

WHITE PAPER

STRATEGY BRIEF FOR INSTITUTIONAL CAPITAL

Building the Missing Starter Home

An Investment Thesis on California's Starter Home Revitalization Act

How SB 684 and SB 1123 create a structural opening for outsized, risk-adjusted returns in California for-sale residential development.

2.5M+

CALIFORNIA HOUSING UNIT
DEFICIT

16%

OF HOUSEHOLDS CAN AFFORD
A MEDIAN HOME

12–18

MONTHS OF ENTITLEMENT
TIME ELIMINATED

PREPARED BY THE MANAGING PARTNER

For Discussion with Limited Partners and Co-Investor



SUNSET VISTA
DEVELOPMENT

EXECUTIVE SUMMARY

California's housing market exhibits the deepest structural supply-demand imbalance of any major economy in the developed world. The state is short an estimated 2.5 million to 3.5 million homes¹, builds less than half of the 180,000 units per year it requires², and remains affordable to only 16 to 18 percent of its households — versus 37 percent nationally.³ The shortage is most acute at the entry level, where the median first-time buyer is now priced out of nearly every metropolitan market in the state.

In response, the Legislature has enacted the most aggressive land-use reform package in the country. The **Starter Home Revitalization Act** — codified by AB 803 (2021) and dramatically expanded by SB 684 (effective July 1, 2024) and SB 1123 (effective July 1, 2025) — converts the approval of small for-sale subdivisions of up to ten homes into a **ministerial, CEQA-exempt, deemed-approved-in-60-days statewide right**.⁴ Every California city and county, charter or general law, must process these projects under uniform state standards.

We believe this regulatory shift creates a **rare and durable opening for above-market, risk-adjusted returns** in for-sale residential development. The opportunity is structural, not cyclical. It arises from nine independent but compounding sources of alpha:

- **Density arbitrage.** Acquiring underutilized parcels at single-family comparable prices and exiting at multiples of underlying density.
- **Acute undersupply of the exit product.** Detached starter homes, townhomes, and small-lot condos are the most chronically undersupplied product type in California.
- **Removed development standards.** State law preempts subjective design review, minimum-lot-size, FAR, parking, and setback rules that historically killed margin.
- **Compressed entitlement timelines.** Building permit within 6–12 months of submittal and full approval within 8–14 months of acquisition, replacing a 24-to-36-month process.
- **Residential (Type V) construction economics.** Detached for-sale product is built under the residential code at materially lower cost per square foot than podium or wrap multifamily.
- **Statewide procedural uniformity.** One playbook works in every jurisdiction in California — a sourcing and underwriting advantage that compounds.
- **Templatized product.** A small fixed catalogue of plans amortizes design and engineering across every acquisition.
- **Exit optionality and separate salability.** Each unit is delivered on its own fee-simple parcel — sellable individually, retainable as rentals, or aggregatable for institutional cap-rate sale.
- **Depreciation and tax-efficient exit.** Held-for-rental units qualify for cost-segregated 100% bonus depreciation, sheltering rental cash flow and improving after-tax returns on mixed-exit projects.

INVESTOR TAKEAWAY

California has effectively created a new product category — the ministerially approved small-lot starter community — without imposing the prevailing-wage or inclusionary covenants that compress returns under SB 35 and AB 2011. The first capital to industrialize delivery will capture disproportionate operating margin.

I. THE CALIFORNIA HOUSING CRISIS

SCALE OF THE SHORTAGE

California has under-built housing for five decades. The Department of Housing and Community Development estimates the state needs roughly **180,000 net new units per year** to keep pace with demand; over the last decade actual production has averaged **fewer than 80,000 units annually**.² The cumulative deficit is variously estimated at 840,000 units (Up For Growth, Freddie Mac), 1.3 million (California Housing Partnership), 2.5 million (LAO), and up to 3.5 million (McKinsey).¹ The American Enterprise Institute attributes roughly 1.4 million of the national housing shortage — by far the largest single state contribution — to California alone.⁵

PRICE AND AFFORDABILITY

Persistent undersupply has driven the California median home price to roughly **\$870,000 to \$910,000** — more than twice the U.S. median. The California Association of Realtors' Housing Affordability Index sits at **16 to 18 percent**, versus 37 percent nationally.³ The income required to qualify for the median home now exceeds \$213,000, against a state median household income of approximately \$96,000.⁶ A bottom-tier California home is approximately 30 percent more expensive than a mid-tier home elsewhere in the United States.⁷

THE LOCK-IN EFFECT TIGHTENS THE RESALE CHANNEL

Approximately **77 percent of California homeowners hold mortgages below 5 percent**, against prevailing rates in the 6.0 to 6.6 percent range.⁷ The resulting refusal to sell has constrained existing inventory and reduced the natural recycling of starter homes back into the market. Move-up buyers cannot trade up; first-time buyers cannot enter. The historical mechanism by which the entry-level market is supplied — older households selling smaller homes — has effectively seized.

THE STARTER HOME HAS BEEN DISAPPEARING

National data show the median size of newly built single-family homes rose materially from the 1980s through the mid-2010s as builders, facing land scarcity, labor inflation, and regulatory load, shifted capital toward higher price points where margin could absorb input volatility.⁸ In California the regulatory premium is particularly acute: nationwide, **regulatory compliance now accounts for roughly 24 percent**

of the final price of a new single-family home — about \$94,000 per unit.⁹ The starter home segment cannot absorb that load and was effectively driven out of production.

THE BOTTOM LINE

California's housing problem is, at its core, a starter-home problem. There is no plausible reading of the data in which entry-level for-sale product becomes oversupplied within the duration of any reasonable institutional fund life.

II. THE STATE RESPONSE AND THE STARTER HOME REVITALIZATION ACT

A DECADE OF LAND-USE REFORM

Since 2017, California has enacted more than two dozen statutes overriding local control of housing. The arc moves consistently in one direction: from *discretionary review* (where local agencies could deny or condition projects on subjective grounds) toward *ministerial approval* (where state law sets the standards and the local agency may only verify compliance). Headline statutes include SB 35 (2017), SB 9 and SB 10 (2021), AB 2011 and SB 6 (2022), SB 423 (2023), AB 130 and SB 131 (2025), and SB 79 (2025), among others.¹⁰

THE STARTER HOME REVITALIZATION ACT

Within this legislative arc, one statute is uniquely valuable to a small-scale, for-sale developer. The **Starter Home Revitalization Act** was originally enacted as AB 803 in 2021 to permit small-lot subdivisions of single-family homes averaging 1,750 square feet or less. In its original form the Act was useful but limited, requiring only that local agencies approve qualifying applications absent specific findings.¹¹

The Act has since been expanded twice — decisively. **SB 684** (Caballero, signed October 11, 2023; operative July 1, 2024) converted the approval pathway for small-lot subdivisions of up to ten parcels and ten units on multifamily-zoned lots up to five acres into a **ministerial, non-discretionary, CEQA-exempt process with a 60-day deemed-approval clock**.⁴ **SB 1123** (Caballero, signed September 19, 2024; operative July 1, 2025) extended the same regime to **vacant lots in single-family zones** up to 1.5 acres, with newly created parcels as small as 1,200 square feet.¹²

THE MECHANICS OF STREAMLINING

Together, SB 684 and SB 1123 add Sections 65852.28, 65913.4.5, and 66499.41 to the Government Code. The operative provisions are unusually clean. A qualifying project:

- Receives ministerial review — no hearings, no discretionary findings, no right of appeal.
- Is statutorily exempt from CEQA, eliminating environmental impact reports and the associated litigation channel.
- Is deemed approved if the local agency fails to act within 60 days of a complete application.
- Is entitled to a building permit before the final map is recorded, allowing construction to commence in parallel with final mapping.
- Is exempt from the requirement to form a homeowners' association, except where the Davis-Stirling Act independently applies.
- Is subject to objective standards only — and many otherwise-applicable objective standards (minimum parcel size, frontage, FAR below 1.0–1.25, side and rear setbacks beyond four feet, certain parking requirements) are statutorily preempted.

- Applies in every California city and county, including charter cities, because the Legislature declared housing a matter of statewide concern.

WHAT THE STATUTE DOES NOT REQUIRE

Equally important is what SB 684 and SB 1123 *do not* require — particularly in comparison to other ministerial streamlining tools:

Requirement	SB 684 / 1123	SB 35	AB 2011
Prevailing wage / skilled & trained workforce	No	Yes (>10 units)	Yes
Below-market inclusionary set-aside	No	Yes	Yes (mixed-income variant)
CEQA review	Exempt	Exempt	Exempt
Discretionary hearing	None	None	None
Approval shot-clock	60 days	60–180 days	60–90 days
Applies to charter cities	Yes	Yes	Yes
Maximum unit count	10	Unlimited	Unlimited

The absence of prevailing-wage and inclusionary obligations is the single most consequential design choice in the statute. It is what makes the for-sale starter home pencil under SB 684/1123 in markets where it does not pencil under SB 35 or AB 2011.

III. NINE SOURCES OF RISK-ADJUSTED ALPHA

The combination of structural undersupply and ministerial entitlement is unusual. Either condition alone would create opportunity; together they create what we view as a multi-year window of structural alpha. We identify nine distinct sources of return, each of which can be quantified and underwritten.

1. Density Arbitrage

In SB 1123 jurisdictions, a **vacant single-family-zoned lot of up to 1.5 acres** can now be subdivided into as many as ten fee-simple parcels and developed with up to ten homes. Such parcels have historically traded at single-family residual values — that is, on the assumption of one home per lot. The Act does not change zoning, but it changes what can be built ministerially within the underlying density assumptions of the General Plan.

In SB 684 jurisdictions the same logic applies to multifamily-zoned lots that have remained underutilized because the development standards, parking, setbacks, or political risk of discretionary review made conventional multifamily uneconomic. SB 684 allows them to be subdivided into for-sale fee-simple lots at densities tied to the General Plan.

The arbitrage is the spread between (i) the price the seller will accept on the legacy density assumption and (ii) the residual land value supported by an as-of-right ten-home for-sale subdivision. Acquisition discipline — patient sourcing of qualifying parcels at single-family or distressed-multifamily comps — captures this spread at the basis.

2. Acute Undersupply of the Exit Product

The exit product — small-lot detached homes, townhomes, and small condos in the entry-level price band — is the single most undersupplied housing typology in California. Builder economics have steadily migrated toward larger, higher-price-point homes because regulatory overhead is roughly fixed per unit and amortizes more easily over higher revenue.⁸ SB 684's 1,750-square-foot average size cap and SB 1123's small-parcel minimums effectively define a product class that for-profit builders have all but stopped producing.

Demand-side conditions reinforce the thesis: 77 percent of California homeowners are locked into sub-5 percent mortgages and will not list existing starter homes; the lock-in effect could persist for a decade or more.⁷ New construction is the only available source of starter inventory at scale.

3. Removed Development Standards and Local Discretion

Under California's historical land-use regime, the principal drivers of cost and risk in small subdivisions were rarely the building itself — they were the discretionary entitlement layers: design review, conditional use permits, variances, planning commission and city council appeals, and CEQA litigation. SB 684 and SB

1123 strip out the discretionary layer entirely. Local agencies retain authority to apply only *objective* standards, and many of the most-binding objective standards are explicitly preempted by state law:

- No minimum-lot-size requirement above 600 square feet (multifamily zones) or 1,200 square feet (single-family zones).
- No floor-area-ratio limit below 1.0 (3–7 unit projects) or 1.25 (8–10 unit projects).
- No side or rear setback greater than four feet from the original lot line, except as required under the California Building Code.
- No height limit below what the underlying zoning otherwise allows.
- No parking requirement that physically precludes development at the density permitted by the General Plan.
- No project-specific design standards applied only to SB 684/1123 projects.
- No requirement to form a homeowners' association (except where Davis-Stirling otherwise requires one).

The cumulative effect is to remove the cost lines — community meetings, expert consultants, traffic and noise studies, CEQA defense reserves, design iteration, HOA legal — that historically rendered small for-sale subdivisions uneconomic at the entry price point.

4. Compressed Entitlement Timelines

Historical entitlement timelines for small California subdivisions ran 24 to 36 months — or longer — from acquisition to building permit, with CEQA review and litigation routinely consuming 12 to 24 months alone. SB 684 and SB 1123 restructure that timeline through three mechanisms working in concert: a statutory CEQA exemption, a **60-day local-agency deemed-approval clock**, and the elimination of the discretionary hearing itself. Industry estimates of the entitlement-time savings under the parallel 2025 CEQA reforms (AB 130, SB 131) cite 12 to 18 months as a *conservative* reduction;¹³ SB 684/1123 projects benefit from those reforms and go materially further.

In real-world execution, this translates to **building permit issuance within 6 to 12 months of submittal under state law, and full project approval within 8 to 14 months of acquisition** — including the pre-submittal period for surveys, civil engineering, architectural plans, and application preparation. Because SB 684 also requires ministerial issuance of building permits before the final map is recorded, construction can begin in parallel with final-map mechanics rather than sequentially. This fundamentally restructures the time-to-shovel risk profile for California for-sale development.

ENTITLEMENT TIME COMPRESSION

Conventional small subdivision: 24–36+ months from acquisition to permit, plus CEQA litigation risk reserve.

SB 684 / 1123 project: building permit within 6–12 months of submittal, full approval within 8–14 months of acquisition, with construction permitted to begin in parallel with final-map recordation.

At a 12% blended cost of capital, eliminating 12 to 18 months of pre-construction carry on a \$4M land basis preserves roughly \$480,000 to \$720,000 of equity return per project — before any operational improvement.

5. Residential (Type V) Construction Economics

Because each SB 684/1123 unit sits on its own fee-simple parcel and is delivered as a detached or attached single-family home, projects qualify for construction under the **California Residential Code (Type V)** rather than the commercial provisions of the California Building Code that govern podium and wrap multifamily. Type V wood-frame residential construction is materially less expensive on a per-square-foot basis than the Type I or Type III construction required for mid-rise multifamily. Avoided cost categories typically include high-rise sprinkler design, podium concrete and post-tensioning, elevators, fire-rated corridors and assemblies, commercial-grade life-safety systems, and prevailing-wage labor that often attaches to larger multifamily projects.

In addition, SB 684/1123 product is sold fee-simple to individual end buyers — eliminating the multifamily rent-to-cap-rate exit dependency and replacing it with retail homebuyer demand at the most undersupplied price point in the state.

6. Statewide Procedural Uniformity

The Legislature found that housing supply is a *matter of statewide concern*, not a municipal affair under Article XI, Section 5 of the California Constitution. As a result, SB 684 and SB 1123 apply uniformly to every city and county in California — including charter cities such as Los Angeles, San Francisco, San Diego, San Jose, Oakland, and Long Beach.⁴

For a developer operating at scale, this is a material advantage. A single underwriting framework, a single set of submittal documents, and a single legal-and-engineering playbook can be deployed across every market in the state. Sourcing, design, entitlement, and construction-management capacity becomes a shared asset across the portfolio — a structural cost advantage that local merchant builders cannot replicate.

7. Templated Product

Because the statute caps average unit size at 1,750 square feet, prescribes lot sizes, preempts subjective design review, and limits the levers local agencies can pull, the design space for SB 684/1123 product is unusually narrow. A disciplined developer can therefore underwrite a small catalogue of standardized plans — typically a 2-bed and a 3-bed townhome plan, a small-lot detached plan, and a duplex/triplex plan — and **amortize the architectural, structural, MEP, Title 24, and CalGreen engineering across every acquisition.**

On each new site, the work reduces to civil engineering and parcel-map mechanics. Hard-cost estimates compress; bidding cycles shorten; trade pricing tightens through repeat relationships; warranty exposure narrows. This is the same operational lever that production homebuilders have used for decades to outperform custom builders — applied here to a product type that production builders have abandoned and that no incumbent currently produces at scale.

8. Exit Optionality and Separate Salability

Our base case is the retail sale of each home to an end-user buyer at the first-time-buyer price point, where demand is structurally unmet and gross margins are typically highest. Because each unit produced under SB 684 or SB 1123 is delivered on its **own fee-simple parcel — separately titled, separately financeable, and separately salable** — the project also carries embedded exit optionality that is structurally unavailable in podium or wrap multifamily. The same ten-unit project can be:

- Sold unit-by-unit to retail homebuyers at the most undersupplied price point in California (the primary thesis, and the highest gross-margin pathway);
- Held and leased — individually or in aggregate — as detached or attached single-family rentals, capturing rental cash flow in markets where retail absorption softens;
- Aggregated and sold at a cap rate to a single-family-rental (SFR) operator or build-to-rent (BTR) institutional buyer, enabling a portfolio exit when implied cap-rate valuation exceeds the retail residual;
- Or any combination — for example, retailing the prime end-cap and corner-lot homes while retaining interior units as rentals in a rising-rent environment, then trading the held block as a stabilized SFR mini-portfolio at a later date.

This optionality has material underwriting consequences. Conventional for-sale builders carry undiluted exposure to retail homebuyer demand at delivery. Conventional multifamily developers carry undiluted exposure to multifamily cap rates at exit. The SB 684/1123 developer can **pivot between channels as market conditions dictate**, selecting the highest-value exit at the moment of sale. The result is a measurable reduction in left-tail exit risk — exactly the kind of optionality institutional capital tends to reward with multiple expansion at the fund level.

IV. RISK CONSIDERATIONS

We underwrite this strategy with full attention to the risks it does and does not eliminate. The Starter Home Revitalization Act removes *entitlement* risk on qualifying sites; it does not remove *execution* risk.

RISKS MATERIALLY MITIGATED BY THE STATUTE

- Discretionary denial: eliminated by ministerial review.
- CEQA litigation: eliminated by statutory exemption.
- Entitlement timeline: capped at 60 days of agency review by deemed approval.
- Local design overreach: preempted by state objective-standards regime and HCD enforcement authority (AB 434, SB 1037).
- HOA formation cost: eliminated except where Davis-Stirling otherwise applies.

RESIDUAL RISKS

- Site selection: qualifying parcels must satisfy specific siting tests (urban use surround, water/sewer service, environmental and tribal consultation triggers, non-coastal in most cases). Disciplined sourcing remains essential.
- Construction cost and labor: tariffs, materials inflation, and skilled-trades availability remain market risks not addressed by the statute.
- Demand-side macro risk: mortgage-rate sensitivity at the first-time-buyer price point is real; conservative underwriting assumes 6.0–6.5% rate environment.
- Implementation variability: although SB 684/1123 are statewide, local agencies vary in administrative readiness. The first cycle of submittals in any jurisdiction may require active engagement with planning staff and, where necessary, HCD's Housing Accountability Unit.
- Statutory amendment: California housing law continues to evolve. We monitor it as a core competency.

V. INVESTMENT THESIS

We believe the convergence of an entrenched structural shortage with a statute that ministerially authorizes the most undersupplied product type in the state represents one of the most attractive risk-adjusted opportunities currently available in U.S. residential development.

The opportunity is **scalable** — qualifying parcels number in the tens of thousands statewide; **defensible** — capital and operational scale create cost advantages that local merchant builders cannot match; and **durable** — the structural conditions that produced the shortage (lock-in effect, builder migration upmarket, regulatory inertia) will not reverse within any reasonable fund life.

Capital deployed against this thesis benefits from the rare conjunction of (i) a regulatory tailwind enacted by the State of California itself, (ii) a product type that retail buyers want but no one is building, (iii) an entitlement process that converts the slowest, most adversarial element of California real estate development into an 8-to-14-month administrative path, and (iv) embedded exit optionality between retail for-sale absorption and institutional SFR cap-rate sale — chosen project-by-project at the moment most favorable to capital.

STRATEGIC SUMMARY

Acquire qualifying urban-infill parcels at single-family or distressed-multifamily comps. Entitle ministerially under SB 684 and SB 1123 — building permit within 6–12 months of submittal, full approval within 8–14 months of acquisition. Build a small templated catalogue of 1,200–1,750 square foot detached and attached homes under the Residential Code. Sell fee-simple to first-time California homebuyers at the most undersupplied price point in the state — and retain the optionality, on every project, to hold and rent select units or aggregate the block as a stabilized SFR portfolio if cap-rate-based exit pricing exceeds the retail residual. Replicate across every California jurisdiction under a single underwriting framework.

ENDNOTES AND SOURCES

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4. Senate Bill 684 (Caballero), Chapter 783, Statutes of 2023, adding Government Code Sections 65852.28, 65913.4.5, and 66499.41 (operative July 1, 2024); Senate Bill 1123 (Caballero), Chapter 294, Statutes of 2024, amending the same sections (operative July 1, 2025); Allen Matkins, "Recent Amendments to the Starter Home Revitalization Act" (2025).
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11. Assembly Bill 803 (Boerner Horvath), Chapter 154, Statutes of 2021 — Starter Home Revitalization Act of 2021.
12. SB 1123 Legislative Counsel's Digest; Sacramento County Planning and Environmental Review, SB 1123 Informational Handout (Sept. 2025); City of San Diego, Starter Home Revitalization Act program page.
13. Voit Real Estate Services, "What the CEQA Exemption Means for Multifamily and Industrial Developers" (Aug. 2025); Urban Land Institute, "Landmark CEQA Reform Unlocks New Era for Multifamily Development in California" (July 2025).
14. Dealer-versus-investor classification is determined at the property level under IRC §1221(a) and applicable case law: *Bramblett v. Commissioner*, 960 F.2d 526 (5th Cir. 1992); Cherry Bekaert, "Real Estate Dealer vs. Investor: IRS Tax Rules"; Hall CPA, "Avoiding Real Estate Dealer Status" (2025); Weaver, "Dealer or Investor: Limiting Your Tax Exposure in Real Estate Development."
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16. One Big Beautiful Bill Act (H.R. 1), signed into law July 4, 2025, permanently restoring 100% bonus depreciation under IRC §168(k) for qualified property (recovery period ≤ 20 years) acquired and placed in service after January 19, 2025: PwC Tax Insight, "OBDBA Permanently Extends 100% Bonus Depreciation" (Aug. 2025); BDO, "OBDBA Expands 100% Depreciation Expensing Opportunities" (Sept. 2025); Stinson LLP, "One Big Beautiful Bill Explained" (2025).
17. Real Estate Professional Status under IRC §469(c)(7); IRS Publication 925, Passive Activity and At-Risk Rules. Qualification requires more than 750 hours and more than 50% of personal services performed in real-property trades or businesses, plus material participation in the rental activity. Limited partner interests are per se passive under IRC §469(h)(2). The §461(l) excess business loss limitation (≈\$313,000 single / \$626,000 MFJ in 2025, inflation-indexed) caps non-corporate active business loss deductions; excess carries forward as a net operating loss. §461(l) was made permanent under the One Big Beautiful Bill Act (2025).
18. Character of partnership income flows through to partners under IRC §702(b), determined at the entity level and retained in each partner's distributive share. Special allocations under §704(b) and the substantial-economic-effect regulations can adjust the amount of items allocated among partners but cannot reassign character. Passive trade-or-business income at the partner level is subject to the 3.8% Net Investment Income Tax under IRC §1411(c)(2). California provides no preferential rate for long-term capital gains; ordinary and capital rates are identical at the state level.

IMPORTANT DISCLOSURES

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