STATE BOARD OF EQUALIZATION
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February 27, 2013

Re: Assessment of Section 8 HUD Project-Based Properties
Assignment No. 12-172

Dear Mr. :

This is in response to your request for a legal opinion as to whether comparable sales and income and expense data derived from market transactions of unrestricted property may be used when valuing Department of Housing and Urban Development (HUD) Section 8 Project-Based Family properties (project-based properties). As explained below, it is our opinion that an assessor shall not consider data from non-HUD properties when valuing HUD project-based properties unless the assessor rebuts the presumption that the restrictions on the property will not be removed or substantially modified in the predictable future, or can demonstrate that that the restrictions on the project-based properties have a demonstrably minimal effect upon value.

Facts

You represent the owners of two project-based apartment buildings located in a lower income area of and a middle income area of .[1] The subject project-based properties are used for low-income housing. The rental assistance paid by HUD makes up the difference between what a low income household can afford and the approved rent for a housing unit in a multifamily project.[2] Your letter indicates that while the more widely used Section 8 rental subsidy vouchers belong to the *tenant*, HUD rental subsidies on project-based properties are tied to the *building*. Admission to the project is determined by HUD income eligibility standards, and rental rates and rental subsidies are determined by HUD. Tenant waiting lists for the project-based units often run several years due to the rental subsidies, driving vacancy rates to near zero.

[1] You have informed us that your clients have two assessment appeals currently pending with the County Assessment Appeals Board involving the valuation of two HUD project-based apartment buildings. We note that the County Assessor's Office (the "Assessor") has provided us with comments responding to the issues and views presented in your letter, and that we received your response to the Assessor's comments in a second letter dated January 3, 2013. A copy of your recent letter will be forwarded to the Assessor's office along with this legal opinion.

[2] Exhibit 1 to your letter titled "Renewal of Section 8 Project-Based Rental Assistance."

Although your letter did not state the term of the contracts between your clients and HUD, or whether your clients' contracts with HUD are recorded or unrecorded, the attachment to your letter indicates that contracts for Section 8 project-based housing assistance payments (HAP) are available for renewal on an annual basis through appropriations acts. We assume that the term of the contracts may be longer than one year, but that the HAP contracts are *funded* on an annual basis. Your letter further indicates that HUD plays no role in the financing of your clients' properties[3] and, as such, it is your belief that your clients' HUD project-based apartment properties are privately financed.

In your view, there are significant differences between HUD and non-HUD project-based properties: the location of a project-based property is rendered almost immaterial due to the rental subsidies; HUD must approve the buyer of a project-based property; escrow periods run six months or longer due to the HUD buyer-vetting process; buyers must use a HUD approved management company; HUD requires annual property inspections; and operating reports must be filed with HUD and are scored for performance. You assert that because the HUD project-based properties are highly regulated, the pool of HUD buyers is limited and therefore HUD project-based properties sell at a discount to non-HUD properties when comparing income multipliers and capitalization rates. Finally, you maintain that it would be difficult, if not impossible, for an appraiser to make adjustments to data derived from market properties sufficient to account for the vast differences between HUD and non-HUD project-based properties. In your view, in order to make an accurate assessment of a HUD project-based property, the assessor would need to rely *solely* upon data from other HUD properties.

The Assessor also believes that expenses for HUD project-based properties tend to be higher than expenses for non-HUD properties. In the Assessor's experience, HUD project-based properties often have shorter restriction periods and are not tied to government financing, whereas section 236 and section 515 HUD projects have much longer restriction periods and are tied to government financing. Additionally, the Assessor's research indicates that capitalization rates for HUD project-based properties tend to be lower (thus pushing assessed values higher) due to the exceptionally stable income streams and very low vacancy rates. The Assessor concludes that the shorter restriction periods of HUD project-based properties and the extremely stable income stream and low vacancy rates associated with HUD project-based properties typically result in a value for HUD project-based properties that is very near the value of market rate properties, thus justifying the use of market rate data in the assessment of HUD project-based properties as long as appropriate adjustments are made.

Law and Analysis

Revenue and Taxation Code[4] section 401 requires that every assessor shall "assess all property subject to general property taxation at its full value." The term "full value" is defined, in part, as the amount of cash or its equivalent a property would bring if exposed for sale in the

[3] We note that the term "government financing" is defined as financing or financial assistance from local, state or federal government used for the acquisition, rehabilitation, construction, development, or operation of a low-income housing property in the form of: (6) project-based federal funding under Section 8 of the Housing Act of 1937. (Cal. Code Regs., tit. 18, § 140, subd. (a)(2).) All future references to "Rules" are to sections of title 18 of the California Code of Regulations. It is our understanding that the subject project-based properties receive financial assistance from the federal government through the rental subsidies for the operation of its low-income housing property, and thus the subject properties are arguably tied to government financing.

[4] All further statutory references are to the California Revenue and Taxation Code, unless otherwise specified.

open market where the buyer and the seller have knowledge of all the uses for which the property is capable of being used, and the enforceable restrictions upon those uses. (Rev. & Tax. Code, § 110, subd. (a); Rule 2, subd. (a).)

Section 402.1, subdivision (a) provides, in part, that the assessor *shall* consider the effect upon value of any enforceable restrictions to which the uses of the land may be subjected, and that these restrictions shall include, but are not limited to, recorded contracts with governmental agencies. (Rev. & Tax. Code, § 402.1, subd. (a)(2).) Subdivision (b) of section 402.1 provides that there is a rebuttable presumption that restrictions will not be removed or substantially modified in the predictable future, while subdivision (c) provides that:

> Grounds for rebutting the presumption may include, but are not necessarily limited to, the past history of like use restrictions in the jurisdiction in question and the similarity of sales prices for restricted and unrestricted land. *The possible expiration of a restriction at a time certain shall not be conclusive evidence of the future removal or modification of the restriction unless there is no opportunity or likelihood of the continuation or renewal of the restriction, or unless a necessary party to the restriction has indicated an intent to permit its expiration at that time.* (Emphasis added.)

Additionally, section 402.1, subdivision (d) provides that "[i]n assessing land with respect to which the presumption is unrebutted, *the assessor shall not consider sales of otherwise comparable land not similarly restricted as to use* as indicative of value of land under restriction, *unless the restrictions have a demonstrably minimal effect upon value*." (Emphasis added.)

Furthermore, section 402.5 provides that:

> When valuing property by comparison with sales of other properties, *in order to be considered comparable, the sales* shall be sufficiently near in time to the valuation date, and the properties sold shall be located sufficiently near the property being valued, and *shall be sufficiently alike in respect to* character, size, situation, usability, zoning or other *legal restriction as to use* unless rebutted pursuant to Section 402.1, *to make it clear that the properties sold and the properties being valued are comparable in value* and that the cash equivalent price realized for the properties sold may fairly be considered as shedding light on the value of the property being valued. (Emphasis added.)

Section 402.5, which applies only to the comparative sales method of valuing property and which codifies the elements of comparability, provides that in order to consider a sale "comparable" to the property being assessed, the sold property must be, inter alia, sufficiently alike as to legal restriction. Thus, when the comparable sales method of valuation is used, the sold property must be subject to the same use restrictions as the subject property or the sold property would not be considered comparable and the use of that method is invalid. (*Jones v. County of Los Angeles* (1981) 114 Cal.App.3d 999; *Dressler v. County of Alpine* (1976), 64 Cal.App.3d 557.) According to the *Jones* and *Dressler* cases, although the standards of comparability are not an inflexible demand for full satisfaction of all the statutory comparability criteria, and are therefore not absolute, *the legislature meant section 402.5 to be obeyed*. (*Jones v. County of Los Angeles, supra,* at p.1006*; Dressler v. County of Alpine, supra,* at p. 569.) Therefore, when the comparable sales method of valuation is used, the "comparable" property

must be subject to the same use restrictions as the subject property or the use of that method is invalid. (*Jones v. County of Los Angeles*, *supra*, at p. 1006.)

While legal staff has never formally opined on the assessment of HUD project-based properties, we have opined on issues related to the assessment of section 236 and section 515 HUD low-income housing projects and the use of tax credits for financing low-income housing. (See Letters to Assessors (LTA) 1976/076; 1976/157; 1977/010; 1977/173/1979/037; 1986/095; 1998/051; 2002/041; 2005/044.)[5] Specifically, we have concluded that the rental limitations and other restrictions contained in the contracts for section 236 and section 515 HUD housing constitute enforceable restrictions for the purposes of section 402.1. (LTA 1998/051.)

In our opinion, the contractual limitations placed on HUD project-based properties are also enforceable restrictions for purposes of section 402.1 since the regulatory agreement imposes several significant restrictions upon the owner as to the property's use and operations: determining the amount of rent which may be charged to the tenants of the project (thereby restricting the maximum rent); determining the income criteria for qualifying tenants; requiring HUD approval of the buyer of a project-based property; and requiring HUD approved management companies and regular operating reports and property inspections.

As stated in an Attorney General's opinion discussing the reasons section 236 projects were deemed enforceable restrictions within the meaning of section 402.1, "[t]here is nothing in the overall context of section 402.1 nor in its legislative history which would suggest that the words 'any enforceable restrictions to which the use of land may be subjected' used therein should not be given their natural significance. This being so, it is clear that an enforceable rent limitation would constitute such a restriction upon what would otherwise be a permissible use to which the land may be subjected, to wit: the rental of the property at the maximum rates the open market would allow." (59 Ops.Cal.Atty.Gen. 293, 294 (1976).)

In considering the effect of HUD restrictions on the value of project-based properties, in our opinion, the statutory language of sections 402.1 and 402.5 is clear. As cited above, there are two situations in which an assessor may use non-restricted comparables to value a HUD project-based property: when the assessor can rebut the presumption in section 402.1, subdivision (b) that the restriction will not be removed in the predictable future, or by establishing that the restrictions have a demonstrably minimal effect upon value as provided in section 402.1, subdivision (d).

In rebutting the presumption that restricted properties should be treated as if the restrictions will remain, the legislature offers examples of grounds the assessor might use for rebutting the presumption, such as the past history of similar restrictions in the jurisdiction or the similarity of sales prices for restricted and unrestricted properties. We note, however, section 402.1, subdivision (c) prohibits treating the expiration of a restriction at a certain time as conclusive evidence that the restriction will be removed at that time. The only exceptions to this prohibition are very specific and very narrow – when there is *no* opportunity or likelihood that

[5] Related, but not directly on point because HUD section 236 low-income projects are discussed (and not Section 8 project-based properties), the California Attorney General has opined that even if the restrictions contained in the regulatory agreements entered into by the federal government and the section 236 project owners did not constitute enforceable use restrictions within the meaning of section 402.1, the assessor would nevertheless be required to consider the restrictions' effects upon the value of the project. (59 Ops.Cal.Atty.Gen. 293 (1976); LTA 1976/076.)

the restriction will continue or if a necessary party has indicated an intention to allow the restriction to expire. (Rev. & Tax. Code, § 402.1, subd. (c).)

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Susan Galbraith

Susan Galbraith
Tax Counsel

SG/yg
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cc: Honorable
County Assessor

Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70