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November 2, 2015

Attention: Kelsie Jones, Executive Secretary
Comptroller of the Treasury – State Board of Equalization
312 Rosa L Parks Ave.
Ste. 900
Nashville, TN 37243-1402

Dear Ms. Jones:

National Housing & Rehabilitation Association's ("NH&RA") Tennessee Developers Council ("TDC") is pleased to provide Comptroller of the Treasury ("COT") with the following comments regarding Draft Rule 0600-10.

Introduction & Background

Affordable rental housing is sorely needed in the State of Tennessee. According to the American Community Survey more than 207,000 Tennessee Households pay more than half their income on rent. The Low-Income Housing Tax Credit (LIHTC) was created in Reagan Administration to provide an incentive to the private sector in exchange for making a long-term investment in affordable rental housing. The private sector assumes all the risk for financing and construction and is responsible for the long-term management and maintenance needs. In exchange for receiving the LIHTC (as well as 1602 Tax Credit Exchange Funds), developers in Tennessee make at least a **30 year commitment** to restrict monthly rents to affordable levels for low-income families.

Financing for LIHTC and 1602 properties generally includes some level of conventional debt financing combined with either equity generated by the availability of LIHTCs or soft debt generated by the 1602 program. Generally, due to the affordability restrictions imposed at LIHTC and 1602 properties, the amount of conventional debt financing supportable by property operations is limited, and much lower than the per unit debt carried by market rate properties or by properties with federal operating subsidies. Even with minimal debt, most LIHTC and 1602 properties do not generate significant cash flow due to their affordability restrictions, and owners have little to no ability to pass operating cost increases to their LIHTC tenants. An increase in property taxes on rental units that provide safe, decent and affordable housing to low-income Tennessee families, at a time of growing need for affordable rental housing, would deprive those families of a basic human need. Many of the same dynamics also apply to Section 515 properties as well and will be addressed later in this letter.

A fair and predictable property tax system is essential to the stability and availability of affordable rental housing in Tennessee. Real estate taxes often represent the single biggest annual operating expense at most affordable rental housing properties. In recent years, changes in interpretation of the appropriate methodology used by assessors in Tennessee to establish value have resulted in drastic increases in property taxes. Members of our organization have seen property taxes increase by as much as 280% in a given year!

We acknowledge that in its attempt to promulgate regulations to establish a uniform methodology for assessing affordable rental housing in Tennessee, COT is attempting to create a predictable taxation system. We understand that under its interpretation of case-law including the Appeal of Troy Place Apartments "Troy Place", (SBOE 11/12/93), Spring Hill, L.P. v. TN State Board of Equalization "Spring Hill" (TN Court of Appeals 12/31/03) and Appeal of Sevierville Senior Apartments et al. "Sevierville Senior Apartments" (SBOE 12/5/14, currently pending before Davidson Co. Chancery Court) COT believes that it must include some value of the LIHTC, 1602 and USDA RD interest credit subsidy in the overall assessment of affordable rental housing. We believe the decisions in this case-law are legally flawed, raise significant fair housing concerns and generally out of step with the values of Tennesseans. <u>We do not believe it is appropriate that the taxable value of a LIHTC, 1602 or USDA RD property should include a component representing the economic benefit of the subsidy to the property owner and are vigorously pursuing remedies to address these concerns</u>. Absent these remedies, we wish to make recommendations in the context of the parameters and legal interpretations COT has set-forth in its proposed rule and to provide guidance as to how they can be more appropriately promulgated.

Recommendations Pertaining to Section 0600-10-.03 Determining Value for LIHTC Property

It is important to note that all new LIHTC properties in Tennessee have income and rent restrictions that run for at least thirty years. These restrictions are recorded on the deed of the property in the form of a Low Income Use Restriction ("LURA") and carry forward even if the property is sold. This thirty year use restriction is comprised of a 15 year tax credit compliance period followed by a fifteen year extended use restriction. Given that the restrictions extend beyond just the years in which the tax credits flow to the investment partnership, we think it is more appropriate that 0600-10-.03 (3) (b.) be amended to reflect the full rental restriction period – not just the period comprising the full life of the credits. As such we recommend the following amendment of 0600-10-.03 (3) (b.):

> b. Have the assessor include in the assessor's annual appraisal, instead of the present value of all future tax credits, the average annual present value of the credit as calculated in (3)(A) above, based on the ~~full life of the credits~~ period of affordability as set out by the Low Income Use Restriction (LURA), and this average annual value shall be used in each year the ~~credit~~ LURA remains in effect.

It should be noted that there are three limited circumstances when a LURA can be released prior to the end of the thirty year extended use restriction. In the case of a tax credit resyndication and recapitalization, THDA releases the original LURA and simultaneously initiates *new* LURA with affordability restrictions extending and an additional thirty years.

Owners may also seek to initiate a Qualified Contract[1]. This highly regulated process allows an owner, at any time after the 14th year of the 15-year compliance period, to request the state housing agency to find a buyer who will operate the building as an LIHTC property. If the housing agency is unable to find a

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[1] Explanations of the qualified contract process can be found at: http://www.nixonpeabody.com/IRS_issues_final_qualified_contract_rules and http://www.huduser.gov/publications/pdf/what_happens_lihtc.pdf

qualified buyer within a year, the land use restrictions terminate. The owner is free to operate the building at market rate subject to a three year period that caps rents for exiting tenants at the LIHTC rents and prohibits eviction except for good cause. Historically, very few properties in Tennessee (or nationally) have initiated the Qualified Contract process, and within that limited sample the state agency is often able to find a qualified buyer committed to maintaining the affordability for the duration of the extended use agreement. In the very rare cases where the contract is exercised and no buyer can be found the affordability restrictions remain in effect for minimum of at least 18 years, and that assumes the qualified contract is exercised at the earliest possible juncture. It should also be noted that at that time property would be assessed like any other unsubsidized market-rate residential project.

Additionally a foreclosure could also potentially extinguish the LURA. However; in most cases the desired outcome for the lender is for the property to continue to operate as affordable (so that the lender can take advantage of the value of any remaining tax credits. The lender usually accomplishes this result by either reinstating the existing LURA following the foreclosure sale or encumbering the property with a new LURA.

Recommendations Pertaining to Section 0600-10-.04 Determining Value for Section 515 Rural Rental Housing Property

Section 515 rural rental housing loans are direct, competitive mortgage loans made to provide affordable multifamily rental housing for very low-, low-, and moderate-income families; the elderly; and persons with disabilities. Loans are for up to 30 years at an effective 1 percent interest rate and are amortized over 50 years. According to the USDA, as of April 2010, the average income of Section 515 tenants was $11,086 with 94 percent of them considered to have very low incomes. Incomes of tenants receiving rental assistance averaged $9,230. Sixty percent of all Section 515 tenants were elderly or disabled. Due to their rural locations, Section 515 Properties are typically on a smaller scale than other multifamily affordable rental properties and operate on much tighter margins. The impact of increase property taxes disproportionately and negatively impacts their financial viability. Affordability restrictions remain in place for the length of the loan and associated contracts. For these reasons and more, in most jurisdictions around the country Section 515 properties are assessed for property tax purposes using the income method of valuation. The methodology utilized in the draft rules to assess the value of the Section 515 subsidy is onerous and further does not align with generally accepted appraisal practices for valuing interest credit subsidies.

Since COT has determined that interest credit subsidy must be considered in valuing Section 515 properties we believe at a minimum it should align with industry best practices as laid out in USDA Guidance in Program Handbook HB-10-3560 Attachment 7-H (GUIDE FOR VALUATION OF INTEREST CREDIT SUBSIDY) [2]. We have highlighted key components of the guidance pertaining to valuing Section 515 properties *when* valuation of the interest credit subsidy is part of the assignment. The guidance notes that “When interest credit subsidy is the only favorable financing involved, the security value, on which the loan is based, has two components: 1) the market value, subject to restricted rents, of the real estate, and 2) the value of the interest credit subsidy. The present value (PV) of the interest credit subsidy can be calculated with a financial calculator using a simple discounted cash flow if three variables are known: payment (PMT), discount rate (i), and period (n).”

[2] For complete guidance see: http://www.rd.usda.gov/files/IA_hp_mfh_Valuations_of_Interest_7H.pdf

The guidance further provides that "PMT is the income stream that accrues to the borrower from the savings in mortgage payments resulting from the interest credit...The borrower's income stream is equal to the difference between the monthly mortgage payment that would have been required at the conventional rate of interest and the actual mortgage payment at the reduced rate…The discount rate (i) to be applied in the income stream is simply the alternative conventional mortgage interest rate….For an existing property, the remaining loan term, which should not exceed the estimated remaining economic life of the property, should be used for the period [(n)] of the loan."

"The value of the interest credit subsidy from RHS direct loans on most existing properties can be calculated by subtracting the monthly debt service at the below-market rate of interest from the monthly payment at the current rate offered for conventional loans and discounting the difference by the current conventional interest rate over the remaining loan term."

Recommendations Pertaining to Section 0600-10-.05 Determining Value for Section 1602 Affordable Housing

Like properties financed using the LIHTC, properties financed using the Section 1602 Tax Credit Exchange Program also have income and rent restrictions that run for at least thirty years. Just as with the LIHTC, these restrictions are also restrictions are recorded on the deed of the property in the form of LURA and carry forward even if the property is sold. If value is going to be attributed to this subsidy for the purposes of property tax assessments it should also be spread out over the full rental restriction period – not just the period in which the loan principal is forgiven. As such we recommend the following amendment of 0600-10-.05 (2):

> (2) The forgivable loan income attributed to the property shall be the total amount of loan principal forgiven ~~for the year at issue~~ divided by the period of affordability as set out by the Low Income Use Restriction (LURA), and this average annual value shall be used in each year the LURA remains in effect.

Conclusion

Once again, TDC deeply appreciates the opportunity to provide COT with this feedback. We would be very happy to discuss any specifics you might have regarding these comments or other subjects of concern. Please feel free to contact me directly with any questions at 202-939-1753 or tamdur@housingonline.com.

Best Regards,

Thom Amdur
Executive Director

About the Tennessee Developers Council

The Tennessee Developers Council is an independent council of the National Housing & Rehabilitation Association. Membership is comprised of LIHTC and affordable multifamily developers (both private and non-profit) and owners who are active in the state of Tennessee. The Council convenes on a regular basis to share ideas, network, and provide a clear voice on key policy issues being considered by THDA, the Legislature and other government agencies.

About National Housing & Rehabilitation Association

NH&RA is a national trade association comprised of professionals involved in the development, ownership, operation and finance of multifamily affordable housing. Formed in 1971, our members include developers, owners, property managers, debt and equity providers, attorneys, accountants, and other professionals involved in tax-advantaged real estate.