

# Low-Income Housing Tax Credit (LIHTC) Property



## Preface

The Arizona Department of Revenue (Department or ADOR) administers the property tax system in cooperation with the 15 county assessors, among others. One of the administrative duties of the Department is to prepare and maintain publications reflecting standard and statutory appraisal methods and techniques that are used in the identification, classification, valuation, and assessment of property for ad valorem purposes. The Department regularly updates these publications, consistent with the following three update types, depending upon the perceived need:

**Review:** Publication conforms to standard style and formatting. Legislative and other citations verified. No changes to content, methodology, policy, or practice.

**Revision:** Includes applicable Review processes. Publication is newly edited. Nonsubstantive legislative changes incorporated. Addition or deletion of information that does not alter methodology.

**Rewrite:** Includes applicable Review and Revision processes. Major substantive changes made to any combination of content, methodology, policy, or practice.

This publication is a Rewrite of the publication entitled *Subsidized Housing Valuation*. This publication supersedes all previous publications by the Department regarding the valuation of property subject to the Low-Income Housing Tax Credit (LIHTC) program and remains effective until replaced. Additional information may be issued as an addendum to this publication or as a separate publication. Due to the flexibility provided for in statute, deadlines and procedures may vary by county. The Department recommends contacting the county assessor of the county in which a subject property is located for detailed information regarding the deadlines and procedures in their jurisdiction. The information in this publication is based upon laws and rules in effect at the time of publication. Should any content in this publication conflict with current laws or rules, the latter shall be controlling.

## Authority

Authority to produce this publication is found in Arizona Revised Statutes (A.R.S.) [42-11054\(A\) \(1\) and \(2\)](#). Regarding the weight of authority of this publication, see A.R.S. [42-13051\(B\)\(2\)](#).

## Practical Examples

All practical examples that may appear herein are representative of how the Department would apply a given set of data while adhering to standard appraisal methods and techniques and to guidelines of the industry and of Arizona. Practical examples may demonstrate the current best practices used to make a necessary determination. Some practical examples may demonstrate the application of a process mandated by statute. See A.R.S. [42-11001\(6\)](#). Other practical examples may demonstrate methods that are adaptable to the particular situations of the various counties. Specific calculations used in the practical examples that may be found herein are for demonstration purposes only.

## Publication Formatting and Style

Publications produced by the Department Property Tax Unit generally follow the rules of citation, format, grammar, punctuation, and related matters found in the following three guides: *Style Manual: An Official Guide to the Form and Style of Federal Government Publications*,<sup>1</sup> *The Chicago Manual of Style*,<sup>2</sup> and *The Bluebook: A Uniform System of Citation*.<sup>3</sup>

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<sup>1</sup> United States Government Publishing Office (U.S. GPO), [Style Manual: An Official Guide to the Form and Style of Federal Government Publications](#), 31st ed. (Washington, DC: U.S. GPO, 2016).

<sup>2</sup> The University of Chicago, [The Chicago Manual of Style](#), 17th ed. (Chicago: University of Chicago Press, 2017).

<sup>3</sup> Editors, Columbia Law Review, et al., comps., [The Bluebook: A Uniform System of Citation](#), 21st ed. (Cambridge: Harvard Law Review Association, 2021).

All comments, inquiries, and suggestions concerning the material in this publication may be submitted to the following:

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This publication can be accessed on the Department website at:

[https://azdor.gov/sites/default/files/2023-03/PROPERTY\\_LIHTCProperty.pdf](https://azdor.gov/sites/default/files/2023-03/PROPERTY_LIHTCProperty.pdf).

## Changes in Law

### Statutory Changes

This publication has been updated according to the 2022 legislative session (the 55th Legislature, 2nd Regular Session). Changes to the Arizona Revised Statutes that may be applicable to this publication are included in the table below.

#### **2021 – Fifty-fifth Legislature – First Regular Session**

##### **Senate Bill 1076: Amended A.R.S. 42-12004 and added 42-13601 et seq.**

Creates and defines a new category of Class Four property: low-income multifamily residential rental property (property subject to the LIHTC program); describes an elective statutory valuation method; sets forth reporting requirements, valuation method, and appeal procedures.

#### **2022 – Fifty-fifth Legislature – Second Regular Session**

##### **House Bill 2610: Amended A.R.S. 42-11133**

Removes the 200-unit limit that was previously required to qualify affordable rental housing (including LIHTC property) for exemption from property taxation. NOTE: This publication does **not** address exempt LIHTC property. For more information, refer to [Property Tax Exemptions](#).

## Caselaw Changes

### Arizona Court of Appeals

#### Maricopa County v. Viola (2021)<sup>4</sup>

Prescribes that the assessor must:

- Account for the rent restrictions applicable to LIHTC property in determining its fair market value, regardless of the valuation method used.<sup>5</sup>
- Use the actual rents charged in determining the full cash value of LIHTC property for taxation purposes.<sup>6</sup>
- Account for deed restrictions regarding the use of LIHTC property in determining its full cash value, and not value LIHTC property as if it were a conventional apartment complex.<sup>7</sup>

These changes in law significantly modify the prior income valuation method for LIHTC property recommended by the Department. Accordingly, the Department advises assessor personnel to become familiar with the material in this publication before valuing housing that is subject to the LIHTC program.

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<sup>4</sup> Maricopa County v. Viola, 251 Ariz. 276, 490 P.3d 385 (App. 2021) [hereinafter, [Viola](#)].

<sup>5</sup> Ibid. at 281, 390 (citing Cottonwood Affordable Housing v. Yavapai County, 205 Ariz. 427, 430, 72 P.3d 357, 360 (Ariz. Tax Ct. 2003) [hereinafter [Cottonwood](#)]).

<sup>6</sup> [Viola](#), *supra* note 4, at 277, 386.

<sup>7</sup> Ibid. at 280, 389.

## Introduction

Subsidized multifamily rental housing programs were first created under state and federal legislation that was passed in response to the Great Depression. Since that time, such housing programs have been modified and expanded.

Incentives in early legislation included low interest rate loans, loan subsidies, and housing preservation programs administered by federal agencies such as the Department of Housing and Urban Development and the Farm Service Agency. This publication addresses the LIHTC program established by the Tax Reform Act of 1986 and codified under Section [42](#) of the Internal Revenue Code.

The objective of the LIHTC program is to provide affordable low-income residential rental property by encouraging the acquisition, construction, and rehabilitation of the same. This is accomplished by providing federal income tax credits to owners and investors of LIHTC projects in exchange for equity participation. Compliance monitoring for the LIHTC program is administered by the Arizona Department of Housing (ADOH).<sup>8</sup> In addition, the restricted rents required by the LIHTC program are reviewed and revised annually by ADOH, according to specific federal requirements.<sup>9</sup>

The purpose of this publication is to provide assessment personnel and other interested parties with the information and procedures necessary to identify, classify, value, and assess **non-exempt** LIHTC property in accordance with Arizona law.

## Identification and Classification of LIHTC Property

### Identification

Pursuant to A.R.S. [42-13601\(3\)](#), LIHTC property is defined as follows:

“Low-income multifamily residential rental property” means multifamily residential property to which all of the following apply:

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<sup>8</sup> See Arizona Department of Housing (ADOH), [Compliance Manual: Low Income Housing Tax Credit Program](#) (Phoenix: ADOH 2019).

<sup>9</sup> See *ibid.*

- (a) The owner received an allocation of federal income tax credits through the low-income housing tax credit program.
- (b) The property remains both income and rent restricted consistent with the low-income housing tax credit program and the provisions of the declaration of affirmative land use restrictive covenants agreement recorded on the property. The requirement of this subdivision is met if an affirmative land use restrictive covenants agreement is not yet recorded on the property but the property is otherwise subject to both income and rent restrictions under the low-income housing tax credit program.
- (c) A federal, state or tribal court has not entered a judgment or order based on a finding that an act or omission of an owner or operator of the property constitutes a breach or violation of either:
  - (i) The declaration of affirmative land use restrictive covenants agreement recorded on the property.
  - (ii) Restrictions under the low-income housing tax credit program imposed on the property but not contained within an affirmative land use restrictive covenants agreement.
- (d) The restrictions apply to all units on the property except employee units.

### **Classification**

Housing that is subject to the LIHTC program is classified as property Class Four with a 10 percent assessment ratio. A.R.S. [42-12004\(11\)](#) and [42-15004](#).

### **Valuation of LIHTC Property**

As set forth in A.R.S. [42-13603\(A\)](#), the owner or operator of LIHTC property may elect to have the property valued using the statutory income method described in A.R.S. [42-13603\(B\)](#). If this election is not made by the owner or operator, or if the property does not qualify for the statutory valuation, the assessor should estimate the value of the LIHTC property using standard appraisal methods and techniques. See A.R.S. [42-11001\(6\)](#). However, regardless of the method used, LIHTC property in Arizona must be valued while taking into account the various restrictions prescribed by the LIHTC program. These restrictions are specified in the next section.

## Valuation Restrictions

In a 2021 opinion, the Arizona Court of Appeals held that in valuing LIHTC property, the assessor must:

- Account for the rent restrictions applicable to LIHTC property in determining its fair market value, regardless of the valuation method used.<sup>10</sup>
- Use the actual rents charged in determining the full cash value of LIHTC property for taxation purposes.<sup>11</sup>
- Account for deed restrictions regarding the use of LIHTC property in determining its full cash value, and not value LIHTC property as if it were a conventional apartment complex.<sup>12</sup>

These holdings significantly modify the prior income valuation method recommended by the Department, which advised the assessor to value LIHTC property as unencumbered fee property without consideration for either the restrictions or the benefits bestowed by the LIHTC program.

## Statutory Valuation of LIHTC Property

### ***Election of the Statutory Income Valuation Method***

To elect the statutory income valuation method for LIHTC property, the owner must submit ADOR Form [82603](#) along with all required documentation to the assessor before September 1 of the year immediately preceding the year for which the property will be

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<sup>10</sup> [Viola](#), *supra* note 4, at 281, 390 (citing [Cottonwood](#), *supra* note 5, at 430, 360).

<sup>11</sup> [Viola](#), *supra* note 4, at 277, 386.

<sup>12</sup> *Ibid.* at 280, 389. In support of this opinion, the court stated:

An LIHTC property cannot be valued as if it were a conventional apartment complex because it is not and cannot be used as such. The “use” of an LIHTC property is not simply that of a conventional apartment complex. The restrictions subject LIHTC properties to continuing government mandates that impose operational and compliance costs, periodic monitoring, on-site inspections, and compliance reviews. The restrictions also limit who can live in LIHTC properties to those with a certain income or who meet other classifications (i.e., homeless, mentally ill, domestic violence victims, physically disabled)... [T]he deed restrictions requiring the properties be used as LIHTC projects must be taken into account to fairly determine the full cash value of the property. A market value approach requires us to consider market value limitations.

*Ibid.* (internal citations omitted).



valued. A.R.S. [42-13603\(C\)](#). Pursuant to A.R.S. [42-13603](#) and [42-13604](#), the required documentation includes the following:

- **Financial Documentation:**
  - The three most current annual audited financial statements required by ADOH, **or**
  - If three annual audited financial statements are not available because the property is too new to the LIHTC program, then the available audited financial statements and the pro forma income and expense data that were provided to ADOH at the time the LIHTC program application was submitted.
- **Qualification Documentation:** Written documentation confirming that the property has been placed in service as low-income multifamily residential rental property, consistent with Section [42](#) of the Internal Revenue Code. This written documentation may include either of the following:
  - Internal Revenue Service Form [8609](#), or an equivalent form designated by the Internal Revenue Code, signed by ADOH, **or**
  - The Certificate of Occupancy and the recorded Declaration of Affirmative Land Use and Restrictive Covenants Agreement (LURA).

### ***Application of the Statutory Income Valuation Method***

If the owner of LIHTC property completes timely and proper election of the statutory income valuation method, the property must be valued according to A.R.S. [42-13603\(B\)](#). The method set forth in this statute prescribes the use of the actual annual income and expenses of the LIHTC property and an adjusted capitalization rate. A.R.S. [42-13603\(B\)](#). These individual components are described in the following paragraphs.

**Actual Annual Income.** Actual annual income is defined in A.R.S. [42-13603\(G\)\(2\)\(a\)](#) as “all operating income generated from the rental of real property, including rents, application and late fees and forfeited security deposits.” Excluded from actual annual

income are “the federal income tax credits or investment proceeds resulting from the federal income tax credits that are allocated to the owner.” A.R.S. [42-13603\(G\)\(2\)\(b\)](#).

**Actual Annual Expenses.** Actual annual expenses include the following, as set forth in A.R.S. [42-13603\(G\)\(1\)](#):

“Actual annual expenses” means all operating expenses, as reflected in the annual income and expense documentation submitted pursuant to subsection C of this section, including the following:

- (a) Maintenance and repair costs.
- (b) Supplies.
- (c) Service contracts.
- (d) Utilities.
- (e) Tenant internet service and other services required by the Arizona department of housing.
- (f) Administrative costs, including costs for the following:
  - (i) Accounting and auditing.
  - (ii) Office supplies.
  - (iii) Compliance and asset management.
  - (iv) Monitoring imposed by the Arizona department of housing.
  - (v) Attorney fees.
  - (vi) Payroll and payroll taxes.
  - (vii) Employee benefits.
  - (viii) Security.
  - (ix) Supportive and any other services stipulated by the affirmative land use restrictive covenants agreement.
  - (x) Marketing, leasing, advertising and promotion.
- (g) Property management fees.
- (h) Ground and land lease costs.
- (i) Property and liability insurance.
- (j) Taxes, except property taxes determined pursuant to subsection B of this section.
- (k) Required replacement and operating reserves.

(l) For properties for which the tenants pay their own utility costs, utility costs for common areas and vacant units.

(m) Any other costs imposed pursuant to the affirmative land use restrictive covenants agreement.

**Adjusted Capitalization Rate.** The statutory income valuation method for LIHTC property requires the use of an adjusted capitalization rate that is:

- Based on the prevailing capitalization rate for conventional multifamily property in the same geographic area.
- Adjusted to account for the differences between low-income multifamily residential rental properties and conventional multifamily properties, including:
  - The additional risk that the recorded LURA places on the net operating income from the property.
  - The restriction on the use of the property as affordable housing.
  - The time period that the income and use restrictions remain in effect on the property.
  - The illiquidity caused by the reduced pool of qualified potential buyers.

A.R.S. [42-13603\(B\)](#). After the adjusted capitalization rate is determined, it is added to the effective tax rate before calculating the full cash value of the property. A.R.S. [42-13603\(B\)](#).

**Change in Qualification.** According to A.R.S. [42-13603\(F\)](#),

If a property previously qualified for valuation under this article but has been fully transitioned to current use as a conventional multifamily property in compliance with 26 United States Code section 42(h)(6)(E), the property shall no longer be valued under this article and the property's limited value shall be calculated pursuant to section 42-13302.

### **Non-Statutory Valuation of LIHTC Property**

As previously stated, if the statutory valuation method is not elected by the owner of LIHTC property, or the property does not qualify for the statutory valuation method, the

assessor should estimate the value of the LIHTC property using standard appraisal methods and techniques, while taking into account the various restrictions prescribed by the LIHTC program. To accomplish this, the following techniques may be used in conjunction with the three approaches to value.

### ***Income Approach***

In Arizona, the income approach is the most commonly applied method used to value LIHTC property, in part due to certain caselaw restrictions. See [Valuation Restrictions](#) above. These restrictions can be accounted for when using the income approach, as follows:

- **Actual Rents:** Actual rents charged must be used to determine the net operating income of the LIHTC property.<sup>13</sup>
- **Income Tax Credits:** Income tax credits received by the owner of LIHTC property are considered intangible personal property, and therefore should not be added to the value of the real property or be considered as part of the income stream.<sup>14</sup>
- **Additional Operating Expenses:** Additional operating expenses that are often associated with LIHTC property (as opposed to conventional or non-subsidized rental housing) must be identified and incorporated where applicable in determining the net operating income of the LIHTC property.
- **Capitalization Rate:** The capitalization rate used in the valuation of LIHTC property may need to be adjusted to account for both positive and negative factors affecting the property, such as debt-to-equity financing and use restrictions.

### ***Cost Approach***

When using the cost approach to estimate the value of LIHTC property, applicable LIHTC program restrictions may be accounted for by comparing the market rents of

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<sup>13</sup> [Viola](#), *supra* note 4, at 277, 386.

<sup>14</sup> [Cottonwood](#), *supra* note 5, at 429, 359.

similar conventional multifamily rental properties to the restricted rents of the subject LIHTC property, and then quantifying the difference into an adjustment for external obsolescence that is applied to the subject improvements.

### ***Sales Comparison Approach***

When using the sales comparison approach to estimate the value of LIHTC property, LIHTC program restrictions are accounted for by using recent sales of similarly-restricted rental properties as comparables. However, in most cases there are not a sufficient number of comparable properties sold or listed for sale to provide the desired quantity and quality of sales data, making the sales comparison approach difficult to use in the valuation of LIHTC property.

For additional information regarding the approaches to value, refer to [Approaches to Value](#) (comprehensive) or to [Overview of the Arizona Property Tax System](#) (summary).

## **Management of LIHTC Property**

### **Election of Credit for State Income Tax or Insurance Premium**

An owner or operator of LIHTC property in Arizona may apply to receive either an “affordable housing tax credit” (state income tax credit) or an insurance premium credit, in addition to the federal income tax credit provided for under Section [42](#) of the Internal Revenue Code. A.R.S. [41-3954](#). However, electing either of the state-provided credits disqualifies the LIHTC property from being valued using the statutory income valuation method in A.R.S. [42-13603\(B\)](#) and from receiving property tax exemption under A.R.S. [42-11133](#).<sup>15</sup> As stated in A.R.S. [41-3954\(F\)](#), “A qualified [LIHTC] project that is approved for the purposes of the [state income tax or insurance premium] credit under this section

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<sup>15</sup> Note that most LIHTC property in Arizona could qualify for exemption from property taxes, assuming the property owner or operator has not applied for and received the state income tax credit or insurance premium credit. For more information regarding the exemption of LIHTC property, refer to [Property Tax Exemptions](#).

is not eligible for any abatement, exemption or other reduction in state or local ad valorem property taxes otherwise allowed by statute.”

### **Valuation Appeals for LIHTC Property**

Pursuant to A.R.S. [42-13605\(A\)](#), an owner or operator of LIHTC property who elects to have the property valued according to the income valuation method set forth in A.R.S. [42-13603\(B\)](#), may appeal the valuation according to A.R.S. [42-16001](#) et seq.

In support of such an appeal, “the owner or operator may submit more recent income and expense data from the year preceding January 1 of the valuation year to be used in calculating the value of the property by the valuation method set forth in this article.” A.R.S. [42-13605\(A\)](#).

An owner or operator of LIHTC property who does **not** opt into the income valuation method in A.R.S. [42-13603\(B\)](#), may nevertheless appeal the value of such property using the statutory income valuation method. A.R.S. [42-13605\(B\)](#).

For additional information regarding valuation appeals, refer to [The Appeals Process](#) (comprehensive) or to [Overview of the Arizona Property Tax System](#) (summary).