How to Minimize Affordable Housing Property Taxes

Owners can save by knowing local laws, carefully vetting assessments and contesting inflated valuations.

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Most people who have studied real estate investing will recall that property expenses are divided into controllable and noncontrollable buckets. In the noncontrollable bin are items like insurance, utilities and property taxes. And while it is true that these expenses usually are unavoidable, an owner should try to exert some level of control, at least in the case of taxes.

Taxing entities calculate property taxes by multiplying a property's assessment by its jurisdiction's tax rate. The rate is indeed noncontrollable, but savvy owners will review their assessments and challenge them when warranted.

Knowing what warrants an appeal requires the taxpayer or their adviser to review each aspect of the assessor's calculations and conclusions and calls for a strong understanding of factors affecting affordable housing valuation that the assessor may have missed or ignored. Assessment review is particularly important for affordable housing owners, who may be aware of recent industry trends or new programs that influence property values within the sector.

Before beginning an assessment review, affordable housing owners or their advisers should familiarize themselves with several valuation principles and related tools that assessors and appraisers consider when valuing affordable housing properties.

As Costs Climb, Values Erode

Many jurisdictions assess affordable housing based on the income approach to valuing real estate. At its simplest, the income approach follows a formula: income divided by rate equals value. Income, or more specifically net income, refers to a property's expected residual income after expenses.

Rate in the basic formula is a capitalization rate, which is essentially the annualized return a buyer would expect over the purchase price to acquire the property.

The income approach formula explains how the increased expenses and climbing capitalization rates that have occurred over the past few years have led to declining asset values in many markets and across property types. Even with some cases of modest improvement in top-line revenue, costs have continued to climb in most markets. Two expense categories that even assessors cannot deny have risen are insurance and labor.

Insurance rates are at record highs for many properties, while increased labor costs and inflation have driven up maintenance expenses for many operators as well. Utilizing those increased expenses to right-size assessments can often help to offset the impact on the bottom line.

While increased expenses have eroded properties' net income streams, years of rising interest rates and market uncertainty have combined to push capitalization rates upward in many areas. Capitalization rates rise when buyers demand larger returns to offset their increased cost of capital and perceived risk.

Taxpayers may be able to achieve a reduced assessment by arguing for a higher capitalization rate in the assessor's calculations, substituting a percentage that more accurately reflects a buyer's expected rate of return.

To ensure they are not being overtaxed, affordable housing owners and operators should exercise care in selecting appropriate property sales for comparison. Using a mortgage-equity or band-of-investment capitalization method to account for the impact of interest rates on a hypothetical buyer's capitalization rate, owners and operators can ensure they are not being over-taxed.

Remove Intangible Income

While expenses and cap rate arguments can often provide a clear-cut path to assessment reductions, affordable housing owners should be sure to consider income as a key component on the front end of the valuation formula.

Income attributable to tax credit benefits for low-income housing is intangible, and therefore should be excluded from the assessment of the tangible real estate. Laws vary widely on the treatment of tax credits, but a good property tax attorney can evaluate whether the argument is worth making in a given jurisdiction.

Many states have programs specifically designed to encourage affordable housing development and to minimize taxes on this property type. Some will exempt portions of a property from being taxed altogether. Here are a few examples of tax treatments for affordable housing properties in various states:

- **Ohio** — Legislation enacted in 2023 sets forth uniform rules for valuing "federally subsidized residential rental property," which can help keep assessments down.
- **Florida** — In March 2024, the state legislature expanded the property tax exemption for affordable housing, which now covers more properties and makes it easier for owners to apply for exemption.
- **Massachusetts** — Local boards may grant exemptions on a year-to-year basis for any portion of a property used for affordable housing that serves households earning up to 80 percent of area median income.
- **Washington, D.C.** — Certain properties are entitled to tax abatements for developments. At least 5 percent of the units in the development must be reserved for low-income households, and an additional 10 percent of units must be reserved for households earning up to 60 percent of area median income.
- **New York** — Depending on the location, construction date and affordability within a project, the law provides both construction-period exemptions and post-construction exemptions, which can be substantial.

Despite all the arguments available to help lower property taxes, owners should avoid rushing into an appeal, as there can be risks involved. Some assessors will argue that the impact of inflation on construction has driven up cost indications, thereby supporting higher appraisals. Additionally, some jurisdictions require assessors to use a lower capitalization rate for affordable housing properties with perceived lower investor risk, due to the presumption of a guaranteed income stream. Given the intricacies of local laws governing affordable housing assessment, owners and operators seeking to right-size their property taxes would be well advised to consult a local property tax professional. ●

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