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February 14, 1992

Honorable Bradley L. Jacobs
Orange County Assessor
630 North Broadway
P.O. Box 149
Santa Ana, CA 92702

Attn:

Re: HUD 236 Properties

Dear Mr. Jacobs:

In your letter of January 6, 1992 you asked for our opinion on several questions involving the interrelationship between Property Tax Rules 4 and 8, Revenue and Taxation Code, sections 110 and 402.1 and Prudential Insurance Company of America v. City and County of San Francisco (1987) 191 Cal. App. 3d 1142 in relation to the assessment of a Section 236 housing project.

First, when no reliable market data is available, may Rule 4 be disregarded and Rule 8 applied? By its own terms Rule 4 is to be used "when reliable market data are available with respect to a given real property." Similarly Rule 8 "is the preferred approach for the appraisal of land when reliable sales data for comparable properties are not available." So given the condition of "no reliable market data", it is clear that Rule 8 would have preference over Rule 4.

This conclusion would be particularly applicable to Section 236 projects because only the same such projects can be used as examples of comparable sales.

In 59 Ops. Cal. Atty. Gen. 293 the California Attorney General has concluded that:

> The rental limitations and other limitations and other restrictions contained in the contract between the Federal Government and the owner of a 236 project are use restrictions within the meaning of Section 402.1 of the Revenue and Taxation Code.

And in Jones v. Los Angeles County (1981) 114 Cal. App. 3d 999 the court of appeal has held that comparable properties must be subject to the same limitation on use as the property to be

assessed. Under these restrictions it would appear that sales of comparable 236 projects would be severely limited.

Further, if Rule 8 is used, does a cash equivalency analysis and/or an adjustment have to be executed? Yes, but only within the context of the methodology of Rule 8, per se. Since Revenue and Taxation Code, Section 110(a) defines "fair market value" as the amount of cash or its "equivalent" that the sale of the property would bring, it is always necessary to convert non-cash items to their equivalents. This is accomplished in Rule 8(g)(1) and (2) by insuring that the capitalization rate is developed from current economic data that takes cash equivalents into consideration.

In reference to Rule 4 and the Prudential case, must a cash equivalent adjustment be done if the Comparable Sales Approach is not used? In Prudential the buyer purchased a hotel for $69 million cash and assumed a loan for $16 million for 12 1/2 years at 8 percent interest. The market interest for loans of this type was between 12 and 13 percent. When discounted to market the cash equivalent of the loan was $11.8 million. The assessor refused to adjust for the cash equivalent primarily because the loan was only 18.8 percent of the sale price whereas usually the loan greatly exceeds the amount paid in cash. In construing the application of the rule the court of appeal held, where a buyer assumes a loan from a seller at an interest rate different from the going market rate, Rule 4 requires that a cash-equivalent adjustment be made. So it is clear that the Prudential decision controls only those appraisals that are based on the application of Rule 4 when the seller doesn't receive the entire purchase price in cash.

May I use Rule 8 and still comply with Section 110 and its inherent cash equivalency directive? Yes, by carefully following the methodology specified in Rule 8(c) and (g) you will insure that the amount to be capitalized and the capitalization rate is in accord with the current economic market. This is where by analogy you correct for the Prudential problem where the loan rate was not at market.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,

James M. Williams

James M. Williams
Senior Tax Counsel

JMW:jd/4357H

cc: Mr. John W. Hagerty
Mr. Verne Walton