Valuation and Taxation of Resale-restricted, Owner-occupied Housing

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Abstract

Resale-restricted, owner-occupied housing (sometimes referred to as "shared-equity homeownership") offers an option for bringing homeownership within reach for lower income households. Few standardized policies and procedures exist for valuing and taxing resale-restricted homes, even in states where public policy favors this category of housing. To date, almost no research has been done in the United States to document the various ways this housing is taxed or to analyze what the best method of taxation might be. This paper aims to fill this information gap by addressing the following questions.

1. What judicial, legislative, or administrative guidance is given to municipal tax assessors within each state with regard to the valuation and taxation of resale-restricted, owner-occupied homes?
2. How do the legal requirements, policy guidelines, and administrative procedures for the taxation of resale-restricted, owner-occupied housing differ from one state to another?

The paper presents information about the treatment of shared-equity housing in five states: California; Massachusetts; New Jersey; New York; and Vermont. The findings suggest that restrictions placed on owner-occupied, shared-equity homes and the consideration of those restrictions in the valuation of the homes can be part of a comprehensive approach to develop and preserve affordable housing.

About the Author

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Introduction

Resale-restricted, owner-occupied housing offers an option for bringing homeownership within reach for lower income households. Four distinguishing features characterize this category of housing, which is sometimes referred to as "shared-equity homeownership."[1] First, the homes are owner-occupied. Second, the amount of equity any one homeowner may capture when reselling her property is limited in order to enable successive generations of low- and moderate-income homeowners to gain access to homeownership. This creates a situation in which equity is shared across the various generations of homeowners. Third, individual homeowners and the larger community (often operating through a nonprofit organization or a government agency) share the rights, responsibilities, and benefits of homeownership. This pertains to such matters as how the property may be used, improved, financed, and conveyed and how wealth and other benefits will be distributed. Finally, the properties are subject to long-term contractual controls over resale and subletting designed to maintain their affordability. The three most common types of shared-equity homeownership are limited-equity cooperatives; community land trusts; and deed-restricted houses, townhouses, and condominiums with resale controls lasting a minimum of 30 years.

The taxation of resale-restricted, owner-occupied homes raises concern among many proponents of shared-equity homeownership. The primary issue for them is not whether the properties should be taxed, but rather how the properties should be valued for tax purposes. Shared-equity housing is heavily encumbered with durable restrictions. In order to ensure that the homes remain affordable for future generations of owners, these restrictions place caps on the prices for which current owners can sell their homes (and also for which they can sublet them, if subletting is even allowed). This practice limits homeowners' ability to accumulate equity and to remove equity when reselling or subletting their homes. When valuing and taxing these properties, many local assessors do not consider the limitations the restrictions place on the properties' marketability and profitability.

A recent report that explores the major features of shared-equity homeownership offers the following example to illustrate why the valuation and taxation issues are crucial.

> Consider, for example, a deed-restricted house produced through a municipality's zoning program that is sold to a lower-income household for $85,000, despite appraising for $210,000 at the time of purchase. If the house appreciates at an annual rate of 7 percent, its appraised value after five years would be nearly $295,000. The maximum resale price that an affordability covenant would allow the homeowner to charge, however, should she decide to move after five years, could be as low as $94,000. Note that the homeowner, in this hypothetical example, only buys 40

[1] John Emmeus Davis, *Shared Equity Homeownership: The Changing Landscape of Resale-Restricted, Owner-Occupied Housing* (Montclair, NJ: National Housing Institute, 2006), 2-6.

> percent of the property's value when purchasing the house. Five years later, she may claim as her own only 32 percent of the property's value, were she to resell the house. If the municipal assessment of her property does not take into account either its below-market purchase price or its restricted resale price, the homeowner will be taxed as if 100 percent of this value belonged to her. By her fifth year of occupancy, in this particular case, she would be forced to pay property taxes on $201,000 of value she does not own.[2]

As this example illustrates, even if the purchase and resale prices of shared-equity homes are restricted, valuing and taxing those homes as if their owners can realize all of the gains from appreciation will render the homes unaffordable for low- and moderate-income households. The manner in which the homes are valued for initial entry on tax rolls and the manner in which their values are adjusted over time as they are resold at restricted prices greatly impact their long-term affordability. In the case of homes on land leased from community land trusts, the manner in which that land is entered on tax rolls and the manner in which it is taxed also affect affordability.

Unfortunately, few standardized policies and procedures exist for valuing and taxing resale-restricted homes, even in states where public policy favors this category of housing. There is great variation in this regard, both across states and within states. Some states, such as Nebraska and Oregon, permit assessments of resale-restricted, *rental* housing to consider the impact of the restrictions on the properties' value to owners.[3] Florida is considering requiring resale-restricted, *owner-occupied* homes to be valued at their sale and resale prices.[4] Under the proposed legislation, land owned by community land trusts and subject to ground leases lasting at least 99 years will be exempt from the property tax.[5]

To date, almost no research has been done in the United States to document the various ways shared-equity housing is taxed or to analyze what the best method of taxation might be. This research project conducted by the National Housing Institute and funded by the Lincoln Institute of Land Policy aims to fill this information gap by addressing the following questions.

1. What judicial, legislative, or administrative guidance is given to municipal tax assessors within each state with regard to the valuation and taxation of shared-equity homes?
2. How do the legal requirements, policy guidelines, and administrative procedures for the taxation of resale-restricted, owner-occupied housing differ from one state to another?

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[2] Ibid., 85.

[3] *Assessment Process for Affordable Housing Projects Regulations*, *Nebraska Administrative Code*, tit. 360, chap. 51. Bayridge Assoc. Ltd. Partnership v. Department of Revenue, 892 P2d 1002 (1995).

[4] *The 2007 Florida Statutes*, sec. 193.017.

[5] *The 2007 Florida Statutes*, sec. 196.1978.

3. Given the discretion that municipal tax assessors are often granted, even in states where guidance is given by state courts, state legislation, or state boards of tax equalization, how are local assessors actually valuing resale-restricted, owner-occupied housing when this property is entered onto local tax rolls? How are local assessors adjusting the value of this property over time?

This working paper presents information about the tax treatment of shared-equity homes in five states: California; Massachusetts; New Jersey; New York; and Vermont. These states were chosen because they have large numbers of shared-equity units and because of their potential for offering guidance concerning the taxation of those units. Examination of these states enabled the identification of important legal principles and issues that should be considered in the future analysis of additional states. It also made possible the development of a template that can be used to structure the analysis of additional states.

This paper examines the taxation of affordable homes created by community land trusts and through the use of deed restrictions that maintain long-term affordability.[6] Limited-equity cooperatives, which constitute the third type of shared-equity housing, are created and governed by state statutes, which vary from state to state. They were excluded from this phase of the study because of the varied forms they take.

The information presented here addresses the first and second research questions identified for the project. The following section provides information about state policies and practices for the valuation and taxation of shared equity housing. The next section offers conclusions about the information presented. The paper ends by suggesting topics for future research.

State Tax Treatment of Resale-restricted, Owner-occupied Housing

The valuation and taxation of resale-restricted, owner-occupied housing varies across the five states examined. Analysis of these states' approaches allowed the identification of the following important features of state tax treatment of this property.

1. Whether the state recognizes long-term affordability restrictions.
2. Whether state legislation, administrative codes, or similar governing documents declare that the restrictions serve a public purpose. In most cases, state recognition of restrictions will likely be tied to such a declaration.
3. Whether the state provides guidance in the form of court rulings, legislation, and/or administrative guidelines concerning the valuation and taxation of price-restricted property.
4. Whether the state permits assessors to consider the impact the restrictions have on the value of property.

[6] Property taxes on deed-restricted homes are paid by the homeowners. According to a 2006 national survey of community land trusts conducted by the Lincoln Institute, more than 90 percent of the land trusts pay property taxes on their land. Forty-five percent of the land trusts reported that property taxes on the land are paid by the homeowners. In some cases, owners of land trust homes also pay property taxes on their homes. Yesim Sungu-Eryilmaz and Rosalind Greenstein, "A National Study of Community Land Trusts," Lincoln Institute of Land Policy Working Paper, 2007.

5. Whether the state requires that restricted property satisfy specific requirements in order for the restrictions to be considered in the valuation process. One requirement sometimes imposed is that the restrictions be of long-term duration. Another is that they "run with the land," or not be linked to a specific property owner. A third is that they be imposed by a government entity, typically in conjunction with the provision of some form of support such as financial or technical assistance for development of the property.
6. Whether the state provides guidelines for valuing restricted property.

Of the five states examined, all but New York recognize long-term affordability restrictions (Table 1). Administrative guidance provided by New York's tax agency points to the lack of legislation authorizing special tax treatment of price-restricted properties, as well as to a court ruling that refused to recognize temporary restrictions interpreted by the court as being personal to the property owner rather than attached to the property itself.

Each of the four states that recognize affordability restrictions has identified a public purpose served by the development of shared-equity homes for owner occupancy by low- and moderate-income households. Both Massachusetts and New Jersey offer guidance in the form of court rulings, legislation, and administrative guidelines concerning the valuation and taxation of price-restricted property. California and Vermont offer legislative and administrative guidance.

All four of the states that recognize restrictions consider their effects on the value of property. They all require that properties subject to price restrictions satisfy certain conditions in order for the restrictions to factor into the valuation of the property. They also require the restrictions to run with the land. California, Massachusetts, and New Jersey require them to be of long-term duration. California requires the restrictions to be government-imposed. Whether Massachusetts and New Jersey require government imposition is unclear. California and Massachusetts provide guidelines for valuing restricted property.

The remainder of this section presents more detailed information about the states' policies and practices.

California

<u>Recognition and Declared Public Purpose</u>**.** State laws in California recognize a public purpose that is served by the development of housing with long-term affordability controls. Laws addressing redevelopment and the provision of incentives for the production of affordable housing foster the development of housing with long-term affordability controls.[7] Other relevant laws concern the disposal, valuation, and taxation of residential property that was acquired by state and local government agencies but is no longer needed by the government. This legislation declares that the promotion of

[7] *California Health and Safety Code*, secs. 33334.2 and 33334.3. *Density Bonuses and Other Incentives*, *California Government Code*, sec. 65915.

perpetual affordability through the sale of surplus residential property "directly [serves] an important public interest."[8]

Types of Guidance Provided. California offers legislative and administrative guidance concerning the tax treatment of resale-restricted, owner-occupied housing. The state's redevelopment law requires community redevelopment agencies to impose 45-year affordability controls on all homeownership units created using tax-increment financing and other government funds set aside for low- and moderate-income housing.[9] California law also requires public agencies to dispose of surplus property in ways that further state policies.[10] It declares that

> the [sale] of surplus residential properties which [results] in the loss of decent and affordable housing for persons and families of low or moderate income is contrary to state housing, urban development, and environmental policies and is a significant environmental effect, within the meaning of Article XIX of the California Constitution.[11]

In addition, this legislation requires that when public agencies sell surplus properties to present occupants who have low or moderate incomes, they must impose terms, conditions, and restrictions to ensure that the properties will remain affordable for future purchase by other low- or moderate-income households.

Advisory letters issued by the Assessment Standards Division of the State Board of Equalization offer administrative guidance that can inform the valuation and taxation of shared-equity homes. These "Letters To Assessors" present staff interpretations of rules, laws, and court decisions concerning property tax assessment. In addition, the Board of Equalization advises assessors on specific topics upon request. The California Revenue and Taxation Code offers additional administrative guidance.

Restrictions Considered in Valuing Property. The California Constitution requires all property to be assessed at the same percentage of value.[12] The Revenue and Taxation Code defines "full cash value" or "fair market value" as

> the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes.[13]

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[8] *Surplus Residential Property*, *California Government Code*, sec. 54235.

[9] Davis, 173.

[10] *Surplus Residential Property*, secs. 54235-54237.

[11] Art. XIX authorizes the use of revenues from the motor vehicle fuel tax for the mitigation of the environmental effects of public streets and highways. *California Constitution*, art. XIX, sec. 1.

[12] Ibid., art. XIII, sec. 1.

[13] *California Revenue and Taxation Code*, sec. 110(a).

In Section 402.1, the tax code recognizes that enforceable restrictions can affect land value and requires that they be considered in the assessment process. In a July 1981 Letter To Assessors, the State Board of Equalization relied on Section 402.1 to advise assessors that affordability restrictions placed on surplus residential property sold by Caltrans, the state transportation agency, should be treated as enforceable restrictions that affect the value of land.[14] In subsequent advisory letters to the Contra Costa and San Louis Obispo county assessors, who had inquired about the assessment of homes with affordability and resale restrictions, the Board of Equalization also relied on this interpretation of Section 402.1.[15] The Los Angeles County Assessor used the same reasoning in responding to an inquiry concerning the assessment of homes developed by a community land trust. A disposition and development agreement between the land trust and the county development commission placed use, occupancy, and other restrictions on the homes. According to the assessor: "Pursuant to Revenue and Taxation Code Section 402.1 and various California State Board of Equalization letters, the assessor must consider enforceable governmental land use restrictions."[16]

Requirements for Consideration of Restrictions**.** In order to be considered in the assessment of land in California, government restrictions must be durable. The Revenue and Taxation Code points to a "rebuttable presumption that restrictions will not be removed or substantially modified in the predictable future."[17] It also contains a provision whereby property owners may apply to local governing bodies for written statements of governmental intent "to refrain from removing or modifying the restrictions in the predictable future." Property owners may then present the statements to county boards of equalization as evidence of restrictions that should be considered in valuing property.

In California, affordability restrictions imposed by governmental agencies run with the land and are recognized as land-use restrictions.[18] The Revenue and Taxation Code identifies a variety of enforceable restrictions on land. Among the restrictions mentioned are "recorded contracts with governmental agencies other than those provided in [the sections of the code addressing open-space land]."[19] A 2007 Assembly bill would amend the code by expanding the list of enforceable restrictions to include those that limit the

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[14] California State Board of Equalization, "Valuation of Single-Family Residential Property Subject to Agreement Between Caltrans and Buyer," Letter to Assessors No. 81/74 (Sacramento: California State Board of Equalization, 7 July 1981).

[15] Charles G. Knudsen, Principal Property Appraiser, State Board of Equalization, Assessment Standards Division, to Stephen Dawkins, Contra Costa County Appraiser, 28 November 1995. Eric F. Eisenlauer, Staff Counsel III, State Board of Equalization, Legal Division, to Dick Frank, San Luis Obispo County Assessor, 13 December 1993.

[16] Robert Quon, Director, Los Angeles County Assessor, Major Appeals Division, to Ann Sewill, President, Community Foundation Land Trust, 8 August 2006.

[17] *California Revenue and Taxation Code*, sec. 1630.

[18] Ibid., sec. 402.1(a)(2).

[19] Ibid., sec. 402.1.

resale price of property and are recorded in deeds or other property-transfer documents.[20] The property must be purchased through affordable-housing programs operated by city, county, or state agencies or by nonprofit organizations.

California considers only government-imposed affordability restrictions in valuing and taxing homes. This is consistent with the ruling in *Carlson v. Assessment Appeals Board*, where the Court of Appeal held that in determining fair market value, the assessor was only required to consider governmentally imposed land restrictions maintaining effective land-use planning, not restrictions imposed "solely for the profit and benefit of the seller."[21] It is also consistent with a December 1993 advisory letter from a staff attorney at the Board of Equalization to the San Luis Obispo County assessor. The assessor sought advice concerning the assessment of townhome units that were purchased by low- and moderate-income residents in a development on which the city government had placed affordability and resale restrictions. In his discussion of the recognition of enforceable restrictions within the state's tax code, the attorney wrote: "In our view, only governmental restrictions are contemplated by section 402.1."[22] However, government entities are not required to assume responsibility for administering the restrictions. As the case involving the community land trust in Los Angeles illustrates, California assessors recognize restrictions that are imposed by government but administered by other entities.

Under the 2007 bill on affordable-housing assessment, restrictions imposed by nonprofit developers of affordable housing will be recognized as enforceable.[23] Government imposition will no longer be required. California already recognizes privately imposed restrictions that are placed on land designated for certain uses. The Revenue and Taxation Code allows enforceable easements to be granted in favor of nonprofit corporations that have as their primary purpose the preservation, protection, or enhancement of land in its natural, scenic, historical, agricultural, forested, or open-space condition or use.[24] When assessing this land, assessors must consider the easements' effects on value.

<u>Guidelines for Valuing Restricted Property</u>**.** Although Section 402.1 requires assessors to consider the effect of restrictions on land values, it does not provide guidelines for assessing affected properties. In its 1981 Letter to Assessors, the Board of Equalization advised that the "valuation of properties subject to the affordability and resale controls

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[20] California State Legislature, California Assembly, California Legislature 2007-08 regular session, A.B. No. 793.

[21] Carlson v. Assessment Appeals Board, 167 Cal.App.3d 1004 (1985).

[22] Eisenlauer to Frank.

[23] A.B. No. 793.

[24] *California Revenue and Taxation Code*, Section 402.1. Bowman, Cordes, and Metcalf define an easement as "a legal status that often involves the right to do or prevent something on the real property of another person." Woods Bowman, Joseph Cordes, and Lori Metcalf, "Preferential Tax Treatment of Property Used for 'Social Purposes:' Fiscal Impacts and Public Policy Implications," Paper prepared for the State Property Tax Policy Roundtable, October 2007.

imposed by Caltrans should be based upon the individual property's purchase price."[25] This is consistent with Section 110(b) of the Revenue and Taxation Code, which requires "full cash value" or "fair market value" to be the purchase price. In its letters to the Contra Costa and San Louis Obispo county assessors, the Board of Equalization advised valuing restricted units at their sale prices.[26] The Los Angeles County assessor followed this approach in indicating that sale prices would serve as the assessable value of homes developed by a land trust.[27] The 2007 bill on affordable-housing assessment excludes from the purchase price financial assistance the homebuyer receives from the program sponsor if payment of principal and interest does not commence for at least 30 years.[28] The terms under which the assistance is provided must be specified in the deed.

The California Revenue and Taxation Code offers guidelines for the treatment of land owned by community land trusts. It regards the creation of a leasehold interest in real property for a term of 35 years or more as a change in ownership.[29] Property must be assessed each time it changes ownership. Consequently, community land trusts must have their land assessed when they enter into new leases or renew existing leases with homeowners.

Massachusetts

Recognition and Declared Public Purpose**.** By enabling special provisions that streamline the public approval process for affordable housing developments, Massachusetts recognizes those developments as serving a public purpose. The Massachusetts Department of Housing and Community Development administers a variety of programs that facilitate the development of homes with long-term affordability restrictions. Its Local Initiative Program (LIP) provides technical assistance to developers and municipalities seeking to develop mixed-income projects that include housing for households with incomes below 80 percent of the median income for their areas. LIP program guidelines include a model deed rider to be used in specifying affordability, resale, and other restrictions placed on homeownership units.[30] The deed rider refers to a public interest "in the creation and retention of affordable housing for persons and households of low and moderate income and in the restricting of the resale price of property in order to assure its affordability by future low and moderate income purchasers."

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[25] California State Board of Equalization, "Valuation of Single-Family Residential Property."

[26] See Knudsen to Dawkins and Eisenlauer to Frank.

[27] See Quon to Sewill.

[28] A.B. No. 793.

[29] *California Revenue and Taxation Code*, sec. 61. Also see Quon to Sewill.

[30] Massachusetts Department of Housing and Community Development, *Local Initiative Program Guidelines* (Boston: Massachusetts Department of Housing and Community Development, updated October 2007).

Types of Guidance Provided**.** Massachusetts has strong legislation that supports the development of deed-restricted, owner-occupied housing. In 1969, the legislature passed Chapter 774, or "An Act Providing for the Construction of Low and Moderate Income Housing in Cities and Towns Where Local Restrictions Hamper Such Construction."[31] That act amended Chapter 40B of the Massachusetts General Laws by adding sections enabling local Zoning Boards of Appeal to use flexible rules to approve affordable housing developments if at least 20 to 25 percent of the units have long-term affordability agreements. This measure was designed to increase the supply and improve the regional distribution of low- and moderate-income housing in the state. Section 31 of Chapter 184 of the General Laws defines "affordable housing restrictions" and recognizes restrictions imposed pursuant to state-sponsored housing programs.

The LIP guidelines specify the required features of the restrictions that must be placed on housing units assisted by the program. Additional administrative guidance can be found in a June 2006 letter from the head of the Bureau of Municipal Finance Law to the Worcester city assessor regarding the proper valuation of a community land trust property with affordability controls.

Two Massachusetts court cases directly address the tax treatment of homes with long-term affordability restrictions. In *Community Development Co. of Gardner v. Board of Assessors of Gardner*, the state Supreme Court ruled in 1979 that the Board of Assessors and the Appellate Tax Board erred in not considering federal rent restrictions when valuing the appellant's property.[32] In 1999, the Appellate Tax Board determined in *Truehart v. Board of Assessors of the Town of Montague* that deed restrictions requiring the long-term affordability of units developed pursuant to Chapter 40B must be considered in arriving at the fair cash value of properties.[33] The Board also ruled that the sale price of each of the subject properties was the best evidence of value.

Restrictions Considered in Valuing Property**.** The *Truehart* decision provides the legal basis for considering the impact of affordability restrictions when valuing government-sponsored units. In stating it's ruling in that case, the Appellate Tax Board wrote:

> A willing and informed buyer of subject properties is presumed to know that he or she must grant MHFA [the Massachusetts Housing Finance Agency] a right of first refusal and that he or she will be limited to a maximum resale price based on the discount rate applicable to the property. Where, as here, the evidence supports a finding that, during the period at issue, MHFA was exercising its rights of first refusal in virtually all instances,…the value of the property cannot accurately be determined without consideration of the discount rate.[34]

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[31] Massachusetts General Court, chap. 774 of the Acts of 1969, H5681.

[32] Community Development Co. of Gardner v. Board of Assessors of Gardner, 377 Mass. 351 (1979).

[33] Truehart et al. v. Board of Assessors of the Town of Montague, Appellate Tax Board Docket Nos. 198055-198057 (1999).

[34] Ibid.

Requirements for Consideration of Restrictions**.** Affordable-housing policy in Massachusetts relies on long-term affordability controls that run with the land. The Local Initiative Program requires that the restrictions be perpetual.[35] The state offers mixed guidance regarding the recognition of private restrictions. In *Truehart*, the Appellate Tax Board ruled that "deed restrictions must be considered in arriving at [the] fair cash value" of publicly developed properties or properties serving a public purpose, but it said nothing about privately imposed restrictions.

In 2006, the chief of the Bureau of Municipal Finance Law wrote an advisory letter to the Worcester city assessor. The assessor had inquired about the proper valuation of three attached, multi-unit row houses that had been developed by a community land trust and were subject to deed restrictions and ground leases regulating resale prices and procedures. The assessor wanted to know whether to value each unit at its fair market value, which in his estimation was approximately $225,000, or at the its sale price, which was $145,000. The units in question received no government assistance. In advising the assessor, the bureau chief acknowledged the legal basis for considering restrictions.

> Provisions affecting the use and enjoyment of the property must be considered by the assessors in any determination of the property's fair cash valuation whether they arise from private or government action. Provisions affecting the income or return a particular owner may derive from the property are generally not to be considered. One exception to this rule, however, is that governmental policies or actions that regulate the return a property can produce and also promote important public interests are factors that must be taken into account in valuing the property. The theory behind this exception seems to be that since the Legislature has indicated support for these policies and actions, it would be inconsistent with the legislative purpose not to take the restrictions into account in determining value.[36]

In considering the matter of privately imposed restrictions, the bureau chief went on to write:

> Whether the operation of a non-governmental affordable housing program is intended to provide the participants with a tax reduction still remains an open question in much of the country. In the absence of any legislation in Massachusetts addressing exactly what constitutes the property value subject to tax when there are private, voluntary, contractual restrictions in deeds, leases or other agreements, we cannot say with certainty whether a determination of fair cash valuation requires taking into account the economic effect of resale and rent restrictions associated with affordable housing properties.

She concluded the letter by noting that although the legal arguments for not considering private restrictions are strong, the Massachusetts courts have recognized "the important

[35] Massachusetts Department of Housing and Community Development, 21.

[36] Kathleen Colleary, Chief, Massachusetts Department of Revenue, Division of Local Services, Bureau of Municipal Finance Law, to Robert J. Allard, Jr., Worcester City Assessor, 1 July 2006.

public policy advanced by government sponsored housing assistance programs." She also noted that the trend among courts in the state was toward considering the effects of affordable housing restrictions when assessing value.

Guidelines for Valuing Restricted Property**.** In *Truehart*, the Appellate Tax Board ruled that sale price is the best evidence of value.

New Jersey

Recognition and Declared Public Purpose. The New Jersey Supreme Court has established that each municipality in growing areas has a constitutional obligation to adopt land-use regulations that enable it to meet its share of the regional need for low- and moderate-income housing.[37] The state's Fair Housing Act declares that the provisions it sets forth are in the public interest in that they offer planning and financing mechanisms pursuant to the constitutional obligation identified by the Supreme Court.[38]

Types of Guidance Provided**.** Like Massachusetts, New Jersey offers a relatively clear policy framework for the development, valuation, and taxation of shared-equity housing. In 1975, the Supreme Court in *Southern Burlington County N.A.A.C.P. et al. v. Township of Mount Laurel* struck down growing municipalities' use of regulations "that make it physically and economically impossible to provide low- and moderate-income housing in the municipality for various categories of persons who need and want it".[39] The Court ruled that ordinances that were so restrictive as to preclude the development of single-family housing not only for low-income households, but for moderate-income households as well, were "contrary to the general welfare," and therefore were unconstitutional.[40] It pointed out that a growing municipality "would satisfy the constitutional obligation by affirmatively affording a realistic opportunity for the construction of its fair share of the present and prospective regional need for low- and moderate-income housing".[41] In a 1983 case that revisited these issues, the Supreme Court defined the constitutional obligation more clearly in an effort to encourage voluntary compliance.[42]

In 1985, the New Jersey legislature passed the Fair Housing Act in response to the *Mount Laurel* decisions. This legislation established the Council on Affordable Housing as the state agency charged with overseeing municipal efforts to satisfy affordable-housing obligations. The state also established Uniform Housing Affordability Controls for the

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[37] Southern Burlington County N.A.A.C.P. et al. v. Township of Mount Laurel, 336 A.2d 713 (1975) *(*Mount Laurel I*)*. Southern Burlington County N.A.A.C.P. et al. v. Township of Mount Laurel, 456 A.2d 390 (1983) (Mount Laurel II).

[38] *Fair Housing Act*, *New Jersey Statutes Annotated*, 52: 27D-301-329.

[39] Mount Laurel I, 713.

[40] Ibid.

[41] Mount Laurel II, 413.

[42] Mount Laurel II.

implementation of the Fair Housing Act.[43] These rules address the establishment and administration of affordability controls placed on housing units pursuant to the Fair Housing Act.

A landmark New Jersey court decision provides clear guidance for the valuation of shared-equity housing. In 1991 in *Prowitz v. Ridgefield Park Village*, the Supreme Court upheld a Superior Court decision requiring assessors to consider resale restrictions when assessing properties that are part of municipalities' "official" affordable housing stock.[44]

Restrictions Considered in Valuing Property**.** In its *Prowitz* ruling that requires valuation procedures to take price restrictions into account, the Superior Court regarded such restrictions as "analogous to value-depreciating government regulation."[45] It noted the following as important features of the restrictions considered in the case:

> The market value of the property, that is, the amount which a bona fide buyer would otherwise pay a bona fide seller in an arms-length transaction, is significantly affected by governmental action taken for the beneficent public purpose of advancing and protecting the housing needs of classes of persons legislatively determined to require housing assistance. The form of that assistance here relevant is the imposition of a value-depreciating burden upon private ownership. That direct burden is justified on the basis of paramount public policy. It is fundamentally fair then for the public to share that burden with private ownership at least to the extent of recognizing, for tax assessment purposes, the market-place consequences of the restriction.

Requirements for Consideration of Restrictions**.** Affordability restrictions on homes developed in New Jersey in accordance with state housing policy are intended to be of long-term duration. The Uniform Housing Affordability Controls require that they last 30 years.[46] The restrictions run with the land. The *Prowitz* decision viewed resale-price restrictions as "a burden on the land itself." The Council on Affordable Housing is charged with overseeing and enforcing the restrictions. It is unclear whether New Jersey requires government imposition of affordability restrictions.

Guidelines for Valuing Restricted Property**.** *Prowitz* offers no guidance concerning the manner in which restrictions are to be considered in valuing property. Two assessors who were interviewed for this study indicated that properties are typically entered on tax rolls at their restricted sale prices and remain at that level until the restrictions are removed.

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[43] *Uniform Housing Affordability Controls*, *New Jersey Administrative Code*, 5:80-26.1-26.10.

[44] Prowitz v. Ridgefield Park Village, 584 A.2d 782 (1991). Wayne Prowitz v. Ridgefield Park Village, 568 A.2d 114 (1989).

[45] Prowitz v. Ridgefield Park Village, 1989.

[46] Restrictions on units located in census tracts with high poverty levels are required to last only 10 years. *Uniform Housing Affordability Controls*, 5:80-26.5.

New York

Recognition and Declared Public Purpose. New York does not recognize the development of permanently affordable housing as serving a public purpose. However, the state's Limited-Profit Housing Companies law declares "that the provision of adequate, safe, and sanitary housing by limited-profit housing companies is a public use and purpose for which public money may be provided and tax exemption granted."[47]

Types of Guidance Provided. Compared to Massachusetts and New Jersey, New York provides little policy guidance for the tax treatment of resale-restricted, owner-occupied homes. Through its Affordable Home Ownership Development Program, the state's Affordable Housing Corporation offers grants for the construction, acquisition, rehabilitation, and improvement of owner-occupied dwellings. However, that program does not require the assisted units to be permanently affordable. The Limited-Profit Housing Companies Law authorizes the state housing finance agency to provide tax exemptions and financial assistance to limited-profit housing companies that develop rental housing for low-income households. The law does not address the valuation and taxation of owner-occupied homes developed by the housing companies and subject to long-term affordability restrictions. The Office of Real Property Standards offers valuation standards and periodic legal opinions, or "Opinions of Counsel," one of which addresses the valuation of homes with restricted resale prices. A 1994 court decision in *78 South First Street Housing Development Fund Corporation v. Commissioner of Finance of City of New York* established some of the requirements affordability restrictions must satisfy in order to be considered by assessors.[48] The court held that temporary sale and use restrictions that were personal to the owner did not lessen the value of a property for assessment purposes.

Restrictions Considered in Valuing Property. Thus far, New York has not regarded affordability restrictions associated with shared-equity homes, in large measure because state legislation is silent on the matter.[49]

Requirements for Consideration of Restrictions. A 1997 Opinion of Counsel issued by the Office of Real Property Services determined that New York statutes do not permit restrictions on resale price to be considered when valuing property.[50] In examining the facts of the situation to which the opinion pertained, the Office regarded the 25-year restrictions imposed as being of "temporary duration" rather than as "an encumbrance on the land of a permanent nature." The Office based its reasoning on the1994 decision in *78 South First Street Housing Development Fund Corporation v. Commissioner of Finance of the City of New York*, in which the court declined to recognize the impact of

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[47] *Private Housing Finance*, *Laws of New York*, Secs. 580-592.

[48] 78 South First Street Housing Development Fund Corporation v. Commissioner of Finance of City of City of New York, 202 A.D.2d 115 (1994).

[49] New York State Office of Real Property Services, Opinions of Counsel Vol. 10, SBRPS No. 34 (Albany: New York State Office of Real Property Services, 1997, modified 2005).

[50] Ibid.

resale price restrictions because it viewed the restrictions as temporary, in contrast to what it regarded as the perpetual restrictions considered in the *Prowitz* case in New Jersey. Interestingly, New Jersey requires restrictions to last 30 years, only 5 years longer than those considered in the situation addressed in the Opinion of Counsel. New York does not appear to recognize affordability restrictions placed on owner-occupied property by private parties.

<u>Guidelines for Valuing Restricted Property</u>**.** New York offers no guidance for the valuations of property subject to price restrictions.

Vermont

<u>Recognition and Declared Public Purpose</u>**.** The long-term affordability of housing for low- and moderate-income households is state policy in Vermont. The state's statutes recognize housing subsidy covenants that encourage the development and continual affordability of rental and owner-occupied housing for those households.[51]

<u>Types of Guidance Provided</u>**.** Vermont provides strong legislative backing for the development of deed-restricted housing with long-term affordability controls. State law permits use of housing subsidy covenants, identifies types of restrictions that may be used, specifies allowable durations, and enables the enforcement of restrictions that run with the land.[52] It also addresses the valuation of properties that involve housing subsidy covenants and the taxation of lands with perpetual leases.[53]

The development of perpetually affordable housing is one of the major policy goals of the Vermont Housing and Conservation Board. The Board is a state-supported funding agency that provides grants, loans, and technical assistance to nonprofit organizations, municipalities, and state agencies. It helps develop housing for households with incomes below the median income and uses housing subsidy covenants to ensure permanent affordability. The Vermont Department of Taxes offers additional administrative guidance in the form of periodic Advisory Bulletins.

<u>Restrictions Considered in Valuing Property</u>**.** Vermont law explicitly requires estimates of fair market value to consider the effects of housing subsidy covenants.

> The estimated fair market value of a property is the price which the property will bring in the market when offered for sale and purchased by another, taking into consideration all the elements of the availability of the property, its use both potential and prospective, any functional deficiencies, and all other elements such as age and condition which combine to give property a market value. Those elements shall include a

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[51] *Housing Subsidy Covenants; Enforceability*, *Vermont Statutes Annotated*, tit. 27, sec. 610.

[52] Ibid.

[53] *Definitions*, *Vermont Statutes Annotated*, tit. 32, sec. 3481. *Buildings on Leased Land*, *Vermont Statutes Annotated*, tit. 32, sec. 3608. *Perpetual or Redeemable Leases*, *Vermont Statutes Annotated*, tit. 32, sec. 3609. *Taxation of Perpetual Leased Lands*, *Vermont Statutes Annotated*, tit. 32, sec. 3610.

> consideration of a decrease in value in non-rental residential property due to a housing subsidy covenant as defined in section 610 of Title 27.[54]

Requirements for Consideration of Restrictions**.** Permanent housing affordability receives high priority in the Vermont Consolidated Plan and in the allocation of funds through the Housing and Conservation Board. However, affordability restrictions need not be permanent in order to be considered in the valuation process. According to the housing subsidy covenants law, affordability restrictions may be perpetual or they may be limited to a period of time. The law requires the restrictions to run with the land. Vermont recognizes private restrictions. It identifies nonprofit corporations, lending institutions that provide subsidies, and private parties that provide subsidies as legitimate creators of the covenants.[55]

Guidelines for Valuing Restricted Property**.** Vermont currently offers no guidance concerning the valuation of property subject to housing subsidy covenants. The state's Department of Taxes plans to issue an Advisory Bulletin on this topic. The bulletin will likely recommend that such a property be valued at the "option price," which equals the sale price paid by a low- or moderate-income purchaser. For resales, the option price also includes the transaction fee charged by the sponsoring nonprofit organization, the homeowner's share of appreciation, and the value of approved capital improvements made by the owner.

Vermont law provides guidelines for the taxation of perpetual leases. Perpetual leases must be entered on tax rolls at their market values, with consideration given to "all limitations upon the use of the land by the lessee which substantially diminish the value of his right to occupy, use, or enjoy the land."[56] Resale restrictions pertaining to buildings on leased land would presumably be regarded as a limitation to be considered.

Conclusions

No standardized approach exists for valuing resale-restricted, owner-occupied homes. The findings presented in this working paper demonstrate how states differ in their treatment of this property. Of the five states examined, only New York does not recognize affordability restrictions placed on shared-equity homes. California, Massachusetts, New Jersey, and Vermont all consider the effects of such restrictions when valuing the homes. Massachusetts, New Jersey, and Vermont offer the most extensive guidance in this regard. Each provides clear guidelines that can support the development of permanently affordable housing. California and Massachusetts require price-restricted homes to be valued at their sale prices. Vermont recognizes privately imposed restrictions. Whether privately imposed restrictions can be imposed in Massachusetts and New Jersey is an open question.

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[54] *Definitions*.

[55] *Housing Subsidy Covenants; Enforceability.*

[56] See *Buildings on Leased Land*, *Perpetual or Redeemable Leases*, and *Taxation of Perpetual Leased Lands.*

The four states that consider the effects of affordability restrictions on the value of residential property also have legislation that recognizes the development of durably affordable housing as serving a public purpose. This pattern is similar to that among states that permit conservation easements.[57] According to Youngman, "most jurisdictions have in fact concluded that legislative authorization for conservation easements implies that they should be taken into account for property tax purposes."[58] Resale-restricted, owner-occupied housing shares important features with conservation easements.[59] Both are forms of negative easements in that they prohibit or restrict some use or benefits that can be derived from the affected property. In both cases, the right to prohibit activity on property is typically held by a nonprofit organization (such as a conservation organization or community development corporation), a land trust, or a government agency. Also in both cases, the restrictions imposed can be of perpetual duration. Additionally, both involve balancing the individual and social benefits associated with property ownership.[60]

The findings presented in this paper suggest that restrictions placed on owner-occupied, shared-equity homes and the consideration of those restrictions in the valuation of the homes can be part of a comprehensive approach to develop and preserve affordable housing. Youngman notes that programs that value farmland based on its current use rather than its market value would be more effective if they geared their benefits toward carefully identified categories of property owners and focused on the achievement of their goals.

> Concretely, this means a legislative definition of eligibility…, an appropriate combination of incentives for covenants to retain land in agricultural use and penalties for withdrawal from the program, and a role for regional planning in identifying land whose long-term preservation offers the greatest public benefit.[61]

These measures can also improve the effectiveness of resale restrictions designed to promote long-term affordability. The New Jersey and Massachusetts policy frameworks for affordable housing incorporate them by designating specific eligibility requirements based on household income; offering incentives that help eligible households purchase homes and encourage local jurisdictions to develop homes they can afford; imposing penalties when participating households and jurisdictions violate restrictions and guidelines; and addressing the provision of permanently affordable housing from the vantage point of land-use planning. Many shared-equity homeownership programs sponsored by nonprofit organizations such as community land trusts and community

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[57] A conservation easement prevents the development of real property in order to promote use of the property as open space.

[58] Joan M. Youngman, "Taxing and Untaxing Land: Open Space and Conservation Easements," *State Tax Notes* (11 September 2006): 752.

[59] Ibid., 758.

[60] Davis, 4.

[61] Joan M. Youngman, "Taxing and Untaxing Land: Current Use Assessment and Farmland," *State Tax Notes* (5 September 2005): 738.

development corporations also incorporate these elements. The valuation of shared-equity homes at their restricted prices is an important element of the policy frameworks created by Massachusetts and New Jersey. Though it is only one component of this overall approach, the manner in which shared-equity homes are valued for tax purposes can either foster or prevent the continued access of low- and moderate-income households to the benefits of homeownership.

Suggestions for Future Research

The research conducted to date for this project provides an analytical framework that can be used for further study of the taxation of resale-restricted, owner-occupied housing. A plan for the continuation of this research should incorporate the following activities.

1. Analyze the tax treatment of limited-equity cooperatives.
2. Expand the analysis to include all states, based on the following categorization:
    - States where there is reason to believe that some state-level guidance is provided and/or where there are large numbers of resale-restricted, owner-occupied units (Colorado; Washington, DC; Illinois; Maryland; Minnesota; Oregon; Washington)
    - States that possibly provide guidance and that have some resale-restricted, owner-occupied units (Arizona, Arkansas, Connecticut, Florida, Hawaii, New Hampshire, New Mexico, North Carolina, Ohio, Pennsylvania, Rhode Island, Wisconsin)
    - States that probably provide no guidance and that have few resale-restricted, owner-occupied units
3. For all states, examine the practices used by assessors in valuing resale-restricted, owner-occupied housing
4. Analyze alternative rationales for valuing resale-restricted, owner-occupied housing
    - Identify alternatives (for example, legal doctrine, tax theory, land value theory, treatment of other categories of restricted property, established practice)
    - Explore the merits and shortcomings of each alternative
5. Analyze best practices
    - Develop criteria for determining what should be regarded as a best practice
    - Identify jurisdictions and organizations that utilize best practices

For each of the last four items, the analysis should identify similarities and differences in the treatment of community land trusts, limited-equity cooperatives, and deed-restricted housing.

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Table 1: Summary of State Tax Treatment of Resale-restricted, Owner-occupied Housing

State	Restrictions Recognized	Public Purpose Served by Restrictions	Guidance	Restrictions Considered in Valuation	Requirements for Consideration of Restrictions	Guidelines for Valuing Restricted Property
California	Yes	Yes	Legislative Administrative	Yes	Restrictions run with land Longevity Gov. involvement	Yes
Massachusetts	Yes	Yes	Judicial Legislative Administrative	Yes	Restrictions run with land Longevity Gov. involvement?	Yes
New Jersey	Yes	Yes	Judicial Legislative Administrative	Yes	Restrictions run with land Longevity Gov. involvement?	No
New York	No	No	Judicial Administrative	No	Restrictions not recognized	No
Vermont	Yes	Yes	Legislative Administrative	Yes	Restrictions run with land	No