

ISSUES

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Exemption from Ad Valorem Taxation for Affordable Housing

On several occasions through the years the Shimberg Center has received inquiries about the exemption of affordable housing from ad valorem taxes. The following article addresses this topic and was published by the Florida Housing Coalition in the Spring 2002 issue of "The Housing News Network", pages 21-23. The article is reprinted in its entirety here with the permission of the authors and the Coalition.

The Florida Housing Coalition is a nonprofit, statewide membership organization whose mission is to act as a catalyst to bring together housing advocates and resources so that Floridians have a safe and affordable home and suitable living environment. The Coalition maintains a web site at www.flhousing.org and can be contacted at 850-878-4219 or by e-mail at info@flhousing.org.

By Louise J. Allen and Brian J. McDonough

Editor's Note: Nonprofits throughout Florida have had mixed experiences in obtaining the ad valorem tax exemption. Some property appraisers have consistently granted the exemption while others have steadfastly refused the exemption. We hope this article helps to clarify when the ad valorem exemption should be granted.

The exemption from ad valorem taxation available for real property owned by a non-profit organization and used for charitable purposes can often make a significant difference in the financial success of an affordable housing project. Historically, non-profit corporations

received an exemption from Florida ad valorem taxes for their properties that were used for the "charitable" purpose of providing low-income housing. However, in 1997, Florida's Fifth District Court of Appeals held in *SouthLake Community Foundation, Inc. v. Havill* (Fla. 5th DCA, 1997) that the exemption is only available for affordable housing projects that provide low-income housing exclusively to persons who are Section 8 Housing and Urban Development voucher tenants. The *SouthLake Community Foundation* case effectively brought into question the continuing availability of the ad valorem exemption for affordable housing projects, which are owned by non-profits in Florida.

Statutory Requirements

In response to the Court of Appeals decision, the 1999 Florida Legislature enacted Florida Statutes Section 196.1978, which provides a specific exemption from ad valorem taxation for nonprofit corporations that provide low-income housing provided they meet certain statutory requirements.

To obtain the ad valorem tax exemption described in Section 196.1978, a property must satisfy the following requirements:

1. The property must provide housing to persons who qualify as low-income (less than 80 percent of the median annual adjusted gross income) or very low-income (less than 50 percent of the median annual adjusted gross income);
2. The property must be entirely owned by a nonprofit entity qualified as charitable under Internal Revenue Code Section 501(c)(3) on January 1st of the year for which the exemption is being sought. Property owned by a limited liability company whose sole member is a 501(c)(3) corporation and which is disregarded for federal income tax purposes as an entity separate from its sole member will qualify under the statute;
3. The property must comply with IRS Revenue Procedure 96-32. The safe harbor rules of Revenue Procedure 96-32 state that an organization will be considered “charitable” if it satisfies the following requirements: (a) at least 75 percent of the units are occupied by low-income residents (less than 80 percent of area median income); (b) either at least 20 percent of the units are occupied by very low-income residents (less than 50

percent of area median income) or 40 percent of the units are occupied by residents that do not exceed 60 percent of area median income (the test described in (b) is referred to as “20 percent at 50 percent” or “40 percent at 60 percent”); (c) the project is actually occupied by poor and distressed residents; and (d) the housing is affordable to the charitable beneficiaries. In the case of rental housing, the requirement described in (d) will ordinarily be satisfied by the adoption of a rental policy that complies with government-imposed rental restrictions. For purposes of the Revenue Procedure 96-32 safe harbor test, there is generally a one year transition period for newly acquired projects to satisfy such requirements; and

4. Florida Department of Revenue Form DR-504, Ad Valorem Tax Exemption and Return, must be filed by March 1st of each year.

Timing and Availability of Exemption

Since the exemption is based on ownership of the property on January 1st of the applicable year, a 501(c)(3) organization which acquires an affordable housing project after January 1st will not be allowed an exemption for the portion of the first calendar year it owns the project. The amount of the exemption is limited to the portion of the property used to provide housing to low and very low-income persons to the extent provided in Section 196.196. The property appraiser obtains this information from a schedule of the tenants and their applicable income limit, which is attached to the DR-504, Ad Valorem Tax Exemption and Return. Assuming the threshold criteria for ad valorem exemption described above are met, the formula for deter-

mining the amount of the available ad valorem exemption is a fraction where the numerator is the number of units in the project used to provide housing to low and very low-income tenants and the denominator is the total number of units in the project. Although students are generally excluded from the definition of low-income and very low-income persons under the Internal Revenue Code rules applicable to tax-exempt bonds, they are included in the definition of low-income persons under the applicable Florida statutes with the result that units rented to students will be considered used for an exempt purpose. The statute does not address the treatment of vacant units. Although we have not done an exhaustive study, it appears that many property appraisers are treating vacant units set aside for rental to low and very low-income tenants as used for an exempt purpose and including them in the numerator of the above fraction, thereby increasing the percentage of the particular project which is exempt. However, if this is an issue for your project, you should contact the county property appraiser for the project to determine how it is treating vacant units.

Section 196.196, a statutory prerequisite for the exemption, requires that the predominant use (i.e., more than 50 percent) of the property be exempt. Our experience is that the property appraisers interpret this to mean that projects which do not lease at least 50 percent of the units to low and very low-income persons will be denied the exemption in full. However, there is a yet unresolved conflict between Revenue Procedure 96-32 which provides a one year transition period for newly acquired projects to satisfy the safe harbor requirements that at least 75 percent of the units be leased to low-income persons and Florida Statutes

Section 196.196 which requires at least 50 percent of the use be exempt on January 1st of the applicable year. This issue is particularly relevant during the first year transition period after a non-profit's acquisition of an existing property not previously operated as an affordable housing project. It is during this period that the new property owner is actively seeking to bring the property in compliance with the Revenue Procedure 96-32 safe harbor guidelines. Our experience has been that many property appraisers are denying the exemption in the first year if at least 50 percent of the units in the project are not leased on January 1st to low-income persons even though the property is operated in compliance with the Revenue Procedure 96-32 safe harbor requirements for obtaining charitable status. Although this result may not be supported by a literal reading of the applicable statutes, this will probably remain the result until a property owner is willing to appeal the denial of an ad valorem exemption in circumstances similar to those described.

Because Revenue Procedure 96-32 requires that at least 75 percent of the tenants be low-income persons within one year after acquisition of the property, the ad valorem exemption will generally be at least 75 percent after the first year and the predominant use requirement will not be a problem. As we advise our clients, if their projects can not satisfy the predominant use requirement after the first year because less than 50 percent of the units are leased to low-income persons, their real problem is they will fail the Revenue Procedure 96-32 safe harbor test and potentially lose their tax exempt status as a charitable organization under Internal Revenue Code Section 501(c)(3). If that happens, denial of the ad valorem exemption will probably be the least of their problems.

Conclusion

Ad valorem exemption makes non-profit owners real “players” in the acquisition of existing multi-family apartment projects by giving them an economic benefit not available to for-profit owners. This modest advantage acts to offset other financial challenges faced by non-profits in acquiring properties. Due to its relative newness, there are issues regarding application of the exemption statute such as the treatment of vacant units and satisfaction of the predominant use requirement during the first year of ownership of the project by the non-profit entity. Even with these open issues, the

ad valorem exemption is so important to the financial viability of an affordable housing project that, in our experience, many lenders are requiring an opinion of counsel that the project will ultimately qualify for the ad valorem exemption under existing law.

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