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TO INTERESTED PARTIES:

VALUATION OF SECTION 515
LOW-INCOME HOUSING PROJECTS

In LTA 2001/039, staff reiterated its position with respect to the valuation of Section 515 low-income housing projects. The LTA announced an interested parties meeting for August 10, 2001. Staff also solicited written comments from interested parties concerning the major issues in Section 515 valuation.

Staff wishes to remind interested parties of the August 10 meeting, which will begin at 9:30 a.m. in Room 122, Board of Equalization, 450 N Street, Sacramento. Also, as an enclosure to this letter, staff has provided a matrix containing the comments received from interested parties and staff's responses. The matrix will be the basis for discussion at the interested parties meeting.

On August 29, 2001, staff will submit an issue paper to the Property Tax Committee summarizing the unresolved issues concerning Section 515 valuation. On September 12, 2001, the Property Tax Committee will consider the matter.

This letter and future documents relating to the project will be posted to the Board's Web site at (www.boe.ca.gov) and can be accessed by way of the following links: (1) Property Taxes, (2) Property Tax Committee Work Plans, (3) Property Tax Committee Work Plans 2001. If you have questions or comments about the project, please contact Paul Lane at (916) 324-5828 (paul.lane@boe.ca.gov) or Mark Nisson at (916) 324-0295 (mark.nisson@boe.ca.gov).

Sincerely,

Richard C. Johnson
Deputy Director
Property Taxes Department

RCJ:pl
Encl

**Section 515 Subsidized Housing
Matrix of Comments from Interested Parties**

Question 1: *Does Revenue and Taxation Code section 402.9 preclude use of the subsidized rate for the debt component in the band-of-investment method of determining the capitalization rate?*

Item	Source	Position/Comment	Staff Position/Comment
1.	Siskiyou County Assessor	"We disagree that R&T Code section 402.9 precludes use of the subsidized rate in the band-of-investment method of determining the capitalization rate. This issue was specifically addressed in the Superior Court Decision in Carl A. Bontrager, Assessor of Siskiyou County vs. Assessment Appeals Board of Siskiyou County, a copy of which is attached for staff's review. Please refer to Page 2 Paragraph 5, in which Judge Cooper's apples & oranges comparison clearly illustrates the inconsistency in applying a market rate to a restricted income."	Concur.
2.	Fresno County Assessor	"No. Section 402.9 refers specifically to interest subsidy payments and whether or not those payments should be considered as income in the income capitalization approach. There is no mention of capitalization rates in this section and to infer such would be a mistake. Clearly, this section [402.9] was not meant to address the cap rate issue."	Concur.

Question 2: *If section 402.9 does not affect the calculation of the capitalization rate, is it nonetheless appropriate to use the subsidized rate considering the Board's own property tax rules, accepted appraisal practices, and principles of finance?*

Item	Source	Position/Comment	Staff Position/Comment
3.	Siskiyou County Assessor	"Use of the subsidized rate is consistent with the Board's own property tax rules, accepted appraisal practices, and principles of finance. Interested Parties contend that Rule 8 requires use of the 'rate appropriate to the California money markets,' however, this phrase cannot be so narrowly construed that the rate used has little relationship to the income being capitalized. The 1% rate is the only true market rate for Section 515 Housing."	Concur.
4.	Fresno County Assessor	"Yes. It is appropriate to use the subsidized rate. 515 projects are governmentally (enforceably) restricted. Consequently, their valuation for property tax purposes must reflect the impact of those restrictions. The use of the subsidized rate reflects accepted appraisal practices in that it mirrors the owner's actual debt component rate that is common with all 515 projects. Since the income to be capitalized is the restricted income, proper appraisal technique would dictate the use of the subsidized rate because it is also reflective of the enforceable restrictions."	Concur.

Question 3: *Is it ever lawful for a project in the Section 515 program to be assessed according to a fair market value determination that is greater than such a determination for an otherwise comparable project outside the Section 515 program?*

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5.	Siskiyou County Assessor	"We contend that properties outside the Section 515 program cannot be considered as comparables in the valuation of Section 515 Housing. We view this situation as analogous to comparing the valuation of unrestricted agricultural land with agricultural land valued under the Williamson Act (another apples and oranges comparison). Therefore, the issue of legality is a moot point."	Staff agrees that properties within and without the Section 515 program are poor substitutes for each other. This observation does not, however, dispose of the legal question raised here.
6.	Fresno County Assessor	"Possible. A fair market value determination of a 515 project necessarily must be based on the government (enforceable) restrictions that accompany that project. And although enforceable restrictions typically carry with them the notion of a lower value than otherwise comparable properties, it is certainly possible that enforceable restrictions may force the fair market value higher than otherwise comparable properties. Since virtually no reliable sales of 515 projects are available, the use of the income approach is warranted in a market value determination. If the recommended income approach indicates a higher value than a non 515 property, it would simply mean the enforceable restrictions actually enhance the property value rather than detract from it."	Concur.

Other Issues:

Item	Source	Position/Comment	Staff Position/Comment
7.	Siskiyou County Assessor	"We are sure that the Board is aware of the two Superior Court cases relating to this matter, which are currently under appeal (Siskiyou and Kern Counties). Assessment Appeals throughout the state have been postponed pending the outcome of these appeals, which will not be heard until early next year. Along those same lines, we feel that the Property Tax Committee should postpone any decision on this matter until after decisions have been rendered in these two precedent setting cases."	No comment.
8.	Plumas County Assessor	"The position of Plumas County is that the valuation approach outlined in LTA 98/51, and which is still supported by the Board's staff, is the correct method for valuing section 515 housing projects."	Concur.
9.	Protax LLC	<p>"The current 'methodology' for assessing Section 515 projects as recommended by the staff of the State Board of Equalization:</p> <p>"(1) is contrary to the intent of the California Legislature when it passed Senate Bill 1706 (Section 402.9)"</p>	<p>Disagree.</p> <ul style="list-style-type: none"> • By its express terms, section 402.9 prohibits an assessor from considering as <i>income</i> any interest subsidy payments by the federal government. Staff's position is consistent with this express prohibition. • From section 402.9's silence about the capitalization rate it does not follow that the Legislature intended that the section be read to mean something that it does not say—namely, that an assessor is prohibited from deriving via the band-of-investments method a capitalization rate that reflects the subsidized debt that is typical of Section 515 projects. • The legislative history of SB 1706 shows that the Legislature knew that section 402.9 would not affect the derivation of the capitalization rate.

Item	Source	Position/Comment	Staff Position/Comment
			<ul style="list-style-type: none"> <li data-bbox="953 256 2018 500">• In 1999 SB 1231 amended section 402.9 to make clear that Section 515 projects should be treated in the same manner as the low-income housing projects that were the subject of section 402.9 as initially enacted. Indeed, an analysis of SB 1231, prepared by staff in the State Assembly, noted: <i>"BOE has recently issued Letter to Assessors' 98/51 that, in part, instructs assessors to exclude the interest subsidy payments when determining the income stream on Section 515 projects. This bill would codify BOE's Letter."</i> <li data-bbox="953 542 2018 711">• That the Legislature specifically intended that staff's longstanding interpretation of section 402.9 should be applied also to Section 515 properties, and the fact that the Legislature was aware of staff's interpretation as restated in LTA 98/51, reaffirms that the Legislature knew that the provisions of section 402.9 would not affect the derivation of the capitalization rate.
10.	Protax LLC	<p data-bbox="369 753 930 850">[The current 'methodology' for assessing Section 515 projects as recommended by the staff of the State Board of Equalization:]</p> <p data-bbox="369 857 930 1029">“.... “(2) is illegal due to the fact that it violates and/or misinterprets a. numerous property tax rules (rule 6(a), 8(a), 8(g)(1), 8(g)(2))”</p>	<p data-bbox="953 753 1073 781">Disagree.</p> <ul style="list-style-type: none"> <li data-bbox="953 824 2018 1138">• Rule 6(a) states, among other things, that the cost approach is preferred when neither reliable sales data are available and when the income from the property is not so regulated as to make the cost approach irrelevant. Staff's guidance as to Section 515 properties is that the income approach to value is used almost exclusively in the valuation of Section 515 properties, for very pragmatic reasons. First, the comparative sales approach is difficult to apply because Section 515 properties do not "sell" as that term is generally understood. So, as a practical matter, there are no comparable sales upon which to base a valuation. Further, the cost approach is not recommended because of the restricted nature of the income. <li data-bbox="953 1182 2018 1382">• Rule 8(a) states that the income approach is preferred when reliable sales data are not available and the cost approaches are unreliable because (for example) the property is subject to legal restrictions on income that are unrelated to cost. As discussed above, however, staff's guidance instructs that the income approach—not the cost approach—is used almost exclusively in the valuation of Section 515 properties.

Item	Source	Position/Comment	Staff Position/Comment
			<ul style="list-style-type: none"> • Rule 8(g)(1) discusses the derivation of a capitalization rate from data developed from recently sold comparable properties. The rule makes clear that, when an appraiser uses this method of deriving a capitalization rate, the sales prices of the comparable properties must be adjusted, if necessary, to cash equivalents. Protax LLC's claim that staff's guidance violates these provisions apparently devolves from advice in LTA 98/51 that no cash equivalent adjustment is warranted where the recently sold comparable properties are in the Section 515 program. We reasoned in the LTA that adjustments for the subsidized debt would result in misrepresentations of the overall investments in Section 515 properties. As discussed above, however, the reality is that true "sales" of these properties almost never occur; thus, as a practical matter, there will be no "market-derived" capitalization rates for appraisals of Section 515 properties. • Rule 8(g)(2) discusses the derivation of a capitalization rate by the band-of-investments method. Specifically, this provision of rule 8 requires that the capitalization rate be derived from a weighted average of the rates for debt and for equity capital appropriate to the California money markets. In LTA 98/51, staff advised that this instruction in the rule should not be construed so narrowly that it would require the use of a debt component that bears little or no relationship to the net income forecast for the overall investment. In response to Protax LLC's claim that LTA 98/51 somehow violates rule 8(g)(2), it is important to note that rule 8(c) requires that the net income to be capitalized is that which reasonably well informed persons may anticipate the property will yield subject to legally enforceable restrictions as such persons may foresee. Rule 8 cannot be construed to require an appraiser to recognize enforceable restrictions on net income, only to have that appraiser turn around and ignore concomitant governmental restrictions relating to the rate for debt.
11.	Protax LLC	[The current 'methodology' for assessing Section 515 projects as recommended by the staff of the State Board of Equalization:] “.... “(2) is illegal due to the fact that it violates and/or misinterprets	Disagree. • <i>Coca-Cola v. State Board of Equalization</i> (1945) 25 Cal.2d 918 supports staff's position in two ways. First, the Court reaffirmed the established rule that the contemporaneous administrative construction of an enactment by those charged with its enforcement and interpretation is entitled to great weight, and courts generally will not depart from such construction unless it is clearly erroneous or

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		<p>“.... “b. several court rulings (Coca Cola) (Prudential) (Mission Housing) “c. Assessor's Handbooks Instructions (AH501)(AH503)”</p>	<p>unauthorized. Under this rule, staff's longstanding and often-repeated interpretation of section 402.9, without any legislative enactment contrary to that interpretation, would be upheld by a court. Similarly, with respect to certain amendments to the Retail Sales Act the <i>Coca Cola</i> Court noted that "[i]t may be presumed that these amendments were made with full knowledge of the construction which had been placed upon the statute by the Board of Equalization, yet there was no modification of the legislation which would require a contrary interpretation. This is a factor that may be considered in determining the meaning of the terms intended by the Legislature. [Citations omitted.] And particularly because of the amendment made at the last session of the Legislature, the board's construction of the act should be decisive of the present litigation." This holding underpins staff's argument that the recent amendments to section 402.9 reaffirmed staff's longstanding interpretation of that statute.</p> <ul style="list-style-type: none"> • As to <i>Prudential Insurance Co. v. City and County of San Francisco</i> (1987) 191 Cal.App.3d 1142, that decision clarified that Property Tax Rule 4 is mandatory in its instruction to convert a sale price to its cash equivalent. The Court also noted, however, that "[s]uch conversion will not significantly affect the determination of market value where, for instance,...the financing of the subject property is typical of that available in the market at the time of the sale." As discussed in LTA 98/51, the subsidized financing for Section 515 properties is typical of that available in the market for such properties. Under these circumstances a cash equivalent adjustment is not required, and, in fact, such an adjustment would distort the market value of the property. Again, however, the entire issue is of little practical import, since there is rarely a true "sale" of a Section 515 property. • There were two <i>Mission Housing Development</i> cases. The first, <i>Mission Housing Development Co. v. City and County of San Francisco</i> (1997) 59 Cal.App.4th 55, among other issues, concluded that the assessor had properly applied the "band of investment" method. (59.Cal.App.4th 55 at 86). The court also said that the taxpayer was entitled to have its opinion of value adopted because the AAB did not act within two years of application for two of the tax years in question. It did not reach the substantive issue. The second, <i>Mission Housing Development Co. v. CCSF</i> (2000) 81 Cal.App.4th 522, held that the plaintiff, Mission Housing Development Co., was limited in its recovery to the amount it stated in its claim for

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			<p>refund. Neither case supports Protax, LLC's position on the interpretation of section 402.9.</p> <ul style="list-style-type: none"> There is nothing in Assessors' Handbook Section 501 (AH 501) that contradicts staff's position in regard to the valuation of Section 515 properties. On the contrary, AH 501 states, in several places, that property must be valued subject to the legal restrictions upon it. In particular, see AH 501, page 47. Similarly, Assessors' Handbook Section 503 (AH 503), which addresses cash equivalence, supports staff's position. Specifically, on page 14, AH 503 states that the financing for Section 236 properties, which is parallel with that provided under the Section 515 program, is not subject to cash equivalent adjustment. The language in both AH 501 and AH 503 is Board-approved.
12.	Protax LLC	<p>[The current 'methodology' for assessing Section 515 projects as recommended by the staff of the State Board of Equalization:] “.... “(2) is illegal due to the fact that it violates and/or misinterprets] “.... “d. The 'ad valorem' principle to assess at fair market value"</p>	<p>Disagree.</p> <ul style="list-style-type: none"> "Market value" is defined in section 110 as "the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, <i>and of the enforceable restrictions upon those uses and purposes.</i>" [Emphasis added.] The contractual arrangement between the federal government and an owner of a Section 515 project constitutes a set of enforceable restrictions that would be recognized by knowledgeable buyers and sellers. The "restrictions" of the Section 515 program extend not only to property income but also to the rates of return (or costs) of both debt and equity. For as long as a property is subject to section 515 provisions, both its income and its financing (debt and equity) will be prescribed (its income at the basic rent, and its financing at debt and equity rates of 1% and 8%, respectively). This is the only income and financing that a knowledgeable, prospective owner of a section 515 property would expect.

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13.	Protax LLC	<p>[The current 'methodology' for assessing Section 515 projects as recommended by the staff of the State Board of Equalization:]</p> <p>“.... (2) is illegal due to the fact that it violates and/or misinterprets “.... “e. Good appraisal practice”</p>	<p>Disagree.</p> <p>Simply put, "good appraisal practice" requires that properties in the Section 515 program be valued under a method that recognizes all of the governmental restrictions with respect to use, income, and financing. Protax LLC's method, by contrast, recognizes some of those restrictions (e.g., limited income) but ignores others (e.g., the subsidized financing).</p>
14.	Protax LLC	<p>[The current 'methodology' for assessing Section 515 projects as recommended by the staff of the State Board of Equalization:]</p> <p>“.... “(3) Uses 'circular reasoning' to derive a value that equals the starting value (loan amount plus down payment) (COST)”</p>	<p>As discussed above, the income that is capitalized is that which can be expected for the remaining term of the contract between the federal government and the owner of the Section 515 project. It is true that, because of the long duration of such contracts, the value arrived at by the income approach may be approximately equal to that derived via the cost approach.</p>
15.	Protax LLC	<p>[The current 'methodology' for assessing Section 515 projects as recommended by the staff of the State Board of Equalization:]</p> <p>“.... “(4) Singles out section 515 and 236 subsidized housing for unfair property taxation ”</p>	<p>Disagree.</p> <p>Staff's method ensures that properties under the Section 515 and 236 programs are assessed at their market value in light of the legally enforceable restrictions imposed by the contractual arrangements between the owners and the government. To appraise these properties in the way that Protax LLC has suggested would be to unfairly treat them under a value standard different from that which is applied to other properties.</p>
16.	Protax LLC	<p>"Finally, numerous county assessors and SBE staff members have recently raised an issue regarding 'retroactivity' should the SBE reverse the staff 'opinion' and methodology regarding this issue. As there are hundreds of appeals currently being postponed pending the outcome of the SBE and/or Appellate Court decision this is a critical issue. LTA 98/51 was issued in October 1998 and was subsequently introduced during numerous 1997 and 1998 appeal hearings with an</p>	<p>To clarify, it has been Protax LLC, not county assessors and SBE staff, that has raised the issue of "retroactivity." Staff's response is that LTA 98/51 represents informal guidance, not law. Such guidance is not binding as to either its current or past application. Accordingly, there is no "retroactivity" issue with respect to LTA 98/51.</p>

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		<p>effective lien date of 1/1/97 and 1/1/98. In other words, LTA 98/51 was introduced, accepted and applied retroactively by numerous county assessment appeals boards in ruling against the Section 515 program. Therefore, the issue of 'retroactivity' should be addressed by any SBE action regarding this issue."</p>	
17.	Protax LLC	<p>"Therefore, the section 515 industry is formally requesting that the State Board of Equalization implement the following 'section 515 industry' proposal by adopting the following actions:</p> <ol style="list-style-type: none"> 1) Rescind all previous LTA's issued for Section 236 and Section 515 Housing issue by Staff of the SBE 2) Issue a formal SBE position <ol style="list-style-type: none"> a. Supporting a methodology that honors the intent of Section 402.9 by excluding the 'interest credit subsidy' from the final capitalized value. b. Instructing all assessors that any and all previous opinions put forth by the staff in the form of LTA's NEVER represented the formal position of the SBE and that they are therefore invalid and should not be considered under any circumstances including but not limited to any currently unresolved assessment appeal hearings." 	<p>Disagree.</p> <ul style="list-style-type: none"> • Historically, the Board has not "rescinded" LTA's, which are not binding as to their application. Rather, when the Board revises its guidance on a particular issue, it may issue a new LTA that states its revised position, noting that prior guidance on the issue is superseded. • The Board should not, as Protax LLC urges, instruct assessors that "any and all previous opinions put forth by the staff in the form of LTA's NEVER represented the formal position of the SBE and that they are therefore invalid." Such an erasure of the Board's past advice would undo 23 years of instruction by both current and prior Boards.