

The Story of Mello-Roos

By Chris Sorensen, Founder, USA Help, Inc. A CA Non-Profit Corporation



The Creation of Prop 13

Prior to 1978, property taxes hovered in many areas around 4%, instead of today's 1%. Values went up based on market conditions. This fact, coupled with a high rate, was forcing seniors in our communities to have to literally sell their homes and move away.

The following is a brief and basic description of Prop 13 which was passed in June of 1978 in order to address this concern;

“Under Proposition 13, the annual real estate tax on a parcel of property is limited to 1% of its assessed value. This "assessed value," however, may only be increased by a maximum of 2% per year, until and unless the property undergoes a [change in ownership](#). At the time of the change in ownership the low assessed value may be reassessed to full current market value which will produce a new base year value for the property, but future assessments are likewise restricted to the 2% annual maximum increase of the new base year value.” –Wikipedia

Prop 13 was very popular and remains so today. The idea of protecting those who have no place

else to go, in many cases, is still appealing to the majority of voters.

The Funding Dilemma & Mello-Roos

Prop 13 created a challenge when it came to developing new neighborhoods. The cost of Prop 13 to the municipalities (Local Government) was significant and left them with little ability to fund the necessary improvements in order to create a safe and quality new development, or neighborhood. Developers and Builders also found themselves in the position of not being able to fund these improvements due to the extreme upfront cost involved.

The answer? In 1982, the California State Legislature enacted the; Community Facilities District Act. The “nick name” generally adopted is called Mello-Roos, named after the Acts co-authors, Senator Henry Mello and Assemblyman Mike Roos.

Mello-Roos Explained

Imagine a typical small city. On one side of the city you have the “older” more established neighborhoods. Schools are older, streets need to be resurfaced, and underground pipes are in constant need of repair. Take the other side of town, a developer comes in and develops this area, a builder builds homes on the land, and the new homeowner has new everything... *and* pays the exact same amount in tax rate? No. The public had a better idea. Why not allow the new homebuyers, with full disclosure, make the decision to

buy these new homes with all of their benefits and pay back the money through an ad valorem tax (“pass-through tax”) collected by the County Tax Collector? This became known as the Mello-Roos tax.

You see, in this new side of the city, the land was not developed. It was one large parcel with a single APN (Assessor Parcel Number). Because it was undeveloped (Raw Land), it had a very low tax base. The developer came to the city and asked permission to develop 200 homes. The city approves this development, with conditions. One of the conditions is that the city must approve a Bond issuance. What this means is that the city approves the action of issuing municipal bonds, sufficient to improve the proposed neighborhood *and* that that will be paid back by the new buyers over a 20-30 year time frame.

Each one of those homes is given its own individual APN number and a value is established. Typically, the value (sales price) is what the buyer and seller (builder) agreed upon. Each home is levied with a certain dollar figure and the County Tax Collector must collect these monies until the Bonds are paid in full. Regardless of the value, whether it goes up, or down, these ad valorem taxes remain constant until they are fully paid.

You may have heard of the term “muni-bond” or “municipal bond”. You can walk into any investment office and ask to “invest” in them. They are nothing more than Bonds to improve a particular

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neighborhood, backed by the City in which the homes reside and collected by the County's Tax Collector.



Mello-Roos & the Home Loan

One bump in the road that can commonly occur is when a new buyer purchases one of these homes and the loan originator fails to disclose what the tax will be once the Assessor's office completes its task of assigning an individual APN number to all 200 homes. This is a lot of work involved with this, especially when there are multiple developments occurring at any one time within a County. If one were to pull the tax information and provide it to a perspective homebuyer, it would appear that the taxes associated with this home are very low, as it is still based on the undeveloped raw land and not the individual home that is sitting on the land today. If a home buyer "impounded," or created an escrow account, and the tax calculation is not done properly, the buyer would receive a "supplemental tax bill" that could be both surprising and devastating. This shock could have been avoided with proper disclosure and a thorough

understanding of how this process works.

Title Reports & Tax Calculations

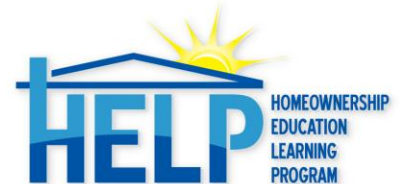
The Title report will disclose the amount of the bond issuance as this will be a tax levied against the home. If the Bond has not been recorded yet, it will be disclosed to the new buyer by the seller/builder. It is critical that one takes the time to have a trusted resource point out the actual tax if one feels a little confused by the explanation of the home builder's representative. Typically, all a person needs to do is to take the base tax rate (Usually approximately 1.25%) multiplied by the purchase price, and then divide this by 12 to obtain a monthly base rate. Next, take the amount of Bond/CFD's/Mello-Roos attached to the property and determine the length of time the money is to be paid back and divide accordingly. Once these numbers are calculated, add them together and you will have the monthly taxes. This simple exercise will allow anyone to determine (with relative accuracy) what the monthly taxes will be and what should be added to the mortgage payment if the buyer's payment is "impounded."

Returning to the example, the "other" side of the city (with the "older" improvements) is paying far less in property taxes than this new development. However, they do not get to enjoy the new schools, parks, roads, lighting and landscaping. Also, the new neighborhood typically enjoys a higher resale value.



The HELP Blog

This blog was created to act as an additional free educational platform where the public can post questions and read previous responses from Founder Chris Sorensen and others. Visit our website to get connected!



The HELP Program promotes consumer protection through education. If you would like to get more information about homeownership or home buying, please visit our website.

www.freehomeownershihelp.org

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