California State
Board *of* Equalization

Legislative Bill Analysis

Assembly Bill 1933 (Friedman)
Date: May 19, 2022 (Amended)
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 meet certain requirements including, but not limited to, the units being owner-occupied and sold only to and purchased by first-time homebuyers that are low-income. The new section would remain in effect only until January 1, 2034, and repealed as of that date.

Summary of Amendments: The **May 19, 2022**, amendments: require the nonprofit to be subject to an annual independent audit mandated in the bill and to make the audit available upon request in order to continue to qualify for the exemption, require the nonprofit to be liable for property taxes for the years for which the property was exempt from taxation if the property was not developed or rehabilitated, or if the development was not in the course of construction during certain timeframes, and extends the section's sunset date until January 1, 2034.

Fiscal Impact Summary: Indeterminable, but likely to result in a local property tax revenue gain over time.

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 certain criteria are met.[2]

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

[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.

The 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 operated 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 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 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.[4]

In 1999, Section 214.15 was added into statute which clarified that the welfare exemption included nonprofit corporations that build residences for low-income persons that would otherwise qualify for the welfare exemption under Section 214.[5] 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.[6]

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.[7]

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.

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[4] Section 214, subd. (g)(1).
[5] AB 1559 (Wiggins), Ch. 927, Statutes of 1999.
[6] Section 214.15, subd. (a).
[7] Section 214.15, subd. (b).

Proposed Law: **Explicitly Includes Properties to be Sold to First-Time Homebuyers in Welfare Exemption.** The bill explicitly applies the welfare exemption 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:

1. All units shall be owner-occupied and sold only to and purchased only by first-time homebuyers that are low-income.

2. 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.

3. Requires the units to be made at an affordable housing cost to buyers.

Requires Audit to Be Eligible for Exemption. The **May 19, 2022,** amendments specify that a nonprofit shall make their annual independent audits available upon request in order to be eligible for the exemption.

Holds Nonprofits Liable for Property Taxes. The **May 19, 2022**, amendments specify that the nonprofit corporation shall be liable for property tax for the years for which the property was exempt from taxation if the property was not developed or rehabilitated, or if the development or rehabilitation was not in the course of construction, in accordance with the following schedule:

- In the case of property acquired by the nonprofit corporation before January 1, 2023, by January 1, 2028;

- In the case of property acquired by the nonprofit corporation on and after January 1, 2023, and before January 1, 2028, within five years of the lien date following the acquisition of the property by the nonprofit corporation.

The **May 19, 2022**, amendments additionally require the nonprofit corporation to notify the appropriate County Assessor if the property that was granted an exemption is not in the course of construction by the dates specified above.

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 persons or families that are not low-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 **April 20, 2022**, amendments provide the following definitions:

1. "Affordable housing cost" with respect to low-income families may not exceed 30 percent of gross income.

2. "First-time homebuyer" means a person who does not currently have any ownership interest in any principal residence and has not had any ownership interest in any principal residence in the three-year period prior to the date that the mortgage is executed for a unit purchased by the person described in paragraph (1) of subdivision (a) of this section. For purposes of this paragraph, "principal residence" means any property used as the person's principal place of residence.

3. "Low-income families" means very low income households, as defined in Section 50105, extremely low income households, as defined in Section 50106, lower income households, as defined in Section 50079.5, and persons and families of low income, as defined in Section 50093, and includes persons and families of extremely low income and persons and families of very low income, as those terms are used in Section 50093 of the Health and Safety Code, as that section those sections read on January 1, 2022.

Affidavits. The **April 20, 2022**, amendments specify that a nonprofit corporation making a claim for the exemption shall not be eligible for the exemption unless the nonprofit corporation signs under the penalty of perjury an affidavit affirming to the County Assessor that the property owned is for future construction of single or multifamily residential units with requirements on that property as required under the bill.

Effective and Sunset Dates. The **April 20, 2022**, amendments specify section 214.15.1 shall be operative for lien dates occurring on or after January 1, 2023, and before January 1, 2028. The **May 19, 2022**, amendments extended the sunset date for the bill to remain in effect until January 1, 2034, and as of that date is repealed.

Findings and Declarations. The **April 20, 2022**, amendments add findings and declarations to comply with section 41 requirements including requiring the BOE to submit an annual report to the Legislature by June 1, 2025, and every June 1 thereafter until June 1, 2028, on data received from County Assessors. The BOE would be required to collect from County Assessors the amount of assessed value exempted, and the number of owner-occupied dwelling units created by nonprofits that were granted the exemption under section 214.15.1.

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.

Mandates and Reimbursements. The **April 20, 2022,** amendments specify no reimbursement of certain costs that may be incurred by a local agency or school district unless the Commission on State Mandates determines the act contains other costs mandated by the state.

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.[8] 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.[9]

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.[10]

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,[11] and that "charitable purposes" be defined broadly.[12]

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[8] *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736.
[9] *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.
[10] Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*, p. 62.
[11] *Ibid*.
[12] *Lundberg v. County of Alameda* (1956) 46 Cal.2d 644, 650

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.

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

Background: Section 214.15 was added into statue in 1999 by AB 1559 (Wiggins) which clarified that nonprofit corporations that are organized and operated for the specific and primary purpose of building and rehabilitating housing units qualify for the welfare exemption and additionally qualify when the property is acquired rather than when construction on the property commenced.[13]

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."[14]

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."[15]

Commentary:

1. **BOE Annual Reporting Requirement.** The **April 20, 2022**, amendments, to comply with RTC section 41 requirements, would require the BOE to annually collect information from county assessors and submit a report to the Legislature in compliance with GC section 9795 reporting the amount of assessed value exempted and the number of owner-occupied dwelling units created by nonprofits granted the exemption, commencing June 1, 2025, and occurring on or before each June 1 thereafter until December 1, 2028.

   However, RTC section 41 only applies to taxes imposed under Parts 1, 10 and 11 of Division 2 of the RTC.[16] These code references refer to sales and use taxes, personal income tax, and

[13] AB 1559 (Wiggins), Ch. 927, Statutes of 1999.
[14] AB 1933 Factsheet.
[15] Ibid.
[16] RTC section 41, subd. (a).

corporation tax. RTC section 41 does not apply to property tax or the welfare exemption. If the reporting requirement is based on RTC section 41, then there is no basis for imposing a reporting requirement since this section does not apply to property tax. Additionally, these reporting requirements are in the findings and declarations section of the bill and are not in statute. It is not clear whether these reporting requirements are enforceable with regard to the BOE and/or County Assessors.

2. **County Assessor Workload.** The **April 20, 2022**, amendments require nonprofits to report to County Assessors information regarding the additional dwelling units created under the expanded exemption. Many County Assessors' offices may not have the staffing, budget, or technology systems to track this type of data separately beyond aggregated data for the welfare exemption regarding low-income housing. This reporting requirement would be an administrative and workload burden on County Assessors' offices. As a result, the BOE may only be able to submit information of those counties that are able to comply with this provision.

3. **Lien Dates.** Section 214.15.1 is operative for lien dates occurring on or after January 1, 2023, and before January 1, 2028. The **May 19, 2022**, amendments then repeal the section January 1, 2034. This section would be operative for the January 1, 2023, lien date through the January 1, 2027, lien date. However, the section is effective until January 1, 2034. Under this interpretation, County Assessors would deny any January 1, 2028, lien date claims since the bill's provisions are only operative "*before January 1, 2028*." The January 1, 2027, lien date would apply for the fiscal year July 1, 2027, to June 30, 2028. This means the statute would be effective until December 31, 2028, but not include the timeframe of July 1, 2028, to December 31, 2028.

4. **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. However, Section 214.15 currently 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. Both section 214.15 and section 214.15.1 would be operative at the same time, as section 214.15 is not made inoperative by the bill. Having two different standards for the welfare exemption for low-income families operative at the same time may increase the administrative and compliance burden and workload on County Assessors to ensure the exemption is fairly and properly administered.

5. **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.

6. **Nonprofits Liable for Property Taxes.** The **May 19, 2022**, amendments hold nonprofit corporations liable for property taxes for the years the property received the welfare exemption but was not actually eligible for exemption because the property was not developed or rehabilitated or in the course of construction during specified time periods. The current wording

of the statute may cause confusion to taxpayers, by stating that organizations 'shall be liable for property tax for the years for which the property was exempt from taxation . . .' This phrase could cause confusion as to why organizations are liable for taxes when the property is exempt from taxation, the author may wish to clarify that nonprofit corporations shall be liable for property tax for the years for which the property received the welfare exemption but were not actually eligible for exemption because the property was not developed or rehabilitated or in the course of construction during specified time periods.

7. **Property Not Developed or in the Course of Construction.** The bill proposes adding Section 214.15.1 which would hold nonprofit corporations liable for property taxes for the years the property received the welfare exemption but was not actually eligible for exemption because the property was not developed or rehabilitated or in the course of construction during specified time periods. However, Section 214.15 currently provides that nonprofit corporations that are organized and operated for the specific and primary purpose of building and rehabilitating housing units qualify for the welfare exemption when the property is acquired and held for future construction, rather than when construction on the property commenced. Both section 214.15 and section 214.15.1 would be operative at the same time, as section 214.15 is not made inoperative by the bill. Having two different standards for the welfare exemption for low-income housing operative at the same time may increase the administrative and compliance burden and workload on County Assessors to ensure the exemption is fairly and properly administered.

8. **Is the land 100% Exempt?** The bill exempts the land, if 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 must the County Assessor prorate the land's exemption and seek escape assessments on the portions of the land that are not eligible for the exemption?

9. **Audit Requirement**. The bill states that eligible nonprofit corporations are "subject to" an annual independent audit. It is unclear whether this requires the nonprofit corporation affirmatively seek out an independent audit annually or whether it is merely subject to an independent audit should an agency such as the Department of Housing and Community Development choose to do an audit. The **May 19, 2022**, amendments specify the nonprofit corporations must make the audit available upon request in order to continue to qualify 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*. The BOE is currently analyzing the agency costs on requesting data from County Assessors and submitting a report to the Legislature.

Revenue Impact: Estimating the future revenue impact of this bill is difficult as it is unknown how many properties would be subject to the bill, the number of units sold, the sales price of those units, the purchase price of the development property, construction time and the amount of tax that would be paid during the construction phase.

Staff cannot estimate the number of units that would be built in compliance with the bill. However, the bill's sponsors did provide the BOE with data for 11 housing development projects (all located in Los Angeles County) that they have built dating back to 2005 including the development locations, sum of property taxes paid by the sponsor during the course of construction, and the property taxes paid by the new homeowners. Staff believes it may be helpful to provide context to how the bill's provisions would have operated had they been in effect for these projects.

Staff analyzed developments that seemed to be strictly low-income and found they were in the course of construction for 5, 6 and 5 years. During that time, the bill's sponsors reported they paid $130,575 in local property taxes for these low-income developments. Under this bill, this amount would qualify for the 100% welfare exemption. If the exemption applied to these developments with an average construction time of 5 years, Los Angeles County would have lost an average of $26,115 in local property tax revenue. Upon completion of construction, the sponsor sold all units to low-income homebuyers and the property's net assessed value increased due to the new construction.

The units in the analysis above were sold from: July 2011 to August 2011 and August 2020 to October 2020.

Since these units were sold, the bill's sponsors estimate based on the property's net assessed value that homeowners have paid $233,785 in local property taxes over the time period from when the units were sold. When adding the homeowner property tax payments to the amount of tax that would be exempted, staff estimated a local property tax revenue gain of approximately $103,210.

-$130,575 (exemption) + $233,785 (homeowner payments) = $103,210 (net property tax gain)

Qualifying Remark:

The data analysis and revenue figures above are only estimates and do not consider future behavior. Additionally, this analysis does not consider potential revenue loss if a county was to instead allow market-rate housing or other property uses rather than low-income housing.

Given the way property is taxed in California based upon a 1% of a property's assessed value adjusted annually for inflation, up to 2%, it is likely that counties who authorize development or rehabilitation of land to low-income housing will see an increase in local property tax revenues over time versus the amount of local property tax revenue lost in the short-term by authorizing the welfare exemption.