STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

Briarwood LDHA Limited Partnership,
Petitioner,

v

MTT Docket Nos. 327826, 338868, 368060, and 368061

City of Clare,
Respondent.

Tribunal Judge Presiding
Kimbal R Smith III

FINAL OPINION AND JUDGMENT

ORDER OF CONSOLIDATION

The Tribunal, having given due consideration to the file in the above-captioned case, finds:

1. The Tribunal issued a Proposed Opinion and Judgment on April 14, 2011. The Proposed Opinion and Judgment states, in pertinent part, "[t]he parties have 20 days from date of entry of this Proposed Opinion and Judgment to file any written exceptions to the Proposed Opinion and Judgment."

2. Neither party has filed exceptions to the Proposed Opinion and Judgment.

3. The Administrative Law Judge included the 2009 assessment in the Proposed Opinion and Judgment. However, the 2008 tax year for these parcels was not under appeal in MTT Docket No. 327826. MTT Docket No. 368060 appeals the 2009 assessment for parcel no. 051-400-023-10, and Docket No. 368061 appeals the 2009 assessment for parcel no. 051-400-007-10.

4. By consolidating the above-captioned cases, the 2009 tax year for the parcels at issue would be added to the original appeal, and judicial economy and efficiency would be served.

5. The Tribunal adopts the Proposed Opinion and Judgment as the Tribunal's final decision in this case. See MCL 205.726. The Tribunal also incorporates by reference the Findings of Fact and Conclusions of Law contained in the Proposed Opinion and Judgment in this Final Opinion and Judgment.

IT IS SO ORDERED.

MICHIGAN TAX TRIBUNAL

Entered: July 22, 2011

By: Kimbal R. Smith III

STATE OF MICHIGAN
STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES

BRIARWOOD LDHA
LIMITED PARTNERSHIP,
Petitioner,

v

CITY OF CLARE,
Respondent.

MICHIGAN TAX TRIBUNAL
MTT Docket No. 327826
consolidated w/ No. 338868

Administrative Law Judge Presiding
Thomas A. Halick

PROPOSED OPINION AND JUDGMENT

A hearing was held on January 14, 2011. Petitioner was represented by Douglas A. Jacobson, Attorney at Law. Respondent was represented by Jayne Smith Hoerauf, Attorney at Law. Each party presented the testimony of witnesses, documentary evidence, and legal argument.

This matter involves two parcels of real property consisting of a 36-unit apartment complex located in the city of Clare, Clare County, State of Michigan, identified by tax parcel numbers 051-400-023-10 and 051-400-007-10. Petitioner invoked the jurisdiction of the Tribunal for tax years 2006, 2007, 2008, 2009, and 2010. At issue are the assessed, taxable, and true cash values for each of the years for the subject property. The property's true cash, assessed, state equalized, and taxable values as reflected on the tax rolls are as follows:

Parcel Number: 051-400-023-10

Year	TCV	AV	SEV	TV
2006	1,095,000	547,500	547,500	537,398
2007	1,152,400	576,200	576,200	557,281
2008	1,150,000	575,000	575,000	570,098
2009	1,150,000	575,000	575,000	575,000

2010	1,014,000	507,000	507,000	507,000

Parcel Number: 051-400-007-10

Year	TCV	AV	SEV	TV
2006	860,600	430,300	430,300	410,776
2007	834,200	467,100	467,100	425,974
2008	895,400	447,700	447,700	435,771
2009	891,400	445,700	445,700	445,700
2010	755,200	377,600	377,600	377,600

The current TCV, AV, SEV, and TV of the two parcels together are:

Parcel Number: 051-400-023-10 and 051-400-007-10

Year	TCV	AV*	SEV*	TV*
2006	1,955,600			
2007	1,986,600			
2008	2,045,400			
2009	2,041,400			
2010	1,769,200			

*There is no need to set forth a combined AV, SEV, or TV here.

PROPOSED FINAL VALUES

Parcel Number: 051-400-023-10 and 051-400-007-10 (both parcels)

Year	TCV	AV*	SEV*	TV*
2006	$862,400			
2007	$862,400			
2008	$898,500			
2009	$870,370			
2010	$870,370			

*There is no need to set forth a combined AV, SEV, or TV here.

The proposed TCV, AV, SEV, and TV for each parcel are:

Parcel Number: 051-400-023-10

Year	TCV	AV	SEV	TV
2006	$482,900	$241,450	$241,450	$241,450
2007	$482,900	$241,450	$241,450	$241,450
2008	$505,100	$252,550	$252,550	$247,003
2009	$490,314	$245,157	$245,157	$245,157

2010	$490,314	$245,157	$245,157	$244,421

Parcel Number: 051-400-007-10

Year	TCV	AV	SEV	TV
2006	$379,500	$189,750	$189,750	$189,750
2007	$379,500	$189,750	$189,750	$189,750
2008	$393,400	$196,700	$196,700	$194,114
2009	$380,056	$190,028	$190,028	$190,028
2010	$380,056	$190,028	$190,028	$189,457

PETITIONER'S CONTENTIONS

Petitioner contends that as of each valuation date the assessed value of the subject property exceeded 50% of its true cash value. Petitioner's appraisal, Exhibit P-2, was introduced, without objection. It was prepared by Kenneth A. Blondell, MAI, of Integra Realty Resources, dated January 19, 2004, and concluded to the following True Cash Values: $175,000 ("As-is" – before completion) as of January 12, 2004; $1,360,000 ("upon completion") as of June 1, 2004; and $1,450,000 ("As Stabilized") as of December 1, 2004. The foregoing values are based on the hypothetical assumption that the property was a "market rate" apartment complex that was not subject to the low income housing tax credits ("LIHTC") or restrictions imposed under IRC sec. 42. The appraiser also offered opinions of value of $740,000 as of June 1, 2004, and $820,000 as of December 1, 2004, which considered the anticipated, restricted rents, but did not include any value attributed to the tax credits.

Petitioner offered Exhibit P-3, a second appraisal report, which was admitted without objection, which included opinions of value as of December 31, 2006 ($1,310,000), December 31, 2007 ($1,260,000), and December 31, 2008 ($1,210,000). This "2009 Appraisal" was performed for

Petitioner specifically for this proceeding. These values were based upon an "extraordinary assumption" that "[t]he subject is being valued as if it were a fee simple apartment complex unencumbered by any restrictions associated with the low income housing tax credits." P-3. Petitioner also offered Exhibit P-1, which was admitted into evidence without objection. P-1 sets forth an estimate of True Cash Value based on the methodology set forth in *Huron Ridge Limited Partnership v Ypsilanti Township*, MTT Docket No. 292811, which indicates a TCV of $1,600,000 as of December 31, 2006, $1,690,000 as of December 31, 2007, $1,630,000 as of December 31, 2008, and $1,400,000 as of December 31, 2009. These values were based on the direct capitalization of income approach, using actual (restricted) rents and actual expenses to calculate net operating income ("NOI"). The contributory value of the tax credits was determined by the discounted cash flow method ("DCF"), and this value was added to the value of the property determined by the direct capitalization of net income approach.

In the 2009 Appraisal, Petitioner valued the subject as if it were a market rate apartment complex, using the income, sales, and cost approaches. <u>Nevertheless, Petitioner asserts that the direct capitalization of income approach using actual (restricted rents), actual expenses, and a market-based capitalization rate is the most reliable indicator of value</u>. TR 82:16-20.

<u>RESPONDENT'S CONTENTIONS</u>

Respondent requests that the Tribunal affirm the current values on the tax rolls, which were arrived at by the cost less depreciation approach, as set forth on the property record cards. Respondent's valuation disclosure was prepared by Daniel R. Kirwin, CMAE3, who is also a certified general appraiser.

Respondent also prepared a discounted cash flow analysis, which determined the present value of the tax credits, which he presumed were allocated in the amount of $212,000 annually for 10 years. A reversion value of the property was estimated and discounted to present value. The property was valued by the direct capitalization of income approach, using market rents. The sum of the present value of the tax credits, the reversion, and the value by the capitalization of income approach resulted in an estimated TCV of $2,800,446 as of December 31, 2005, $2,615,654 as of December 31, 2006, $2,454,580 as of December 31, 2007, $2,314,177 as of December 31, 2008, and $2,191,795 as of December 31, 2009 (see Exhibits R-4 through R-9).

PETITIONER'S CASE IN CHIEF

Petitioner presented two witnesses and three exhibits, which were admitted without objection.

Petitioner's Exhibits:

P-1 Application of Huron Ridge LP v Township of Ypsilanti, 3 pages
P-2 "2004 Appraisal" by Kenneth A. Blondell, MAI
P-3 P-3 "2009 Appraisal" by Kenneth A. Blondell, MAI

Kenneth A. Blondell, MAI, is an expert in the valuation of real property who testified in support of the appraisals that he prepared. Petitioner's Exhibits 2 and 3 ("P-2" and "P-3"). Mr. Blondell is a certified general real estate appraiser with 23 years of experience, including appraisal of LIHTC properties. Mr. Blondell explained that the proper methodology for this type of property is the income capitalization and sales comparison approaches. The cost approach, although considered, was not used because typical buyers/investors would not use this approach.

Petitioner's primary theory advanced at the hearing was that for all times relevant to this case the subject should be valued by the income approach using actual rents, actual expenses, and an overall capitalization rate ("OAR") that takes into account various factors that are associated with an LIHTC property. The appraiser concluded in the "2004 appraisal" that the OAR should be 8.25%, which is 50 basis points lower than if a "market" cap rate was used. P-2, p 70. This resulted in a TCV of $820,000 (for 2005). This approach was not specifically used for the 2006, 2007, 2008, 2009, or 2010 tax years at issue in this case.

Petitioner's "2004 Appraisal" also included a cost approach, which determined the depreciated cost to be $810,000 (for 2005), and also applied economic obsolescence of $1,780,000. This was estimated by calculating the difference between actual NOI (restricted rents of $67,238) and the NOI required for feasibility ($214,071). The total NOI required for feasibility was calculated by multiplying the total actual construction cost by the OAR of 8.25%. The deficient NOI was capitalized at 8.25% to determine external obsolescence of $1,780,000, which was subtracted from replacement cost (less physical depreciation), for an indicated value of $810,000 (rounded). P-2, p 72.

The 2004 appraisal indicates that as of that time there were no sales of "subsidized apartment projects" such that the sales approach was inapplicable. Petitioner's appraiser stated that the sales approach would be viable if good sales were available. The intended user of the 2004 Appraisal (P-2) was Chemical Bank.

Petitioner's Income Approach

Petitioner's "2009 appraisal" (P-3) included opinions of value as of December 31, 2006 ($1,310,000), December 31, 2007 ($1,260,000), and December 31, 2008 ($1,210,000). Petitioner valued the subject as if it were a market rate apartment complex, using the income, sales, and cost approaches. Petitioner asked Mr. Blondell to "prepare an appraisal based on market conditions" as if there were no restricted rents. TR 52:7.

Mr. Blondell considers the tax credits to be a function of financing. He noted that he valued the property according to the definition of fair market value set forth on page 6 of the 2009 Appraisal. The appraiser was guided by the following definition of market value:

> The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
>
> - Buyer and seller are typically motivated;
> - Both parties are well informed or well advised, and acting in what they consider their best interests;
> - A reasonable time is allowed for exposure in the open market;
> - Payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and
> - The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

The above definition is difficult to apply to properties that are rarely sold. There is no legal restriction against selling the subject property on the tax days at issue, but LIHTC properties rarely sell during the 15 year compliance period. After the 15 year compliance period, a new owner may qualify for additional tax credits that can be used to raise capital needed to rehabilitate the property. Mr. Blondell testified that a determination of market value requires an assumption that the subject property would sell in a transaction that meets the above definition, including that the price represents the normal consideration for the property *unaffected by special or creative financing* or sales concessions granted by anyone associated with the sale. The appraiser considered the tax credits to be a type of creative financing, and that the appraisal problem should be analyzed as if typical financing would be used. As discussed later in this Proposed Opinion, although the tax credits may be considered a form of creative financing, the credits contribute no value to the real property. It is concluded that using market rents fails to take into account the restrictions on rent that negatively influence market value.

Market Rents

The market or economic rent for the subject's units is the rental income that the property would most probably command in the open market, as indicated by current rents for conventional apartment properties. Petitioner's appraiser considered five "market-rate" properties, with four being located outside the City of Clare, due to the unavailability of market rate properties in Clare. For purposes of analysis, the actual, restricted rents for the subject's unit types are:

Quantity	BR	Baths	S.F	2007	2008	2009
24	2	1	896	$413	$430	$455
8	3	2	1,176	$467	$490	$520
4	3	2	1,288	$467	$490	$520

The market rents are:

Quantity	BR	Baths	S.F	2007	2008	2009
24	2	1	896	$550	$560	$565
8	3	2	1,176	$620	$630	$635
4	3	2	1,288	$620	$630	$635

Occupancy

Average vacancy rates for five comparable apartment complexes were 5% for 2006, 6.2% for 2007 and 6.8% for 2008. The subject's actual vacancy rate in 2006 was 0%, in 2007 and 2008 it was 8%. The appraiser concluded that economic vacancy and credit loss for the three years analyzed were 5%, 8%, and 8%, respectively.

Effective Gross Income

Effective gross income ("EGI"), which includes "other income" such as late fees, lost security deposits, application fees, was an average of $4,500 for each year. The stabilized market EGI for the three years is $235,090 (2007), $231,703 (2008), and $233,651 (2009) based on market rents.

Expenses

Operating expenses were determined by studying the subject's operating statements for 2007, 2008, and 2009. The appraiser also considered expenses for several properties of similar age and design. Market expenses were estimated for management fees, administration, operating expenses, maintenance and repairs, payroll, insurance, and replacement reserves. Property taxes were not treated as an expense. The actual expenses for the subject are higher than expenses for market rent properties. The three year average expense ratio for the subject is 75%, whereas the average expense ratio for the comparables is 47%. P-3, page 39. Again, Petitioner used market expenses, not the actual expenses.

Capitalization Rate Analysis

The appraiser considered investor surveys, extraction of rates from comparable sales, and the band of investment method, which provided a range of probable overall capitalization rates. The most reliable method is extraction from recent sales of comparable properties. Market participants take into account anticipated growth in income from a property when negotiating a purchase price, which is reflected in the overall capitalization rate ("OAR"). The perceived risk of the investment influences the OAR. A high quality property that promises a steady stream of income, low vacancy rates, and increasing rents, will generally sell at a lower OAR. The buyer will pay a higher price in relation to the current NOI of such a property, resulting in a lower OAR. The investor is willing to accept a lower return on the capital investment and, therefore, will pay a higher price for the same NOI, as compared to a lesser quality property with more risk. Mr. Blondell testified that the subject is "a fairly low risk, assuming you are asking for restricted rents and lower restricted rents." TR 100:9. He also stated that the restricted rents are a negative influence that is an offset to the lower risk. However, the reasoning in the 2004 appraisal is persuasive and it is concluded herein that overall, the restricted rents and quality of the building result in lower risk that should be reflected in the OAR.

The appraiser considered five sales of market rate apartments from June 2005 to November 2007, with OAR's ranging from 7.5% to 9.1%, with an average of 8.3%. No LIHTC properties were included in this analysis. Rates were trending upward in the second half of 2008.

The band of investment method is a technique in which the capitalization rates attributable to components of a capital investment are weighted and combined to derive a weighted-average rate attributable to the total investment. This method considers the rate of return that an investor would require to service the debt (mortgage component) at prevailing interest rates, and also the return that the investor would demand on the equity capital, by comparison to returns available on investments with similar risk. The appraiser determined that the OAR by this method was 8% for 2007 and 2008, and 8.2% for 2009.

The concluded OAR was determined by considering the strengths of the subject property (built in 2003, large units, and tenant paid utilities). The weaknesses are: projected decline in demand, rising vacancy rates, and stable or modestly increasing rents. The appraiser concluded that the applicable OAR's are 8.0%, 8.0%, and 8.5% for 2007, 2008, and 2009. The values indicated by the direct capitalization of income approach are:

Tax Year	NOI		Loaded OAR		Indicated Value	Rounded
2007	$142,408	/	10.8612%	=	$1,311,157	$1,310,000
2008	$136,904	/	10.8246%	=	$1,264,746	$1,260,000
2009	$136,474	/	11.3246%	=	$1,205,105	$1,210,000

The above value conclusions are based on the hypothetical assumption that the subject is a market rate apartment project with no restrictions imposed by the LIHTC program.

Petitioner’s Sales Comparison Approach

Petitioner’s appraiser considered five sales of physically similar, market rate apartment properties. The properties were located 78 to 92 miles from the subject, but were considered to be located in markets with characteristics similar to the subject. The limited number of sales of similar apartment complexes did not allow for matched pair analysis in order to develop quantitative adjustments. The appraiser applied qualitative adjustments for age and condition, number of units, amenities, and location. An inferior feature in a comp resulted in a plus 1 adjustment, and a superior feature resulted in a minus 1 adjustment. Comps 1, 3, and 4 resulted in offsetting positive and negative adjustments with net adjustments of zero. Comp 2 had a positive 2 net adjustment, and comp 5 had a positive 1 adjustment. Nevertheless, for all of the five comps, the unadjusted price per unit was the same as the adjusted price per unit. The indicated price per unit ranged from $34,286 to $45,833. The average value (rounded) of $40,000 per unit was selected for the subject, for a total value of $1,440,000 for 2008 and 2009.

Petitioner’s Cost Approach

The first step in the cost approach is to estimate the land value by comparison to sales of similar land. The subject land was purchased in 2003 for $64,000. Three land sales were considered that support the purchase price as a reasonable indicator of market value. Petitioner’s appraiser opined that land values have remained flat and that the same value should apply to all years at issue. The land values are not a significant component of this valuation dispute. (The property record card indicates land value for the two parcels of $144,500 for all years at issue.)

Actual cost to construct the subject improvements totaled $1,944,000, or $55,389 per unit, which was based on actual costs obtained from the developer. The replacement cost new as indicated by Marshall Valuation Service is $2,239,330 for all site improvements, excluding developer's profit. Greater weight was assigned to the actual cost, for an estimated cost of $2,100,000, or $58,000 per unit. Developers profit for this type of property is estimated at 10%. Petitioner's appraiser states that for this type of property ". . . developers profit is primarily received from the successful operation of this income-producing asset as opposed to the construction of the improvements." P-3, p 54.

Physical Depreciation

The subject property was built in 2003, with an estimated useful life of 50 years. Physical depreciation for the buildings is estimated at 6% (2007), 8% (2008), and 10% (2009). Physical depreciation for the site improvements (such as drives and sidewalks with a useful life of 15 years) is 20% (2007), 26.7% (2008), and 33% (2009).

Economic Obsolescence

Petitioner determined that the cost of construction required the capital from the low income housing tax credits as the prevailing market rents are not sufficient to produce annual income sufficient to cover the debt service at market rates and terms. The appraiser estimated that the market rents are deficient on average in the amount of $150 per unit per month, for a total of $64,800 per year. This amount was capitalized at 8.0% (2007 and 2008) and 8.5% (2009) for indicated economic obsolescence of $810,000 (2007 and 2008) and $762,353 (2009). The market value indications by the cost approach, after deducting for all forms of depreciation are $1,390,000 (2007), $1,400,000 (2008), and $1,450,000 (2009).

Testimony of Douglas F. Larner

Petitioner's witness, Douglas F. Larner, is a certified public accountant who testified regarding his professional knowledge and experience with developing LIHTC properties under IRC sec. 42, including the subject property. The LIHTC program began in 1987 to create incentives for private real estate developers to build quality housing that is affordable to persons with low to moderate incomes. Generally, residents must earn not more than 60% of the county area median income ("AMI"). The program targets locations where the cost of building housing is too high to be supported by affordable rents. If mortgage money was borrowed at market rates, the below-market rents would be insufficient to service the debt and allow for a reasonable return on investment. The LIHTC program replaced prior subsidized housing programs that provided a mortgage interest subsidy. TR 13-15.

Petitioner applied under the LIHTC program to the federal Department of Housing and Urban Development (HUD) to receive tax credits that are based on a percentage of the proposed cost of construction. Mr. Larner explained that the actual eligible costs of construction were less than indicated on the application and the effective rate was 8.1% of costs. TR 31-32. The development costs that are included in the tax credit calculation include amounts paid to the construction contractor, engineering fees, construction period interest, and a developer fee. TR 35. These costs are paid through the proceeds from the sale of the tax credits or from cash flow from the project. TR 35.

Petitioner was allocated tax credits in 2003. The credits must be used over a 10-year period: \$54,000 in tax credits were available in 2004 (year 1), \$212,000 in tax credits were available for years 2 through 10, and \$157,429 in year 11 (this indicates a total of \$2,119,429). P-1.

As of 2004 and 2005, demand for the LIHTC program exceeded the amount of available credits. Projects were awarded credits based on the quality of the proposed project and the degree of compliance with state and federal standards. The program is administered by the Michigan State Housing Development Authority (MSHDA). Federal law requires that restricted rents remain in effect for a minimum of 15 years, but MSHDA imposes restrictions for an additional 15 years. TR 19:25, 59:3. Projects are awarded based on scoring criteria that include the length of the rental restrictions, financing, site approval, availability of utilities, whether a PILOT ordinance exists, and the income levels prevailing in that market. In order to increase its score in the selection process, Petitioner elected to keep the restrictions in place in perpetuity. TR 20:3.

In the application process, Petitioner was required to present a 15-year *pro forma* income statement based on anticipated restricted rents and expenses. TR 23. This required an estimation of operating costs by examining costs associated with similar projects. Property taxes are an operating cost. Petitioner estimated property taxes by researching the tax rates and discussing the potential assessment with the taxing authorities. After meeting with Respondent’s former assessor, Mr. Larner stated that he believed the subject would be assessed at approximately \$15,000 per unit (\$30,000 true cash value per unit). TR 25:21.

Petitioner is a limited dividend housing association ("LDHA") subject to income distribution limitations, which means it shall not make a profit in excess of 10% of its investment in the property. TR 20. The general partner, Mr. Gary L. DeShano, is also the developer. The general partner raised financing from a bank loan. Additional financing was provided by the tax credits that were transferred to the limited partner. The bank determined that it was willing to loan $648,000 based on its estimate of fair market value of approximately $880,000, using restricted rents. If the bank were to take control of the property due to a default by the borrower, the restricted rents would remain in effect (at least for 3 years) and therefore, the bank considered the property's fair market value with the restricted rents. TR 39-40.

The credits are transferable, and the transferee may use them to pay federal income tax liability. In order to convert these credits into cash that can be used for construction costs, Petitioner took on a limited partner, Raymond James1, which is a firm that acts as a broker for low income housing tax credits. TR 16:7. The sale of the tax credits raised equity to build the project. TR 36:22. Mr. Larner testified that once tax credits are awarded to a developer, firms such as Raymond James actively solicit the developer to purchase the tax credits. TR 35:21, 42:10-15. The limited partner purchased the credits from the general partner at a discounted value (83.5% of the total tax credit value of $2,120,000, or approximately $1,770,200). Raymond James made payments according to a schedule, with a certain amount immediately due, another payment at 50% completion of the project, and the balance due upon stabilization. Raymond James then marketed the credits to unrelated parties who could apply them to federal income tax liability.

The proceeds from the tax credit sale are not accounted for as an income stream inuring to Petitioner over 10 years. The tax credits are not included in gross income from the project. The credits are not a rent operating subsidy and they provide no income from which to pay operating expenses. TR 65:9-17. Mr. Larner indicated that even though the tax credits might be viewed as a "capital contribution," he also stated that the limited partner is a passive investor not involved in the ownership of the property. The tax credits are a mechanism by which the federal government "create[s] an equity market to provide financing funds to put up the brick and mortar . . . ." TR 66:1. It is Mr. Larner's opinion, as a CPA with expertise in organizing LIHTC projects, that the subject property's fair market value should be based on the actual rents. Mr. Larner's testimony indicates that the decision to value the property using market rents is based on an "argument" that restricted rents should not impact the taxing authority. TR 66:16. This is in the nature of a policy consideration and does not negate his other testimony indicating that the fair market value should be based on restricted rents, rather than considering the influence of the financing arrangements, which do not increase the market value of the property.

In the event that the income from rents and other financing sources are insufficient to cover debt service and operating costs, the developer is required to provide loans to the partnership.
The general partner loaned the partnership approximately $10,000 per year in order to pay for the unanticipated property taxes. Rents cannot be raised to make up this difference. In order to cover the deficiency, rents would have to be raised by $23 per unit per month. If the rents were raised, the law would require a recapture of the tax credits. The partnership agreement requires the partnership to repay the limited partner, Raymond James, for any lost tax credits. If Petitioner

1 "Raymond James Tax Credit Fund XXV-A, LLC." R-15, p 5.

violates any requirements of the LIHTC program during the 15 year compliance period, federal law recapture provisions take effect. After the 15 year compliance period, during years 16 to 30, the federal recapture provisions expire, but Petitioner remains obligated to MSHDA to keep the rent restrictions in effect. The partnership agreement requires the general partner to guarantee deficit loans up to $250,000 in order to ensure the viability of the project.

An LIHTC property is generally held by the initial developer (LDHA) for at least the 15 year compliance period. After 15 years, the property generally requires rehabilitation. If the property is sold after 10 years, the new owner may qualify for tax credits to rehabilitate the property.

During the recent economic downturn, there has been insufficient demand for IRC sec. 42 tax credits and production of new LIHTC properties came to a halt. A new program was enacted under IRC sec. 1602, which provided direct grants to developers. Mr. Larner stated that the economic effect is the same whether the developer finances the project by selling tax credits at a discount or if the federal government paid for the construction costs with a direct grant.

Mr. Larner testified that in most sales of LIHTC properties, the seller receives little or no cash from the deal. He is familiar with a sale of an LIHTC property in Evart, Michigan where there were no payments to the seller, but the buyer assumed the mortgage. At the time of sale, the outstanding loan on the Clarendon Glen property was only a few thousand dollars less than the sale price. The price paid for an LIHTC property is generally equal to or slightly more than the balance of the mortgage. TR 89:21-25. Mr. Larner testified regarding his personal knowledge of two sales where this was the case.

RESPONDENT'S CASE IN CHIEF

Respondent presented one witness, Daniel R. Kirwin, CMAE3. Mr. Kirwin is also a certified general appraiser and was the City Assessor during the years at issue. Respondent presented 26 exhibits, which were admitted without objection:

R-1 State of Michigan Certificate for Daniel R. Kirwin, Advanced Assessing Officer
R-1 (p 2) Daniel R. Kirwin's Certified General Appraiser License (copy)
R-3 Property Record Cards (36 pages)
R-4 Discounted Cash Flow calculations 2005 (2 pages)
R-5 Income Capitalization Calculations
R-6 Discounted Cash Flow calculations 2006
R-7 Discounted Cash Flow calculations 2007
R-8 Discounted Cash Flow calculations 2008
R-9 Discounted Cash Flow calculations 2009
R-10 Discounted Cash Flow calculations 2010
R-11 Balance Sheet of Project
R-12 Apartment Multifamily Listings Summary (2 pages)
R-13 Page from Petitioner's Appraisal (projected market NOI = $126,630)
R-14 Page 59 from Petitioner's Appraisal
R-14 (p 2) Clarendon Glen Apartments – reconstructed income statement
R-14 (p 3) Clarendon Glen Apartments – PILOT proposal
R-15 Financial Statements for Briarwood, December 31, 2004 – 2008 (35 pages)
R-16 Tax Records – commercial properties with rental income in Clare (2 pages)
R-17 Development Summaries, Clarendon Glen
R-18 Briarwood Promissory Note issue by Chemical Bank, 2/2/2006, $648,000
R-18 (p 3) Mortgage issued by Briarwood, 2/2/2006 securing $648,000 note
R-19 Tax dollar per unit and per bedroom analysis for comparison purposes
R-19 (p 2) Tax Summary 2010 – Clarendon Glen (total 2010 taxes = $18,544.22)
R-19 (p 3) Tax Summary 2010 – 307 Briarwood
R-19 (p 4) Tax Summary 2010 – 304 Briarwood (total 2010 taxes = $50,418.45)
R-20 Pilot Value Comparison – includes sale of Clarendon Glen
R-21 Sketches and Maps (4 pages)
R-22 Arial map
R-23 Clarendon Glen sale information
R-24 News article 1-13-2009, re: fire at Briarwood
R-25 Complete Parcel file of Commercial/Industrial Parcels (15 pages)
R-26 City of Clare Subject Parcels & Sale Information

Respondent's Valuation Disclosure consisted of the above documentary evidence. Respondent did not prepare a formal appraisal report.

Respondent's Sales Comparison Analysis

Respondent did not develop an opinion of value by the sales comparison approach.

Respondent's Cost Approach

Respondent established the assessments at issue by the cost less depreciation approach, with the application of an economic condition factor, as indicated on the property record cards. R3.

Respondent's DCF Approach

Respondent assumed that the total tax credits of $2,120,000 were available to the Petitioner in equal installments over 10 years, consistent with factual assumptions that form the basis of the *Huron Ridge* decision. See Exhibit P-6. The discounted present value of the tax credits as of the 2006 tax year was determined to be $1,075,269. Respondent also estimated a resale value of the real property at the end of the 10 year holding period and discounted that to the present value of $452,520, resulting in a total value of the tax credits plus a reversion value of $1,527,789. Next, Respondent calculated the value of the real estate by the direct capitalization of income approach, using NOI of $126,630 (market rent) and a tax loaded cap rate of 11.049%, for an indicated value of $1,146,027. The sum of the DCF and direct capitalization approaches indicated a TCV of $2,800,446 ($77,790 per unit). Respondent's witness attempted to comply with *Huron Ridge*, but stated that he did not believe this produced a reliable indication of value.

The above calculations are in error in several respects. The DCF approach is intended to determine the present value of the tax credits under a factual assumption that the credits are actually available to the owner over a 10 year period, consistent with the facts that were stipulated to in *Huron Ridge*. Assuming for the moment that this methodology has merit as applied to this case, the actual tax credits available were less than $212,000 in year one and year 11. Furthermore, the DCF analysis is not intended to determine a present value of all future benefits anticipated from the entire property, but measures only the contributory value of the tax credits (not including the restricted income stream). This approach assumes that the direct capitalization of income approach using restricted rents and actual expenses undervalues the property, because it makes no provision for the $2 million in tax credits provided to the developer by the federal government. The direct capitalization of actual income approach results in an estimate of value that a purchaser would rely on, assuming that the only anticipated benefits are the restricted income stream. Based on the evidence in *Huron Ridge*, and legal authorities cited therein, it was found that if the property were sold during the tax credit allocation period, the buyer would "step into the shoes" of the seller, and would be entitled to the remaining tax credits. Therefore, under the facts in *Huron Ridge*, the consideration paid for the property would include the value of the remaining credits.

Respondent's attempt to apply the *Huron Ridge* approach includes the value of the real estate twice: once as a reversion value in the DCF analysis, and again in the direct capitalization of income approach. Also, the direct capitalization of income approach incorrectly used NOI based on *market* rents, when that approach requires the restricted rents. If Respondent's calculations are adjusted such that restricted NOI is used and the reversion value subtracted, the indicated value is approximately $1,700,000 (based on testimony that the actual NOI was $75,000, and using a cap rate of 11.049%). If the cap rate extracted from the Clarendon Glen sale is used (6.38%, adjusted by the tax rate) the indicated value is $1,175,548. The above discussion applies to all the calculations on P-6 through P-10.

FINDINGS OF FACT

The subject property is an apartment complex constructed and owned by a limited dividend housing association that is organized as a limited partnership. The developer and general partner is Mr. Gary L. Deshano. The property consists of 2.93+/- acres of land improved by a 36-unit apartment complex constructed in 2003 and 2004 as housing for persons with low and moderate incomes. The property is located at 304 Briarwood and 307 Briarwood, Clare, Michigan.

The subject is "considered to be one of the nicer properties in the market." P-3, p 15. There are 90 uncovered parking spaces and a playground area. The buildings are "Class D, Average Quality, Low Rise Multiple Residence Building" based on the Marshall Valuation Service. P-3, p 19. There are 24 units with two bedrooms and 1 bath (896 square feet), 8 units with three bedrooms and two baths (1,176 square feet), and four units with three bedrooms and two baths (1,288 square feet), for a total of 36 units. The rents for all 12 of the three bedroom units are the same (the 1,176 square foot-three bedroom units are the same as the slightly larger 1,288 square foot units). A total of 18 units are designated for tenants earning up to 60% of the area median income (AMI) and 18 units are designated for tenants earning up to 50% of AMI. P2, p 10.

Prior to construction, Petitioner applied for and received federal tax credits under the "low income housing tax credit" ("LIHTC") program, IRC sec. 42. Petitioner acquired the subject land on March 21, 2003 for $64,000. Building permits for the subject apartment buildings and a 392 square foot building were issued on November 14, 2003, August 17, 2004, and August 18, 2004.

The 392 square foot building is a leasing office (also described on the record card as a detached garage) and is located on parcel "007". According to Petitioner's 2004 Appraisal (P-2), the construction was projected to be completed as of June 1, 2004, and occupancy was to be stabilized by December 1, 2004. The property record card indicates that the completed, improved property was first assessed property taxes for tax year 2006 (not 2005). R-3, p 1 and p 21.

Overall, the property was in good physical condition during the years at issue with no deferred maintenance. The building layouts and amenities are "good" as compared to competing properties. The subject property's highest and best use is its current use as a low income housing apartment complex under IRC sec. 42. The buildings have an estimated economic life of 50 years, with estimated remaining life of 47 years.

The facts pertaining to the physical characteristics of the subject property described in the previous sections of this opinion are not subject to a genuine dispute, and are adopted herein.

The testimony of Mr. Larner is found to be credible and accurate and the factual matters summarized above from his testimony are adopted as findings of fact.

The testimony of Mr. Blondell is found to be credible and accurate and the factual matters summarized above from his testimony are adopted as findings of fact, except as indicated herein. The cost approach does not result in a reliable indication of value without subtracting economic obsolescence because the market rents cannot support the cost to construct the subject. Mr. Blondell's methodology is correct; however, it is found here that the economic obsolescence should be measured by the deficient rent calculated by subtracting *actual rent* (rather than market rent) from the rent required for feasibility.

Respondent's cost approach does not take into account the substantial economic obsolescence. The economic condition factor ("ECF") does not measure the economic obsolescence in the subject because it was not developed from sales of other LIHTC properties or properties subject to the same degree of economic obsolescence.

If the subject were sold, the buyer would consider the value of the two improved parcels as an assemblage that would sell in a single transaction and would not allocate the purchase price to each parcel separately.

Clarendon Glen is a 24-unit, LIHTC apartment complex located adjacent to the subject. It sold in 2007 and the new owners substantially rehabilitated it. It competes directly with the subject. Clarendon Glen sold on October 22, 2007, for $701,000, or $29,208 per unit. R-20. According to Mr. Kirwin, the Clarendon Glen property was near the end of its physical life when it was sold and the property qualified for new tax credits for rehabilitation purposes. Clarendon Glen units are available for rent to families earning at or below 60% of area median income (AMI). R-17. The total development cost was $1,599,928 ($66,666 per unit) at the time of acquisition in 2007. Although not clear from R-17 itself, the testimony indicates that this was the cost to acquire and rehabilitate the property in 2007. The source of funds is: "Great Lakes Capital Fund for Housing Limited Partnerships XVI-3" ($792,238), "USDA" ($638,240), Fifth Third Bank ($150,000), and a general partner loan[2] ($16,000). Also listed is a "deferred development fee" of $3,450. The testimony is insufficient to determine whether the $792,238 is capital raised from the sale of tax credits and whether "USDA" ($638,240) refers to a loan or grant from the United States Department of Agriculture rural development program. The consideration that changed hands between the buyer and seller was $701,000. R-20, p 1. Although this single sale is insufficient to develop an opinion of value by the sales comparison approach, it tends to demonstrate that the cost to develop an LIHTC property does not equal its fair market value.

CONCLUSIONS OF LAW

Real property in Michigan shall not be assessed in excess of 50% of its true cash value, as equalized, and beginning in 1995 the taxable value is limited by the statutorily determined general price increases, adjusted for additions and losses. Const 1963, art 9, sec 3.

"True cash value" means the usual selling price at the place where the property to which the term is applied is at the time of assessment, being the price that could be obtained for the property at private sale. MCL 211.27(1). "True cash value" is synonymous with "fair market value." *CAF Investment Co v State Tax Comm*, 392 Mich 442, 450; 221 NW2d 588 (1974). The goal of the assessment process is to determine "the usual selling price for a given piece of property." *Meadowlanes Limited Dividend Housing Ass'n v City of Holland*, 437 Mich 473; 473 NW2d 363 (1991). Michigan courts and the Tribunal recognize the three traditional valuation approaches as reliable evidence of value. *Antisdale v City of Galesburg*, 420 Mich 265 (1985). The three most

2 The testimony does not elaborate upon the $16,000 general partner "loan." It appears that the general partner loans this amount to the partnership and that the loan is repaid from operating income.

common approaches to valuation are the capitalization of income approach, the sales comparison or market approach, and the cost-less-depreciation approach. *Meadowlanes,* at 484-485; *Pantlind Hotel Co v State Tax Comm*, 3 Mich App 170; 141 NW2d 699 (1966), aff'd 380 Mich 390 (1968); *Antisdale*, at 276. The Tribunal shall apply its expertise to the facts of the case to determine the appropriate method of arriving at the true cash value of the property, utilizing an approach that provides the most accurate valuation under the circumstances. *Antisdale,* at 277.

A proceeding before the Tax Tribunal is original, independent, and de novo. MCL 205.735(1). "The petitioner has the burden of establishing the true cash value of the property . . . ." MCL 205.737(3); MCL 211.27(1); *Meadowlanes Limited Dividend Housing Ass'n v City of Holland*, 437 Mich 473, 483-484; 473 NW2d 363 (1991). "This burden encompasses two separate concepts: (1) the burden of persuasion, which does not shift during the course of the hearing; and (2) the burden of going forward with the evidence, which may shift to the opposing party." *Kar v Hogan*, 399 Mich 529, 539-540; 251 NW2d 77 (1976); *Holy Spirit Ass'n for the Unification of World Christianity v Dept of Treasury*, 131 Mich App 743, 752; 347 NW2d 707 (1984).

The Tribunal must find a property's true cash value in determining a lawful property assessment. MCL 205.737 (1), *Alhi Development Co v Orion Twp*, 110 Mich App 764, 767; 314 NW2d 479 (1981). The Tribunal may not automatically accept a respondent's assessment but must make its own findings of fact and arrive at a legally supportable true cash value. *Pinelake Housing Cooperative v Ann Arbor*, 159 Mich App 208, 220; 406 NW2d 832 (1987); *Consolidated Aluminum Corp v Richmond Twp*, 88 Mich App 229, 232-233; 276 NW2d 566 (1979). The Tribunal is not bound to accept either of the parties' theories of valuation. *Teledyne Continental*

Motors v Muskegon Twp, 145 Mich App 749, 754; 377 NW2d 908 (1985). The Tribunal may accept one theory and reject the other, it may reject both theories, or it may utilize a combination of both in arriving at its determination. *Meadowlanes*, at 485-486; *Wolverine Tower Associates v City of Ann Arbor*, 96 Mich App 780; 293 NW2d 669 (1980); *Tatham v City of Birmingham,* 119 Mich App 583, 597; 326 NW2d 568 (1982).

Valuation of "Subsidized" Housing

In *Antisdale v City of Galesburg*, 420 Mich 265 (1985), the Michigan Supreme Court held that a low income apartment complex financed by a federally subsidized, below market interest rate mortgage was properly valued using the sales approach which considered sales of other federally subsidized apartments complexes. In *Antisdale,* the property was subject to an assumable, below-market interest mortgage. It was held that a purchaser and the seller would consider the benefit of the assumable low-interest mortgage when negotiating the sale price for the property, which is more desirable than an otherwise identical property for which the purchaser would be required to obtain financing at market rates.

> To the extent that tax benefits to a typical owner affect the "usual selling price" of property, they are properly included within the true cash value of the property. Tax benefits, like deed restrictions, *Helin v Grosse Pointe Twp*, 329 Mich 396 (1951), and zoning classifications, *Kensington Hills Development Co v Milford Twp*, 10 Mich App 368 (1968), of course are not real property. Nevertheless, such incorporeal items, not taxable in and of themselves, can increase or decrease the value of real property, and that amount should be reflected in the assessment process. *Antisdale v City of Galesburg*, 240 Mich 265 (1985).

In *Meadowlanes Limited Dividend Housing Ass'n v City of Holland,* 437 Mich 473, 483-484; 473 NW2d 363 (1991), the Michigan Supreme Court held that the Michigan Tax Tribunal was correct to consider the value, if any, of a federal government mortgage subsidy when computing true cash value of the petitioner's property, although the Court rejected the Tribunal's chosen methodology. The Meadowlanes project was built under section 236 of the National Housing Act, 12 USC 1715z-1; 24 CFR 236.1, et seq. The section 236 mortgage subsidy was designed to assist developers in constructing and operating quality housing for low and moderate-income families. *Meadowlanes*, page 477. The project was subject to rent restrictions and a cap on the rate of return of six percent on the equity investment. Finally, the project owner received "federal mortgage insurance of a private, long-term (40 year) mortgage loan in an amount not in excess of ninety percent of the FHA-determined certified cost of the project" and an "interest subsidy" which gave the owner an effective interest rate of 1%. The interest subsidy was *transferable*. *Meadowlanes*, page 498. The section 8 rent and the section 236 subsidy "made ownership of the property more desirable than it would be without them." *Meadowlanes*, page 499. The interest subsidy produced an actual pecuniary benefit (monthly cash flow) to the property owner during the term of the mortgage loan. The interest subsidy paid for a portion of the property owner's monthly debt service.

The IRC section 42 ("LIHTC") program at issue here, like the former section 236 subsidy, was created to attract private investment to address the national undersupply of low income housing. However, unlike a mortgage interest subsidy that could be assumed by a purchaser, the tax credits in this case do not provide cash flow to the owner or a potential purchaser. The fact that the credits provided a benefit to the developer to finance construction does not increase the fair market value of the subject real property.

In *Antisdale,* the Court approved the sales approach, where the evidence included sufficient sales of similar, subsidized apartment properties. In that case, the sales prices of the comparables reflected the market value as influenced by all of the positive and negative aspects of the federal subsidies and rent restrictions. The sales approach eliminated the need to isolate and adjust for any particular element of value for which the subject and the comparables did not differ. It is presumed that the market considered and assigned value to all relevant value influencing elements related to the federal subsidies and rent restrictions.

Under *Meadowlanes*, any benefits related to the low income housing tax credits under IRC 42 must be considered. For property that would be purchased by an investor for its income-producing capacity, it is relevant to consider all approaches to value that reflect the motivations of a purchaser. The primary motive here is to earn a return on investment and a return of investment. Therefore, an income approach is most relevant to the subject property. The sales approach is also relevant but there is only one sale of a similar, LIHTC property, which does not allow for a valid sales comparison approach. The available sales are of conventional market rent properties, which would require an adjustment for the market rents and perhaps for other differences related to the LIHTC program as well. Also, the timing of the sole LIHTC property sale (Clarendon Glen, which sold at the end of the 15 year compliance period) raises questions as to whether that sale price can be compared to the subject without adjustments for this difference.

The accuracy of the cost approach in this case is dependent upon an estimate of economic obsolescence that is “borrowed” from the income approach by capitalizing deficient rents.

For an income-producing property, the income approach is generally considered most relevant. *Northwood Apartments v City of Royal Oak*, 98 Mich App 721; 296 NW2d 639 (1980); *Eversdyk v City of Wyoming*, 10 MTT 664 (1999), MTT Docket No. 195925. The assessor is required to consider the "present economic income" of an income-producing property, which is defined as market income. MCL 211.27(4). The assessor may also consider a property's actual income, but actual income is not controlling in all cases. MCL 211.27(4). As applied to the subject property, this suggests that the true cash value should be determined by the three recognized approaches, including the income approach, which should consider both actual (restricted) and market rents. Upon consideration of all applicable approaches to value, it is concluded the income approach using actual income and expenses is most reliable based on the facts in this case.

In a sale of the subject on the relevant tax days, a buyer would determine the fair market value based on the actual income earning capacity, not by reference to what the property could earn if it were unrestricted. TR 82:16-20. The subject was constructed in 2004. The subject's rents are restricted until 2019 under the LIHTC program, and for many years thereafter due to recorded deed restrictions required by MSHDA. There is no evidence that these restrictions could be removed by agreement between the owner and a potential buyer or that MSHDA would consent to release the restrictions. Therefore, the subject's highest and best use (HBU) is continued use as a restricted, LIHTC apartment property. This is the maximally productive use under its current, legally permissible use. The subject cannot legally be used as a conventional, market-rate apartment, and should not be appraised for ad valorem taxation purposes under a hypothetical assumption that it could be so used.

In a limited partnership, the general partner(s) and limited partner(s) are named in the certificate of limited partnership and in the partnership agreement. MCL 449.1101. The general partner is responsible for management decisions. The sole limited partner is the Raymond James firm, who has no right to vote, manage, or control the partnership, except as may be specifically provided in the limited partnership agreement. MCL 449.1302. A limited partner is not liable for an obligation of the partnership, as long as the limited partner does not participate in the control of the business. MCL 449.1303. There is no evidence that the limited partner is entitled to a share of the income derived from rents, but rather earned a return on its capital by selling the discounted tax credits. The tax credits are effectively granted to the general partner. Raymond James became a limited partner when it exchanged cash for the tax credits. The partnership remains obligated to the limited partner to continue to operate the project in compliance with the LIHTC program to ensure that the tax credits are not recaptured. The partnership agreement requires the general partner to repay any lost benefits to the limited partner. A limited partner may transact business with the partnership and has the same rights and obligations to the partnership as a person who is not a partner. MCL 449.1108. The limited partner is a passive investor with no direct ownership interest in the real property. A partnership interest is personal property. MCL 449.1701. The limited partner had little or no involvement with the partnership other than the right to recover from the general partner any tax credits lost due to noncompliance with the requirements of IRC sec. 42.

It is most likely that the subject would sell at the end of the 15 year compliance period, but the property could be sold during the years at issue. The law requires an annual determination of TCV based on a hypothetical sale of the subject on tax day for each year at issue. There is no apparent reason why a buyer would be willing to pay more than what the current, restricted rents would support. During the years at issue, a buyer could not qualify for an allocation of new tax credits to finance the acquisition or rehabilitation. TR 63:7. The evidence in this case indicates that the subject was in above-average or good condition during the years at issue, and therefore, the property did not need rehabilitation. It has not been demonstrated that a sale on the relevant tax days would involve any additional allocation of tax credits. The subject property's stabilized NOI is useful as an indicator of value in the direct capitalization of income approach.

The LIHTC program was enacted with the tax reform act of 1986 to provide incentives for private sector production of low-to-moderate-income housing. IRC 42. The tax credits apply to a range of development activities, including new construction (as in the present case), substantial rehabilitation, moderate rehabilitation, acquisition, and repair by existing owners. The credits are granted in a lump sum that is available to be used in installments over a 10 year period to pay federal income taxes. The credits are transferable. There is a 15 year compliance period within which the tax credits are subject to recapture for noncompliance with program requirements. The state agency (MSHDA) requires the property owner to consent to restrictive covenants that require the property to be used as low income housing well beyond the 15 year compliance period. As the LIHTC program developed, the most common practice is for the owner to be organized as a limited partnership, with one limited partner that is usually a financial institution or a firm that specializes in purchasing and selling the tax credits.

In *Huron Ridge v Township of Ypsilanti*, MTT No. 292811 (2005), the Tribunal ruled as follows:

> LIHTC properties can be sold, in which case the purchaser "steps into the shoes" of the prior owner with respect to the remaining credit. Rev Rul 91-38, Q&A 4,

> 1991-2 CB 3. If a building or an interest in the building that qualifies for the LIHTC is acquired by a purchaser before the end of the compliance period, the purchaser's LIHTC is the amount of the credit that would have been allowable to the prior owner if the prior owner had not sold the building or interest in the building. IRC 42(d)(7). Furthermore, rehabilitation expenses by the purchaser on the property may qualify for a credit. Rev Rul 91-38, Q&A 7, 1991-2 CB 3; Conf Rept No 99-841, Vol. II (PL 99-154) p II-102.

In that case, it was undisputed that the project was constructed in 1998 and 1999, and the project received tax credits totaling $1,359,049 in 2001, which could be used over a 10 year period. Guidance published by the IRS and other authorities indicated that sales of LIHTC properties occur. Rev Rul 91-38, Q&A 4, 1991-2 CB 3. There was no evidence that the owner of Huron Ridge Apartments had sold the credits to a limited partner. Rather, the parties and the Tribunal presumed that the owner retained the benefit of the credits that would be realized over a 10 year period, which made it reasonable to consider the present value of the future credits utilizing a DCF valuation approach set forth in that case. It was presumed that the tax credits would have been available to a qualifying purchaser. A purchaser would have received the real property with its actual income-earning capacity and the annual dollar value of the tax credits.

Applying the above authorities to our case, the subject property could be sold and the purchaser would "step into the shoes" of Petitioner with regard to obligations under the LIHTC program. However, the purchaser <u>would not acquire the right to receive annual installments of remaining tax credits</u>. Therefore, the DCF approach applied in *Huron Ridge* is of little value here.

Consumers Power Company v Big Prairie Township, 81 Mich App 120; 265 NW2d 182 (1977), involved land owned by Consumers Power that was appurtenant to its hydroelectric power station. The taxpayer argued that the land "had no value beyond historical value" (purchase price) because it was subject to restrictions imposed by the Federal Power Commission ("FPC"). The land could not be sold without FPC approval and the use of the land was restricted by law. The Tribunal estimated that the land value would be $1,000 per acre if unrestricted, and reduced that value by 50% to account for use restrictions. There were two types of restrictions. First, there was a restriction upon alienability, meaning a sale required approval from the FPC. Second, the property was restricted to recreational use. The Tribunal determined the value under the assumption the FPC would approve a sale, and estimated a reduction to the value due to the restrictions upon use that would be binding upon a private buyer. The restrictions in *Consumers Power* were imposed by a governmental entity that was not an owner of the land, but which had a statutory duty to regulate the sale and use of the land. If the FPC approved a sale, the lands would be subject to restrictions upon use that would reduce its value.[3] *Consumers*, p 146. The FPC Order No. 313 required the seller to include in the document of conveyance a covenant running with the land to insure that the lands would remain restricted.

Consumers Power shows that the restrictions upon use are analogous to rent restrictions, both of which reduce the property's value. The LIHTC program imposes restrictions upon alienability in that potential buyers must be willing to accept restricted rents and comply with other requirements of the LIHTC program.

On March 22, 2006, the State Tax Commission issued a memorandum to assessors on the subject of Conservation Easements, which cites the Michigan Tax Tribunal case of *Indian Garden*

3 The FPC "will not grant any authorization for a licensee to dispose of any interest in project lands, unless a showing is made that such disposal is not inconsistent with any approved recreational plan or in the absence of such

Group v *Resort Township,* MTT Docket No. 157543, 205036 (1995); 1995 WL 901434, 5. In *Indian Garden Group*, the MTT held:

> The issue of the valuation impact from a conservation easement has not been before the Michigan Court of Appeals nor a Tribunal Judge prior to this case. A similar issue was dealt with in *Lochmoor Club* v *Grosse Pointe Woods*, 10 Mich App 394-398 (1968), where a private club voluntarily placed permanent restrictive covenants limiting building on an otherwise buildable adjacent parcel. The court held that "[l]and restricted in its use, such as in the instant case, cannot be compared in valuation to subdivision lots in the same general area which may be utilized for the erection of homes. To ignore such a restriction constitutes fraud on the taxpayer...." *Id,* 398. The Tribunal finds that the restrictive easement does affect value because it was created in accordance with State and Federal law with the express intent of placing permanent limitations upon the property that negatively affect the market value. *Indian Garden Group v Resort Tp,* MTT Docket No. 157543, 205036 (1995); 1995 WL 901434, 5.

The evidence is consistent with the following statement found on the MSHDA web site:

> Developments with allocations of 1990 credit and after will have entered into a restrictive covenant with MSHDA at the time of final allocation. The restrictive covenant is a recorded land use agreement. These developments must comply with eligibility requirements for an additional 15 years beyond the initial 15 year compliance period (or a total of 30 years).
>
> www.michigan.gov/documents/mshda/mshda_crh_m_02_section_ii_lihtc_prog_overview_185437_7.pdf

In an unpublished decision of the Court of Appeals, *Amurcon, infra,* the respondent argued for the use of actual rents, which included section 8 subsidies paid directly to MSHDA for the benefit of the petitioner. The actual restricted rents plus the section 8 subsidy were higher than the "hypothetical market rent" advocated by the petitioner. *Amurcon/Ridgewood Vista v Leoni Township,* unpublished opinion per curiam of the Court of Appeals issued March 7, 1997

a plan, that the lands do not have recreational value." *Id.,* p 146.

(Docket No. 192485). That case held that the legislature has generally defined "present economic income" to mean market income *but in certain cases actual income may be appropriate* to measure the "property's true earning capacity." *Id*. "Additionally, courts in both this state and other jurisdictions have recognized the appropriateness of considering actual rents. . . because the actual rents are a better indication of the property's true earning capacity. *Meadowlanes*, *supra*, 437 Mich 499; *Kankakee Co Bd of Review v Property Tax Appeal Bd*, 163 Ill App 3d 811; 516 NE2d 1006 (1987) . . . ." *Amurcon/Ridgewood Vista, supra.*

Case Law from Other States

Bayridge Associates Limited Partnership v Dep't of Revenue, 321 Or 21: 892 P2d 1002 (1995), involved two LIHTC properties. The Oregon Tax Court concluded that actual, restricted rents should be used to determine true cash value under a statute that required the assessor to account for "governmental restriction as to use." The Court rejected the taxing authority's claim that a governmental restriction cannot reduce the value of a property if the taxpayer voluntarily consented to the restriction and because the taxpayer received a benefit in return for the restriction. Also, that case rejected the alternative argument, that if the restricted rents were used in the income approach, the annual tax credits should be included as additional income. It was held that a potential buyer would not receive any value related to the credits because the credits would be recaptured in the event of sale. *Id*. The taxpayer's appraiser used restricted rents. The taxing authority's appraiser used market rents. The assessment date was early in the 15-year period of restricted rents. It was concluded that the true cash value of the properties should be measured by their actual or contract rents. In a lengthy dissent, two Justices of the Oregon Supreme Court argued that the department was correct to use market rents.

In *Paradise Place Associates Limited Partnership v City of West* Bend, 204 Wis 2d 276; 554 NW2d 683 (1996), the assessor valued an LIHTC property at $2,105,500 using the cost approach. The taxpayer argued for a value of $1,011,687 by the income approach using restricted rents. The taxpayer failed in its burden of proof and the assessment was upheld.

In *Parkside Townhomes Associates v Board of Assessment*, 711 A 2d 611 (1998), an LIHTC property was assessed at a fair market value of $3.5 million and the taxpayer alleged the value was $1.25 million. The appellate court reversed the trial court's directed verdict and remanded the case for further proceedings, ordering the trial judge to consider the taxpayer's claims that the property should be valued without consideration of the tax credits.

In *Cascade Court Limited Partnership v King County Assessor*, 105 Wash App 563; 20 P-3d 997 (2004), the assessor agreed that the LIHTC property should be valued by the income approach using restricted rents, but that the value of the tax credits should be included. The appellate court reversed the Board of Tax Appeals' determination that the LIHTC property should be valued using market rents and that the tax credits should be considered. The Court held that the rent restrictions were similar to recorded "use covenants against the title of a golf course" that were voluntarily entered into in order to qualify for desirable planned use development (PUD) zoning. It was also held that the assessor should not take the tax credits into account in the assessment, under the rationale that the credits were intangible property not subject to taxation under that state's law. In *Meadowlanes*, the Michigan Supreme Court rejected the argument that the subsidy is a non-taxable intangible, and therefore, any value influence related to tax benefits, credits, or subsidies must be *considered*, but this does support a conclusion that the tax credits at issue in our present case contribute any value to the property.

Rainbow Apartments v Illinois Property Tax Appeals Board, 326 Ill App 3d 1105; 762 NE2d 534 (2001), involved a 72-unit LIHTC property built in 1995. The tax year at issue was 1997. The taxpayer's appraiser applied the income approach using the property's actual net operating income and a 10% capitalization rate, resulting in a FMV of $1,372,000 ($19,000 per unit). He also calculated the unencumbered value at $2,052,000, and determined the present value of the tax credits to be $1,460,000, but did not include the credit value in his value conclusion. The Property Tax Appeal Board added Petitioner's restricted rent value to the tax credit value, and determined the FMV to be $2,832,000 ($39,333 per unit). The appellate court affirmed the board's determination, reasoning that the tax credits that were allocated to the limited partners are additional cash flow derived from the real property. It was apparently found, as in *Huron Ridge*, that the unused tax credits would be sold along with the real estate, such that a willing buyer "would most certainly consider the availability" of the credits. *Id*.

> We disagree with the characterization of the tax credits as intangible property sold and existing apart from the real estate. Section 42 tax credits are not intangible property because they do not constitute a right to a payment of money, have no independent value, and are not freely transferable upon receipt. *City of Chicago v Michigan Beach Housing Cooperative,* 242 Ill App 3d 636, 648, 182 Ill Dec 343, 609 NE2d 877, 886 (1993). A limited partnership does not "sell" the tax credits to investors; they remain in the limited partnership. Limited partners buy securities giving them an interest in the limited partnership. The benefit of a tax credit to a limited partner is entirely incidental to that investment. *Michigan Beach Housing Cooperative,* 242 Ill App3d at 647, 182 Ill Dec 343, 609 NE2d at 886. Because the section 42 tax credits affect the income-earning capacity of Rainbow's property, PTAB appropriately considered their present value in determining the fair cash value of Rainbow's property. *Rainbow Apartments v Illinois Property Tax Appeal Bd,* 326 Ill App 3d 1105, 1108-1109, 762 NE2d 534, 53, 260 Ill Dec

875, 878 (2001).

The above reasoning is not persuasive in our case because Petitioner transferred the credits with a face value of approximately $2.12 million to the sole limited partner for the discounted value of $1.77 million. It is true that the limited partner benefited by earning the discount income (interest) upon transferring the credits to others. In that sense, the unused credits “remain in the limited partnership” until the limited partner transfers them to another buyer, but the credits do not transfer with the real estate. There is no indication from the record in our case that the tax credits contribute to the fair market value (value in exchange) of the real property. The income that the limited partner earns from the tax credits adds no value to the property, just as interest payments to a secured lender do not add value to mortgaged property.

In *Cottonwood Affordable Housing v Yavapai County*, 205 Ariz 427; 72 P-3d 357 (2003), the taxing unit argued that the LIHTC property should be valued either using market rents, or with restricted rents plus the tax credits included in income. The court held that the value should be based on the restricted rents without any value attributed to the tax credits, relying upon *Cascade Court Limited Partnership v King County Assessor*, 105 Wash App 563; 20 P-3d 997 (2004). *Cottonwood* cites USPAP Advisory Opinion 14 for the proposition that “LIHTC’s are an example of an incentive that results in intangible property rights. . . .” This implies that the credits do not influence the fair market value of the realty and should not be considered in an appraisal of the real property. The Court noted that the credits are an incentive to invest and are not part of the income stream from the property. The credits “do not add to the long term value of the real property.”

In *Town Square Limited Partnership v Clay County*, 704 NW2d 896 (2005), the South Dakota Supreme Court supported the income approach with restricted rents, and further ruled that the tax credits contribute market value to the property because the credits are transferable with the real property and a buyer would acquire rights to the unused tax credits. The court presumed that the credits increase the market value of the property and remanded the case to determine "to what degree the reduced rents and the tax credits offset each other." *Id*. The reasoning and factual assumptions of this case are similar to *Huron Ridge*.

Stone Brooke Limited Partnership v Sisinni, 224 W Va 691; 688 SE2d 300 (2009), involved several LIHTC properties. For one of the properties, the court upheld the assessor's value by the cost approach of $1,784,100. As the case worked its way through the administrative and trial court process, the State Tax Commissioner valued the property by the income approach with restricted rents plus the value of the tax credits, which produced a higher value ($1,971,000). The taxpayer's appraiser valued the property using restricted rents with no value ascribed to the tax credits ($1,159,000). (Note that in LIHTC valuation disputes it is common for the assessor's value to be approximately twice, if not more than twice, the taxpayer's value indicated by the income approach using restricted rents). The same pattern was exhibited for the other properties at issue in *Stone Brooke*.

The Court noted that six lower court decisions were split regarding the proper valuation approach for LIHTC properties, with three opting for the cost approach, and three the income approach, and at least one of those courts using actual, restricted rents. The taxpayer cited eight appellate court decisions from various states that applied the income approach using restricted rents (including *Huron Ridge*, *supra*, although the court failed to note that the discounted value of the tax credits was also included). The Court declined to select a preferred valuation method in light of statutory provisions that vest the assessor with discretion to choose the most appropriate method and the assessor had not abused his discretion. Further, in West Virginia, the taxpayer must carry the burden of proof by clear and convincing evidence. The assessor and the State Tax Commission did not dispute that actual rents should be used in the income approach, but they believed that the value of the tax credits must be added. The Court held that the income approach is not required but that if the cost approach is used, the "unique characteristics of the LIHTC program" must be considered. The Court did not elaborate upon how the LIHTC program would affect the cost analysis (such as whether the cost must be reduced by economic obsolescence or whether value related to the tax credits should be added.) The case was remanded to the lower courts for further proceedings.

The dissenting judge in *Stone Brooke* is candid in his observations regarding judicial attempts to define the appropriate appraisal methods for LIHTC properties that are influenced by these "very complicated programs that have many technical rules. . . ." *Id*, p 317. That dissent cites inconsistent decisions from 18 state courts that have addressed LIHTC "appraisal schemes." The dissenting judge also stated that the governmentally restricted rents are a form of economic obsolescence that lowers the value of the property. This case supports a conclusion that the replacement cost new includes substantial economic obsolescence. The government essentially constructs a building that is not financially feasible in its location. The free market has not and would not place that building in that location for that use. Once the highest and best use ("HBU") is established under the LIHTC program – the property must be valued at that HBU. No investor would pay more for the subject than is warranted by the anticipated future benefits, which is the actual NOI that will remain relatively stable during a reasonable holding period.

In *Woda Ivy Glen Limited Partnership v Fayette County Board of Revision*, 121 Ohio St3d 175; 902 NE2d 984 (2009), the Supreme Court of Ohio rejected the assessor's cost approach applied to an LIHTC property and ordered that the value must consider the use restrictions. The assessor's value was $4,854,970 and the taxpayer asserted the true value was $2,400,000. The taxpayer's appraiser testified that the restricted rent "results in a project that offers limited direct economic return to the partners." *Id*. The Court concluded that the credits "should not be viewed as pertaining to the realty." The Court's discussion of the tax credits comports with the facts of our present case. In *Woda*, ". . . tax benefits are transferred apart from any transfer of the underlying fee interest in the property." *Id*. An LIHTC development "involves syndicating the credit by selling passive investment (in this case limited partner interests) to entities that can benefit from the tax credit." *Id*. The Court found that the tax credits are transferred apart from the entire legal fee interest in the property.

In *Poplar Bluff Associates v Butler County*, 2009 WL 4949819 (2009), the State Tax Commission for the state of Missouri held that an LIHTC property should be valued using the income approach, with actual, restricted rents, actual expenses (which are higher than market expenses), with the net operating income capitalized using a market rate. It was held that no adjustment to the capitalization rate was proven due to any increased or decreased risk associated with this type of property. Neither was there any proven adjustment for illiquidity. An OAR of

8.375% (not tax loaded) was adopted.

In *Schuyler Apartment Partners, LLC v Colfax County Board of Equalization*, 279 Neb 989; 783 NW2d 587 (2010), the Supreme Court of Nebraska upheld the assessor's valuation that relied primarily upon the cost approach, and also considered the income approach with a lower capitalization rate to account for value related to the tax credits. The decision is not clear as to whether the assessor's income approach used actual or market rents. This case involves a specific statutory provision under Nebraska law that disallows the tax credits from inclusion in the net income calculation, but specifically provides that the credits "may be considered in determining the capitalization rate when capitalizing the income stream. . . ." *Id*. Notice that this statute does not indicate whether the tax credits would result in a higher or lower capitalization rate. The outcome of this case was largely based on the failure to meet the burden of proof, and the reasoning leaves important issues undeveloped.

In *Shelby County Assessor v Shelby's Landing-II, LP, infra*, the Tax Court of Indiana recently held in an unpublished decision that an LIHTC property should be valued by the income approach, using actual income and expenses with a market capitalization rate derived from sales of conventional apartments. The Court rejected the assessor's value of $9,195,800 and adopted the taxpayer's value of $3,742,500, with the approximate average value of $30,000 per unit. *Shelby County Assessor v Shelby's Landing-II, LP*, unpublished opinion per curiam of the Indiana Tax Court, issued December 6, 2010, 939 NE2d 134; 2010 WL 4950099 (2010).

On March 11, 2011, the Supreme Court of Alaska noted that "Courts differ on whether and why rental restrictions must be considered." *Horan v Kenai Peninsula Borough Board of Equalization*, ___ P 3d ___ ; 2011 WL 832805 (Alaska).4 Alaska statutory law provides that for properties qualifying for tax credits under IRC 42 prior to 2001, actual income must be used without adjustment for the tax credits. However, for properties constructed after that deadline, local governments have authority to determine by ordinance whether to use actual income or another method on a case-by-case basis. AS 29.45.110(d). The new statute did not mandate actual rents for the subject property in that case. The assessor valued the 30-unit project for 2005, 2006, and 2007 at $2,930,700 ($97,690 per unit) using the cost approach. The petitioner's restricted rent income approach resulted in a market value of $652,000 ($21,000 per unit). In that case, the project was completed in 2003. The construction was financed in part by $383,833 in tax credits. The taxpayer appealed, and the assessor increased the assessment to $3,067,800. The appeal board found that the property was over-valued in relation to similar properties and determined, without explanation, that a 40% economic obsolescence factor should be applied (reducing the assessment to $1,758,420, or $58,614 per unit). The Court held that it was appropriate for the board to consider rental restrictions in estimating economic obsolescence under the cost approach, although the case was remanded in order for the lower court to clarify how it reached its reduced value, and further to clarify how the tax credits were treated. The Court stated that the board's 40% obsolescence factor was not appropriately explained and it was unclear whether this included the economic conditions in the subject's market or only the rental restrictions.

4 The Westlaw report states: "Notice: This opinion has not been released for publication in the permanent law reports. Until released, it is subject to revision or withdrawal."

Analysis and Value Conclusions

It is unlikely that the subject would be withdrawn from the LITHC program and sold as a market rate property during the compliance period, because this would require recapture of the tax credits. This would require the owner or a successor owner to repay taxes previously offset by the credits plus penalties and interest. *See*, Joseph Rosenblum, Assessing the Value of Affordablity: Ad Valorem Taxation of Properties Participating in the Low Income Tax Credit Program (2006), 2 J. Marshall Law School Fair & Affordable Housing Commentary 36; IRC 42(j). Therefore, it was financially infeasible to take the property out of the program.

Petitioner was granted approximately $2,120,000 in tax credits and sold them to the limited partner for the discounted value of $1.77 million, which was used to construct the subject property in accordance with requirements of the LIHTC program. It has not been established that Petitioner could ever realize a direct economic benefit from that $1.77 million upon a sale of the property. The $1.77 million in proceeds from the tax credit sale was invested in the bricks and mortar. The proceeds from the tax credits cannot be characterized as operating income available to the partnership. The limited partner earns a return on its capital when it "sells" the credits for face value. However, this is similar to interest earned by a mortgagee. It has not been demonstrated that the limited partner's gain from the sale of tax credits contributes to the fair market value of the subject property.

To the extent that the cost of construction exceeds the value indicated by the income approach using actual NOI, any potential value related to that excess is negated by economic obsolescence. The LIHTC program provided a mechanism for financing construction at a cost that far exceeds the market value of the project. The federal government is not an investor that demands a return on this amount. Rather, this expenditure allows the government to achieve its policy goal of increasing the supply of housing that is affordable to low-income individuals.

LIHTC projects are targeted for locations with low to moderate incomes where there is insufficient demand for a market rate apartment project. A physically identical apartment complex would cost an investor approximately $2.1 million, but there are not enough potential tenants in this market able to pay rents sufficient to cover the debt service to finance that cost. Therefore, it cannot be presumed that the subject would be financially feasible as market rate apartments, even if legally permissible. Achievable rents at the subject's location may exceed the current, restricted rents, but would be less than the "market" rents indicated in Petitioner's appraisals. Petitioner's sales comparables (P-3, p 49) are located approximately 80 to 90 miles from the subject. There is only one rental comparable located in the city of Clare. Therefore, it has not been persuasively demonstrated that the subject could actually achieve the indicated market rents if it were unregulated.

The construction was financed by the proceeds from the transfer of the tax credits for approximately $1.77 million, plus $680,000 loaned by Chemical Bank at a market interest rate, for a total of approximately $2,380,000, which is higher than market construction costs indicated by Marshall Valuation Service. Mr. Larner testified that the bank loan was based on the 2004 appraisal and was limited by what the net operating income from the project would be, with restricted rent. TR 37:19. The market cost of construction (new) was $2,100,000 (indicating a TCV of $2,164,000 including land) or $60,000 per unit (rounded). P-3, p 54. Prior to construction, the bank appraised the property using both restricted rents ($880,000) and market rents ($1,450,000).

Based on this record, there is no reason to believe that an investor would expect to achieve rental income similar to what could be achieved with “market rate” properties located in the vicinity of Clare because the subject property is locked into restricted rents. Nor is there any substantial evidence that an investor would take into account any other future benefits in determining value.

Respondent’s expert witness testified that the total investment in the project must be accounted for in the estimate of TCV for property tax purposes. He reasoned that all of the investors demand a return on their capital, land, labor, and management. TR 181:19, 181,182. “Why would . . . anybody on the planet put this much money in and not expect that money to be – return of that money and return on that money in the tax rates.” TR 175:14-25. However, Petitioner, in conjunction with the federal government, constructed the subject with full knowledge that it would be immediately impacted by significant economic obsolescence. See the testimony of Mr. Blondell. TR 107:21.The tax credits are a grant to Petitioner with certain conditions attached. The grant ultimately benefits the residents of the property by providing below market rents for above average quality housing, but it has not been demonstrated that the tax credits contribute market value to the real property. The limited partner’s capital is invested in the tax credits, which, in the hands of the limited partner, are like a promissory note issued by the federal government. The limited partner gets paid as the tax credits “mature.” It is true that if the project fails, the tax credits will be lost, but this is similar to the risk of default that accompanies any financing arrangement. This dynamic has no discernable influence on the fair market value of the property.

The central issue in this dispute is: what is the true cash (market) value of the subject property for tax years 2006, 2007, 2008, 2009, and 2010. This requires the Tribunal to determine which valuation methods are useful to determine an accurate market value estimate of the subject property and to make an independent determination of the true cash value based upon its evaluation and analysis of the evidence.

Respondent's cost approach indicated on the property record cards is an accurate application of procedures set forth in the State Assessors Manual, authorized by the Michigan State Tax Commission. However, Respondent's cost approach does not consider economic obsolescence related to the restricted rents. A purchaser of the subject would not place significant reliance upon the cost approach. Respondent's cost approach is not a reliable indication of TCV.

The flaws in Respondent's DCF analysis were discussed in the Findings of Fact (above) and those calculations are rejected. Petitioner's DCF analysis complies with the *Huron Ridge* case, but that methodology is rejected for reasons stated above.

Petitioner's direct capitalization of income approach, substituting restricted rents for the market rents, produces the most reliable estimate of TCV. The capitalization of income approach using restricted rents, actual expenses, and a market capitalization rate (adjusted downward by 50 basis points) is a persuasive indicator of value. Petitioner's analysis of the various factors influencing the capitalization rate found in the "2004 appraisal" is found to be persuasive and provides reasonable support that the OAR should be 50 basis points lower than if a "market" capitalization rate was used. P-2, p 70. The following table sets forth the calculation of net operating income based on the subject's gross potential rent (using actual, restricted rents), other income, and actual expenses:

	2006	2007	2008	2009
Potential Gross Income5	$186,192	$186,192	$192,192	$205,920
Other Income	$6,500	$6,500	$6,716	$9,205
Vacancy	0%	0%	8%	8%
Effective Gross Income6	$192,692	$192,692	$183,532	$197,915
Total Expenses7	$103,328	$103,328	$90,762	$103,701
Net Operating Income	$89,364	$89,364	$92,770	$94,214
OAR	10.3612%	10.3612%	10.3246%	10.8246%
Indicated Values (NOI / OAR)	$862,486	$862,486	$898,553	$870,369

The Potential Gross Income based on contract rent as of 12/31/2006 ($186,192) as reported by Petitioner (P-3, p 28) is accepted for the 2007 tax year. The actual "other income" reported in P-3 ($124) is not representative of actual experience in prior or subsequent years. Therefore, the average "other income" used in the 2004 appraisal and for the subsequent years in the 2009 appraisal (P-3) is adopted for the 2007 tax year ($6,500). The subject experienced an actual

5 The NOI for tax years 2007, 2008, and 2009 is based on "current unit mix and contract rents as of the date of value" set forth in Exhibit P-3, p 28. The 2006 NOI is based on data set forth in Petitioner's and Respondent's Valuation Disclosures, as discussed in the text of this opinion.
6 EGI includes vacancy, credit loss, and other income. See P-3, p 35.
7 Property taxes are added back to total expenses listed on the Reconstructed Operating Statement, P-3, p 35. These expenses are adopted here as "actual expenses" based on Petitioner's appraiser's review of the year end operating statements for the subject property. P-3, p 34.

vacancy rate of zero as of 12/31/2006, and therefore, that vacancy rate is adopted in the above analysis. The vacancy rate increased to 8% in the subsequent years, which occurred as rents increased. The actual vacancy rate of 8% is adopted for those years. The total expenses are adopted from P-3, p 35 (“Reconstructed Operating Statement – Briarwood Apartments”) with the property taxes added back.

The 2006 tax year NOI is based on Gross Potential Income of $186,192, which was used in Petitioner’s December, 2004 appraisal, which included an opinion of value using restricted rents. P-2, p 69. Petitioner’s exhibit P-3 used this same amount for the 2007 tax year (1/31/2006). Based on the available data, it is reasonable to adopt this NOI for the 2006 tax year at issue. Petitioner’s exhibit P-1 includes “actual NOI” figures for the tax years at issue, and Mr. Larner testified in support of those amounts. TR 79. However, the evidentiary foundation for these NOI amounts is lacking, and therefore, the actual rents set forth in Petitioner’s appraisal (P-3) are found to be better supported by the evidence.

There is insufficient data in evidence upon which to calculate NOI specific to the 2010 tax year. However, there is evidence that the annual NOI was relatively stable during the years at issue. Although the current assessments declined by approximately 13% in 2010, this is based on Respondent’s cost approach adjusted by an economic conditions factor (ECF), which is not relevant to the above value conclusions. Therefore, the 2009 values are adopted as reasonable for 2010, with the TV adjusted by the CPI multiplier of .997 as required by law.

Petitioner used overall capitalization rates of 8%, 8% and 8.5% for tax years 2007, 2008, and

2009, respectively. Petitioner's 2004 appraisal (P2) used a rate of 8.25%, but it is determined that the 8% rate used for 2007 is reasonable for the 2006 tax year. However, a downward adjustment of 50 basis points is required to reflect the subject's status as an LIHTC property for each year, as described in the Findings of Fact section above. P-2, p 70. The tax rates used in the overall, tax-loaded, capitalization rates set forth in Petitioner's 2009 appraisal are adopted. P-3, p 44. Respondent's exhibit R-6, p 1, indicates an effective tax rate of 2.861% for 2006, which is the same rate that Petitioner used in its 2007 valuation (based on 12/31/2006), and that rate is adopted for 2006.

Summary

The subject is an-income producing property for which the direct capitalization of income approach provides the most reliable indication of value because it most closely models investor behavior. The gross potential income from the subject property's actual, restricted rents should be used, along with actual expenses, to calculate NOI.

The sales approach is of limited value due to the lack of sufficient sales of LIHTC properties. The cost approach requires adjustment for economic obsolescence based on capitalization of deficient rents, which draws from the income approach.

The factual underpinnings of this case differ from *Huron Ridge*, *supra*, and therefore, the discounted cash flow method used in that case is not applicable here. Upon analysis of our present facts, it has not been demonstrated that the capital provided by the tax credit mechanism contributes to the fair market value of the real property. Credible testimony establishes that the tax credits are the economic equivalent of the federal government making a direct payment for the construction costs of the project. The evidence strongly supports a conclusion that the property's fair market value cannot equal either the actual construction costs, or the market replacement cost. Under no scenario could the market rents support the value indicated by the cost approach. The difference between the income approach value and the cost approach value equals value lost to economic depreciation as soon as the property is put into service.

The limited partner realizes a gain in the form of compensation for the time value of money and for the services that it provides by locating taxpayers who can use the credits as they become available over the 10 year period. It has not been demonstrated that the tax credit mechanism or any resulting economic benefit to the limited partner contributes value to the real estate. It has not been demonstrated that the initial developer (Petitioner) will ever realize a return of this amount ($1.77 million) as reversion value from a future sale. Nor has it been demonstrated that a future buyer would consider the $1.77 million as contributing value to the property, but rather would determine a purchase price based on capitalization of the actual, anticipated income stream from the property, the same as any other investment property.

JUDGMENT

IT IS ORDERED that the property's assessed and taxable values for the tax years at issue shall be as set forth in the *Final Values* section of this Proposed Opinion and Judgment.

IT IS FURTHER ORDERED that the parties shall have 20 days from date of entry of this Proposed Opinion and Judgment to file exceptions and written arguments with the Tribunal consistent with Section 81 of the Administrative Procedures Act (MCL 24.281). The exceptions and written arguments shall be limited to the evidence and legal issues presented at the hearing. This Proposed Opinion and Judgment, together with any exceptions and written arguments, shall be considered by the Tribunal in arriving at a final decision in this matter pursuant to Section 26 of the Tax Tribunal Act (MCL 205.726).

MICHIGAN TAX TRIBUNAL

Entered: April 15, 2011 By: Thomas A. Halick