

Reduce your LIHTC property tax assessments

By Gilbert D. Davila, Esquire

While low-income housing tax credits (LIHTCs) will reduce federal tax liability for investors, the underlying properties face uncertain treatment at the hands of property tax assessors.

The unique characteristics of LIHTC projects make it difficult for assessors to agree on how they should be valued for appraisal purposes. Vagueness in state statutes and conflicting trial court decisions across the country provide little guidance to assessors. This is why it is imperative for LIHTC property owners to understand the difficulties assessors face in valuing their projects. Armed with that knowledge, an owner needs to educate the assessor about the factors that affect a tax credit property's market value and ultimately the property tax bill.

The problem for assessors begins with the unusual restrictions imposed on LIHTC projects, which traditional multifamily complexes do not face. LIHTC properties must abide by the provisions of land-use restriction agreements (LURAs) to avoid recapture of credits in the first 15 years (and other penalties in extended-use periods). The LURA typically calls for rent restrictions, occupancy guidelines, restrictions on the sale of the property, usually a 30-year compliance period, and compliance monitoring.

These LURA restrictions remain with the property even after it is sold. While these facts are well known in the

affordable housing industry, assessors, for the most part, remain unaware of them.

In most jurisdictions, an assessor's statutory responsibility is to value a property at its "market value" as of a particular valuation date. An assessor will commonly derive a market value using one or more of the three classic approaches to value – cost, income or sales comparison – but these are difficult to apply to an LIHTC property.

The *cost approach* presents inherent difficulties for the assessor because of 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. 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." Finally, the assessor faces the question of whether the tax credits themselves should comprise any component of the property's market value.

A debate continues in the appraisal community about whether the benefits attributable to the tax credits should be considered in valuations. A LIHTC property's total value derives from two primary components: the real estate and the tax shelter benefits. Appraisal scholars argue that for purposes of a market-value assessment, these benefits should be segregated into tangible value (that is, the benefits

attributable to the real estate) and intangible value (that is, the benefit attributable to the tax credits). This classification is crucial because in most jurisdictions, assessors cannot include intangible values in their property tax assessments. An assessor's view on a tax credit's tangible or intangible nature can have a significant impact (positive or negative) on a LIHTC project's market-value determination.

The debate between assessors and owners regarding the application of the approaches to value and the tangible or intangible classification of the tax credits is ongoing because assessors have been given little guidance in valuing LIHTC properties. A review of state statutes and court cases indicates that more than one-third of the states do not address subsidized or financially assisted housing valuation issues at all.

The remaining states address LIHTC project valuation specifically or subsidized housing assessment in general (or both) either by statute or through recorded court cases. For example, six states (Alaska, Colorado, Florida, Illinois, Iowa and Wisconsin) favor excluding the tax credits from the market-value assessment. However, four states (Connecticut, Idaho, Indiana and Pennsylvania) consider the tax credits as a component of a property's market value. LIHTC property owners should consult a property tax professional in their state to discuss multifamily valuation issues for their particular taxing jurisdiction.

Knowing the challenges different



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assessors face in valuing LIHTC properties, what can these property owners do to help reduce their ever-increasing property tax bills? The key to avoiding excessive property tax valuations is maintaining an ongoing dialogue with assessors. That dialogue should provide education about the distinctive nature of LIHTC properties and the fact that these properties warrant a deviation from "normal" appraisal methods. The following are some talking points for discussions with assessors:

- **Restrictions:** The property is operating under limited potential because of the restrictions associated with LIHTC regulations. The restrictions are long term and penalties for violations are severe. Rent restrictions cause rental rates per unit to be much lower than in comparable conventional

properties. Resident restrictions result in additional risk and effort.

- **Expenses:** Expenses are higher for LIHTC owners because they must meet certain reporting, recordkeeping and documentation edicts beyond conventional practice. 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.

- **Illiquidity:** An owner cannot sell, transfer or exchange a LIHTC property unless certain conditions are met and government approvals are obtained. The LURA dictates who the property can be sold to, and the property's restrictions survive a sale. Tax credits expire after 10 years, but the restrictions may last for another 20 years or more. A purchaser would, in effect, be buying only the restrictions without getting the benefit of the credits. These factors make for an

extremely illiquid asset.

- **Intangible value:** Tax credits are not a benefit attributable to the real estate and are thus intangible value that should not be a component of the market-value assessment.

Owners of LIHTC properties need to be a catalyst for an evolution in the valuation of affordable housing. The power to reduce property tax assessments lies in the owners' knowledge of their industry and their ability to educate assessors about the environment in which their properties operate. ■

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