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COMMENTARY

**Assessing the Value of Affordability:
Ad Valorem Taxation of Properties Participating in the
Low Income Housing Tax Credit Program**

By Joseph Rosenblum

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I. Introduction

Valuation of Low Income Housing Tax Credit (LIHTC) properties for property taxation is a complex issue due to unusual rules and restrictions imposed upon such properties by federal and state regulation. Accounting for such restrictions presents special difficulties because of the limited number of these properties, the potential value of the related tax credits, and the severity of the restrictions, including a lack of residual value, restricted rental rates, and a compliance period of more than 30 years. Both assessors and courts have struggled with a number of issues regarding how best to value LIHTC properties. These difficulties focus on two general questions. First, whether to base a valuation on a property's restricted rents or market rents. Second, whether tax credits are properly used as a factor in determining the fair market value of the real property upon which they were awarded.

As a result of conflicting state court decisions and often vague statutes, valuation of LIHTC properties remain uncertain. Consequently LIHTC property owners are faced with potentially significant and unpredictable economic costs. The concern is thus, that without consistent methodology for valuing LIHTC properties, owners will not have confidence in the financial viability of their properties and they will bare a greater risk of default.

Part I of this paper briefly summarizes the LIHTC program and examines the methods used by states and localities for assessing the value of LIHTC properties for *ad valorem* taxation. Part II explores the current split among state courts examining the appropriate methodology for valuing LIHTC properties – the relevant issues and the courts' reasoning. Part III addresses the recent increase in state statutes addressing valuation of LIHTC properties. This section categorizes and attempts to assess the clarity and consistency of the varied statutory schemes. Part IV suggests both a need for states to enact clarifying statutes and for those statutes to broadly address LIHTC valuation issues in order to provide increased uniformity and predictability of LIHTC property valuation for property owners, assessors, and local governments.

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A. Low-Income Housing Tax Credits Generally

The low-income housing tax credit (LIHTC) program codified as section 42 of title 26, the Internal Revenue Code (“Code”), is the primary federal program for subsidized affordable housing production,¹ with nearly 22,000 projects and more than 1,141,000 housing units placed in service in between 1987 and 2002.² Section 42 allows eligible taxpayers to take a dollar for dollar credit against federal income taxes.³ A tax payer becomes eligible for Low-Income Housing Tax Credits (LIHTCs) by holding an ownership interest in a qualified low-income housing project awarded by a state housing agency.⁴ Tax credits can be claimed annually over a 10-year period by the owners, 10 percent annually for 10 years.⁵ Typically, however, developers need current equity to fund development costs. Consequently, developers will sell the rights to the future credits in exchange for cash, a process called syndication.⁶

As a matter of tax law, the credit purchasers must be part of the property ownership entity.⁷ Usually this is accomplished by creating either a limited partnership in which the credit purchaser is a 99.9 percent limited partner and the developer, as general partner, holds a *de minimus* 0.01 percent interest. Alternately, the same result can be reached using a limited liability company in which the credit purchaser is a 99.9 percent non-managing member with the developer holding a *de minimus*.⁸ The general partner, developer, is responsible for managing the project, while the limited partners are passive investors.⁹ Profits, losses, deductions and tax credits are shared pro-rata according to the partners’ percentage ownership interests.¹⁰

In return for tax credits, project owners agree to operate the project in accordance with restrictions contained in Section 42 and related IRS regulations.

¹ JILL KHADDURI & DAVID RODDA, MAKING BEST USE OF YOUR LIHTC DOLLARS: A PLANNING PAPER FOR STATE POLICY MAKERS 1 (2004) (prepared for the U.S. Department of Housing and Urban Development Office of Policy Development and Research), *available at* <http://www.huduser.org/Publications/pdf/LIHTCDollars.pdf>.

² HUD, Low-Income Housing Tax Credit Database, <http://lihtc.huduser.org/> (last visited Feb. 17, 2006).

³ *See generally*, Michael J. Novogradac & Eric J. Fortenbach, *The Low-Income Housing Tax Credit*, 46 TAX NOTES 113 (1990); 26 U.S.C. § 42.

⁴ *See generally* 26 U.S.C. § 42.

⁵ 26 USC § 42(b)(2)(B); Michael J. Novogradac & Eric J. Fortenbach, *The Low-Income Housing Tax Credit*, 46 TAX NOTES 113 (1990).

⁶ Jeanne L. Peterson, *The Low-Income Housing Tax Credit*, 73 MICH. B.J. 1154, 1157-58 (1994) (explaining sale of taxcredits through syndication).

⁷ HERBERT STEVENS & THOMAS TRACY, DEVELOPER’S GUIDE TO THE LOW INCOME HOUSING TAX CREDIT 18, 81 (2000).

⁸ *Id.* (Noting that it is “not uncommon to see only .01% of the Tax Credits, losses, and income allocated to the general partner or managing member and 99.99% of these items allocated to limited partner(s) or other members.”)

⁹ *Id.*

¹⁰ *Id.*

As a condition of receiving LIHTC, the owner must enter into a recorded regulatory agreement restricting the use of the property. In order for a project to qualify for tax credits, it needs to provide a minimum set aside, which can be satisfied either by providing that, 20 percent of the units be occupied by individuals with incomes of 20 percent or less of area median income,¹¹ or 40 percent of the units be occupied by individuals with incomes of 60 percent or less of area median income.¹²

For all LIHTC units rents cannot exceed 30 percent of an imputed income limit based upon the household size occupying the unit.¹³ In addition to the federal restrictions, LIHTC projects are also subject to agreements with state housing agencies to restrict rents for a period of at least 15 years in excess of the 15-year federal restrictions.¹⁴

B. Methods For Assessing Ad valorem Taxes Generally

In valuing property, assessors and courts rely on the following traditional appraisal methods: market sales, cost less depreciation, and income capitalization.¹⁵ Some jurisdictions allow assessors to use a combination of methods while others do not. Of the three methods, the cost less depreciation approach and the income approach are likely to provide the best estimates of an LIHTC property's value.¹⁶ Of the three methods, the income approach is used most often by courts, assessors, and legislatures for valuing LIHTC properties.

The market sales approach, the most commonly employed method for estimating property values of multi-family market rate properties, uses

¹¹ 26 USC § 42 (g)(1)(A). This is often called the 20-50 test. Novogradac & Company LLP, *Affordable Housing Lexicon*, http://www.novoco.com/Facts_Figures/Lexicon.shtml [hereinafter *Affordable Housing Lexicon*] (last visited Feb. 10, 2006); IRS Form 8609, Low-Income Housing Credit Allocation and Certification 4 (2005), available at <http://www.irs.gov/pub/irs-pdf/f8609.pdf>.

¹² 26 USC § 42 (g)(1)(B). This is often called the 40-60 test. *Affordable Housing Lexicon*, *supra* note 11.

¹³ 26 USC § 42(g)(2)(A).

¹⁴ 26 U.S.C. § 42(h)(6)(D); *see e.g.*, Colorado Housing and Finance Authority, Program Overview, http://www.colohfa.org/multifam/multifamily_developers/LIHTC%20allocation/LIHTC_program_overview.icm; Connecticut Housing Finance Authority, CHFA Tax Credits, http://www.chfa.org/TaxCredits/taxcredits_LowIncomeTaxCredAllocations.asp; Oregon Housing & Community Services, Low Income Housing Tax Credit Program Fact Sheet, http://www.oregon.gov/OHCS/HRS_LIHTCFacts.shtml

¹⁵ Richard R. Powell, *Powell on Real Property* § 10B.06 (Matthew Bender & Co. 2005); Jonathan Penna, *Fairness in Valuation of Low-Income Housing Tax Credit Properties: An Argument for Tax Exemption*, 11 J. AFFORDABLE HOUSING & CMTY DEV L. 53, 67 (2001); *see also Thomas v. First Federal Sav. Bank*, 653 F. Supp. 1330, 1334 (D. Ind. 1987).

¹⁶ Richard E. Polton, *Valuing Property Developed with Low-Income Housing Tax Credits*, 62 APPRAISAL J. 446, 452 (1994)

comparable sales to estimate the subject properties market value.¹⁷ This is accomplished by comparing the subject property to other properties recently sold, with similar structure and size, improvements, and location.¹⁸ Recent sale prices of comparable properties are then used to estimate the value of the subject property.¹⁹ Courts and the appraisal literature are generally in agreement that the market sales approach “is likely to be of little value because comparable sales are highly unlikely,” and thus “units of comparison” are not available for comparison and adjustment of value.²⁰

The second accepted assessment method, the cost approach, “estimates the cost of producing a new or substitute property and adjusts this estimated cost for differences in age, utility and condition between the subject property and a new property.”²¹ Under this method an assessor will first determine the total cost to construct a replacement facility. The assessor will then deduct the amount of physical depreciation that the property has experienced, as well as the value of related personal property, finally adding the value of the land to determine a total estimated property market value.²²

The final method, income capitalization, generally provides “the critical methods of analysis” for valuing LIHTC properties. This “approach analyzes a property’s ability to generate income and reversion and converts these benefits into an indication of present value.”²³ First the net operating income, income expected to be earned, “is estimated, allowing for reasonable expenses, vacancy, and/or collection loss. . . .”²⁴ Present value is then calculated by dividing the net operating income by a capitalization rate, with the capitalization rate “reflecting the annual rate of return necessary to attract investment capital.” The capitalization rate is determined by such factors as “apparent risk, market attitudes toward future inflation, the prospective rates of return for alternative investments, the rates of return earned by comparable properties in the past, the supply of and demand for mortgage funds, and the availability of tax shelters.”²⁵ Although determining net operating income is usually quite straight forward, determining

¹⁷ Powell, *supra* note 15; *Thomas v. First Federal Sav. Bank*, 653 F. Supp. 1330, 1334 (D. Ind. 1987). Also called the market data method.

¹⁸ Powell, *supra* note 15.

¹⁹ *Id.*

²⁰ Richard E. Polton, *supra* note 16, at 452; *Deerfield 95 Investor Assocs.*, 1999 Conn. Super. LEXIS 1747 (“The market sales approach is of little help since there is a dearth of comparable sales to the subject given the conditions and limitations placed upon the subject.”); *Wilsonville Heights Assoc. v. Dep’t of Revenue*, 339 Ore. 462, 465 (Or. 2005).

²¹ *Cascade Court LTD. P’ship v. Noble*, 105 Wn. App. 563, 565 (Wash. Ct. App. 2001)

²² *See Hometowne Assocs., L.P. v. Maley*, 839 N.E.2d 269, 276 (Ind. Tax Ct. 2005)

²³ *Cascade Court LTD. P’ship*, 105 Wn. App. at 565.

²⁴ *See* AM. INST. OF REAL ESTATE APPRAISERS, *THE APPRAISAL OF REAL ESTATE*, 409–17 (10th ed. 1992).

²⁵ *Hometowne Assocs., L.P.*, 839 N.E.2d at 275.

the appropriate capitalization rate for LIHTC properties is potentially contentious.²⁶

C. Valuation and Assessment of Properties in the LIHTC Program

Applying any of the three standard appraisal techniques to LIHTC property is a complicated and uncertain task. As the Massachusetts Supreme Court recognized in 1973²⁷ “[t]he great dilemma in assessing federally assisted housing projects is that the ‘value’ of these projects is inherently ambiguous . . . since in the absence of subsidy the rental stream produced by the property would not justify the actual expenditure on construction.”²⁸

The legal character of LIHTC properties raises significant difficulties for real property assessors. Four characteristics pose significant difficulty to an appraiser or court valuing LIHTC properties. These characteristics are government-mandated restrictions on rent and rental, additional costs and expenses, illiquidity, and difficulty in attributing the value of the principal benefits of LIHTC projects to the related properties. These principal benefits are low-income housing tax credits, cash flow, depreciation losses, and residual value.²⁹

As noted earlier, LIHTC properties are operating under limited gross potential income because of the restrictions imposed by both the Service and state agencies associated with LIHTC regulations. The restrictions are long term and penalties for violations are severe. From the investor’s perspective, there are multiple risks resulting from the investment in a tax credit project.³⁰ In the event of non-compliance, the investor could face a recapture of the LIHTCs claimed, a repayment of income taxes previously offset with credits, penalties and interest on the underpaid tax liability, as well as a loss of the equity invested.³¹ If the project sponsor fails to adequately manage the property and the project lender forecloses and assumes title, the investor will face the loss of the invested capital, the

²⁶ See *supra* Section (IV)(C), Calculating Capitalization Rates.

²⁷ The Massachusetts Supreme Court was deciding the appropriate valuation of a property funded in part by The Housing and Community Development Act of 1974, Pub L No 93-383, 201(a), 88 Stat 633, 653 (1974), codified at 42 USC 1437 *et seq.* (1976), as amended at 42 USC 1437f *et seq.* (1988), a supply-oriented program that provided assistance to private developers by subsidizing the interest rate paid on loans used to acquire or build low cost housing. Michael H. Schill, *Distressed Public Housing: Where Do We Go From Here?* 60 U. CHI. L. REV. 497, 524 (1993)

²⁸ *Community Development Co. v. Board of Assessors*, 377 Mass. 351, 354-355 (Mass. 1979) (quoting GEORGE E. PETERSON, ET. AL., PROPERTY TAXES, HOUSING AND THE CITIES 73 (1973)).

²⁹ *Deerfield 95 Investor Assocs*, 1999 Conn. Super. LEXIS 1747; R. Polton, Valuing Property Developed with Low-Income Housing Tax Credits, Appraisal J. 450 (1994).

³⁰ 26 USC § 42(j).

³¹ *Id.*

recapture of a portion of the LIHTC previously claimed, and the loss of access to the future stream of credits.³²

In most cases these compliance periods are further extended because “[a]ffordable housing owners tend to be public agencies, nonprofit organizations, and limited partnerships . . . [who] have made long-term commitments to provide affordable housing as part of their mission or because of the restrictions of their funding sources.”³³ Rent restrictions cause rental rates per unit to be much lower than in comparable conventional properties.³⁴ Resident restrictions result in additional risk and effort. “For these reasons, very few affordable housing developments are sold during their compliance periods.”³⁵

Second, expenses are higher for LIHTC owners because they must meet certain reporting, record keeping and documentation edicts beyond conventional practice.³⁶ Rents are limited but expenses are not. Expenses growing at the rate of inflation can cause net operating income to decrease if inflation exceeds the growth in the median income upon which the rents are based.³⁷ Specifically, affordable developments are limited in the amount of revenue they can generate “[b]ecause of the rent and income restrictions imposed by their funding sources.”³⁸ While revenues are limited, operating expenses for affordable housing tend to be similar or higher than those for market-rate units. Annual certification of tenant income and eligibility, as well as regulatory reporting to various funding sources can be time-consuming and staff-intensive. Additionally, maintenance costs may be higher in affordable developments due to high turnover rates and larger households.³⁹

Third, illiquidity poses a significant obstacle to assessment. LIHTC owners cannot transfer LIHTC properties without first complying with specific conditions and regulations.⁴⁰ Although tax credits have been exhausted after ten years, restrictions remain for at least another 20-years, in some projects and in certain jurisdictions this compliance period is significantly longer.⁴¹ In the case of

³² The recapture of LIHTC claimed is calculated as the difference in the amount of credits that would have been available if they had been earned over a 15 fifteen-year period and the amount claimed according to the ten-year schedule.

³³ KRISTEN FITZPATRICK, MINNESOTA PROPERTY TAXES AND AFFORDABLE RENTAL HOUSING: THE IMPACT OF THE ELIMINATION OF 4D AND RISING PROPERTY VALUES 24 (Apr. 2005) (Prepared for Housing Minnesota).

³⁴ 26 USC § 42(j).

³⁵ David. C. Nahas, *Appraising Affordable Multifamily Housing*, 63 APPRAISAL J. 455, 455 (1994).

³⁶ See 26 USC § 42(l).

³⁷ Nahas, *supra* note 35.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ Gilbert D. Davila, *Reduce Your LIHTC Property Tax Assessments*, AFFORDABLE HOUSING Finance 60 (Sept. 2004).

⁴¹ *Id.*

a sale, a purchaser would acquire only the restrictions without the benefit of LIHTCs.⁴² This results in an extremely illiquid asset.

Finally, the nature of the ownership structure and the tax credits pose a significant dilemma to assessors and appraisers.⁴³ From an assessor's perspective, "the total project value is derived from the real estate and the tax benefits." Whether both of these benefits are included for tax assessment is often unclear and thus left to the assessor. The majority view among assessors is to categorize these two benefits as tangible value, attributable to the real estate, and intangible value, attributable to the LIHTC.⁴⁴ Although this appears to be the majority approach for real estate assessment, some appraisal theorists have proposed alternate characterization methodologies for LIHTC properties, often contending that tax credits are not intangible.⁴⁵

Whether the appraisal community has reached a clear consensus as to how to best value LIHTC projects is somewhat unclear.⁴⁶ Regardless, the burden falls on LIHTC property owners and their attorneys to both understand whether their state has a formal policy for assessing LIHTC properties and if so, their state's mandated method for assessment under case law, statute, and executive policy. LIHTC property owners and their attorneys need to individually apply these policies to determine whether to appeal their property tax assessments and collectively need to determine when to lobby for legislation and what statutory models exist for LIHTC assessment requirements.

Jurisdictions treat LIHTCs differently. Some value them solely on the basis of actual net income and capitalization.⁴⁷ Other jurisdictions value the unencumbered fee simple interest on the premise that valuation for *ad valorem* purposes should not involve voluntary rent restrictions, creative financing, and tax credits. Whether tax credits are benefits attributable to the real estate or whether they are intangible property attributable only to the partnership greatly impacts a determination of the market-value assessment.

D. The Economic Costs of Valuing LIHTCs

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ The Dictionary of Real Estate Appraisal defines an intangible benefit as "[a] value that cannot be imputed to any part of the physical property, e.g., the value attributable to good will."

DICTIONARY OF REAL ESTATE APPRAISAL 186 (3d ed. 1993).

⁴⁶ See George E. Jordan, *Appraising the Assets of Low-Income Housing Tax Credit Properties*, 67 APPRAISAL J. 41, 46 (1999); Nahas, *supra* note 35 at 455-462; but see Michael W. Collins, *Another Ad Valorem View of Low-Income Housing Tax Credit Properties* 67 APPRAISAL J. 306 (1999).

⁴⁷ GOVERNOR'S HOUSING TASK FORCE, COMPREHENSIVE HOUSING STRATEGY FOR IOWA 65 (2000), available at <http://www.sppg.com/uploads/pdf/housingstrategy.pdf>.

For an LIHTC project “[p]roperty taxes may well be the largest single expense line item in the operating statement. . . .”⁴⁸ Typical property tax estimates for market housing are between 20 percent and 25 percent of gross rents.⁴⁹ For LIHTC properties the percentage of gross rents devoted to property taxes are typically significantly higher.⁵⁰ In fact, failing LIHTC projects spend on average twice as much of their effective gross income on property taxes as successful projects.⁵¹

Because the typical operating budget of an LIHTC property includes little or no cash flow and rental rates are restricted by statute, nonprofit developers must sometimes abandon projects before they get off the drawing board.⁵² Unlike other types of developed property, appraisers have in some cases prepared assessments of LIHTC properties later found to be “more than double the market value of the property.”⁵³ For example, the assessment of Meridian West, an LIHTC apartment complex located in Miami, Florida, was initially assessed at over \$15,000,000.⁵⁴ After preliminary negotiations this was reduced to \$9,967,111.⁵⁵ “Finally, after submittal of 90 pages of evidence, including actual income, income analyses, appraisal journal literature, argument of the special statutes applied by the Legislature solely to LIHTC properties,” the assessment was reduced to \$6,300,000 representing “a 58% reduction from the preliminary assessment. . . .”⁵⁶

The concern is thus that units will be taxed at a rate that LIHTC projects cannot absorb. In such cases, “real estate valuation procedures jeopardize the ongoing economic viability of projects created in recent years under the Federal Low-Income Housing Tax Credit program.” Additionally, “[e]xcessive real estate valuation can discourage the development of needed affordable housing and contribute to mortgage defaults or poor maintenance.”⁵⁷

The inclusion or exclusion of tax credits in valuation of LIHTC properties can have a significant economic impact on property owners. For example, the Tennessee Supreme Court addressing the issue of inclusion of tax credits in LIHTC property valuation concluded that for three contested properties

⁴⁸ RICHARD E. POLTON, VALUATION AND MARKET STUDIES FOR AFFORDABLE HOUSING 96 (2002).

⁴⁹ Philip Halpern, *Strategies for Financing Affordable Housing*, 24 REAL ESTATE REV. 47 (Spring 1994).

⁵⁰ *Id.*

⁵¹ Chicago Rehab Network, Present Realities, Future Prospects: Chicago’s Low Income Housing Tax Credit Portfolio Summary Report 2002 7, available at <http://www.chicagorehab.org/policy/pdf/Presentrealities.pdf>.

⁵² See Jonathan Penna, *Fairness In Valuation Of Low-Income Housing Tax Credit Properties: An Argument For Tax Exemption*, 11 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 53 (2001).

⁵³ Florida Lawyers Property Tax Appeals, *Top 2 Secrets To Reducing Miami Property Tax Assessments By 50% Or More!*, <http://floridalawyerspropertytaxappeals.blogspot.com/> (Nov. 27, 2005, 11:38 EST).

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ GOVERNOR’S HOUSING TASK FORCE, *supra* note 47, at 65.

assessments excluding LIHTCs were between \$1,528,450 and \$2,896,960 less than assessment including LIHTCs, as shown in Figure 1: Impact of Tax Credits on Total Value Assessed for Disputed Properties . In these cases the inclusion of LIHTCs in property valuation increased taxes due by between \$22,131 and \$51,478 annually, as shown in Figure 2: Impact of Tax Credits on the Real Property Tax Due and Payable .

*Figure 1: Impact of Tax Credits on Total Value Assessed for Disputed Properties*⁵⁸

PROPERTY	TOTAL VALUE WITHOUT TAX CREDITS CONSIDERED	TOTAL VALUE WITH TAX CREDITS CONSIDERED	ASSESSMENT IN DISPUTE
Spring Hill	\$ 2,551,987	\$ 4,440,300	\$ 1,775,120
Greentree	\$ 3,512,078	\$ 7,242,400	\$ 2,896,960
Acorn	\$ 1,407,244	\$ 3,821,000	\$ 1,528,450

*Figure 2: Impact of Tax Credits on the Real Property Tax Due and Payable*⁵⁹

PROPERTY	PROPERTY TAX DUE WITH TAX CREDITS	PROPERTY TAX DUE WITHOUT TAX CREDITS	DIFFERENCE
Spring Hill	\$ 79,156.88	\$ 52,040.32	\$ 22,131.03
Greentree	\$ 104,134.80	\$ 48,466.68	\$ 51,478.44
Acorn	\$ 23,697.99	\$ 64,345.64	\$ 40,647.65

Determination of whether market rates or restricted rates are used for capitalization rates poses a similarly significant burden on project owners. For example, in one Connecticut case, despite agreement on all other issues, the property owner alleged an overvaluation of \$1,900,000, based on a dispute over the applicable capitalization rate. As a result of the trial court’s decision, using a capitalization rate based on market value apartments, the owners’ property taxes were reduced by more than \$30,000 annually.⁶⁰

On the other hand, some counties rely on property taxes for more than 50 percent of their budget.⁶¹ This number has increased over the last five years as local property taxes have been forced to bare a lot of the brunt of decreasing

⁵⁸ *Spring Hill, L.P. v. Tenn. State Bd. of Equalization*, 2003 Tenn. App. LEXIS 952 (Tenn. Ct. App. 2003).

⁵⁹ *Id.*

⁶⁰ Elliott B. Pollack, Property Tax Win Saves LIHTC Project \$30,000 A Year, AFFORDABLE HOUSING FIN., (July 2005), available at http://www.housingfinance.com/ahf/articles/2005/july/042_AHF_12-3.htm.

⁶¹ Richard Roesler, *Eyman to target local property taxes*, Dec. 31, 2003, SPOKESMAN REV., <http://www.spokesmanreview.com/news-story.asp?date=123103&ID=s1464405>.

federal funding.⁶² Consequently property taxes across America have been increasing by an average of more than ten percent annually.⁶³ Thus, “[w]ith operating budgets being squeezed and development/ acquisition sources harder to find, real estate taxes, especially those levied based on *ad valorem* assessment, loom ever-larger in transaction and property viability.”⁶⁴

Although analysis of the impact on governments of valuation methodology is not readily available, at least one state has done a full impact analysis of excluding LIHTCs from property valuation. To determine the revenue impact of California Revenue & Tax Code § 402.95, the California Property Tax Department compiled a spreadsheet of the present value of all outstanding Low Income Housing Tax Credits.⁶⁵ The value of outstanding LIHTC, affected by the legislation, amounted to \$1.75 billion.⁶⁶ The revenue impact of which was “at most \$17.5 million (\$1.75 billion x 1%) in property tax revenue loss.”⁶⁷

These economic costs, for both governments and property owners, are exacerbated by the uncertainty associated with often vague state statutes, and state court decisions which are conflicting and often difficult to predict. The result in many states is an uncertainty in property valuation of LIHTC properties, resulting in potentially significant economic costs to developers and owners. The concern is thus, that without consistent methodology for valuing LIHTC properties, owners will not have confidence in the financial viability of their properties or they will bear a greater risk of default.

II. Judicial Valuation of Low-Income Housing Tax Credit Properties

Courts have struggled with a number of issues regarding how best to value LIHTC properties, focusing on two general questions. First, when applying the income approach to value a project, whether to use a property’s restricted rents or market rents. Second, whether tax credits are properly used as a factor in determining the fair market value of the real property upon which they were awarded. This second question is in turn heavily influenced by determination of whether tax credits are categorized as intangible benefits.⁶⁸ This is particularly

⁶² Robert B. Reich, *The Trickle-Down Tax Revolt: Property taxes can’t fund the country forever*, Oct. 27, 2004, AMERICAN PROSPECT, <http://www.prospect.org/web/page.ww?section=root&name=ViewWeb&articleId=8810>.

⁶³ *Id.*

⁶⁴ DAVID A. SMITH ET AL., WEB UPDATE 33: *AD VALOREM* REAL ESTATE TAX ASSESSMENT OF AFFORDABLE HOUSING I (2004), <http://www.recapadvisors.com/pdf/Wu33.pdf>.

⁶⁵ California State Board Of Equalization Staff, Legislative Bill Analysis, AB 2846 (Mar., 2004), available at <http://134.186.44.198/legdiv/ptleg/pdf/ab2846-1rk-final.pdf>

⁶⁶ *Id.* at 3.

⁶⁷ *Id.*

⁶⁸ *Town Square Ltd. P’ship v. Clay County Bd. of Equalization*, 704 N.W.2d 896, 901 (S.D. 2005) (“some of these [state court] . . . decisions hinge solely on the question whether tax credits are intangibles.”).

important because many jurisdictions prohibit inclusion of intangible values in a property's assessed value.⁶⁹

The question of valuation of LIHTC properties falls firmly within the bounds of state law. Reviewing courts have easily and consistently concluded that including tax credits in property valuation neither violates the Supremacy Clause nor Federal case law.⁷⁰

Eighteen states have court decisions addressing the property tax assessment of LIHTC properties. These states are Arizona, Connecticut, Georgia, Idaho, Illinois, Indiana, Kansas, Michigan, Missouri, Montana, New Hampshire, North Carolina, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, and Washington.⁷¹ Of these 18 states, seven have subsequently passed statutes addressing valuation of LIHTC properties.⁷² An additional 15 states, despite having no relevant court decisions, have passed statutes addressing valuation of LIHTC properties, for a total of 22 states that have statute addressing at least some portion of the LIHTC valuation issue. Only 17 states have not addressed any of the aspects of valuation of LIHTC properties through either statute or case

⁶⁹ See INCLUSION OF INTANGIBLE ASSET VALUES IN TANGIBLE PROPERTY TAX ASSESSMENTS, 90 A.L.R.5th 547 (2005).

⁷⁰ See *Parkside Townhomes Assoc. v. Bd. of Assessment Appeals of York County*, 711 A.2d 607, 611 (PaCommwCt 1998) (distinguishing *Xerox Corporation v. County of Harris*, 459 U.S. 145 (1982) finding no Supremacy clause violation because “there is no comprehensive federal scheme encompassing the [low-income housing] tax credit program as the tax credit program is administered by the individual states); *Pine Pointe Hous., L.P. v. Lowndes County Bd. of Tax Assessors*, 254 Ga. App. 197, 202 (Ga. Ct. App. 2002)(distinguishing *Randall v. Loftsgaarden*, 478 U.S. 647 (1986), which held that federal income tax credits have no value in and of themselves, because “that does not mean that the tax credits do not influence a property’s fair market value”).

⁷¹ *Cottonwood Affordable Housing v. Yavapai*, 72 P3d 357 (Ariz TC 2003); *Deerfield 95 Investor Assocs. v. Town of E. Lyme*, 1999 Conn. Super. LEXIS 1747 (Conn. Super. Ct. 1999); *Pine Pointe Housing, L.P. v. Lowndes County Bd. of Tax Assessors*, 561 S.E.2d 860 (GaCtApp 2002); *Greenfield Village Apartments, L.P. v. Ada County*, 938 P.2d 1245 (Idaho 1997); *Rainbow Apartments v. Illinois Property Tax Appeal Bd.*, 762 N.E.2d 534 (IllAppCt 2001); *Vill. Hous. Partners. II, L.P. v. Wayne Twp. Assessor*, 2005 Ind. Tax LEXIS 92 (Ind. Tax Ct. 2005); *In re Ottawa Housing Assoc., L.P.*, 10 P3d 777 (KanCtApp 2000); *Huron Ridge LP, v. Township of Ypsilanti*, MTT Docket No. 292811 (Michigan Tax Tribunal 2004); *Maryville Properties, L.P. v. Nelson*, 83 SW3d 608 (MoCtApp 2002); *Kalispell Assoc. Lmtd v. DOR*, 1997 Mont. Dist. LEXIS 438 (Mont. Dist. 1997); *Epping Senior Housing Associates, LP v. Town of Epping*, Docket No. 19135-01PT/20263-03PT (N.H. Bd. Tax & Land App. 2001); *In the Matter of Appeal of The Greens of Pine Glen Ltd. Partnership*, 576 S.E.2d 316 (NC 2003); *Bayridge Associates Ltd. Partnership v. Department of Revenue*, 892 P.2d 1002 (Oregon Supreme Ct. 1995); *Parkside Townhomes Assoc. v. Bd. of Assessment Appeals of York County*, 711 A.2d 607 (PaCommwCt 1998); *Willow St. Assocs. LLP v. Bd. of Tax Assessment Review*, 798 A.2d 896 (R.I. 2002); *Town Square Ltd. P’ship v. Clay County Bd. of Equalization*, 704 N.W.2d 896 (S.D. 2005); *Spring Hill, L.P. v. Tenn. State Bd. of Equalization*, 2003 Tenn. App. LEXIS 952 (Tenn. Ct. App. 2003); *Cascade Court, L.P. v. Noble*, 20 P3d 997 (WashCtApp 2001).

⁷² These states are Georgia, Illinois, Indiana, Montana, Oregon, Pennsylvania, and Rhode Island.

law.⁷³ Of these 17 states, the state supreme courts of an additional three have made, what appear to be, broad pronouncements concerning the valuation of federally rent restricted affordable housing properties.⁷⁴

These numbers, however, mask a continued level of uncertainty. Although, 22 states have addressed LIHTC valuation through statute, few have addressed both whether LIHTCs can be valued and whether restricted rents should be used.⁷⁵ Further, only two have addressed the proper capitalization rate for valuing LIHTC properties. Thus, despite a growing number of court decisions and statutes the law in many states remains unclear. Further, although the majority of statutes are favorable to LIHTC property owners a large number of court decisions are not. In most cases the outcome hinges on whether the court feels that LIHTC provides intrinsic value to the property, and thus should be included in the valuation equation, or whether they treat them as non-taxable, intangible property.

A. Valuation of Tax Credits

In 1995, the Oregon Supreme Court was the first court of record to issue a decision as to the valuation of LIHTC properties.⁷⁶ In *Bayridge Assoc. Ltd. Partnership v. Department of Revenue*, 892 P.2d 1002 (1995), the court found for the taxpayer holding that the rent restrictions present in an LIHTC property are “governmental restriction as to use” requiring a reduction in the valuation of the property for assessment purposes, even though the restrictions were voluntary.⁷⁷ According to the Bayridge Court, the taxpayer’s agreement to limit rentals to low income tenants were governmental restrictions like zoning and therefore must be included in valuation.⁷⁸ In short, the court held that “appraisal based on actual or contract rents [is] more accurate in determining the true cash value of the properties than the appraisal based on market rents. . . .”⁷⁹ “The [C]ourt also agreed that the federal tax credits produced by the project should not be added to the income of the property as no buyer would receive the benefit of those credits and they would be recaptured if the property was not maintained as a federal project.”⁸⁰

⁷³ An additional 16 states have court decisions addressing valuation of other HUD rent restricted properties.

⁷⁴ *Alliance Towers Ltd. v. Bd. of Revision*, 523 N.E.2d 826 (Ohio 1988); *Community Development Co. v. Board of Assessors*, 385 N.E.2d 1376 (Mass. 1979); *Glenridge Development Co. v. City of Augusta*, 662 A.2d 928 (Me. 1995).

⁷⁵ Court decisions have more consistently addressed both issues. See generally *Bayridge Associates Ltd. Partnership*, 892 P.2d 1002; *Town Square Ltd. P’ship*, 704 N.W.2d 896.

⁷⁶ *Bayridge Assoc. Ltd. Partnership*, 892 P.2d 1002.

⁷⁷ *Id.* at 1006.

⁷⁸ *Id.* at 1006.

⁷⁹ *Id.* at 1003.

⁸⁰ *Wilsonville Heights Assoc., LTD*, 17 OTR at 143 (explaining *Bayridge Assoc. Ltd. Partnership* 892 P.2d at 1007).

Shortly after the Oregon Supreme Court decided *Bayridge*, the Idaho Supreme Court reached a similar decision in *Greenfield Village Apartments*.⁸¹ In *Greenfield Village Apartments* the court held that restricted rents should be used for valuation of LIHTC properties, while tax credits should not.⁸² The court remanded to the lower court “for valuation considering the actual and functional use of the property as low-income, rent-restricted property.”⁸³

In 1997, a Montana District Court issued another taxpayer friendly holding.⁸⁴ The court in *Kalispell Associates* suggested that Montana Supreme Court precedent likely required consideration of restricted rather than market rate rents.⁸⁵ Consequently, the court remanded to the State Tax Appeals Board to consider “use restriction in determining market value. . .” of an LIHTC project.⁸⁶

After these initial decisions disallowing consideration of LIHTCs, a Pennsylvania appellate court issued the first decision finding for local government. In 1998, the Pennsylvania Commonwealth Court held that the value of LIHTC credits should be included in property valuation. The court in *Parkside Townhomes Assoc. v. Bd. of Assessment Appeals of York County*, 711 A.2d 607, 611 (PaCommwCt 1998), found that LIHTCs are properly included in a property assessment because the credits were “part of the economic reality.” The court concluded that “[t]ax related benefits associated with investment property ownership inherently affect value and the court is not constrained to determine [fair market value] as though the property lacked tax shelter features.”⁸⁷ Thus, LIHTC credits should be included in valuation; however, restricted rents rather than market rents should be used.⁸⁸

Shortly after *Parkside Townhomes*, a Connecticut trial court reached a similar conclusion in *Deerfield 95 Investor Associates v. Town of East Lyme*, 25 Conn. L. Rptr. 51 (Conn. Super. Ct. 1999). The *Deerfield 95* court held that section 42 tax credits were a benefit to the owners of the properties rather than a government restriction and, as such, should be added to the net operating income.⁸⁹

⁸¹ *Greenfield Vill. Apts., L.P. v. Ada County*, 130 Idaho 207 (Idaho 1997).

⁸² *Id.*

⁸³ *Id.* at 210.

⁸⁴ *Kalispell Assoc. Lmtd v. DOR*, 1997 Mont. Dist. LEXIS 438 (Mont. Dist. 1997).

⁸⁵ *Id.*

⁸⁶ *Id.* On remand, the State Tax Appeal Board of the State Of Montana held that “tax credits themselves are not part of the valuation process for the subject property; however, the amount of equity generated through the sale of those tax credits most certainly affects the value of the subject property when using the income approach.” *Kalispell Assoc. Lmtd v. DOR*, State Tax Appeals Board, DOCKET NO: PT-1995-21, 14 (1998), available at <http://stab.mt.gov/pdf/dump/kalassoc.pdf>.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.* However a new Connecticut case, *Saranor Apts. Ltd. P'ship v. City of Milford*, 2005 Conn. Super. LEXIS 911 (Conn. Super. Ct. 2005), adds an interesting twist to the question of LIHTC valuation in Connecticut. In *Saranor* both the city's expert and the taxpayers' experts were in

Other jurisdictions have reached similar conclusions, holding that the value of section 42 tax credits are properly considered in assessing the fair market value of the properties. For example, in the most recently decided case, *Town Square Ltd. P'ship v. Clay County Bd. of Equalization*, 704 N.W.2d 896 (S.D. 2005), the Supreme Court of South Dakota considered whether LIHTCs, restricted rents, and other Section 42 requirements, must be measured when determining the market value of apartment complexes totaling 70 units.⁹⁰ The Court held that the value of LIHTCs must be included in the property valuation. Because the benefits associated with LIHTC properties would be included in a potential buyer's evaluation of the project, credits are naturally part of the true market value.⁹¹ The Court concluded that "tax credits make ownership of the property more desirable. And because the tax credits can be transferred to purchasers, they enhance the value of the property in the marketplace."⁹² Courts in Michigan⁹³, New Hampshire⁹⁴, Tennessee⁹⁵, North Carolina⁹⁶, South Dakota, and Kansas⁹⁷ have reached similar conclusions.

In only six court decisions have courts held that tax credits should not be considered when valuing LIHTC properties.⁹⁸ In two of these cases the courts relied almost exclusively on determination of whether tax credits were intangible and thus nontaxable under state law. The Court of Appeals of Missouri in *Maryville Properties* reversed a decision allowing tax credits to be included in valuing LIHTC properties. The Court held that tax credits are intangible personal property and thus not subject to real property taxation. In classifying LIHTCs as intangible property, the *Maryville Properties* Court stated that "LIHTCs are not characteristics of the property. Rather they are assets having direct monetary value. Their restricted transferability does not destroy their essential status as

agreement that it would be improper to find value in tax credits. *Id.*; see also Elliott B. Pollack, Property Tax Win Saves LIHTC Project \$30,000 A Year, AFFORDABLE HOUSING FIN., (July 2005), available at http://www.housingfinance.com/ahf/articles/2005/july/042_AHF_12-3.htm.

⁹⁰ *Town Square Ltd. P'ship*, 704 N.W.2d at 897, 901.

⁹¹ *Id.* at 903.

⁹² *Town Square Ltd. P'ship*, 704 N.W.2d at 903.

⁹³ *Huron Ridge LP*, MTT Docket No. 292811.

⁹⁴ *Epping Senior Housing Associates, LP*, Docket No. 19135-01PT/20263-03PT.

⁹⁵ *Spring Hill, L.P.*, 2003 Tenn. App. LEXIS at 953-54.

⁹⁶ *In re Greens of Pine Glen Ltd. Partnership*, 576 S.E.2d at 322.

⁹⁷ *In re Ottawa Housing Assoc., L.P.* 10 P3d 777.

⁹⁸ In a Wisconsin case addressing the valuation of LIHT properties, *Metro Holding*, the Wisconsin Supreme Court held that property assessment for low-income housing should be based on actual rents and expenses. A subsequent Wisconsin Court of Appeals case found that "nothing in either the [Metro Holding] court's holding or the underlying principles of the decision suggest that the federal subsidy given in exchange for the restrictions on rent or income of residents-in this case, in the form of income tax credits-should not be considered in arriving at a fair market value." The Court went on to conclude that due to subsequent Wisconsin legislation it was unnecessary to address the issue.

State ex rel. Heartland-Beloit Watertower, L.L.C. v. Bd. of Review, 2000 WI App 116 (Wis. Ct. App. 2000).

intangible property having value primarily to their owner. Objective standards should be used for determining fair market value in the market place. The particular circumstances of the owner are not a proper consideration.”⁹⁹ The Washington Court of Appeals in the Cascade Court case similarly held that LIHTCs are intangible personal property that could not be considered by assessors when valuing real property.

B. Are LIHTCs Tangible or Intangible Property?

Some of these court concluded that LIHTCs were not intangible property,¹⁰⁰ while state law in other jurisdictions allowed for valuation of intangibles.¹⁰¹ Some courts addressing this issue have concluded that “even if . . . tax credits could be designated as intangible property, a distinction can be made between taxing intangible property and considering such credits as a value increasing feature.”¹⁰² In other words, even if LIHTCs are intangibles and state law prohibits taxation of intangibles, LIHTCs “do have an effect on the valuation of real estate for assessment purposes, and should be a factor in determining the fair market value.”¹⁰³

The conclusion reached by the court in *Deerfield 95 Investor Assocs.* is probably the correct outcome, that is, LIHTCs are intangible however their impact on the value of tangible property can be properly included in valuation. Under all of the standard definitions LIHTCs appear to be intangible property. According to the appraisal literature, intangible are property that “cannot be imputed to any part of the physical property”¹⁰⁴ According to BLACK’S LAW DICTIONARY (8th ed. 2004) intangible property is any “[p]roperty that lacks a physical existence.” Or as the Supreme Court stated, intangibles are “rights which are not related to physical things . . . relationships between persons, natural or corporate, which the law recognizes by attaching to them certain sanctions enforceable in courts. The power of government over them and the protection which it gives them cannot be exerted through control of a physical thing. They can be made effective only through control over and protection afforded to those persons whose relationships are the origin of the rights.”¹⁰⁵ Although arguably distinguishable from the typical example of intangible property, good will, LIHTCs fit neatly within the standard definitions.

The second part of the question, whether the impact of intangible property on related tangible property can be valued, appears to be a similarly simple

⁹⁹ *Maryville Props., L.P.*, 83 S.W.3d at 616.

¹⁰⁰ *Pine Pointe Housing, L.P.*, 561 S.E.2d at 863.

¹⁰¹ *Town Square Ltd. P’ship*, 704 N.W.2d 99.

¹⁰² *Id.*

¹⁰³ *Deerfield 95 Investor Assocs.*, 1999 Conn. Super. LEXIS 1747; *See also Spring Hill, L.P.*, 2003 Tenn. App. LEXIS 952.

¹⁰⁴ DICTIONARY OF REAL ESTATE APPRAISAL 186 (3d ed. 1993).

¹⁰⁵ *Curry v. McCannless*, 307 U.S. 357, 365–366 (U.S. 1939).

question based on prior analogous case law. A number of cases in non-LIHTC contexts have involved disputes as to whether the values of intangible assets were included in an assessment of real property or tangible personal property used in a business. These courts have generally held that intangible values “that cannot be separately taxed as property may be reflected in the valuation of taxable property.”¹⁰⁶ “Thus, in determining the value of property, assessing authorities may take into consideration earnings derived therefrom, which may depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property.”¹⁰⁷

In the most closely analogous situation, the Michigan Supreme Court in *Meadowlanes Ltd. Dividend Housing Ass’n v. City of Holland*, 473 N.W.2d 636 (1991), held that, in valuing a mortgage-interest subsidy for low-income housing, an assessor should take into account the mortgage interest subsidy paid by the federal government to the mortgage lender. Finding that these types of properties would not exist without the subsidy, the court said that “although the mortgage-interest subsidy is an intangible, and not taxable in and of itself, it is a value-influencing factor.”

Courts have reached similar conclusions in determining whether the value of other intangible government benefits such as licenses, subsidies or contracts could be properly included in an assessment.¹⁰⁸ For example, in *Freeport-McMoran Resource Partners v. County of Lake*, 12 Cal. App. 4th 634 (1st Dist. 1993), the court held that the assessor’s valuation of two geothermal power plants, made under the income approach by capitalizing the plant owner’s income from long-term, fixed-price contracts for the sale of electricity to a public utility at above-market rates, properly considered the presence of the contracts. In reaching the conclusion the court found that despite being intangible the assessor properly considered the impact of the contracts, because they were integral to the economic viability of the plants.¹⁰⁹

Thus although specific state laws may require a different outcome,¹¹⁰ based on a relatively consistent line of analogous cases at least some of the value associated with LIHTCs should be included in property valuation. Presumably, after the initial ten-year LIHTC allocation period the credits would no longer

¹⁰⁶ *Roehm v. County of Orange*, 32 Cal. 2d 280, 285 (Cal. 1948)

¹⁰⁷ *Id.* For a thorough list of such cases see INCLUSION OF INTANGIBLE ASSET VALUES IN TANGIBLE PROPERTY TAX ASSESSMENTS, 90 A.L.R.5th 547 (2005).

¹⁰⁸ See *Susquehanna Power Co. v. State Tax Com.*, 283 U.S. 291 (U.S. 1931); *Perrault v. Commissioner*, 25 T.C. 439, 451-452 (T.C. 1955) (citing *Susquehanna Power Co.*, 283 U.S. 291) (“where the value of physical property has been enhanced by reason of the presence of an intangible legal interest, nevertheless the enhanced value still adheres to the property.”); *Florida E. Coast Ry. Co. v. Department of Revenue*, 620 So. 2d 1051 (Fla. Dist. Ct. App. 1993); *Claringbold v. Council of Newark*, 28 Del. 507 (Del. 1915);.

¹⁰⁹ *Freeport-McMoran Resource Partners*, 12 Cal. App. 4th 634.

¹¹⁰ Utah Code § 59-2-1101(3).

impact the value of the property and thus would no longer be included in the assessment.

Most recently, an Arizona Tax Court focused on a LIHTC project's restricted income potential when siding with the taxpayer in a tax assessment suit. In *Cottonwood Affordable Housing*, the Arizona Court stated that a property's value should be determined from its restricted income potential, without regard to low-income housing tax credits.¹¹¹ The Court further ruled that while LIHTCs do provide an incentive for an investor or developer to invest in and construct these low-income housing projects, they also act as a disincentive for a current owner to sell, and provide little or no incentive for a new buyer to purchase the property.¹¹² Thus, the Court found that LIHTCs add little, if anything, to the long-term value of the property.

The reasoning in *Cottonwood* illustrates a factual disagreement between the majority and minority. While *Cottonwood* found that LIHTCs act as a disincentive for a current owner to sell, and provide little or no incentive for a new buyer to purchase the property, the South Dakota Supreme Court in *Town Square Ltd.* concluded that "tax credits make ownership of the property more desirable . . . because the tax credits can be transferred to purchasers, they enhance the value of the property in the marketplace."¹¹³ Thus whether the tax credits and properties are functionally transferable appears to play a significant role in the determination of their inclusion in valuation. Although, properties are occasionally transferred, the rules and risks are so onerous that such transfers are exceedingly rare. For example, according to Wayne Tenenbaum, a property tax attorney with Neill, Terrill & Embree LLC in Overland Park, Kansas "[s]ince the credits run out after ten years, but the restrictions may last for another 20 years beyond that time, a purchaser would, in effect, be buying only the restrictions without getting the benefit of the credits. Not surprisingly . . . there has been no sale of an operating Section 42 LIHTC project."¹¹⁴ In all of the above reported cases, the tax credits were still being distributed. Whether courts would reach the same conclusion in the clear absence of tax credits is entirely unclear. This is likely to renew the issue in some states as more LIHTC properties fully distribute their tax credits and reach the end of their federal compliance period.

C. Application of Market Rents and Restricted Rents

Only one court, the Supreme Court of North Carolina, has ruled that valuation should be based on market rents rather than actual rents because a voluntary agreement by a developer to be bound by restricted rents is not a

¹¹¹ *Cottonwood Affordable Housing v. Yavapai*, 72 P3d 357 (Ariz TC 2003).

¹¹² *Id.*

¹¹³ *Town Square Ltd. P'ship*, 704 N.W.2d at 903.

¹¹⁴ Wayne Tenenbaum, "Fitting a Square Peg into a Round Hole: The Difficulty in Valuing Section 42 Low Income Tax Credit Properties for *Ad valorem* Tax Purposes" 3-4 (November, 2002), available at http://www.nahb.org/fileUpload_details.aspx?contentID=19545.

“government restriction” requiring consideration of the lower rents. *In the Matter of Appeal of The Greens of Pine Glen Ltd. Partnership*, the court reasoned that “unlike a governmental restriction such as zoning, [LIHTC] restrictions do not diminish the property’s value, but instead balance tax credits allowed to the developer against rent restrictions imposed on the developer,” and “because [LIHTC] restrictions are freely entered contractual covenants, not governmental regulations,” the “taxpayer may not artificially alter the value of [the] property below fair market value.”¹¹⁵ A minority of courts examining other subsidy programs have also concluded that market rents rather than actual rents should be used when a HUD projects has actual rents “far below fair market value.”¹¹⁶ However, “a clear majority of courts have ruled that the restricted rents must be taken into account when assessing LIHTC property.”¹¹⁷

D. Other Affordable Housing Subsidies

The conclusion reached by the majority of courts, as to valuation of LIHTCs, appears consistent with treatment by other courts determining the appropriate considerations for valuation of properties impacted by federal housing subsidy programs. In the majority of court decision addressing whether government subsidy impacts the value of low-income properties and therefore should be included when determining the fair market value for property tax, courts have concluded that subsidy may be considered.¹¹⁸ “These cases apply the general theory that a low-income housing contract is an investment tool for maximizing an investment in real estate.”¹¹⁹ Consequently, “buyers and sellers of real estate consider these tools in determining the market value of real estate.”¹²⁰ In determining valuation of properties financed with various HUD programs courts in California,¹²¹ New Jersey,¹²² Louisiana,¹²³ Mississippi,¹²⁴ Michigan,¹²⁵

¹¹⁵ 576 S.E.2d 316, 322 (NC 2003).

¹¹⁶ *John P. Burke Apartments, Inc. v. Swan*, 137 A.D.2d 321, 326 (N.Y. App. Div. 1988); *Canton Towers, Ltd. v. Board of Revision*, 3 Ohio St. 3d 4 (Ohio 1983); *but see Kankakee County Bd. of Review v. Property Tax Appeal Bd.*, 131 Ill. 2d 1, 19 (Ill. 1989).

¹¹⁷ *Town Square Ltd. P’ship*, 704 N.W.2d at 900.

¹¹⁸ *See In re Ottawa Hous. Assoc.*, 27 Kan. App. 2d 1008; *but see Alliance Towers, Ltd. v. Stark County Bd. Of Revision*, 37 Ohio St. 3d 16, 523 N.E.2d 826 (Ohio 1988), appeal after remand, 50 Ohio St. 3d 42, 552 N.E.2d 632 (1990)(artificial effects of the federal housing assistance program not indicative of the value of the real estate).

¹¹⁹ *In re Ottawa Hous. Assoc.*, 27 Kan. App. 2d at 1013 (citing *Penns Grove Gardens*, 18 N.J. Tax at 261-62; *Parkside Townhomes*, 711 A.2d at 611).

¹²⁰ *In re Ottawa Hous. Assoc.*, 27 Kan. App. 2d at 1013 (citing *Pedcor Investments*, 715 N.E.2d at 437; *Rebelwood, Ltd.*, 544 So. 2d at 1364).

¹²¹ *Maples v. Kern County Assessment Appeals Bd.*, 96 Cal. App. 4th 1007, 1010 (Cal. Ct. App. 2002) (assessor may consider a subsidize 1% interest rate paid by taxpayer to develop 42 U.S.C. § 1485 low-income apartment complex in valuation of property);

¹²² *Penns Grove Gardens v. Penns Grove*, 18 N.J. Tax 253, 264-65 (1999) (holding that the governmental contract rent and the actual management fee should be used in determining valuation).

Illinois,¹²⁶ Maine,¹²⁷ and Maryland¹²⁸ have all concluded that the value of the subsidy should be included in assessment of the property for tax purposes. These cases either involved inclusion of mortgage-interest subsidy¹²⁹ or inclusion of rent subsidies based on above market contract rents¹³⁰ in the valuation process.

E. Calculating Capitalization Rates

As noted earlier, capitalization rates play a significant, and somewhat complicated, role in the income valuation approach. “Small changes in capitalization rate can make large differences in ultimate indicated value.” Such rates are typically developed either from examination of actual sales and income data or from methods such as the band-of-investment approach. Generally, the capitalization rate is intended to “reflect what investors generally are expecting from an investment in a particular type of property.”

Recent cases have tried to determine the proper approach for determining the capitalization rate of LIHTC and other federally subsidized properties. For example a Connecticut trial court, *Saranor Apts. Ltd. P’ship v. City of Milford*, 2005 Conn. Super. LEXIS 911 (2005), determined that the correct capitalization rate for an LIHTC property should rely on a comparison of market value apartments. The *Saranor* Court relied heavily on the Oregon Tax Court’s decision in *Wilsonville Heights Assoc., LTD. v. Dep’t of Revenue*, 17 OTR 139 (2003), which reached a similar conclusion in a case examining the proper

¹²³ *New Walnut Square; Ltd. Partnership v. Louisiana Tax Com’n*, 626 So. 2d 430 (La. Ct. App. 4th Cir. 1993) (holding appropriate to consider as “income” the subsidized low-interest mortgage used to finance complex for property tax purposes);

¹²⁴ *Rebelwood, Ltd. v. Hinds County*, 544 So. 2d 1356, 1364 (Miss. 1989) (holding that because the benefits of participating in a federal low-income housing program affect the value of the property in the open market, they must sensibly be considered in assessing value).

¹²⁵ *Meadowlanes Ltd. Dividend Housing Ass’n v. Holland*, 437 Mich. 473, 500 (Mich. 1991) (holding “Section 236 properties are subject to unique restrictions and advantages. All of them, including the subsidized interest feature, must be at least considered in the assessment process”).

¹²⁶ *Kankakee County Bd. of Review v. Property Tax Appeal Bd.*, 544 N.E.2d 762 (Ill. 1989) (federal rent subsidy must be considered in assessing the value of housing project).

¹²⁷ *Glenridge Development Co. v. City of Augusta*, 662 A.2d 928 (Me. 1995) (holding assessor properly considered both the interest subsidy payments made by federal government, as well as the rent ceiling in his income approach valuation).

¹²⁸ *Supervisor of Assessments of Baltimore City v. Har Sinai West Corp.*, 95 Md. App. 631, 622 A.2d 786 (1993) (Me. App. 1993) (holding inclusion of HUD rent subsidy appropriate in valuation for property tax purposes).

¹²⁹ *New Walnut Square Ltd. Partnership v. Louisiana Tax Comm’n*, 626 So. 2d 430, 432 (La. Ct. App. 1993); *Glenridge Dev. Co. v. City of Augusta*, 662 A.2d 928, 931 (Me. 1995); *Maples v. Kern County Assessment Appeals Bd.*, 96 Cal. App. 4th 1007, 1010 (Cal. Ct. App. 2002); *Meadowlanes Ltd. Dividend Housing Ass’n v. Holland*, 437 Mich. 473, 499 (Mich. 1991).

¹³⁰ *Penns Grove Gardens v. Penns Grove*, 18 N.J. Tax 253, 264-65 (1999); *Rebelwood, Ltd. v. Hinds County*, 544 So. 2d 1356, 1364 (Miss. 1989); *Kankakee County Bd. of Review v. Property Tax Appeal Bd.*, 544 N.E.2d 762 (Ill. 1989); *Supervisor of Assessments of Baltimore City v. Har Sinai West Corp.*, 95 Md. App. 631, 622 A.2d 786 (Me. App. 1993).

capitalization rate of an apartment complex constructed with financing obtained under 42 USC § 1485 (1990).¹³¹

Both courts held that capitalization rates should reflect the value that hypothetical “market participants would expect as a debt return and an equity return, again as of the date of assessment.”¹³² On the other hand, both courts rejected a capitalization rate which fails to reference any “market but only reference the facts of the particular project at issue, at the time of original construction of the project.”¹³³ Such a limited approach, rather than capturing the true market value, incorrectly “prevents any fluctuation in value based on shifting expectations of the capital markets over time.”¹³⁴

F. Valuation of LIHTCs Outside of the Property Tax Context

There are different techniques of valuing an LIHTC property, depending on the purpose of the appraisal, i.e., mortgage financing, insurance, or *ad valorem* taxation. Although never cited by reviewing courts, there are executive guidelines at the federal levels and among the appraisal literature describing how to value LIHTC properties for not tax purposes. For example guidelines issued jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, Federal Reserve Board, and the Office of the Thrift Supervision state generally that appraisals of projects which are constructed with low income housing tax credits should consider the market value impact of these credits. According to the joint release:

An institution that extends credit for development of an affordable housing project should consider the financial assistance that frequently accompanies these projects, such as low-income housing tax credits (LIHTC), subsidies, and grants. Such financial assistance creates an incentive for developers and investors to undertake the project. . . . When a regulated financial institution obtains an appraisal for an affordable housing project, the appraisal should contain a market value estimate that reflects the real estate collateral and typical interests in the real estate on a cash or cash equivalent basis. The agencies’ appraisal regulations permit the appraiser to include in the

¹³¹ See also *Whitewater Court, Ltd. v. City of Whitewater*, 2005 WI App 1, 690 N.W.2d 885 (Wis.App. 2004)(complex financed under 42 USC § 1485); but see *In re Appeal of Soda Springs Associates*, No. 04-A-2196 (ID Bd. Tax Appeals, 2004) (failing to adopt taxpayer’s capitalization rate derived from market-rate multi-family), available at <http://www2.state.id.us/bta/decisions/2004/SodaSpring.car.htm>; *Stockton Estates v. Paul Johnson, Assessor*, No. 97-49502 (Tax Comm. MO, 2006) (finding that “It is not wholly clear that individuals who invest in subsidized housing projects are placing their funds at higher risk than other investments. . . .”), available at <http://www.stc.mo.gov/2006/StocktonEstates97-49502.htm>.

¹³² *Wilsonville Heights Assoc.*, 17 OTR 155.

¹³³ *Id.*

¹³⁴ *Id.*

market value estimate any significant financial assistance that would survive sale or foreclosure, such as the value of LIHTC, subsidies, and grants.¹³⁵

The impact of these guidelines is that the value associated with the tax credits can be added to the value of the property.

There is thus an inherent tension between this initial valuation for financing and tax credit purposes and later property tax assessments. In the initial stage of valuation, developers will wish to include the value of tax credits in valuation because capital sources need them to show high values, lenders must justify loans and investors must show equity above debt.¹³⁶ On the other hand, all the analysis used to support the financing is equally good evidence to support a high *ad valorem* assessment.¹³⁷

G. Conclusion

Appellate courts are almost evenly split as to whether tax credits should be included in the valuation of LIHTC properties. To a large extent this split appears to depend on three issues, first, whether LIHTCs are tangible or intangible, second whether LIHTCs if intangible can be valued to the extent that they impact the value of the associated tangible property, and third whether LIHTC properties can be transferred so as to provide incentive for a new buyer to purchase the property.

Based on standard definitions and analogous case law, it seems clear that LIHTCs are intangible property. However, impact of the LIHTCs, on the related tangible property is properly included in a property assessment because it is so integral to the economic viability of the project. The third issue is a much more difficult factual question. While The Arizona Tax Court found in *Cottonwood* that LIHTCs act as a disincentive for a current owner to sell, and provide little or no incentive for a new buyer to purchase the property, the South Dakota Supreme Court in *Town Square* concluded that “tax credits make ownership of the property more desirable” to a purchaser.¹³⁸ The true value is probably located somewhere between. That is, the *Town Square* court failed to consider the significant limits on illiquidity, while the *Cottonwood* court failed to consider the transferability of the credits at the entity level. Although from a purely legal position the *Cottonwood* court is probably closer to being correct, this issue is probably best

¹³⁵ Joint Release, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve Board, Office of Thrift Supervision, Interagency Statement on Appraisals for Affordable Housing Loans (1995), available at <http://www.occ.treas.gov/ftp/bulletin/95-16a.htm> (citing OCC 12 C.F.R. Part 34; FRB 12 C.F.R. Part 225; FDIC 12 C.F.R. Part 323; and OTS C.F.R. Part 564).

¹³⁶ SMITHET. AL., *supra* note 64, at 2.

¹³⁷ *Id.*

¹³⁸ *Town Square Ltd. P'ship*, 704 N.W.2d at 903.

decided by the legislature, which is better able to assess the relative illiquidity and transferability of projects generally and determine an intermediate valuation.

III. Legislative Valuation of Low-Income Housing Tax Credit Properties

It is hard to predict how a court will rule on an issue as complicated as the valuation of LIHTC properties. Conflicting court decisions prove problematic for both the LIHTC property owner and assessors. Courts are placed in a difficult position, in most cases recognizing that “federal tax credits significantly enhance the value of subsidized housing. . . .” In light of this, the question becomes whether “there may be some valuable policy reason underlying” a decision not to include LIHTCs in property valuation. As the dissent in *Bayridge* stated, “[t]he legislature knows how to provide property tax relief to owners of low-income housing. . . . Had the legislature intended owners of property that qualified under IRC § 42 to be entitled to property tax relief on that basis, it surely would have provided for an explicit exemption or reduction.”¹³⁹ Courts in the majority have consistently cited statutory authority in other jurisdictions indicating that despite arguments by “taxpayers and amici” urging consideration of “policy implications of the inclusion of the Tax Credits in valuation. . . . The legislature is the appropriate body to determine public policy on this issue.”¹⁴⁰ Since shortly after the first decisions requiring inclusion of the value of LIHTCs, legislatures have, begun to enact various forms of clarifying legislation.

Twenty-two states have passed legislation addressing the valuation of LIHTC properties.¹⁴¹ All of these states’ statutes provide valuation guidance beneficial to both LIHTC property owners and assessors. A majority of these states require that LIHTC properties be assessed under the income approach and that assessors exclude tax credits from the assessment process.¹⁴² The impetus for enactment appears to be to “help insure that their valuation for property taxation does not result in taxes so high that rent levels must be raised to cover this project expense, which can cause excess vacancies, project loan defaults, and eventual loss of rental housing facilities for those most in need of them. . . .”¹⁴³ In almost all cases these statutes passed unanimously.

¹³⁹ *Bayridge Assocs. Ltd. Partnership*, 892 P.2d at 1012 (Van Hoomissen, J., dissenting).

¹⁴⁰ *Spring Hill, L.P.*, 2003 Tenn. App. LEXIS 952 (note 25).

¹⁴¹ These states are Alaska, California, Colorado, Florida, Georgia, Illinois, Indiana, Iowa, Maryland, Minnesota, Mississippi, Montana, Nebraska, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Texas, Utah, Vermont, and Wisconsin.

¹⁴² Wis. Stat. § 70.32; Utah Code § 59-2-1101 and § 59-2-102 (Intangible); 72 P.S. § 5020-402; R.R.S. Neb. § 77-1333; Md. Tax-Property Code Ann. § 8-105; Iowa Code § 441.21; Ind. Code § 6-1.1-4-40 and ; O.C.G.A. § 48-5-2; Fla. Stat. § 193.017; Cal Rev & Tax Code § 402.95; 35 ILCS § 200/10-235; NY CLS RPTL § 581-a.

¹⁴³ 35 ILCS § 200/10-235.

Some academics have argued for a broad property tax exemption for LIHTC properties.¹⁴⁴ Currently, only one statute requires tax exemption for LIHTC properties owned and operated by nonprofit entities,¹⁴⁵ although some other states allow exemption under narrow circumstance,¹⁴⁶ and others allow for bargaining between LIHTC property owners and governments which could result in tax exemption.¹⁴⁷ LIHTC project owners have been generally unsuccessful in obtaining property tax exempt status under other statutes which provide exemption for affordable housing properties generally.¹⁴⁸

There is some concern that exempting properties may lead to increased hostility between local taxing authorities and property owners.¹⁴⁹ Such concerns “at the local level may be exacerbated by numerous factors which obscure the perception of the public benefit . . . the imposition of the exemption scheme by state government; a high concentration of exempt property in a given municipality disproportionate to local benefits; and beliefs of local citizens and assessors about equitable distribution of the property tax burden.”¹⁵⁰ This would tend to diminish some of the significant strengths of the LIHTC program, namely the well developed multilevel partnership between private parties and government entities at the local, state and federal level. Because of the unique structure of the LIHTC program, LIHTC properties “have less of a stigma than public housing ‘projects’ that are sure to inspire NIMBY-ism in almost any neighborhood.”¹⁵¹ Further,

¹⁴⁴ See Jonathan Penna, *supra* note 52; Lance S. Bocarsly & Steven C. Koppel, *Real Property Tax Exemptions in Affordable Housing Transactions*, 2 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 12, 19 (1993).

¹⁴⁵ Mont. Code Anno., § 15-6-221 (2005).

¹⁴⁶ See e.g. Tex. Tax Code § 11.182 (2005).

¹⁴⁷ See e.g. R.I. Gen. Laws § 44-5-13.11.

¹⁴⁸ See e.g. *Maplewood Cmty., Inc. v. Craig*, 607 S.E.2d 379 (W. Va. 2004); *Am. Hous. Found. v. Brazos County Appraisal Dist.*, 166 S.W.3d 885 (Tex. App. 2005).

¹⁴⁹ This can be seen in the statements made by Gary Superman who voted against lowered valuation for LIHTCs in the Alaskan Borough of Kenai, who said “the clincher for him at this point was the fact the borough already was required to assess two apartment complexes at the lower rate by virtue of their being qualified prior to Jan. 1, 2001, and that the state is not reimbursing us one cent for that cost. Until the state comes to grips with that, he said, he would not be supporting additional low-assessment properties.” Hal Spence, No tax break for low-income housing Kenai Peninsula Online, September 23, 2004, http://peninsulaclarion.com/stories/092304/news_923new003.shtml; This is discussed in greater detail in the land conservation context in Kirk G. Siegel, Comment, *Weighing the Costs and Benefits of Property tax Exemption: Nonprofit Organization Land Conservation*, 49 ME. L. REV. 399, 434 (1997) (The lack of recourse in some municipalities makes exempt property a likely target of broad-based animosity).

¹⁵⁰ *Id.* at 411.

¹⁵¹ Lance Freeman, *Siting Affordable Housing: Location and Neighborhood Trends of Low Income Housing Tax Credit Developments in the 1990s* 4 (2004) (The Brookings Institution, Census 2000 Survey Series).

exempting LIHTC properties from taxation ignores the fact that “[d]evelopers and owners of affordable housing want to pay their fair share in local taxes.”¹⁵²

Thus, rather than focusing on exemption, this paper argues for enactment of statutes which would increase the uniformity and predictability of LIHTC property valuation. In particular it identifies four criteria desirable in LIHTC valuation legislation: 1) predictability for preconstruction project viability, 2) consistency of application over the life of the project, 3) uniformity of application to similar projects, and 4) fostering of ongoing amicable relationships between LIHTC project managers and local governments.

A. Typical LIHTC Valuation Statutes

The most recently enacted legislation is a good representative of the standard LIHTC valuation statute. In October 2005, the New York Legislature amended the New York Real Property Tax Law by adding Section 581-a, which requires property assessors to value affordable housing projects “using the income approach as applied to the actual net operating income . . . and shall not include federal . . . income tax credits.”

Legislatures in California, Florida, Georgia, Indiana, Iowa, Illinois, Maryland, Nebraska, Pennsylvania, and Wisconsin have all enacted statutes substantially similar to the New York legislation. For example, Section 402.95 of California’s Revenue and Taxation Code states, “in valuing property under the income method of appraisal, the assessor shall exclude from income the benefit from federal and state low-income housing tax credits.” Maryland’s statute provides assessors one of the clearest guidance. Maryland’s Tax Code § 8-105 states that:

In determining the value of commercial real property developed under Sec. 42...the [assessor]:

- (i) shall consider the impact of applicable rent restrictions...required by Sec. 42;
- (ii) may not consider income tax credits under Sec. 42...as income attributable to the real property; and
- (iii) may consider the replacement cost approach only if the value produced by the replacement cost approach is less than the value produced by the income approach....

Other states, like Georgia and Wisconsin, address the LIHTC valuation issue in broader terms. For instance, Georgia Revenue and Taxation Code § 48-5-

¹⁵² National Association of Home Builders, Local Tax Assessments of Low Income Housing Tax Credit (LIHTC) Projects 9 (White Paper), *available at* http://www.nahb.org/fileUpload_details.aspx?contentTypeID=3&contentID=46438&subContentID=28221.

2 states that when determining the fair market value of property, “the tax assessor shall not consider any income tax credits with respect to real property.”

Alaska Statute 29.45.110(d)(1) takes a unique approach to valuing LIHTC properties. Under 29.45.110(d)(1), the assessor is required to value low-income housing tax credit projects existing prior to the effective date of the legislation, January 2001, based on the actual income derived from the property. Alaska Statute 29.45.110(d)(2) also requires the governing body of localities to determine by ordinance whether projects qualified for LIHTCs after January 2001, be assessed based on income derived in the same way as preenactment properties. If the assembly does not exempt newly qualified parcels from the income method, it may determine on a parcel-by-parcel basis whether the property be assessed based on the restricted rent income approach or at full and true value.¹⁵³

Although Alaska’s opt-out state is unique other state legislatures have exempted large cities or counties from their LIHTC valuation statute. For example, the recent New York statute “was not intended to include New York City properties. Although the Legislation does not exclude such properties, it is expected that the law will be amended in the next session of the New York State Legislature to exclude properties in New York City.”¹⁵⁴ The Illinois statute similarly, exempts “counties with a population of more than 200,000” from the state statutory limitations.

B. Discount Valuation Statutes

Under Illinois statute, 35 ILCS § 200/10-235, “low-income housing projects . . . that qualify for the low-income housing tax credit . . . shall be valued at 33 and one-third percent of the fair market value of their economic productivity to the owners of the projects” This approach is taken with the stated purpose “to help insure that their valuation for property taxation does not result in taxes so high that rent levels must be raised to cover this project expense, which can cause

¹⁵³ Of those Alaskan boroughs with LIHTC properties in the Municipality of Anchorage despite a failed ordinance in 2001 all LIHTC projects are assessed at their full and true value; no ordinance is in place Matanuska-Susitna Borough, however the “restricted rent valuation is provided to those projects that qualify, apply timely and provide all requested financial information;” six projects receive assessments based on restricted rents in the Borough of Juneau, and the Borough is currently drafting an ordinance; one property in the Ketchikan Borough benefits from a reduced assessment as by local Ordinance 45.11.055 (b). Memorandum from Shane Horan Director of Assessing for the Kenai Peninsula Borough to Members of the Kenai Peninsula Borough Assembly, Valuation of Low-Income Housing Tax Credit (LIHTC) (Oct. 16, 2003), *available at* <http://www.borough.kenai.ak.us/assemblyclerk/Assembly/Ordinances/2003/O2003-43memo.htm>. The Kenai Peninsula Borough failed to pass an ordinance and values post enactment properties at their full and true value. Hal Spence, *supra* note 149.

¹⁵⁴ JOHN KELLY ET. AL., NEW YORK STATE AFFORDABLE HOUSING PROPERTY TAX ASSESSMENT BILL, NIXON PEABODY LLP AFFORDABLE HOUSING LAW ALERT 2 (Oct. 18, 2005), *available at* http://www.nixonpeabody.com/linked_media/publications/AHLA_10182005.pdf

excess vacancies, project loan defaults, and eventual loss of rental housing facilities for those most in need of them, low-income families and the elderly.”¹⁵⁵

Rhode Island General Law § 44-5-13.11 takes a similar valuation approach, although explicitly allowing municipalities to value at a lower percentage. Illinois takes a substantially similar approach to Rhode Island. Minnesota Statute, § 273.128 also discounts LIHTC properties although it does so by providing for a decreased tax rate for LIHTC properties rather than a decreased income based valuation. Under the Rhode Island and Illinois statutes, which compute value based on income, a developer may not have to worry as much about prohibitive property taxes. Generally, although these statutes presumably decrease the likelihood of default, they do not appear to increase consistency of application or predictability.

C. Limitations

Notably, only one state provides explicit guidance as to calculation of tax credits, valuation method, and capitalization rate. Nebraska’s LIHTC valuation statute requires county assessors to “perform an income-approach calculation,” in which “low-income housing tax credits . . . shall not be considered income for purposes of the calculation” However, the statute explicitly allows the low-income housing tax credits to “be considered in determining the capitalization rate to be used when capitalizing the income stream.” As to determination of capitalization rate, the Nebraska statute appears to place discretion with the assessor. Although this results in a clear legal standard, it also allows for unpredictable and inconsistent application.

Only two other state statutes address capitalization rates at all. Mississippi Code Ann. § 27-35-50 mandates that “appraisal shall be made according to actual net operating income” and “capitalized at a market value capitalization rate.” Texas Tax Code § 11.1825 requires that the assessor “use the same capitalization rate that the chief appraiser uses to appraise other rent-restricted properties.” Notably, neither the Mississippi statute nor the Texas statute explicitly addresses the valuation of LIHTCs. Although the statutory language in the Mississippi Code “according to actual net operating income” might be interpreted to prohibit inclusion of LIHTCs language excluding valuation of LIHTCs was removed from a prior version of the Bill. The Texas statute is similarly ambiguous.

D. Conclusion

Where enacted, statutes do not as yet provide a clear and complete answer to the question of LIHTC valuation. As outlined above, statutes either address only some of the major valuation issues or fail to provide clear guidance. This paper recommends that in order to best support a fair distribution of affordable

¹⁵⁵ 35 ILCS § 200/10-235.

housing development statutes should be drafted with the goals of 1) predictability for preconstruction project viability, 2) consistent application over the life of the project, 3) uniformity of application to similar projects, and, 4) fostering amicable relationships between LIHTC project managers and local governments; statutes should provide clear language addressing valuation of credits, assessment methodology (i.e. income capitalization method using actual rents), and applicable capitalization rate.

Examining these goals in comparison to current statutes demonstrates the inadequacies of those statutes. The bulk of statutes do not address all three of the major factors impacting assessed value: inclusion of LIHTCs, use of market or restricted rents, and proper calculation of capitalization rates. These statutes are especially lacking in their failure to define the proper capitalization rate for LIHTC properties.

State courts have clearly demonstrated a preference that legislatures address this issue. Further, courts have demonstrated confusion over the factual workings of the LIHTC program, especially with regard to transfer and sale of LIHTC properties. The difficulties experienced by courts in determining the proper valuation of LIHTC properties is likely to increase as properties continue to operate after the ten-year credit allocation period.

IV. Conclusion

Property taxes are one of the largest single line items in project operating costs. High tax burdens threaten the stability of a multimillion public investment. “State allocating agencies, knowing the local assessments will be higher, could be forced to choose between not supporting projects in certain areas or only approving projects that serve higher income tenants (thus resulting in higher rents) in that community because only those projects are feasible.”¹⁵⁶ In the end, much-needed affordable housing is lost and those who require this housing the most have the least access to it.¹⁵⁷ Consequently, considerations must be made about the extent to which housing funded with public monies should be taxed.

Generally, state courts are divided. Although a clear majority of state courts hold that actual rents rather than market rents must be used for tax assessment, courts are quite divided as to whether value of tax credits should be included in the property value. This difference of opinion is based on three major factors, classification of LIHTCs as tangible or intangible property, valuation of the impact of intangible property on tangible property, and the liquidity of LIHTCs. Based on standard definitions and analogous case law, it seems clear that LIHTCs are intangible property; however, the impact of intangible LIHTCs on related tangible property is properly included in an assessment. The third issue is a much closer question. Thus, although from a factual perspective LIHTCs are

¹⁵⁶ National Association of Home Builders, *supra* note 152.

¹⁵⁷ *Id.*

extremely illiquid, this issue is probably best resolved by the legislature, which is better able to assess the relative illiquidity and transferability of projects generally and settle upon an intermediate valuation.

State courts have only just begun to address whether capitalization rates should be adjusted or based solely on market rate comparables. Further, state courts appear disinclined to address these issues in favor of property owners in the absence of statute, believing that the legislature is the most capable institution to provide protection to the interest of LIHTC property owners.

Similarly, statutes, where enacted, do not provide a clear answer. However, looking at the individual elements of current LIHTC valuation statutes, one can see both significant progress being made by states towards uniformity and predictability of LIHTC property valuation and also the future possibility of clear complete valuation statutes. Finally, as legislatures are in a better position to properly analyze the workings of the LIHTC program, this paper recommends that legislatures take a proactive position on this issue and clearly describe proper valuation methods for both the initial period in which credits are being distributed and all years after credits have been expended.