

# Low Income Housing Tax Credit



**Valuation and Assessment Issues**

**NCAHMA**

**October 2013**

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# Program Outline



- **Introduction**
- **Appraisal Issues/USPAP**
- **Assessment Issues**
- **Suggestions and Recommendations**

# Public Intervention in Market



## **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 Interventions



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

# Components of Value in LIHTC



- **Low Income Housing Tax Credits - A Direct Deduction from Taxes**
- **Cash Flow (minimal)**
- **Other Tax Benefits (depreciation)**
- **Residual Value (What will the value be when the property can be sold at the end of the holding period?)**

# Rental Issues



- LIHTC can only be taken on qualified units
- Units must remain rented to qualified residents even if there are move-outs
- 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.

# Appraisal Issues



# USPAP Advisory Opinion AO-14

- **Guides Appraisal Practice and Addresses:**
  - Competency Issues
  - Property Rights Issues
  - Value Definition Issues
  - Market Analysis Issues



# Property Rights Issues



*“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)*

# 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.*

# Issues of Value



- **Value** *The total value of an affordable housing development is derived from the real estate and the non-realty items, indirect or direct government subsidies, tax benefits or other concessions/restriction exchanges.*
- **Investment Value** *The specific value of an investment to a particular investor or class of investors based on individual investment requirements; distinguished from market value, which is impersonal and detached.*

# Appraising Tax Credit Properties



- **Cost Approach** - Useful for New Projects. Must Take Into Account Special Costs.
- **Sales Approach** - Usually Not Useful - Sales are Usually Not Comparable and Adjustments Become Subjective.
- **Income Approach** - Greatest Weight - Serves As the Basis for Most Valuation
  - **Issues of Rent, Expenses and Capitalization Rate**

# Tax Assessment Issues



# Assessment Issues & Questions



- **Should Tax Credits be Assessed?**
- **Do Tax Credits Enhance Real Estate Value**
- **Real Estate Cost/ Market Value?**
- **Which Rents and Expenses are Appropriate**
- **Appropriate Capitalization Rates**

# LIHTC and Property Tax



- **Property tax is a critical issue to project viability. Can be largest operating expense.**
- **Most projects operate on thin cash flows. Low rents and high expenses.**
- **Many states require an abatement agreement before allocating units.**

# 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.**



# Impact on Real Property



- **Restricted rents (may or may not be economic rents) for a fixed period**
- **“Bundle of rights” limitations.**
- **Additional management and operational costs.**
- **Property may be improved at higher than market standards.**

# What Rent to Consider?



- **Market Rent**
  - May or May Not be Higher than Restricted
  - Rents cannot be higher than Restricted Rents
- **Restricted Proscribed Rent**
  - Actuals can be lower, never higher
  - Apartments must be remain affordable at these rents for holding period.

# 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”.**
- **Term of restriction is key issue. When does it expire? What is a reasonable expectation.**

# Capitalization Rate



- **Capitalization Rate = Risk**
- **Base Capitalization Rate based on Conventional Apartments in Market with Adjustments**
- **Adjustments for Benefits and Burdens**
  - Market Characteristics
  - Rent Advantage
  - Quality and Durability of Income
  - Expense Control
  - Site and Neighborhood
  - Physical
  - Program Structure

# Policy Issues & Recommendations



- **Payment in Lieu of Taxes based on Rents**
- **Recognize the Public Purpose in the Program and Thin Operating Margins**
- **Cost Does Not Equate to Value**
- **Reconsider the Assessable Value of the Project When Restrictions Expire**

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