



## Legislative Bill Analysis

[Assembly Bill 1933](#) (Friedman)

Date: February 10, 2022 (Introduced)

Program: Property Taxes

Revenue and Taxation Code section 214.15.1

Effective: Immediately

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**Summary:** Adds Revenue and Taxation Code (RTC) section 214.15.1 to provide the welfare exemption from property tax for property that is owned and operated by a nonprofit corporation, that is otherwise qualified for the exemption, and is organized and operated for the specific and primary purpose of building and rehabilitating single or multifamily residential units that meets certain requirements including, but not limited to, the units being sold only to and purchased by first-time homebuyers that are low-income or moderate-income families.

**Fiscal Impact Summary:** Indeterminable.

**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.<sup>1</sup> 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 certain criteria are met.<sup>2</sup>

This exemption is known as the "welfare exemption" and is implemented pursuant to RTC<sup>3</sup> section [214](#).

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

Section 214(g)(1) provides generally 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 to be within the exemption authorized by section 214.

The State Board of Equalization (BOE) and 58 County Assessors are jointly responsible for administering 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 the use of a qualifying organization's property is eligible for the welfare exemption. The County Assessor shall 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

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<sup>1</sup> California Constitution, [article XIII, section 1](#).

<sup>2</sup> California Constitution, [article XIII, section 4\(b\)](#).

<sup>3</sup> 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.*

issued the organization an OCC or SCC. The BOE tracks [eligible nonprofit organizations and Limited Liability Companies](#) who hold valid OCCs and SCCs and monitors those organizations for continued eligibility.

Once an OCC or an SCC is issued by the BOE to a qualified organization, the organization must then file a 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 for 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 certain 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.<sup>4</sup>

In 1999, Section 214.15 was added into statute which expanded the welfare exemption to include nonprofit corporations that build residences for low-income persons that would otherwise qualify for the welfare exemption under Section 214.<sup>5</sup> The section requires the nonprofit corporation must be 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.<sup>6</sup>

In the case of property not previously designated as open space, the exemption provided under 214.15 may not be denied to a property on the basis that the property currently does not include a single or multifamily residence, or a single or multifamily residence that is in the course of construction.<sup>7</sup>

Additionally, this section made a qualitative difference between nonprofits that own and operate a housing project on an ongoing basis as opposed to nonprofits in this section that make housing, and the land necessary for that housing, available for sale to low-income residents.

Given this distinction, the Legislature deemed the holding of real property by a nonprofit corporation that builds housing for sale to low-income households as central to that corporation's exempt purposes and activities, thus constituting 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.

**Proposed Law: Expands Welfare Exemption to Include Properties to be Sold to First-Time Homebuyers.** The bill allows the welfare exemption to apply to property owned and operated by nonprofit corporations that would otherwise qualify for the welfare exemption under RTC section 214, that are organized and operated for the specific purpose of rehabilitating and building single or multifamily residential units, if the units are subject to a 45-year recorded agreement with the appropriate local agency and the agreement includes all of the following:

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<sup>4</sup> Section 214, subd. (g)(1).

<sup>5</sup> AB 1559 (Wiggins), ch. 927, Statutes of 1999.

<sup>6</sup> Section 214.15, subd. (a).

<sup>7</sup> Section 214.15, subd. (b).

1. All units shall be sold only to and purchased only by first-time homebuyers that are low-income or moderate-income families.
2. Requires all purchases from the nonprofit corporation to include a first-right-to-buy-back provision that provides the nonprofit corporation the first right to repurchase the home when the occupants are prepared to sell the unit and that requires the nonprofit corporation, if it repurchases the home, to rerecord a deed that meets the requirements of this paragraph against that property.
3. Requires the initial down payment on the units to be 5 percent or less of the market value of the unit at the time of purchase.
4. Requires the units to be made at an affordable housing cost to buyers.

**Allows Mixed Development.** The bill allows the exemption to apply to larger, mixed-income development projects where a portion of the units may be available to above-moderate income families. However, the exemption would only be available to the portion of the units that meet the requirements listed above.

**Prevents Denial of the Exemption if Land Does Not Have Housing.** This bill specifies that if the property was not previously designated as open space then the welfare exemption may not be denied on the basis that the property does not currently include a single or multifamily residential unit, or a single or multifamily residential unit that is in the course of construction.

**Holding of Real Property.** The bill provides that the holding of real property by a nonprofit corporation for purposes of future construction for housing that complies with this bill's provisions is central to that corporation's exempt purposes and activities.

**Future Construction.** This bill provides that the holding of property by a nonprofit corporation for future construction on that property of a single or multifamily residence as described in subdivision (a), 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.

**Definitions.** The bill provides the following definitions:

1. "Above moderate-income families" means persons and families whose income does not exceed 150 percent of the area median income.
2. "Affordable housing cost" with respect to low-income families may not exceed 30 percent of gross income and with respect to moderate-income families may not exceed 35 percent of gross income.
3. "First-time homebuyer" has the same meaning as defined in Section 92.2 of Part 24 of the Code of Federal Regulations, as that section read on January 1, 2022.
4. "Low-income or moderate-income families" has the same meaning as "persons and families of low or moderate income" as defined in Section 50093 of the Health and Safety Code, as that section read on January 1, 2022.

**Audits.** Nonprofit corporations that utilize the exemption under this newly added section shall be subject to an annual independent audit to ensure that buyers of the units meet the requirements of this section. The nonprofit corporations shall then make the audit available on request to certain local and state agencies.

**No Reimbursement Revenues.** Any local agencies that lose local property tax revenues because of the expanded welfare exemption proposed by this bill will not be reimbursed by the State.

**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, which reiterates the constitutional authorization and outlines numerous conditions and qualifications for receiving the exemption, and adds 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 owner is not organized 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.

**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 so as 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.<sup>8</sup> 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.<sup>9</sup>

**Housing Welfare Exemption.** Property tax administrators have historically taken a narrow view of the exemption and have viewed much housing to be non-exempt on the grounds that the property is being used primarily for private residential purposes rather than exempt purposes and is not being used exclusively for exempt purposes as required by section 214.<sup>10</sup>

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<sup>8</sup> *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736.

<sup>9</sup> *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.

<sup>10</sup> Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*, p. 62.

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.<sup>11</sup>

In 1999, the BOE adopted [Property Tax Rule 137](#), *Application of the Welfare Exemption to Property Used For Housing*, effective December 31, 1999. The purpose of Rule 137 is to clarify that the welfare exemption from property taxation applies to housing and related facilities owned and operated by qualified nonprofit organizations and to establish a single uniform statewide standard for determining qualification for the welfare exemption as it applies to such properties.<sup>12</sup>

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

**Background:** Section 214.15 was added into statute in 1999 by AB 1559 (Wiggins) which allowed authorized nonprofit corporations that are organized and operated for the specific and primary purpose of building and rehabilitating housing units to qualify for the welfare exemption and additionally qualify when the property is acquired rather than when construction on the property commenced.<sup>13</sup>

Sales made to low-income residents must include a 0% interest rate loan to homebuyers. According to the author, the sponsor of AB 1933, Heritage Housing Partners, utilizes public sector subsidies to fill the gap between what the homebuyer can afford and what the full cost of development is. These subsidies are then recast as a 0% interest junior loan with a 30 to 45-year repayment to the low-income homebuyer and paired with a conventional first mortgage from a traditional lender.

The 0% interest junior loan is non-performing, meaning the homebuyer only needs to make principal and interest payments on the conventional first mortgage which is set based on the size of the down payment and a pricing formula specific to the subsidy source.

AB 1933's sponsors claim to have been denied the property tax exemption by County Assessors because the homebuyer is paying interest on a conventional mortgage instead of all financing going through a 0% interest loan. As a result, the bill's sponsors must pay property taxes from the time they purchase the land, develop through construction, and until the close of escrow with the homebuyer. The bill's sponsors say this additional property tax burden results in "many thousands of dollars per home that could instead be placed back into development and construction."<sup>14</sup>

According to the author, AB 1933 updates "California law to reflect the unique ways non-profit organizations are using and leveraging public subsidies to construct affordable homeownership units."<sup>15</sup>

## Commentary:

1. **Possible Administrative Issue.** The bill proposes adding Section 214.15.1 which would authorize the welfare exemption if the properties are subject to a 45-year agreement with the appropriate local agency and requires several items including the units be sold to first-time homebuyers that are low-income or moderate-income families. However, current statute under Section 214.15

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<sup>11</sup> *Ibid.*

<sup>12</sup> *Id.* at p. 65.

<sup>13</sup> AB 1559 (Wiggins), ch. 927, Statutes of 1999.

<sup>14</sup> AB 1933 Factsheet.

<sup>15</sup> *Ibid.*

requires a 0% interest loan that must be available to only low-income families and does not provide additional requirements on persons being a first-time homebuyer. Having two different standards for the welfare exemption for low-income families and a new standard for moderate-income families may increase the administrative and compliance burden and workload on County Assessors to ensure the exemption is fairly and properly administered.

2. **Addresses Technical Issue.** The current welfare exemption provided to nonprofit corporations that rehabilitate housing and sell to low-income families under Section 214.15 requires the financing to be done with a zero-interest rate loan. Some nonprofits recast the zero-interest junior loan with a 30-to-45-year repayment, and pair it with a conventional first mortgage from a traditional lender. The junior loan is non-performing meaning all principal and interest payments service the traditional loan. Because of this financing structure, County Assessors have denied the welfare exemption to entities that otherwise qualify for the exemption since the homebuyer is paying interest on a conventional loan instead of all financing being serviced through the 0% interest loan. This bill would prevent County Assessors from denying the welfare exemption if the mortgage financing is coupled between a non-performing 0% interest rate junior loan and a conventional mortgage from a lender.
3. **Is the land 100% Exempt?** The bill exempts the land, as long as it was not restricted to open space, prior to the course of construction on the land. If a developer meets the requirements of the welfare exemption and plans to build 100% affordable housing on the land, then the County Assessor would authorize a 100% exemption. However, if the developer develops less than 100% of qualified housing, then does the developer still receive 100% of the welfare exemption for the land or does the County Assessor have to prorate the land's exemption and offer escape assessments to the portions of the land that are not eligible for the exemption?

**Costs:** The BOE would incur costs of approximately \$1,734 and 21 personnel hours to update claim forms; Assessors' Handbook Section [267](#), *Welfare, Church, and Religious Exemptions*; and [Publication 149](#), *Property Tax Welfare Exemption*.

**Revenue Impact:** Estimating the revenue impact of this bill is difficult. Staff cannot estimate the number of units that would be built in compliance with the bill. The bill's sponsors claim they have built and sold close to 203 homes to low, moderate and workforce income, first-time homebuyers with plans for another 104 homes.<sup>16</sup> However, staff does not know the location and value of those properties that have been sold or the other entities that would benefit under this bill. Revenue impact depends on: (1) the number of properties that would qualify under this bill, (2) the taxable value of the property, and (3) the location of these properties. At this time, based on these unknown factors, the revenue loss is indeterminable.

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<sup>16</sup> [www.hphousing.org](http://www.hphousing.org).