NEBRASKA ADMINISTRATIVE CODE

Title 350 - Nebraska Department of Property Assessment and Taxation

Chapter 51 – Assessment Process for Affordable Housing Projects Regulations

Effective Date

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REGULATION 51-001 PURPOSE

001.01 The purpose of this regulation is to provide a guide to appraisers and assessors in Nebraska in the appraisal of multi-family and/or single family housing for which some, or all, of the units are subject to income and/or rent restrictions imposed by federal/state/local programs (affordable housing), including those that are subject to the restrictions imposed by the federal Internal Revenue Code (IRC) Section 42 Low Income Housing Tax Credits (hereinafter referred to as LIHTC) and IRC Section 142 relating to tax-exempt financing for qualified rental housing projects. The discussion will include issues regarding the three accepted methods for mass appraisal in varying detail. The intended users are the Property Tax Administrator and the ~~appraisers and assessors of the~~ Department of Property Assessment and Taxation, and County Assessors and their appraisers.

001.02 The ~~property rights that are to be appraised are the fee simple interests in multi-family housing property. These rights include the real estate and all rights and privileges associated with the ownership therein. The~~ value to be determined in the appraisal of the multi-family and/or single family housing is the actual or market value of the property as set forth in Neb. Rev. Stat. section 77-112 R.R.S. ~~2003.~~ 2003, recognizing that the actual or market value is influenced by the income and/or rent restrictions (or other restrictions) imposed by the federal/state/local programs (affordable housing).

(Neb. Rev. Stat. Sections 77-112, and 77-1301.01 R.R.S. 2003, and Neb. Rev. Stat. section 77-1330, R.S. Supp., ~~2004~~ 2006.)

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REGULATION 51-002 DEFINITIONS

002.01 For this regulation the following definitions apply:

002.01A IRC Section 42 Low Income Housing Tax Credit (LIHTC) program, created by the Tax Reform Act of 1986, is a program created to encourage investment of private capital in the development of rental housing for low-income tenants by providing a credit to offset an investor's federal income tax liability. The amount of the credit is directly related to the amount of qualified development costs incurred and the number of low-income units developed that meet the applicable federal requirements for both tenant income and rents.

002.01A(1) The allocation of tax credits in Nebraska is administered through the Nebraska Investment Finance Authority.

002.01A(2) The income tax credit is available only to the owner of real property developed in compliance with provisions of this Section 42 of Internal Revenue Code.

002.01A(3) Typically the developer must irrevocably elect to designate twenty percent (20%) or more of the housing units available to rent to occupants with incomes at fifty percent (50%) or less of the area median income (20/50 test), or;

002.01A(4) To designate forty percent (40%) or more of the housing units available to rent to occupants with incomes at sixty percent (60%) or less of the area median income (40/60 test).

002.01A(5) It is common in Nebraska for all available units in an affordable housing project to be designated for the targeted income levels.

002.01A(6) Rent for a unit is restricted to a maximum of 30 percent (30%) of the applicable income limit or targeted rent level (less an allowance for utilities).

002.01A(7) The rent restriction and use requirements ~~must~~ shall be maintained for fifteen years; failure to do so will result in a recapture of a portion of the tax credit claimed. The restriction must remain in place at least 15 more years (a total of thirty years).

002.01B Section 515 of the Rural Rental Housing Program is administered by the United States Department of Agriculture.

002.01C Community Empowerment Resource Funds (CERF).

002.01D Tax Exempt Bond financing Program for Multi-Family Projects under Sections 103 and 142(d) of the Internal Revenue Code providing for tax exemption of interest on bonds issued to finance the construction or acquisition and rehabilitation of multifamily rental housing for low to moderate-income persons.

002.01D(1) The Nebraska Investment Finance Authority is the agency entrusted with compliance monitoring in the state of Nebraska.

002.01E Contract (actual) rent is the rent received.

002.01F Economic rent or market rent is the rent received for the use of property and is subject to the economic principle of supply and demand based on the size, condition, and desirability of the property. Market rent is typically used in the income approach to valuation of property as an indicator of 'future' benefits to ownership of real property.

002.01G Fair Market Rent (FMR) is the maximum rent allowed to be collected on housing units subject to federal subsidy payments. They are published annually by the Department of Housing and Urban Development (HUD). These rents are based on the median incomes by county or standard metropolitan statistical reporting area. Household income is based on a family of four and the rents represent the maximum allowed for a three-bedroom unit. Adjustments are made for variations from the base family size or bedrooms in a unit and are set for studio apartments through five bedrooms. Generally, Nebraska has FMRs calculated for the Lincoln area, the Omaha area, the South Sioux City area, and for each of the remaining counties.

002.01H Maximum Restricted Rent is the maximum rent allowed to be collected on housing units subject to the applicable restrictions. These rents are generally based on income limits determined by reference to the median incomes published annually by the Department of Housing and Urban Development (HUD) for the county or standard metropolitan statistical reporting area. The median incomes are based on a family of four. The Maximum Restricted Rent for an individual project must be calculated with reference to the specific income limits or targeted rent levels established for the project. For projects from 1990 or later, the standard formula for determining the rent limit is based on the 1.5 person income limit, divided by 12 and then multiplied by 30%. This Maximum Restricted Rent includes all utilities that can be charged for the project. The 1.5 person income limit refers to the number of persons in the unit. Under the applicable programs, the calculations are based on a determination of 1.5 persons per bedroom unit.

(Neb. Rev. Stat. Section 77-1330, R.S. Supp., ~~2004~~ 2006.)

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REGULATION 51-003 PRELIMINARY SURVEY AND PLANNING

003.01 In planning for the appraisal of these properties, it is essential that the assessor/appraiser seek the information necessary to do the appraisal assignment in a competent manner. As competency is always an issue in the appraisal process, the assessor/appraiser should seek out the information and assistance that ~~they feel~~ is necessary ~~in order~~ to arrive at a fair, impartial, and equitable estimate of value for taxable real property throughout ~~their~~ the county. ~~Some assessors might choose to hire the~~ The services of ~~hired~~ competent contract appraisers may be used to complete the appraisal assignment ~~initially~~, but ~~at some point~~ the assessor ~~will become~~ is responsible for the valuation determined and for maintaining the value into future years~~, so it would serve them~~ well to If the services of a ~~hired~~ contract appraiser ~~is~~ are used, the assessor should work closely with the appraiser to understand the assumptions and conclusions made in arriving at the opinion of value.

003.01A Summaries of property types in the various counties indicate that multi-family residential property exists in most counties representing various proportions of the tax base or number of taxable parcels. Depending on the number and size of the properties located in the county, planning for the collection of data should be undertaken to assure the economic use of the resources available to the county assessor's office. The assessor may wish to review existing information to determine the extent or necessity of collecting the specific and comparative data either as an on-site inspection, a written survey or questionnaire, or a telephone interview to be completed with the property owner or site manager for the property.

(Neb. Rev. Stat. Section 77-1301.01, ~~and 77-1311~~ R.R.S. 2003, ~~and~~ and Neb. Rev. Stat. Sections 77-1311 and 77-1330, R.S. Supp., 2006. ~~2004., and Neb. Rev. Stat. section 77-1311, R.S. Supp., 2005.~~)

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REGULATION 51-004 DATA COLLECTION AND ANALYSIS

004.01 General data regarding multi-family and/or single family residential property should include those factors within the county, community, or neighborhood that affect value such as neighborhood characteristics, trends in the supply and demand for this type of property, and a general opinion of whether these factors and trends will be increasing, remaining static, or declining in consideration of the national, regional, and local economies.

004.02 Specific data needed for the appraisal ~~would include~~ includes information regarding the size, shape, topography, and legal zoning of the site. Off-site improvements that contribute to the value and desirability of the site such as paving, sidewalks, public transit, and availability of public utilities such as electrical power, public water and sewer systems, and natural gas. The availability of these elements in relationship to the zoning and size of the site are instrumental in determining the highest and best use of the site and whether the site as improved is appropriate to the highest and best use determined.

004.03 The comparative data necessary to the appraisal include the size of structure including common areas, number of rental units in the structure, the rentable portion of the structure expressed either as an overall square footage or some other unit of comparison such as number of rooms or number of bedrooms per unit. ~~These will become~~ This data is important ~~in~~ for the cost approach, the income approach, and the sales comparison approaches to value. The more ~~information~~ data collected and analyzed the more comfortable the appraiser should be in applying the information in estimating the value of the property.

004.04 The LIHTC provides a dollar-for-dollar reduction in the federal tax liability for the construction of affordable housing that meets program requirements. Most often, the owner of the affordable housing transfers the credits to limited partner investors in the ownership entity. The owner of the affordable housing then uses this equity contribution to assist in the financing of the affordable housing. Depending on the specifics of the property, housing credits can generate 50 to 60 percent or more of the cost of development. These projects boost the local economy by creating jobs; making housing affordable to the targeted residents who pay a percentage of their household income as rent; and creating an incentive for investors to invest in affordable housing. The LIHTC is a tax credit, not a direct appropriation. The effectiveness of the program may be threatened if administrative policy changes the tax status of corporate dividends. Project participation is based on reserving at least 20 percent of the units for tenants with incomes at 60 percent or less of the area median income; however, it is not uncommon for projects in Nebraska to reserve 100 percent of the units for low and very-low income tenants. The amount of the credits for a specific project may be affected when financing is supplemented by other affordable housing programs particularly those with special mortgage rate considerations. Section 8 housing (voucher) programs do not effect the tax credits as long as the tenant is not charged more than the contract rent based on percentage of household income. In some instances this may result in a unit's gross rent above the fair market rent (FMR) targeted by HUD.

004.05 The IRC Section 142 provisions provide that interest on obligations issued by states and local governments will be exempt from federal income taxation if the proceeds of those obligations are used to finance qualified rental housing. Such housing, while not subject to rent restrictions, is similarly subject to the tenant income restrictions imposed upon LIHTC affordable housing developments.

004.06 When collecting data, three "rents" ~~should~~ may be collected and analyzed, as follows;

004.06A ~~First, the~~ The economic rent ~~should~~ may be determined for the county, community, or neighborhood and should be expressed in terms of units of comparison, such as rent per unit, rent per square foot, or rent per bedroom. This ~~should~~ may accommodate the estimation of the economic rent for the subject properties in the income approach to valuation~~.;~~ and,

004.06B ~~Second, the~~ The Maximum Restricted Rent for the project ~~should~~ may be analyzed. The Maximum Restricted Rent is calculated based on the applicable income limits or targeted rent levels for the project and must be calculated in accordance with the rules issued by NIFA. Since this calculation is based on income limits or targeted rent levels and not the market's supply and demand for this type of housing, the Maximum Restricted Rent may or may not reflect the economic rent for the area~~.;~~ and;

004.06C ~~Third, the~~ The actual or contract rent collected ~~should~~ may be analyzed and compared to the other two rents. This rent is not calculated based on a percentage of a tenant's actual income and the actual rent collected may or may not equal the Maximum Restricted Rent for the project. The actual or contract rent will never exceed the Maximum Restricted Rent.

004.07 Occupancy (vacancy) rates for multi-family ~~residential~~ developments in the area ~~should~~ may be noted as this will affect the estimate of potential gross income attributable to the property being appraised. Likewise the allowable expense information ~~should~~ may be collected so that an appropriate estimate of allowable expenses may be made in estimating the net income attributable to the property in the income approach. A comparison and contrast of the occupancy rates and allowable expenses ~~should~~ may be made to determine if the affordable housing properties reflect trends atypical in the area. If there are substantial differences in the occupancy rates this will affect the estimate of potential gross income if there are both market-rent units and LIHTC units. One situation to be aware of is the restriction on renting the market units before the LIHTC units have been occupied.

004.08 The county assessor shall perform an income-approach calculation for all rent-restricted housing projects constructed to allow an allocation of low-income housing tax credits under section 42 of the Internal Revenue Code and approved by the Nebraska Investment Finance Authority when considering the assessed valuation to place on the property for each assessment year. The income-approach calculation shall be consistent with any rules and regulations adopted and promulgated by the Property Tax Administrator and shall comply with professionally accepted mass appraisal techniques. Any low-income housing tax credits authorized under section 42 of the Internal Revenue Code that were granted to owners of the project shall not be considered income for purposes of the calculation but may be considered in determining the capitalization rate to be used when capitalizing the income stream. The county assessor, in determining the actual value of any specific property, may consider other methods of determining value that are consistent with professionally accepted mass appraisal methods described in Neb. Rev. Stat. Neb. Rev. Stat. 77-112.

004.08A The owner of a rent-restricted housing project shall file a statement with the county assessor on or before October 1 of each year that details:

004.08A(1) Income and expense data for the prior year;

004.08A(2) A description of any land-use restrictions; and,

004.08A(3) Such other information as the county assessor may require.

(Neb. Rev. Stat. Sections 77-112~~,~~ and 77-1301.01, ~~and 77-1311~~ R.R.S. 2003, ~~and~~ and Neb. Rev. Stat. Sections ~~section~~ 77-1311, 77-1330~~,~~ and 77-1333, R.S. Supp., 2006. ~~2004, and Neb. Rev. Stat. section 77-1311, R.S. Supp., 2005.~~)

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REGULATION 51-005 APPLICATION OF THE DATA

005.01 When determining actual value, all factors, including uses and restrictions applicable to real property, that can, within reason, affect the price in negotiations between a willing buyer and a willing seller must be taken into account.

005.02 Cost approach

005.02A The Property Tax Administrator has prescribed the use of the Marshall Valuation Service including associated handbooks as published and updated by the Marshall and Swift Publishing Company in estimating replacement cost new in the cost approach to valuation. It is imperative to the assessment assignment that the assessor/appraiser understands the proper application of these manuals and makes every effort to implement the costing service in such a way as to accurately estimate the replacement cost of the structure(s) subject to the appraisal assignment. When possible, the assessor/appraiser should compare the manual cost estimates against known actual costs either from surveying the builders of similar buildings, or as reflected in the sales of recently constructed improvements, or as reflected in the legal building permits or information statements filed with the city or county. The specific data from each structure should be matched against the manual descriptions of the various styles and construction classes as they compare to the quality and quantity of materials so that the properties are consistently classified. The classification may be used to make the comparisons and adjustments necessary to all three approaches to value.

005.02B An appropriate amount of depreciation should be allowed against the estimate of replacement cost to reflect the physical condition of the structures as observed. The Marshall Valuation Service provides an age-life table in the depreciation section in order to assign an estimate of the physical wear and tear based on the construction class and quality of construction. Additionally the depreciation should reflect obsolescence due to functional disutility inherent in the property.

005.02C The cost approach may not, in every case, provide an accurate value of the affordable housing development. This is due, in part, to the state and federally imposed encumbrances on the affordable housing development such as qualifications on tenants, rents, and transfer of the property. This element of obsolescence which is more difficult to ascertain is the economic or locational obsolescence; that is, the negative effect on value that is inherent in the area not directly related to the physical condition or design of the improvements. The appraiser should be aware of the proper methodology to document the depreciation used in applying age/life tables, measuring functional obsolescence, and in determining the economic obsolescence which is generally reflected in the relationship of income levels associated with the property. The estimate of functional and economic obsolescence should be consistent with and supported by the assumptions and adjustments to the income approach to valuation. The appraiser must determine if there is economic obsolescence which relates to all multi-family and/or single family housing in the area and if there is a different economic obsolescence applicable to the affordable housing projects. Analysis should consider whether the economic obsolescence is a result of local supply and demand or whether it is related to the restrictions imposed by the land use restriction agreements which impose additional conditions on affordable housing developments. This estimate should be correlated and supported by the assumptions and indicated value resulting from a proper application of the income approach to valuation.

005.02C(1) The location of the affordable housing project, coupled with the restrictions on tenant incomes forces (or mandates) owner rents and may cause a greater disparity between affordable housing development's construction cost and its actual or market value. The fact that the development's cost may exceed market value is inherent in certain programs, particularly the LIHTC program. The actual use of affordable housing developments as rent and/or income restricted housing must be taken into consideration. These restrictions constitute a form of economic obsolescence. There are land use restriction agreements on the use of the property that may, in some cases, run for up to 50 years. The appraiser should consider whether the value of the property would be affected if it were sold on the open market.

005.03 Sales comparison approach

005.03A Recent sales of properties comparable to the subject property should be collected and analyzed. Generally, the sales comparison approach is the preferred approach to valuing properties when the value to be determined is actual value or market value as is the case for ad valorem tax purposes in Nebraska. This approach may best be used in the instance where residences are single-family, free-standing structures;

however, in the case of affordable housing developments involving large multi-family complexes and/or single family housing subject to the restrictions of the affordable housing program, the sales comparison approach may not be practical. The burdens on such developments and the restrictions imposed upon the sale of affordable housing properties result in few, if any, examples of comparison sales.

005.04 Income approach

005.04A The income approach (absent sufficient comparable sales) may be the best approach to assess the impact of the restrictions on affordable housing developments, thereby most closely resulting in the determination of actual value for the affordable housing development. The appropriate income approach for use in the appraisal of affordable housing developments is to determine the potential gross income attributable to the property using ~~economic or typical rent~~ the lesser of market rent or the Maximum Restricted Rent for the type of property in the county, community, or neighborhood. Allowances for vacancies and collections relative to the type of property being appraised are deducted from the estimate of potential gross income. Typically, allowable expenses are deducted from the estimate of potential gross income to give an indication of the net operating income attributable to ownership of the property. Expenses peculiar to affordable housing should not be over-looked. In many cases, owners of such housing are required to keep detailed records in order to meet state and federal compliance reporting requirements. To the net income from the rental of the property is added net income from other operations. Typically the “other net income” includes income from laundry, vending machines, and rental of garages. This net operating income is capitalized or divided by a rate which reflects the returns to ownership of the type of property common to the area.

005.04B When valuing affordable housing, the direct capitalization method of the income approach is used. Using this approach, the estimated net operating income (NOI) of the affordable housing is divided by an overall capitalization rate to derive an indication of the value of the affordable residential rental property for the assessment year.

005.04C NOI is based on the productive and earning capacity of the affordable housing property utilizing

005.04C(1) Potential gross income reflecting rental income (using the lesser of market rent or Maximum Restricted Rent),

005.04C(2) A normal vacancy/collection allowance,

005.04C(3) Projected annual operating expenses associated with the affordable residential rental property, excluding non-cash items such as depreciation and amortization, but including ~~property taxes and~~ those actual costs expected to be incurred and paid as required by federal, state or local regulations, provision, and restrictions as applicable to the assessment year, and

005.04C(4) An appropriate provision for replacement reserves.

005.04C(4)a If no separate line item is included for reserves for replacement in the historic income and expense data, then the maintenance and repair categories of the historic expense data should be itemized.

005.04D For properties that have attained a normalized operating history, the NOI results of the prior three years (as represented in the statement variously named as the Income and Loss Statement, the Profit and Loss Statement, the Income Statement, the Actual to Budget Comparison Statement, Balance Sheet, or some name variation of these) may be used to support the estimated NOI used for purposes of applying the direct capitalization method for the year of assessment, provided an appropriate replacement reserve is included in the NOI determination and provided any additional costs required as a result of federal, state, or local regulation or compliance changes for the assessment year are included as an operating expense in the NOI determination. In addition, the assessor may utilize the current year operating budget to develop a measure of NOI for the assessment year.

005.04E The income capitalization method should not be applied in a manner that unfairly ignores the market for similar properties in the area. Rental rates, productivity, and restrictions imposed upon the use of the real property must be considered to determine actual value.

005.04E(1) The capitalization rate is the theoretical risk rate of interest applied ~~by valuators~~ in calculating the present value of future returns. ~~The capitalization rate for affordable housing may be developed from time to time through the band-of-investment technique.~~

~~005.04E(2) The band of investment technique may be used to develop a composite rate from the market.~~

005.04E(2) The capitalization rate to be used with the income approach is a market derived capitalization rate. A market derived capitalization rate takes into account the existence and the value of any low-income housing tax credits relating to the property. A market derived capitalization rate may be determined by the band of investment technique or other generally accepted techniques used to derive the capitalization rate depending upon the data available.

005.04E(3) ~~From the market composite rate the equity yield rate for the equity investor may be estimated recognizing the ratio of loan to value for the subject property.~~ Once a market derived capitalization rate has been determined, the property tax levy applicable to the property should be loaded onto the capitalization rate.

~~005.04E(4) This method has the advantages of:~~

~~005.04E(4)a. The composite rate will always be the same regardless of mortgage and equity ratios;~~

~~005.04E(4)b. Any mortgage position should always be superior to that of the equity rate because it is fixed by contract and burden of management is the responsibility of the equity owner; and,~~

~~005.04E(4)c. The risk of equity investment increases as its ratio to value declines thus prospective yield should increase accordingly.~~

005.04F One of the following methods may be selected to estimate an income approach valuation for the property.

005.04F(1) Direct capitalization of net operating income utilizing a ~~capitalization rate developed in consideration of the value of any low-income housing tax credits relating to the property; 005.04F(2) Capitalization by a modified band of investment technique~~ market derived capitalization rate (with the property tax levy applicable to the property loaded onto the capitalization rate).

(Neb. Rev. Stat. Sections 77-112, and 77-1301.01 ~~and 77-1311~~ R.R.S. 2003, ~~and~~ Neb. Rev. Stat.Sections ~~section~~ 77-201, 77-1311, ~~and~~ 77-1330 and 77-1333 R.S. Supp., 2006. ~~2004, and Neb. Rev. Stat. Sections 77-201 and 77-1311 R.S. Supp., 2005.~~)

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REGULATION 51-006 RECONCILIATION OF INDICATED VALUES

006.01 The indicated values from each of the approaches should be considered in relationship to the amount of information available to the appraiser, the reliability of that information, how well it is adapted to the appraisal assignment and in which approach the appraiser feels the most appropriate to the appraisal. If sales of comparable properties are lacking and there is little or no income information available, the appraiser may feel more confident in the cost approach. If there is sufficient sales information available, that approach may be the most reliable indication of value. If the appraiser is confident in the estimate of income and the required return to investors, perhaps the income approach is most appropriate. When properties generally sell in the open market in relationship to the income the property has the potential to provide in ownership, the income approach would be the most appropriate.

(Neb. Rev. Stat. Sections 77-102, 77-103, 77-112, 77-115, 77-121, 77-126, 77-131, 77-1301.01, ~~77-1311,~~ and 77-1371. R.R.S., 2003, ~~and~~ and Neb. Rev. Stat. Sections ~~section 77-201 and~~ 77-201, 77-1311, 77-1330 and 77-1333, R.S. Supp., 2006~~ 2004, and Neb. Rev. Stat. Sections 77-201 and 77-1311 R.S. Supp., 2005.~~)

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REGULATION 51-007 FINAL VALUE ESTIMATE

007.01 The final value estimate is ~~usually~~ the value determined by the approach in which the appraiser has the most confidence. Typically the cost approach will provide the high end of the range of value and the income approach will produce the low end of the range. ~~and~~ ~~m~~Most often the final value estimate will be within the range set by these two value indicators. The final value estimate is never a mathematically calculated averaging of the values arrived at through the three approaches and may not be exactly any of the individual indicated values. The final value estimate acknowledges the limitations on the use of the property agreed to for participation in the programs. This estimate should also be made recognizing the economic incentives for investing in affordable housing projects.

007.02 In determining the final value of the property for tax purposes the appraiser should consider the value most likely to represent the market value of the property yet equitable and proportionate in relationship to properties with similar physical characteristics serving the same function and use.

(Neb. Rev. Stat. Sections 77-102, 77-103, 77-112, 77-115, 77-121, 77-126, 77-131, 77-1301.01, ~~77-1311~~, and 77-1371. R.R.S. 2003, ~~and~~ and Neb. Rev. Stat. Sections ~~section 77-201 and~~ 77-201, 77-1311, 77-1330 and 77-1333, R.S. Supp., 2006. ~~2004, and Neb. Rev. Stat. Sections 77-201 and 77-1311 R.S. Supp., 2005.~~)