

NORTH CAROLINA

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

WAKE COUNTY

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

This Matter was heard 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, on April 13 and 14, 2000, pursuant to the appeal of The Greens of Pine Glen Limited Partnership (hereinafter "Taxpayer") from the decision of the Durham County Board of Equalization and Review (hereinafter "County Board") concerning the valuation of certain real property for tax year 1997.

Chairman Terry L. Wheeler presiding over the hearing with Vice Chair Juleigh Sitton and Commission members R. Bruce Cope, Linda M. Absher and Wade F. Wilmoth participating.

Charles C. Meeker, attorney at law, represented the Taxpayer at the hearing before the Commission; Kimberly M. Grantham, Assistant County Attorney, and Curtis Massey, Assistant County Attorney represented Durham County at the hearing.

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 G.S. 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 further asserts that the tax credits allowed under this federal program are nothing more than an inducement to investors to build affordable housing and that to capitalize the subject's actual income would result in an appraisal that is somewhat akin to a leased fee appraisal of the property. Durham County agrees that the tax credits, provided by Section 42, are intangible property, which are not taxable by Durham County.

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 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 the two above issues are answered in the affirmative, what was the true value in money of the subject property as of January 1, 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.

EVIDENCE

The Commission received the following evidence:

1. Taxpayer Exhibit A - Site location map.
2. Taxpayer Exhibit B - April 9, 1997 assessment notice.
3. Taxpayer Exhibit C - August 23, 1999 letter with attached income formula from the Schedule of Values.
4. Taxpayer Exhibit D - May 9, 1997 assessment notice.
5. Taxpayer Exhibit E - Summary of Assessments by Durham County.
6. Taxpayer Exhibit F -September 23, 1997 decision by Board of Equalization and Review.
7. Taxpayer Exhibit G - Durham County's response to Greens of Pine Glen's First Set of Interrogatories.
8. Taxpayer Exhibit H - Parcel ownership data dated June 11, 1998.
9. Taxpayer Exhibit I - Agreement of Limited Partnership dated December 13, 1994.
10. Taxpayer Exhibit J - Declaration of Land Use Restrictive Covenants for Low-Income Housing Tax Credits.
11. Taxpayer Exhibit K - March 28, 1996 memorandum concerning maximum allowable rents.

12. Taxpayer Exhibit L - Income approach to value.
 13. Taxpayer Exhibit O - Excerpts from deposition of Sam Gantt. (pp. 6-22)
 14. Oral Testimony of Mr. Robert E. Schuler, Vice President, W. O. Brisben Companies, Inc., Cincinnati, Ohio.
 15. Oral Testimony of Mr. Samuel Fox Gantt.
1. County Exhibit 1 - Property Record Card for Durham County Tax Parcel 536-01-003C, \$7,488,350 value.
 2. County Exhibit 2 - Durham County Board of Equalization & Review Appeal Form submitted by Greens of Pine Glen Limited Partnership on June 2, 1997.
 3. County Exhibit 5 - Spaeth & Batterberry, Ltd. Report on Schedule of Project Costs - Greens of Pine Glen Townhomes of the Greens of Pine Glen Limited Partnership for the period 9/1/94 through 11/30/96.
 4. County Exhibit 6 - June 9, 1997 letter to Mr. Sam Gantt, Durham County Tax Administration, from Brisben Companies by Robert E. Schuler.
 5. County Exhibit 7 - Appraisal of Greens of Pine Glen Apartments prepared by Donald S. Johnson, MAI, dated April 2000.
 6. County Exhibit 13 - Curriculum Vitae for Donald S. Johnson, MAI.
 7. County Exhibit 14 - Curriculum Vitae for Chris R. Morris, MAI.
 8. Oral Testimony of Donald S. Johnson, MAI, Henderson, North Carolina. Admitted to testify as an expert in the area of real estate appraisal.
 9. Oral Testimony of Chris R. Morris, MAI, Raleigh, North Carolina.
 10. Oral Testimony of Steve D. Worthington, Appraiser, Durham County Assessor Office, Durham, North Carolina.

COMMISSION EXHIBITS

In addition to the evidence presented by the parties, the Commission also considered the following Commission Exhibits:

C1-Notice of Appeal filed 10/10/97.

C2-Commission acknowledgment of C-1, dated 10/13/97.

C3-Transmittal letter and Application for Hearing, filed 10/13/97.

C4-Copy of letter from Attorney for Taxpayer to Durham County Tax Office, filed 2/16/98.

C5-Proposed hearing calendar for October 1999 meeting of the Property Tax Commission, dated 9/1/99.

C6-Durham County's Second Set of Requests for Production of Documents to Taxpayer, filed 9/14/99.

C7-Letter from Commission Secretary to Attorney for Taxpayer, continuing hearing, dated 9/30/99.

C8-Letter from Commission Secretary to Taxpayer's Attorney, continuing hearing, dated 10/28/99.

C9-Notice of Hearing (Taxpayer), for January hearing, dated 1/06/00.

C10-Notice of Hearing (County), for January hearing, dated 1/06/00.

C11-Faxed request from Durham County to issue subpoenas received 1/05/00.

C12-Durham County's Motion to Continue, filed 1/11/00.

C13-Taxpayer's Response in Opposition to County's Motion to Continue, faxed on 1/10/00.

C14-Commission acknowledgment of C-12, dated 1/12/00.

C15-Notice of Hearing (Taxpayer), dated 3/23/00.

C16-Notice of Hearing (County), dated 3/23/00.

C17-Faxed request from Durham County to issue subpoena, March 30, 2000.

C18-Copy of Subpoena, issued March 30, 2000.

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.

BASED UPON THE EVIDENCE PRESENTED AND THE STIPULATION OF THE PARTIES, THE COMMISSION 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. Based upon evidence presented at the hearing, by current and former appraisal staff of the Durham County tax office, 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 correctly assessed the subject property at a total value of \$7,488,350 as of January 1, 1997. This reappraisal was preformed 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. 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 the matter pursuant to G.S. 105-290.

8. 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).

9. 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.

10. 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.

11. 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 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).

12. 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.

13. 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.

14. 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 AND STIPULATIONS, THE NORTH CAROLINA 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, G.S. 05-283 provides that in part:

“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 G.S. 105-276 contemplates a situation such as this, where part of the value of real property lies in an intangible source. G.S. 105-276 provides in part that: "The exclusion of a class of intangible personal property from taxation under G.S. 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 May 9, 1997 appraisal of the subject property was arbitrary, illegal or that the value of \$7,488,350 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 G.S. 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.

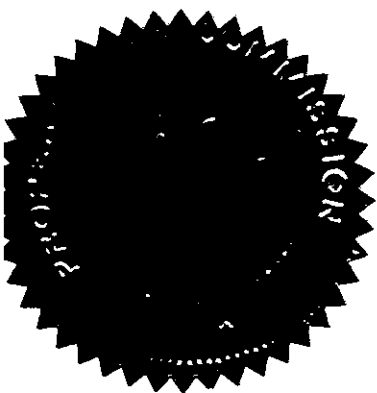
8. Appraisers have at their disposal a number of different tools and types of analyses that they can use to ascertain the true value in money of real property. These types of analyses include the cost approach, the sales comparison approach, and the income approach. All three approaches are designed 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 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 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 NOW, THEREFORE, ORDERS, ADJUDGES AND DECREES that the value of the subject property determined by the Durham County Board of Equalization and Review for tax year 1997 of \$7,488,350 is CONFIRMED.



NORTH CAROLINA PROPERTY TAX COMMISSION

A handwritten signature in black ink, appearing to read "T. Wheeler", is written over a horizontal line.

Terry L. Wheeler, Chairman

Commission members Cope and Absher concur.
Vice Chair Sitton and Commission member Wilmoth
respectfully dissent and file a separate opinion.

Entered: June 19, 2000

ATTEST:

A handwritten signature in black ink, appearing to read "Janet L. Shires", is written over a horizontal line.

Janet L. Shires, Secretary

Dissenting opinion of Vice Chair Sitton and Commissioner Wilmoth.

This case presents an important issue of law regarding how low and moderate income housing, constructed pursuant to 26 U.S.C. § 42 (“Section 42”), should be assessed in North Carolina. Since we believe the Commission majority has made errors of law, we respectfully submit that the following findings and conclusions should have been made.

BASED UPON THE EVIDENCE AS PRESENTED AND THE STIPULATION OF THE PARTIES, WE CONSIDER THE FINDINGS OF FACT TO BE AS FOLLOWS:

1. The property under appeal is 168 apartments located in Durham County on the 19-acre tract on which the apartments are sited. The apartments were completed in the fall of 1996. Approximately one-half of the apartments have two bedrooms; the other half of the apartments have three bedrooms. These apartments are known as The Greens of Pine Glen and are located between Highway 54 and Interstate 40.

2. The limited partnership, which owns The Greens of Pine Glen, has its office in Cincinnati, Ohio. This partnership receives Federal income tax credits pursuant to Section 42 for operating The Greens of Pine Glen as affordable housing. Ninety-nine percent (99%) of the tax credits are allocated to the limited partner, whose office is in the State of Nevada.

3. The limited partner made capital contributions of approximately \$4.6 million to pay for the allocation of tax credits. These funds paid approximately one-half of the construction costs of the apartments. Without these credits, The Greens of Pine Glen could not have been built. The tax credits expire 10 years after each building is put in service. Durham County stated in its opening statement that such credits are not subject to ad valorem taxation.

4. Pursuant to Section 42, The Greens of Pine Glen’s apartments are restricted by a recorded Declaration of Land Use Restrictive Covenants. These covenants restrict the rents that may be charged for 30 years. The rents charged are limited by a formula based on a percentage of the median income of families in Durham County. The rents charged are approximately 25-30% less than rents that are charged for comparable apartments, which have no rent restrictions. Under Section 42, the rent restrictions may be enforced by a lawsuit for specific performance as well as recapture of the tax credits.

5. The assessment date at issue is January 1, 1997. The last year of general reappraisal in Durham County was 1993.

6. On April 9, 1997, Durham County sent The Greens of Pine Glen (hereinafter "Taxpayer") a valuation notice for 1997. The notice showed a 100% market value of \$5,941,692.00. Durham County used the income method for this appraisal. The County had previously obtained income and expense information from the Taxpayer. The income method was permitted by Durham County's 1993 schedule of values, standards and rules.

7. On May 9, 1997, Durham County sent The Greens of Pine Glen a second notice of property appraisal. This notice increased the appraisal to \$7,488,350.00. Upon realizing that the Greens of Pine Glen's rents were restricted pursuant to Section 42, Durham County used another method of appraisal. The May 9, 1997 appraisal was based on the cost to replace these apartments, rather than their income. No adjustment was made to this cost calculation due to the restricted rents. The May 19, 1997 appraisal thus includes the cost to replace the subject property.

8. The May 9, 1997 appraisal contained an over measurement error of approximately five percent (5%) of the square footage of the apartments. Although this error was discovered in the 1998 assessment, this error has not been corrected for the 1997 assessment.

9. The 19 acres of land on which the apartments are sited was assessed at \$174,990.00 in 1996. Durham County changed its assessment to \$808,250.00 in the May 9, 1997 appraisal. Land assessments customarily are not changed in years of non-general revaluation. Durham County presented general explanations that a prior zoning change may not have been picked up in 1993 and that the property had been receiving present use-value assessment. Durham County did not present specific evidence as to why these 19 acres were reassessed between 1996 and 1997 when the last year of general revaluation was 1993.

10. The 19-acre parcel is subject to a Planned Density Residential District, which allows 10.6 units per acre. The property is also subject to a 100-foot wide Major Transportation Corridor Overlay District as well as watershed protected buffers along the drainways.

11. The owner of the subject property as well as Durham County's two experts all testified that the income method is the most reliable method for assessing investment properties such as apartments. Likewise, these witnesses testified that rent restricted apartments are worth less than comparable unrestricted apartments.

12. Durham County presented the appraisal of Donald Johnson, who was instructed by Durham County to ignore the Section 42 rent restrictions. Mr. Johnson's appraisal thus used comparable sales of apartments, which were not subject to rent restriction

and income projections that involved no rent restrictions. Finally, Mr. Johnson's appraisal included a downward adjustment of \$957,899 for economic obsolescence.

BASED UPON THE FOREGOING FINDINGS OF FACTS, WE CONSIDER THE CONCLUSIONS OF LAW TO BE AS FOLLOWS:

1. The income approach is the most reliable method in reaching true value of investment property. Although a combination of approaches may be used in certain instances, the income approach should be the primary method used to value apartments. See In the Matter of Charles D. Owen, 132 N.C. App. 281, 287 (1999), and In re Appeal of Belk-Broome Company, 119 N.C. App. 470, 474 (1995).

2. When Durham County assessed these Section 42 apartments on the income method based on actual rents in April, 1997, the County correctly determined that the subject property's true value as \$5,941,692 pursuant to the adopted schedules of values, standards and rules.

3. The rents for these apartments are restricted for 30 years pursuant to a governmental program. Due to (a) the length of those restrictions, (b) the governmental nature of those restrictions similar to zoning, overlay districts and buffers, and (3) the restrictions' enforceability, the rent restrictions must be taken into account in assessing the true value of these apartments. Caselaw authority concerning uneconomic leases does not apply to the governmental restrictions at issue here. See In re Pine Raleigh, 258 N.C. 298 (1962).

4. An investor in Section 42 apartments would only be willing to pay the same amount as that investor would be willing to pay for comparable apartments with unrestricted rents.

5. Durham County's use of the income method to assess some apartments but use of the cost to replace method for Section 42 apartments is an arbitrary and illegal method of valuation. Since apartments are investment properties, they must all be valued on the same method so that assessments are uniform.

6. The cost to replace method used by Durham County in May, 1997 made no adjustment for the rent restrictions that apply to these apartments. While Durham County contended that such restrictions were a mere "personal encumbrance" and thus not entitled to consideration, such restrictions are part of a Federal program which is administered by the State of North Carolina and which the United States Congress has determined to be in the public interest. The restrictions last for 30 years, extending 20 years beyond the expiration

of the tax credits. Indeed, these apartments would not have been built if the Section 42 program did not exist. Since these restrictions are governmental in nature and enforceable, it was arbitrary and illegal to use a valuation method, which ignored these restrictions.

7. Due to the rent restrictions, The Greens of Pine Glen's apartments must charge rents that are 25-30% lower than comparable apartments, which are not so restricted. By ignoring these restrictions, Durham County assessed the apartments in May, 1997 at a value that substantially exceeded true value. The mismeasurement of square footage contributed further to this excessive value.

8. The appraisal presented by Durham county is not persuasive because, as directed by Durham County, the appraisal ignored the Section 42 rent restrictions. Moreover, the Commission may not rely on an independent appraiser's collateral determination of value in a year of non-general revaluation. See In the Matter of Allred, 351 N.C. 1, 6-7 (1999).

9. The tax credits provided by Section 42 are intangible property, which are not directly or indirectly taxable by Durham County. See G.S. § 105-275(31). By assessing The Greens of Pine Glen on the cost to replace basis without making an adjustment for the rent restrictions, Durham County has in effect assessed the Section 42 tax credits because the capital contributions made for the tax credit allocation are included in the County's cost method.

10. The Commission majority's conclusion that G.S. § 105-276 allows tax credits to be included in the assessment of real property is in error. Rather, G.S. 105-276 states that the exclusion of intangible property, such as tax credits, from taxation does not "affect" the assessment of real property. This section thus does not affirmatively authorize the assessment of Section 42 credits. Moreover, Durham County conceded in its opening statement that the tax credits should not be assessed.

We conclude that the decision of the Durham County Board of Equalization and Review, dated September 23, 1997, should be reversed and that Durham County is instructed to reinstate its appraisal dated April 9, 1997 in the amount of \$5,941,692.