Defending Against Excessive LIHTC Property Taxes

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The unique characteristics of LIHTC projects make it difficult for assessors to appraise these properties for property tax purposes. The assessment difficulties ultimately lead to excessive valuations. However, LIHTC owners need not despair as they have at their disposal several methodologies for determining whether property taxes are excessive and to, then, challenge those assessments.

HOW TO RECOGNIZE EXCESSIVE TAXATION

Errors in Basic Data

The initial step calls for a review of the basic data contained in the taxing authority's property records. This examination offers the LIHTC owner the first and easiest place to ascertain the appropriateness of levied tax assessments. Assessor's records commonly contain errors in one or more of the following areas: a property's age, square footage, unit mix and/or facility amenities. An error in even one of these fundamental property characteristics can significantly increase a property's overall assessment.

> **How Simple Errors Cost Taxpayers Big Money**
> An assessor's records indicate a project's net leaseable area is 175,000 sf. and the project has been valued at $45/sf, which equates to a total assessment of $7,875,000. In reality, the project only contains 160,000 sf. And, thus, should be valued at $7,200,000. This one error alone results in a significant $675,000 over assessment. Were the owner to find a second mistake in the records, such as the valuation of a $150,000 swimming pool that did not exist at the property, the excessive valuation based on errors in basic data would be even more egregious. The two recording errors in this scenario would amount to $825,000 in excessive valuation, or more than 10% of the initial valuation. A simple review of the assessor's records in this example would have netted the owner almost $25,000 in tax savings in a jurisdiction with a $3.00 mill rate for every $100 of value.

A more significant error commonly made by assessors results from their assessing a LIHTC project as if it were a traditional, multi-family complex. Property codes are commonly assigned to property types, which dictate what criteria will be used in arriving at the property tax assessment. A simple coding error can result in an excessive valuation in the millions of dollars. LIHTC owners should verify that their projects have been coded as low-income housing properties.

Most jurisdictions provide taxpayers specific protest avenues to correct these common mistakes. LIHTC owners should be prepared to share a current rent roll with their assessor in order to document the property's square footage and unit mix. Owners should also provide the assessor with a copy of the property's Land Use Restriction Agreement (LURA) to confirm its LIHTC status.

Does the Assessment Lack Equality and Uniformity

LIHTC owners should ensure that their property has been valued fairly and equally in comparison to other LIHTC projects in the taxing jurisdiction. Many states require that assessments among comparable properties be equal and uniform. A LIHTC owner's assessment should fall within a uniform range of values when compared to other LIHTC properties. For example, if an owner's project is valued at $60/sf and there are 10 other comparable LIHTC projects in the taxing jurisdiction valued between $40 and $45/sf, the owner's property should also fall within the $40 to $45/sf range. The example clearly demonstrates the importance of assessors properly categorizing and coding a LIHTC project in its records. A low-income housing project should not be valued at the same level of appraisal as a traditional market project.

Owners need to compare their property's assessment to other LIHTC properties on a square footage and per unit basis. If an owner's property is assessed disproportionately higher than comparable properties on these two factors, an argument can be made for a value reduction based on equality and uniformity regardless of the assessor's "market value" claims.

Educating the Assessor about LIHTCs

In most jurisdictions, the assessor's statutory responsibility is to value a property at its "market value" as of a particular valuation date. Assessors commonly derive a market value using one or more of the three classic approaches to value: cost, income or sales comparison. They will encounter difficulty in applying these valuation methodologies to an LIHTC property because of the unusual restrictions imposed by the LURA.

The cost approach presents inherent obstacles for the assessor due to the need to quantify functional and, in particular, economic obsolescence brought about by the LURA restrictions. Under the income approach, the assessor experiences problems with the quantification of income (actual vs. market), the extraordinary expenses incurred by LIHTC projects and the calculation of a reasonable capitalization rate. Finally, the sales comparison approach will be difficult to apply when there are no sales of comparable properties and because of the restrictive covenants that "run with the land."

LIHTC owners find it beneficial to educate themselves about the difficulties assessors face when valuing projects. This helps the LIHTC owner educate the assessor about the unique characteristics of the project and helps to inspire confidence in the appraisal methodologies proposed as a solution to the valuation difficulties.

POINTS TO DISCUSS WITH THE ASSESSOR

Creating an ongoing dialogue with the assessor becomes the key to avoiding excessive property tax valuations. This dialogue should educate the assessor about the distinctive nature of LIHTC properties and send the message that the LIHTC owner will be cooperative, yet aggressive in protesting excessive property valuations. The following issues provide owners with arguments to prove to the assessor that they should deviate from their "normal" appraisal methods.

Intangible Value

A debate continues among assessors concerning whether tax credits should be considered when valuing a LIHTC project. A LIHTC property's total value derives from two primary components: the real estate and the tax shelter benefits. Appraisal scholars argue that, for tax assessment purposes, these benefits should be segregated into tangible value (i.e. the benefits attributable to the real estate) and intangible value (i.e., the benefit attributable to the LIHTC). This classification is crucial because, in most jurisdictions, assessors cannot include intangible values in their property tax assessments.

If a LIHTC owner's property is located in a jurisdiction that does not give the assessor guidance on the tangibility issue, owners should always argue that the credits are not a benefit attributable to the real estate but rather, comprise intangible value that should not be a component of the market value assessment. This argument will always lead to reduced property values. To help bolster this argument, an owner should show the assessor sample legislation from other jurisdictions, which dictates that tax credits are intangible. Even better, LIHTC owners should join forces and lobby their state legislators to enact statutes that direct the assessor to exclude tax credits from the valuation equation.

Illiquidity

A LIHTC owner cannot sell, transfer or exchange the property without meeting certain conditions and obtaining government approvals. The LURA dictates who the property can be sold to. In addition, the property's restrictions survive a sale. These factors make for an extremely illiquid asset. Most "market value" definitions assume a willing buyer and willing seller in the open market. Such a definition cannot be easily applied to a LIHTC project. Owners should argue that the illiquidity of a LIHTC project should be accounted for in the property tax assessment. One suggestion is to recommend a 15% to 25% discount off the indicated value via the income approach to account for the illiquid investment.

Restrictions and Expenses

A LIHTC property operates under limited potential due to the restrictions associated with the LURA. The restrictions are long term with severe penalties for violations. Resident restrictions result in additional risk and effort.

In addition, LIHTC owners experience higher expenses because they must meet certain reporting, record-keeping and documentation edicts beyond conventional practice. Rental rates are limited but expenses are not.

Owners should insist that the assessor take into account the effects of these restrictions and expenses on a property's tax assessment. An owner could argue that the restrictions, risk and expenses, which distinguish a LIHTC project from a typical market complex, support the use of a higher capitalization rate in an income analysis. This will, in turn, produce a reduced taxable value. Armed with methods of recognizing excessive tax

assessments and arguments to thwart these excesses put LIHTC owners in a position to gain fair taxation of their properties.

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