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Bill Analysis

Version: As Introduced

Primary Sponsor: Sen. M. Huffman

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Summary

- Requires federally subsidized residential rental property to be valued for tax purposes based on its market rent without regard to the effects of government police powers or other governmental action, which may include subsidized rent, favorable financing, tax credits, or use restrictions.

Detailed Analysis

Valuation of subsidized residential rental property

The bill modifies the manner by which county auditors may value federally subsidized low-income rental housing for property tax purposes. In particular, the bill prescribes a special rule of valuation for any property, except college and university dormitories, on which at least one leased residential dwelling unit is situated and to which any of the following apply:

1. Some portion of the unit's construction or renovation costs are paid by financial incentives authorized under federal law;
2. Some portion of the unit tenant's rent is subsidized pursuant to federal law;
3. The unit's developer received federal tax credits to construct the unit as a condition of renting all or a portion of the units to low-income tenants at a less-than-market rent.

In the bill and for the purposes of this analysis, this property is referred to as "subsidized residential rental property."¹

Real property appraisal, generally

The Ohio Constitution requires real property to be "taxed by uniform rule according to value."² To comply with this constitutional requirement, county auditors are generally required

¹ R.C. 5715.01(A)(1).

to appraise real property according to the value at which the unencumbered property would be sold between a willing buyer and a willing seller, often referred to as “fair market value.”

Though a property’s recent sales price is generally to be regarded as the best evidence of its fair market value, recent sales are relatively infrequent, and unconventional terms of sale can be present, so three methods of valuation may be applied to estimate value: one based on sales of comparable properties, one based on the cost of construction, and one based on income capacity such as from rental income. The best method for a given property may depend on how the property is or may legally be used, but the methods are not mutually exclusive; more than one approach may be applied and compared with the results of another. These approaches are prescribed and detailed in administrative rules.

Whatever method may be applied, the law directs the appraiser to disregard encumbrances on property, such as easements, when determining its fair market value, unless they arise from “the exercise of police powers” or “other governmental actions,” such as zoning or government subsidies.³

Subsidized residential rental property

Special considerations are required in valuing subsidized residential rental property. These considerations have been developed in a series of court cases in which tax appraisals of such property were challenged. Courts have generally favored the use of the income approach to value such property, but this approach is complicated because the subsidized rents and construction costs for such property are generally above what the market would otherwise bear without the federal subsidies (subsidized rent is often referred to as “contract rent”). This inflated value is not its unencumbered fair market value because it reflects the rent subsidy, so courts have required the valuation of such property to account for the affirmative value of the subsidies by discounting their effect on value.⁴ Nor should the tax value of such property be inflated to account for tax shelter advantages that might be connected to the property, since courts consider these to be intangible items that do not increase property’s fair market value.⁵

However, appraisers are required to account for governmental actions that restrict how the property may be used, so if a property is subject to significant tenant and rent restrictions as the result of the developer accepting a federal income tax credit, the property should be valued in accordance with those restrictions, which equates to how the property would be valued if sold on the open market with those restrictions.⁶

After deciding several cases where one or both of those considerations have been applied in diverse circumstances, courts have summarized them as follows: (1) the inflated value of subsidized residential rental property resulting from federal subsidies must be adjusted

² Article XII, Section 2, Ohio Constitution. Exceptions are made only for certain agricultural property (CAUV) and for computing tax reduction factors.

³ R.C. 5713.03.

⁴ See *Alliance Towers v. Stark Co. Bd. of Revision*, 37 Ohio St.3d 16, 24-25 (1988).

⁵ *Alliance Towers*, 37 Ohio St.3d at 23.

⁶ See *Woda Ivy Glen L.P. v. Fayette Co. Bd. of Revision*, 121 Ohio St.3d 175 (2009).

out of the determination of its fair market value, generally by using imputed market rents instead of contract rents, and (2) significant restrictions placed on the use of the property as a condition of receiving the subsidies must be accounted for in determining its fair market value.⁷

The practical effect of these considerations may vary according to each situation, particularly with respect to the type of federal subsidy the property is subject to. For example, in one recent case, *Notestine Manor, Inc. v. Logan Co. Bd. of Revision*, the Ohio Supreme Court considered the valuation of subsidized residential rental property subject to a federal program that provided a nonprofit developer with a “capital advance” (i.e., favorable financing) from the U.S. Department of Housing and Urban Development (HUD) to build rental housing for very low-income elderly tenants. HUD and the developer signed an agreement restricting the rent that the tenants would pay and imposing several use restrictions on the property, as well as a restriction on the developer profiting from the lease (i.e., governmental actions).

The Court in *Notestine Manor* upheld a valuation of the property that was determined under the income approach on the basis of the HUD restricted rent, even though the county auditor had used the property’s market rent as a basis for the property’s valuation, which in this instance was lower than the restricted contract rent and would have resulted in a higher valuation. The use restrictions were used to justify the use of contract rent, coupled with the fact that the federal rent subsidies did not actually raise the rent on the units above what the market could bear.⁸

The bill’s modifications

The bill deviates from the analysis prescribed in the *Notestine Manor* case and modifies the standards county auditors must use to value subsidized residential rental property (see **Comment**). First, the bill explicitly requires these properties to be valued according to the income approach. This may not be much of a deviation from current practice because, as discussed above, this approach is already favored in valuing such property.

Second, the bill requires auditors to use a property’s presumed market rent and not the property’s contract rent when employing the income approach to value such property.⁹ This approach deviates somewhat from *Notestine Manor*, in which the Court had rejected the “iron rule” that market rent be used to value all such property, regardless of the federal subsidy program the property is subject to.¹⁰ Under the bill, market rent is to be calculated without accounting for the effects that police powers or other governmental actions may have on the property.¹¹ This is an exception to the general rule that such factors must be considered in valuing real property. The practical effect of this change on current valuation practices depends on the nature of the federal program or subsidy a property is subject to.

⁷ See *Columbus City Schs. Bd. of Educ. v. Franklin Co. Bd. of Revision*, 151 Ohio St.3d 12, 15-16 (2017).

⁸ *Notestine Manor, Inc. v. Logan Co. Bd. of Revision*, 152 Ohio St.3d 439 (2018).

⁹ R.C. 5715.01(A)(1).

¹⁰ See *Notestine Manor, Inc.*, 152 Ohio St.3d at 444-45.

¹¹ R.C. 5713.03 and 5715.01(A)(1).

Comment

The Ohio Constitution requires real property to be taxed “by uniform rule according to value.”¹² The Ohio Supreme Court has interpreted this “uniform rule” to require real property be assessed at a uniform percentage of its fair market value. (According to the Court: “. . . no matter what method of evaluation is used, the ultimate result of such an appraisal must be to determine the amount which such property should bring if sold on the open market.”) To this end, the Court requires uniformity in real property’s “mode of assessment.”¹³

Because the requirement to appraise property at its fair market value is a constitutional requirement, a statute that causes some property to be valued in a manner yielding a value other than its fair market value may conflict with this provision. The bill requires subsidized residential rental property to be valued pursuant to a special method for the purpose of deviating, to some extent, from a series of court cases prescribing standards for determining such property’s fair market value. Thus, the bill could conflict with the uniform rule to the extent the bill’s valuation method results in such property being valued at more or less than its fair market value.

History

Action	Date
Introduced	02-12-19

S0036-I-133/ts

¹² Article XII, Section 2, Ohio Constitution.

¹³ *State ex rel. Park Investment Co. v. Bd. of Tax Appeals*, 175 Ohio St. 410, 412-13 (1964).