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VIA ELECTRONIC AND U.S. MAIL

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Mr. Kelsie Jones
Comptroller of the Treasury
State Board of Equalization
312 Rosa L. Parks Ave., Suite 900
Nashville, Tennessee 37243-1402

Re: Ad Valorem Taxation of Subsidized Affordable Housing

Dear Mr. Jones:

This firm represents 30-40 developers of subsidized affordable housing in the State of Tennessee. These clients own and manage approximately 30,000 units of affordable rental housing. We have been asked by a vast majority of these clients to respond to the Notice of Rulemaking for Ad Valorem Taxation of Subsidized Affordable Housing (the "Proposed Rule"). Defined terms herein refer to the definitions in the Proposed Rule.

With respect to Section 0600-10-.03 and determining the value of the LIHTC property, we note that the Proposed Rule seems to memorialize the current approach taken by many assessors in Tennessee. That current approach results in a punitive taxing scheme that focuses disproportionately on the financing used to fund construction of these affordable housing projects rather than on the income generated by them, as is done for all other commercial real estate in Tennessee. The punitive aspects of the current approach further results in a drastic reduction in the production of affordable units, and perhaps most importantly, may violate prohibitions against having an impermissible disparate impact on certain Tennesseans.[1] We would propose an alternative approach that addresses the inequity of the current approach.

I. Initial LIHTC Premise. Section 0600-10-.03(1) of the Proposed Rule provides the taxable value of LIHTC property shall consist of a restricted use component and a "component representing the economic benefit of the subsidy" to the property owners. The component representing the economic benefit of the subsidy in the proposed formula does not properly take into account that by its very nature, a "present value" of the LIHTCs in a single year reflects ALL of the remaining LIHTCs added together and then capitalized for that year. So the property owner

[1] Tennessee's current property tax assessment methods for LIHTC affordable units may have an impermissible disparate impact on minority and disabled residents intended to be served by this housing. *Tex. Dept. Hous. & Cmty Affairs v. Inclusive Cmtys Project, Inc.*, 192 L. Ed. 2d 514, 533 (June 25, 2015 (the U.S. Supreme Court holding that under the Fair Housing Act, plaintiffs may challenge practices having a "disproportionately adverse effect on minorities" that are otherwise unjustified by a legitimate rationale). Furthermore, such property assessment practices may violate the new Affirmatively Furthering Fair Housing rule issued by the U.S. Department of Housing and Urban Development ("HUD") in 2015, which rule requires local governments and entities that receive and/or administer HUD funds to "affirmatively further affordable housing" by taking "meaningful actions" to increase the supply of affordable units and shall "take no action that is materially inconsistent" with this obligation. Affirmatively Furthering Fair Housing Rule, 24 CFR §§5.150-5.180; 24 CFR § 91.225.

ends up being taxed in year 1 on ALL of the LIHTCs, then in year 2 on ALL of the credits minus 1 year, then year 3 on ALL of the credits minus 2 years, etc. The result being that the taxpayer is taxed on 55 years' worth of credits instead of 10 years' worth of credits. This approach substantially reduces the funds available to construct this housing.

II. Equitable Proposals. The ideal approach would be to eliminate altogether the component representing the economic benefit of the subsidy since such subsidy was converted to funds to construct/rehab the property and therefore provides no economic benefit to the owner once the construction is placed in service. However, noting the *Spring Hill* case and subsequent pronouncements on the subject, such as the 2015 "*Report of the Tennessee Advisory Committee of Intergovernmental Relations – Valuing Low-Income Housing Tax Credit Properties in Tennessee*" ("TACIR Report"), if the LIHTCs are to be valued, they should be valued in a manner that eliminates the disparate impact on the development of affordable housing that has occurred since the late 1990s. A change in the assessment approach would increase significantly the number of units produced for the benefit of low income residents, including minorities and disabled persons. Either of two approaches would seem to make sense to address the foregoing.

1. Add the value of the LIHTCs received each year to the restricted use component. This method would eliminate the inequitable "multiple counting" effect in the current approach that is described above. It does not require present value calculations or other computation that combines imputed funds over a period of time. This approach also does not require the use of discount rates, about which the parties' experts often disagree. The benefit received is recognized in the year in which it was received, without speculation about future payments and/or discount rates.

2. If there is insistence that the stream of LIHTCs be capitalized, then the use of the "Idaho" approach set out in the TACIR Report is appropriate. As set forth on page 23 of the TACIR Report, the approach smooths the LIHTCs over the restricted rent agreement period.[2] The total amount of LIHTCs to be received over the remaining period of the restrictive covenants is divided by the number of years that the property is subject to such rental restrictions. In Tennessee, the rental restrictions are in place for 30 years. This approach is rational/equitable because the credit values INCREASE the value over the same time period that the restricted rents REDUCE the value – reflecting the entire principal of the *Spring Hill* line of cases, which is that the value reducing and enhancing factors should both be considered. The approach allows for taxation of the full value received by the taxpayer, without the "multiple counting" inherent in the combined-present-values approach, and spreads the payment of the taxes based on that value received over the same time period as the value of the property is subject to the rental restrictions.

III. Initial §1602 Premise. Section 0600-10-.05(1) of the Proposed Rule provides the taxable value of §1602 affordable housing property shall be calculated by the income approach value resulting from using actual rents paid or payable by needy tenants plus "the forgivable loan income attributed to the property for the year at issue." The forgivable loan income attributed to the property is the amount of loan principal forgiven for the year at issue. The §1602 proposal simply codifies the approach taken by the State Board of Equalization.

IV. Equitable §1602 Proposal. Section 1602 funds do not add value to a property under any accepted appraisal theory and such funds should not be included as a component of the

[2] See attached excerpt from the TACIR Report.

ad valorem taxation of these properties. The §1602 funds are fundamentally different from LIHTCs. According to THDA, the §1602 program was treated by that agency as a grant program, not a loan program. The taxpayer has a "recapture" liability to the U.S. Treasury if the restrictive covenants are not met, and this potential liability is reduced annually, but there effectively is no loan forgiveness because the taxpayer has no repayment obligation. Section 1602 funds were fully disbursed prior to December 31, 2011, and there is no subsidy or further "benefit" received by the property or the taxpayers thereafter. If there is no future income stream or other benefit received by the taxpayer, then Spring Hill and its progenitors do not provide any basis for taxation of the funds. The §1602 do not supplement the income value of the property and the valuation methodology should not include a component based upon these funds.

V. Procedural. Finally, the timing provision proposed in Section 0600-10-.06(1) of the Proposed Rule is insufficient. That section of the proposed rule provides that the assessor shall update an existing valuation on the occasion of any county-wide reappraisal, "or upon being directed by the county or state board of equalization to update the valuation for a year in which the assessment is properly appealed." This fails to recognize that under current practice – if that is codified by the Proposed Rule – the value of an LIHTC property declines every year because one year of credits are "burned off." It is inappropriate to require the taxpayer to appeal every year in order to receive a reduction that is based upon a known annual reduction in a component of the property value. Regardless of what value determination method is established through the Proposed Rule, this section of the Proposed Rule should direct assessors to utilize that method to assign a value to these properties each year during which credits are to be included in the value. The taxpayer can then appeal the value to the County Board of Equalization if they do not agree with the assessed value.

If adopted, the foregoing recommendations for ad valorem taxation of LIHTC properties would mitigate the disparate impact on affordable housing production and increase the number of low income units for the benefit of low income Tennessee residents, including minorities and disabled persons. If you should have any questions or need any additional information about the proposals or any issue referenced herein, please do not hesitate to contact me.

Very truly yours,

RENO & CAVANAUGH, PLLC

Dwayne W. Barrett

/dwb
CC: David Kleinfelter, Esq.

Report of the Tennessee Advisory Commission on Intergovernmental Relations

Valuing Low-Income Housing Tax Credit Properties in Tennessee

Property Tax Treatment of LIHTCs in Other States

In fifteen states, neither the courts nor the legislature has provided guidance for the valuation of LIHTC properties developed by for-profit companies. See table 3 and the map below. Although an administrative law body in Maine ruled that the credits should be considered in property valuations, the legislature has not acted, and the case has not reached the courts. North Dakota law requires all non-profit developers of LIHTC properties to arrange PILOTs with local jurisdictions, and Montana law excludes those LIHTC projects developed by non-profits or public housing authorities entirely from taxation, but neither state provides guidance for properties developed by for-profit companies.

Despite the fact that the tax credits are a direct economic benefit that investors receive from owning LIHTC properties, legislatures in twenty-four states have excluded the credits from use in property valuations. Of these, eighteen acted without guidance from state courts, including two—Hawaii and Nevada—that exempted LIHTC properties from property taxes altogether. In Mississippi and Nebraska, subsequent court rulings have clarified that the legislature's intent was to exclude the credits. In six states, legislatures overturned court decisions that ruled credits should be considered in valuation.

Courts in six states have, absent any action from the legislature, ruled that the credits should be excluded from valuation for property tax purposes. Three of these—Missouri, Oklahoma, and Washington—ruled that the credits were not taxable because they were intangible property and either existing statutes (Missouri and Washington) or the state constitution (Oklahoma) exempts intangible property from property taxes.

The credits are considered in valuing LIHTC properties by law or court decision in only four states other than Tennessee. Idaho is the only state where both the courts and the legislature have agreed that the credits should be considered in property valuations. The Idaho legislature has established a special formula for including the tax credits that takes the total value of tax credits allocated to a project; divides it by the number of years in the restricted rent agreement; and adds that value to the value obtained using the standard income approach and restricted rents. Kansas and Michigan are the only states other than Tennessee that consider the credits because of court ruling alone. Vermont is the only state that requires the use of market rents by statute when valuing LIHTC properties under the income approach.