ARIZONA DEPARTMENT OF REVENUE
Division of Property Valuation & Equalization

GUIDELINE

SUBSIDIZED HOUSING VALUATION

Purpose

The purpose of this guideline is to provide a standardized, uniform appraisal methodology for the valuation of non-exempt, low-income, subsidized multi-housing projects.

Introduction

Low-income, subsidized multi-housing was created by the Federal Housing Act of 1933. The Act has been modified and expanded several times to not only include federal, but state and local subsidy programs. In the 1970's, HUD Section 235 and 236 subsidy programs (low interest rate programs) were prevalent along with Farm and Home Administration loan programs for rural areas.

A HUD Section 8 program (tenant vouchers subsidizing the difference between market rent and a family's share of the housing cost) was also created to address the increased operating costs of subsidized projects and to add flexibility by allowing tenants to move from project to project. The result is a mixture of partially and fully subsidized projects that greatly increase the complexity of valuing such projects when, and if, rent subsidies are considered in the appraisal process.

Today, most federal direct subsidy programs are being phased out. The current emphasis appears to be on the indirect approach of providing income tax credits to investors in low-income housing projects (Section 42 of the Internal Revenue Code known as the Low-Income Housing Tax Credit (LIHTC) Program) and/or providing mortgage loans for rural rental housing (Section 515, administered by the Department of Agriculture). The LIHTC is given to project investors in exchange for equity participation and to offset the restriction requiring that all or part of the project be leased at below-market rents to qualified low-income tenants. Under the provisions of Section 515, in return for renting to low-income tenants, the investor is only required to make a small down payment (3%-5%) and in addition, receive a government subsidy of the difference in interest between the market rate (8%) and the cost of funds to the investor (1%).

Special Considerations

The following are potential issues the Assessor may face when valuing subsidized multi-housing projects:

1. In some cases, subsidized multi-housing projects would not have been constructed in a market economy, or they are sometimes built in areas that developers would not ordinarily consider building without subsidies (e.g., the subsidies made these projects feasible). The Assessor should search similar market areas in which the subject property is located for conventional, non-subsidized sales and income data.

2. What is the "current use" of the property? For property tax valuation purposes, the "current use" should be considered a *conventional* (market rental rate) apartment project. Mortgage financing of the project should not be considered.

3. Actual *subsidized* income and expenses reflect benefits and liabilities associated with subsidized projects. Market based rents and expenses should be used to avoid this problem.

4. Actual construction costs for a subsidized project may be higher than market costs due to extras required by federal minimum standards.[1] Replacement costs for a typical, conventional apartment project should always be used in lieu of actual costs of construction.

5. Should USPAP Advisory Opinion A0-14 be followed when appraising subsidized apartment projects for property tax purposes? Because mortgage financing and related restrictions and benefits are to be ignored, this Advisory Opinion is not applicable when appraising property for tax purposes.

Arizona Law

No specific statute exists in Arizona regarding the valuation of subsidized multi-housing properties. However, considerable Arizona case law, as cited in Recreation Centers of Sun City, Inc. v. Maricopa County,[2] deals with the valuation of encumbered property for tax purposes. As noted in the Recreation Centers decision, "Under established Arizona law, property burdened by long term leases or mortgages is not appraised at its potentially restricted selling price, but is compared to similar property without such burdens. Even if such encumbrances make a particular property more or less desirable to a prospective buyer, the assessed value for tax purposes is not affected."

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[1] David M. Goldberg, "FHA Apartment Projects: Valuation for Real Estate Tax Purposes," The Appraisal Journal, July 1993, pp. 448-450.

[2] Recreation Centers of Sun City, Inc. v. Maricopa County, 162 Ariz. 281, 782 P.2d 1174 (1989).

Valuation Procedure

For property tax purposes in Arizona, case law dictates that property is valued as unencumbered, fee property based on comparison with similar property not subject to encumbrances. Appraising the unencumbered fee estate avoids the problem of identifying "tangible" and "intangible" values as set forth in USPAP Advisory Opinion A0-14. This methodology also avoids the problems with using *actual* income and construction costs. Only *market* income and construction costs, along with sales of conventional apartment projects, should be used in the valuation process. In addition, appraising the unencumbered, fee estate avoids cumbersome and subjective valuation of government benefits (rent and loan subsidies) and offsetting restrictions (rents, return on investment and sale of property).

The Assessor must, however, address potential "feasibility" problems with subsidized multi-housing properties (e.g., would this property be viable as a conventional project). From studying the market area, the appraiser must determine market rent, vacancy levels and operating expenses for conventional, non-subsidized properties. Market based capitalization rates for similar conventional properties must also be used in the income valuation process. The approaches to value used should then be reconciled and an estimate of final value derived for the property being appraised.