

## TAX CREDITS COUNT TOWARD PROPERTY'S VALUE

The Town of Manchester has succeeded in a tax appeal involving the question of whether federal low-income housing credits may be considered as taxable income by local listers or appraisers in setting the grand list value of an affordable housing property. In *In re: Appeal of Manchester Knoll Housing Limited Partnership*, Judge Karen Carroll of the Bennington Superior Court stated that federal “tax credits are intangible property which the Vermont Supreme Court has recognized must be included in an appraisal of low-income housing projects.” *In re: Appeal of Manchester Knoll Housing Limited Partnership*, Docket No. 52-2-02Bncv (March 31, 2004).

There are at least three accepted methods of property valuation, including the “income approach,” the “cost approach,” and the “direct sale comparison approach.” The primary question in this proceeding is whether it is appropriate to consider tax credits as income when calculating the value of a property using the income approach. Under this theory of property appraisal, an appraiser of real property is trying to establish the fair market value of the property by translating the “future benefits of property ownership into an expression of present worth.” *Beach Properties, Inc. v. Town of Ferrisburg*, 161 Vt. 368, 372 (1994) (internal cite omitted). This approach to valuation is particularly useful in the appraisal of commercial properties, as its goal is to quantify property value on the basis of what income it will yield to the property owner in the future (the keystone principle being that income is the primary reason for owning a commercial property).

The property at issue in *Manchester Knoll* is an affordable housing development of four buildings, each containing five apartments. Pursuant to the federal Internal Revenue Service (IRS) code, affordable housing projects are entitled to federal low-income housing tax credits, which affordable housing investors may claim on their federal income tax returns. 26 U.S.C. § 42. The entity that owns the project, Manchester Knoll Housing Limited Partnership (“Partnership”), is a non-taxable entity (because of its status as a partnership). Because of this exemption from income taxation, the Partnership cannot use the federal low-income tax credits that other, taxable organizations could. Therefore, the Partnership marketed interests in the partnership to investors who would, in turn, be able to use the tax credits themselves. These tax credits were, in fact, the primary financial benefit to investing in the project. In its “Offering Summary,” the Partnership estimated that the value of the tax credits to an institutional investor would be worth \$1,379,849 over a ten-year period. (Income generated by banks is taxed at the rate of 40%; banks also have community investment obligations pursuant to the federal Community Reinvestment Act of 1977, 12 U.S.C. §§ 2901 *et seq.*, additionally, institutional investors are the primary investors in affordable housing developments.)

In appraising the Manchester Knoll property, the Town of Manchester considered the value of the federal low-income tax credits as income. The Partnership appealed this valuation to the Bennington Superior Court, where it argued that tax credits are not “real estate” and, therefore, should not be considered as income when calculating the fair market value of the property. The question for the Superior Court was whether this issue had ever been addressed by the Vermont Supreme Court. While the Court has never directly answered the question about whether federal low-income housing tax credits should be considered as income, it has decided on a closely related matter. In *Brattleboro Housing Limited Partnership v. Town of Brattleboro*, No. 97-402 (Vt. Sept. 3, 1998), the Court decided that depreciation and debt service calculations should be included in

determining a property's fair market value under the income approach. The Court stated, "it is uncontested that the subject property has *tangible* value from the real estate and *intangible* value from the tax credits *and that both should be considered for appraisal purposes.*" *Id* at 2. Therefore, intangible characteristics of income accrual should be included in a proper income capitalization approach valuation.

Courts in many states have determined that federal low-income housing tax credits are income and should be considered as such in property appraisals based on the income approach. Based on this Court's analysis, there is at least one state which has held to the contrary. However, Judge Carroll decided that, based on the Vermont Supreme Court's decision in *Brattleboro Housing Limited Partnership*, federal low-income housing tax credits should be considered as income for real property appraisals.

This issue will no doubt apply to a number of Vermont municipalities which have low-income housing, and where listers and appraisers are struggling with the issue of whether to include the tax credits as income when using the income method of property appraisal. It is important to realize that, while the Vermont Supreme Court has indicated, at least conceptually, its support of including the value of tax credits in the property appraisal, it has not laid down a direct ruling on this issue. Additionally, the Vermont Legislature is currently addressing this issue and whether the law should be changed to favor affordable housing developments even more through a property tax exemption for federal low-income housing tax credits.

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