HB 235

Department of Legislative Services

Maryland General Assembly
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FISCAL AND POLICY NOTE
Revised

House Bill 235 (Delegate King, *et al.*)
Ways and Means Budget and Taxation

Property Tax - Valuation - Low Income Housing Tax Credit Projects

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The bill establishes a new subclass for commercial real property developed using federal low income housing tax credits (LIHTCs). The bill also specifies the methodology to be used by the State Department of Assessments and Taxation (SDAT) when assessing affordable housing developments financed through the use of federal LIHTCs. Specifically, when valuing these properties SDAT: (1) must consider the impact of applicable rent restrictions, affordability requirements, or any other restrictions required by § 42 of the Internal Revenue Code; (2) may not consider the federal LIHTCs as income attributable to the real property; and (3) may consider the replacement cost approach to valuing the property only if it is less than the income approach.

The bill takes effect July 1, 2005.

Fiscal Summary

State Effect: Potential special fund revenue decrease. State expenditures would not be affected.

Local Effect: Potential decrease in local government revenues. Local government expenditures would not be affected.

Small Business Effect: Potential meaningful.

Analysis

Current Law: When determining the value of commercial property financed by a federal or State affordable housing program, SDAT is not explicitly required to consider the impact of applicable rent restrictions, affordability requirements, or other related restrictions required by federal or State programs. However, SDAT's current practice is to consider these factors to the extent the information is available. SDAT is not prohibited from valuing LIHTCs or the replacement cost of property in the assessment of low-income housing projects.

The State real property tax rate is $0.132 per $100 of assessed value. All State property tax revenues are credited to a special fund, the Annuity Bond Fund, dedicated exclusively to paying the debt service on State general obligation bonds. Local governments generally have the authority to set their own property tax rates.

Background: In recent years, LIHTCs have supplanted traditional programs used to encourage the development and provision of low-income housing. The traditional programs revolved around insurance, direct loans, or rental assistance.

Insurance: Previous programs insured and subsidized mortgage loans to facilitate new construction or subsequent rehabilitation of multifamily rental or cooperative housing for low- or moderate-income families. Often the reduced mortgage rate could be in the 1% to 3% range. These projects may have renters who receive Section 8 housing assistance to assist with the occupancy rates of the project. Some projects have tenants paying at least a basic rental rate. The rental rate paid by the tenants varies based on their income. However, it cannot be more than the market rates. There are also separate programs involving loan insurance for elderly and disabled renters. These projects require at least 50% of the units be rented to elderly or disabled renters.

Direct Loans: Projects may be financed under low-interest loans, formula interest rate loans (where the interest rate is based upon the average yield on 30-year U.S. government obligations), and capital advances (an interest-free capital advance with no required repayment as long as the housing remains available to very low-income elderly or disabled persons).

Rental Subsidies: These are paid directly to the owner of the property and are tied to the project as opposed to the tenant based real assistance programs (housing choice vouchers) where the assistance moves with the tenant.

For the most part, these traditional affordable housing programs have been supplanted by low-income housing tax credit projects. LIHTC was enacted by the 1986 Federal Tax Reform Act. Through LIHTC, government funds are used to construct new rental housing or are used to acquire and rehabilitate existing rental housing for low-income households. The program provides an incentive for developers to leverage additional funds to construct or rehabilitate housing for low-income housing. The tax credits are awarded to developers of low-income housing who in turn offer the credits to investors.

The investors gain a dollar-for-dollar reduction in their federal tax liability in exchange for providing equity to finance the development of low-income housing. Investors receive a tax write off because they use the credits, claimed in equal installments over a 10-year period to offset taxes otherwise owed. The money raised from the sale of tax credits is used as equity to finance a portion of the costs of the development.

The incentive of the tax credit is critical because rental income and returns from investment in low-income housing are not always adequate to cover building, operating, and maintenance costs for these projects. Compared to the required life of the project, usually 40 years, the tax credits have a relatively short life. None of these types of projects in Maryland have yet sold and it is uncertain as to what would happen to the projects at the end of the life of the credits. It is assumed that the primary market for these properties would be nonprofit entities that would acquire the project for any remaining mortgage balance or a slightly greater amount.

Currently, 17 states have not determined how to value LIHTC in relationship to the total project value. Courts in Connecticut, Idaho, Indiana, Pennsylvania, and Tennessee have held that the tax credits should be valued as part of the property tax value. Courts in Kansas, Mississippi, North Carolina, Oregon, Arizona, and Washington have held that the tax credits should not be valued as part of the property tax value. While tax credits are an integral part of these projects, earlier projects based on insurance, direct loans, and rental subsidies do not involve tax credits. However, these projects would fall under the broad category of affordable housing and would be subject to the provisions of this bill.

There are three approaches to valuation: cost, market, and income. This bill would prohibit the use of the cost approach, which, according to SDAT, is a legitimate approach to value, for properties which are defined as affordable housing. SDAT estimates that there are over 300 low-income housing tax credit projects statewide. In some jurisdictions a payment in lieu of taxes program has been used instead of charging property taxes. Older low-income housing projects do not involve tax credits.

Currently, SDAT does not have a specific policy regarding the valuation of property developed using federal LIHTCs. As a result, the bill will provide SDAT with a uniform policy.

State Fiscal Effect: This bill alters the method SDAT values low-income housing by prohibiting SDAT from considering the value of specified income tax credits attributable to the real property and by specifying when the cost approach to valuation may be used when valuing an affordable housing project. It also requires the supervisor to consider the impact of rent restrictions, affordability requirements, and other restrictions when valuing these projects.

As discussed, the use of LIHTCs is relatively new. As such, SDAT does not have a uniform policy regarding the valuing of these tax credits when assessing a low-income housing project. In some cases they are included in the value of the project, but in many cases they are not. A court case is currently pending in Maryland that deals with the State's ability to value LIHTCs in commercial assessments.

As a result, special fund revenues would decrease to the extent that LIHTCs are included in the assessment of commercial property. However, because these credits are not always included in the assessment, the actual decrease attributable to the bill cannot be reliably estimated.

Local Fiscal Effect: This bill could lower the assessed values placed on low-income housing projects and could decrease property tax revenues to the extent that the value of LIHTCs are currently included in the assessment of commercial properties. As a result, the amount of that decrease cannot be determined at this time.

Small Business Effect: This bill could potentially lower the assessment on low-income housing projects and could benefit owners, developers, and managers of those projects due to lower property taxes.

Additional Information

Prior Introductions: None.

Cross File: SB 67 (Senator Kramer, *et al.*) – Budget and Taxation.

Information Source(s): State Department of Assessments and Taxation, Department of Housing and Community Development, U.S. Department of Housing and Urban Development, Department of Legislative Services

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