

220. RULE PERTAINING TO ASSESSMENT OF INTERNAL REVENUE CODE (IRC) SECTION 42 LOW-INCOME PROPERTIES (RULE220)

Following are three (3) examples illustrating analysis of economic obsolescence. In these examples intermediate step calculation results are rounded to the nearest dollar.

Example 1: This example illustrates analysis of economic obsolescence in a market that supports construction of market rent apartments. In this example, the annual difference between market rent and the restricted rent of a tax credit project is capitalized. Market rent must consider any adjustments due to physical characteristics of the subject.

Assumptions	
Number of Units	- 24
Age	- 3 Years
Monthly Market Gross Rent Per Unit	- \$550
Monthly Subject Gross Restricted Rent Per Unit	- \$475
Market Derived Capitalization Rate	- 7.00%

REPLACEMENT COST NEW (RCN)	\$1,401,961
DEPRECIATION %	
PHYSICAL	8.00% \$112,157
FUNCTIONAL & ECONOMIC	See Below \$308,571
TOTAL DEPRECIATION	\$420,728
DEPRECIATED REPLACEMENT COST	\$981,233
LAND VALUE	\$35,000
TOTAL COST APPROACH	\$1,016,233

Example 1 Economic Obsolescence Calculation

Step	Description	Calculations
1	Monthly Market Gross Rent Per Unit	\$550
2	Monthly Subject Gross Restricted Rent Per Unit	\$475
3	Difference	Subtract Step 2 from Step 1 $\$550 - \$475 = \$75$
4	Number of Units	24
5	Monthly Rent Loss	Multiply Step 3 by Step 4 $\$75 \times 24 = \$1,800$
6	Annual Rent Loss	Multiply Step 5 by 12 Months $\$1,800 \times 12 = \$21,600$
7	Market Derived Capitalization Rate	7.00%
8	Economic Obsolescence	Divide Step 6 by Step 7 $\$21,600 / .07 = \$308,571$

Example 2: This example illustrates analysis of economic obsolescence in a market that does not support construction of market rate apartments. The difference between the subject gross restricted rent and the feasible gross monthly rent is capitalized, and the resulting calculation shows the total economic obsolescence. Feasible gross monthly rent is calculated by adding the physically depreciated cost plus land value and dividing it by a gross income multiplier, which is found by analyzing sales of similar market rate apartments. The result is the market rent required to support the cost of the subject apartment project.

Assumptions	
Number of Units	- 24
Age	- 3 Years
Monthly Market Gross Rent Per Unit	- \$550
Monthly Subject Gross Restricted Rent Per Unit	- \$475
Market Derived Capitalization Rate	- 7.00%

REPLACEMENT COST NEW (RCN)		\$1,401,961
DEPRECIATION %		
PHYSICAL	8.00%	\$112,157
FUNCTIONAL & ECONOMIC	See Below	\$271,543
TOTAL DEPRECIATION		\$383,700
DEPRECIATED REPLACEMENT COST		\$1,018,261
LAND VALUE		\$35,000
TOTAL COST APPROACH		\$1,053,261

Example 2 Economic Obsolescence Calculation

Step	Description	Calculations
1	Physically Depreciated Cost Plus Land Value	Subtract Physical Depreciation From RCN and Add Land Value \$1,401,961 - \$112,157 + \$35,000 = \$1,324,804
2	Market Gross Income Multiplier	8.5
3	Annual Feasible Gross Rent	Divide Step 1 by Step 2 \$1,324,804 / 8.50 = \$155,859
4	Annual Feasible Gross Rent Per Unit	Divide Step 3 by 24 Units \$155,859 / 24 = \$6,494
5	Monthly Feasible Gross Rent Per Unit	Divide Step 4 by 12 Months \$6,494 / 12 = \$541
6	Monthly Subject Gross Restricted Gross Rent Per Unit	475
7	Monthly Per Unit Rent Loss	Subtract Step 6 from Step 5 \$541 - \$475 = \$66
8	Monthly Project Rent Loss	Multiply Step 7 by 24 Units \$66 x 24 = \$1,584
9	Annual Project Rent Loss	Multiply Step 8 by 12 Months \$1,584 x 12 = \$19,008
10	Capitalization Rate	0.07
11	Depreciation (Economic/Functional)	Divide Step 9 by Step 10 \$19,008 / 0.07 = \$271,543

Example 3: This example illustrates that when subject gross restricted rents are at or above market gross rental rates, and the feasible gross rent per unit is less than the subject gross restricted rent, no economic obsolescence is found.

Assumptions	
Number of Units	- 24
Age	- 15 Year
Monthly Market Rent Per Unit	- \$475
Monthly Subject Restricted Rent Per Unit	- \$475
Market Derived Capitalization Rate	- 7.00%

REPLACEMENT COST NEW (RCN)		\$1,401,961
DEPRECIATION %		
PHYSICAL	20.00%	\$280,392
FUNCTIONAL & ECONOMIC	See Below	\$0
TOTAL DEPRECIATION		\$280,392
DEPRECIATED REPLACEMENT COST		\$1,121,569
LAND VALUE		\$35,000
TOTAL COST APPROACH		\$1,156,569

Step	Calculations
1	Physically Depreciated Cost Plus Land Value $\$1,401,961 - \$280,392 + \$35,000 = \$1,156,569$
2	Market Gross Income Multiplier 8.5
3	Annual Feasible Gross Rent $\$1,156,569 / 8.50 = \$136,067$
4	Annual Feasible Gross Rent Per Unit $\$136,067 / 24 = \$5,669$
5	Monthly Feasible Gross Rent Per Unit $\$5,669 / 12 = \472
6	Monthly Subject Gross Restricted Gross Rent Per Unit \$475
7	Monthly Per Unit Rent Loss <\$3>
8	Monthly Project Rent Loss
9	Annual Project Rent Loss
10	Capitalization Rate 0.07
11	Depreciation (Economic/Functional)

