

June 22, 2020

## **CITY OF LOS ANGELES PROPOSES PENALTIES FOR UNOCCUPIED PROPERTY BY IMPOSING NEW VACANCY TAX**

To Our Clients and Friends:

On June 16, 2020, the Los Angeles City Council voted 13-0 to approve a motion instructing the City Attorney to draft an ordinance for consideration by voters on the November 3, 2020 citywide ballot, to impose an annual “vacancy tax” on certain unoccupied multi-family residential and other vacant real property in the City of Los Angeles. Under California Proposition 218, the proposal requires voter approval prior to the imposition or increase of any tax assessment.<sup>[1]</sup> **In order to be eligible for the November 3, 2020 ballot, the ordinance must be finalized and approved by the City Council no later than July 1, 2020. As of today, the item has not yet been placed on the agenda for a regularly scheduled City Council meeting.**<sup>[2]</sup>

A motion to consider adoption of a vacancy tax in Los Angeles was originally passed by the Los Angeles City Council on June 11, 2019, and was presented by Mike Bonin (11th District), Marqueece Harris-Dawson (8th District), Paul Koretz (5th District), and David Ryu (4th District). The stated purpose of the tax is to “encourage, push or require existing vacant and habitable housing units to be put on the rental market,” in order to help alleviate Los Angeles’ ongoing housing and homelessness crises. It is estimated that there are approximately 3,000 vacant parcels, 2,500 unoccupied commercial units, and 20,000 unoccupied residential units in the City.<sup>[3]</sup> A report ordered by the Los Angeles Commission on Revenue Generation and released on May 8, 2020 determined that a vacancy tax would generate annual revenue of \$128 million for the City of Los Angeles during the first year of implementation, and approximately \$100 million in revenue annually thereafter.<sup>[4]</sup>

Vacancy taxes are generally designed to motivate owners to develop vacant parcels and to either sell or rent unoccupied units, while also serving as an additional source of revenue for the local jurisdiction. Vacancy taxes were adopted in Washington, DC in 2016; Vancouver, British Columbia in 2017; and Oakland, California in 2018. However, the Vancouver vacancy tax is currently being contested in court, while the Oakland vacancy tax has not been fully implemented, as the Oakland ordinance provides that the tax will not be levied prior to the 2020-2021 tax year. As a result of the limited sample of vacancy taxes currently in effect, the Los Angeles Chief Legislative Analyst (the “CLA”) notes: “[g]iven that a vacancy tax has only recently been implemented in other cities, there is minimal information on its efficacy and clarity on whether the tax or other economic factors will result in anticipated outcomes.”<sup>[5]</sup> The CLA further suggests that “[a]n assessment of the long-term impacts and policy implications of a vacancy tax is limited at this time due to the recent implementation of similar measures. Further, there are numerous uncertainties that complicate the analysis of a tax under the current economic conditions and legal challenges. The City could benefit from collecting and analyzing this information prior to formulating a framework for a potential tax.”<sup>[6]</sup>

## **City Council Guidance, Major Policy Decisions, and Oakland Model**

As a draft of the Los Angeles ordinance has not yet been made available, the exact scope of the proposed Los Angeles vacancy tax is unclear. However, during the June 16 City Council meeting, it was agreed that (i) the ordinance drafted by the City Attorney would be based on the Oakland vacancy tax model; (ii) the vacancy tax would not apply to commercial non-mixed-use units or to single family households owned by individuals; and (iii) the tax rate would be \$5,000 per parcel per year, with a proportionately higher rate for “larger” parcels,[7] as set forth in the Los Angeles Commission on Revenue Generation report. The CLA further identified certain major policy decisions to be considered by the City Council:[8]

### ***1. Determine if the tax should apply to residential properties only or both residential and commercial properties, and if the tax applies to vacant and/or underutilized sites, units, and buildings.***

The City Council stated at its June 16 meeting that a vacancy tax in Los Angeles would not apply to commercial units (other than commercial units within a mixed-use development) or to single family homes owned by individual homeowners. It appears that all other vacant lots and residential buildings and units would be subject to the new vacancy tax.

### ***2. Define “vacant” and/or “underutilized,” including the number of vacancy days allowed.***

Under the Oakland model, the following are considered “vacant” parcels: (i) any parcel of land, whether undeveloped, residential, or non-residential, that is in use less than fifty (50) days during a calendar year; (ii) any condominium, duplex, or townhouse unit under separate ownership that is in use less than fifty (50) days during a calendar year; (iii) any parcel of land where ground floor commercial activities are allowed by applicable zoning or are a legal nonconforming use where all of the ground floor space that could lawfully be occupied by commercial activities is in use less than fifty (50) days in a calendar year.[9] The City Council discussed at its June 16 meeting adopting a similar fifty (50) day vacancy requirement.

Further, under the Oakland vacancy tax ordinance, the following functions or operations are considered “use” for purposes of determining whether a property is vacant: (i) physical occupancy of a residential parcel, condominium, duplex, or townhouse unit by a lawful inhabitant; (ii) carrying on any civic, commercial, industrial, agricultural, or extractive activity (as defined in the Oakland Planning Code) in or on a non-residential parcel; (iii) maintenance of an undeveloped parcel that is contiguous or within 500 feet of an occupied residential parcel owned by the same owner; (iv) ingress and egress of persons or vehicles across substantially all of the parcel; and (v) other functions or operations as the Oakland City Administrator may deem appropriate.[10]

We note that in Oakland a parcel with multiple units, whether residential or non-residential, is not considered “vacant” if any unit on the parcel is not vacant. However, this does not apply to any condominium, duplex, or townhouse until under separate ownership. It is unclear if the Los Angeles ordinance will include the same exception.

### ***3. Determine the City's process for identifying properties subject to the tax.***

The Oakland vacancy tax provides that the Oakland City Administrator may develop administrative methods appropriate to identify properties “based on objective, available data” that are “most likely to be vacant,” and the City Administrator may send initial determination notices to the owners of such properties. Upon receiving an initial determination notice, an owner may, within twenty (20) days of the receipt of such notice, file a petition of vacancy, which must include appropriate evidence demonstrating that the property was not vacant or was entitled to an exemption. The Oakland City Administrator will then make a determination regarding the vacancy of the property based on the evidence provided by the owner. An owner may appeal the City Administrator’s decision within twenty (20) days, and an “independent hearing officer” will be appointed to hear such an appeal.[11] As the Oakland City Administrator only began sending out vacancy notices in February 2020, at present there is little guidance on how this will work as a practical matter.

### ***4. Determine any exemptions to the tax that would apply.***

The Oakland vacancy tax includes exemptions for the following taxpayers: (i) an owner who qualifies as “very low income”;<sup>[12]</sup> (ii) an owner for whom the payment of the vacancy tax would be a financial hardship; (iii) an owner whose property is vacant as a result of a demonstrable hardship that is unrelated to the owner’s personal finances; (iv) an owner who can demonstrate that “exceptional specific circumstances” prevent the use or development of the property (i.e. damage from a recent natural disaster); (v) an owner of a property that is under active construction; (vi) an owner of property for which an active building permit application is being processed; (vii) an owner who is sixty-five (65) years of age or older and qualifies as “low income”;<sup>[13]</sup> (viii) an owner who receives supplemental security income for a disability or social security disability benefits and whose yearly income does not exceed 250% of the 2012 federal poverty guidelines; (ix) an owner that is a non-profit organization or entity owned or controlled by a non-profit organization; and (x) an owner of a parcel included in a substantially complete application for planning approvals that has not yet received approval.[14] It is likely the Los Angeles vacancy tax will include similar exemptions, but it is unclear whether subjective terms such as “hardship” will be clearly defined, and what documentation will need to be provided to substantiate any claims for exemption.

### ***5. Consider phasing in the tax so as not to “flood the market” with available vacant properties and depress property values.***

The Oakland vacancy tax, which was passed in 2018, provided that the tax could not be levied prior to the 2020-2021 tax year, commencing on July 1, 2020, but does not otherwise include an express phasing mechanism. It is unclear if the Los Angeles ordinance will allow for phasing, and if so, the first tax year in which the vacancy tax would be levied.

### ***6. Establish tax rates, and consider not-to-exceed maximums with the ability to adjust in any given year.***

Per the June 16 City Council meeting, it appears the Los Angeles vacancy tax will include the rates set forth in the Commission on Revenue Generation’s report, which is a \$5,000 tax per parcel per year, with

a proportionately higher rate for “larger” parcels. The definition of “larger parcels,” and the corresponding increase in taxes, is not defined in the report.[15]

**7. Consider uses for the special tax, and designate the use of tax revenues.**

The Oakland vacancy tax is imposed as a special tax on the vacant parcels, and it appears that, once in effect, Alameda County will collect vacancy taxes at the same time and in the same manner, and subject to the same penalties and procedures, as the other property taxes collected by the County. Any vacancy taxes assessed will be included on the property tax bill for the fiscal year that begins July 1 following the end of the calendar year in which the parcel was determined vacant by the City of Oakland.[16]

As in Oakland, the CLA notes that a Los Angeles vacancy tax could be structured as a parcel tax as part of the annual property tax assessment process, as the City Attorney has determined that a financial penalty or fine assessed on vacant units or parcels would not be feasible, as the State of California does not currently recognize vacancy as an illegal activity. It is unclear whether the Los Angeles vacancy tax will be categorized as a general tax or a special tax.

Proceeds from the Oakland vacancy tax are to be used only for (i) providing services and programs to persons experiencing homelessness, to reduce homelessness, and to support the protection of existing housing and production of new housing affordable to lower income households; (ii) paying the cost of audits for the use of funds; (iii) paying for the City of Oakland’s costs of the election required to obtain voter approval of the vacancy tax; and (iv) paying for the costs of administering the vacancy tax.[17]

**8. Consider a sunset provision for the tax.**

The Oakland vacancy tax has a term of twenty (20) years. It is unclear if the proposed Los Angeles vacancy tax will have a similar limitation.

**9. Establish the administering City department.**

The Oakland ordinance grants the City Administrator broad authority to adopt rules and regulations to enforce the Oakland vacancy tax, including the establishment of administrative rules to determine how a vacant property is identified.[18] It is unclear which City department would administer a vacancy tax in Los Angeles.

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Gibson Dunn will continue to monitor the progress of the proposed vacancy tax and provide updates as available.

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[1] If categorized as a “general tax,” a simple majority vote will be required. However, if earmarked as a “special tax” for a specific purpose, a two-thirds majority vote will be needed to pass the tax.

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[2] The vacancy tax has not been included on the agenda for the City Council meetings on June 23 or June 24, 2020, but the item could be heard on June 26 or June 30, 2020.

[3] *See Report of the Chief Legislative Analyst on Vacancy Tax and Empty Homes Penalty, Council File No. 19-0623, Assignment No. 19-12-1124, dated as of June 8, 2020 (the “CLA Report”).*

[4] *See Commission on Revenue Generation Final Report 2020.* These revenue figures assume that a vacancy tax would cover residential units, ground floor commercial space, and vacant land at a rate of \$5,000 per unit or parcel, with “larger parcels paying proportionately more.” The report does not state how such an increase would be calculated.

[5] *See CLA Report.*

[6] *Id.*

[7] The size of such parcels and the corresponding increases in taxes have not been disclosed.

[8] *See CLA Report.*

[9] *See Oakland Municipal Code, Title 4, Chapter 4.56.020.*

[10] *See Oakland Municipal Code, Title 4, Chapter 4.56.080.*

[11] *See Oakland Municipal Code, Title 4, Chapter 4.56.100 and 4.56.110.*

[12] The “very low” income exemption applies if an owner's combined family income for the relevant calendar year is equal to or less than the United States Department of Housing and Urban Development “Very Low Income Limit” for the Oakland-Fremont, CA HUD Metro FMR Area.

[13] The “low income senior” exception applies if the owner is at least sixty-five (65) years of age or older and their combined family income for the relevant calendar year is equal to or less than the United States Department of Housing and Urban Development “Low Income Limit” for the Oakland-Fremont, CA HUD Metro FMR Area.

[14] *See Oakland Municipal Code, Title 4, Chapter 4.56.030(J) and 4.56.090.*

[15] The Oakland vacancy tax includes a maximum tax of \$6,000 per vacant residential, non-residential, or undeveloped parcel, and a maximum tax of \$3,000 per vacant condominium, duplex, or townhouse under separate ownership or a parcel with ground floor commercial activity allowed, but vacant. *See Oakland Municipal Code, Title 4, Chapter 4.56.030.*

[16] *See Oakland Municipal Code, Title 4, Chapter 4.56.030.*

[17] *See Oakland Municipal Code, Title 4, Chapter 4.56.050.*

[18] *See Oakland Municipal Code, Title 4, Chapter 4.56.120.*

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*Gibson Dunn's lawyers are available to assist with any questions you may have regarding these issues. For further information, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Real Estate or Land Use practice groups, or the following authors:*

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