Subsidized Housing Valuation
Preface

In 2018, the Department of Revenue (Department) Manuals Team undertook a major project to update all manuals and guidelines produced by the Property Tax Unit. The following three levels of updates were to be applied, dependent upon the perceived need:

**Review:** Manual or guideline conforms to standard style and formatting. Legislative and other citations verified. No changes to content, methodology, policy, or practice.

**Revision:** Includes applicable Review processes. Manual or guideline is newly edited. Nonsubstantive legislative changes incorporated. Addition or deletion of information that does not alter valuation methodology.

**Rewrite:** Includes applicable Review and Revision processes. Major substantive changes made to any combination of content, valuation methodology, policy, or practice.

This 2020 Subsidized Housing Valuation Guideline (Guideline) is a Revision of the 1998 Subsidized Housing Valuation Guideline issued by the Department on December 1, 1998, and supersedes all previous subsidized housing valuation guidelines issued by the Department. This Guideline was published November 24, 2020, and remains effective until replaced. Additional information may be issued as an addendum to this Guideline or as a separate guideline. Due to the flexibility provided for in statute, deadlines and procedures may vary from county to county across the state. The Department recommends contacting your county assessor for detailed information regarding the deadlines and procedures in their jurisdiction. The information in this Guideline is based upon laws and rules in effect at the time of publication. Should any content in this Guideline conflict with current laws or rules, the latter shall be controlling.
All inquiries, comments, and suggestions concerning the material in this Guideline may be submitted to the following:

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The 2020 Subsidized Housing Valuation Guideline is available at:
https://azdor.gov/sites/default/files/media/PROPERTY_SubsidizedHousingValuation.pdf

Changes in Law
There have been no changes in Arizona law regarding the identification, classification, valuation, or assessment of non-exempt, limited-income, subsidized multi-family housing property since the prior version of this Guideline was published.

Purpose
The purpose of this Guideline is to provide a uniform appraisal methodology, in accordance with the Arizona Constitution\(^1\) and applicable statutes, for the valuation of non-exempt, limited-income, subsidized multi-family housing projects.

Introduction
Subsidized multi-family housing was first created under state and federal legislation that was passed in response to the Great Depression. Since that time, subsidized multi-family housing programs have been modified and expanded.

Incentives in early legislation included low interest rate loans, loan subsidies, and housing preservation programs administered by federal agencies such as the

\(^1\) The Uniformity Clause states, “[A]ll taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax”. Ariz. Const. art. IX, sec. 9(1).
Department of Housing and Urban Development (HUD) and the Farm Service Agency. For example, previous programs created under HUD Sections 235 and 236 provided reduced interest rates and direct subsidies to assist owners of subsidized multi-family housing with their mortgages. The HUD Section 8 program was created in 1974, and still operates today to increase affordable housing choices by allowing limited-income families to choose privately-owned rental housing. The Section 8 subsidy program also pays the landlord the difference between market rent and what the household can afford.

However, the contemporary legislative trend has been to phase out direct rental payment programs like Section 8 subsidies and to emphasize “indirect” approaches instead. Examples include providing income tax credits to investors of limited-income housing projects such as the Low-Income Housing Tax Credit (LIHTC) established by Internal Revenue Code Section 42, and providing mortgage loans for rural rental housing such as those furnished by HUD Section 515 and administered by the Department of Agriculture.

The LIHTC is given to subsidized multi-family housing project investors in exchange for equity participation. Thus, rather than compensating owners and investors with direct rental payments as is done under Section 8 to account for low, restricted rents paid by tenants, owners and investors of LIHTC properties receive a return on their investment via tax credits. The restricted rents are reviewed and revised annually by the Arizona Department of Housing according to specific federal requirements.

Under the provisions of HUD Section 515, limited-income housing project investors qualify for a low down payment (3%-5%) and receive a subsidy representing the difference between the market interest rate and the cost of funds to the investors (1%).

The various subsidized multi-family housing programs have created issues with respect to the valuation of multi-family residential properties for property taxation purposes, properties that are allegedly encumbered by the fact that tenants may pay below-market
rent under the terms set forth in the respective subsidized multi-family housing program. The discussion below addresses some of these issues.

**Arizona Law**

There is no Arizona statute that specifically relates to the valuation of subsidized multi-family housing properties. However, considerable Arizona case law deals with the valuation of “encumbered” property for property tax purposes, as discussed by the Arizona Supreme Court in *Recreation Centers of Sun City, Inc. v. Maricopa County*\(^2\) (Recreation Centers).

In that case, the Department of Revenue restated the following principle: “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.”\(^3\)

The Supreme Court supported this principle by affirming that the property tax is levied on the property itself, not on the interests in the property or the profitability of the property.\(^4\) The court then held that in determining the assessed value of a property, the assessor “may not consider the restrictions limiting profitability or the class of users to be benefited” because such restrictions do not affect value.\(^5\) However, with respect to restrictions on the use of a property, the court held that such restrictions must be considered during valuation because they affect the inherent value of a property.\(^6\) The court concluded by stating that “[t]he assessor may utilize any appraisal approach or

\(^{3}\) Ibid. at 285, 1178 (citations omitted).
\(^{4}\) Ibid. at 288, 1181 (citations omitted).
\(^{5}\) Ibid. at 290, 1183.
\(^{6}\) Ibid. at 291, 1184.
hybrid method of appraisal that takes the principles explained in this opinion into consideration.”

Valuation Procedure

For property tax purposes in Arizona, statutory and case law dictate that property is to be valued as unencumbered fee property based on comparison with similar property not subject to encumbrances. Moreover, under A.R.S 42-11001(6), “‘Full Cash Value’, for property tax purposes, means the value determined as prescribed by statute. If a statutory method is not prescribed, full cash value is synonymous with market value, which means the estimate of value that is derived annually by using standard appraisal methods and techniques.”

However, no statutory valuation method exists for LIHTC multi-family properties, or for any other multi-family property that offers low rent housing under any state or federal subsidized housing program. Accordingly, such properties are to be valued as unencumbered fee properties using all or any of the three standard appraisal methods—income, market, and cost—as would be appropriate for similar multi-family properties in the area.

When using the income approach, the assessor must study the market area of the subject multi-family housing project to determine market rent, vacancy levels, and operating expenses for conventional, non-subsidized properties. Market-based capitalization rates for similar conventional properties must also be developed and utilized in the income approach. Finally, the estimates of value made via the various approaches to value should be reconciled to derive a final estimate of value for the subsidized multi-family housing property being appraised.

When valuing subsidized multi-family housing properties, the assessor must be aware that applicable Arizona law precludes compliance with a portion of the Uniform

7 Ibid.
Standards of Professional Appraisal Practice (USPAP), thus invoking the USPAP Jurisdictional Exception Rule. Part of the instruction provided in USPAP Advisory Opinion 14 (AO-14), entitled Appraisals for Subsidized Housing, is precluded by Arizona law. The same Opinion sets forth this relevant advice from the Appraisal Standards Board, “The COMPETENCY RULE also requires: recognition of, and compliance with, laws and regulations that apply to the appraiser or to the assignment.” In conjunction with this requirement, the Jurisdictional Exception Rule states that “[i]n an assignment involving a jurisdictional exception, an appraiser must: 1. identify the law or regulation that precludes compliance with USPAP; 2. comply with that law or regulation[.]” The term “law” is defined in a comment to the Jurisdictional Exception Rule, which states: “Law includes constitutions, legislative and court-made law, and administrative rules and ordinances. Regulations include rules or orders having legal force, issued by an administrative agency. Instructions from a client or attorney do not establish a jurisdictional exception.” In other words, the appraiser must comply with the entirety of USPAP, unless the Jurisdictional Exception Rule applies due to a conflict between USPAP and applicable law or regulation.

Special Considerations Summary

Potential issues the assessor may face when valuing subsidized multi-family housing projects are presented below.

1. Some subsidized projects might not have been constructed in an identical place, manner, and/or scope but for their involvement in a subsidized housing program. In these cases, higher equity (limited partners) versus loan participation and potential lower market rents are offset by the income tax credits, developer fees, and minimal direct developer equity investment, reducing project risk and

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9 Ibid. at 83.
10 Ibid. at 15.
11 Ibid.
increasing the internal rate of return. It is these benefits that offset the restricted lower rents and tenant income restrictions based on the restricted land use agreement. Therefore, the assessor should search market areas similar to that of the subject property to obtain conventional, non-subsidized sales and income data.

2. Each subsidized project must be considered as if it were 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, the consideration of which will skew the valuation estimate. Market-based rents and expenses should be used to avoid this problem.

4. Actual construction costs for subsidized projects may be higher than typical market construction costs due to certain property features required by the federal minimum standards in Section 42 of the Internal Revenue Code. Replacement costs for typical, conventional apartment projects should be used in lieu of actual construction costs in such instances.

5. When appraising subsidized housing for property tax purposes, mortgage financing and related restrictions and benefits must be ignored pursuant to the Recreation Centers\(^\text{12}\) case, which also precludes compliance with a portion of USPAP Advisory Opinion 14 (AO-14), as authorized by the USPAP Jurisdictional Exception Rule.\(^\text{13}\)

\(^{12}\) 12 162 Ariz. 281, 288-91, 782 P.2d 1174, 1181-94.