FEATURES

Appraising Low-Income Housing Tax Credit Real Estate

by Kenneth N. Alford, MAI, and David C. Wellsandt

ABSTRACT

When appraising properties in the Low-Income Housing Tax Credit (LIHTC) program, appraisers need to fully understand the property rights being appraised, the restrictions of the LIHTC program, and the potential benefits of the tax credits. While this article's primary focus is LIHTC properties in Nebraska, the discussion here should assist appraisers in appraising LIHTC properties nationwide.

The valuation of properties in the Low-Income Housing Tax Credit (LIHTC) program, which is authorized in Internal Revenue Code Section 42, presents some unusual challenges for real estate appraisers. Although much has been written on the topic, not all appraisers are in agreement regarding some of the fundamental issues. Three issues in particular have sparked disagreements: (1) the proper handling of an LIHTC property's land use restrictions, (2) the proper handling of the tax credits, and (3) the proper selection of the relevant property rights to appraise.

This article is intended to provide appraisers with an introduction to LIHTC properties and offer a credible approach for handling the thorny issues of land use restrictions, tax credits, and property rights. Keep in mind some states have supplemental regulations that are more rigorous than the Section 42 requirements, and LIHTC programs vary from state to state. This article examines LIHTC properties in Nebraska, which are subject to both federal and Nebraska regulations; however, most of the issues described in this article have nationwide applicability.

Overview

Purpose of the LIHTC Program

LIHTC properties are housing developments that have rental and operational restrictions that benefit low-income households. To ensure that the benefits of these properties are directed to low-income households, the properties have household income ceilings for tenants. The tax credits are incentives to encourage the development of LIHTC properties in order to promote the public policy goal of providing housing for the needy.

Low-income housing developments often would not be viable without the subsidy of tax credits. In his book, *Valuation and Market Studies for Affordable Housing*, Richard E. Polton states, "the major premise on which affordable

housing is based is the idea that the housing would not have been built were it not for the introduction of subsidies."[1] During the first 10 years of an LIHTC project, tax credits provide substantial financial benefits that are the property owner's reward for accepting the restrictions on the property's use. The tax credits are given to the property owner in exchange for the owner giving up certain rights of use, including the right to rent to any tenant and the right to charge any rental rate.

Regulatory Authority

The Low-Income Housing Tax Credit (LIHTC) program was established by the U.S. Tax Reform Act of 1986, and it was codified as Section 42 of the Internal Revenue Code of 1986, as amended. The program is administered through state housing credit agencies (HCAs). Each HCA receives an annual allocation of Section 42 tax credits, which it in turn awards to new LIHTC development projects each year according to its own project selection criteria.

The Nebraska Investment Finance Authority (NIFA) administrates the LIHTC program in Nebraska, issuing the Section 42 tax credits as an incentive to induce property owners to build and operate affordable housing properties. NIFA selects projects for participation in the LIHTC program on a competitive basis, and the length and severity of the restrictions for proposed projects are major competitive points. NIFA scores each proposed LIHTC project according to its criteria, which can change annually. A project is scored for characteristics such as its location, targeted market (e.g., family, senior, special needs), duration of restrictions, and severity of restrictions. LIHTC program tax credits are then awarded on a competitive basis, with the highest-scoring applications receiving allocations until the available credits are exhausted. In order to enhance a project's application score, a developer may propose property restrictions that are more stringent than the minimums required. For example, a developer may adopt one or more of the following measures:

- Restrict the rents below the rent limits required by Section 42 guidelines
- Set income limits for tenants that are lower than those required in Section 42
- Increase the qualified contract required number of years, as described later in this article
- Lengthen the restriction period beyond 30 years, as described later in this article
- Provide a right of first refusal, sometimes at a nominal price, to a charitable organization at the end of the restriction period

The Land Use Restriction Agreement (LURA)

In exchange for the promise of future tax credits, the LIHTC property owner agrees to subject the real estate to a land use restriction agreement (LURA), in which the owner gives up some of the rights of use. The land use restrictions are documented in the LURA, which is recorded in the public record and runs with the land.[2] If an LIHTC property is sold during the term of the project, then the LURA's restrictions are binding upon the buyer. The LURA's restrictions are designed to make the property's housing more affordable for low-income households by limiting the maximum rent that can be charged for a unit and by requiring that some or all of the units be made available only to households with incomes below a given ceiling.

The Restriction Period

The restrictions in the LURA apply for set periods of time, known as the *compliance period* and the *extended use period*, which are stipulated in the LURA. Originally, LIHTC programs only had a compliance period of 15 years, but an amendment of the Section 42 regulations in 1990 permitted an extended use period of an additional 15 years after the initial 15-year compliance period. Under the amended program, the initial 15-year compliance period is enforced by Internal Revenue Service (IRS) regulations, and any additional extended use period is enforced by the actions of the individual states.

The terminology related to compliance periods can be confusing. The IRS applies the term *compliance period* only to the first 15 years; however, in Nebraska, NIFA uses the term *compliance period* to indicate the whole period that the LURA is in effect, which may be 30 years or more. To help prevent confusion in this article, the term *restriction period* is used to refer to the 30-year period that includes the first 15-year compliance period and the additional

1. Richard E. Polton, *Valuation and Market Studies for Affordable Housing* (Chicago: Appraisal Institute, 2005).
2. Within this article, the phrase "running with the land" means that the land use restriction agreement (LURA) flows with the real estate and is enforceable upon the property owner and any successors in the real property interest for the duration of the LURA.

15-year extended use period. Currently, 30 years (the initial 15-year compliance period plus the additional 15-year extended use period) is the minimum restriction period for new Nebraska LIHTC projects, but many new LIHTC properties in Nebraska and elsewhere have longer restriction periods, which may stretch out 40 years or more.

The Tax Credits

In exchange for submitting to the land use restrictions, the LIHTC property owner receives a series of tax credits that provide dollar-for-dollar reductions in its federal tax liabilities. Unlike tax deductions, which are reductions in the taxable income to which the tax rate is applied, tax credits are direct reductions of the amount of net tax owed. They are a cash substitute; just as a Target gift card can be received as payment in lieu of cash at a Target store, in the same fashion a tax credit is received as payment by the IRS at tax time. Although it would be annoying to be paid a large sum of money in Target gift cards, it is clear that the gift cards—and the tax credits—are monetary consideration.

LIHTC properties receive the contracted amount of tax credits annually during the first 10 years of the agreement. The appraiser must understand the timing of the tax credit receipts in order to appropriately analyze their future benefits. The tax credits are not transferrable; they flow exclusively to the property owner on the basis of the ownership of the eligible LIHTC real property. Section 42 of the U.S. Internal Revenue Code, Subsection (f)(4), titled "Dispositions of Property," states,

> If a building (or an interest therein) is disposed of during any year for which credit is allowable under subsection (a), such credit shall be allocated between the parties on the basis of the number of days during such year the building (or interest) was held by each.

The point bears repeating: the tax credits flow to the property owner solely by virtue of its ownership of an eligible LIHTC property. The credits are monetary consideration paid to the property owner in exchange for the owner giving up some rights of use: the right to rent to anyone and the right to charge any rental rate. As Ronnie J. Hawkins states in "Misconceptions Associated with LIHTC Valuations," the "tax credits cannot individually be separated from the real property rights and sold separately—*tax credits always coincide with the real property ownership*."[3] Although market participants often talk casually about "selling" the tax credits, they are actually referring to selling a partial ownership interest in the entity that owns the real estate. The tax credits themselves cannot be severed from the ownership of the real estate. To further illustrate this point, an example of a tax credit "sale" is provided in the Appendix.

Selling LIHTC Property

It is legally permissible for a property owner to sell an LIHTC property during the restriction period. However, there are some special issues that apply to this scenario and differ from conventional property sales. These issues include approval of the sale, seller liability, and right of first refusal.

In Nebraska, for example, the sale of an LIHTC property must be approved by the state agency, NIFA. Through its own due diligence analysis, NIFA may determine if the proposed buyer is suitable for operating the property under the terms of the LURA. NIFA may evaluate the buyer's financial conditions and its experience with LIHTC properties and may contact other states for a background check in order to consider the buyer's compliance record in other states.

Also, if the property is sold during the restriction period, the seller may be forced to retain liability for any possible future noncompliance of the LIHTC property. If the buyer fails to fully comply with the terms of the LURA, the seller may face recapture of tax credits received prior to the sale.

Finally, LIHTC properties may have very restrictive rights of first refusal that are negotiated in the LIHTC application process and are identified in the LURA. LIHTC applicants sometimes offer a right of first refusal to enhance their application scoring. The right of first refusal is commonly offered to a nonprofit entity. It may be open to any interested nonprofit entity or it may be specifically limited to a single nonprofit entity. The exact details of the right of first refusal, if one exists, dramatically influence the value of the property's reversion.

Because of these issues, sales of LIHTC properties are very rare. When sales do occur, they are difficult to compare because the land use restrictions may be quite different from one LIHTC property to another. The extreme scarcity of comparable sales

3. Ronnie J. Hawkins, "Misconceptions Associated with Low Income Housing Tax Credit (LIHTC) Valuations," *The Appraisal Journal* (October 2001): 388–393.

and the difficulties in evaluating the differences between the comparable properties' LURAs present formidable obstacles to performing a credible sales comparison approach for an LIHTC property.

Termination of the LURA

During the restriction period of an LIHTC program (the compliance period plus the extended use period), the land use restrictions remain in place, limiting its operations and running with the land. Eventually, however, the LURA's restrictions come to an end. The specific length of time that the restriction period lasts is specified in the terms of the LURA. The LURA's restrictions terminate in one of three ways: (1) through the qualified contract termination process, (2) through lender foreclosure proceedings, or (3) through the natural expiration of time (30 years or more).

Qualified contract termination. Section 42 regulations grant a concession to LIHTC property owners in the form of an escape clause that is called the *qualified contract* procedure. After a given point in the restriction period, the property owner may offer the LIHTC property for sale at a predetermined price, and if no qualified buyer can be found, then the LURA can be terminated. The property owner may, in its sole discretion, initiate the qualified contract procedure any time after the qualified contract required number of years, which is the number of years that must pass after the beginning of the project before the property owner can exercise the qualified contract. The required number of years can vary from one LIHTC project to another, but it may not be less than the 14-year minimum. It is always fixed for each individual property in the LURA and is set during the LIHTC application process.

In order to exercise the qualified contract option in Nebraska, the property owner must notify NIFA of its decision, and then NIFA has one year to find a qualified buyer for the project at the predetermined price. The predetermined price, known as the *qualified contract price* (QCP), is set according to a formula that is stipulated in the Section 42 regulations. If a qualified buyer is found for the property, then the property can be sold and the buyer must agree to comply with the LURA for the remainder of the restriction period. If a qualified buyer cannot be found, then the LURA is terminated, the property prematurely enters the 3-year decontrol period, and after the decontrol period, it becomes a conventional property. (The decontrol period is addressed later in this discussion.)

Lender foreclosure. The LURA contains a second condition–foreclosure–that can produce a termination of the land use restrictions before the restriction period expires. In the event that the lender forecloses upon the property, the LURA terminates immediately and the property enters the decontrol period. In Nebraska, NIFA's current LURA form states that the LURA terminates "on the date such building is acquired by foreclosure or instrument in lieu of foreclosure (including a deed of trust)." This escape clause is provided as a concession to lenders, but as a practical matter, lenders normally provide only a small percentage of the property's capital and it is rare for an LIHTC property to fall into foreclosure. Although a foreclosure can extinguish the land use restrictions, it should be noted that if this occurs in the compliance period (the first 15 years), it may result in the recapture of tax credits from the defaulting owner by the IRS.

Expiration of time. The last condition that results in the termination of the LURA's restrictions is the natural passage of time. In an LIHTC property with a typical 30-year restriction period (a 15-year compliance period and a 15-year extended use period), the program naturally expires at the end of the thirtieth year. Although the LURA expires then, the restrictions remain partially in force during the subsequent 3-year decontrol period. At the end of the decontrol period, which in this example is the end of the thirty-third year, the property is released from all restrictions and becomes a conventional market property.

Decontrol Period

In each of the three termination conditions, the restriction period is followed by a 3-year decontrol period, in which the LURA restrictions are phased out. During this decontrol time, the rent restrictions remain in place for existing tenants; however, new tenants may be charged market rates. During the decontrol period, the property owner (1) may lease any vacant units without any further rent or income restrictions, (2) may not evict any existing tenants without good cause, and (3) may not increase the rents for any existing tenants above the maximum gross rent allowed under Section 42.

After the 3-year decontrol period, the property is not subject to any further restrictions and becomes a conventional market property. As a practical manner, some issues may remain as the result of past LIHTC participation, such as the presence of below-

market leases or a negative property stigma, but these are issues that are also sometimes encountered in other properties that have never participated in an LIHTC program.

Property Ownership Entities

An LIHTC property could theoretically be owned by any type of entity—one or more individuals, a partnership, or a corporation. In practice, they are developed almost exclusively by limited partnerships (LP), because this ownership structure is a convenient vehicle for distributing the tax benefit. Although the inner workings of these limited partnerships do not affect the value of the real estate, it is helpful to understand the players that are involved within the limited partnership that owns an LIHTC property. Limited partnerships that are created for this purpose are typically structured with a general partner (the developer) that owns 1% or less of the LP, and a number of limited partners that own 99% or more. Figure 1 illustrates the typical ownership structure.

In a simplified example, the general partner does all of the work and receives a development fee up front, while the limited partners contribute the start-up capital in return for their ownership share and the expectation of receiving the tax credits over a 10-year period. The limited partnership agreement ultimately dictates the exact responsibilities, liabilities, and benefits of the various partners. The general partner (which can be a legal entity like a limited liability company) usually plans the project, acquires the necessary permits and approvals, applies for an allocation of tax credits from the state agency, and operates the property.

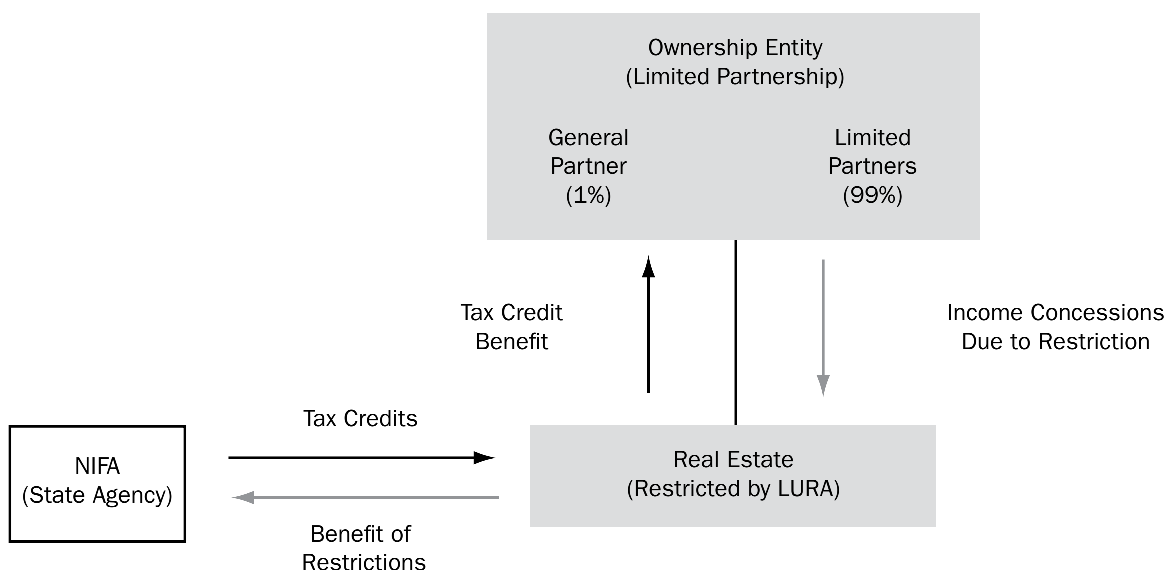
The limited partnership agreement dictates how the limited partnership's income, cash flows, tax credits, responsibilities, and liabilities will be internally divided up between the general partner and the limited partners; however, it is important to remember that the whole limited partnership, which is a legal entity, actually owns the real estate, and not the individual partners. Partners may buy or sell interests in the limited partnership; however, these sales do not change the status of the limited partnership as the direct property owner and the direct recipient of all of the benefits arising from the ownership of the real property. An example of a limited partnership interest sale is provided in the Appendix for further illustration on this point.

LIHTC Appraisal Issues

The Ownership Interest Relevant to Market Value

As mentioned previously, the owner of an LIHTC property is typically a limited partnership. The partners own shares of the limited partnership, but do not directly own the real estate. Appraisers sometimes mistakenly consider only the general partner's incomes and expenses under the partnership

Figure 1 Typical LIHTC Property Ownership Structure



agreement, not recognizing that the general partner is not the direct owner of the real estate.

The general partner's interest by itself or the limited partner's interest by itself is each a partial interest in the ownership entity (partial interest in the limited partnership) and not the direct ownership of the real property. If the assignment is to appraise the real estate, then representing the value of either the general partner's partial interest or the limited partner's partial interest as the total value of the real estate is misleading. The market value of the real estate must be based on all of the benefits and liabilities that flow directly from the ownership of the real estate.

Contributory Value of Tax Credits

This article previously referred to the misleading, casual speech among market participants about "selling tax credits." These participants talk about selling the tax credits for a certain number of cents on the dollar. The phrase "cents on the dollar" refers to a unit of comparison—the practice of describing the purchase price of the partnership interest as a percentage of the sum of the total allocation of tax credits to be received over the 10-year period. For example, if a property was awarded $100,000 of credits annually, then the total allocation would be $1,000,000. If there is only one limited partner, and if he pays $750,000 for his partner interest, then this is commonly described as paying "75 cents on the dollar."

Although the purchase price may be expressed as a percentage of the tax credits, the purchase actually includes the partner's indirect ownership percentage of the real estate itself; the partner's expected share of the property reversion and the timing of the reversion; the partner's expected share of the operating profits; the expected tax benefit of depreciation; and (of course) the present value of the future tax credits. An informed buyer gives appropriate consideration to each of these factors in the purchase decision.

Other factors also influence the prices that are paid for partnership interests, such as the supply of available LIHTC partnership interests, the number of potential limited partners active in the market at any time, the total amount of demand for these partnership interests, the standing and reputation of the general partner, and the timing of the limited partner's capital contributions in the LIHTC project. The best way to evaluate the contributory value of the tax credits is to enter into a direct dialogue with market participants in which these issues are clearly addressed and analyzed.

Real Property Rights

As stated previously, the tax credits flow to the property owner solely by virtue of its ownership of an eligible LIHTC property, and the credits cannot be separated from the real estate. They are monetary consideration paid to the property owner in exchange for giving up certain rights of use that are inherent in the ownership of real estate: the right of renting to anyone and the right to rent at any rate the owner chooses. The Uniform Standards of Professional Appraisal Practice (USPAP) defines *real property* as "the interests, benefits, and rights inherent in the ownership of real estate."[4] Since the property owner gives up real property rights in exchange for monetary consideration (the tax credits), it must be concluded that the tax credits are real property income.[5]

The land use restrictions also directly relate to the real property. The LURA's restrictions are legally binding on the property, they are enforced by the IRS and by the individual states, and they run with the land. They alter the permitted use, and they may alter the property's value. Restrictive zoning changes are conceptually similar to the LURA's restrictions; both restrict real property rights, both may restrict the legal use of a property, and both may impair the property's market value. The LURA's restrictions are relevant and must be considered in an estimate of the real estate's market value.

LIHTC Property Values over Time

LIHTC property values vary over the project's lifespan and may not follow value trends of typical market rate properties. At the completion of the improvements, an LIHTC property may have 10 years of tax credit benefits to look forward to. The tax credits are received over the first 10 years of the property's operation, and by the eleventh year the tax

4. Appraisal Standards Board, "Definitions," *Uniform Standards of Professional Appraisal Practice*, 2010–2011 ed. (Washington, DC: The Appraisal Foundation, 2010), Line 127.

5. *Income* is defined as "money or other benefits that are assumed to be received periodically." *The Dictionary of Real Estate*, 5th ed. (Chicago: Appraisal Institute, 2010), 99.

credits have been exhausted. For the remaining portion of the restriction period, the property operates subject to the LIHTC restrictions, but without any further tax credit benefits. At the end of the decontrol period, the property reverts to a conventional market-rate property.

All other things being equal, it is reasonable to assume that an LIHTC property would have a much higher value in its first year than in its eleventh year because of the steady reduction of future tax credits. According to *The Appraisal of Real Estate*, the principle of anticipation is "the perception that value is created by the expectation of benefits to be derived in the future."[6] As the tax credits are received, the fixed amount of future tax credits declines. Since a buyer of an LIHTC property in the first year anticipates more future tax credit benefits than a buyer in the ninth year, we would intuitively expect a first-year buyer to pay more than a ninth-year buyer because of this difference. By the time the LIHTC property enters its eleventh year, the tax credits have been consumed and the property's remaining benefits are limited to any profits from operations and the reversion.

If the land use restrictions impair the property's profitability, then it would be reasonable to expect that the market value of an 11-year-old LIHTC property would be lower than the value of an 11-year-old conventional, non-LIHTC property. As the end of the restriction period approaches and the number of remaining years of restricted operations dwindle, the differences in value between an LIHTC property and a non-LIHTC property also diminish. Eventually, the land use restrictions expire and the property reverts to conventional market terms.

Assignment Issues

Approaches to Value

The applicability of each approach to value must be carefully considered in an LIHTC assignment. In the cost approach to value a replacement cost estimate does not reflect value associated with the future tax credits. A replacement cost estimate also does not reflect any impairment of value that may result from the LURA's restrictions unless a specific deduction is applied. This deduction is measured by the consideration of the loss in income caused by the restrictions, so the cost approach may be inbred with the income capitalization approach and cease to be an independent indicator of value. In cases where the LURA's restrictions have significantly impaired value, it may be difficult to perform a credible cost approach.

The sales comparison approach would be very compelling if there were any truly comparable sales. The characteristics of an LIHTC property potentially include future tax credits, lower operating income, and prolonged illiquidity. Adjusting for these differences from a conventional property sales comparison is extremely difficult and may produce unreliable results. Comparison to LIHTC sales is difficult because LIHTC properties rarely sell, especially during the first 10 years of the project. Partners do sometimes sell their interest in the ownership entity, but those are not sales of the real estate. If an LIHTC sale is found, it is incumbent on the appraiser to carefully consider all of the differences between the subject property's LURA and future tax credits and the comparable property's LURA and future tax credits, adjusting for all those differences that affect value.

Because of the steep challenges encountered in the cost approach and sales comparison approach, the income capitalization approach is generally considered the best indicator of an LIHTC property's value. It contains the mechanisms needed to reflect differences in future tax credits as well as differences in rents, occupancy, and expenses according to the restrictions. There are a number of issues to consider in applying the income capitalization approach in valuation of an LIHTC property:

- The rent ceilings set by the LURA may or may not be below normal market levels.
- The income limits set by the LURA may influence occupancy, administrative costs, and achievable rents.
- LIHTC properties require additional management expertise and as a result may experience higher management fees.
- LIHTC properties frequently require additional administrative activities (additional tenant processing to establish the tenant income for LIHTC compliance, submitting compliance reports to NIFA), which may increase the administrative expenses.
- LIHTC real estate tax expenses may vary significantly from conventional properties, depending on how the local assessor treats LIHTC properties.

6. *The Appraisal of Real Estate*, 13th ed. (Chicago: Appraisal Institute, 2008), 35.

- The reversion for an LIHTC property may be very different from a conventional property, especially if the LURA contains a restrictive right of first refusal.
- The tax credit income has a duration (only 10 years) that is different from the income from operations, and if direct capitalization is used the credits must be capitalized separately at their own appropriate rate.

The greatest challenge in an LIHTC income capitalization approach is obtaining reliable capitalization rate data. Because there are few sales of LIHTC properties (especially during first 10 years of the project), it is difficult to directly extract capitalization rates from similar sales. In his book,[7] Richard Polton suggests a strategy for adjusting capitalization rates that were extracted from conventional property sales. Since the risk, liquidity, appreciation, and reversion value characteristics of LIHTC properties may vary significantly from conventional ones, extreme care must be given to developing meaningful capitalization rate adjustments when comparing capitalization rates that were extracted from conventional sales.

Because of differences in an LIHTC property's liquidity, appreciation, and reversion value, a discounted cash flow analysis is considered to be a more reliable indicator of value than a direct capitalization of income. A discounted cash flow analysis spells out the future expectations of tax credits, income, expense, and reversion, and avoids many of the pitfalls contained in the implicit assumptions of a direct capitalization rate. It is possible to extract expected internal rates of return (yield rates) from similar LIHTC properties based on their expected costs and expected cash flows, and in so doing directly reflect actual LIHTC market expectations and rates of return. When internal rate of return information is available from similar LIHTC properties, a discounted cash flow analysis provides a very reliable indicator of value.

Appraisal of LIHTC Property for Mortgage Underwriting

Most mortgage loan appraisals are performed in order to help evaluate the property as collateral to securitize the loan. The value of an LIHTC property may be quite different under a normal operation scenario as compared to a foreclosure scenario. In normal operation, the LIHTC property is subject to the land use restrictions and may also still have future tax credits. Under a foreclosure scenario, the LURA is extinguished, the property enters the decontrol period, and there will not be any more tax credits. Therefore, the appraiser should clearly communicate these unique features of LIHTC properties in discussions with the client in order to ensure that the assignment conditions meet the client's needs.

Appraisal for Tax Assessment

LIHTC appraisals for property tax assessment present additional unique challenges. In Nebraska, the "Assessment Process for Affordable Housing Projects"[8] provides guidance for assessors to address the specific issues of LIHTC properties. The regulations require assessors to consider the impact of LURA restrictions on a property's value. The regulations note that the cost approach and sales comparison approach may be unreliable indications of value.

As for the income capitalization approach, Nebraska Regulation 51-004.08 states,

> The county assessor shall perform an income-approach calculation for all rent-restricted housing projects … Any low-income housing tax credits ... shall not be considered income for purposes of the calculation, but may be considered in determining the capitalization rate to be used when capitalizing the income stream.

The two clauses, "tax credits... shall not be considered income," and "but may be considered in determining the capitalization rate," seem to have contradictory effects. It is easy to understand that the tax credits must be excluded from income. The regulation permits that they *may be* considered in determining the capitalization rate; however, the application of this phrase appears to be open to interpretation.

It is important to note that these Nebraska regulations set a different standard for handling LIHTC appraisals for assessment-related intended uses, and that standard applies only to appraisals for assessment-related intended uses. When excluding tax credits from income in this way, Nebraska appraisers need to prominently cite the jurisdictional exception to USPAP, noting that the Nebraska regulation requires that this portion of the real property income be excluded from consideration for real estate tax assessment purposes.

7. Polton, *Valuation and Market Studies for Affordable Housing*.
8. Nebraska Administrative Code, Title 350, Chapter 51.

Conclusions

Appraisers Must Consider the LURA

Each LIHTC property has a LURA, and the terms of the LURAs vary considerably from one project to another. The terms of the LURA must be understood in order to credibly appraise an LIHTC property. The land use restrictions are pertinent to all the real property interests. USPAP Standards Rule 1-1(b) states, "In developing a real property appraisal, an appraiser must: … not commit a substantial error of omission or commission that significantly affects an appraisal."[9] Failure to consider the effect of the LURA on the value of the real property could constitute a substantial error of omission that can significantly affect the appraisal results. Appraisers should obtain a copy of the appraised property's individual LURA and understand its terms and conditions in order to perform a credible market value appraisal.

Appraisers Must Consider All the Real Property

Care must be given to valuing the correct property interest. If the assignment is to appraise the real estate, then all the real property benefits that flow to the property's direct owner must be considered, and not just a partner's partial interest in the entity. It is important to remember who owns the real estate; it is usually a limited partnership as a legal entity, not the individual general or limited partners.

Appraisers Must Consider the Tax Credits

The tax credits flow to the property owner solely by virtue of its ownership of an eligible LIHTC property, and they cannot be separated from the real estate. They are monetary consideration paid to the property owner in exchange for giving up real property rights that are inherent in the ownership of the real estate. The tax credits are as much a part of the real property as the rent that is paid by the tenants. If the assignment is to appraise the real estate, then a failure to consider the tax credits could constitute a substantial error of omission unless the assignment conditions prominently and clearly exclude the value of that part of the real property from the appraisal.

Kenneth N. Alford, MAI, is a certified general real estate appraiser with the firm of Alford & Associates, Inc., in Omaha, Nebraska. He is a board member of the Nebraska Chapter of the Appraisal Institute and a member of the Omaha Board of Realtors. He holds a BA in economics from Wheaton College and received his appraisal education from the Appraisal Institute. His real estate appraisal experience covers a wide variety of property types, including office properties, retail properties, industrial properties, multifamily properties, residential and commercial subdivision analyses, commercial lots, and development land.
Contact: ken@alfordassociates.com

David C. Wellsandt is a certified general real property appraiser with the appraisal firm of Mitchell & Associates, Inc. in Omaha, Nebraska. He is a former board member of the Nebraska Chapter of the Appraisal Institute and a member of the Omaha Board of Realtors. He holds a BS in business administration with an emphasis in finance from University of Nebraska–Lincoln. His real estate appraisal experience covers a wide variety of property types, including several affordable housing (Section 8) and low-income housing tax credit properties. **Contact: david@mitchellassociates.com**

Additional Reading

Appraisal Standards Board. Advisory Opinion 14, "Appraisals for Subsidized Housing." *Uniform Standards of Professional Appraisal Practice.* 2010–2011 ed. Washington, DC: The Appraisal Foundation, 2010.

Low-Income Housing Tax Credit Program 2009 LURA. Nebraska Investment Finance Authority (NIFA).

U.S. Internal Revenue Code. Title 26, Subtitle A, Chapter 1, Subchapter A, Part IV, Subpart D, Section 42. "Low-Income Housing Credit."

9. *Uniform Standards of Professional Appraisal Practice*, 2010–2011 ed., Lines 461, 476–477.

Appendix

Tax Credit "Sales"

The casual talk about "selling" tax credits has caused a great deal of confusion. In order to illustrate the nature of the transaction, imagine a 60-unit LIHTC apartment building that is owned by Apartments 4U LP, a Nebraska Limited Partnership. People talk about the property's tax credits having been "sold off" and disposed of, when in fact they have merely been internally divided up among the individual partners within Apartments 4U.

At Apartments 4U's inception, before the apartment building was built, the general partner owned 100% of the partnership. In order to raise money to build the apartments, the general partner sold 99% of the ownership interest of Apartments 4U to limited partners. Notice that the tax credits were not ever sold; they always remained with Apartments 4U. Instead, the limited partners bought into the firm so that they could enjoy its benefits.

The limited partners will, of course, enjoy the benefit of future tax credits by virtue of their ownership interest in Apartments 4U; however, the fact that one partner owns a bigger or smaller share of Apartments 4U and/or receives a bigger or smaller share of Apartments 4U's tax credits is not relevant to the value of the real estate. The property's value reflects the real property benefits flowing to the property's direct owner, which is Apartments 4U LP. If the real estate were owned by a single individual, there would be less confusion. Apartments 4U is a legal entity, a "person" in the eyes of the law. **All** of the tax credits flow to Apartments 4U, irrespective of how the partners internally divide them.

Consider a second example: a conventional apartment building that is owned by Profits-R-US LP, a Nebraska Limited Partnership. If one partner within Profits-R-US receives more or less of the operating profit from the conventional apartment building than another partner, it does not change the total benefit that Profits-R-US receives from its real property, and the internal divisions within Profits-R-US have no effect on the value of the real estate. **All** of the real estate's income is received by the real estate's direct owner, which in this example is Profits-R-US LP.

Web Connections

Internet resources suggested by the Y. T. and Louise Lee Lum Library

Affordable Housing Investors Council (AHIC)
http://www.ahic.org

National Association of Local Housing Finance Agencies (NALHFA)
http://www.nalhfa.org

National Council of State Housing Agencies
http://www.ncsha.org

Office of the Comptroller of the Currency (OCC)
Low-Income Housing Tax Credit Fact Sheet
http://www.occ.treas.gov/cdd/fact_sheet_LIHTC.pdf
Tax Credit Resource Guide
http://occ.treas.gov/cdd/taxcreditresource.htm

U.S. Department of Housing and Urban Development (HUD)
LIHTC Basics
http://www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/basics/
LIHTC Database
http://www.huduser.org/portal/datasets/lihtc.html