

STATE OF NORTH CAROLINA BEFORE THE PROPERTY TAX COMMISSION
SITTING AS THE STATE BOARD OF
COUNTY OF WAKE EQUALIZATION AND REVIEW
97 PTC 427

IN THE MATTER OF:
APPEAL OF **the Greens of Pine
Glen Ltd. Partnership** from the
decision of the Durham County Board
of Equalization and Review regarding
the valuation of certain real property
for tax year 1997.

FINAL DECISION
on
REMAND

This matter initially came on for hearing before the North Carolina Property Tax Commission (hereinafter "Commission"), sitting as the State Board of Equalization and Review in the City of Raleigh, Wake County, North Carolina, at its regularly scheduled Session of Hearings on April 13 and 14, 2000, pursuant to the appeal of The Greens of Pine Glen Ltd. Partnership (hereinafter "Taxpayer") from the decision of the Durham County Board of Equalization and Review (hereinafter "County Board") regarding the valuation of certain real property for tax year 1997.

At the time of the above-referenced hearing, Chairman Terry L. Wheeler presided with Vice Chair Juleigh Sitton and Commission members R. Bruce Cope, Linda M. Absher and Wade F. Wilmoth participating.

On June 19, 2000, the Commission entered a Final Decision determining, by a 3:2 vote, with then Vice Chair Sitton and Commissioner Wilmoth dissenting, that Durham County did not use an illegal or arbitrary method of appraisal in reaching the assessed value that was assigned to the Taxpayer's property as of January 1, 1997. On July 12, 2000, the Taxpayer, through counsel, filed the notice of appeal and exceptions with the Commission regarding this decision that confirmed the valuation of the subject property by the 1997 Durham County Board of Equalization and Review.

On September 12, 2001, the North Carolina Court of Appeals heard oral arguments regarding the Taxpayer's appeal of the Commission's final decision. On November 20, 2001, the Court of Appeals issued an opinion reversing the Commission's decision and instructing the Commission to either hold a new hearing to redetermine the value of the subject property or further remand to the County for a redetermination of value. On December 20, 2001, pursuant to G.S. 7A-31, Durham County, through counsel, filed a petition for discretionary review with the Supreme Court of North Carolina. In its petition, Durham County requested the Supreme Court to certify for discretionary review the judgment of the North Carolina Court of Appeals reversing and remanding the decision of the Property Tax Commission. In its petition, Durham County established that the subject

matter of the appeal has significant public interest, involves legal principles of major significance to the jurisprudence of the State, and the decision of the Court of Appeals is in conflict with numerous prior decisions of the Supreme Court on a host of issues, including: the conduct of property tax appeals before the Property Tax Commission and our appellate courts, waiver of rights, and separation of powers.

On February 28, 2003, the Supreme Court of North Carolina issued the opinion of the Honorable Robert H. Edmunds, Jr., Associate Justice to the North Carolina Supreme Court. Writing for the Court, Justice Edmunds reversed the Court of Appeals' opinion and remanded the matter to the Court of Appeals with further remand to the North Carolina Property Tax Commission for the limited purpose of substituting in its final decision the correct square footage value for the subject property. On April 1, 2003, the Court of Appeal issued the certification of judgment to the North Carolina Property Tax Commission which ordered that its prior decision be vacated and that this matter is remanded to the North Carolina Property Tax Commission for further proceedings consistent with the opinion of the Supreme Court.

The current Commission consisting of Chairman Terry L. Wheeler, Vice Chairman R. Bruce Cope and Commission members Wade F. Wilmoth Harvey W. Raynor, III and Anthony L. Young renders this decision as directed by the Supreme Court in the opinion filed on February 28, 2003.

STATEMENT OF CASE

The property subject to this appeal is a 168 unit apartment complex located along the I-40 corridor in the southern part of Durham County near the Research Triangle Park. Construction of the apartment complex was completed in the fall of 1996 and the Durham County Tax Administrator first appraised the subject property, as a completed project, in 1997 pursuant to N. C. Gen. Stat. § 105-287. Durham County's most recent general reappraisal was effective January 1, 1993. Effective January 1, 1997, Durham County sent the Taxpayer a notice showing the appraised value of the subject property at \$5,941,692, which was based upon the capitalization of the actual income reported to the Durham County Tax Administrator by the Taxpayer. Subsequently, the Durham County Tax Administrator discovered that the actual income, as reported, had been contractually restricted due to the Taxpayer's participation in an affordable housing program administered under Section 42 of the Internal Revenue Code. In essence this federal program provides the Taxpayer, in exchange for rent restrictions on the subject property, significant federal income tax credits. The tax credits provided by Section 42 are intangible property, which is not taxable by Durham County.

The Taxpayer contends that the value should be \$5,723,000 based upon the application of the income approach and recognizing the restricted income position of the

subject property. The Taxpayer also contends that the tax credits issued to the partners in ownership are intangible personal property that is not taxable in North Carolina.

In response to Taxpayer's contentions, Durham County asserts that the unusual financing arrangement, allowed under Section 42, does not reflect the market value of the property, and use of actual income figures, which reflect below market rents, would constitute a misapplication of the County's schedules of values, standards and rules. Hence, Durham County appraised the subject property using the cost approach method of valuation and after making the appropriate correction, appraised the subject property at a total of \$7,488,350 for tax year 1997. Durham County later discovered that it had erred in calculating the property's square footage in its May 1997 appraisal and accordingly sent a corrected third appraisal to the taxpayer in 1998, decreasing the appraised value to \$7,250,050 for tax year 1998.

ISSUES

In the Order on Final Pre-Hearing Conference, the parties presented different versions of the issues to be decided by the Commission. Noting that the North Carolina Supreme Court has established guidelines for property tax appraisal appeals in the matter of In re Appeal of Amp, Inc., 287 N.C. 547, 215 S.E.2d 752 (1975), the Commission finds that the issues presented in this appeal were:

1. Did Durham County employ an arbitrary or illegal method of appraisal in reaching the value assigned to the Greens of Pine Glen Apartments for 1 January 1997?
2. Did Durham County's appraisal of the Greens of Pine Glen Apartments **substantially** exceed the true value in money of the property as of 1 January 1997?
3. If these two issues are answered in the affirmative, what was the true value in money of the subject property as of 1 January 1997?

Under the guidelines of AMP, supra, the Taxpayer has the burden of establishing:

1. The County employed an arbitrary or illegal method of appraisal; and
2. The value assigned by the County Board was **substantially** greater than the true value in money of the property as of January 1 for the year at issue.

STIPLUATIONS

In the Order on Final Pre-Hearing Conference, the parties stipulated to the following fact:

1. The most recent general reappraisal in Durham County was effective January 1, 1993.

THE COMMISSION, AS DIRECTED IN THE OPINION OF THE NORTH CAROLINA SUPREME COURT, MAKES THE FOLLOWING FINDINGS OF FACT:

1. The property under appeal is a 168 unit apartment complex located on a 19.00 acre tract in the southern part of Durham County, North Carolina, and identified on the Durham County property record card as tax parcel 536-01-003C.

2. The Taxpayer, Greens of Pine Glen Limited Partnership, an Ohio limited partnership, developed and owns the subject property, known as, The Greens of Pine Glen Apartments. The Greens of Pine Glen Limited Partnership includes one general partner, WO Brisben Companies, Inc., an Ohio corporation, and one limited partner, SunAmerica Housing Fund 213, a Nevada limited partnership.

3. The Taxpayer developed the subject property using low-income housing tax credits granted under Section 42 of the Internal Revenue Code and awarded by the North Carolina Housing Finance Agency. In exchange for receiving the tax credits under Section 42, the Taxpayer agreed to certain restrictions on the rental of the subject apartments. Pursuant to a restrictive covenant contract, which was signed by the Taxpayer and filed in the Durham County Register of Deeds Office, the Taxpayer agreed to rent all 168 units only to families whose income was equivalent to or less than sixty percent (60%) of the median area income for the Triangle Area. In addition, the Taxpayer agreed to comply with the rent formula established under Section 42, which established a maximum rent for the subject apartments. Taxpayer offered testimony that the rents established under the program guidelines are roughly twenty-five to thirty percent (25%-30%) lower than what the subject units would rent for outside of the program.

4. Construction of the subject apartments was completed in the Fall of 1996 and the Durham County Tax Administrator first appraised the subject property as a completed project beginning in tax year 1997. Effective January 1, 1997, the Durham County Tax Administrator sent the Taxpayer a notice, dated April 9, 1997, showing the total appraised value of the subject property at \$5,941,692, which was based upon the capitalization of actual contract rents reported to the Durham County Tax Administrator by the Taxpayer. The initial appraisal of the subject property was arrived at by use of actual contract rents,

which are not reflective of market rents. The Durham County appraiser that prepared the initial appraisal was unaware that the rents he used in the income formula were contractual rents and not market rents and such actual rents reflected the restrictions imposed by the tax credit program.

5. After the mailing of the April 9, 1997 notice to the Taxpayer, a Durham County appraiser was alerted that the initial appraisal of the subject property at a total value of \$5,941,692 was in error. The initial appraisal was not proper because contractual rents, instead of the legally required market rents, were applied to the income approach to value which resulted in a misapplication of Durham County's schedules of values, standards, and rules. During the 1993 countywide reappraisal, all apartments were appraised using the cost approach. When a Taxpayer challenged a value and furnished the tax office with market data regarding rents and expenses, the Durham County Assessor would consider the income approach method and if this approach resulted in market value, then the taxpayer's property assessment was changed to reflect the lower value.

6. Applying the cost approach method to value, the Taxpayer received a new notice of value, dated May 9, 1997, wherein Durham County assessed the subject property at a total value of \$7,488,350 as of January 1, 1997. This reappraisal was performed in accordance with Durham County's duly adopted schedules of values, standards, and rules for the 1993 countywide general reappraisal and in a manner consistent with the County's appraisal of similar properties. In fact, all apartment projects in the county, except for the initial valuation of the subject property, which were constructed under the Section 42 Program, were appraised by using the cost approach method to value.

7. Durham County later discovered that it had erred in calculating the property's square footage in its May 1997 appraisal of the subject property at a total value of \$7,488,350 and accordingly sent a corrected third appraisal to the Taxpayer in 1998, decreasing the appraised value to \$7,250,050. This reappraisal was performed in accordance with Durham County's duly adopted schedules of values, standards, and rules for the 1993 countywide general reappraisal and in a manner consistent with the County's appraisal of similar properties.

8. The Taxpayer filed an appeal with the Durham County Board of Equalization and Review, contesting Durham County's appraisal of the subject property, and argued that the fair market value of the subject property was \$5,723,000 as of January 1, 1997. The Durham County Board of Equalization and Review affirmed the County's assessment of \$7,488,350, finding that the reappraisal of the subject property was correct and ordered no change in value. From that decision, Taxpayer filed a timely appeal with the Commission and requested a full hearing in this matter pursuant to N.C. Gen. Stat. § 105-290.

9. At the hearing, Durham County called upon Donald S. Johnson, MAI, to testify regarding the true value in money of the subject property. Mr. Johnson submitted a written appraisal report regarding his findings and opinions of value for the subject property. He testified that the highest and best use of the subject property is its present use as an apartment complex. (See County Exhibit 7, at page 24).

10. Mr. Johnson testified regarding the three accepted appraisal approaches to value, namely the cost approach, comparable sales approach, and income approach. He testified and reported in his written appraisal that for ad valorem tax purposes, the tax assessor must consider the full fee simple interest in the subject property. He explained that the fee simple interest is not diminished by contractual obligations assumed by the owners of the property, such as leases, mortgages, or, as in the case of the Greens of Pine Glen, rent restrictions placed on the property in order to qualify for certain tax incentives. Mr. Johnson further testified that the fee simple interest would be the value of the property as if unencumbered by any contract or restriction, other than one imposed by one of the four powers of government, taxation, eminent domain, police powers and escheat. A fee simple estate implies absolute ownership, the utmost rights that can be owned by an individual excepting the governmental powers.

11. Mr. Johnson used all three approaches to value in his report to develop an opinion of value for the subject apartments. In applying the cost approach, Mr. Johnson used Marshall and Swift valuation service, which is also the basis for Durham County's 1993 schedules of values, standards and rules. Under this approach, he arrived at an opinion of value of \$8,148,500 as of January 1, 1993. Under the sales comparison approach, Mr. Johnson arrived at a total value of \$8,000,000, giving greatest weight to the effective gross income multiplier. In applying the income approach, Mr. Johnson arrived at a total value of \$8,111,700 for the subject property after reconciling the direct capitalization analysis and the discounted cash flow analysis. After reconciling the figures obtained using the three approaches, Mr. Johnson gave a final opinion of value for the subject property as of January 1, 1993, of \$8,100,000. Durham County did not request that the Commission raise the appraised value to this figure, but sought the opinion of Mr. Johnson to refute the Taxpayer's contention that the assessed value of \$7,488,350 substantially exceeded the true value in money of the subject apartments.

12. The Taxpayer offered neither testimony of an expert appraiser regarding the value of the subject property, nor evidence of the value of the subject property using all three of the generally recognized methods of appraisal. Rather, the Taxpayer argued that the property should be valued using the income approach only and considering only the rents as restricted under the contract signed to participate in the program under Section 42 of the Internal Revenue Code. In addition, the Taxpayer contended that in valuing the property in this manner there should be no consideration of the tax credits that the Taxpayer received which compensated for the restrictions on the rental income. As

evidence of value, the Taxpayer offered only a pro forma income statement presented by an officer of W. O. Brisben Companies, the general partner in the partnership that owns the property. (See Taxpayer Exhibit L).

13. The Commission finds that the income approach, as applied in Taxpayer Exhibit L, does not reflect the value of the full fee simple interest in the subject property. Under the Section 42 Program guidelines, developers must, in order to qualify for the tax credits, lease the apartments at rates that will not cover the cost to construct the buildings. These developers, however, are not engaged in charity. They agree to the sub-market rents in order to obtain the highly sought after benefits of the tax credit. Mr. Schuler testified to their tremendous value when he explained to the Commission the intensity of the competition between developers in trying to get into the program administered under Section 42 of the Internal Revenue Code and in applying for tax credits from the housing finance agencies. These tax credits are enormously valuable to the developer, but their value is not reflected in the lease rate. For this reason, application of the income approach to value to nominal rents in this situation inevitably leads to an appraisal much lower than the true value in money of the property.

14. At the hearing, the Taxpayer argued that the program under Section 42 involved a governmental restriction that encourages the building and maintenance of low and moderate-income housing. The Commission finds no merit in Taxpayer's argument, by Mr. Schuler, that appraising the property based on the full fee simple interest would frustrate public policy by imposing a tax burden that would discourage private developers from building low-income housing. Since the Taxpayer has voluntarily agreed, to contractual rents, below market, in exchange for tax credits, then it has done nothing more than establish a financial arrangement that financially benefits the Taxpayer. Thus, this is clearly not a government restriction akin to zoning or environmental protection restrictions. Furthermore, Taxpayer offered no evidence, and the Commission finds no indication whatsoever, that Congress intended to create subsidies by the local governments in addition to the substantial federal economic incentives already provided to induce private developers to construct and operate quality low and moderate-income housing. It is clear from the evidence that no federal, state, or local units of government have the power to impose rent restrictions on private property.

15. In this matter, the Taxpayer compared the subject tax credits to a mortgage loan and as such are not subject to taxation by Durham County. Durham County, in its opening statement, agrees that the tax credits, provided by Section 42, are intangible property, which is not taxable by Durham County. But the tax credits make the construction project feasible with the infusion of cash from the sale of the credits.

BASED UPON THE FOREGOING FINDINGS OF FACT, STIPULATION AND OPINION OF THE NORTH CAROLINA SUPREME COURT, THE PROPERTY TAX COMMISSION CONCLUDES AS A MATTER OF LAW:

1. The Commission has jurisdiction to hear this appeal and correct any assessment of real property that is shown to be based upon an arbitrary or illegal method of valuation and that the valuation substantially exceeds the true value in money.

2. In North Carolina property must be valued for ad valorem tax assessment purposes at its true value in money, which is statutorily defined as market value. Specifically, N.C. Gen. Stat. § 105-283 provides in part that:

“All property, real and personal, shall as far as practicable be appraised or valued at its true value in money. When used in this Subchapter, the words “true value” shall be interpreted as meaning market value, that is, the price estimated in terms of money at which the property would change hands between a willing and financially able buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all the uses to which the property is adapted and for which it is capable of being used.”

3. Ad valorem assessments are presumed to be correct. In order for the Taxpayer to rebut the presumption of correctness, the Taxpayer must prove that the County employed an arbitrary or illegal method of valuation and that the assessment of the subject property substantially exceeded the true value in money of the subject property.

4. The Taxpayer’s insistence upon using the income approach with the rents as restricted under the federal program administered pursuant to Section 42 would result in a value of only a partial interest in the subject property. The rents that the Taxpayer is entitled to receive represent only a part of the bundle of rights in the subject property. The party who is entitled to receive the tax credits that have been granted holds the remainder of the bundle of rights in the subject property. In North Carolina, a property tax appraisal applies to the whole bundle of rights, or the fee simple interest in the property.

5. Taxpayer argued before the Commission that the tax credits are intangible personal property and that it is illegal in the state of North Carolina to assess real property taxes on them. The Commission finds however that N.C. Gen. Stat. § 105-276 contemplates a situation such as this, where part of the value of real property lies in an intangible source. N.C. Gen. Stat. § 105-276 provides in part that: “The exclusion of a class of intangible personal property from taxation under N. C. Gen. Stat. § 105-275 does

not affect the appraisal or assessment of real property....” This provision clearly permits the appraisal of the full bundle of rights in the subject property, even where some of the property’s value lies in the tax credits.

6. Taxpayer failed to show by competent, material or substantial evidence that Durham County’s appraisal of the subject property was arbitrary, illegal or that the value substantially exceeded the true value in money of the subject property. See In re Amp, Inc., 287 N.C. 547, 215 S.E.2d 752 (1975). The Taxpayer argued that the use of the cost approach to appraise an income-producing property was arbitrary and illegal. However, the cost approach is a commonly recognized method for appraising real property, and where the income approach cannot reliably estimate the true value of the subject property, as here, the appraiser is obligated to look at other factors to determine the true value. (See N.C. Gen. Stat. § 105-317). There is nothing arbitrary or illegal about considering factors that have been specifically enumerated by the General Assembly. The Commission thus concludes that the methods used by Durham County, in the appraisal of the subject property, were neither arbitrary nor illegal.

7. While it is generally accepted that the income approach is the most reliable method in reaching the true market value of commercial or investment property, see In re Belk-Broome Co., 119 N.C. App. 470, 474, 458 S.E.2d 921, 924 (1995). The North Carolina Supreme Court has specifically addressed the use of this approach in situations where there is a contractual obligation on property that artificially fixes its earning capacity. In In re Southern Railway Company, 313 N.C. 177, 328 S.E.2d 235 (1985), the Court explained the use of the income approach as follows:

Under the income approach to value, fair market value must be determined by current market conditions, not existing contractual obligations with reference to the asset being valued . . . [V]aluations of real property for ad valorem tax purposes using the income approach must be based on fair market rents, not actual contract rents. Id. at 190, 328 S.E.2d at 244. Following this reasoning, the Court stated that the use of actual contract rents not reflective of market rents is *illegal* in making market value appraisals under the income approach. Id. (emphasis added). This is the foundational legal principal that the courts established in In re Greensboro Office Partnership, 72 N.C. App. 635, 325 S.E.2d 855 (1985), In re Pine Raleigh, 258 N.C. 298, 128 S.E.2d 855 (1962), and also in In re Valuation of Property Located at 411-417 West Fourth Street, 282 N.C. 71, 191 S.E.2d 692 (1972), in which the Supreme Court found that where the contract rents produced a higher value, the appraiser still had to look at the market.

8. Appraisers have at their disposal a number of different tools and types of analyses that they can use to ascertain the true value in money of real property. These types of analyses include the cost approach, the sales comparison approach, and the income approach. All three approaches are designed to yield the true value in money of a piece of property. While it is true that the income approach is used most often in appraising commercial property, the courts have found that the cost approach is better suited for valuing specialty property or newly developed property and that it is also very useful where, as in the present case, no other method will yield a realistic value. See In re Belk-Broome Co., 119 N.C. App. 470, 474, 458 S.E.2d 921, 924 (1995).

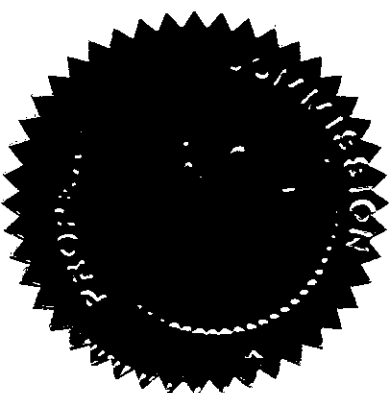
9. Durham County was legally required to appraise the subject property for ad valorem tax purposes as though it were not encumbered by the Section 42 restrictions. In the prior words of this Commission, A [p]roperty owner who, for their own reasons, choose to encumber their property through long-term contractual obligations must nonetheless pay taxes on the full value of their property. See In re Thetford, 87 PTC 94 at page 9. This was also the holding of the Commission in its decisions in In re Hanover Gardens, Ltd., 86 PTC 33, and In re Thetford Properties III, 88 PTC 230.

10. Durham County adequately showed that its corrected appraisal of the Greens of Pine Glen Apartments was performed in accordance with its duly adopted schedules of values, standards and rules and that the manner in which it appraised the subject property was consistent with the county's appraisal of comparable properties.

11. The true value in money of the subject property was \$7,250,050, as of January 1, 1997. This reappraisal was performed in accordance with Durham County's duly adopted schedules of values, standards, and rules for the 1993 countywide general reappraisal and in a manner consistent with the County's appraisal of similar properties and reflects the correct square footage value of the subject property.

12. The Taxpayer failed to show by competent, material and substantial evidence that the assessed value of the subject property exceeded its fair market value.

THE COMMISSION THEREFORE, ORDERS, ADJUDGES AND DECREES that the decision of the Durham County Board of Equalization and Review assigning a total value of \$7,488,350 to the subject real property is hereby **MODIFIED**, and the County shall revise its tax records as may be necessary to reflect the Findings of Fact and Conclusions of Law of the Commission, assigning a total value of \$7,250,050 to the subject property as of January 1, 1997.



NORTH CAROLINA PROPERTY TAX COMMISSION

A handwritten signature in cursive script, appearing to read "T. Wheeler", is written above a horizontal line.

Terry L. Wheeler, Chairman

Vice Chairman Cope and Commission members Wilmoth,
Raynor and Young concur.

Entered: June 30, 2003

ATTEST:

A handwritten signature in cursive script, appearing to read "Janet L. Shires", is written above a horizontal line.

Janet L. Shires, Secretary