Office of the Mayor

David J. Cieslewicz, Mayor

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December 10, 2007

Timothy J. Radelet, Esq.
Foley & Lardner LLP
P.O. Box 1497
Madison, WI 53701-1497

Re: Non-profit housing tax exemption

Dear Tim:

Thank you for taking the time to correspond with City Attorney Mike May regarding the matter of the property tax exemption for non-profit housing providers following the *Columbus Park* opinion, as well as the current language contained in section 70.11 of the Wisconsin Statutes. I attach a memorandum prepared by Atty. May that describes the City of Madison's posture regarding this issue.

In short, Attorney May recommends that the City refrain from moving any properties which were formerly tax exempt to taxable status, if such a move would be solely based on the "rent use" language in section 70.11, Stats. To the extent that any properties were moved to a taxable status, the City Attorney has authorized that any resulting property tax bill be rescinded.[1]

Attorney May, however, correctly insists that the City of Madison, and communities throughout the State of Wisconsin, need further guidance and clarification regarding the "rent use" language in 70.11, Stats. There are three potential sources for this guidance and clarification. First, the City Attorney will seek an opinion from the Attorney General regarding this language. Second, there is ongoing litigation between the City of Madison and certain property owners that include questions regarding the interpretation of the "rent use" language. Third, the City of Madison will continue to advocate clarification of this language through legislation. I am hopeful that we will receive guidance and clarification from one or more of these sources, and that the outcome will be such that the hard-working providers of low-income housing in our community can continue their good work.

1 I am informed that only two such property owners will receive tax bills, which the City Attorney has authorized to rescind pursuant to the rationale set forth in the attached memorandum: Madison Development Corporation and Wisconsin Initiatives in Sustainable Housing, Inc. These two properties had their exemption requests due this year.

Please share this letter and the attached memorandum with all the members of Third Sector Housing. If you have any further questions, please do not hesitate to contact Atty. May or Mario Mendoza from my office.

Sincerely,

David J. Cieslewicz
Mayor

DJC/lll

Enclosure

cc: Michael May, City Attorney
Mark Hanson, City Assessor
Mike Kurth, Chief Assessor
Marianne Morton, Common Wealth Development
Frank Staniszewski, Madison Development Corporation
Howard Mandeville, Movin' Out
Lucia Nuñez, Director, City Department of Civil Rights

CITY OF MADISON
OFFICE OF THE CITY ATTORNEY
Room 401, CCB
266-4511

CITY OF MADISON
Office of the Mayor

Date: December 5, 2007

DEC 5 2007

RECEIVED

MEMORANDUM

TO: Mayor Dave Cieslewicz
Mark Hanson, City Assessor

FROM: Michael P. May, City Attorney

RE: **Tax Exemption for Low Income Housing Providers; Supplement to Memorandum of November 9, 2007**

On November 9, 2007, I provided you with a Memorandum setting forth my legal interpretation of Wis. Stat. § 70.11 as applied to low-income rental housing providers. The Memorandum arose out of communications from a group of Madison-based non-profit low-income housing providers acting collectively under the name "Third Sector Housing" (Third Sector).

In that Memorandum, I explained the genesis of the "strict but reasonable" interpretation of tax statutes as required by Wisconsin case law. The statutes and case law also make clear that taxation is the rule and exemption the exception. In that Memorandum, I concluded that I did not see a reading of the statutes that would bring the Third Sector members within the exemption.

After issuing that Memorandum, we attended a meeting with the Third Sector members. They suggested an alternative reading of the statutes. I requested their counsel, Tim Radelet, set forth that reading in a letter to me.

I received the letter from Attorney Radelet, dated November 18, 2007. In that letter, Attorney Radelet proposes an alternative reading of the statutory language at issue. I will discuss that statutory interpretation below.

In addition, since our meeting, I have had additional conversations with Assistant City Attorney Larry O'Brien and Mike Kurth of the City Assessor's Office, and have done additional research on the likely interpretation of the statute's addition.

C-

Summary

Based upon the information provided to the City, and my additional research and consideration of the issue, I am recommending at this time that the City not move any tax exempt entities into a taxable status based solely on the statutory clause relating to use of "all of the leasehold income for maintenance of the leased property or construction debt retirement of the leased property, or both . . . ." Although I continue to believe that this language presents difficult hurdles for the non-profit, low-income housing providers, I am not convinced that a legal ruling at this time would find that these entities are taxable.

Therefore, I am recommending that the City take the following steps:

1. Refrain, at this time, from moving any properties which were previously tax exempt to the taxable status, if such movement is solely based on the statutory language cited above. To the extent some properties were moved into a taxable status in the interim, I recommend that that change be reversed.

2. Seek an opinion of the Attorney General of Wisconsin on the interpretation of the statutory language, which interpretation may provide guidance for the City's subsequent steps. We may wish to request that Milwaukee join us in that request. At the same time, pursue pending cases that might provide guidance from a court, and support legislation to clarify the statute.

3. If the requested Attorney General's opinion, a court decision, or legislation within the next year does not clarify the statutory language, I believe the City should proceed to deny tax exempt status in the case or cases which would test the interpretation of the statute.

The Statutory Language at Issue

As set forth in my Memorandum of November 9, 2007, the statutory language at issue is in Wis. Stats. § 70.11 (intro), which sets as a condition for tax exemption that the lessor "uses all of the leasehold income for maintenance of the leased property or construction debt retirement of the leased property, or both . . . ."

In my Memorandum of November 9, 2007, I provided the following definitions of "maintain" and "construct:"

> Webster's New Collegiate Dictionary, for example, defines "maintain" as "to keep in an existing state (as of repair, efficiency, or validity); preserve from failure or decline. It defines "construct" as "to make or form by combining parts; build."

In *Black's Law Dictionary* (4th Rev. Ed.), the following is stated under the definition of "maintain:"

> It is variously defined as acts of repairs and other acts to prevent a decline, lapse or cessation from existing state or condition; bear the expense of; carry on; commence; continue; furnish means for subsistence or existence of; hold; hold or keep in an existing state or condition; hold or preserve in any particular state or condition; . . . keep from falling, declining or ceasing; keep in existence or continuance . . . "

I also looked at the definition provided in the *Wisconsin Property Assessment Manual* (Manual). It is proper to look to this Manual in determining the proper assessment of property. Wis. Stat. § 70.32(1).

At page 22.4 of the Manual, it states the following:

> All of the leasehold income must be used for maintenance of the leased property, construction debt retirement of the leased property, or both. Maintenance is defined in Webster's Third Unabridged Dictionary as " . . . the labor of keeping something (as buildings or equipment) in a state of repair or efficiency." The International Association of Assessing Officers defines maintenance as "An expenditure of a fixed asset that increases or tends to preserve the asset's value. . . "

These definitions provide little help in determining the meaning of the word "maintenance" in the statute. As Attorney Radelet argued in his letter to me of November 18, 2007:

> The Member . . . would say that <u>all ordinary and necessary expenses of owning and operating rental apartments are maintenance expenses</u> that fall within this definition in the meaning of the statute.
>
> If the operating expenses are not paid, the property will decline and ultimately fail. If the mortgage loan is not paid (any kind of mortgage loan), the lender will foreclose and the property will fail. . .
>
> In order to maintain the leased property as such and keep it in its existing state, all of the ordinary and necessary expenses of owning and operating the leased property must be paid. Otherwise, it fails. It is not maintained. (Emphasis in original).

Both the dictionary definitions and the reading proposed by Attorney Radelet leave the City trying to determine whether maintenance is to be defined in a more limited manner, that is, merely to keep the property in a state of repair, or is to be defined in a more expansive manner, that is, to keep the property operational. The word "maintenance" can be used in either way.

Limited Definition from the Property Assessment Manual

The Wisconsin Property Assessment Manual also contains a more limited definition of maintenance at pages 9-15 to 9-16. In defining "repairs and maintenance," it states in part:

> This category includes expenses incurred for minor repairs and maintenance necessary for the continual operation of the property. This would include minor roof repairs, minor repairs to the heating system, replacement of broken windows and other relatively minor but required repairs.

The difficulty with relying on this more limited definition of maintenance is that it does not come from the section of the Manual dealing with tax exemption of property. Rather, it comes from the section dealing with assessing property utilizing the income approach. Such an approach must measure operating income less operating expenses.

A similarly limited definition may be found in the treatise, *The Appraisal of Real Estate* (12th Edition, 2001, The Appraisal Institute). In discussing use of the income and expense analysis for assessing property, it lists a number of expenses at pages 510-511. These include fixed expenses such as insurance and variable expenses such as utilities, payroll, repairs and maintenance, administrative and management fees.

If one were to adopt this limited definition of maintenance as provided in these examples, then very few of the expenses incurred by the non-profit low income housing providers would meet the test, that is, even such expenses such as insurance, utilities and administrative fees are not "maintenance." If one assumes that "maintenance" can be expanded beyond this limited definition to include other "operating expenses," then one has essentially admitted that "maintenance" *may have* an expanded definition. Why is that expanded definition limited to the accounting definition of "operating expenses" rather than the broader definition of all "necessary expenses" to keep the property operable?

Upon reviewing all these matters and materials, I became very uncertain whether the Legislature intended the word "maintenance" to be limited to the very specific items of maintenance used in a strict accounting or income approach to assessments. This means it must encompass something more. There is no guidance as to whether that should be some subset of operating expenses, or something broader.

Subsidized Housing Statement

There was one other interesting statement in the *Wisconsin Property Assessment Manual.* A portion of Chapter 9 deals with the treatment of subsidized housing, pages 9-42 to 9-50. Many of the non-profit, low-income housing providers in the Third Sector are subsidized housing. In determining how to assess property that has subsidized housing, the manual states at page 9-48:

> Ownership Types.
> *If a limited partnership owns property, the property is likely to be assessable.*
>
> *If a non-profit organization or a public agency owns property, the property is likely to be exempt.* . . .
>
> Review Statutes 70.11(4) to understand when the exemption applies. (Emphasis in original).

While this statement certainly is not determinative, since it leads us directly back to the statute at issue, it is interesting that the Manual suggests that non-profit, subsidized housing is likely to be exempt.

Construction Debt Retirement

Despite the above analysis, it is difficult to make a clear determination that the non-profit, low-income housing providers should be tax exempt given that the statutory language also states that leasehold income may be used for "construction debt retirement."

Why was this language added by the Legislature? If debt retirement of all sorts is encompassed within the meaning of the word "maintenance" the addition of this language would seem superfluous. One is not to interpret a statute such that language is superfluous.

Attorney Radelet offered an interpretation whereby this language covered the short period of time from the beginning of construction until a final mortgage is taken out at the completion of construction. Under his suggestion, there may be no leasehold income during this period, or there may be a limited amount of leasehold income, some of which goes to cover the debt retirement during construction. He suggested that this debt retirement might not be considered "maintenance" since the project was not fully operational.

It is not clear from the legislative history exactly what was intended by this language. It is unclear whether it was meant to signal that other types of debt retirement should *not* be considered within the term "maintenance," or whether it was meant to plug a loophole only because construction debt retirement might not be considered to be encompassed within the term "maintenance."

Other Related Matters

In considering how to treat the Third Sector members, it is important to note that the City is already involved in litigation with three entities, all of which raise the maintenance and construction debt retirement language. This includes litigation against Green Tree Glen, Wisconsin Housing Preservation Corp., and Future Madison. However, in each of these cases, there are additional issues beyond the statutory language cited above. They

include questions of whether the entities qualify as benevolent associations and, in two cases, whether the limitation of 10 acres would bar the tax exemption. (It should also be noted that, just as members of Third Sector stated that they would not be able to pay a tax and challenge it in court, similar claims were made by some of these entities when the City determined they were subject to taxation. Those entities paid the disputed tax, and the matters are now in litigation.)

Finally, I attempted to determine how other cities are treating this issue. In particular, I contacted the Milwaukee City Attorney and the City Assessor's office. I was informed by Mary Reavey, the Milwaukee Assessment Commissioner, that Milwaukee is struggling with the same issues as Madison. They have not moved to assess these properties yet, in large part because of the suggestion that legislation may be in the works that would negate the issue through clarification of the statute.

Recommendation

Based upon my analysis above, and based upon a number of other matters that the City has in litigation with respect to taxation, I recommend that the City not place any entity in the taxable status solely based on the statutory language related to use of leasehold income on maintenance of the leased property or construction debt retirement. If there are other issues with respect to the property, such as whether the properties qualify as benevolent or whether they meet the 10 acre requirement, I would recommend that the City follow its existing policy of denying the exemption if the property does not meet the statutory language.

However, I do not believe the City can take this stance indefinitely. It must be remembered that the burden is on the property owner to meet the exemption language. I have concluded that the language is vague enough that prior exemptions ought not to be changed, based solely on this language, until other avenues of interpretation are exhausted. I intend to seek an opinion from the Attorney General of Wisconsin with respect to the interpretation of the relevant statutory language. The Attorney General may provide an interpretation which supports taxation, an interpretation which supports exemption, or may decline or be unable to provide a clear reading of the statutory language. When and if the City receives such an Attorney General opinion, the City may then proceed to apply the statutes as suggested.

If the Attorney General does not give a clear ruling and if, in the meantime, no statutory changes clarifying the language are obtained and no court rulings on the language are obtained, I recommend that the City seek to obtain a judicial determination of the meaning of the language. Perhaps this can be done through a test case with a single member of the Third Sector group, or the Assessor's office may simply deny any requested tax exemption based upon the ambiguous language and the property owner's burden to prove that an exemption applies.

Please let me know if you have any questions.

Michael P. May
City Attorney

MPM:skm

cc: Mike Kurth
Larry O'Brien
Mario Mendoza