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Opinion No. 00-066

Authority of the Legislature to Direct Valuation Methods for Low-Income Residential Property
under Article II, § 28 and § 29 of the Tennessee Constitution

QUESTION

Does the proposed taxation method provided in Senate Bill 2481/House Bill 2584 for low-income residential property violate the requirements of Article II, Sections 28 and 29 of the Constitution of Tennessee?

OPINION

Article II, § 28 of the Tennessee Constitution expressly grants the Legislature the authority to direct the manner in which the value and definition of property shall be ascertained. Although there are limits to the Legislature's power to direct methods by which property may be valued, it is clear that, in a controversy over the appropriate valuation method to be applied under a particular set of facts or circumstances in which authorities are divided, the Legislature is competent to direct which method should be used. In addition, the Legislature clearly has the power to invite property owners to restrict the use of their property and to mandate that such restrictions be recognized as having an effect on the fair market value of the property. Accordingly, enactment of the method prescribed by Senate Bill 2481/House Bill 2584 for valuing low-income residential property would come within the Legislature's power, so long as the Bill is construed not to limit the assessor to considering only actual property income in assessing such properties.

ANALYSIS

Article II, § 28 of the Tennessee Constitution, the taxation article, was extensively revised by an amendment adopted in 1972. *Sherwood Co. v. Clary*, 734 S.W.2d 318, 320 (Tenn. 1987). Constitutional provisions prohibiting classification of property for tax purposes according to use and mandating all property to be taxed according to its value so that taxes would be equal and uniform throughout the State were changed by the 1972 amendment, which made all property in the State subject to the taxing power of the Legislature but authorized classifications of real property and of tangible and intangible personal property. *Id.* In order to resolve issues relating to classification and valuation, Article II, § 28 expressly states:

The ratio of assessment to value of property in each class or subclass shall be equal and uniform throughout the State, the *value and definition of property in each class or subclass to be ascertained in such manner as the Legislature shall direct.* [emphasis added]

Article II, § 29 contains no language that limits the authority granted to the Legislature under Article II, § 28 and merely provides that “all property shall be taxed according to its value, upon the principles established in regard to State taxation.”

Inherent in the provisions of the Tennessee Constitution that were superseded by the 1972 amendment were an overriding public policy that taxes be equal and uniform throughout the State and, as a result, a strict limitation upon the power of the Legislature to exempt property from taxation. This public policy continues to inform the analysis of Article II and is expressed in the mandate in § 28 that the “ratio of assessment to value of property in each class or subclass shall be equal and uniform throughout the State” and the mandate in § 29 that “all property shall be taxed according to its value.”

However, for the reasons expressed below, the question presented does not require that we explore the outer limits of the Legislature's power to direct the manner in which the value and definition of property shall be ascertained.

Senate Bill 2481/House Bill 2584 provides a method for appraising the value of real property that qualifies for certain federal income tax credits authorized by § 42 of the Internal Revenue Code of 1986, as amended under the Federal Low Income Housing Tax Credit Program (“LIHTC Program”). At issue is the assignment of value in the appraisal of the real property to the tax credits authorized or awarded under the LIHTC Program and whether the restrictions on use of the property under the LIHTC Program require a reduction in the valuation of the property for tax assessment purposes.

The specific issue addressed by Senate Bill 2481/House Bill 2584 has not been resolved by the courts in Tennessee and is currently the subject of litigation to which the State Board of Equalization is a party. The issue has been dealt with by courts in several sister states, which are divided as to whether or not value should be assigned to the tax credits authorized or awarded under, and whether or not the assessed value of real property should reflect the restrictions imposed by, the LIHTC Program.

In support of the valuation methodology set forth in the proposed legislation, at least two jurisdictions have held that the LIHTC program constitutes a “governmental restriction as to use” of property requiring a reduction in value for assessment purposes and that tax credits under the LIHTC Program should not be assessed value because the tax benefits are limited to the first owner, or are recaptured when the property is transferred. *See Bayridge Assoc. Ltd. Partnership v. Department of Revenue*, 892 P.2d. 1002 (Ore. 1995); *Greenfield Village Apartments v. Ada County*, 938 P.2d 1245 (Ida. 1997). In direct contrast, several other jurisdictions have held that the use of

government subsidies under the LIHTC Program operates as a benefit to the owners of multi-family real estate developments rather than a “governmental restriction as to use” which reduces the value of the property. *See Deerfield 95 Investor Associates, LLC v. Town of East Lyme*, 1999 WL 291999 (Conn. Super. 1999); *Cascade Court Limited Partnership v. Noble*, Wash. Board of Tax Appeals, BTA Docket Nos. 49295, 50249-50253, 96-17 to 96-18, 96-20 to 96-22, and 96-33 to 96-34 (1998); *Meadowlands Ltd. Dividend Housing Assn. v. City of Holland*, 437 Mich. 473, 473 N.W.2d 636 (1991); *Glenridge Development Co. v. City of Augusta*, 662 A.2d 928 (Me. 1995). In *Deerfield*, the Superior Court of Connecticut, after reviewing the conflicting decisions of the states and discussing at length the arguments in support of a decision on each side of the issue, concluded that “LIHTCs, although intangibles, do have an effect on the valuation of real estate for assessment purposes and should be a factor in determining the fair market value.” *Deerfield* at 5.

For the purposes of the question presented, it is sufficient that the courts are divided as to the appropriate method for the valuation of real property qualifying for tax credits under the LIHTC Program. Article II, § 28 expressly grants the Legislature the authority to direct the method to be used in ascertaining the value of real property and constitutes a clear and unambiguous declaration that the Legislature possesses the institutional competency to make such determinations. When courts are unable to agree as to the appropriate method to ascertain value, the Legislature clearly has the power to exercise its competency and direct which method shall be used.

A clear precedent for the Legislature's exercise of its power to direct valuation methodology is the enactment of the “Greenbelt Law,” Tenn. Code Ann. §§ 65-5-1002, *et seq.* The Greenbelt Law permits property owners voluntarily to restrict the use of their property and directs that the assessment of value of such property reflect such restriction. The constitutionality of the Greenbelt Law was upheld by the Court of Appeals in *Marion County vs. State Board of Equalization*, 710 S.W.2d 521 (Tenn. Ct. App. 1986). In *Marion County*, the Court of Appeals stated that “there are many different definitions of value. The constitution does not give any clue as to how value is to be determined; instead it leaves the method of determining value to the Legislature.” *Id.* at 523. The Court expressly found that the Legislature has the power to require that the “fair market value” of property be assessed according to actual use as opposed to a hypothetical best use, and reasoned:

It seems to us that in enacting this legislation, the Legislature has issued an invitation to property owners to voluntarily restrict the use of their property for agricultural, forest or open space purposes. Once assumed, that restriction affects the property's value. ***If it can only be used for farm purposes for instance, then it would be free from any artificial value attributed to its possible use for development. It should have only the same value as any similar property that is as productive and accessible as it is.*** [emphasis added]

Id. Because, like the owners of real property that elect to qualify under the Greenbelt Law, owners of property that qualify for the LIHTC Program voluntarily restrict the use of their property at the Legislature's invitation, the logic expressed in *Marion County* is directly applicable to a legislative

determination that the voluntary restriction under the LIHTC Program affects the restricted property's value and that such property should be assessed by the value determined by actual use as opposed to an artificial value attributed to its highest and best use.

It must be noted that a clear distinction must be drawn between a taxpayer's voluntary restriction of the use of his property at the invitation of the Legislature, which restriction may be recognized as a factor affecting fair market value of the property under *Marion County*, and a taxpayer's voluntary restriction of the use of his property without any governmental invitation, which restriction may not be recognized. *See Hoover vs. State Board of Equalization*, 579 S.W.2d 192 (Tenn. Ct. App. 1978).

Consistent with the decision in *Marion County*, the Court of Appeals held in *Fayette County Taxpayers vs. State Board of Equalization*, 1985 Tenn. App. LEXIS 2926 (June 4, 1985), that the Legislature has the constitutional authority under the Greenbelt Law to direct that the method of determining fair market value of the qualifying property reflect the actual restricted use of such property. The Court stated:

Tennessee Code Annotated § 67-5-1008 requires property owners qualifying under "The Agricultural, Forest, and Open Space Land Act of 1976" ***to be valued at fair market value but restricts the use of the property to agricultural, forest, or open space land as the highest and best use. Consideration may not be given to any use other than the current use in determining the qualifying land's value.*** Tenn. Code Ann. § 67-5-1008 does not violate either Article 2, Section 28 of the Tennessee Constitution or the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution because the property is being valued at its fair market value with the only restriction being that the property can be used only for agricultural, forest, or open space land purposes. [emphasis added]

Id. at 5. The Court, however, held that a formula developed by the State Board to assess the value of such property was unconstitutional under Article II, § 28 because that formula applied a market capitalization rate that was not market based but instead was based upon the Federal Land Bank interest rate ("FLB Rate"). *Id.* Because the use of this FLB Rate would clearly produce a property value that was not the market value, the formula was ruled unconstitutional. In addition, the Court disagreed with the plaintiff's assertion that "present use value" should be derived solely from the actual income derived from the property and not from a determination of fair market value, albeit a fair market value of the property under restricted use, pursuant to Tenn. Code Ann. § 67-5-602. *Id.*

The provisions of the proposed legislation merely direct that (i) the intangible property rights created by the tax credits under the LIHTC Program are not to be considered in calculating the fair market value, and (ii) the voluntary restrictions that have an effect on the fair market value should be recognized. In neither case does the Legislature require that the formula to be used to assess the qualifying property be separate or distinct from the formula to be used to assess non-qualifying

property or that such formula determine a value other than fair market value. The Legislature merely exercises its inherent power, as under the Greenbelt Law, to invite property owners to voluntarily restrict the use of the property and to recognize that such restrictions have an effect on the value of the property. Consistent with the Tennessee Constitution and the case law interpreting it, the Bill requires the assessor to consider the effect of use restrictions in valuing these properties, and it forbids the assessor from considering the federal income tax credits as a separate component of the property value. The Bill should not be construed, however, as preventing the assessor from considering market influences or as limiting the assessor to considering only the contracted rents in valuing the property, either of which would place the Bill at odds with the holding in the *Fayette County Taxpayers* case.

The last sentence of the Bill directs that other “affordable housing” “shall be assessed based on the income appraisal approach if rental rates are restricted due to governmental regulations.” We construe this provision to require that the income approach, as it is generally recognized by property appraisers, be used to determine the fair market value of the property, albeit subject to the governmental regulations. A contrary construction under which the valuations would be derived from contracted rents only would bring that provision into direct conflict with the Court of Appeal's decision in *Fayette County*. In specifying use of the generally recognized income approach, rather than other legitimate methods of valuation, this provision would appear to be a valid exercise of the Legislature’s authority to specify how the restrictions voluntarily imposed upon the property because of its participation in the federal program are to be recognized in determining fair market value.

For the reasons expressed above, it is the opinion of this Office that the proposed taxation method provided in Senate Bill 2481/House Bill 2584 for low-income residential property as interpreted herein is a proper exercise of the Legislature's authority under, and does not violate the requirements of, Article II, §§ 28 and 29 of the Tennessee Constitution.

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