State of California **Board of Equalization**
Legal Division-MIC: 82

M e m o r a n d u m

To: Mr. Peter Gaffney
Exemptions Unit

Date: March 2, 2000

From: Mary Ann Alonzo
Sr. Tax Counsel

Subject: ***Eligibility for Welfare Exemption of Residential Properties owned by:***

This memo is in response to your request to Larry Augusta for a legal opinion on the above-stated matter, which has been forwarded to me for a response. You would like to know whether single-family residences owed by the three nonprofit corporations qualify for the welfare exemption pursuant to section 214, subd. (g) of the Revenue and Taxation Code[1] or some other provision of section 214. As set forth below, the residences owned by these nonprofit organizations are not eligible for exemption under any provision of section 214.

The following facts are relevant for purposes of our analysis:

- Nonprofit corporations purchase the single-family residences from the Veterans Administration[2] (hereinafter VA); most are obtained at 50 percent of the fair market value of the property, at a lower interest rate (1% below going rate), and at favorable loan terms such as no down payment, fixed interest rate and 30 year term for repayment.[3]

- Pursuant to a deed restriction required by the VA, the nonprofit corporations agree to "shelter primarily homeless veterans" and not to encumber or sell the properties for a period of three years.[4] The standard restriction states: "As part of the consideration

---

[1] All section references are to the Revenue and Taxation Code unless otherwise indicated.

[2] Homes purchased under the Homeless Veterans Comprehensive Service Programs Act of 1992 (Public Law 102-590).

[3] On February 29, 2000, I spoke with Mr. David Piersall, a loan guarantee officer at the Veterans Administration regional office in the City of Oakland, who clarified and supplemented information provided by Peter Gaffney in his e-mail memo to Larry Augusta of August 16, 1999. The Veterans Administration requires the nonprofit organizations that have purchased the residential properties to submit monthly reports on their tenants, including their names, whether they are veterans, and duration of occupancy.

[4] According to the Veterans Administration, the typical tenants of residential properties owned by nonprofit organizations are not homeless families who populate the shelters, and actually are more stable than the shelter population.

for the transfer of this property, it is to be used in accordance with *an agreement by the Grantees to shelter primarily homeless veterans*, and the property may therefore not be encumbered or sold for a period of 3 years from date of this transfer without the express written consent of the grantor.".[5] (Emphasis added, see Attachment No. 1, Deed Restriction Example) However, the VA has elected to administer this program without the requirement of a separate written agreement.

- The rental of the residential properties is not restricted to low income households as defined by section 50079.5 of the Health and Safety Code. The VA would like the properties rented to homeless veterans at least 70% of the time, but does not require it. According to the VA, the nonprofit organizations monthly reports indicate that, in fact, the properties are occupied by low income homeless veterans and their families approximately 90 percent of the time. However, the VA reports that S , Inc., was leasing its properties to homeless veterans only 50 percent of the time about two years ago. Nonetheless, if homeless veterans are not available to lease the houses, the nonprofit organizations are permitted to lease to other tenants about 30 percent or nearly one third of the time, with no restriction on the household income of the tenants.

Background Information

Since 1993, the Veterans Administration in northern California, has sold 53 single-family residences repossessed by the agency, to nonprofit organizations that are required to rent these properties primarily to homeless veterans and their families.[6] Three nonprofit corporations: S , Inc. (Contra Costa County), T , Inc. (Yolo County), and A (Alameda, Eldorado, Lake, Monterey, Sacramento, Solano, Tulare, Tuolome and Yolo Counties) have purchased residential properties under this program in northern California. The Board's Exemptions Unit has received numerous claims for exemption for these residential properties:[7] some have been returned to the counties because the filings were incomplete; others have been approved (S , Inc. and T , Inc.); and, some have not been approved because of concerns that the residential properties may not satisfy the requirements for exemption under section 214, subd. (g) or under any other provision under section 214 for property used for housing purposes.

LAW AND ANALYSIS

[5] It has been the experience of the Veterans Administration that typically, at the expiration of the three year period, the nonprofit organizations sell the residential properties at fair market value.

[6] According to Mr. Dave Piersall of the Veterans Administration, the number of such properties are significantly lower in southern California. Mr. Piersall states the number of residential properties sold to nonprofits for housing homeless veterans and their families is likely not to increase due to the improvement in the real estate market.

[7] A review of Board files indicate that A , Inc. has filed claims for 1997-2000, T ; Inc. has filed claims for 1997-2000; S , Inc. has filed claims for 1993-2000.

I. The Properties Do Not Qualify For Exemption Under the Low-Income Housing Provisions of Section 214, subd. (g)(1)

Subd. (g) of section 214 provides exemption for property used exclusively for rental housing and related facilities for lower income households, as defined by section 50079.5 of the Health and Safety Code, provided that all the statutory requirements are satisfied. As discussed at length below, the residential properties are not eligible for exemption under section 214 (g)(1), based on: (1) lack of qualifying deed restriction; and (2) properties not rented exclusively to low-income tenants.

Prior to the amendments to section 214, subd. (g) pursuant to Assembly Bill 1559 (Chapter 927, effective October 10, 1999), exemption of such properties through December 31, 1999,was conditioned upon the following:

- The owner must be a qualified nonprofit organization [IRC § 501(c)(3)], or a limited partnership with a qualified nonprofit managing general partner, meeting all the requirements of subd. (a)(1) through subd. (a)(7) of section 214. Assuming these statutory requirements were satisfied, the property could qualify under any of three criteria under the former subd. (g)(1) of section 214:

    1. Twenty percent for more of the occupants of the property are lower income households as defined by section 50079.5 of the Health and Safety Code, whose rent does not exceed that prescribed by section 50053 of that code. (§ 214, subd. (g)(1)(A).)

    2. The acquisition, rehabilitation, development or operation of the property or any combination of these factors, is financed with tax-exempt mortgage revenue bonds, or local state or federal loans or grants, and the rents do not exceed those prescribed by deed restrictions or regulatory agreements pursuant to the terms of the financing or financial assistance. (§ 214, subd. (g)(1)(B).)

    3. The owner of the property is eligible for and receives low income housing tax credits pursuant to section 42 of the Internal Revenue Code of 1986, as added by Public Law 99-514. (§ 214, subd. (g)(1)(C).)

Further, the owner must certify and ensure that there is a deed restriction, agreement or other legal document that restricts the project's usage and provides that the units designated for use by lower income households are continuously available to or occupied by lower income households at rents that do not exceed those prescribed by section 50053 of the Health and Safety Code, or in the case of a conflict between that provision and the terms of the financing agreements, rents that do not exceed those prescribed by the terms of those agreements. (§ 214, subd. (g)(2)(A).)

The owner must also certify that 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 lower income households. (§ 214, subd. (g)(2)(B).)

A. Lack of a Qualifying Deed Restriction

Under a deed restriction required by the VA, the nonprofit organizations are restricted from conveying the residential properties for three years and reference is made to an agreement that has the purpose of restricting the use of the property "to shelter primarily homeless veterans." (See Attachment No. 2, Bulletin, page 2, no. 5) Former section 214, subd. (g)(2)(A) is specific regarding the language required in the deed restriction, however, requiring that the "deed restriction, agreement or other legal document" restrict the use of the housing property to rental to low income households, as defined, and provide that units designated for use by lower income households are continuously available to or occupied by lower income households at the prescribed rent levels. While the VA deed restriction language that the grantee is to use the property "to shelter primarily homeless veterans" could be interpreted as requiring rental to low income households, the restriction lacks language requiring: (1) the property to be continuously available to such tenants; and, (2) a restriction on rents charged, as prescribed by section 50053 of the Health and Safety Code. Accordingly, the language in the VA deed restriction is not satisfactory for purposes of former section 214, subd. (g)(2)(A). As noted above, the VA has elected not to require the nonprofit organization to enter into a separate written agreement that would have required the nonprofit to use the residence to shelter *primarily* homeless veterans and their families for a minimum period of three years. Accordingly, the lack of a deed restriction, agreement or other legal document meeting the requirements of former section 214, subd. (g)(2)(A) disqualifies the properties from exemption pursuant to subd. (g)(1) of section 214 on this basis alone for 1999 and years prior.

B. Property Not Used Exclusively for Rental to Qualifying Low Income Households

The VA does not require owners to rent their residential properties exclusively to qualifying lower income households. The expectation is that the properties will be rented to homeless veterans and their families about 70 percent of the time. According to the VA, the nonprofit organizations report that, in fact, the properties are occupied by "low income" homeless veterans and their families approximately 90 percent of the time. This self-reported information has not been verified by the Veterans Administration. As noted

above, subd. (g) of section 214 provides exemption for property used exclusively for rental housing and related facilities for lower income households. The term, used exclusively for purposes of section 214, does not mean used solely for the purposes stated to the exclusion of any other use.[8] Further, well-established judicial precedent has established that occasional use of the property not within an organization's exempt purpose and activities are not disqualifying.[9]

It should be noted, however, that low income housing is subject to additional, more specific requirements regarding the use of the property. The statutory language imposing a deed restriction requires that the property "designated for use by lower income households *are continuously available to or occupied by lower income households*," as defined by section 50079.5 of the Health and Safety Code. (former section 214, subd. (g)(1)(A).) During such periods that the housing properties are held available to or rented to homeless veterans and their families, presumably, the requirement that the occupants are lower income households as defined by section 50079.5 of the Health and Safety Code would be met. However, this additional requirement is not met when the properties are rented to other than qualified low income tenants, which the VA permits for up to 30 percent of the time. A partial exemption is available for portions or units of a multi-unit housing project designated for rental to low income households. This partial exemption is not applicable in this case since the properties are single family residences. As you are aware, there is no statutory provision that allows the exemption to be pro-rated, based on time rented to qualifying tenants. Thus, the lack of use of the properties on a continuous basis for qualified low income tenants is a further basis for ineligibility of the residences (section 214 (g)(1)).

C. <u>Lack of Compliance with Certification Requirements Would Result</u>

The owner/claimant is required to certify and ensure that there is a deed restriction, agreement or other legal document that restricts the property's usage and that provides that designated units are continuously available at restricted rents prescribed by statute, and that funds that would have been necessary for property taxes are used to maintain the affordability of, or reduce rents." (§§214, subds. (g)(2)(A) and (g)(2)(B).)

The lack of compliance with a qualifying deed restriction, agreement or other legal document and income levels of tenants, as discussed above, would have the effect of rendering invalid any such certification that these conditions, or any of them, have been met. In our view, the claimant would not, in good faith, be able to certify that these requirements have been met, and if questioned about them (Rev. and Tax. Code § 254.5), no doubt would not be able to demonstrate that they existed.

---

[8] *Cedars of Lebanon v. County of Los Angeles* (1952) 35 Cal.2d, 729, 736.
[9] *Fellowship of Humanity v. County of Alameda* (1957) 153 Cal.App.2d 673, 699.

D. Non-Compliance with Requirements Imposed by Amendments to Section 214, subd. (g) (1), Effective October 10, 2000

Section 214 (g)(1(A), as amended, deletes the language allowing claimants to qualify their low income housing projects for exemption if twenty percent or more of the occupants are lower income households and the rents do not exceed that prescribed by section 50053 of the Health and Safety Code. Thus, only claimants with properties leased at the prescribed rent levels that: (1) are financed with tax-exempt mortgage revenue bonds, general obligation bonds or financed by local, state or federal loans or grants (§214 (g)(1)(A)); or, (2) receiving low income housing tax credits pursuant to section 42 of the Internal Revenue Code of 1986, as added by Public Law 99-514 (§214 (g)(1)(B)), may be eligible for exemption under section 214, subd. (g)(1).

A review of the files indicates that the claimants have claimed exemption for some properties in prior years under the provision deleted by amendment to section 214, subd, (g)(1) that provided exemption for properties with twenty percent or more lower income households, whose rent does not exceed that prescribed by section 50053 of the Health and Safety Code. However, the nonprofit corporations purchased the properties from the VA with loans provided by the VA. As such, the properties may meet the requirement for exemption under subd. (g)(1)(A) of section 214 which provides, in relevant part, that property purchased with federal loans is eligible for exemption.

The amendments to section 214, subd. (g)(2)(A) also substituted the requirement of "an enforceable and verifiable [regulatory] agreement with a public agency **or** a *recorded* deed restriction, that restricts the project's usage" [in the manner indicated] for former statutory language requiring a deed restriction, agreement or other legal document that restricts the project's usage [in the manner indicated]. There is no [regulatory] agreement with a public agency for these properties, and as noted above, the VA deed restriction does not satisfy the requirements in section 214, subd. (g)(2)(A). Thus, the properties would not qualify for the low income housing exemption for the year 2000 and forward, pursuant to this revision to the statute.

II. Other Provisions of Section 214 Are Not Applicable to Exempt the Residential Properties of the Nonprofit Organizations

It is the opinion of the Exemptions staff that other provisions of section 214 which exempt certain properties used for housing purposes are not applicable to exempt the subject properties. As discussed in detail below, staff is correct that such provisions are not applicable and the properties do not satisfy the statutory requirements for exemption.

- Subd. (f) of section 214 provides exemption for property used exclusively for housing and related facilities for elderly or handicapped families, provided that the stated requirements are satisfied, one of which is the restriction on the income of the tenants, which must be low or moderate income as defined by section 50093 of the Health and

Safety Code. However, there is no indication that the residential properties are used exclusively for housing for qualifying elderly or handicapped families.

- Subd. (h) of section 214 provides exemption for property used exclusively for an emergency or temporary shelter and related facilities for homeless persons and families. As used in this subdivision, "emergency or temporary shelter means a facility that would be eligible for funding pursuant to Chapter 11 commencing with Section 50800) of Part 2 of Division 31 of the Health and Safety Code." "Emergency Shelter" is defined as "housing with minimal supportive services to homeless persons that is limited to occupancy of six months or less by a homeless person. No individual or household may be denied emergency shelter because of inability to pay." (Section 50801, subd. (e) of the Health and Safety Code) Subd. (d) of section 50801 provides in relevant part, that an "eligible organization" means "[a] nonprofit corporation that provides or contracts with community organizations to provide, emergency shelter, transitional housing, or both." While the facts indicate that the residences are intended for rental to homeless veterans and their families, the nonprofit organizations have not submitted information to support a claim for exemption under section 214, subd. (h) that they are an "eligible organization" within the meaning of section 50801, subd. (d) of the Health and Safety Code, providing emergency shelter as defined, with supportive services for homeless persons and regardless of such persons' ability to pay. (Health and Safety Code §50801,subd. (e).)

- Subd. (i) of section 214, which allows exemption for housing and related facilities for employees of qualified nonprofit corporations, would not apply here since these organizations are not using the properties to house employees.

If you have further questions, please do not hesitate to contact me at 324-1392.

MAA:tr
prop/precdnt/welexqal/00/10maa

Attachments

cc: Mr. Richard Johnson, MIC:63
Mr. David Gau, MIC:64