View from the Witness Stand

Valuation and Assessment Issues

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LIHTC and Property Tax

- Property tax is a critical issue to project viability. Can be largest project operating expense.
- Most projects operate on thin cash flows. Low rents and high expenses.
- Getting a “finder of fact” to understand the critical issues is key.
- Consider using an appraiser to explain the nature of the property and the proper way to value the property for assessment purposes.

Tax Assessment Issues

Key Issues in Tax Appeals

- Several Issues that shape the Tax Appeal

1. Why not tax the LIHTC as Income?
2. Income and Expense Analysis – What to Use
3. Capitalizing the Income – Explaining the Cap Rates

Should Tax Credits Be Assessed?

- Intangible Value (according to USPAP) may not be assessable under local standards
- Not Income - Capital Write-down
- Wasting Asset - only received for 10 years
- Limited market. Only certain classes of investors interested.
- Risk of Recapture if conditions are not met.

Intangible Value

Non physical assets, including but not limited to franchises. trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts, as distinguished from physical assets such as facilities and equipment.

Property Rights Issues

USPAP Advisory Opinion AO-14

"Subsidies and incentives that encourage housing for low and moderate income households may create intangible property rights in addition to real property rights and also create restrictions that modify real property rights." (USPAP AO 14)

Important Point to Make

- Taxing the Tax Credits is Bad Public Policy that diminishes the value of needed subsidy
- Tax Credits, as an intangible asset, do not meet the test of an assessable category in most jurisdictions.

2. How Should Section 42 Properties be Valued?

- Income Approach is most meaningful approach
- Income and Expenses Differ from Market Rate properties
- Specific characteristics of the projects is important to explain
- Draw distinctions between Section 42 projects and market rate projects that may “look the same”

Market Rent - Low Income Rent

- Restricted rent is all that can be charged to tenants.
- Apartment cannot be sublet at higher rent.
- Not like a "below market rent" -- there is no "leasehold interest" and "landlord interest".
- Projects may have difficulty finding tenants "poor enough to qualify -- wealthy enough to pay the rent". (Ribbon of Eligibility)
- No assured subsidies - risk of rents.
- Actual restricted rents are typically the best measure of income.

Expense Issues

- Actual Expenses in well managed project are usually best indicator.
- Higher expenses than market rate, especially for Administrative Expense category and Maintenance.
- Account for Social Service requirements.
- Focus on real estate expenses.

3. Capitalization Rate

- Capitalization Rate = Risk
- Base Capitalization Rate based on Conventional Apartments in Market with Adjustments
- Adjustments
  - Expenses are not subject to controls
  - Income is typically stable with competitive advantages
  - Lack of Net Income Growth – No “Upside”
  - Physical requirements for CapEx
  - Cap Rate May Be Close or Equal Yield Rate (higher than typical apartments)

Policy Issues & Recommendations

- Payment in Lieu of Taxes based on Rents is optimal.
- Stress the Public Purpose in the Program and Thin Operating Margins
- Cost Does Not Equate to Value
- Not the same property type as market rate housing.

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Public Intervention in Market

Why Section 42 Housing is Different

- Affordable Housing as a "Public Good"
- Market Failure - Public Sector Intervenes
- Cost of Housing is Too High for Low Income Residents
- Income of Low Income Residents is Too Low to Acquire Reasonable Quality Housing

Types of Assistance to Make Projects Work

Market isn't working. Must be some form of assistance or market intervention to make the housing affordable

- Land Contributions
- Inclusionary Zoning
- Direct Construction
- Debt Write-Downs
- Income Subsidies
- Expense Abatements
- *Accelerated Depreciation*
- *Low Income Housing Tax Credits*
- *Limited Time Restrictions on Regulated Rent*

1. Why Not Tax LIHTC?

- It is not Income -- It is a Subsidy and without it, there is no project.
- If government taxes a subsidy, it creates a need for more subsidy.
- It is a wasting asset

- In appraisal parlance, it is an “Intangible Asset” that is separate and distinct from the real estate.