

STATE OF NORTH CAROLINA
COUNTY OF WAKE

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

IN THE MATTER OF THE
APPEALS OF:

KIMBERLY PARK II, LLC;

18 PTC 0029

KIMBERLY PARK III, LLC; and

18 PTC 0025

**HHG II, LLC,
(collectively) Appellants,**

18 PTC 0026

From the decisions of the Forsyth
County Board of Equalization and
Review

FINAL DECISION

These matters came on for hearing before the North Carolina Property Tax Commission (“Commission”) sitting as the State Board of Equalization and Review in the City of Raleigh, Wake County, North Carolina on Tuesday, June 25, 2019, pursuant to the Appellants’ appeals from the decisions of the Forsyth County Board of Equalization and Review (“Board”).

Chairman Robert C. Hunter presided over the hearing, with Vice Chairman Terry L. Wheeler and Commission Members William W. Peaslee, Alexander A. Guess, and Charles W. Penny¹ participating.

Attorney Frederick P. Johnson appeared on behalf of Forsyth County (“County”). Attorneys John A. Cocklereece and Justin M. Hardy appeared on behalf of the Appellants.

STATEMENT OF THE CASE

The properties under appeal are all low-income housing developments. The Appellants timely appealed the assessed value of the subject properties to the Forsyth County Board of

¹ Although Mr. Penny is no longer a Commission Member as of the date this decision is entered, he was a Member at the time of this hearing, and participated in the hearing and resulting decision.

Equalization and Review (“Board”), and subsequently timely appealed the Board’s decisions to the Commission.

Many of the facts in these matters are not only common to each appeal, but are essentially undisputed. The primary area of disagreement between the parties relates to the appropriate calculation of operating expenses with respect to the properties: whereas the Appellants contend that the actual expenses for each property should be considered, the County’s position is that the operating expenses claimed by the Appellants are not justifiable and are not typical for the subject property type, and should be limited to a fixed percentage of effective gross income.

ANALYSIS AND ISSUES

Most properties in North Carolina are appraised for property tax purposes at “true value,” as that term is defined in N.C. Gen. Stat. §105-283. N.C. Gen. Stat. §105-317 provides specific elements that must be considered in appraising property at true value, and the North Carolina Courts have recognized three valuation approaches as accommodating those considerations (i.e., the cost, income, and sales comparison approaches²).

Certain low-income housing, however, is entitled to appraisal, assessment, and taxation based upon the provisions of N.C. Gen. Stat. §105-277.16, which provides the exclusive statutory means for valuing such properties, in lieu of true value. The statute provides in pertinent part that:

1. The income approach is the only approved method of valuation;
2. Rent restrictions must be considered in determining the property’s income; and
3. Income tax credits received under Section 42 of the [Internal Revenue] Code may not be considered in determining the property’s income.

Neither the rent restrictions nor the income tax credits associated with the properties are at issue in these matters. As to the income approach, the parties have stipulated the capitalization rate, and the effective gross incomes determined by each party for the respective properties are similar. Accordingly, the sole issue considered by the Commission in these matters is whether the appropriate measure of operating expenses for the properties is the actual expenses or some percentage of effective gross income, in order to reach the net operating income for the properties.

² See, for example, *In re Greens of Pine Glen Ltd.*, 356 N.C. 642, 648, 576 S.E.2d 316, 320 (2003)

**FROM THE EVIDENCE PRESENTED AND ALL DOCUMENTS OF RECORD,
THE COMMISSION MAKES THE FOLLOWING FINDINGS OF FACT:**

1. Each of the above-captioned appeals involves a common question of law. Accordingly, and with the consent of the parties, we have consolidated the appeals for purposes of the hearing and this decision. References herein to the singular or plural forms of “Appellants” or “properties” or the like are meant to be used interchangeably, unless specifically stated otherwise.
2. The parties have stipulated that the properties are subject to the provisions of N.C. Gen. Stat. §105-277.16 and are to be appraised using the income approach as therein provided.
3. The income approach involves the capitalization of an income stream as an estimator of value for an income-producing property. The two essential components to estimating value under this approach are the property’s income and some mathematical rate or factor used to express the value of the property’s income stream. Here, the parties have stipulated that a capitalization rate of 9.5% is appropriate to capitalize the annual net income of the properties.
4. Net income is the portion of effective gross income remaining after subtracting operating expenses, including appropriate reserves for replacing items associated with a property that have relatively long lives and are only infrequently replaced (e.g., roofing or HVAC systems).
5. Neither party significantly disputed the reserves for replacement amounts considered for the properties. Similarly, there was no more than a 2.24% difference in the effective gross income figures presented by each party. Accordingly, we find no need to discuss these items in detail.
6. Broadly, however, it is relevant that the effective gross income figures provided by the parties are based on the actual income received by the subject properties. The actual income amounts came from audited financial statements prepared for each of the properties, in connection with reviews of the properties conducted regularly by various regulatory agencies, such as the North Carolina Housing Finance Agency (“NCHFA”), the U.S. Department of Housing and Urban Development (“HUD”), and others. Testimony at the hearing indicated that the audits were required both for the initial underwriting of low-income housing projects and for the continued allocation of tax credits to the property owners. We therefore find that the effective gross income amounts presented by the Appellants are appropriate.
7. Similarly, the actual operating expense figures offered by the Appellants are also sourced from audited financial statements prepared for each of the properties, in connection with reviews of

the properties conducted regularly by various regulatory agencies, just as were the income figures. . In addition, the Appellants have offered evidence that the reported expenses are consistent with the operating expenses of other properties subject to the same level of regulation as the subject properties, and, further, that the reported expenses are consistent with NCHFA underwriting guidelines.

8. The Appellants' witness Gaye Morgan, CEO of the company that manages and has an equity interest in the subject properties, testified that there are several types of low-income housing, each affected by different layers of government regulation, and that the subject properties were among the most heavily regulated types of low-income housing.
9. Ms. Gaye further testified that none of the audits of the financial records of the subject properties had ever suggested that the operating expenses reported for the properties were excessive.
10. The County explained that its estimation of operating expenses for each of the properties was based on an operating expense ratio, or a percentage of effective gross income, that was assumed to be typical for low-income housing properties. As support for the 60% ratio chosen, the County indicated that another county had adopted a similar approach and figure, and that it was County staff's understanding that this ratio fell within an appropriate range.
11. The County provided information concerning the expense ratios it had chosen for the assessment of other properties, but did not offer evidence that those ratios were based on actual data received from those properties. Moreover, the County's chosen expense ratios for these other properties ranged from 50% to 60%, with no explanation for the variation.
12. As support for the dollar amount of expense produced by applying the chosen ratio, the County offered information from a published survey of low-income-housing properties, but could not confirm to what extent the survey reflected the typical expenses for properties subject to the same level of regulation as the subject properties.
13. The County offered information from a different survey as additional evidence that its estimation of the expense amount was consistent with the survey results. However, the County could not confirm that this additional survey reflected the typical expenses for properties subject to the same level of regulation as the subject properties. Furthermore, the second survey was dated 2010, and the year in which the operating expenses were being considered was 2017.

14. We determine that property type and age are both important considerations for determining an appropriate level of expenses for the subject properties. Neither report offered by the County as support for its choice of expense ratio sufficiently identified the types and ages of properties considered.
15. While the County contended that the expenses claimed by the Appellants were excessive, unjustifiable, and untypical, the County did not offer reliable and specific market evidence that the Appellants' claimed expenses were in fact untypical or unjustifiable.
16. Accordingly, we find that, while the Appellants have offered evidence that their claimed operating expenses are both actual and typical for properties similar to the subjects, the County has offered little justification for substituting the actual expenses with an estimated expense ratio. We find, therefore, by the greater weight of the evidence that the Appellants' figures for operating expenses (including reserves) are justifiable and typical for the subject properties.
17. Specifically, the relevant elements of the income approach for the subject properties are as follows:

	<u>Kimberly Park II, LLC</u>	<u>Kimberly Park III, LLC</u>	<u>HHG II, LLC</u>
Effective Gross Income	\$ 1,309,667	\$ 521,107	\$ 399,361
Operating Expenses and Reserves	\$ 955,570	\$ 386,424	\$ 306,411
Net Operating Income	\$ 354,097	\$ 134,683	\$ 92,950
Capitalization Rate	9.5%	9.5%	9.5%
Indicated Resulting Value	\$ 3,727,337	\$ 1,417,716	\$ 978,421

BASED UPON THE FOREGOING FINDINGS OF FACT, THE PROPERTY TAX COMMISSION CONCLUDES AS A MATTER OF LAW:

1. The Commission has jurisdiction over the parties and the subject matter of this appeal.
2. The Appellant properties are subject to the provisions of N.C. Gen. Stat. §105-277.16.
3. In these matters and for these properties, the effective gross income amounts as listed above are appropriate for use in determining the value of the subject properties using the income approach, when there is evidence from the Appellants that the income amounts are both actual and supported by audited financial statements, and when there is little evidence to the contrary from the County.

4. In these matters and for these properties, the expenses as listed above are appropriate for use in determining the value of the subject properties using the income approach, when there is evidence from the Appellants that the expenses are both actual and supported not only by audited financial statements, but also by relevant market data, and when there is little evidence to the contrary from the County.
5. Because the parties have stipulated to a mutually agreeable capitalization rate, the Commission has not considered the capitalization rate with respect to the subject properties. The indicated values are simply the quotient of the net operating income divided by the stipulated capitalization rate.

WHEREFORE, the Commission herewith orders that the 2017 tax value of the subject properties be changed as follows:

Kimberly Park II:	\$3,727,337;
Kimberly Park III:	\$1,417,716; and
HHG II:	\$978,421,

and that the Forsyth County abstracts and tax records be changed to give effect to this decision.

NORTH CAROLINA PROPERTY TAX COMMISSION



Robert C. Hunter
 Robert C. Hunter, Chairman

Vice Chairman Wheeler and
 Commission Members Peaslee and Guess concur.

Commission Member Penny dissents without separate
 opinion.

Date Entered: 7-15-19

ATTEST: *Stephen W. Pelfrey*
 Stephen W. Pelfrey, Commission Secretary