Kentucky Legislation Creates New Property Tax Valuation Method for Affordable Multifamily Properties

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Kentucky Governor Andy Beshear recently signed a bill that will provide more certainty for annual property tax valuations and potentially lower property tax assessments for many affordable multifamily housing projects across the Commonwealth of Kentucky. House Bill 360 represents a significant development for the stability and growth of much needed affordable housing in the Commonwealth. The bill is effective immediately and could apply to Kentucky's upcoming annual 2023 real property tax appeal (open inspection) period starting May 1, 2023.

Under Kentucky's current property tax valuation methods, low-income multifamily housing that is not otherwise exempt from property tax under Section 170 of the Kentucky Constitution, is generally assessed using the same calculations as market-rate multifamily housing. The typical valuation method for commercial real estate applies the income approach, which calculates the value of the property by dividing its net operating income by its applicable capitalization rate, which will vary among markets and asset types.

However, capitalization rates for affordable multifamily housing projects are generally higher than similarly situated market-rate multifamily housing projects, which leads to an overvaluation of affordable multifamily housing projects because government regulations, such as rent restrictions, impact the income potential of such projects. Many states already have separate provisions for accurately determining affordable housing property taxes, and Kentucky is now following that trend with House Bill 360.

Legislation Overview and Applicability

House Bill 360 is an omnibus bill encompassing a wide variety of fiscal legislation. While the low-income multifamily property tax

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provisions originated in another bill that never received a vote out of committee, the relevant language was added to House Bill 360 through the persistent efforts of organizations such as the Kentucky Affordable Housing Coalition. These provisions amend KRS 132.191 by creating a new formula for low-income housing properties with "government restriction on use." These properties include multifamily projects with four or more units where at least half of the units are restricted to residents living at or below 80% of Area Median Income, as defined for each geographic area by the U.S. Department of Housing and Urban Development (HUD). The new formula broadly applies to any affordable housing properties using low-income housing tax credits (LIHTC), tax-exempt bond financing, rent subsidies, guaranteed loans, grants, and low-interest HUD loans.

New Valuation Methodology

Under the amended KRS 132.191, the property owner may elect to use one of two new formulas for valuing qualifying affordable multifamily housing properties. The first option is an annual net operating income approach using the difference between actual income and stabilized operating expenses for the property, divided by a unique capitalization rate. Using Uniform Standards of Professional Appraisal Practice, this capitalization rate will consider factors arising from low-income housing regulations such as diminished income potential, liquidity opportunity, and ownership control in addition to common market factors such as property condition, class, location, and size. This unique capitalization rate will be equal to or greater than the rate used for market-rate apartments, in a range of 50-150 basis points higher than the national average. The Kentucky Department of Revenue (the "Department") will be responsible for calculating this rate and publishing it each year.

The second new valuation method is a comparison approach. This approach starts by calculating the value of a particular rental housing property with conventional methods, then adjusting the value based on a ratio of the average annual income-restricted rents against the average annual market rents from comparable

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multifamily properties. For each of these methods, the statutory amendments make clear that income tax credits obtained under any state or federal LIHTC will not be included in assessing the value of a LIHTC project. That methodology had become a serious concern in 2022 due to a recent reassessment initiative by the Department for affordable housing properties throughout the state to include such credits and apply generalized (not actual) expenses, costs, and other factors when valuing these properties.

Accordingly, these new statutory valuation methods will not only provide more certainty and consistency, but also help get to the correct "fair cash value" for property tax purposes, to the benefit of affordable multifamily housing projects (and owners) throughout Kentucky.

Next Steps

Now that House Bill 360 has been signed into law, the Department will be tasked with promulgating more specific administrative regulations to carry out the new legislation. Owners of multifamily rental housing will be obligated to notify their local property valuation administrator (PVA) if their property is subject to low-income government use restrictions to use these new valuation methods. Owners will also need to notify the PVA of any changes in the future, including a change in low-income status or if the property is subject to a foreclosure action. All notifications will need to be sent in writing within 60 days or risk being subject to a fine of up to $200. The Department will be responsible for producing a form that owners will use to provide their local PVA with information necessary to utilize the new property valuation methodology. We will continue to help keep affordable housing owners informed as further administrative regulations and guidance become available.

For more information, please contact the authors of this article or any attorney with Frost Brown Todd's Multifamily Housing and Tax teams.

Frost Brown Todd counsels investors, developers, sponsors, lenders, and other key stakeholders on low-income housing transactions across the country, while also advising and representing such

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clients in connection with Kentucky's annual real property tax appeals occurring only two weeks each May. We stay at the forefront of all legislative efforts affecting the industry, and we are ready to assist clients with navigating the changing legislative environment. Learn more.

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