and limited liability companies that hold valid OCCs and SCCs and monitors those organizations for continued eligibility.

Once the BOE issues an OCC or an SCC to a qualified organization, the organization must file a BOE-267 claim for the welfare exemption with the County Assessor where the property is located. The County Assessor is responsible for evaluating the application, determining whether the use of the property meets the statutory requirements for receiving the welfare exemption, and ultimately granting or denying the exemption to claimants.

Under existing property tax law, properties that meet these requirements and are used exclusively for rental housing, including related facilities, are entitled to a partial exemption, equal to that percentage of the value of the property that is equal to the percentage that the number of units serving lower income households represents of the total number of residential units, in any year that specific criteria apply. These criteria include that the property be subject to a legal restriction that provides that units designated for use by lower-income households are continuously available to or occupied by lower-income households at rents not exceeding specified limits.[4]

Proposed Law: **Expands Welfare Exemption.** This bill expands the welfare exemption for low-income rental housing in three ways:

1. Allows vacant land to qualify for the welfare exemption and creates a requirement to certify that property tax savings be used appropriately in the case of unoccupied land and improvements thereto, including buildings under construction.

2. Allows an over-income tenant of 140 percent AMI to be treated as occupied by a lower-income household if the owner of the property is subject to an enforceable and verifiable agreement with a public agency, a recorded deed restriction, or other legal document consistent with the requirements of RTC section 214(g)(2)(A)(i). While the tenant must initially qualify for the housing with an AMI of 80 percent or below, the bill allows the tenant to stay indefinitely if they do not exceed 140 percent.

3. Makes properties financed with qualified 501(c)(3) bonds eligible for the exemption.

Considered Eligible upon Application The bill allows the property to be presumed eligible for the exemption by the County Assessor's office within 30 days of application. The Assessor is required to rebut the presumption of eligibility within 30 days of the application if they believe a property is ineligible for the exemption.

140 Percent AMI. This bill modifies a sunset clause (RTC section 214(g)(2)(A)(iii)(II)) for an over-income tenant of 140 percent AMI residing in property that receives a low-income housing tax credit (LIHTC) from 2027-28 fiscal year to 2023-24 fiscal year, and replaces it with the new, expanded qualification described in #2 above, which begins in the 2023-24 fiscal year and does not have a sunset date.

[4] Section 214, subdivision (g)(1).

501(c)(3) Bonds. This bill defines these bonds as that term is defined in Section 145 of Title 26 of the United States Code. Qualified 501(c)(3) bonds are tax-exempt qualified private activity bonds issued by a state or local government, the proceeds of which are used by a 501(c)(3) organization to continue their mission and exempt purpose.

Form Requirement. The bill would require a claim for a welfare exemption pursuant to this requirement to be accompanied by an affidavit containing specified information regarding the units for which the exemption is claimed and would provide that the affidavit is not subject to public disclosure.

Effective Immediately. If signed by the Governor, the exemption will go into effect immediately.

In General: Under section 4(b) of article XIII of the California Constitution, the Legislature is authorized to exempt from taxation, in whole or in part:

> 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 operated for those purposes, (2) that are nonprofit, and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual.

In exercising the above constitutional authorization, the Legislature enacted section 214, reiterating the constitutional authorization and outlining numerous conditions and qualifications for receiving the exemption, and adding scientific as the fourth qualifying purpose. Section 214 provides that property used exclusively for charitable purposes owned and operated by entities organized and operated for charitable purposes is exempt from taxation if the entities are not owned and operated for profit and the property is used for the actual operation of the exempt activity.

Charitable Purposes. 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. The State Supreme Court has broadly construed the charitable purpose aspect of the welfare exemption to include a wide range of activities which benefit the general public.[5] The term "charitable" is not confined to the relief of poverty, but includes all kinds of humanitarian activities, rendered at cost or less, the object of which is the care of the physical and mental well-being of the recipients.

Exclusive Use. The Revenue and Taxation Code does not specifically define the term *used exclusively*; however, the courts have done so in a series of decisions. The California Supreme Court has stated that the phrase "exclusively used" may not be given a literal interpretation to mean that the property exempted must be used solely for the purposes stated to the total exclusion of any other use. The Supreme Court held that *used exclusively* for exempt purposes includes any property which is used exclusively for any activity which is incidental to and reasonably necessary for the accomplishment of the exempt purpose.[6] Courts have applied this precedent to mean that a qualified organization's primary use of its property must be for exempt purposes, and any other uses of property must be related to and reasonably necessary for the accomplishment of the exempt purpose.[7]

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[5] *Stockton Civic Theatre v. Board of Supervisors* (1967) 66 Cal.2d. 13.

[6] *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736.

[7] *Honeywell Information Systems, Inc*. v. *County of Sonoma* (1974) 44 Cal.App.3d 23; *YMCA* v. *County of Los Angeles* (1950) 35 Cal.2d 760; *St. Germain Foundation* v. *County of Siskiyou* (1963) 212 Cal.App.2d 911; *Greek Theatre Association* v. *County of Los Angeles* (1978) 76 Cal.App.3d 768.

Housing Welfare Exemption. Property tax administrators have historically taken a narrow view of the exemption. They have viewed most housing as non-exempt because the property is used primarily for private residential purposes rather than exempt purposes and is not used exclusively for exempt purposes as required by section 214.[8]

However, the courts have taken a broader view, consistent with the Supreme Court's directive that statutory and constitutional provisions granting exemptions are to be construed strictly but reasonably.[9]

In 1999, the BOE adopted Property Tax Rule 137, *Application of the Welfare Exemption to Property Used For Housing*, effective December 31, 1999. Rule 137 clarifies that the welfare exemption applies to housing and related facilities owned and operated by qualified nonprofit organizations and establishes a single uniform statewide standard for determining qualification for the welfare exemption as it applies to such properties.[10]

In addition, Property Tax Rule 140 further specifies requirements for the welfare exemption for low-income housing properties.

Background:

Currently, many developers approved for exemptions must pay the taxes up front as their project is evaluated for eligibility by both the BOE and Assessor. The approval process can be lengthy, causing the tax payment funds to be tied up and unavailable for a substantial amount of time, while potentially incurring interest charges if the developer has a loan for the project.

Regarding the 140 percent AMI, commencing with fiscal year 2018-19, 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 (LIHTC). 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 financial hardship.

Assembly Bill 1193 is currently set to sunset in fiscal year 2027-2028.

Commentary:

1. **Escape Assessments.** This bill adds an unprecedented presumption that property is eligible for exemption and requires Assessors to conditionally grant the exemption within 30 days of application. However, it is most likely not feasible for the Assessor to determine if the property qualifies for the exemption within 30 days and subsequently units that are found to be ineligible for exemption would require Assessors to make escape assessments. Sections 75.11 and 532 provide a four-year statute of limitations for supplemental and escape assessments, respectively. For projects under construction or rehabilitation, if the construction takes more than four years and ultimately is not eligible for exemption or the Assessor does not receive tenant household

[8] Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*, p. 62.
[9] *Ibid*.
[10] *Id.* at p. 65.

income data timely, the county may lose tax dollars because the county cannot issue supplemental or escape assessments timely.

2. **140% AMI.** This bill allows occupants initially qualifying as low income to have an income of 140% of AMI and deletes the sunset date. This creates a situation where many units intended for low income are occupied by moderate-income households. If their income were to rise beyond the 140 percent of AMI, it would cause the unit to be ineligible for the exemption, and tracking this could be problematic.

3. **Exemption Before Construction.** Having an exemption before construction creates difficulties in establishing base year value. This may cause a delay in assessing property that is ultimately deemed ineligible for exemption. Due to the four-year statute of limitations in issuing supplemental and escape assessments, the county may lose out on tax dollars.

Costs: The BOE would incur base year costs of approximately $29,053 and on-going costs of approximately $5,530 per year to update claim forms; Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*; and Publication 149, *Property Tax Welfare Exemption*.

Revenue Impact: In a 2019 study by the UC Berkeley Terner Center for Housing Innovation titled *Making it Pencil: The Math Behind Housing Development*, new building construction costs were discussed. An estimated 10% of the overall building project costs were related to land cost or acquisition. According to the California Tax Credit Allocation Committee, an estimated 270 projects were financed through the 9% and 4% tax credits in 2021. Staff analysis concluded that the average cost of a project was $39 million. Using the 10% ratio, the average land cost for affordable housing projects is estimated to be $3.9 million (10% × $39 million). Factoring in the 270 projects and the $3.9 million average land cost, the result is an estimated $1.1 billion in land exclusion (270 × $3.9 million). Based on the one percent property tax rate, revenue loss related to land exemption is estimated to be approximately $11 million (1% × $1.1 billion).

The above analysis and numbers do not include 501(c)(3) bond and privately financed projects but do include those of Habitat for Humanity and Community Land Trusts.

According to BOE 2022 data, more than five thousand non-profit entities have been issued Supplemental Clearance Certificates concerning the welfare exemption for affordable housing. This BOE data nor data reported by counties provide any specifics in relation to assessed value and income groups of low-income non-tax-credit projects. It is difficult to determine the number of entities, properties, or units that would additionally qualify for the expansion of the 140% rule. Hence, based on these unknown factors, the revenue loss is indeterminable.