Santa Clara County
Assessor's Office

<u>Mills Act</u>
Historical Preservation Through Tax Incentives

What is Mills Act?

A local property tax incentive to encourage restoration, rehabilitation and preservation of privately owned historic properties.

A historic preservation tool to revitalize historic residential neighborhoods and commercial districts.

A program administered by Local Municipalities (Cities).

Benefits to Property Owners

Incentive to keep historic property rather than develop or sell.

For commercial owners, can be packaged with other incentives.

Tax benefit runs with title – a selling point.

Tax benefit is indefinite. Open ended as the annual renewal is automatic, until non-renewal notice is filed.

Benefits to Local Government

Helps retain and maintain historic properties.
Can foster preservation of historic neighborhoods.

Incentive can help revitalize downtown commercial districts.

Can preserve historic fabric of community, boost cultural tourism and increase civic pride.

How does Mills Act work?

Local municipalities may enter into 10 year contract with a property owner. In exchange for restricted assessment, the owners agree to restore and maintain historic property in accordance with the contract.

The properties must be on a local, state, or national register of historic places.

Properties must be privately owned.

Contracts extend one year annually unless either party elects to non-renew.

How does Mills Act work?

Local government agencies control application process and generally perform inspections on intervals of 1 to 5 years.

Property must be restored and maintained in manner compatible with its architecture and use the original materials where feasible.

Contract specifies what maintenance or rehabilitation must be done. The local agency should notify the Assessor of any change in the contract.

<u>Mills Act requires annual assessment by the Assessor</u>.

When do Mills Act values become effective?

Once a contract is signed, accepted and recorded the property subject to the contract must be assessed under section 439.2 on the <u>ensuing lien date</u>.

For example, if the contract is recorded in August of 2019, the property should be valued pursuant to section 439.2 for lien date January 1, 2020 for the tax period from 7/1/2020 to 6/30/2021.

Mills Act tax valuation process
How restricted value is derived

Mills Act properties are valued using the income approach.

The income approach relies on anticipated income that a property might produce. We generally see this approach used in valuing income-producing commercial properties.

The State Board of Equalization has strict guidelines the assessor must follow in order to value Mills Act properties. They are specified in Revenue and Taxation Code Section 439.2.

Valuation Process

Elements of Income Approach

The income approach to value is composed of three main components:

Gross income a property may produce (fair market rents);

Expenses it may incur;

Capitalization rate, or the risk factor that affects the return on investment.

Gross Income

The Assessor has several ways of finding market annual income for residential or commercial properties:

We can rely on local listing services such as MLS and Costar which brokers and realtors use to conduct their business;

The Assessor's Office sends out annual survey letters asking participants for this information, including copies of any leases that might be in place;

At any change of ownership the Assessor inquires about terms of the sale. This questionnaire requests market rents and expenses that affected the sale.

Annual Expenses

The Assessor must apply fair market expenses that the property owner incurs and deduct it from the gross income in order to derive Mills Act value.

Some examples of these expenses include management, maintenance, operating expenses, utilities, insurance etc.

Debt service, property taxes and depreciation are not considered deductible expenses.

Capitalization Rate:

Components of Mills Act Capitalization Rate

The capitalization rate used to value Mills Act properties is strictly governed by the State Board of Equalization. It consists of four components:

First component is the interest component that is issued yearly by the State Board of Equalization. It is based on the effective rate of conventional mortgages as provided by Federal Housing Finance Board.

Second component is historical risk, which is determined by property type. Single family residences have 4% historical risk, while income-producing properties (commercial or apartments) have 2% historical risk.

Capitalization Rate:

Components of Mills Act Capitalization Rate

Third is the amortization component for improvements expressed as a percentage. For example:

Remaining Life	25 Years	50 Years
Amortization Component	4%	2%

This component is applied to improvements only.

The fourth and final component to the capitalization rate is the tax component. This tax rate includes the 1% basic tax rate, as well as any bonded indebtedness related to that tax rate area. Special district assessments and direct charges are not added into the tax rate component.

Annual Valuation and Enrollment of Correct Value

After conducting the Mills Act valuation as specified by the State Board of Equalization, the Assessor has to conduct two more valuations in order to determine the correct value to enroll in any specific year.

First: the market value approach, which indicates the value of the property in the open market on the lien date.

Second: the tax incentive value using the income approach we discussed earlier.

Third: the Assessor considers the indexed Proposition 13 value of the property .

The correct value to enroll is the lowest of the three valuations.

Open Market Valuation of Single Family Residence

	Subject	Comp 1	Comp 2	Comp 3
Sale Price	750,000	735,250	750,000	761,888
Size(sq ft)	2524	2650	2500	2350
Land Size	8500	9000	8250	9500
Age	1898	1910	1907	1886
Location	SJ(downtown)	Same	Same	Same
Condition	Average	Inferior +2%	Same	Superior -2%
Adjusted Value		$749,950	$ 750,000	$746,650

Total Market Value = $750,000

Example of Single Family Residence Tax Incentive Value

Fair Market Rent(gross income) = $3000/mo * 12mo =$36000

Expenses

Maintenance:	$5,000
Utilities:	$0 (tenant paid)
Property Management: 10%	$3,600
Water and Garbage:	$0 (tenant paid)
Insurance:	$1200
Total:	-$9,800
N.O.I :	$26,200

Capitalization rate

SBE=	4.25%
Historical risk SFR=	4.00%
Amortization=	2.00%
Tax component=	1.1056%
Total=	11.3556% or .113556

$26,200/.113556= $230,723

Tax Incentive Value

Open Market Valuation of Income-Producing Properties

Fair Market Rent (gross income)
(5 apts @1300 per mo) $6500/mo * 12 mo =$78,000

Expenses

Vacancy and Collection: 5% fair rent =	$3,900	
Maintenance:	$5,000	
Utilities:	$5,000	
Property Management: 10%	$7,800	
Water and Garbage:	$1,600	
Insurance:	$1,700	
Total:		-$24,400
N.O.I:		$53,600

Market Capitalization rate = 6.25% or .06250

Market Value = $53,600/.06250 = $857,600

Example of Income-Producing Property Tax Incentive Value

Fair Market Rent (gross income)

(5 apts @1300 per mo) $6500/mo * 12 mo =$78,000

Expenses

Vacancy and Collection: 5% fair rent=	$3,900	
Maintenance:	$5,000	
Utilities:	$5,000	
Property Management: 10%	$7,800	
Water and Garbage:	$1,600	
Insurance:	$1,700	
Total:		-$24,400
N.O.I.:		$53,600

Capitalization rate

SBE=	4.25%
Historical risk commercial properties =	2.00%
Amortization=	4.00%
Tax component=	1.1056%
Total=	11.3556% or .113556

Tax Incentive Value = $53,600/.113556 = $472,014

Tax Incentive Value

Anticipated Savings by Enrolling into Mills Act Contract

In the example of a recently sold Single Family Residence:

Market value:	**$750,000**
Tax incentive value:	**$230,723**
Proposition 13 Value:	**$750,000**
Difference:	**$519,277**

Tax savings of: $519,277 * 1.1056% = $5,741

In the example of a recently sold Income-Producing Property:

Market Value:	**$857,600**
Tax Incentive value:	**$472,014**
Proposition 13 Value:	**$857,600**
Difference:	**$385,586**

Tax savings of: $385,586* 1.1056%= $4,263

Mills Act: By The Numbers

On 2019 lien date the County of Santa Clara have 318 properties with active Mills Act contract.

Some properties do not benefit from Mills Act value as their base year values are lower than the tax incentive value Mills Act provides. Lowest reduction given: 0%

This large range, and continually changing market conditions, makes it difficult for the Assessor to forecast the exact savings for any potential Mills Act property prior to the actual assessment.

Cancellation and Non-Renewal of the Mills Act Contract

If the property is found to be in breach of its contract with the local municipality (via notice and pubic hearing) or the owner decides to end the contract, the Mills Act contract may be cancelled outright or placed under non-renewal status.

If the contract is cancelled the property owner will be required to pay a penalty equivalent to 12.5% of the current market value of the property.

If the contract is non-renewed the Assessor will gradually bring the tax incentive value back to the indexed proposition 13 value over the next 10 year period as it is directed by R&T Code 439.3.

Supplemental Billing

The Assessor is precluded from issuing a supplemental assessment for property that is under a Mills Act contract and subsequently changes ownership, but the Assessor must establish a new base year value.
The same is considered when the owner completes any new construction that is included/required in their Mills Act contract.

However, there are two events that will create a supplemental assessment:

> If the property changes ownership and then enters into a Mills Act contract, the property is subject to supplemental assessment. Tax incentive becomes effective the following January 1st lien date.
>
> Additionally, if the property owner builds a structure (such as a detached garage) or builds an addition that is not covered by the contract, this would be subject to supplemental assessment. This type of addition is deemed not to have historical value.

New Construction

Every Mills Act contract that is signed and recorded describes all the buildings and accessory buildings that are covered by the contract.

If the homeowner decides to build a new addition and or any new accessory buildings, this structure may not be covered by the Mills Act and as such it would be subject to new base year value and subsequent indexing.

In this case the Assessor must keep two base year values on the property: the tax incentive value as well as indexed base year value of the new construction.

Recap

The Mills Act is a beneficial tool for local municipalities, as well as local property owners, to maintain, preserve and restore historical properties.

Property owners benefit from property tax incentives which are appraised by the county assessor using strict State Board of Equalization standards.

Local municipalities benefit from revitalization of neighborhoods that otherwise would be rundown or marked for re-development.

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Additional Information

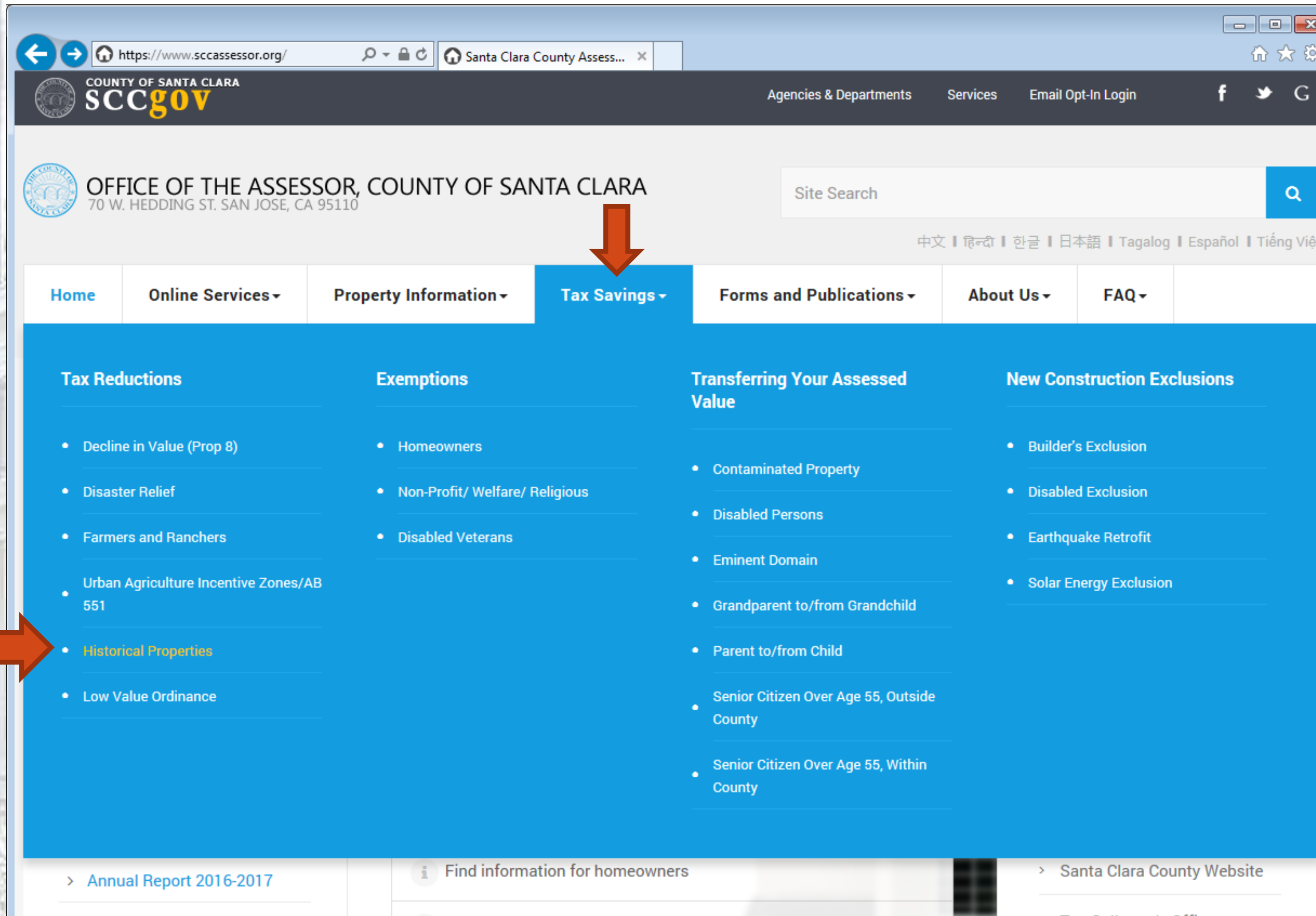
The Assessor's Office website will have links to:

Revenue and Taxation Code 439.2

Letter to the Assessors 2005-035

Also on the website will be a copy of this presentation.

www.sccassessor.org



Thank You

Office of the Assessor, Santa Clara County