STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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#76/157

September 24, 1976

TO COUNTY ASSESSORS:

VALUATION OF SECTION 236 HOUSING

Housing projects constructed pursuant to Section 236 of the National Housing Act are subject to an enforceable restriction that must be considered by appraisers when valuing the project for property tax purposes (see Attorney General Opinion No. CV 75/267, April 21, 1976). The appraiser's goal is to estimate the market value of the property subject to existing controls and regulations imposed by FHA.

The comparative sales approach will have little application in the appraisal because open-market sales of 236 housing projects are rare, and data from sales of unrestricted properties cannot be used (see Revenue and Taxation Code Section 402.5). However, the sales comparison approach will become more meaningful when open-market transactions of 236 projects take place.

The income approach should be considered the preferred approach. The gross income to be processed and converted to a value indicator should include both the basic rental received by the landlord and the interest subsidy payments made by the government to a lending institution on behalf of the landlord. Any rent paid by "high income" tenants in excess of the base rental established by FHA should not be included in the income stream; this excess rent, if any, is refunded to FHA to assist in making interest subsidy payments.

Since sales data from 236 projects are not available, capitalization rates should be developed by the band-of-investment method. The equity yield portion of the investment should not be confused with the six percent maximum return on annual cash flow allowed limited-dividend ownerships; equity yield resulting from cash flow and equity build-up may well exceed six percent. The debt interest portion of the rate should reflect the full mortgage interest rate required for the original loan. Capitalization rates derived from unrestricted properties are inapplicable. However, mortgage-equity overall rates developed from a refined band-of-investment technique are well suited for these properties.

However, there may be occasions when the replacement cost approach will be a reliable check against the capitalized earnings approach. FHA regulations do not restrict the use for which the improvements were designed: multiple-family residences. Also, the regulations may not restrict a project's economic earnings since the interest subsidy can offset economic rental loss. If the economic income is not substantially restricted, and the land value used in the cost approach reflects multiple-family residential use, then the cost approach can be used to gauge the accuracy of the income approach.

Sincerely,

Jack F. Eisenlauer

Jack F. Eisenlauer, Chief
Assessment Standards Division

JFE:gm