

Is a Consensus Emerging on LIHTC Property Valuations?

By

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For two decades, owners and managers of low-income housing tax credit (LIHTC) projects have labored to control property taxes that for many are their single largest expense. It has been a hard fight, as local assessing authorities, state legislatures, and courts have struggled to develop clear policies on the many complicated valuation issues that LIHTC properties create.

The last 10 years have brought significant clarification in many jurisdictions. At least 32 states have established some statewide guidance to taxpayers on LIHTC valuation, with 17 states passing legislation and nine state courts issuing decisions clarifying some aspect of the law related to the methodology used to value these assets.

There is still a significant number of jurisdictions without a clear policy, but a consensus may be emerging. Here is a rundown on progress-and remaining challenges-in those states that have addressed the valuation of LIHTC properties.

Differing valuation methods

Few jurisdictions prescribe a valuation methodology for LIHTC projects, but the vast majority of assessing authorities use the income capitalization approach rather than sales comparison or cost method.

Almost all jurisdictions and appraisal literature agree that the sales comparison method is inapplicable to LIHTC properties because these assets rarely, if ever, are sold. When LIHTC transactions occur, finding similarly situated properties is difficult because land-use restrictions can vary greatly from project to project.

Similarly, the cost approach is a poor indicator of LIHTC property values for several reasons. First, the actual development costs for these assets

typically exceed those for an otherwise comparable, market-rent property. Most LIHTC projects include additional amenities to serve the elderly and disabled, and comply with federal regulations for subsidized housing.

Second, tax credit projects preclude the principle of substitution that is an underlying assumption of the cost approach. Substitution holds that a knowledgeable buyer would pay no more for a property than the cost to acquire a similar site and to construct similar improvements. But without federal tax credits, most low-income housing would be financially unfeasible, and thus never constructed.

Finally, taxpayers and assessing authorities continue to argue over the question of how to estimate depreciation or economic obsolescence due to the restrictive covenants and federal regulations imposed on LIHTC operations.

By default, then, the income capitalization approach is the most common method used to assess LIHTC properties. Even with the income capitalization method, however, significant disagreement persists among jurisdictions regarding its application, primarily because of the rental restrictions and tax credits associated with LIHTC properties.

An assessor valuing a LIHTC complex using the income capitalization method must choose between market rent and the property's restricted rent to derive gross potential income. A clear consensus among jurisdictions has emerged that the property's restricted rents should be used.

Currently, 30 jurisdictions mandate the use of restricted rent amounts in valuing LIHTC properties. Remaining jurisdictions provide no clear guidelines.

Credit for tax credits

There is less clarity, however, on the valuation of the federal tax credits given to owners of LIHTC properties.

Nine jurisdictions include the value of the LIHTC allocation as part of a property's net operating income. Those authorities contend that the tax credit enhances a project's value and becomes something a prospective buyer would take into account when estimating the project's value.

By contrast, 21 jurisdictions exclude tax credits from property income. The proponents of excluding tax credits point out that excessive tax assessments make low-income housing less economically feasible, and thereby undermine the credit program's goal of encouraging the development of such projects.

The courts also have emphasized that a buyer would receive only the remainder of the tax credits, if any, and a seller might be subject to a recapture of the tax credits. Thus, if the project is sold near or at the end of the 10-year period when the tax credits expire, the tax credits would not add to the value of the project.

In many jurisdictions, the decision to include or exclude tax credits from income hinges on the tax credits being categorized as intangible property under state law. The courts in Arizona, Missouri, Ohio, Oklahoma, and Washington have ruled that the tax credits are intangible and should not be considered part of income for purposes of valuation. By contrast, the courts in Georgia, Idaho, Indiana, Illinois, Pennsylvania, South Dakota, and Tennessee have reached the opposite conclusion.

Of these jurisdictions, the legislatures of Georgia, Idaho, Indiana, Pennsylvania, and South Dakota have since acted to overturn those court decisions. And in a few places including Connecticut and Michigan, tax credits were found to be intangible, but the courts nevertheless found that the value of the intangible tax credits must be taken into account for purposes of assessing an LIHTC project.

Consensus and dissent

There is certainly a greater consistency and clarity today than there was 10 years ago on the complex legal and valuation issues affecting LIHTC projects. Yet significant disagreements remain in the ways jurisdictions handle these assets.

Each state has a complex property tax system. For LIHTC project owners and managers, working with local counsel is the most effective way to understand how a jurisdiction's policy toward LIHTC valuation will affect their property tax assessment.

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