



Property Tax Exemption Issue
Raised by
Columbus Park Housing Corporation v. City of Kenosha

Potential Effects for
Wisconsin Housing and Economic Development Multifamily Portfolio
And Preservation Initiatives

WISCONSIN
HOUSING AND
ECONOMIC
DEVELOPMENT
AUTHORITY

Executive Summary

- The results of the analysis on existing WHEDA portfolio indicated that immediate cash need for WHEDA financed affordable housing projects is approximately \$3 million (\$9 million if assessors reach back two years)
- It was necessary for WHEDA to add fifteen properties to our own targeted Saving our Stock (SOS) program – an increase of \$1.5 million in immediate need (again \$4.5 million if assessors reach back) – as a result of this court ruling.
- Future preservation efforts rely on not-for-profit participation. One of the ways the not-for-profits are able to reduce expenses to hold property in perpetuity is by benefit of a property tax reduction and/or exemption, freeing up additional income to reinvest in the property. That "incentive" will be eliminated making it more difficult to address the pressing need of preserving the existing affordable housing stock, both federally subsidized and expiring through the low-income housing tax credit "The Y15 program".

Jim Doyle
Governor

Perry Armstrong
Chairman

Antonio R. Riley
Executive Director

The Challenge

On November 19, 2003 the Wisconsin Supreme Court filed its decision in the above referenced case. At the heart of the matter is language contained in the introductory Section 70.11, *Wisconsin Statutes* (Lessee Identity Condition) regarding property tax exemption that reads:

Leasing a part of the property described in this section does not render it taxable if the...lessee would be exempt from taxation under this chapter if it owned the property.

The application of this language on WHEDA's multifamily portfolio means that our "benevolent" owners (usually defined internally as not-for-profits) can own and rent their apartment developments, but if the residents would not be exempt under the Statute if they owned the property, it is ineligible for property tax exemption. In practice this clause had not been applied to residential property.

Potential Impact – Current Portfolio

A cursory review of the WHEDA financed, multifamily portfolio indicates that 145 developments, containing over 6,600 units are currently owned by not-for-profit entities or Public Housing Authorities. These entities were either currently exempt from property taxes or had negotiated a payment in lieu of taxes (PILOT) within their municipality under the existing Statute. An analysis was completed to determine the potential effect on the financial stability of these developments should full taxation be implemented.

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housing opportunities for
all persons

Several assumptions were utilized:

1. It appears property of Public Housing Authorities is exempt from taxation under Section 66.1202(22), Wis. Stats., though it is not entirely clear. We assumed these properties would remain exempt or maintain any PILOT they may have negotiated so no dollar need was identified, yet the units are represented in the totals on the attached map. If the PHAs are removed from the total, 123 developments containing over 5,400 units would be affected.
2. Since assessments are unavailable for the remaining portfolio, an average tax per unit, by county was calculated from WHEDA's for-profit portfolio. This average was applied to each affected development based on number of units so an estimated tax could be assumed.
3. The assumed tax was deducted from the property's most currently reported net operating income (NOI) and debt service coverage (DCR) was recalculated. To predict the dollar impact against the portfolio, the increase in tax used:
 - If current DCR was >1.0 and deduction of tax resulted in DCR still >1.0, the increase was included in full.
 - If current DCR was >1.0 and deduction of tax resulted in DCR <1.0, the increase was reduced just to get the property back to breakeven.
 - If current DCR was <1.0 and deduction of tax resulted in further reduction, the increase was included in full.
4. Under Section 70.44 of the Statutes, it appears that the assessor may also be able to add an assessment for property omitted from the tax rolls for two previous years.

The results of the analysis indicated that immediate cash need for the developments is approximately \$3 million (\$9 million if assessors reach back two years). It should be noted, that this estimate is based on "point in time" as of the reported 2002 financial condition of the developments. This estimation would be expected to increase in ensuing years. A map of the location of the affected developments is attached.

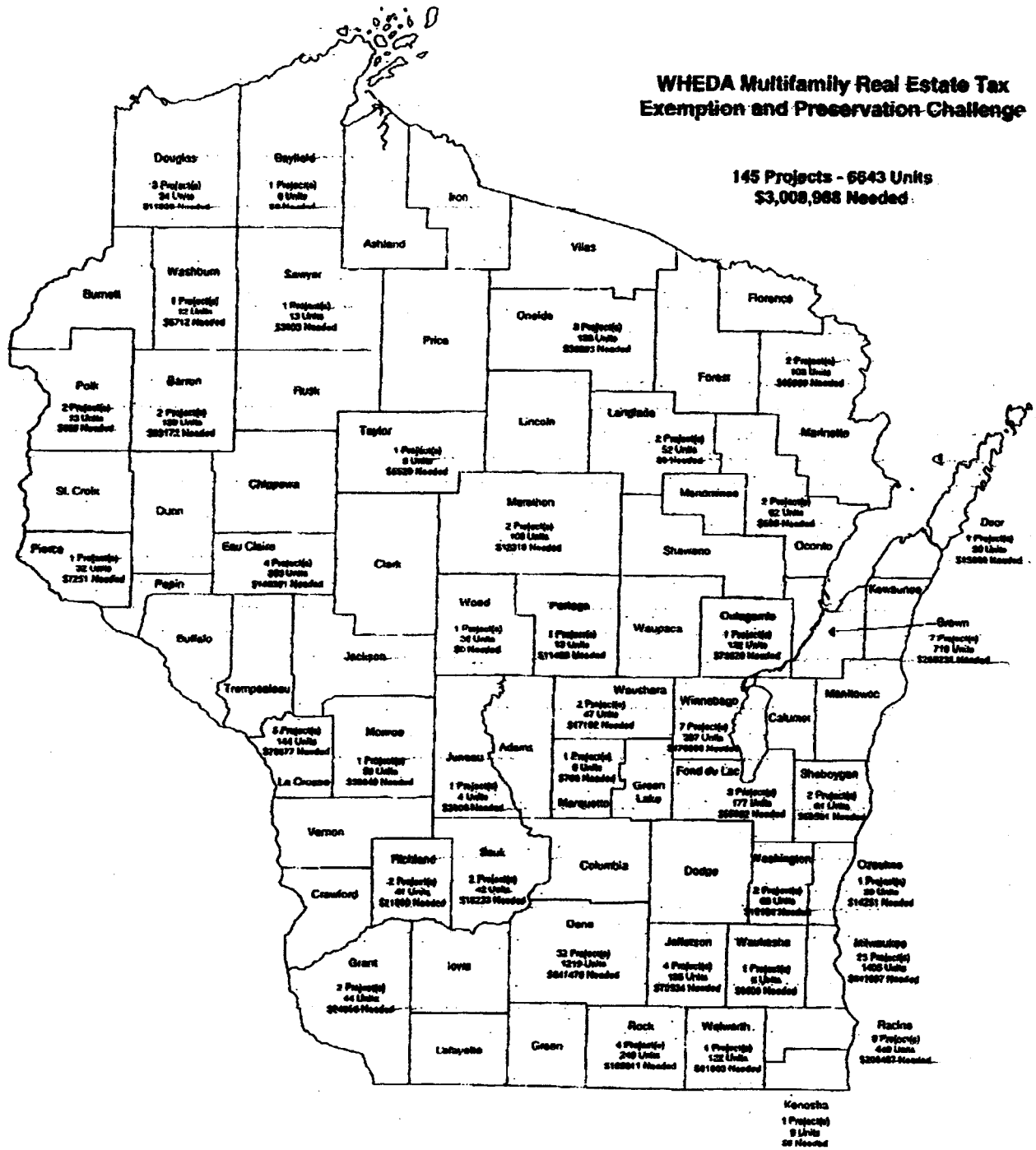
Potential Impact – Preservation Initiative

In addition, staff revisited the financial stress tests - designed as a result of the rent comparability rules imposed by HUD - conducted on WHEDA's project-based Section 8 portfolio. Under the Wisconsin SOS program being developed, we had proposed a \$10 million WHEDA commitment for the preservation of subsidized housing throughout the state. Our original analysis indicated that approximately half of that amount would be needed to address stress within our own portfolio, the remaining funds to be used to spur preservation throughout the state. It was necessary for WHEDA to add fifteen properties to our own targeted preservation list – an increase of \$1.5 million in immediate need (again \$4.5 million if assessors reach back) – as a result of this court ruling.

The Governor also recently announced the formation of an all-inclusive preservation task force to address the pressing need of preserving the existing housing stock, both federally subsidized and expiring through the low-income housing tax credit program. HUD and the IRS, through regulation and application have shown preference to not-for-profit ownership. The basis for this preference are three fold; 1) the housing is thought to be held in perpetuity by the benevolence of the ownership entity, 2) the not-for-profit owners typically are located within the market that the property is situated and can address changing market conditions more readily, and, 3) it is believed that the not-for-profit owners can operate the properties less expensively. However, one of the ways the not-for-profits were able to reduce expenses was by benefit of a property tax reduction and/or exemption, freeing up additional income to reinvest in the property. That "incentive" will be eliminated.

WHEDA Multifamily Real Estate Tax Exemption and Preservation Challenge

**145 Projects - 6643 Units
\$3,008,988 Needed**



POSSIBLE AMENDMENTS TO SECTION 70.11, WISCONSIN STATUTES
TO ADDRESS
COLUMBUS PARK HOUSING CORPORATION v. CITY OF KENOSHA

January 31, 2004 Draft
By Wisconsin Housing and Economic Development Authority.

[This gives tax exemption for Section 501(c)(3) owned residential property based on resident income by cross reference to federal tax exempt bond requirements.]

1. Amend the second sentence in the first paragraph of §70.11 by adding the phrase shown below in bold italics:

Leasing a part of the property described in this section does not render it taxable if the lessor uses all of the leasehold income for the maintenance of the leased property, construction debt retirement of the leased property or both and, except for residential property, if the lessee would be exempt from taxation under this chapter if it owned the property.

2. Add the following as a new third sentence in the first paragraph of §70.11:

Effective January 1, 2006, the preceding sentence is deleted and replaced with the following: Leasing a part of the property described in this section does not render it taxable if the lessor uses all of the leasehold income for the maintenance of the leased property, construction debt retirement of the leased property or both and, ***except for property described in s. 70.11(43)***, if the lessee would be exempt from taxation under this chapter if it owned the property.

3. Amend §70.11 by adding the following as a new last subsection:

(43) Qualified Residential Rental Project.

(1) Any portion of property the beneficial owner of which is an organization described in s. 501(c)(3) of the internal revenue code and which is a qualified residential rental project as defined in s. 142(d) of the internal revenue code except:

(a) The phrase "... issuer at the time of the issuance of the issue with respect to such project" in s. 142(d)(1) is deleted and replaced with "... the project owner";

(b) S. 142(d)(2)(A) shall not apply, and instead the phrase "qualified project period" shall mean at least one year;

(c) The word "Secretary" shall mean the housing and economic development authority; and

(d) S. 142(d)(6) and (7) shall not apply.

(2) A qualified residential rental property may be located on more than one tax parcel owned by an owner if the parcels are adjacent, across a street from one another, or within one condominium development. When a cooperative owns a property, and the beneficial owner of any of its shares is an organization described in s. 501(c)(3) of the internal revenue code, and such shares carry with them the right to lease one or more residential units within the property, a qualified residential rental property may consist of the units such organization leases from the cooperative pursuant to such right provided the units are otherwise operated as a qualified residential rental property.

4. This act first applies to the property tax assessments as of January 1, 2002.
5. This act takes effect retroactively to January 1, 2002.

MEMORANDUM

To: Interested Parties

From: Wisconsin Housing and Economic Development Authority

Date: January 31, 2004

Re: Possible Statutory Amendments to Address *Columbus Park Housing Corporation v. City of Kenosha*

Attached is a draft of possible amendments to Section 70.11, *Wisconsin Statutes* to address *Columbus Park Housing Corporation v. City of Kenosha*. The document number in the lower left corner of the draft is 003.470671.2.

This draft addresses the needs of the poorest of the poor. If at least 20% of the apartments in a residential project are leased to households with annual incomes not in excess of 50% of the annual median income of households of the same size in the county or other area in which the project is located ("CMI"), or at least 40% of the apartments are leased to households with annual incomes not in excess of 60% of CMI, then the project would be exempt from property taxation, as long as the owner of the project is an organization described in Section 501(c)(3) of the Internal Revenue Code ("Code").

This approach mirrors the occupancy requirements under the Code for tax exempt bond financing and low-income housing tax credits and the very low-income occupancy safe harbor requirements under the Code for low-income housing owned by Section 501(c)(3) organizations.

The method for calculating income would be the same method used in all three of the above as well as in all of the U.S. Department of Housing and Urban Development financing and subsidy programs, including HUD's various Section 8 Housing Assistance Payments Programs. It is also the same method used in WHEDA's financing programs and in the U.S. Department of Agriculture's Rural Development financing and subsidy programs.

It also incorporates all of the protections for the general public afforded by Section 501(c)(3); in that the property cannot be used for profit or private benefit, income to the owner can only be used for nonprofit purposes, the social, religious, financial and healthcare needs of the elderly must be addressed in the project, the project must be affordable by low-income residents, and, for non-elderly projects, generally at least 75% of the resident households cannot have annual incomes in excess of 80% of CMI.

This approach goes beyond the requirements of the Code for Section 501(c)(3) organizations providing elderly housing, because the Code does not impose any income set aside requirements for elderly housing.

003.470897.1

The result of this approach will be that independent apartments occupied only by wealthy elderly will be subject to property taxation.

This approach allows so-called "mixed-income" housing projects to be tax exempt, where some apartments are occupied by low-income households and others are occupied by wealthier households, in recognition of the fact that rental income from wealthier households is usually applied to subsidize the rent of low-income households, and a concern about "ghettoizing" low-income households to projects occupied by no others. These concerns are reflected in modern rules for federal housing subsidies and in other laws, such as the inclusionary zoning ordinance recently adopted in Madison. It also takes into account the extraordinary cost to elderly households and those with special needs for necessary healthcare and personal services.

This draft provides that this new approach will become effective as of January 1, 2006. It also provides that for the period from January 1, 2002 through December 31, 2005 residential housing will not be subject to the "lessee identity condition" which was interpreted by the Wisconsin Supreme Court in *Columbus Park*. This is the position that most tax assessors took before *Columbus Park*, and it is reflected in the *Wisconsin Tax Assessors Manual* published by the Wisconsin Department of Revenue. Nonprofit housing providers relied upon that interpretation. Without this relief, municipalities would be required under the law to assess nonprofit leased housing providers for 2002 and 2003 property taxes in arrears, despite the fact that nonprofits would not have collected rents in those years sufficient to pay taxes. It also takes into account the fact that many leases are now in effect at rents insufficient to pay taxes, that many of those leases have terms of a year, and that nonprofits cannot raise rents until the leases are up for renewal.

Consistent with Wisconsin property tax law, under this proposal a property would be taxed in part to the extent that it does not meet the requirements of the new set aside requirements. Consistent with *Columbus Park*, property in which people live primarily to receive services, such as nursing homes and continuing care facilities, would continue to be exempt under the existing law, without regard to the income of the residents.