

PILOT Agreements and their Potential Impact on a Low-Income Housing Development's Welfare Exemption

The Welfare Exemption for Low-Income Housing Developments: Article XIII, Section 4(b) of the California Constitution authorizes the Legislature to exempt from taxation property used exclusively for religious, hospital, or charitable purposes, as specified. The Legislature has implemented this "welfare exemption" in Revenue and Taxation Code (R&TC) Section 214.

AB 2144 (Filante), of the 1987-88 Regular Session, amended R&TC Section 214 specifically to exempt low-income housing developments operated by non-profit organizations. As noted in the Senate Revenue and Taxation Committee analysis, AB 2144's proponents argued that the property tax funds then being paid "could better be used in furtherance of the goals of providing low income housing."

To this end, R&TC Section 214(g) currently includes a "certification requirement" for low-income housing owners seeking the welfare exemption. Specifically, the law requires a project's owner to "[c]ertify that the funds that would have been necessary to pay property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households." [R&TC Section 214(g)(2)(B).]

Prior to the amendment including this certification requirement, AB 2144 instead required a low-income housing owner to *demonstrate* that property tax savings were being used to maintain affordability or to reduce rents. This demonstration requirement was subsequently removed in favor of the certification requirement in apparent response to concerns raised by the State Board of Equalization (BOE). Specifically, the BOE's September 9, 1987 analysis of AB 2144 noted the following:

It is not clear how the owner of the property could demonstrate that this requirement is satisfied. If the owner of the property receives rents in excess of the amounts required to pay out-of-pocket expenses, it may be difficult or impossible for the owner to satisfactorily demonstrate that this requirement is satisfied. Further, how can the owner demonstrate that the property tax benefit has not been reflected in lower rents for those households which do not qualify as lower-income? This requirement would also add administrative complications for the agencies administering the exemption.

PILOT Agreements and their Potential Impact on the Welfare Exemption: Since local governments do not receive their share of property taxes from exempt properties, certain local governments have entered into agreements with low-income housing developers to compensate them for their lost revenues. These agreements, known as "payment in lieu of taxes" (PILOT) agreements, often provide for payments that closely resemble property tax payments.

While there is no express authority for low-income housing developers to pay PILOTs, PILOTs are authorized in state statute in two cases: for low-income housing owned by either public housing authorities or federally recognized Indian tribes. For example, Health and Safety Code (H&SC) Section 34401 specifically authorizes, but does not require, *a public housing authority*

to make payments in lieu of taxes to a local government entity with respect to a housing development.¹ Under this statute, the PILOT amount may not exceed the estimated cost to the local entity of services, improvements, or facilities it furnishes for the housing project's benefit.² In the case of developments owned by housing authorities, federal statute requires the properties be exempt from local and state property taxes to receive federal funds. The federal statute also requires public housing authorities to pay PILOTs of up to 10 percent of the sum of the rents charged. By way of background, public housing authorities were created to administer federal funding for low-income housing. Historically, public housing authorities developed and owned most of the low-income housing in local communities. This model changed when the Federal Government created the Low-Income Housing Tax Credit in the late 1980s. After the creation of this tax credit, a new model developed in which non-profit housing developers alone, or in some cases in partnership with for-profit developers, build and own low-income housing developments.

A recent informal survey of low-income housing developers generally provides some insight into the nature and structure of PILOTs currently in place in California. According to the survey, PILOT amounts are determined in various ways, including as: a portion or all of the property taxes the local government would have received without the exemption, a percentage of the assessed value of the building, a flat fee, and an amount to compensate for police and fire service needs generated by the residents of the project. A few PILOT agreements provided to committee staff were also structured to increase the payment amount over time and were included as part of the bond issued by the city for the project.

A question has arisen regarding whether the existence of such a PILOT agreement jeopardizes a low-income development's welfare exemption. Specifically, some have argued that the existence of a PILOT agreement negates a developer's ability to certify, as required by R&TC Section 214(g)(2)(B), that property tax savings are being used to reduce rents or maintain unit affordability. As a result, at least one county assessor has begun to pursue escape assessments equal to the amount of property taxes owed during the time low-income housing developments received the welfare exemption and paid PILOTs.

BOE's Legal Memorandum: Recently, BOE's legal staff analyzed the question of whether a low-income housing developer subject to a PILOT agreement may properly make the certification required by R&TC Section 214(g)(2)(B). BOE's legal staff concluded:

[A]s long as the developer has maintained rents in accord with those required by section 214, subdivision (g)(2)(A) . . . and has a reasonable belief that its PILOT payments will

¹ H&SC Section 34401 provides as follows: "The property of an authority is exempt from all taxes and special assessments of the State or any city, county, or political subdivision of the State. In lieu of such taxes or special assessments the authority may agree to make payments to any city, county, or political subdivision of the State for services, improvements, or facilities furnished by such city, county, or political subdivision for the benefit of a housing project owned by the authority; but in no event shall such payments exceed the estimated cost to such city, county, or political subdivision of the services, improvements, or facilities."

² R&TC Section 237 includes similar authority for low-income housing owned by Indian tribes.

be used to support or benefit the low income housing development, in our view, such developer can make the Section 214(g)(2)(B) certification in good faith.

Development Impact Fees: California Constitution Article XI, Section 7, grants counties and cities the authority to make and enforce all local, police, sanitary and other ordinances and regulations not in conflict with general laws. The police power is the constitutional authority to impose regulatory fees.

Cities and counties have statutory authority to charge a "development impact fee" as a condition of approval of a development project. Government Code (GC) Section 66000(b) defines this type of "fee" as:

[A] monetary exaction other than a tax or special assessment, whether established for a broad class of projects by legislation of general applicability or imposed on a specific project on an ad hoc basis, that is charged by a local agency to the applicant in connection with approval of a development project for the purpose of defraying all or a portion of the cost of public facilities related to the development project

Development impact fees are subject to GC Section 66000 *et seq.*, which is known as the Mitigation Fee Act.

Development fee revenues must be deposited in a separate dedicated capital facilities account. State law provides specific accounting procedures to ensure that the funds are used properly. The local agency must make annual findings regarding the unexpended portion of any remaining fee revenue, and publish a report detailing the fund balances and the public improvements made and amounts spent.

Local agencies can also charge "regulatory fees" that are limited to covering the cost of the regulatory program. These types of regulatory fees cover development-related processing fees (including building and use permits, zoning variances and changes, building and safety inspections, map applications, and planning services).

Finally, local governments are prohibited from imposing different requirements on developments intended for occupancy by low-income persons and families than those imposed on developments in general [GC Section 65008 (d)(2)(A)]. Specifically, GC Section 65008(d)(1) provides that cities, counties and other local governmental agencies may not:

[I]mpose different requirements on a residential development or emergency shelter that is subsidized, financed, insured, or otherwise assisted by the federal or state government or by a local public entity, as defined in Section 50079 of the Health and Safety Code, than those imposed on nonassisted developments, except as provided in subdivision (e). The discrimination prohibited by this subdivision includes the denial or conditioning of a residential development or emergency shelter based in whole or in part on the fact that the development is subsidized, financed, insured, or otherwise assisted as described in this paragraph.

Questions for Consideration: Members may wish to consider the following policy questions in connection with this informational hearing:

- 1) What was the Legislature's intent in applying the welfare exemption to low-income housing projects?
- 2) Is legislative action needed to maintain the welfare exemptions for projects that are subject to a PILOT agreement?
- 3) How should PILOT agreements be treated going forward? Are they consistent with the Legislature's intent of including low-income housing developments under the welfare exemption? Is legislation needed?