

THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN THE ARIZONA TAX COURT

TX 2020-001134

06/24/2024

HONORABLE SARA J. AGNE

CLERK OF THE COURT
J. Holguin
Deputy

CEDAR CREST / FLAGSTAFF L P

DAWN R GABEL

v.

COCONINO COUNTY

JAMES M SUSA

JUDGE AGNE

MINUTE ENTRY

This matter is under advisement following a bench trial held on March 4–7, 2024. After considering the witness testimony and exhibits admitted at trial as well as Coconino County’s Motion for Judgment as a Matter of Law, filed March 5, 2024, and the Parties’ written closing arguments, proposed findings of fact and conclusions of law, and responses and objections to the same, the Court makes the following findings, conclusions, and orders.

FINDINGS OF FACT

The Assessor’s Valuation and Full Cash Value History

1. For the 2021 tax year, the Coconino County Assessor (the “Assessor”) valued the property located at 2251 North Isabel Street, Flagstaff, Arizona, and bearing parcel number 109-02-001M (the “Subject Property”) at a full cash value of \$12,519,510 and a limited value of \$3,709,998. Joint Pretrial Statement, Stipulated Material Fact (“JPSF”) ¶¶ 7, 9.

2. The Subject Property is operated subject to the limitations, restrictions and regulations of the Federal Low Income Housing Tax Credit (“LIHTC”) program under I.R.C. § 42 as implemented and administered by the Arizona Department of Housing. JPSF ¶ 5.

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3. For the 2022 tax year, the Assessor valued the Subject Property at a full cash value of \$13,174,470 and a limited value of \$3,895,498. JPSF ¶ 10.

4. The Assessor determined the value of the Subject Property by performing what it terms a “modified cost approach.” The way that this modified cost approach is calculated is to first determine the replacement cost of the property and then to add to that replacement cost an “adjustment” based on sales of market rate apartment complexes in Flagstaff. JPSF ¶¶ 34-35, County’s Pretrial Memorandum, 4:11-16.

5. The Assessor did not take rent or tenant restrictions into account when valuing the Subject Property for the 2021 and 2022 tax years. JPSF ¶ 37; Rose Deposition Designations, 35:3-8; 46:3-18; 48:16-49:1.

6. The Assessor acknowledged that the Assessor’s full cash values for the 2021 and 2022 tax years are excessive. Trial testimony of Armando Ruiz; County’s Pretrial Memorandum, p. 2.

7. The Assessor used a cost approach mass appraisal model to value the Subject Property for the 2021 and 2022 tax years. JPSF ¶ 34.

8. The only adjustment that the Assessor made to the model was a market adjustment calculated with reference to three market rate apartment sales. JPSF ¶ 35.

9. When establishing the value of the Subject Property for the 2021 and 2022 tax years, the Assessor made no adjustment to value to account for any of the LIHTC program restrictions. JPSF ¶ 36.

10. Cedar Crest appealed the Subject Property’s full cash value for tax year 2018 in TX2017-000562. The parties settled that litigation by agreeing to a full cash value of \$3,737,853. JPSF ¶ 39.

11. Cedar Crest appealed the Subject Property’s full cash value for tax year 2019 in TX2018-000733. The parties settled that litigation by agreeing to a full cash value of \$3,737,853. JPSF ¶ 40.

12. The 2020 full cash value was the statutory “roll-over” value from a property tax settlement that established the full cash value of the Subject Property as a LIHTC property for the 2019 tax year. JPSF ¶ 41.

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History of Others' Valuation of the Subject Property

13. In 2015, as part of the sale of the Subject Property from Mountainside Village to Cedar Crest, an Appraisal firm named Gill Company appraised the Subject Property at \$3,250,000 and the sale was consummated at that value. Trial testimony of William Spreitzer; DTE 6.

14. At the time the Gill Company performed its appraisal, the Subject Property was restricted to renting to tenants at only the 60% Area Median Gross Income ("AMGI") level. Trial testimony of William Spreitzer and Albert Nava.

15. Properties that are able to rent to only the 60% AMGI level are more valuable than properties that have deeply skewed rents because they can collect higher rents and thus achieve higher net operating incomes. Trial testimony of Albert Nava and Gerald Zaddack.

16. Later in 2015, the owner of Cedar Crest applied for a construction loan and permanent financing from U.S. Bank. U.S. Bank commissioned an appraisal for lending purposes from Albert Nava of the Brekan Nava appraisal firm. Trial testimony of William Spreitzer; Defendant's Trial Exhibit ("DTE") 4 at CCA_00258.

17. Mr. Nava appraised the Subject Property under several scenarios including As Rent Restricted As-Is and As Rent Restricted As If Completed and As If Stabilized. DTE 4 at CCA_00257; Trial testimony of Albert Nava.

18. The As-Is valuation was \$5,530,000 and the As Completed and Stabilized valuation was \$3,680,000. DTE 4 at CCA_00257.

19. The As Completed and Stabilized valuation using the deeply skewed rents for the rehabilitated and re-syndicated property was 66.5% of the As-Is valuation using the 60% AMGI rent levels. DTE 4 at CCA_00257.

20. Deeply skewed rents are those that can be charged to tenants in the 40%, 50% and 60% AMGI categories rather than exclusively to the 60% cohort. Trial testimony of William Spreitzer.

21. U.S. Bank's loan to value ratio was 80%. Trial testimony of William Spreitzer.

22. U.S. Bank did not rely on the valuation in the Nava appraisal and would only make a permanent loan of \$1,455,000. Trial testimony of William Spreitzer.

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23. \$1,455,000 is 80% of approximately \$1,820,000, the value U.S. Bank determined to be more correct than Mr. Nava's higher value.

24. The value after rehabilitation construction and under the new LIHTC tenant income limits was lower than it had been before the construction using an income approach to value.

25. Mr. Zaddack has determined the value of the Subject Property as of January 1, 2020 for the 2021 tax year to be \$2,700,000, almost 150% higher than when it was placed in service in 2016, a gain in value of more than 10% per year from the value U.S. Bank determined the value to be upon rehabilitation in 2016. Plaintiff's Trial Exhibit ("PTE") 34 at CCA_00078.

26. Mr. Zaddack has determined the value of the Subject Property as of January 1, 2021 to be \$2,860,000 for the 2022 tax year, a 157% increase over the end of 2016. PTE 35 at CCA_00156.

27. Mr. Nava opined that the value of the Subject Property as of January 1, 2020 was \$6,100,000, 335% higher than the U.S. Bank value of \$1,820,000 and more than 160% higher than the Parties had settled full cash value for the previous years. DTE 9 at SD0003.

28. Mr. Nava opined that the value of the Subject Property as of January 1, 2021 was \$5,500,000, a reduction from the prior year. DTE 9 at SD0003.

29. No buyer of a LIHTC property would consider buying the Subject Property for Mr. Nava's 2020 or 2021 values because those values would not give investors the returns on cash or investment that LIHTC buyers require. Testimony of Thomas Bly.

30. A buyer of a LIHTC property would consider buying the Subject Property for Mr. Zaddack's 2021 value of \$2,700,000 but might find his 2022 value of \$2,860,000 to be too high. Trial testimony of Thomas Bly.

Correct Valuation Facts and Considerations

31. The current use of the Subject Property is as a LIHTC apartment complex. Trial testimony of Gerald Zaddack and Albert Nava; Rose Deposition Designation, 12:24-13:8.

32. Deed restrictions that run with the land are recorded against the Subject Property through a document called the Declaration of Affirmative Land Use and Restrictive Covenants

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Agreement (“LURA”). “The Owner, under the terms of this Agreement, intends, declares, acknowledges, and covenants for itself, its successors and assigns that the warranties, covenants, obligations, and duties set forth herein, are covenants running with the Project for the term stated herein and are binding upon all subsequent owners of the Project for such term.” PTE 1, p. 1 of 21, ¶ F. *See also*, PTE 1, p. 10 of 21, ¶ 13.

- a. The LURA restricts the amount of rent that can be charged to an amount determined by the U.S. Department of Housing and Urban Development (“HUD”) and the Arizona Department of Housing (“ADOH”). PTE 1, p. 3 of 21, ¶ 4(b); Trial testimony of William Spreitzer.
- b. The LURA restricts the tenants who can rent apartments at the Subject Property to those who make 40%, 50% or 60% of the AMGI, as determined by HUD. PTE, p. 16 of 21, ¶ 4; Trial testimony of William Spreitzer.
- c. The LURA grants monitoring and enforcement rights to the ADOH. PTE 1, p. 4 of 21, ¶ 6.
- d. The LURA provides remedies for breach of the terms of the LURA including tax credit recapture, suit for specific performance by the ADOH or any tenant, and return of funds provided by the ADOH. PTE 1, pp. 5-6 of 21, ¶ 8.
- e. The LURA provides that the restrictions terminate only upon expiration of the extended use period or upon foreclosure by a lender. PTE 1, pp. 4 and 6 of 21, ¶¶ 5 and 9.
- f. The LURA provides that ADOH must approve any transfer of ownership of the Subject Property during the term of the agreement. PTE 1, p. 9 of 21, ¶ 11(g).
- g. The LURA provides that the owner has waived the qualified contract process and the Subject Property is restricted under the LIHTC program for 30 years, until December 31, 2045. PTE 1, p. 8 of 31, ¶ 10(l); p. 4 of 21, ¶ 5(c).
- h. The LURA requires the owner to offer at least 30% of the units on a preferential basis to households with children. PTE 1, p. 15 of 21, ¶ 1(a).
- i. The LURA requires the owner to provide tenant/supportive services on site at the Subject Property’s expense including educational programming, job training, financial consulting, health and wellness information, and publication of a newsletter. PTE, p. 17 of 21, ¶ (4)h; Testimony of William Spreitzer.

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33. The restrictions set forth in subparagraphs b-g are not reflected in the income or expenses of the Subject Property. Testimony of William Spreitzer, Albert Nava and Gerald Zaddack.

34. The Subject Property's net operating income is used to pay the debt and cannot at this time pay the soft debt on the Subject Property including a HOME Loan and a City of Flagstaff Loan. *See* Joint Pretrial Stipulation of Law, ¶ 3 ("JPSL"); Trial Testimony of William Spreitzer.

35. Cedar Crest was placed in service in 2016. LIHTC properties that applied for credits before 2012 and that are approaching or have met their initial 15-year compliance period could be taken out the program and converted to a market rate property through the qualified contract process. This makes them dissimilar to Cedar Crest, which cannot be converted to a market rate property until 2045. JPSF ¶ 14.

36. Rent restrictions are net rent restrictions, based on a fixed gross number, but netted by a utility allowance. What this means is not only can a project's expenses increase without limitation, but the income is reduced as the rent restrictions cause the landlord to assume all of the risk of increasing tenant utility costs. JPSF ¶ 16.

37. Tax credits may be recaptured for compliance failure or merely for failure to document compliance. Multiple government entities impose compliance requirements. LIHTC projects are monitored by the Arizona Department of Housing and must submit reports annually showing their compliance in at least two major areas. JPSF ¶ 17.

38. LIHTC properties must show that they have charged the rental rates established by the Arizona Department of Housing for the correct number of units. But more importantly, they must show that the tenants themselves meet the various income qualifications imposed by the program for the number of family members living in the unit. JPSF ¶ 18.

39. The owner must show that it has verified these income limitations and that it has retained records of each of the tenants' qualifications. The resident qualification restrictions result in substantially greater effort and add additional risk. JPSF ¶ 19.

40. Failure to verify the tenants' qualifications, or failure to maintain records of the verification, can cause the project to fall out of compliance for one or more buildings in a multi-building project. When that occurs, tax credits (both prior to and subsequent to the event in question) are subject to recapture. JPSF ¶ 20.

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41. IRC Section 42 provides that a transfer of an ownership interest prior to the end of the taxpayer's compliance period will trigger tax credit recapture. JPSF ¶ 21.

42. To maximize the loan amounts for properties, thereby reducing the amount of necessary tax credit financing, the extended use period for any building terminates upon foreclosure (or an instrument in lieu of foreclosure). (*See* I.R.C. § 42(h)(6)(E)). JPSF ¶ 22.

43. In the event of a foreclosure of the Subject Property, the LIHTC restrictions are removed from the Subject Property. As a result, lenders would not be subject to the rent or resident restrictions over an extended 30-year period, or be subject to additional reporting and record keeping requirements. JPSF ¶ 23.

44. LIHTC properties typically do not sell within the first 15-year compliance period because of the credit recapture risk to the investment limited partner. JPSF ¶ 24.

45. Institutional investors do not typically buy LIHTC properties as a one-off purchase of a less than one-hundred unit property located in a secondary or a tertiary market. That may occur in the unusual circumstance that such a property is a part of a portfolio sale that includes multi-family properties in primary markets. In fact, institutional investors are typically interested in portfolios of properties, or a single offering of a large multi-family property in a primary market. Single, small-unit (less than 100 units) LIHTC properties are purchased by small investment groups that specialize in the purchase of LIHTC properties. JPSF ¶ 25.

46. According to Section 3.7 of the Arizona Department of Housing Compliance Manual: Low Income Housing Tax Credit Program, "Gross Rent does not include any rental assistance payments made on behalf of the resident under Section 8." JPSF ¶ 26.

47. These rental assistance payments are indicated on the Rent Rolls under the column titled "Housing." JPSF ¶ 27.

48. ADOH has audited the Cedar Crest financial statements for compliance and has expressly found no evidence of non-compliance with Section 42 of the IRC. JPSF ¶ 28.

49. The Subject Property is located at the base of a substantial hill, which is owned by the City of Flagstaff. The City built a maintenance-equipment and construction-materials storage yard at the top of that hill. Unlike private property owners, the City is not required to and does not restrict the storm water runoff within the boundaries of its storage yard. The storm water runs down the City's hill onto the Subject Property. This runoff creates ongoing erosion issues for the Subject Property, particularly during years with heavy rainfall and snow. JPSF ¶ 29.

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50. 2018 and 2019 were both years in which Flagstaff and the Subject Property experienced heavier than average rainfall and snow which caused the Subject Property to incur additional expenses in 2019 associated with erosion, snow removal costs, and snow equipment maintenance. Those costs can be expected to recur when these conditions occur again. Further, the Subject Property is located in an area of Flagstaff that receives greater snowfall generally than other areas of the City. JPSF ¶ 30.

51. The owner/operator of the Subject Property is required to deposit and hold replacement reserves in a separate account and to deposit \$350/unit per year into that account, which it has done. JPSF ¶ 31.

52. The effective tax rate for 2021 was .909. JPSF ¶ 32.

53. The effective tax rate for 2022 was .911. JPSF ¶ 33.

54. Management agreements for properties in Northern Arizona entered into since Cedar Crest entered the program are at 10% to adequately compensate the management company for the management and compliance obligations they perform. Prior to that, 6% was the norm. Trial Testimony of William Spreitzer.

55. The LURA requires that the Subject Property provide tenant/supportive services. PTE 1, p. 17 of 21, ¶4(h).

56. The CPA firm that prepares the Subject Property's audited financial statements reports the expense of providing those services in the advertising line item of the audited financial statements. Trial testimony of William Spreitzer.

57. The Form 3 for the 2014 year in which the application for credits was made provided that the cost of supportive services would be included in the operating costs of the Subject Property. Trial testimony of William Spreitzer.

58. The ADOH changes the terms of the projects for which it will award credits frequently and the requirements can be different year after year. Trial testimony of William Spreitzer.

59. Wescap Real Estate Services ("WRES") is a well-known and reputable LIHTC management company in Arizona. Trial testimony of William Spreitzer, Thomas Bly and Gerald Zaddack.

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60. The value of the Subject Property for the 2021 tax year is \$2,700,000. PTE 34.

61. The value of the Subject Property for the 2022 tax year is \$2,860,000. PTE 35.

History of the Value of the Subject Property

62. The Subject Property sold in 2015 for \$3,250,000 in an arm's length transaction between unrelated parties. Trial testimony of William Spreitzer.

63. The purchase price was supported by an appraisal prepared by the Gill Company that found the value to be \$3,250,000. Trial testimony of William Spreitzer.

64. At the time of the sale, the Subject Property was outside of its initial compliance period and near the end of its extended use period. Trial testimony of William Spreitzer, Gerald Zaddack.

65. At the time of the sale, the Subject Property was renting only at the 60% AMGI allowed maximum rents. Trial testimony of William Spreitzer, Gerald Zaddack, Albert Nava.

66. The Subject Property was intended to be re-syndicated into the LIHTC program, renting at the 40%, 50% and 60% AMGI limits. Trial testimony of William Spreitzer, Albert Nava.

67. Rents at the 40%, 50%, and 60% AMGI limits are considered to be deeply skewed. Trial testimony of William Spreitzer.

68. Properties that rent at the 60% AMGI limit are more valuable than properties with deeply skewed rents because they earn more income. Trial testimony of William Spreitzer, Albert Nava.

69. U.S. Bank commissioned Albert Nava to perform an appraisal of the Subject Property after the sale and in anticipation of a loan in 2015 and asked him to opine as to several valuation scenarios including with restricted rents As-Is and with restricted rents as completed after the rehabilitation construction had been completed. DTE 4 at CCA_00249, CCA_00258; Testimony of Albert Nava.

70. Mr. Nava opined that the value of the Subject Property as of August 12, 2015, as encumbered by the LIHTC program was \$5,530,000 As-Is. DTE 4 at CCA_00257.

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71. Mr. Nava's As-Is value of \$5,530,000 was substantially higher than the sales price just months before for \$3,250,000.

72. Mr. Nava opined that the value of the Subject Property as of January 1, 2017, as completed and as encumbered by the LIHTC program was \$3,680,000. DTE 4 at CCA_00257.

73. U.S. Bank had an 80% loan to value ratio for this loan meaning it would only make a loan for 80% of what it believed the value of the Subject Property to be. Trial testimony of William Spreitzer, Albert Nava.

74. U.S. Bank would only loan \$1,455,000. Trial Testimony of William Spreitzer. \$1,455,000 is 80% of approximately \$1,820,000.

75. Mr. Zaddack opined that the value of the Subject Property for the 2021 tax year was \$2,700,000. PTE 34 at CCA_00078.

76. Mr. Zaddack opined that the value of the Subject Property for the 2022 tax year was \$2,860,000. PTE 35 at CCA_00156.

77. Mr. Zaddack's valuations considered the LIHTC restrictions that run with the land. PTE 1; PTE 34 at CCA_00078; PTE 35 at CCA_00156.

Differences between the Appraisal Witnesses

78. Mr. Zaddack valued the Subject Property using exclusively the income approach to value. PTE 34 at CCA_00122; PTE 35 at CCA_00200.

79. Mr. Nava valued the Subject Property using an income approach to value and a sales comparison approach as a "check of reasonableness." DTE 9 at SD0045; SD0080.

80. Mr. Nava's sales comparison approach was incomplete because he did no analysis of the comparability of the sales, including location, unit size, whether they were LIHTC sales or not or any other measure of adjustment that is required to perform a competent Sales Comparison. Trial testimony of Albert Nava, Gerald Zaddack, Nava Deposition Designations, 26:18-27:4; 24:4-8.

81. Mr. Nava calculated a per unit price for each property in his sales comparison approach that ranged from \$57,971 to \$160,909. DTE 9 at SD0047.

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82. Three of his “comparable sales” were sold long after the first date of value and thus were not known or knowable. DTE 9 at SD0047.

83. Including the post date of value sales gave a price-per-unit range of \$57,971 to \$160,909, but removing those sales changed the range to \$57,971 to \$120,408. DTE 9 at SD0047.

84. Mr. Nava used a property called Vermillion View in the quasi-sales-comparison approach, and he used the same property as an expense comparable for both of his tax years, but he ignored it completely when calculating a capitalization rate, even though it was a LIHTC sale. DTE 9 at SD0047, SD0056, SD0060, SD0072, SD0076.

85. The Vermillion View sale in Coconino County sold for the lowest price per unit of all of Mr. Nava’s “comparable” sales at \$57,971 per unit. DTE 9 at SD0047.

86. An income approach to value for a LIHTC property includes studying the market area, understanding the LIHTC program and its restrictions, inspecting the property, using actual income according to Arizona law, estimating the next year’s expenses based upon the property’s historical operating expenses and a review of expenses experienced by comparable LIHTC properties, researching and analyzing the appropriate capitalization rate to apply the net operating income. The capitalization rate should incorporate the risks that are contained within the deed restrictions. Trial testimony of Gerald Zaddack.

87. The purpose of creating a next year’s operating statement is to mimic what a potential buyer would do to value the property for purchase. Trial testimony of Gerald Zaddack.

88. A potential buyer would estimate expected income and expenses to develop a net operating income. The buyer will adjust income up or down based on their expectancy of receiving more or less income. Similarly, the buyer will adjust expenses up or down based on their expectancy of having to pay similar expenses or being able to avoid them. Trial testimony of Gerald Zaddack.

89. Mr. Zaddack agreed with Defendant’s Counsel that the Subject Property’s revenues were increasing at 5% per year since the Subject Property entered the program. Trial testimony of Gerald Zaddack.

90. Mr. Nava believed LIHTC rents were increasing at double that amount, or 40% between 2015 and 2020. Nava Deposition Designation, 109:2-5.

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91. Mr. Nava's erroneous belief about the strength of increasing rents in the LIHTC market supported his belief that capitalization rates should be low. Trial testimony of Albert Nava.

92. The two appraisers came to similar income projections. DTE 9 at SD0059 (\$806,657), SD0075 (\$805,393); PTE 34 at CCA_00083 (\$807,315); PTE 35 at CCA_00161 (\$850,376).

93. The two appraisers had dramatically different expense projections. DTE 9 at SD0059 (\$419,599), SD0075 (\$467,524); PTE 34 at CCA_00083 (\$570,657); PTE 35 at CCA_00161 (\$599,312).

94. Mr. Zaddack asked for income and expense statements for properties known to be comparable to the Subject Property and reviewed those in comparison to the Subject Property's expenses. Trial testimony of Gerald Zaddack.

95. He also reviewed the Subject Property's historic operating expenses. Trial testimony of Gerald Zaddack.

96. Mr. Zaddack noticed that four categories of expenses for the Subject Property seemed to be high: repair and maintenance, payroll, management fee and advertising. Trial testimony of Gerald Zaddack.

97. He asked the owner of the Subject Property to provide more information about those expenses. Trial testimony of Gerald Zaddack.

98. Regarding the repairs and maintenance, he learned that the Subject Property had to replace water heaters on a regular basis, that the Subject Property was located in an area of Flagstaff that receives heavier snowfall than other areas, that the Subject Property experiences heavy run-off from and adjacent, up-hill City-owned property that causes additional repair and maintenance expenses, that the Subject Property rents to many families with children which increases repair and maintenance expenses, and that a Flagstaff city ordinance was passed by voters that has caused the minimum wage in Flagstaff to rise each year since 2017 which in turn increases the cost of repairs and maintenance. Trial testimony of Gerald Zaddack and William Spreitzer.

99. Regarding the payroll expenses Mr. Zaddack learned that several issues had combined to decrease payroll in 2018 and that those issues were rectified in 2019 making that year more normal. Payroll was also affected by the minimum wage ordinance. Trial testimony of Gerald Zaddack.

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100. Mr. Zaddack also asked about the management fee of 10% with an additional 4% incentive. He learned that the management expense of 10% was normal for a LIHTC property that entered the program since 2014 but that the 4% incentive was not usual. As a result, Mr. Zaddack projected a management expense of 10% because that is what a buyer would expect to pay, too. Trial testimony of Gerald Zaddack.

101. Mr. Spreitzer testified that the increased and complex compliance burden is in part responsible for the shift from the former 6% management fee to the more recent 10% management fee. Trial testimony of William Spreitzer.

102. Mr. Nava also thought that the expenses for repairs and maintenance, payroll, management and advertising were high. Trial testimony of Albert Nava.

103. Mr. Nava testified that when an appraiser recognizes that expenses appear to be high, the correct way to consider the issue is to ask the owner for an explanation. He further testified he did not do that and that he did not ask the County to ask for the information from Plaintiff. Trial testimony of Albert Nava.

104. Mr. Zaddack questioned the advertising expense and learned from the owner that the CPA that prepares the audited financial statements put the cost of the LURA required tenant/supportive services in the advertising line. Trial testimony of Gerald Zaddack.

105. Mr. Nava excluded those expenses, claiming that he “knew” that they were not allowed as operating expenses by “Form 3.” But he did not know which year’s Form 3 he reviewed. Trial testimony of Albert Nava.

106. Mr. Spreitzer testified that Form 3 changes from year to year and that supportive services as required by the LURA, are allowed as operating expenses for properties that qualified for tax credits in 2014. Trial testimony of William Spreitzer.

107. The audited financial statements, prepared by independent public accounting firm Novogradac, include the costs of supportive services in the operating expenses of the Subject Property in the advertising line. Testimony of Gerald Zaddack; PTE 2.

108. Mr. Zaddack found the explanations from management to be reasonable and the expenses to be reasonable with the lone exception of the 4% management fee incentive. Trial testimony of Gerald Zaddack.

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109. For the 2021 tax year, Mr. Nava estimated expenses for his projected next year income and expense to be more than \$233,000 lower than the Subject Property experienced in 2019 and more than \$96,000 lower than it had experienced in 2018. DTE 9 at SD0055.

110. For the 2022 tax year, Mr. Nava estimated expenses to be lower than the prior three years actual expenses by over \$138,000, \$185,000 and \$48,000. DTE 9 at SD0071.

111. To support his estimate of expenses, Mr. Nava relied upon four expense comparable properties for each of the tax years at issue. DTE 9 at SD0056, SD0072.

112. The source data for those expense comparable properties was not in Mr. Nava's file; rather, the data was input in a spreadsheet created by Mr. Nava's firm. Trial testimony of Albert Nava.

113. Mr. Nava's first expense comparable was a property identified on the spreadsheet as Vermillion View. Mr. Nava's spreadsheet support showed that Vermillion View had a little over \$30,000 in repair and maintenance expenses for the 2019 calendar year. DTE 9 at SD0056.

114. WRES operated Vermillion View for the first five months of 2019. Trial testimony of William Spreitzer.

115. Vermillion View's repair and maintenance expenses for just the first five months of 2019 were above \$45,000. PTE 36 at CCA_00233.

116. Because no source data exists, Plaintiff cannot know what the true expenses were for the last seven months of 2019, but it is proved that the expenses used by Mr. Nava for Vermillion View were underreported. PTE 36; DTE 9.

117. Mr. Nava's second expense comparable was labelled as Village at St. Mary's Crossing. DTE 9 at DTE SD0056.

118. No supporting data was maintained in Mr. Nava's work file, and so Plaintiff was unable to cross-examine the veracity of the data reported in Mr. Nava's appraisal.

119. The third expense comparable was not identified. Mr. Nava claimed it was confidential. The court found that expense comparable to be inadmissible and therefore not usable to support Mr. Nava's expense analysis.

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120. The fourth expense comparable used by Mr. Nava for the 2021 tax year was property called Valley View, which he reported having 224 units. But because this is a WRES-managed property, Plaintiff knows that the property he referred to is really three separate properties under three separate ownership entities, and the three properties respectively have 80, 72, and 72 units. Mr. Nava took the expenses from one of the three properties, divided each expense category by 224 units, not by the number of units that really experienced those expenses. DTE 9 at SD0056; Trial testimony of William Spreitzer.

121. By calculating the expenses incorrectly in this manner, Mr. Nava used the Valley View erroneous data as the bottom of his expense comparable range.

122. For the 2022 tax year, Mr. Nava used the same expense comparables 1-3, which suffer from the same disqualifying characteristics as they did for the 2021 tax year. DTE 9 at SD0072. The fourth expense comparable was not a LIHTC property.

123. Both appraisers calculated net operating incomes from their projected income and expenses. PTE 34 at CCA_00083 (\$236,659); PTE 35 at CCA_00161 (\$251,064); DTE 9 at SD0059 (\$387,058), SD0075 (\$337,869).

124. Both appraisers developed capitalization rates. PTE 34; PTE 35; DTE 9.

125. Both appraisers acknowledged that it is difficult to find sales of LIHTC properties and that LIHTC properties do not sell until the end of their compliance period. Trial testimony of Gerald Zaddack and Albert Nava; Nava Deposition Designation, 24:4-8.

126. Mr. Zaddack's capitalization rate was supported by a search for sales of LIHTC properties and he found three such sales from around the country, including Vermillion View in Coconino County. PTE 34 at CCA_00135-136; PTE 35 at CCA_00213-214; Trial testimony of Gerald Zaddack.

127. Mr. Zaddack's capitalization rate was supported by a search for market-rate sales. PTE 34 at CCA_00137; PTE 35 at CCA_00215; Trial testimony of Gerald Zaddack.

128. Mr. Zaddack's capitalization rate was supported by his prior work that analyzed the effect on value caused by the time remaining in a LIHTC property's initial compliance period. PTE 34 at CCA_00138; PTE 35 at CCA_00216; PTE 47; Trial testimony of Gerald Zaddack.

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129. Mr. Zaddack's capitalization rate was supported by an identification of the specific risks created by the LURA that increased the capitalization rate. PTE 34 at CCA_00138; PTE 35 at CCA_00216; Trial testimony of Gerald Zaddack.

130. Mr. Zaddack loaded his capitalization rate with the accurate effective tax rate agreed to by the parties to reach an adjusted capitalization rate. PTE 34 at CCA_00139; PTE 35 at CCA_00217; JPSF ¶¶ 32-33.

131. Mr. Nava relied upon interviews of market participants to support his preconceived notion that the capitalization rate for a LIHTC property is the same as for a market rate property. The first interview was reported to be with Ms. Rebecca Arthur of Novogradac. DTE 9 at SD0061-62, SD0077-78.

132. The description of this interview is a verbatim copy of the same interview he used in the 2015 U.S. Bank appraisal. DTE 4 at CCA_00373-374; DTE 9 at SD0061-62, SD0077-78.

133. Mr. Nava admitted that he did not ask Ms. Arthur whether her opinion would be the same if he told her that the property was selling within its initial compliance period. Nava Deposition Designation, 32:24-33:4.

134. Mr. Nava also reported interviewing Mr. John Nichols who told him that LIHTC capitalization rates were higher than market-rate capitalization rates. DTE 4 at CCA_00373-374; DTE 9 at SD0061-62, SD0077-78. But he testified that he ignored that opinion because it was inconsistent with his experience, which was merely derived from other interviews of brokers, not from actual experience. Nava Deposition Designation, 34:2-35:5.

135. In fact, Mr. Nava has done no independent analysis of whether the capitalization rates for LIHTC properties are different than for market rate properties. Nava Deposition Designation, 34:25-35:2.

136. Mr. Nava then turned to investor surveys of market rate properties to learn what they reported a market-rate apartment capitalization rate to be. Mr. Nava relied upon surveys from PWC, Costar and Situs RERC in his revised report. The Situs and RERC surveys are for the third quarter of 2020 for his 2021 tax year. That tax year has a date of value of January 1, 2020 meaning that this data is after the date of value and not competent to support a capitalization rate for the 2021 tax year. DTE 9 at SD0061.

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137. Mr. Nava's use of investor surveys for the 2022 tax year include PWC data from the fourth quarter of 2019, but that data is not in his working file and cannot be checked or cross-examined. DTE 9 at SD0077; Trial testimony of Albert Nava.

138. Mr. Nava also relied upon the Situs RERC data from the third quarter of 2021 for his 2022 tax year capitalization analysis. Because the date of value for that year is January 1, 2021, the third quarter data was not known or knowable and is not competent evidence of the capitalization rate for that tax year. DTE 9 at SD0077.

139. Mr. Nava does not know how many or what type of properties are included in the Costar data for either tax year. Trial testimony of Albert Nava.

140. The PWC investor survey obtains information from investors such as insurance companies and pension funds. These types of investors do not buy single LIHTC properties of less than 100 units in a market like Flagstaff. The buyers of property like the Subject Property are small investing firms and wealthy individuals familiar with the LIHTC program. Trial testimony of William Spreitzer.

141. Mr. Nava testified that he did not use or report a CBRE Affordable Housing Investor Survey that showed LIHTC capitalization rates were higher than market rate apartments. Trial testimony of Albert Nava.

142. Mr. Nava also testified that he did not rely on an investor survey from RealtyRates.com data, which was included in a spreadsheet in his file, but which reported higher capitalization rates than he used. Trial testimony of Albert Nava; DTE 9.

143. Mr. Nava also analyzed the sales of five market rate properties to derive a capitalization rate. None of those sales were of LIHTC properties. DTE 9 at SD0060, SD0076.

144. If Mr. Nava's post-date of value sales are eliminated from his "sales comparison approach" none of the sales he used as comparable sales for his capitalization rate analysis would have satisfied his "test of reasonableness" because all of them had sales prices per unit that were above \$159,000 per unit. DTE 9, Trial testimony of Albert Nava.

145. For his capitalization analysis, Mr. Nava did not use the Vermillion View sale in Coconino County that he used as an expense comparable even though it was a LIHTC sale in Coconino County. DTE 9 at SD0060, SD0076; Trial testimony of Albert Nava.

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146. Mr. Nava calculated an effective tax rate that was less than the true effective tax rate. He then added that lower effective tax rate to his market-rate apartment capitalization rate to reach an even higher value. DTE 9; Trial testimony of Albert Nava.

CONCLUSIONS OF LAW

147. All property subject to ad valorem tax in Arizona must be valued in its current use. A.R.S. § 42-11054(C)(1).

148. “A valuation for an LIHTC project, determined under any of the standard appraisal methods, that does not take the deed restrictions into account will not result in a determination of fair market value for that property.” *Maricopa Cty. v. Viola*, 251 Ariz. 276, 279-280 ¶13 (App. 2021) (quoting *Cottonwood Affordable Housing v. Yavapai Cty.*, 205 Ariz. 427, 430 (Tax 2003)).

149. “[T]he deed restrictions requiring the properties be used as LIHTC projects must be taken into account to fairly determine the full cash value of the property. A market value approach requires us to consider market value limitations.” *Id.* at 280 ¶15. Use as a LIHTC property is different from the current use as a market rent property. *Id.* at 279 ¶12.

150. The LIHTC program is a part of the Internal Revenue Code. Thus, it is not administered by HUD. Other federal low-income housing programs assist owners by either subsidizing rents or by providing very low interest rate mortgages to owners. In contrast, the LIHTC program restricts the amount of rent owners may collect from tenants but provides property owners with tax credits over a ten-year period if certain conditions are met. Internal Revenue Code (“IRC”) § 42(f)(1). JPSL ¶ 1.

151. The most important of these conditions include the rent restrictions themselves as well as requirements that specify the percentage of occupants who must meet certain low-income criteria. IRC § 42(g)(1) & (2). These restrictions must be met for fifteen years or more or the tax credits may be recaptured. IRC § 42(i) & (j). JPSL ¶ 2.

152. To operate under the LIHTC program, a developer first secures a tax credit allocation from the state agency that administers the program – the Arizona Department of Housing (formerly the Arizona Department of Commerce). If awarded, developers receive an annual allocation of tax credits over a ten-year period. Upon receipt, the developer then sells the entire allocation of tax credits to limited partners. The developer does not, however, sell the credits on a dollar-for-dollar basis. Instead, the limited partners purchase a percentage of the annual allocation at a discount. The proceeds of the sale provide the equity dollars for the developer to significantly reduce the amount of debt required to finance construction. Typically,

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a third party lender issues a mortgage to cover the balance of the construction costs. Consequently, the project is constructed with funds from the sale of the tax credits and third-party debt. The property's income is used to service only the debt component. JPSL ¶ 3.

153. Expenses are higher for LIHTC properties because they must meet certain minimum reporting, recordkeeping and documentation edicts beyond that which market rate properties must do. Annual fees are charged for internal and external audits performed by governmental and non-governmental entities. JPSL ¶ 4.

154. The Subject Property must be valued using an income approach to value which includes the actual income and expenses and a capitalization rate that appropriately represents the risk inherent in a LIHTC property. *Maricopa County v. Viola*, 251 Ariz. 276 (App. 2021). JPSL ¶ 5.

155. Any approach to value must consider the restrictions imposed upon the property and its current usage as a LIHTC property. *Cottonwood Affordable Housing LP v. Yavapai County*, 205 Ariz. 427 (Tax 2003). JPSL ¶ 6.

156. When performing a retrospective appraisal, an appraiser is limited to using information that was known or knowable as of the date of value. JPSL ¶ 10.

157. Tax rates for 2021 and 2022 were not known or knowable as of the valuation dates for those tax years. JPSL ¶ 9.

158. The Assessor's determination of full cash value must utilize standard appraisal techniques. JPSL ¶ 11.

159. And, here, the Parties stipulated to the applicable legal conclusion that market rents do not reflect the current usage of the property as a rent-restricted LIHTC project. JPSL ¶ 8.

Based on the above findings and conclusions,

IT IS ORDERED denying Coconino County's Motion for Judgment as a Matter of Law, filed March 5, 2024.

IT IS FURTHER ORDERED finding in favor of Plaintiff as to the Subject Property's fair market value for the 2021 and 2022 tax years.

IT IS FURTHER ORDERED that not later than twenty (20) calendar days after the filing of these Orders by the Clerk of the Superior Court, Plaintiff may submit a verified

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application for awards of attorney's fees and costs. A.R.S. § 12-348. If an application is submitted that Defendant wishes to oppose, a response must be filed not later than 20 calendar days after service. Plaintiff is not permitted to file a reply unless requested to do so by the Court.

IT IS FURTHER ORDERED that not later than twenty (20) calendar days after the filing of these Orders by the Clerk of the Superior Court, Plaintiff must also submit a proposed form of judgment. That form of judgment may incorporate from this minute entry ruling but otherwise should be confined to fees and costs being awarded, along with Rule 54(c), Ariz. R. Civ. P., language.