Issue Paper Number **15-002**

- ☐ Board Meeting
- ☐ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☒ Property Tax Committee
- ☐ Other

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

Letter To Assessors -Welfare Exemption Low-Income Housing Property Partial Exemptions

I. Issue

Should the State Board of Equalization (Board) adopt and authorize issuance of the attached proposed Letter To Assessors (LTA), *Welfare Exemption Low-Income Housing Property Partial Exemptions*?

II. Alternative 1 - Staff Recommendation

Staff recommends that the attached proposed LTA, *Welfare Exemption Low-Income Housing Property Partial Exemptions*, be adopted and authorized for issuance (see Attachment A).

III. Other Alternative(s) Considered

No other alternatives.

IV. Background

Under authority of Article XIII, section 4, subdivision (b) of the California Constitution, the Legislature enacted Revenue and Taxation Code section 214 to exempt from property taxation property used exclusively for religious, hospital, scientific or charitable purposes, owned by qualifying organizations, if certain requirements are met. This exemption is commonly known as the welfare exemption.

Section 214(g) provides for partial exemption for property used exclusively for rental housing and related facilities that are owned and operated by qualifying organizations. Prior to January 1, 2015, the law did not provide for a specific method of calculating partial exemptions. Effective January 1, 2015, Senate Bill 1203 (Stats. 2014, ch. 693) amended section 214(g) in several respects to make clear the method of calculating partial exemptions.[1]

Government Code section 15606, subdivision (e), provides that the Board shall issue to assessors instructions designed to promote assessment uniformity throughout the state. One vehicle for issuing such instructions is the Letters To Assessors (LTAs) series, which presents Board staff's interpretation of rules, laws, and court decisions on property tax assessment matters.[2]

V. Discussion

On December 29, 2014, Board staff issued LTA 2014/070 advising interested parties of a project to develop guidelines to assist county assessors' staff in applying the welfare exemption to low-income housing property when the rental housing does not exclusively serve lower income households. The LTA requested comments from interested parties on the proposed guidelines, which were attached to the letter. Suggested text changes and proposed additions were received from interested parties.

On February 4, 2015, staff held an interested parties meeting at the Board's headquarters in Sacramento to discuss proposed changes. The attached proposed LTA represents a consensus of interested parties who participated in the project (Attachment A).

VI. Alternative 1 - Staff Recommendation

Staff recommends that the Board adopts and authorizes for issuance the attached proposed LTA, *Welfare Exemption Low-Income Housing Property Partial Exemptions* (see Attachment A).

A. Description of Alternative 1

Staff recommends that the Board issue guidelines that discuss the following issues related to partial exemptions for properties not used exclusively for low-income housing.

- Information on the statutory changes to section 214(g).
- Step-by-step procedure for calculating partial exemptions under section 214(g).
- Examples of the calculation procedure.

[1] Under Section 214(g) as amended (1) the partial exemption shall be equal to the percentage of the property's value that is equal to the percentage that the number of units serving lower income households represents of the total number of residential units; (2) the term "related facilities" is defined to explicitly include certain items; and (3) the term "units serving lower income households" is defined to explicitly address units that are vacant when determining the occupancy percentage.
[2] See www.boe.ca.gov/proptaxes/ltacont.htm.

B. Pros of Alternative 1

Alternative 1 provides guidance designed to promote statewide assessment uniformity as contemplated by Government Code section 15606(e). Issuing the proposed LTA will provide instruction/guidance to assessors to assist in calculating partial exemptions for properties not used exclusively for low-income housing.

C. Cons of Alternative 1

None

D. Statutory or Regulatory Change for Alternative 1

None

E. Operational Impact of Alternative 1

None

F. Administrative Impact of Alternative 1

1. Cost Impact

No cost impact is anticipated. Electronic copies of the LTA will be distributed and posted to the Board's website.

2. Revenue Impact

None

G. Taxpayer/Customer Impact of Alternative 1

None

H. Critical Time Frames of Alternative 1

None

VII. Other Alternatives

None

Preparer/Reviewer Information

Prepared by: Property and Special Taxes Department, County-Assessed Properties Division

Current as of: February 23, 2015

PROPOSED LETTER TO ASSESSORS

WELFARE EXEMPTION LOW-INCOME HOUSING PROPERTY PARTIAL EXEMPTIONS

On September 27, 2014, the Governor signed Senate Bill 1203 (Stats. 2014, ch. 693), which relates to a property tax exemption for low-income rental housing projects. Included in the bill are amendments to portions of Revenue and Taxation Code section 214(g),[1] which allow for a partial exemption on property and related facilities when the rental housing does not solely serve lower income households. The amendments are effective January 1, 2015.

Section 214(g) provides for partial exemption for property used exclusively for rental housing and related facilities that are owned and operated by qualifying organizations. The amendments to section 214(g) relate to partial exemption calculation issues by: (1) specifying that the partial exemption calculation use a "number of units" basis (section 214(g)(1)); (2) defining "related facilities" to explicitly include certain items (section 214(g)(3)(B)); and (3) defining "units serving lower income households" to explicitly address units that are vacant when determining the occupancy percentage (section 214(g)(3)(C)).

Section 214(g)(1) is amended to read, in part, as follows:

> Property used exclusively for rental housing and related facilities and owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, or corporations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation or eligible limited liability company, meeting the requirements of this section…*shall be 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*…[Emphasis added.]

[1] All statutory references are to the Revenue and Taxation Code, unless otherwise provided.

In addition, section 214(g)(3) is amended to include subparagraphs (B) and (C). Section 214(g)(3)(B) states:

> "Related facilities" means any manager's units and any and all common area spaces that are included within the physical boundaries of the rental housing development, including, but not limited to, common area space, walkways, balconies, patios, clubhouse space, meeting rooms, laundry facilities and parking areas, except any portions of the overall development that are nonexempt commercial space.

Section 214(g)(3)(C) states:

> "Units serving lower income households" shall mean units that are occupied by lower income households at an affordable rent, as defined in Section 50053 of the Health and Safety Code or, to the extent that the terms of federal, state, or local financing or financial assistance conflicts with Section 50053, rents that do not exceed those prescribed by the terms of the financing or financial assistance. Units reserved for lower income households at an affordable rent that are temporarily vacant due to tenant turnover or repairs shall be counted as occupied.

Forms BOE-267-L, *Welfare Exemption Supplemental Affidavit*, *Housing – Lower Income Households*, and BOE-267-L1, *Welfare Exemption Supplemental Affidavit, Low-Income Housing Property of Limited Partnership*, were updated to reflect these amendments. In addition, the following exempt value calculation procedure should be used when applying the welfare exemption to a low-income housing property:

1. Determine the total taxable value of the property[2].
2. Determine the taxable value of the rental housing and related facilities by subtracting the taxable value of the nonexempt commercial property, if any, from the total property value.[3]

[2] Revenue and Taxation Code sections 51 and 110.1.

[3] When property consists of commercial and residential shared space, the common footprint of the land must be allocated between commercial and residential uses.

3. Determine the percentage of residential units eligible for exemption by dividing the number of units serving lower income households by the total number of residential units.
4. Finally, determine the exempt value by multiplying the percentage of residential units eligible for exemption by the value of the rental housing and related facilities.

The following examples illustrate the application of the exempt value calculation procedure:

Example 1 – Low-Income Residential Housing Project

Subject property is a five-story, low-income residential housing project located on a 2.0 acre parcel. The total square footage of the building is 50,000 square feet. There are common area spaces, walkways, laundry facilities, a manager's unit, and parking. The property is entirely dedicated to residential housing. The building includes a total of 50 residential units, with 40 units designated for lower income households. The current taxable value of the property is $10 million.

40 LIH[4] units / 50 total units = 80 percent

$10 million X 80 percent = $8 million

Therefore, $8 million of the total taxable property value consists of low-income housing and related facilities, which are exempt from taxation, while the remaining $2 million is taxable.

Example 2 – Low-Income Residential Housing Project with Vacant Units

Subject property is a five-story, low-income residential housing project located on a 2.0 acre parcel. The total square footage of the building is 50,000 square feet. There are common area spaces, walkways, laundry facilities, a manager's unit, and parking. The property is entirely dedicated to residential housing. The building includes a total of 50 residential units, with 40 units designated for lower income households. Of those 40 lower income household units, 35 units are occupied and 5 units are vacant, but reserved for low-income residents. The current taxable value of the property is $10 million.

[4] Lower Income Household (LIH).

35 LIH units + 5 vacant LIH units = 40 LIH units

40 LIH units / 50 total units = 80 percent

$10 million X 80 percent = $8 million

Therefore, $8 million of the total taxable property value consists of low-income housing and related facilities, which are exempt from taxation, while the remaining $2 million is taxable.

Example 3 – Low-Income Residential Housing Project with Commercial Space

Subject property is a five-story, low-income residential housing project located on a 2.0 acre parcel. The total square footage of the building is 50,000 square feet. There are common area spaces, walkways, laundry facilities, a manager's unit, and parking. The property is a mixed use of residential housing and commercial space. The building includes a total of 50 residential units, with 40 units designated for lower income households, and 10,000 square feet of commercial space. Of those 40 lower income household units, 35 units are occupied and 5 units are vacant, but reserved for low-income residents. The current taxable value of the property is $11 million, which includes $2 million attributable to nonexempt commercial property.

Current taxable value of total property	$11,000,000
Taxable value of nonexempt commercial property	(2,000,000)
Taxable value residential property	9,000,000
Exempt taxable value low-income housing (80%)[5]	(7,200,000)
Taxable value nonexempt residential housing	$1,800,000

Current taxable value of total property	$11,000,000
Exempt taxable value low-income housing	(7,200,000)
Total taxable value of nonexempt property	$3,800,000

In determining the taxable value of the nonexempt commercial portion of the property, care must be taken to ensure that the value includes all components of the property that contribute to the commercial use, including that portion of the land attributable to the commercial property and

[5] See Example 2 for calculation of the percentage of residential units eligible for exemption (35 LIH units + 5 vacant LIH units = 40 LIH units / 50 total units = 80 percent).

any common property, such as parking and walkways. The income approach to value may already include these components in the income to be capitalized; the comparative sales approach to value may already include these components in the unit of comparison. However, when using the cost approach to value, these components may have to be explicitly added to capture the full value of the property used for nonexempt commercial use.

Example 4 – Low-Income Residential Housing Project with Commercial Space and Vacant Excess Land

Subject property is a five-story, low-income residential housing project located on a 4.0 acre parcel. Of those 4.0 acres, only 2 acres are being utilized. The total square footage of the building is 50,000 square feet. There are common area spaces, walkways, laundry facilities, a manager's unit, and parking. The property is a mixed use of residential housing, commercial space, and 2.0 acres of vacant excess land. The building includes a total of 50 residential units, with 40 units designated for lower income households, and 10,000 square feet of commercial space. Of those 40 lower income household units, 35 units are occupied and 5 units are vacant, but reserved for low-income residents. The current taxable value of the property is $11.5 million, which includes $500,000 attributable to nonexempt vacant excess land and $2 million attributable to nonexempt commercial property.

Current taxable value of total property	$11,500,000
Taxable value of nonexempt vacant excess land	(500,000)
Taxable value of nonexempt commercial property	(2,000,000)
Taxable value residential property	9,000,000
Exempt taxable value low-income housing (80%)[6]	(7,200,000)
Taxable value nonexempt residential housing	$1,800,000

Current taxable value of total property	$11,500,000
Exempt taxable value low-income housing	(7,200,000)
Total taxable value of nonexempt property	$4,300,000

[6] See Example 2 for calculation of the percentage of residential units eligible for exemption (35 LIH units + 5 vacant LIH units = 40 LIH units / 50 total units = 80 percent).

In this example, the nonexempt portion of the property includes excess land, which must be removed prior to determining that portion eligible for the low-income housing exemption. Excess land is that which is not needed to support the existing improvements and, as such, would not qualify as rental housing and related facilities.[7]

[7] Generally, unused vacant property does not qualify for the welfare exemption. However, section 214.15, provides that vacant land owned by qualifying nonprofit organizations, whose primary purpose is to build and rehabilitate single- or multi-family residences for sale at cost to low-income families with zero interest rate loan financing, may qualify for exemption.