New Procedure for Valuing Federally Subsidized Rental Property in Ohio

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Authors:

Jonathan E. Roach
Samantha E. Bagley
John C. Krug
Yazan S. Ashrawi

Owners of federally subsidized multifamily properties in Ohio are now able to make specific financial disclosures to take advantage of a new law that changes the way such properties are valued for real estate taxes. These changes are set forth in Ohio Revised Code (R.C.) 5713.031 and became effective on October 3, 2023. This new law also creates important considerations for buyers of federally subsidized residential rental properties, such as qualified Low-Income Housing Tax Credit and Section 8 properties. Although this law became effective last year, the administrative rule with the new valuation formula (described below) is still in process and is expected to become final in 2025. So, now is the time to start thinking about taking advantage of the new valuation formula.

Prior to the enactment of R.C. 5713.031, federally subsidized residential rental properties were valued pursuant to R.C. 5713.01, like most other properties. Now, owners of federally subsidized rental properties can capitalize on a specific valuation formula set forth in R.C. 5715.01(A)(4), but only if they timely submit certain financial information to their county auditor.

To begin, R.C. 5713.031(A) defines "federally subsidized residential rental property" as property meeting any of the following definitions:

- It is part of a qualified low-income housing project, through its compliance and extended use period, as those terms are defined in section 42 of the Internal Revenue Code, or any other period during which it is similarly restricted under section 42 of the Internal Revenue Code.
- It receives assistance pursuant to section 202 of the Housing Act of 1959 and remains restricted pursuant to that section.
- It receives assistance pursuant to Section 811 of the Cranston-Gonzalez National Affordable Housing Act and remains restricted pursuant to that section.

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- It receives project-based assistance pursuant to section 8 of the United States Housing Act of 1937 and remains restricted pursuant to that section.
- It receives assistance pursuant to sections 515, 521, and 538 of the Housing Act of 1949 and remains restricted pursuant to those sections.

Owners of federally subsidized residential rental property must file the following information with their county auditor in order for the property to be eligible for valuation under the formula identified in R.C. 5715.01(A)(4):

- Operating income of the property;
- Operating expenses of the property; and
- Annual amount of contribution to replacement reserve funds or accounts related to the property.

This information must be filed on or before March 1st in each of the following years: (1) before the property is placed in service, (2) after the commencement of the property's operations, and (3) each sexennial reappraisal year or triennial update year. The financial information provided must cover the three previous years and must be audited by an independent public accountant, auditor, or certified public accountant prior to filing.

Owners of federally subsidized rental property that submit this information will be entitled to have their property valued in accordance with the formula identified in R.C. 5715.01(A)(4). Most notably, the formula will allow these properties to be valued based on the actual rent collected—typically much lower than market rents for federally subsidized rental properties. Generally, this should result in a lower valuation than being assessed at market value under R.C. 5713.01. The new valuation formula for federally subsidized rental property is still in the administrative rulemaking process; however, it will use the income capitalization approach to value, and under R.C. 5715.01(A)(4) it must be based upon the following:

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- Up to three years of operating income of the property, which includes gross potential rent, income derived from other sources, a presumed allowance of 4% for vacancy losses, and a presumed 3% allowance for unpaid rent losses. The presumed allowances may be exceeded with evidence demonstrating actual income.
- Operating expenses of the property, which are presumed to be 48% of operating income plus utility expenses as reported by the property owner to the county auditor. Operating expenses should also include a presumed replacement reserve of 5% of gross potential rent and a presumed account contribution of 5% of gross potential rent. These presumed allowances may be exceeded with evidence demonstrating actual expenses. Real property taxes, depreciation, amortization expenses, and the replacement of short-term capitalized assets are excluded from operating expenses.
- A market-appropriate, uniform cap rate plus a tax additur accounting for the real property tax rate of the property's location. For federally subsidized residential rental property that is a qualified low-income housing project subject to Section 42 of the Internal Revenue Code, one percentage point shall be subtracted from the uniform cap rate.

The current version of the proposed rule can be accessed here.

Also, note that R.C. 5715.01(A)(4) prescribes a minimum valuation for federally subsidized rental property equal to the greater of $5,000 multiplied by the number of dwelling units comprising the property or 150% of the property's unimproved land value.

We understand that the State of Ohio has been instructing county auditors to follow the valuation formula in the draft rule until the rule becomes final (likely in early 2025). So, property owners may find it advisable to proceed as if the rule is final and submit the information required by R.C. 5715.01(A)(4) (as listed above) to the applicable county auditor.

Once this rule is finalized, it will have a significant impact on how federally subsidized rental properties are valued, likely bringing more clarity and certainty to the valuation of these properties.

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Additionally, the enactment of R.C. 5713.031 creates important considerations for a potential buyer of federally subsidized rental property. Potential buyers will need to consider whether the current owner has submitted the required information under R.C. 5713.031 during the previous triennial or sexennial year. If not, the property may currently be overvalued by the county auditor, resulting in greater amounts of real estate taxes levied on the property. Buyers of these types of properties should consider adding representations and warranties to their purchase agreements regarding whether and to what extent the seller has provided this information to the county auditor; they should also request copies of any such information submitted as part of their due diligence.

Buyers of federally subsidized rental property that has not been valued in accordance with R.C. 5713.031 will still be free to pursue a traditional Board of Revision complaint to obtain a lower value. The enactment of R.C. 5713.031 does not affect Ohio case law governing the valuation of subsidized rental property, including the Ohio Supreme Court's holding in *Notestine Manor, Inc. v. Logan Cnty. Bd. of Revision* that Ohio "law requires a market-rent approach when federal subsidies would inflate the property's value." However, such buyers should be careful regarding the conveyance fee statement and any recorded documents identifying the price of the real estate. The best practice for such buyers remains to obtain an appraisal at closing that can support an allocation of the purchase price to non-realty items. A well-supported allocation of value to non-realty considerations—such as federal subsidies—will assist the buyer in future disputes regarding the property's value.

These are just a few of the myriad issues that can arise when buying, selling, or managing federally subsidized rental property. Frost Brown Todd counsels investors, developers, local governments, nonprofits, and other key stakeholders on affordable housing transactions in states across the country. 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. For more information, please contact the authors or any attorney on Frost Brown Todd's Multifamily Housing industry team or in Frost Brown Todd's Government Services practice group.

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