

THE VALUATION REPORT

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Missouri Property Tax Ruling Represents Win for LIHC Developers, Owners

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Since the low-income housing tax credit (LIHC) program's inception in 1986, affordable housing communities have faced numerous financial hurdles in their attempts to operate on budget and comply with required rent restrictions. More recently, increased utility costs and rising insurance premiums have increased downward pressure on net operating income. What's next?

Due to a string of recent court decisions, real estate taxes could be affordable housing's next great hurdle. Given the proliferation of affordable housing to the more than one-million-unit mark, states, counties and assessors have come to view these communities as significant revenue generators. These parties have a vested interest in including the value of LIHCs in the valuation of our nation's affordable housing stock, thereby triggering higher property taxes.

The issue at hand is whether assessors can value and include the tax credits in the valuation of the property. *Maryville Properties, L.P. v. Nelson* was the latest case to address this issue. Although the decision in the Western District of Missouri, Court of Appeals was in favor of excluding the tax credits in the determination of real property values, the taxpayer, Maryville Properties L.P., had a long and protracted fight, with a further assessor appeal to the Missouri Supreme Court still possible.

The State Tax Commission of Missouri originally ruled on Oct. 21, 1999 that the assessor had correctly included the value of the tax credits in the real property's value. However, the Court of Appeals reversed this decision on June 25, 2002, ruling that the low-income housing tax credits are intangible assets separate and apart from the real property.

In 1992, Maryville Properties developed a 24-unit affordable housing community. It was financed under the Section 515 rural rental-housing program and LIHCs. Both of these financing vehicles require that the property restrict the rents charged to residents. On Jan. 1, 1997 and Jan. 1, 1998, Pat Nelson, the assessor of Nodaway County, Missouri, valued the property at \$758,300. The Board of Equalization affirmed the value. Maryville argued that since the property was subject to rental restrictions, its value was \$350,000. This difference in valuation amounted to more than \$4,300 in annual taxes to be levied on the property. Under the assessor's recommendation, the property would have faced annual taxes of approximately \$340 per unit, or 11 percent of gross income.

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The vacancy rate for rental apartments declined from 10.8 percent to 10.4 percent in the second quarter of 2002, according to the U.S. Department of Commerce. Following is the rate of change from the first quarter to the second quarter, according to the Commerce Department: South Region 10.7 percent, vs

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During the proceedings, both parties agreed that the income approach to valuation was the most reliable indicator of true value for the subject property. Where the parties differed was in whether the value of the tax credits should be added to the value of the real property when calculating the property taxes.

Maryville presented three key arguments to the court. First, the tax credits, which are passed through to the limited partners, are not real property. Second, the assessor's valuation violated the state's constitution, which requires the property to be valued at "fair market value" instead of valuing the interest of the owners. Finally, the commission strayed from its own prior decision in that such tax credits were not included in the valuation of real property.

The Court of Appeals' decision hinged on a number of critical issues. The court held that the LIHCs do not run with the property, and that the "value of the tax credits is to the owner of the property and not to the property itself." Thus, the credits are assets that have a specific monetary value to an individual owner and any purchaser would discount the value of the property by the remaining credits. The court's decision noted that "LIHCs are not characteristics of the property...Their restricted transferability does not destroy their essential status as intangible property having value primarily to their owner." Although the court recognized the tax credits as a "substitute" for

income, their nature, according to this ruling, remains intangible.

With the recent increase in insurance premiums and the continued rise of utility costs in many parts of the country, higher property taxes will further pinch both a property's net operating income and the developer's cash portion of the developer fee. The lower net operating income will force a resizing and reduction in the permanent loan amount. In this likely event, developers would be forced to defer an increased portion of their fee or, in extreme cases, contribute capital (through the general partner affiliate) to fund the gap between permanent sources and uses.

The Missouri court's recent reversal has provided a sigh of relief for housing advocates and developers of affordable housing in Missouri and elsewhere. This ruling will, hopefully, trigger comparable decisions in other states where affordable communities face similar problems. In the effort to increase the financial stability of affordable housing communities, this decision is an extremely positive step with long-lasting effects. ❖

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