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GUEST COLUMN

LA's Homelessness and Housing Solutions Tax could be short-lived

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The Taxpayer Protection and Government Accountability Act has gathered sufficient signatures to be placed on the California state ballot for November 2024. If passed, the two-thirds vote requirement is the key to overturning the Homelessness and Housing Solutions Tax.

Real property sales and transfers in the City of Los Angeles involving properties valued over \$5 million will be assessed a significant new transfer tax beginning April 1, 2023. The new transfer tax, described as the "Homelessness and Housing Solutions Tax" became effective with the passage of Measure ULA, approved by 57% of the voters in the Nov. 8, 2022 election. The new transfer tax is imposed on transfers of "any lands, tenements, or other realty sold within the City of Los Angeles" when the value of the property sold or transferred exceeds certain threshold valuations. Although not specifically addressed, we presume that transfers of interests in entities holding title to property will trigger the tax if such transfers constitute a change of ownership under Revenue & Taxation Code Section 64. As of April 1, 2023, the tax is 4% for properties valued at \$5 million or more, but less than \$10 million, and 5.5% for properties valued at \$10 million or more. Unlike the calculation of the County and City transfer taxes, the valuation for calculating the new transfer tax is not reduced by the value of any liens or encumbrances remaining on the property at the time of the sale and transfer.

This new tax is in addition to the current County and City transfer taxes in the amount of \$1.10 and \$4.50 per \$1,000 value of the transferred property, respectively.

The LA City Director of Finance is authorized to issue rules and regulations to enforce and administer the new transfer tax, and to establish procedures for administering exemptions to the new tax. The measure also requires the Director to annually adjust the property consideration or value thresholds for the imposition of such transfer tax, based upon changes to the Chained Consumer Price Index pursuant to guidelines and procedures as may be established by the Director.

The Ordinance provides exemptions for property transfers where the transferee is a non-profit entity within IRC Section 501(c)(3), a Community Land Trust, a Limited-Equity Housing Cooperative, or a limited partnership or limited liability company in which only bona fide nonprofit corporations, Community Land Trusts, and/or Limited-Equity Housing Cooperatives are the general partners or managing members, and will be developing the property transferred with affordable housing. Certain other exemptions include transfers to federal, state or local agencies or instrumentalities thereof, and to other transferees exempt from the City's taxation power.

The ordinance does not provide for the standard exemptions available for County and City documentary transfer taxes, including transfers involving bankruptcy, reorganizations, receiverships, transfers involving merely a change in the form of ownership but where pro-

portionate ownership interests remain unchanged, transfers in lieu of foreclosure, or transfers among spouses required by a decree of dissolution or legal separation.

The new tax was enacted to generate revenue to address the affordable housing crisis in the City of Los Angeles. The Ordinance requires at least 92% of proceeds from the fee to fund acquisition, development, preservation, rehabilitation and operation of affordable housing and to fund tenant assistance programs. No more than eight percent (8%) of the proceeds will be available to fund program administration, reporting, compliance and implementation.

Homelessness and the severe scarcity of affordable housing are related problems that have plagued Los Angeles and surrounding communities for decades with limited progress despite numerous initiatives. In 2019, 59% of renter households in the City were cost-burdened, spending more than 30% of their household income on housing costs, with 32% of renter households severely cost-burdened, spending more than 50% of their household income on housing costs. In 2020, 41,290 people experienced homelessness in the City of Los Angeles, with approximately 70% remaining unsheltered, living on sidewalks, under bridges and in parks.

In September 2022, the UCLA Lewis Center for Regional Policy Studies estimated that the initiative will generate approximately \$923 million annually for affordable housing production and homelessness prevention, and will affect approximately 4% of real estate transactions in the City in a given year.

Approximately 72% of the revenue would be generated from transfers of properties with values in excess of \$10 million and less than 3% of single-family homes and condominiums transferred would be subject to the tax.

A Nov. 28, 2022 article by Jason M. Ward, Associate Director RAND Center on Housing and Homelessness in Los Angeles, argues that the project labor agreement requirement for all projects to be developed with initiative funds involving 40 or more units will unnecessarily increase the cost of construction of such units. Ward notes that his 2021 Rand study found that the requirement for project labor agreements for projects involving 65 or more units under Proposition HHH, the \$1.2 billion supportive housing bond initiative passed by Los Angeles

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voters in 2016, increased costs by approximately fifteen percent (15%). Initial estimates for HHH projects were approximately \$400,000 per unit, such costs are now approximately \$600,000 per unit. Ward also notes that the initiative proponents were likely overly-optimistic as to their estimates for the production of new units. Assuming \$8 billion in revenue is generated over a 10 year period, of which 60% (\$4.8 billion) is directed to produce new housing, the creation of 26,000 units assumes a cost/unit of \$185,000, approximately 30% of the current cost of HHH projects.

On Dec. 21, 2022, the Howard Jarvis Taxpayers Association (HJTA) and the Apartment Association of Greater Los Angeles (AAGLA) filed a complaint in Los Angeles County Superior Court. The lawsuit asserts that the new tax is a “special tax” rather than a “general tax,” and requires the approval of two-thirds vote of qualified electors under Proposition 13.

In February 2023 certain property owners filed a challenge to Measure ULA in the District Court for the Central District of California, to which the City responded by filing a motion to dismiss the complaint.

Based upon two 2020 California Court of Appeal opinions, it would appear that the challenges to the initiative may not be successful. In *City of S.F. v. All Persons Interested in Matter of Proposition C* (June 2020), 51 Cal. App. 5th 703 (“All Persons”), the First Appellate District considered whether Propo-

sition C, approved by 61% of the voters in the November 2018 election, had been validly enacted. Proposition C involved a special business tax to raise funds for homeless services. The HJTA, the California Business Roundtable and the California Business Properties Association (the “Associations”) challenged the validity of the tax because it was approved by less than two-thirds of the voters.

The Court of Appeal, recognizing the inherent power of the people to enact laws through the initiative process, framed the issue as to “whether the people of a city or county may exercise this initiative power to adopt a special tax when a majority of voters concludes it would serve the public good, or does the California Constitution require a two-thirds vote?” The Associations argued that the limitation on the imposition of new taxes under Proposition 13 extends to cities, counties and their respective electorates. The Court rejected that interpretation, noting that, at the time Proposition 13 was approved by the voters “the initiative power had long been ensconced” in the California Constitution, that Proposition 13 was silent on the initiative process and that if the intent was to require initiatives enacting taxes to be subject to the supermajority approval, it should have been manifested in the Proposition. The Court held that the two-thirds voter approval thresholds for certain taxes included in Propositions 13 and 218

are “coexisting with, not displacing, the people’s power to enact initiatives by majority vote,” citing two California Supreme Court decisions *Kennedy Wholesale, Inc. v. State Board of Education* (1991), 53 Cal. 3d 245, and *California Cannabis Coalition v. City of Upland* (2017), 3 Cal. 5th 924.

Six months after All Persons, the Court of Appeal for the Fifth Appellate District issued its opinion in *City of Fresno v. Fresno Building Healthy Communities* (December 2020), 59 Cal. App. 5th 220 (“FBHC”). FBHC involved a challenge to an initiative adopted by 52.17% of Fresno voters at the November 2018 election approving a 3/8 percent sales tax to raise funds for, among other things, improvements to park safety and accessibility, to update and maintain playgrounds and restrooms, to provide youth and veteran job training and to improve after-school, arts and recreation programs. The Court noted that All Persons “presented exactly the same questions presented here.” As a result, the FBHC Court reversed the trial court’s decision to grant FBHC’s motion for judgment on the pleadings, agreeing with and endorsing “the holdings and reasoning of [All Persons], and [finding] that case controls the outcome here.”

Although it is likely that the current challenges to the initiative will fail under the authority of All Persons and FBHC, it is possible that the initiative may be short-lived. The Taxpayer Protection and

Government Accountability Act has gathered sufficient signatures to be placed on the California state ballot for November 2024. The Taxpayer Protection Act will require that all new taxes passed by the California State Legislature be approved by voters, and will require two-thirds voter approval for all new local special tax increases. This two-thirds vote is the key to overturning the Homelessness and Housing Solutions Tax as all such measures passed between January 2022 and November 2024 would be invalidated to the extent not approved by two-thirds of voters, subject to reinstatement if approved by two-thirds of the voters within one year.

The Taxpayer Protection Act does not address payments made under the Homelessness and Housing Solutions Tax from April 1, 2023 until the effective date of the Act if enacted by the voters. Therefore, it is unlikely that property sellers forced to pay the initiative transfer taxes will be able to recover such taxes paid if the Taxpayer Protection Act is approved by the voters in November 2024.

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