

## **FINANCE AND ADMINISTRATION CABINET**

### **Department of Revenue**

#### **(New Administrative Regulation)**

#### **103 KAR 5:200. Valuation of multi-unit rental housing subject to government restriction on use.**

RELATES TO: KRS 131.130, 132.191, 132.420, Ky. Const. 172, 174

STATUTORY AUTHORITY: KRS 131.130, 132.191

NECESSITY, FUNCTION, AND CONFORMITY: KRS 131.130(1) authorizes the department to promulgate administrative regulations necessary to administer and enforce Kentucky's tax laws. KRS 132.191(5)(d) requires the Department of Revenue to promulgate an administrative regulation to implement criteria for the valuation and assessment of property used as multi-unit rental housing that is subject to government restriction on use for ad valorem taxation purposes based on an income approach methodology. This administrative regulation establishes a uniform system for assessing the value of this class of property when using an annual net operating income approach to value or a ratio of restricted rent to market rent approach to value.

##### **Section 1. Definitions.**

- (1) "Department" is defined by KRS 132.010(1).
- (2) "Direct capitalization" means capitalization of the net operating income, that was developed using the owner's income and stabilized operating expenses based on an actual history of the property, when available, and an altered capitalization rate.
- (3) "Government restriction on use" is defined by KRS 132.010(35).
- (4) "Low income" is defined by KRS 132.010(36).
- (5) "Multi-unit rental housing" is defined by KRS 132.010(37).
- (6) "PVA" means the Property Valuation Administrator.
- (7) "Ratio of restricted rent to market rent" means the percentage derived from dividing the annual gross rental income of a multi-unit rental housing property that is subject to government restriction on use by the annual gross rental income of a similar multi-unit rental housing property that is not subject to government restriction on use.

##### **Section 2. Assessment of Multi-unit Rental Housing That is Subject to Government Restriction on Use.**

- (1) When using an annual net operating income approach to value multi-unit rental housing that is subject to government restrictions, a PVA shall determine the assessed value of that class of property by using the direct capitalization approach to value or the ratio of restricted rent to market rent approach to value.
- (2) An owner of a multi-unit rental housing that is subject to government restrictions shall report the following information to the PVA of the county in which the property is located by March 1 of each calendar year:
  - (a) The full address of the property and the business name of the property;
  - (b) The name and address of the property owner;
  - (c) The total number of rental units located at the address of the property;
  - (d) The number of:
    1. Studio apartments;
    2. One (1) bedroom apartments;
    3. Two (2) bedroom apartments;
    4. Three (3) bedroom apartments;
    5. Four (4) or more bedroom apartments;
    6. Townhouses; and
    7. Any other types of units;

- (e) The name and full address of the person or business responsible for paying the ad valorem property tax on the real property;
- (f) If the real property was subject to governmental restrictions on its use as of January 1 of the tax year;
- (g) If the property is currently subject to a foreclosure action; and
- (h) Income, occupancy, and expense information for the three (3) years prior to January 1 of the current tax year including:
  - 1. All tenant rental income, including any rental subsidies;
  - 2. All other income directly generated from the use of the property;
  - 3. Total bad debt;
  - 4. The average annual vacancy rate of the property;
  - 5. Annual payroll;
  - 6. Annual administrative expenses;
  - 7. Annual operating and maintenance expenses, such as utilities, repairs, cleaning, and groundskeeping;
  - 8. Annual property insurance costs; and
  - 9. Any other information reasonably necessary to determine the fair cash value of the property.
- (3) The owner shall report the information required by this section on Assessment of Multi-Unit Rental Housing Subject to Government Restrictions on Use, Form 62A320. This form and all required supporting documents and information shall be filed within sixty (60) days of:
  - (a) the property in question becoming subject to government restriction on use,
  - (b) all government restrictions on use of the property being lifted, or
  - (c) the owner or owner's agent for service being served with civil summons regarding a foreclosure action upon the property.
- (4) If the property owner fails to file Assessment of Multi-Unit Rental Housing Subject to Government Restrictions on Use, Form 62A320, and all required supporting documents and information with the county PVA within the deadlines established in this section, the property owner may be subject to a penalty of \$100. The penalty under this subsection shall be paid by the owner of the property to the department within thirty (30) days of submitting the Assessment of Multi-Unit Rental Housing Subject to Government Restrictions on Use, Form 62A320.

Section 3. Formula for Assessing the Value of Multi-unit Rental Housing Subject to Government Restriction on Use under the Direct Capitalization Approach to Value. The formula used to determine the assessed value of multi-unit rental housing that is subject to government restriction on use under the direct capitalization approach to value shall be as follows:

- (1) Actual income generated by the property shall be adjusted by deducting allowable operating expenses based on the actual history of the property. This result shall be the adjusted net income.
- (2) The adjusted net income shall be divided by a capitalization rate that is determined under Section 4 of this administrative regulation.
- (3) The result of that calculation is the property's assessed value.

Section 4. Web Site Subscription for Capitalization Rate Data. (1) The department shall subscribe to [www.realtyrates.com](http://www.realtyrates.com) (or any successor organization) to access the most recent quarterly survey of the national average of capitalization rates for multi-family properties.

- (1) The department shall publish the capitalization rate for use in the valuation of multi-unit rental housing subject to government restriction on use for each assessment year on the department's website and shall provide the capitalization rate to all PVAs to use in assessing multi-unit rental housing subject to government restriction on use.

(2) The capitalization rate used by a PVA when assessing multi-unit rental housing subject to government restriction on use shall be fifty (50) to 150 basis points (one-half percent (0.5%) to one and one-half percent (1.5%)) above the average capitalization rate obtained through the national average of capitalization rates for multi-family properties published by [www.realtyrates.com](http://www.realtyrates.com) or a successor organization for the fourth quarter of the year immediately preceding the January 1 assessment date.

#### Section 5. Formula for Assessing the Value of Multi-Unit Rental Housing Subject to Government Restriction on Use under the Ratio of Restricted Rent to Market Rent Approach to Value.

- (1) The assessor shall determine the value of the property using a direct capitalization of the net operating income and allowable operating expenses and utilizing a traditional capitalization rate.
- (2) The gross rent produced by the subject property in its restricted state shall be compared to the gross rent produced by a comparable unrestricted property and expressed as a ratio.
- (3) The ratio shall be applied to the value determined under Section 3 of this administrative regulation to determine the value of the subject property.

#### Section 6. Examples.

- (1) This section includes examples of the direct capitalization approach to value and the restricted rent to market rent method that may be used to determine the assessed value of multi-unit rental housing subject to government restriction on use. Both examples utilize the following information:

##### History of Income and Expense Statements

|                             |  |              |              |                           |
|-----------------------------|--|--------------|--------------|---------------------------|
| Property Name:              | Bluegrass County Apartments            |              |              |                           |
| Address                     | 100 Main Street, Springville, Kentucky |              |              |                           |
|                             | Year<br>2021                           | Year<br>2022 | Year<br>2023 | Three (3) Year<br>Average |
| Income                      |  |              |              |                           |
| Rental Income               | 560,000                                | 590,000      | 560,000      | 570,000                   |
| Vacancy & Collection Loss   | -40,000                                | -60,000      | -50,000      | -50,000                   |
| Other Income (Loss)         | 25,000                                 | 30,000       | 20,000       | 25,000                    |
| Bad Debt                    | -7,000                                 | -10,000      | -10,000      | -9,000                    |
| Total Income                | 538,000                                | 550,000      | 520,000      | 536,000                   |
| Allowable Expenses (Actual) |  |              |              |                           |
| Payroll & Related           | 110,000                                | 115,000      | 120,000      | 115,000                   |
| Administrative              | 75,000                                 | 100,000      | 95,000       | 90,000                    |
| Utilities                   | 45,000                                 | 45,000       | 45,000       | 45,000                    |
| Operating & Maintenance     | 45,000                                 | 5,000        | 25,000       | 25,000                    |
| Insurance                   | 30,000                                 | 31,000       | 32,000       | 31,000                    |
| Other                       | 15,000                                 | 15,000       | 15,000       | 15,000                    |
| Total Operating Expense     | 320,000                                | 311,000      | 332,000      | 321,000                   |

|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Net Operating Income                          | 218,000 | 239,000 | 188,000 | 215,000 |
| (Loss)  |         |         |         |         |
| (Total Income Minus Total Allowable Expenses) |         |         |         |         |

(2) Direct Capitalization. The rates within the following example shall be for example purposes only and shall not be construed to be capitalization rates set by the department:

#### Direct Capitalization Approach

|                             |  |  |
|-----------------------------|--|--|
| Property Name:              | Bluegrass County Apartments            |  |
| Address                     | 100 Main Street, Springville, Kentucky |  |
| Income                      | Stabilized Pro Forma                   |  |
| Rental Income               | 570,000                                |  |
| Vacancy & Collection Loss   | -50,000                                |  |
| Other Income (Loss)         | 25,000                                 |  |
| Bad Debt                    | -9,000                                 |  |
| Total Income                | 536,000                                |  |
| Allowable Expenses (Actual) |  |  |
| Payroll & Related           | 115,000                                |  |
| Administrative              | 90,000                                 |  |
| Utilities                   | 45,000                                 |  |
| Operating & Maintenance     | 25,000                                 |  |
| Insurance                   | 31,000                                 |  |
| Other                       | 321,000                                |  |
| Net Operating Income (Loss) | 215,000                                |  |

|   |        |        |
|---|--------|--------|
| Capitalization Rate                                     | Low    | High   |
| Realtyrate.com 4th Quarter 2023 (Example Only)          | 8.43%  | 8.43%  |
| 2023 House Bill 360 Adjustment (50 to 150 Basis Points) | 0.50%  | 1.50%  |
| Tax Rate Component (Including City Taxes)               | 1.15%  | 1.15%  |
| Total Overall Capitalization Rate                       | 10.08% | 11.08% |

#### Direct Capitalization

|                             |         |         |
|-----------------------------|---------|---------|
| Net Operating Income        | 215,000 | 215,000 |
| Overall Capitalization Rate | 10.08%  | 11.08%  |

|   |           |           |
|---|-----------|-----------|
| Indicated Value by Income Approach                            | 2,132,937 | 1,940,433 |
| (Net operating income divided by overall capitalization rate) |           |           |
| Indicated Assessment Rate (Rounded to nearest thousand)       | 2,133,000 | 1,940,000 |

(3) Restricted Rent to Market Rent. The rates within the following example shall be for example purposes only and shall not be construed to be capitalization rates set by the department.

Ratio of Restricted Rent to Market Rent

|                           |  |                      |
|---------------------------|--|----------------------|
| Property Name:            | Bluegrass County Apartments            |                      |
| Address                   | 100 Main Street, Springville, Kentucky |                      |
| Unrestricted Market Value | Percent of Stabilized Pro Forma        | Stabilized Pro Forma |
| Potential Gross Income    |  |                      |
| Market Rent               |  | 750,000              |
| Vacancy & Collection Loss | 4.00%                                  | -30,000              |
| Other Income (Loss)       | -                                      | -                    |
| Bad Debt                  | -                                      | -                    |
| Effective Gross Income    |  | 720,000              |

|   |                                   |         |
|---|-----------------------------------|---------|
| Market Expenses (Rounded)                     | Percent of Effective Gross Income |         |
| Payroll and Related                           | 15.60%                            | 112,300 |
| Administrative                                | 12.10%                            | 87,100  |
| Utilities                                     | 9.17%                             | 66,000  |
| Operating & Maintenance                       | 9.10%                             | 65,500  |
| Insurance                                     | 3.80%                             | 27,400  |
| Other   | 8.60%                             | 61,900  |
| Net Operating Income (Loss)                   |                                   | 299,800 |
| (Total Income Minus Total Allowable Expenses) |                                   |         |

Capitalization Rate

|  |       |
|--|-------|
| Realtyrate.com 4th Quarter 2023 (Example only) | 8.43% |
| Tax Rate Component (Including City Taxes)      | 1.15% |
| Total Overall Capitalization Rate              | 9.58% |

Direct Capitalization

|                             |         |
|-----------------------------|---------|
| Net Operating Income        | 299,800 |
| Overall Capitalization Rate | 9.58%   |

|   |           |
|---|-----------|
| Indicated Value by Income Approach                            | 3,129,436 |
| (Net operating income divided by overall capitalization rate) |           |

Ratio of Average Annual Rent of Restricted to Unrestricted Properties

|   |         |
|---|---------|
| Potential Gross Income – Unrestricted/Market Rent | 750,000 |
|---|---------|

|   |         |
|---|---------|
| Average Annual Rent – Restricted/Contract Rent  | 570,000 |
| Ratio of Restricted Rent to Market Rent<br>(Average Annual Rent/Potential Gross Income) | 76.0%   |

Adjustment of Market Value by Ratio of Rent Comparison

|  |           |
|--|-----------|
| Capitalized Value of Annual Net Operating Income   | 3,129,436 |
| Ratio of Restricted Rent to Market Rent            | 76.0%     |
| Indicated Value per Ratio of Restricted Rent       | 2,378,372 |
| Indicated Assessment (rounded to nearest thousand) | 2,378,000 |

Section 7. Forms. The form referenced in this administrative regulation may be inspected, copied, or obtained, subject to applicable copyright law, at:

- (1) The Kentucky Department of Revenue, 501 High Street, Frankfort, Kentucky 40601;
- (2) A Kentucky Taxpayer Service Center, Monday through Friday, 8:00 a.m. to 4:30 p.m.;
- or
- (3) The department's Web site at [www.revenue.ky.gov](http://www.revenue.ky.gov).

Withdrawn 12-13-2024, SOC not filed by deadline.

*THOMAS B. MILLER, Commissioner*

APPROVED BY AGENCY: August 14, 2024

FILED WITH LRC: August 15, 2024 at 11:45 p.m.

**PUBLIC HEARING AND COMMENT PERIOD:** A public comment on this administrative regulation shall be held on October 23, 2024, at 1:00 p.m. in Room 11A, State Office Building, 501 High Street, Frankfort, Kentucky 40601. Individuals interested in being heard at this hearing shall notify this agency in writing at least five (5) workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing is received by that date, the hearing may be canceled. A transcript of the public hearing will not be made unless a written request for a transcript is made. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments shall be accepted through October 31, 2024. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

**CONTACT PERSON:** Gary Morris, Executive Director, Office of Tax Policy and Regulation, Department of Revenue, 501 High Street, Station 1, Frankfort, Kentucky 40601, phone (502) 564-0424, fax (502) 564-3875, email [Gary.Morris@ky.gov](mailto:Gary.Morris@ky.gov).