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Kentucky Board of Tax Appeals Holds Recorded Restrictive Covenants and Actual Expenses Must Be Considered in Determining Fair Cash Value of Low-Income Housing

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In *Beattyville School Apartments v. Lee County Property Valuation Administrator*, KBTA, File No. K11-S-879, (Oct. 11, 2012), the Kentucky Board of Tax Appeals' ("KBTA") Hearing Officer issued Findings of Fact, Conclusions of Law and Recommended Order regarding the Beattyville School Apartments (the "BSA"), a former school building refurbished and modified into low-income apartments, in accordance with Section 42 of the Internal Revenue Code. The Hearing Officer held that the Property Valuation Administrator ("PVA") properly considered the BSA's rent restrictions in determining the fair cash value of the property, as required under Kentucky law, but failed to consider the project's actual expenses and failed to present any evidence that the actual expenses as demonstrated by the BSA were inappropriate for low income housing. Accordingly, the Hearing Officer recommended that the property tax assessment imposed by PVA in the amount of \$662,700 for tax year 2011 should be reduced to \$150,000.

The Hearing Officer first indicated that the question whether the property was exempt from tax was not before the Board. He also indicated that the question of whether issued tax credits added any value to the property was not before the Board because the PVA did not include the value of the tax credits in the assessment. The Hearing Officer noted that the parties stipulated that the income approach to valuation should be used to value the property and that a 10% capitalization rate should be used. The parties also stipulated to several documents, including a Declaration of Land Use Restrictive Covenants for Low Income Housing Tax Credits and Subordination Agreement, which set forth the rental restrictions for the property. The Hearing Officer indicated that the parties had stipulated that "the property has a land use restrictive covenant for low-income housing credits, with the covenants to run with the land for a period of thirty years. The residents of the property are restricted to incomes not to exceed 50% of median income" [in the county].

The Hearing Officer then cited to *Revenue Cabinet v. Gillig*, 957 S.W.2d 206 (Ky. 1997), and held that "in valuing any type of property, while the assessor need not consider each and every characteristic of the property, he must consider the factors that most affect the value of that property in order to reach a logical estimate of the property's value." He went on to hold that "in valuing rent-restricted housing, there must be consideration given to those characteristics that make it different from non-restricted rental housing." He noted that "the PVA agreed to

recognize, at least some of these differing characteristics for rent-restricted housing, when she agreed to use the restricted rents for the property in her income approach.”

However, the Hearing Officer held that the PVA erred by failing to consider the actual audited expenses for the BSA, which had been reviewed and approved by Housing and Urban Development and the Kentucky Housing Corporation, and using a much lower expense figure instead. He determined that the PVA’s use of the lower expense figure was inappropriate in the valuation of low-income rent-restricted property. He reasoned that “low-income rent-restricted properties are creatures of state and federal regulation and they generate expenses that non-regulated properties do not generate.” The Hearing Officer held that the BSA had met the burden of establishing that the assessment was incorrect and had “shown that the PVA improperly failed to consider its audited actual expenses for the project and the PVA failed to produce any evidence that those actual expenses were inappropriate for a restricted rent project of this type.”

The Hearing Officer concluded that “a willing buyer knowing there is a restriction as to the amount of rent that can be charged would pay less for a low income housing project than for a regular commercial apartment complex. While the PVA properly considered the rent restrictions in the application of her income approach, she failed to consider the project’s actual expenses and presented no evidence that those expenses were inappropriate for this type of project.” He therefore recommended to the Board that the value of the property for the 2011 tax year be set at \$150,000.

The Recommended Order provided that both parties had 15 days from the date of mailing of the Order to file exceptions to the recommendations, and failure to file exceptions would preclude appellate review. The PVA failed to file timely exceptions to the Order, and the Hearing Officer’s Recommended Order was approved by the full Board. The decision is therefore final. The author’s law firm represented BSA in this case on a *pro bono* basis.

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