August 17, 2018

State Board of Equalization Members:
George Runner
Fiona Ma
Jerome E. Horton
Diane L. Harkey
Betty T. Yee

And

David Yeung,
Chief of County-Assessed Properties Division

And

Dean R. Kinnee
Deputy Director
Property Tax Department
STATE BOARD OF EQUALIZATION
450 N Street, Sacramento, California
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RE: CALIFORNIA COMMUNITY LAND TRUST NETWORK MEMBERS' PROPOSED ALTERNATIVE LANGUAGE FOR THE DRAFT LTA – POSTED JULY 20, 2018-- REGARDING ASSESSMENT OF OWNER-OCCUPIED HOMES IN COMMUNITY LAND TRUSTS

The members of the California Community Land Trust Network, as sponsor of AB2818, greatly appreciate the opportunity to provide alternative language and our interpretations of AB2818 to the BOE for inclusion in the Formal Issue Paper to be presented to the Board Members for consideration.

The proposed alternative language below comes from pp 3 & 4 of the revised draft LTA issued 7/20/18 and are highlighted in blue.

9 **ASSESSMENT OF IMPROVEMENTS and ASSESSMENT OF UNDERLYING LAND PARCELS**

21 For purposes of the purchase price presumption, the "total consideration provided by the
22 purchaser" of a home subject to a CLT ground lease will generally be the agreed-upon purchase

23 price. Therefore, the valuation of the improvements and leasehold estate sold subject to CLT restrictions should be
24 based upon the ~~individual improvements~~ purchase price and should be allocated between improvements and land unless it can be shown through sales of
25 similarly restricted properties that the purchase price is not full value.

~~27 ASSESSMENT OF UNDERLYING LAND PARCELS~~
~~28 Since CLTs retain ownership of the land indefinitely and the land is always leased to the owner~~
~~29 of the improvements, any transfer of the land to a new lessee constitutes a change in ownership~~
~~30 under section 61(c)(1).~~
~~31~~
~~32 CLT land leases may be structured in a variety of ways. In some cases, the total lease payment~~
~~33 may be described as the sum of several components, such as a replacement reserve fee or an~~
~~34 administrative charge. In all cases, however, the valuation of the land upon a change in~~
~~35 ownership depends on the lease terms.~~
~~36~~
~~p. 4~~
~~1 Absent the sale of similarly restricted properties for use in the comparable sales approach, the~~
~~2 value of the land upon a change in ownership should be determined by converting the lease~~
~~3 payments to their present value using income capitalization.[14]~~
4
~~5 Where the lease explicitly restricts the amount of the payment attributable to a land use fee or a~~
~~6 charge for the value of the land, the assessor should recognize those restrictions pursuant to~~
~~7 section 402.1(a)(11). Where such payments or charges are de minimis, the stated purchase price~~
~~8 for the improvements may be considered to be inclusive of the value of the land.[15]~~
~~9~~
~~10~~
~~11 *Capitalization Rate*~~
~~12 If there is a The lack of meaningful data on sales of similarly restricted properties brought about~~
~~13 by the affordability restrictions on homeowner resales means that, of the two authorized methods~~
~~14 for computing a capitalization rate, only one – the band of investment technique – is of practical~~
~~15 import for purposes of capitalizing the lease payments for lands leased from CLTs. Accordingly,~~
~~16 as provided in Property Tax Rule 8(g)(2), assessors should look to the California money markets~~
~~17 to derive weighted averages of capitalization rates for debt and for equity capital, and, under the~~
~~18 legal doctrine that the absence of an "actual market" for property does not mean that it has no~~
~~19 value,[16] should weight those rates in a such a way as to reflect the rates that might be employed~~
~~20 by hypothetical prospective purchasers.~~

Comments/Rationale of CACLTN (AB2818 Sponsor)

The members of the Network hereby reiterate their common position that the Restricted Sale Price (or the 'the total consideration provided by the purchaser or on the purchaser's behalf') represents

the total fungible value of the home (improvements and land combined) and that this amount should represent the taxable value of the CLT home (improvements and land).

With respect to the valuation of the land underlying the improvements owned by the CLT and leased to the homeowner, the Network continues to question the viability of using a present valuation of the land lease fees (which are essentially administrative fees) and feels that allocation of the purchase price between land and improvements is the most appropriate and accurate approach.

In the event our alternative language viz allocation is not adopted, we would like to see guidance (either through definitions, or methodology) for how to determine what constitutes 'de minimis' v.s. an amount that would be deemed high enough to warrant using income capitalization—this with respect to draft LTA's clarification on Land Valuation--***"Where such payments or charges are de minimis, the stated purchase price for the improvements may be considered to be inclusive of the value of the land."*** We are concerned about the lack of guidance (either through definitions, or methodology) for how to determine what constitutes 'de minimis' v.s. an amount that would be deemed high enough to warrant using income capitalization.

Fundamental Problem of an Income Capitalization approach:

We continue to stress that there are many fundamental problems with an income capitalization approach for valuation of the land:

- Difficulty deriving a meaningful capitalization rate: The Network argues that the band of investment technique for deriving a capitalization rate, is arguably the *least* appropriate method for deriving a present value of CLT land lease fee payments:

  The rates tracked in the California money markets, in the main, reflect municipal and utility district bonds which are specifically structured to provide a stable rate of return *of* and *on* the investment. The sources of capital for these bonds are typically private capital which expect a competitive rate of return. They are in short, loans. In contrast, the 'investments' in CLT land are *necessarily* grants, due to the extremely long term of the land lease restriction, and the inability of the land lease payments to provide *any* return of or on the 'investment'. *In some cases*, the land acquisition funds are nominally structured as loans (secured by a Deed of Trust tied to some form of affordability covenant or regulatory agreement) *but they are invariably forgivable* by the lender, which is almost always a governmental entity (such as a state or local housing department). The source of these 'investment' funds are correctly characterized in the draft LTA as HOME, CDBG, and a variety of state and local sources. In a few rare instances, the source is from private grants or philanthropy (such as in a 'bargain sale' to the CLT, or an outright grant from a foundation).

  In short the fundamental economic precepts of California money market funds are diametrically in opposition to the funding used to acquire CLT land. The underlying CLT land acquisition transaction has been structured to remove (as much as possible) all of the market pressures

imposed by capital (either equity or financing); and eliminates any 'reversionary value' due to the land lease requirement to compensate the homeowner for 'reversionary value' of the improvements in the unlikely (and very remote) event of reversion.

- Calculating Net Income from land lease payments: We reiterate our argument (in prior responses) that the relevant 'fair market value' of the land lease payments is constrained by the terms of the land lease, which stipulate the components of the land lease fee collected, and cap it. The goal is to remove the cost of the land from the ongoing expenses to the homeowner. Thus the land lease fee is always a nominal amount, deeply subsidized by the non-profit public benefit corporation (the CLT). Further compounding this subsidy, the costs of administering such a unique and sophisticated lease are higher than a typical open-market land lease. In general, stewardship (i.e. 'property management') of these CLT land leases is the primary activity of CLTs, and cannot be outsourced to a typical for-profit property or asset management firm, which have no expertise in the type of monitoring and oversight required.
  There is truly no 'economic' rent from these land leases, rather the payments made by homeowners to CLTs can more appropriately be described as administrative fees.

The Cost of Land is not passed on to CLT Homeowner nor recaptured through Ground Rent.

We re-assert our arguments (from previous communications, see attached below) that the Board of Equalization Draft Memo states that:

- The nominal fee payable under the ground lease should not be regarded as a rent payment made in consideration for the homeowner's use of the land (as in the UC Irvine ground leased homes), but is better understood as an administrative fee to cover the costs of the CLT's oversight and administration of the ground lease.
- Per the Author's Statement provided by Assemblyman Chiu in connection with AB 2818: "… A CLT home is sold to a qualifying low or moderate-income family, but the cost of the land is not passed on through the transaction..." (Senate Third Reading Floor Analysis, Pages 6-7). And thus, the value of the land under a CLT home is fully included in the restricted sales price.
- The Legislature's intent through the passage of AB 2818 is that the valuation of CLT ground leases that do not pass on the cost of the land through rent, and that only impose nominal administrative fees, should disregard the nominal administrative fee. These tenant leaseholds should be valued as zero rent leases.

While the leasehold estate has an immense *social* value—to the community at large (and to the homeowner) in that it ensures the permanent affordability of the home and leasehold estate to future Qualified Homebuyers—it does *not* have any fungible *economic* value. That is, the leasehold estate (and improvements) can *never* be transferred for a value in excess of the restricted sale price contained in the land lease (and which comprises the full potential price for the improvements *and*

leasehold estate). Conversely, the CLT can never realize an economic rent from the leased fee due to the durable affordability restrictions in the land lease.

Page 4:
23 **DECLINES IN VALUE AND CORRECTIONS**

We are glad to see that the LTA now allows CLT homes purchased before the effective date of AB 2818 to be corrected pursuant to R&T section 4831 and 51.5, but we agree with Assessor Benson that the appropriate sections cited in footnote 17 are 4831(a)(1), not (c), and in footnote 18 Section 51.5 (a), not (b), because the correction would be based on a factual error, not an error in judgment.

We would disagree, however, with his statement that "it would not be appropriate" to correct for a lien date before Jan 1 2017. It is our belief (and that of several Assessors) that the resale restrictions on a CLT homeowner could have been recognized before AB 2818 went into effect because the list of restrictions which section 402.1 requires an Assessor to consider is not exclusive, and, unlike the case of *Carlson v Assessment Appeals Board* (167 CalApp 3d 1004), affordability restrictions imposed by a non-profit CLT have a clear public purpose.

Sincerely,

Bay Area CLT
Bolinas Community Land Trust
Beverly-Vermont Community Land Trust
CLAM (Community Land Trust of West Marin)
Irvine Community Land Trust
LA EcoVillage
Northern California Land Trust
OakCLT
PAHALI (Preserving Affordable Housing Assets Longterm, Inc)
Sacramento Community Land Trust
San Diego Community Land Trust
San Francisco Community Land Trust
Housing Land Trust of Sonoma County
T.R.U.S.T. South LA

For convenience, we attach here some of our arguments from prior letters, to elaborate our position/concerns:

1. **The Cost of Land is not passed on to CLT Homeowner nor recaptured through Ground Rent.**

The Board of Equalization Draft Memo states that "The base year value [of the underlying land] should be determined by reference to the present value of the lease payments to the CLT." (Assessment of Underlying Land Parcels, Page 3). We understand that certain county assessors have approached the valuation of homes on ground leased land in the same manner as proposed in the Board of Equalization memo. For example, this is the approach used by the Orange County Assessor in the valuation of the on-campus homes for the faculty and staff of the University of California, Irvine. The land underlying those homes is subleased to homebuyers at the land's fair rental value. The Assessor values the improvements at their initial purchase price, and values the subleasehold value of the land at the net present value of the rent payable over the course of the ground sublease.

We believe that AB 2818 requires a different approach in the valuation of homes in a CLT project. The nominal fee payable under the ground lease should not be regarded as a rent payment made in consideration for the homeowner's use of the land (as in the UC Irvine ground leased homes), but is better understood as an administrative fee to cover the costs of the CLT's oversight and administration of the ground lease. This is explained in the Author's Statement provided by Assemblyman Chiu in connection with AB 2818:

> "Community Land Trusts (CLTs) are nonprofit organizations that employ a unique and innovative method to permanently preserve the availability of affordable homeownership opportunities. CLTs achieve this goal by separating the ownership of the land from the ownership of a home (the improvements). A CLT home is sold to a qualifying low or moderate-income family, <u>but the cost of the land is not passed on through the transaction</u>. Instead, the nonprofit CLT retains ownership on the land and maintains a supportive relationship with homeowners to help ensure their success. While the homeowner does not possess title to the land, they lease the land from the CLT <u>for a nominal monthly administrative fee</u> which grants them exclusive rights to the land." (Senate Third Reading Floor Analysis, Pages 6-7).

The same concept is explained in the Senate Third Reading Floor Analysis, which states that "For example, the Oakland CLT (OakCLT) states that while it technically owns the land, '<u>there is no value to the land that it can realize apart from the nominal below-market monthly lease fee ($50/month) collected</u>…<u>the value of the land under an OakCLT home is fully included in the restricted sales price</u>.'"

We believe that the Legislature's intent through the passage of AB 2818 is that the valuation of CLT ground leases that do not pass on the cost of the land through rent, and that only impose nominal administrative fees, should disregard the nominal administrative fee. These tenant leaseholds should be valued as zero rent leases.

The actual value of a CLT home is in the improvements and not the leasehold. We concur with the "Assessment of Improvements" paragraph of the Board of Equalization Draft Memo which states that "For purposes of the purchase price presumption, the 'total consideration provided by the purchaser' of a home subject to a CLT ground lease will generally be the agreed-upon purchase price. Thus, the new base year value of the improvements should reflect that purchase price."

As stated in the Senate Third Reading Floor Analysis, the value of the land under a CLT home is fully included in the restricted sales price. Therefore, the valuation of the home considering the purchase price of the improvements alone best implements the legislative intent of AB 2818 to ensure that the assessed valuation of the property is consistently and reliably based upon the purchase price of the property with the affordability restrictions in place.

While the leasehold estate has an immense *social* value—to the community at large (and to the homeowner) in that it ensures the permanent affordability of the home and leasehold estate to future Qualified Homebuyers—it does *not* have any fungible *economic* value. That is, the leasehold estate (and improvements) can *never* be transferred for a value in excess of the restricted sale price contained in the land lease (and which comprises the full potential price for the improvements *and* leasehold estate). Conversely, the CLT can never realize an economic rent from the leased fee due to the durable affordability restrictions in the land lease.

1. **Assessment of Limited Equity Housing Cooperatives**

AB2818 specifically includes the assessment of Limited Equity Housing Cooperatives (LEHCs) subject to a Community Land Trust land lease, however does not detail how LEHCs differ from single family homes (i.e. units which are individually taxed parcels, including condo units). The draft LTA is silent on this issue, and we want to offer our analysis.

AB2818 directs assessors to consider the impacts of the CLT land lease upon the value of the home. In the case of a LEHC subject to a CLT land lease, the restrictions on value are more dramatice, particularly on the transferrable value of the LEHC member's share value. LEHCs by definition restrict the equity that coop members can accumulate. LEHCs subject to a CLT land lease are restricted in that the coop member does *not* accrue any of the equity from reduction of mortgage principal. More dramatically, the formula for the allowable appreciation of the limited equity of the coop member's share is generally restricted by a modest index, such as the Consumer Price Index. Thus, even if the 'Fair Market Value' of an LEHC is $1,000,0000, all that a coop member could

realize upon sale of their share would be the initial share price multiplied by the percentage increase in the CPI (or AMI) from the date of their original purchase, as in the following example:

> If in the $1M coop above, the individual share prices were $10,000, with 10 units in the coop, the total value of the member equity in the property would be $100K. When any of those coop members goes to sell their share, the most they could gain would be the $10K plus whatever appreciation due to the cumulative increase in the CPI (since the date of purchase). This mechanism makes the coop units permanently affordable to future low-income households.

Thus the coop share prices are the *only* fungible part of the value of the coop, and the only portion of the value which can ever accrue to private individuals. The rest of the value of the property is permanently locked up in the charitable purpose of the Community Land Trust, as restricted in the recorded land lease. (Again, the same arguments as to the restrictions to land and leasehold estate value apply here as well.)

We argue that the BOE should adopt this analysis (first used by Phil Ting as San Francisco County Assessor) for valuation of LEHCs on CLT land: The assessed value of the land & improvements is equal to the combined share prices of the coop members. Thus in the above example, the LEHC's assessed taxable value (land and improvements) would be $100,000, because this is the only portion of the property's value which could ever be transferred.