

# Low Income Housing Valuation

## Valuation of Low Income Housing Tax Credit Properties for Real Estate Tax Purposes – an update from the Ohio Supreme Court

By Cecilia Hyun, Esq., as published by CMBA Journal, October 2009



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There is a joke that made the rounds by email and on various real estate blogs awhile ago showing a house through the eyes of five different people: yourself, your buyer, your lender, your appraiser, and your tax assessor. (You can see a version of it [here](#)). The first image is of a nice, well kept, single family house with flowers, a nicely landscaped front yard and path. This is how you see your house. The next image shows what your potential buyer sees when looking at the same property: a smaller, more modest home resembling a modern log cabin. The next two images show how your lender and appraiser view the property. The lender sees an even smaller structure, with no lot to speak of, that looks like it was constructed piecemeal. Tarp covers part of the roof; the only thing that looks like it may be a window is boarded up, and there is laundry hanging from a clothesline out back. The appraiser sees a property that looks like it has been in the middle of a severe storm at the very least, if not a hurricane, parts of the walls are missing, there is flooding, and trees have been uprooted. The final picture depicts what your tax assessor sees when he looks at your house: a palatial, walled estate, with acres of land, surrounded by professionally landscaped gardens and trees, multiple wings, and at least one carriage or recreation house.

Like all good jokes, it contains a kernel of truth: property can be and is viewed through different prisms and within different frameworks. Different methods of valuing your property can lead to significant differences in value conclusions, and accordingly, your real estate tax bill.

The Ohio Supreme Court recently clarified how to value property constructed pursuant to federal low income housing tax credits (“LIHTC”)<sup>1</sup>. The property in *Woda* consisted of sixty separate parcels of land improved with sixty detached, single family, homes containing two, three, or four bedrooms. The houses were built in 2002 pursuant to Section 42, Title 26 of the United States Code<sup>2</sup> (“IRC 42”). As the court explains, under this program, federal tax credits are given to passive investors in low income housing developments. In return for these credits, rent restrictions are imposed on the property for a minimum of thirty years. These rent restrictions are binding on successive owners and must be recorded in the chain of title. Violations of these restrictions can lead to the recapture of the tax credits with penalties and interest.<sup>3</sup> The Supreme Court held the use and rent restrictions are encumbrances that must be considered when valuing these types of properties for real estate tax purposes.

The owner-taxpayer of the low income housing property in *Woda* filed a complaint contesting the value the Fayette County Auditor placed on the property for tax year 2004. After a hearing at the local county board of revision (“BOR”), the Auditor’s value was retained. The taxpayer then filed an appeal of the BOR decision to the Ohio Board of Tax Appeals (“BTA”) located in Columbus.<sup>4</sup> The BTA held that the taxpayer’s evidence was unpersuasive and determined that the Auditor’s value was correct.<sup>5</sup> After reconsideration by the BTA, but no change in its decision, the taxpayer appealed the BTA decision to the Ohio Supreme Court.

At the BTA hearing, the taxpayer had offered the report and testimony of a state certified general real estate appraiser. The appraiser did not develop a cost approach or sales comparison approach to value, using only the income approach to determine value. (The Ohio Adm. Code Section 5703-25-07 outlines the three recognized approaches to value: 1) the market data or sales comparison approach, 2) the income approach, and 3) the cost approach). In the income approach, the appraiser developed a net operating income for the property, then directly capitalized that income to arrive at an overall value. He also developed a discounted cash flow analysis as if the units could be subdivided and sold to individual buyers (similar to an apartment conversion to condominium units) to serve as a check on the direct capitalization method.

The BTA rejected the appraiser’s evidence based on the two main reasons: 1) the Board thought that the highest and best use of the property was for sale as individual units, rather than for continued use as rentals operated as one economic unit; and, 2) the cost approach

The *Woda* Court makes a similar point with respect to the tax credits, explicitly stating that the value of the low income tax credits should not be valued as part of the real estate. The court reasons that the credits are transferable apart from the underlying real estate and the value of the credit is determined by the tax situation of the purchaser, rather than any anticipated value from the real estate itself (or the “bricks and sticks”).

On the other hand, the Supreme Court holds that the federal use restrictions in *Woda* must be taken into account when valuing a low income housing tax credit property, even if the value of the credits themselves are separate from the value of the real estate. In so holding, the *Woda* Court distinguishes between private e and involuntary government limitations to the estate such as eminent domain, escheat, police power, and taxation.<sup>7</sup> The court finds that the LIHTC use restrictions are imposed by the government for the general welfare, qualifying as “police power” restrictions which express the judgment of Congress concerning public policy.<sup>8</sup> Therefore, such use restrictions must be taken into account when valuing the property. The case is remanded by the Supreme Court back to the BTA to receive additional evidence if necessary.

After the *Woda* decision was announced, the Ohio Department of Taxation issued a memorandum to all county auditors summarizing the holding and indicating that the Department read *Woda* as requiring the consideration of the use and rent restrictions that run with the land and prohibiting the inclusion of the value of the intangible tax credits when valuing LIHTC property for real estate tax purposes.

It clearly makes a material difference to value if the sixty parcels are valued as sixty individual homes, rather than as one economic unit consisting of rental units, or if the construction cost is used to determine value in a case like *Woda*. It will also matter in many cases whether contract rent, which could be higher or lower than market rent, is used to determine the income produced by a property. Intangible items unrelated to the value of the real estate, such as the value of the tax credits also must be separated out from the real property value to be taxed. As the joke demonstrates, appraising a property is not an exact science. A property is going to be valued differently by someone who is currently using the property, compared to someone who is considering buying the property, compared to someone who is going to lend you money for its purchase. Similarly, the value conclusion for your property and your resulting tax liability will be different based on what appraisal approach is used and which data is considered.

### References:

1. *Woda Ivy Glen Ltd. Partnership v. Fayette Cty. Bd. of Revision* (2009), 121 Ohio St.3d 175, 2009-Ohio-762.
2. 26 USCA §42.
3. *Woda* at 179.
4. *Woda Ivy Glen Ltd. Partnership v. Fayette Cty. Bd. of Revision* (Sept. 21, 2007), BTA Case No. 2005-A-749, unreported.
5. *Woda Ivy Glen Ltd. Partnership v. Fayette Cty. Bd. of Revision* (Jan. 11, 2008), BTA Case No. 2005-A-749, unreported.
6. *Alliance Towers, Ltd. v. Stark Cty. Bd. of Revision* (1988), 37 Ohio St.3d 16, 523 N.E.2d 826.
7. *Woda* at 181 (citing Appraisal Institute, *The Appraisal of Real Estate* (12 th ed. 2001)).
8. *Woda* at 181.

was not utilized even though the subject property was relatively new, only having been constructed two years before tax lien date.

The Supreme Court reverses and remands the case to the BTA, holding that the effect of the LIHTC use restrictions must be considered when valuing the subject property. In past cases involving subsidized housing, the court had generally held that the properties were to be valued as if unencumbered by lesser estates, deed restrictions, or restrictive contracts with the government.<sup>6</sup> Similar to the *Woda* property, the *Alliance* Court noted that without the federal loan guarantees, favorable mortgage terms, rent subsidies, and tax advantages associated with these properties, the properties would not have been built because the market rents would prohibitively low. The *Alliance* Court also notes that the tax shelter advantages associated with such properties are intangible items that do not add any value to the real estate.



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