NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: SB 207 (First Edition)

SHORT TITLE: Low-Income Housing Property Tax

SPONSOR(S): Sen. Clodfelter

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

($ Millions)

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
General Fund			*** No General Fund Impact ***		
Local Governments	**0**		**1.19 – 3.72 annually**		

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Department of Revenue, Property Tax Division and Local Governments.

EFFECTIVE DATE: The bill becomes effective for taxes imposed for taxable years beginning on or after July 1, 2002.

BILL SUMMARY: The bill amends the statutes related to property tax appraisal. Specifically, the bill requires that rent and income restrictions on property be considered when assessing rental housing if all of the following criteria are met: 1) the property is subject to restrictions on the income of tenants to whom it is leased or rented, 2) the tenants leasing the property meet those eligibility requirements, and 3) the rents charged meet any applicable rent restrictions. In addition, the bill authorizes the assessor to change an appraisal value in a year without a general reappraisal or horizontal adjustment to values if there is a change that causes a particular property to meet the above requirements.

BACKGROUND: The bill is designed primarily to address the taxation of low-income housing developed with a special federal tax credit. This credit is outlined in Section 42 of the Internal Revenue Code. Under this federal program, property owners receive a significant federal tax credit to develop housing, offer that housing to low-income individuals, and provide those units at below market rent.

Under current law county assessors can value this type of property on the basis of the property's income (income approach), other comparable properties in the area (comparable sales approach), or the cost approach. Many assessors use a combination of two or more of these methods to value rental property. According to the Department of Revenue, assessors have been advised that when using the income approach to value this type of rental housing, they should include the value of the federal tax credits in the "income" of the property.

In 1997 this issue was taken before the North Carolina Property Tax Commission, acting in their capacity as the State Board of Equalization and Review. In this case of the Greens of Pine Glen Ltd. Partnership (the Greens) v. Durham County, the discussion centered around a 168 unit structure in the southern part of Durham County. The owners of this property offered these units for rent to low-income individuals at the reduced rates outlined in Section 42 of the Internal Revenue Code. These limitations on tenants and rents were offered in exchange for a federal tax credit. Durham County initially assessed the property using the income approach and actual rents. Once the County discovered that these incomes had been "contractually restricted" by the owner's participation in the Section 42 program, the cost approach was applied. Using the cost approach significantly increased the assessed value. The taxpayer argued that only the income approach should be used to value these properties, and that the income should consider only the actual, restricted rents paid by the tenants. The taxpayer also argued that these tax credit are intangible property and are therefore exempt from tax.

The Commission ruled "the rents that the Taxpayer is entitled to receive represent only a part of the bundle of rights in the subject property" and that "In North Carolina, a property tax appraisal applies to the whole bundle of rights" (p. 10). They also note that G.S. 105-276 "clearly permits the appraisal of the full bundle of rights in the subject property, even where some of the property's value lies in the tax credits" (p. 11). The Commission sited four count cases (In re Southern Railway Company, In re Greensboro Office Partnerships, In re Pine Raleigh, and In re Valuation of Property Located at 411-417 West Fourth Street) that required the assessor to use market rents, and not contract rents, to determine value. In short, the Commission sided with the county against the taxpayer.

The case has been forwarded to the Court of Appeals, but has yet to be assigned to a particular judge. The Department reports that they are holding approximately 25 similar appeals pending the outcome of the Greens case.

ASSUMPTIONS AND METHODOLOGY: Because this bill addresses only local property taxes there is no general fund impact.

The North Carolina Housing Finance Agency reports that between 1992 and 2000 16,017 units of low-income housing were created in 536 projects funded, in part, with Section 42 tax credits. The total value of these projects is estimated by the Housing Finance Agency as $923,646,403.

Two methods are used to determine the fiscal impact of the bill. Both methods assume that the bill will result in a reduced property tax assessment equal to the value of the federal credits.

The first estimate is based on what the North Carolina Housing Finance Agency (NCHFA) estimates to be the annual value of the credits. According to date provided by the NCHFA, annual tax credits for projects developed between 1992 and 2000 total to $80,886,713, or

$8,088,671 per year. Since the tax credits extend for 10 years, the actual annual value of all credits is $101,108,392. Applying the statewide weighted average for municipal property suggest that local governments will loose approximately $1.19 million in taxes per year. This creates the lower end estimate.

The second estimate is based on testimony given at the Tax Policy Commission hearing. During that hearing the taxpayer testified that the credits represent approximately 25%-30% of the value of the property. As was noted earlier, property developed between 1992 and 2000 is valued at $923,646,403. This number is then adjusted to $1,154,558,004 to account for ten years of investment. Using the mid-point of 27.5% suggests that the values of the credits are equal to approximately $317,503,451. Since almost all the property in question is in a municipality, the weighted average tax rate for municipal property of $1.173 is used. Applying this rate to the above credit value suggests that approximately $3.72 million ($317.5 * 1.173 per $100) in property tax dollars will be lost annually by local governments as a result of the bill. This creates the upper end of the estimate range.

Of course all estimates assume the federal government continues the Section 42 program in its current form.

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