



TACIR

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MEMORANDUM

TO: Commission Members

FROM:  Winnisse Roehrich-Patrick
Executive Director

DATE: 3 September 2014

SUBJECT: Taxation of Property Financed with Low-Income Housing Tax Credits

"Little is known about the LIHTC program outside of the circle of affordable housing developers, syndicators, and some investors who have waded through its sometimes oblique rules to take advantage of this rather unique incentive for the creation of affordable rental housing for lower income people. . . ."

Bills introduced in the 2014 session of the 108th Tennessee General Assembly by Senator Steve Southerland (Senate Bill 1671) and Representative Jeremy Faison (House Bill 1390) would have prohibited local property assessors from including the value of the federal Low Income Housing Tax Credit (LIHTC) in a property's assessed value. The bills were sent to the Commission for study by the Senate Finance, Ways and Means Committee and the House Finance, Ways and Means Subcommittee.

If anything, the quote that opens this memo, a footnote from Tennessee's leading case on taxing low-income housing (Spring Hill, L.P., et al. v. Tenn. State Bd. of Equalization et al.)* understates the complexities of the LIHTC program. When those complexities converge with the complexities of appraising such properties, the result can resemble a bait-cast backlash. The attached articles and the presentations by the panelists listed below are a first step toward untangling and simplifying the challenging issues involved.

The first article attached to this memo is from the Federal Reserve Bank of San Francisco. It explains the origins of the LIHTC program and its business model, but much of its focus is on the social impacts of the program, the public policy concerns that are at the heart of the issues

* Spring Hill, L.P. v. Tenn. State Bd. of Equalization, No. M2001-02683-COA-R3-CV, 2003 Tenn. App. LEXIS 952 (Tenn. Ct. App. Dec. 31, 2003).

before the Commission. As the article points out, low-income housing is of critical importance, and the LIHTC program is “the single most important form of federal assistance to preserve and expand the supply of affordable rental housing for low-income households.” The program has bipartisan support, is virtually scandal free, and has “a default record that any private credit guarantor would die for.”

The second article attached to this memo is from The Appraisal Journal of the Appraisal Institute. This article gives an overview of the LIHTC program using Nebraska’s implementation of it as an example. The basic elements presented hold equally for Tennessee:

- Internal Revenue Code Section 42 tax credits are issued by the state’s housing authority on a competitive basis as an incentive to build and operate affordable housing properties.
- In order to receive the credits, the LIHTC property owner agrees to land-use restrictions that “run with the land” and remain enforceable against any successor owner of the property interest for the duration of the agreement.
 - Restrictions require the owner to rent some or all of the units to households with incomes below a certain amount and limit the maximum rent they can be charged.
 - Restrictions apply for set periods, including a compliance period of 15 years set by the Internal Revenue Service plus an extended period set by the state housing authority, which in some states extends the restrictions for as long as 40 years in total.

The main point of the article is that the tax credits received in return for these restrictions “are a cash substitute,” . . . “monetary consideration paid to the property owner in exchange for the owner giving up . . . the right to rent to anyone and the right to charge any rental rate.” “The tax credits themselves cannot be severed from the ownership of the real estate.” Although it is often said that the credits are sold, for instance by the developer of the property, they are not. What is sold is a partial ownership interest in the property. The article illustrates this point in an appendix. Perhaps more importantly, it explains the nature of the various entities that own the property and illustrates the ownership structure in figure 1.

The article closes with an excellent discussion of appraisal issues, including the need to consider the land-use restriction agreements placed on the property and the tax credits, cautioning that the failure to consider either “could constitute a substantial error of omission that can significantly affect the appraisal results.” This does not settle the question of property taxation, which brings us to the third and last attached article, written by a tax attorney who is a member of the Appraisal Institute, the source of the second article, as well as the Arizona State Board of Equalization.

This last article, *Is a Consensus Emerging on LIHTC Property Valuations?*, published in the magazine *Affordable Housing Finance*, is a short one that brings us directly to the issue at hand. It considers each valuation method, asserting that

- the **sales comparison** method is inapplicable to LIHTC properties because they are rarely sold and finding similarly situated properties is difficult because land-use restrictions can vary greatly from project to project;
- the **cost approach** is a poor indicator of LIHTC property values because
 - actual development costs typically exceed those for otherwise comparable, market-rent property in order to comply with federal regulations for subsidized housing and often include additional amenities to serve the elderly and disabled and
 - tax credit projects preclude the principle of substitution that underlies the cost approach, which holds that a knowledgeable buyer would pay no more for a property than the cost to acquire a similar site and construct similar improvements, but without federal tax credits, most low-income housing would be financially unfeasible and would not be built; and
- the **income capitalization approach** is, therefore, the most common approach by default, but significant disagreement persists across jurisdictions about how to apply it, primarily because of the land-use restrictions and tax credits.

According to the article, 30 states require use of the restricted rent amounts rather than market rents, but the issue of whether to include the federal tax credits is less clear:

- Nine states include the credits as part of a property's net operating income, contending 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."
- Twenty-one states exclude the tax credits from property income because "excessive tax assessments make low-income housing less economically feasible and thereby undermine the credit program's goal of encouraging" their development.

Finally, the article also briefly discusses judicial decisions in cases challenging inclusion of the credits when appraising LIHTC properties for property-tax purposes and whether those decisions turn on the nature of the credits as tangible or intangible property. The *Spring Hill* case here in Tennessee says they "are not an intangible benefit severable and sold to third parties" and are, therefore, includable. Courts in Georgia, Idaho, Indiana, Illinois, Pennsylvania, and South Dakota agreed at least until legislatures in five of them, all but Illinois, overturned those decisions. Courts in Arizona, Missouri, Ohio, Oklahoma, and Washington have said that they are intangible and should not be considered. But a few states, including Connecticut and Michigan, say the credits are intangible but must nevertheless be considered.

Panelists speaking to these issues include the following:

Financing Low-Income Housing

Tennessee Housing Development Agency, Ralph Perrey, Executive Director

Tennessee Association of Housing and Redevelopment Authorities, Alvin Nance, Executive Director/CEO of Knoxville's Community Development Corporation

Tennessee Bankers Association, David Verble, President and CEO of Citizens National Bank in Sevierville

Tennessee Developers Council, Phil Lawson, Chief Executive Officer of Lawler Wood Housing, LLC and Lawler Wood Housing Partners, LLC

Valuation of Low-Income Housing for Tax Purposes

Tennessee Association of Assessing Officers, Will Denami, Executive Director

Tennessee County Services Association, David Connor, Executive Director

Tennessee Comptroller of the Treasury, Robert Lee, General Counsel

Tennessee State Board of Equalization, Kelsie Jones, Executive Secretary