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STATE BOARD OF EQUALIZATION

January 25, 2022

TO: Members of the Board of Equalization

FROM: Malia M. Cohen, Chair

RE: Board of Equalization Board Meeting, January 25, 2022, L.1.a.
Property Tax Abatement Work Group Update

The Board will receive an update on the strategy and proposed plan to convene the Property Tax Abatement Work Group to spur the development of affordable housing in California.

The purpose of this agenda item is to provide the Board an update on the strategy and proposed plan to convene the Property Tax Abatement Work Group and provide Board Members the opportunity to make recommendations regarding the strategy and proposed plan.

The Board will also receive the Property Tax Abatement Work Group's preliminary review of some of the challenges and the opportunities to consider when proposing property tax abatement policies to spur the development of more affordable housing, particularly to address the housing needs of the "missing middle" in California.

Background

Historically, some jurisdictions have used property tax abatements to incentivize development. Whether it is foregoing or exempting a tax indefinitely, for a designated period, or incrementally phasing in a tax, such action has been taken to stimulate development on vacant lots, encourage housing development and address housing needs, and spur economic development in general.

Within the Board of Equalization, the agency has traditionally considered property tax abatements to address penalties and interest related to the failure to pay or late property tax payments.

This Work Group will consider property tax abatements from the lens of incentivizing development and expanding the resources available to government when addressing the unprecedented affordable housing crisis in California.

The Board's leadership in this area was initiated at the November 19, 2019 Board Meeting through a Board Member Requested Matter (L Item-Board Member Cohen) regarding the Board receiving testimony to review property tax exemptions to spur the development of affordable housing.

In response, at several subsequent Board Meetings in late 2019 and early 2020, the Board received testimony from housing experts and various stakeholders. The testimony of these experts was summarized in a memorandum sent to Board Members in June 2021. The summary included a presentation on the Section 421-A Affordable Housing New York Program.

At the July 27, 2021 Board Meeting, the Board voted to sponsor necessary legislative proposals or support legislation that would make the Welfare Exemption more available to new models of low-income housing developments, and to establish a Board Work Group on property tax abatement to spur the development of affordable housing.

Review of Property Tax Abatement Policies: Addressing the "Missing Middle"

In response to this charge, the Work Group has engaged in outreach to housing development experts to examine the challenges and opportunities of property tax abatements as a policy option to spur the development of affordable housing, particularly how to incentivize the development of housing to respond to the needs of the "missing middle."

The "missing middle" comprises families that do not qualify for low-income housing or families that have sufficient income to enter the housing market without assistance.

The Board recognizes and strongly supports the Welfare Exemption for the development of affordable housing for lower income households under Revenue and Taxation Code Section 214 and Property Tax Rule 140. The Board also applauds the efforts of the Governor to increase funding for affordable housing. However, to address the unprecedented housing crisis facing California, California government leaders are exploring all possible options and alternatives.

The option that the Board Work Group will consider is the feasibility of using targeted property tax abatements or temporary tax reductions to spur housing development for lower income and middle-class income persons. To put this in perspective, the cost of developing a single unit of housing is at a historic high level and is increasing daily.

A 2019 study by the Bay Area Council Economic Institute found that the average unit of construction cost of new below market rate housing – excluding the Bay Area – averaged \$385,185 per unit in California. In San Francisco this per unit cost to build new below market rate housing was over \$737,000. In Alameda County, the cost per unit was over \$726,000. In Santa Clara County, the cost per unit was over \$621,000. And, even in Sonoma County, home to Santa Rosa, the cost was almost \$500,000.

These record high costs per unit require innovative approaches to address our housing crisis or we will continue to have the discussions about building affordable housing for decades and decades. And, during those decades, government and local think tanks will

issue additional studies, only to foster greater frustration about our inability to address our housing crisis.

It is time to explore – in a fiscally prudent way – the creation of a mechanism to abate or reduce property taxes paid by for-profit developers who want to build below-market rate housing for lower income and middle-income renters and homebuyers. The Board may also want to explore options related to property taxes paid by purchasers of homes in such developments.

Of course, whenever the Board initiates a discussion about property tax exemptions, abatements, and reductions, the Board must also consider the fiscal impacts on our schools and local governments.

In addition to examining whether property tax abatements are appropriate, the Board must also consider how the state may backfill lost property tax revenues.

As a state with a goal and commitment to building affordable housing, it requires creativity and the understanding that there is a cost and a sacrifice to achieving this goal.

The Board Work Group will continue to review these challenges and opportunities on property tax abatements. This examination will allow the Board to hear from the experts, to gain a full appreciation for fiscal implications, and to explore innovative proposals that will in fact encourage affordable housing development.

Challenges and Questions Regarding Tax Abatements for Housing Development

There are challenges and compelling questions that require answers regarding property tax abatements. They include, but are not limited to, the following items:

- Examine factors such as development costs, restrictive zoning, and hard construction costs. The impact of these factors varies by area. It will require wise and judicious discussions about how to provide the best policy response.
- Examine whether proposed abatement incentives will spur the development of new affordable housing, as opposed to simply rewarding development that would have taken place anyway.
- Explore whether property tax abatements should be made available just for housing developers, or should they also be made available for first-time home buyers.
- Review how property tax abatements facilitate a specific project to pencil-out. This should involve the examination of specific pro-formas to show how property tax abatements could provide the incentive to make a project work.
- Examine how property tax abatements would work including addressing the following questions: Would there be a direct abatement of property taxes in full? Could property taxes be abated by loans from a government agency or pension fund? How would these loans be paid back?
- Review whether a Joint Powers Authority (JPA) structure could receive the property tax abatement and simultaneously develop property, apply a restricted use for a term of years, and have the local governments receive the property at the end of the term?

- Determine which proposals would require a Constitutional amendment, and which proposals would require a statutory change?
- Explore whether the state or local government would control a property tax abatement program?
- Review whether local governments would have a buy-in or buy-out option?
- Explore whether a property tax abatement program integrates with other programs, such as recent federal infrastructure expenditures?
- Explore whether the federal infrastructure expenditures could be leveraged to support a reduction in local development fees that are traditionally dedicated -- in part -- to local infrastructure needs?
- Examine if there are ways to reduce local development fees that often make it infeasible to build affordable housing projects.

Currently, the Work Group is in the process of reaching out and developing a team of housing and finance experts in private industry, in academia, and in state and local governments.

The Work Group anticipates holding hearings about property tax abatement options in 2022 to examine these questions and challenges. Our goal is to determine if there are suitable policy options that can spur the development of more affordable housing with an emphasis on the “missing middle”.

Scope of the Property Tax Abatement Working Group's Review

The following is an outline of an agenda to guide the inquiry of the Property Tax Abatement Work Group at upcoming Work Group Meetings:

- Overview of the Current Housing Crisis & Housing Development Challenges -- Challenges of Building Market Rate, “Missing Middle”, & Affordable.
- Overview of Current Property Tax Related Incentives in California.
- Providing a Statewide Solution -- Large Cities, Smaller Cities, Rural Areas.
- Addressing Equity Issues -- Systemic Racism -- Redlining -- Access to Financing.
- Property Tax Abatements as Incentives -- the New York City Experience -- the Section 421-A experience, and other Cities.
- Using Joint Power Authorities as a Vehicle for Property Tax Abatements.
- Abatement Programs to Incentivize Development in California -- Developers & New Home Buyers -- Length & Scope of Abatements?
- Examining an Abatement Pro-forma -- New York City Example.
- Abatement Legal Issues -- Statutory or Constitutional Changes Needed.
- Funding Issues -- State Funds Used -- Abatements as Loans or Mello-Roos style Repayment Structures.
- Abatements and Backfill Challenges for Schools and Local Governments.

As the Work Group continues to engage stakeholders, the Work Group may expand our review and proposed agenda items.

Conclusion

Acknowledging all of the above, the Property Tax Abatement Work Group will position the Board to engage in meaningful fact-finding efforts and dialogue with stakeholders

about viable options that may exist in using property tax abatements to address the housing crisis facing California.

The Board is uniquely positioned to convene these meetings and ultimately develop a white paper that summarizes our findings and provides potential policy recommendations.

I am available to answer any questions regarding the Work Group's proposed strategy and plan.