

Affordable Housing and Property Tax Relief

Background

At its May 25, 2021, Board Meeting, the Board of Equalization (BOE) discussed California's housing crisis and the Board's role in policy development to help address this statewide crisis. This discussion was a continuation of the Board's engagements with leaders and subject matter experts in 2019 and 2020. The Board received a staff presentation at its June 2021 Board Meeting, which specifically focused on BOE's current authority in co-administering the Welfare Exemption, as set forth in Revenue and Taxation Code section 214. This white paper expands on the June 2021 presentation and intends to outline the relationship between the Welfare Exemption and its benefits to affordable housing.

The series of discussions and presentations provide a foundation for a proposed public policy hearing to identify opportunities for the Board to assist with California's affordable housing efforts.

Introduction

A variety of federal, state, and local government programs target California's housing crisis. In general, these programs involve rent subsidies, financing incentives, and grants. Affordable housing programs aim to make rental housing available at reduced rates, provide subsidies for security deposits, or provide direct rental assistance. Other affordable housing programs promote home ownership through reduced purchase prices, down payment assistance, financing assistance, or a combination of these incentives. Often, nonprofit entities partner with government to facilitate housing affordability.

In the property tax arena, the Welfare Exemption for low-income rental housing is the primary program providing benefits to affordable housing.

Current Affordable Housing Programs in California

The California Department of Housing and Community Development (HCD) lists 26 programs promoting affordable housing that either have current funding or will have funding in the next 12 months.¹ HCD lists another 8 programs that currently lack funding but are still active.²

¹ *Programs: Active Currently Funded.* <https://www.hcd.ca.gov/grants-funding/active-funding/index.shtml>
Accessed 15 July 2021.

² *Programs: Active - No Current Funding.* <https://www.hcd.ca.gov/grants-funding/active-no-funding/index.shtml>
Accessed 15 July 2021.

These programs administer funding in a variety of ways over many areas of need, including:

- Preferential financing for first-time homebuyers (CalHOME)
- Assisting persons experiencing or at risk of homelessness (CESH)
- Expanding economic opportunity and providing decent housing to low-income households (CDBG)
- Emergency shelter and transitional housing Emergency Solutions Grants Program (ESG)
- Assisting cities, counties, and non-profit community housing development organizations to create and retain affordable housing for lower-income renters or owners (HOME)
- Acquisition and rehabilitation of housing to serve people experiencing homelessness or serious illness from COVID-19 (Homekey)
- Long-term project-based rental assistance from the U.S. Department of Housing and Urban Development (Section 811 Project Rental Assistance)
- Development or preservation of rental housing for very low- and low-income veterans and their families (Veterans Housing and Homelessness Prevention Program)

Property Tax Relief Programs

Welfare Exemption

The main relief program in the property tax arena is the Welfare Exemption for low-income rental housing. This exemption is available to property used exclusively for rental housing and related facilities.

Eligibility

To be eligible for the Welfare Exemption, a property must generally be financed with specified tax-exempt bonds, government loans or grants, or the property's owner receives low-income housing tax credits (LIHTCs) pursuant to section 42 of the Internal Revenue Code (IRC). Eligible properties may receive a partial exemption based on the proportion of units serving lower income households.

More specifically, if a property is owned and operated by a nonprofit organization, the property is eligible under the following conditions:

- The property use is restricted to low-income housing by a regulatory agreement, recorded deed restriction, or other legal document.
- The funds that would have been necessary to pay property taxes are used to maintain the affordability of the housing or to reduce the rents for the units occupied by lower income households, defined by HUD as households earning below 80% of the Area Median Income (AMI).
- The property receives either state or federal low-income housing tax credits or government financing, or 90 percent or more of the tenants are qualified low-income tenants within the prescribed rent levels.

If a property is owned by a limited partnership with a nonprofit corporation or eligible limited liability company as managing general partner, in addition to the requirements for properties owned and operated by nonprofit organizations, the limited partnership agreement must provide the claimant with

sufficient management authority and duties in the partnership operations to qualify the property for exemption.

Limitations

The law allows an unlimited exemption for low-income rental housing owned by a nonprofit organization if it receives government financing or low-income housing tax credits (LIHTCs). However, the law generally limits the exemption to the first \$20 million in assessed value statewide for low-income rental housing that is (1) owned by a nonprofit organization that does not receive government financing or LIHTCs and (2) occupied at least 90% by lower income households.³ Counties annually provide information to the BOE to track the statewide cap.

Administration

The Welfare Exemption is co-administered by the BOE and County Assessors. The BOE is responsible for determining whether an *organization* is organized and operated for a qualifying purpose under Revenue and Taxation Code section 214. If it is so determined, the BOE issues an Organizational Clearance Certificate (OCC), which the organization then files along with its claim for exemption with the County Assessor.

In addition to having been issued an OCC, a limited partnership operating low-income rental housing must be issued a Supplemental Clearance Certificate (SCC) for *each property* that is to receive the exemption. The County Assessor is responsible for determining whether the *use* of the qualifying organization's property is eligible for the exemption.

The Assessor may not grant a Welfare Exemption on an organization's property unless the organization holds the required OCC and, if applicable, the required SCC for each property. The Assessor may, however, deny an exemption claim based on non-qualifying use of the property, notwithstanding that the BOE has issued the required OCC or SCC(s).

Since SCCs are issued only to those limited partnerships in which the managing general partner is a qualifying nonprofit corporation or limited liability company and holds a valid OCC, and since each SCC is associated with a specific low-income rental housing property, we can provide exemption statistics for those properties. Table 1 summarizes the BOE's SCC claim activity over the past five years:

Table 1

1/1/2017 to 5/19/2021	SCC
New Claims Received	1,460
Certificates Issued	1,364
Incomplete Claims	772
Claims Denied	31

³ The \$20 million cap is intended to limit the available exemption to owners that might misuse it by creating a nonprofit organization for that sole purpose.

Filing Requirements

An organization seeking exemption for the first time must file a proper claim for an OCC and, where applicable, an SCC with the BOE. In addition, the organization must file a proper claim with the County Assessor. The claim must be accompanied by the following documents:

1. Organizational documents

An organization must attach a copy of the Articles of Incorporation certified by the Secretary of State (and any amendments to the original Articles), or comparable documents for unincorporated organizations. If the organization is a Limited Liability Company (LLC), the LLC must attach a copy of its Articles of Organization, and any amendments, certified by the Secretary of State. BOE staff will review the organization's start-up (formative) documents to verify that the documents include both an acceptable statement of irrevocable dedication and a dissolution clause.

2. Tax exemption letter

An organization must include a copy of a valid federal or state tax exemption letter. The tax exemption letter may be either from the Internal Revenue Service or Franchise Tax Board, stating that the organization is exempt under their respective provisions of law during the years for which an OCC is sought (Internal Revenue Code section 501(c)(3), Revenue and Taxation Code section 23701(d)).

3. Financial statements

An organization must include a certified copy of its financial statements (balance sheet and income statement). The financial statements must be for the period immediately preceding the lien date (January 1) for the claim.

4. Description of activities

An organization must provide detailed information about the activities conducted by the organization. From this information, BOE staff must be able to determine whether the organization is exclusively organized and operated for one or more of the qualifying purposes for the Welfare Exemption.

Low-Income Housing Tax Credit Projects

Under Rule 140.2, one of the criteria for eligibility for an SCC is a certification by the general partners of the limited partnership that the project is financed with LIHTCs or government financing. The LIHTC program encourages private investment in affordable rental housing that meets certain requirements.

The federal LIHTC program, instituted by the 1986 Tax Reform Act and subsequently codified as section 42 of the Internal Revenue Code (IRC), is the primary federal program for subsidizing the production of affordable housing. Under Section 42, eligible taxpayers may take a credit against federal income taxes due for qualified expenditures involving qualified low-income housing projects. To be eligible for the credit, the taxpayer must hold an ownership interest in a low-income housing project for which tax credits have been awarded.

California's state LIHTC program augments the federal program. Authorized by Chapter 1138, Statutes of 1987, the state credit is only available to a project which has previously received, or is concurrently receiving, an allocation of federal credits.

The California Tax Credit Allocation Committee (CTCAC) administers the LIHTC program in California. Credits are available for both new projects and existing projects undergoing rehabilitation.

According to CTCAC, two types of federal tax credits are available and are generally referred to as nine percent (9%) and four percent (4%) credits. Each number refers to the approximate percentage that is multiplied against a project's requested "qualified basis"⁴ to determine the amount of annual federal credits CTCAC will award the project.

The 9% federal credits are so desirable and limited that CTCAC awards them through a competitive process twice per year. The 4% percent tax credits are non-competitive and the California Debt Limit Allocation Committee (CDLAC) awards to all projects that meet specific criteria.

The amount of 9% federal credits is limited; California's limit for 2018 was \$106.7 million in annual credits. Because project owners can take the annual credit each year for ten years, CTCAC effectively can award \$1.067 billion in 9% tax credits.

The 4% credits derive from a project's use of tax-exempt bond authority allocated by the California Debt Limit Allocation Committee (CDLAC) and are limited only by the amount of bond cap available to California. In 2017, CTCAC awarded \$124.9 million in annual 4% tax credits, which again equates to \$1.249 billion in total credits over ten years. CTCAC awards 4% tax credits non-competitively (i.e., over the counter) to all projects that meet threshold criteria.

In 2020, the California Tax Credit Allocation Committee (CTCAC) awarded federal credits worth \$112,088,900 and state credits worth \$87,233,658. These awards applied to 69 projects statewide comprising 3,932 low-income housing units.

Streamlining Claims Processing

The BOE has been reviewing SCC claims for over ten years in accordance with Rules 140.1 and 140.2. This has allowed the BOE to note a duplication of efforts between the County Assessors and the BOE, and corresponding delays in the exemption approval process. This occurs because an SCC is property-specific, and thus the information and certifications required by Rule 140.2 are similar to the information and certifications the claimant must provide to the Assessor when applying for the Welfare Exemption.

Since the Assessor is precluded by law from granting the exemption on property unless the claimant submits the BOE-issued OCC and SCC with the exemption claim, the Assessor may not grant the claim until the required certificates are received. Depending on the number of OCC and SCC claim filings received by the BOE at a given time, and the order and completeness of those claims, there can be a period of four to nine months from the date an SCC claim is received to the date the SCC certificate is issued. Therefore, it may be prudent to re-examine the SCC requirements.

Since duplicative review functions may exist between the BOE and County Assessors in the review process of low-income housing property of a limited partnership with a qualified managing general partner,

⁴ Roughly, a project's qualified basis is its cost of construction, excluding the land.

consideration should be made to streamline the review by requiring the necessary information is captured once and only once. This may require Rule 140.1 and 140.2 to be amended.

Review of the regulatory requirement to hold an SCC could reduce delays for qualifying claimants to receive the Welfare Exemption on its low-income housing properties. Other benefits include:

- Receiving the Welfare Exemption timelier can increase a low-income housing provider's ability to provide housing to low-income households, provide needed services to existing occupants of the low-income housing property, and pay debt service or loan payments from government financing sooner.
- Streamlining the requirement to obtain an SCC would decrease the exemption approval time and may allow Assessors to enroll the exemption from property tax before the assessment roll is issued rather than performing a roll correction to apply the exemption and avoid having claimants pay property taxes and then wait for refunds.

The Board may wish to consider directing the Executive Director to start a comprehensive review to streamline the application, review, and approval process for low-income rental housing.

Community Land Trust Property

Community land trusts (CLTs) are non-profit organizations that facilitate the development of permanently affordable for-sale and rental housing on land owned by the CLT. In the case of for-sale housing, buyers acquire full ownership of the improvements, but lease the underlying land parcels from the CLTs under renewable 99-year ground leases restricting resale to low- and moderate-income purchasers at affordable prices.

Over the past several years, BOE staff and interested parties have been engaged in discussions about preferential treatment of CLT properties. Based on those discussions and considering related legislation, staff have drafted an advisory Letter To Assessors (LTA) to provide guidance on the treatment of CLT properties. The LTA, which is in the final stages of development and approval, covers the following legislation:

- AB 2818 (Chapter 701, Statutes of 2016) specified that, in valuing CLT properties, County Assessors must recognize the restrictions on use under a CLT lease.
- SB 196 (Chapter 669, Statutes of 2019) and SB 1473 (Chapter 371, Statutes of 2020) clarify that the Welfare Exemption is applicable to CLT low-income rental properties under certain conditions.

The Board may wish to consider sponsoring or supporting legislation that would make section 402.1 applicable to new models of affordable housing developments, provided the characteristics of any such new development fit the general intent of section 402.1.

Pending Legislation

Assembly Bill (AB) 1206 introduced on February 19, 2021, would impact affordable housing by changing aspects of ownership and the Welfare Exemption. AB 1206 would provide a Welfare Exemption to non-profit limited equity housing cooperatives (LEHCs), allow LEHC properties to be exempt from property

tax reassessment during a sale, and would allow community land trusts to maintain their Welfare Exemption if the income of a resident rises to 140% of the area median income.

AB 1206 or a similar proposal may be considered in the 2022 legislative session.

The Board may wish to consider sponsoring legislative proposals or supporting legislation that would make the Welfare Exemption available to new models of low-income housing developments, depending on the characteristics of specific projects.

Conclusion

In conclusion, there may be a need for more fact-finding among stakeholders to determine how best to streamline the Welfare Exemption application process for low-income housing and what legislation may be needed by the BOE to support affordable housing development.