SLO

2415 East Camelback Road, Suite 700
Phoenix, Arizona 85016
www.santoslawpllc.com

DOMINGOS R. SANTOS, JR.
Managing Member
Telephone: (602) 549-9130
E-mail: ds@santoslawpllc.com

Valuing Low-Income Housing Tax Credit Properties for Property Tax Purposes

I. Introduction

Low-Income Housing Tax Credit ("LIHTC") properties present unique valuation issues property owners should consider in evaluating annual notices of valuation issued by county assessors in Arizona. This article discusses these issues and reviews statutes, administrative directives, and case law addressing these valuation issues.

II. Summary of the LIHTC Program

The LIHTC program is a dollar-for-dollar federal tax credit to promote affordable housing investment. Taxpayers with expected federal income tax liability provide equity contributions for the development of affordable housing. Project developers apply for an allocation of LIHTCs from the Arizona Department of Housing. If the project developer receives an allocation, the project developer seeks capital contributions from LIHTC investors, who, in return, receive the LIHTCs to offset the LIHTC investors' federal tax liability.

Significant risk is entailed in owning LIHTC property. For example, failure to comply with the applicable rules can result in a recapture of the LIHTCs. As a result, a LIHTC property incurs compliance costs not incurred by market-rate multi-family housing. In addition, rent restrictions on LIHTC property negatively impact the income-producing potential of the property.

III. Property Tax Valuation Issues

In Arizona, each of the 15 local county assessors value multi-family housing, including LIHTC property, in their county. In 1998, the Arizona Department of Revenue ("ADOR") provided local county assessors guidance on valuating subsidized housing, which includes LIHTC properties. Ariz. Dep't of Revenue, Subsidized Housing Valuation (Dec. 1, 1998) (the "Guideline"). After ADOR published the Guideline, the Arizona Tax Court ("Tax Court") decided *Cottonwood Affordable Housing v. Yavapai County*, 205 Ariz. 427, 72 P.3d 357 (Ariz. Tax Ct. May 9, 2003), which, while not binding authority on other Arizona courts because the decision is a trial court ruling, clarifies the Guideline as it applies to LIHTC property.

A. Subsidized Housing Valuation Guideline

The Guideline recognizes that valuing subsidized housing for property tax purposes presents unique issues that local county assessors should consider. However, the Guideline goes on to instruct local county assessors to value LIHTC properties like any other market-rate multi-family project. The Guideline instructs local county assessors to: 1. use market-rate sales comparables, despite acknowledging that LIHTC properties would likely not be built without the underlying subsidies, 2. disregard the restrictions on the property's use and income potential, and 3. disregard the additional costs associated with construction and on-going compliance.

The Guideline likely fails to meet the current use requirement for valuing property for property tax purposes because it does not provide consideration for the unique characteristics of LIHTC property. A.R.S. § 42-11054(C)(1). In Cottonwood Affordable Housing, the Tax Court recognized that the unique characteristics of LIHTC property must be taken into consideration when valuing LIHTC property for property tax purposes.

B. Cottonwood Affordable Housing v. Yavapai County

More than four years after ADOR published the Guideline, the Tax Court decided *Cottonwood Affordable Housing v. Yavapai County*, 205 Ariz. 427, 72 P.3d 357 (Ariz. Tax Ct. May 9, 2003), which recognized that the unique characteristics of LIHTC property must be taken into consideration when valuing LIHTC property for property tax purposes.

In *Cottonwood Affordable Housing v. Maricopa County*, the taxpayer challenged the full cash value of its LIHTC property. In the suit, the taxpayer argued that the full cash value was in excess of the LIHTC property's market value. While both the taxpayer and the local county assessor agreed that the income approach to value was the most appropriate method of valuation, the parties disagreed on how to apply the income approach to a LIHTC property. The taxpayer argued that "the actual income and expenses of the project should form the basis for valuation." The county assessor argued that "either, . . . market rents generated by regular commercial apartment complexes should be used to determine the value of the property via the income approach rather than actual rents collected by [the taxpayer] or the [tax] credits themselves should be added to the income stream."

The Tax Court ruled that: 1. LIHTCs are "intangible property and should not be added to the value of [the LIHTC property] or considered as part of [the LIHTC property's] income stream;" and, 2. "[t]he restrictions imposed under the LIHTC program[, namely, restrictions on the amount of rent charged to tenants,] have a direct and immediate affect upon marketability and must be taken into account."

With respect to the second point, the Tax Court observed:

> A willing buyer, knowing that there is a restriction as to the amount of rent that can be charged, would pay less for a low income housing project than for a regular commercial apartment complex. This property should not be valued as though a buyer would not consider the restrictions. A valuation for an LIHTC project, determined under any of the standard appraisal methods, that does not take the deed restrictions into account will not result in a determination of fair market value for that property.

The Tax Court provided clear guidance for local county assessors: "[T]he subject property's value should be determined from [1] its restricted income potential [2] without regard to the LIHTCs which create a disincentive for a current owner to sell, and little if any incentive for a new buyer to buy."

IV. Conclusion

Based upon the *Cottonwood Affordable Housing* case and Arizona's current use requirement, the full cash value of a LIHTC property that does not consider the risks associated with owning such a property (as reflected in a capitalization rate premium) and that does not base the valuation on the actual income and expenses of the LIHTC property is likely excessive. Property owners should consider evaluating the basis for the local county assessor's full cash value determination to determine whether these factors were considered in valuing the LIHTC property for property tax purposes.

Domingos Santos of Santos Law Office, P.L.L.C. advises property owners on property tax issues and has represented property owners before local county assessors, the Arizona State Board of Equalization, the Arizona Tax Court, and the Arizona Supreme Court.