Reducing Property Taxes in a Rising Market

IT IS AGAIN TIME TO CELEBRATE a rising real estate market. Rents are rising. Vacancy is declining. Inflation and expenses remain stable. These fundamentals are increasing values, and are increasing property tax assessments. As the real estate community turns its attention to the joys of deal making and development, the diligent will do better as they remember those still important operations efforts, such as property tax appeals. Furthermore the sophisticated will do best as they employ the full range of tax appeal tools, while many others are conceding that the increased assessments are inevitable.

As a market and its values rise, assessments in general rise. However the values of some individual property may rise at a slower rate than the general market. Furthermore certain classes of properties rise and fall at different rates. Each property is unique. The over-generalizing market psychology of assessors and owners is particularly hard to overcome in rising markets. Consequently it remains highly recommended that all re-assessments be analyzed by the property owner for their appeal potential, even in rising markets. In New York State and New York City, where properties are effectively re-assessed every year, assessments should be analyzed every year.

The Basic Appeal Strategy

The fundamental property tax appeal issues do not change in a rising market. They remain, 'What is the market value of the property in question?', and 'How does this market value compare to the assessment?' What changes is the market psychology and the need to employ additional of methods of assessment analysis and appeal.

As in any period of a market cycle, the most common appeal strategy in a rising market is to determine whether the assessed value is appropriate relative to the new higher market value. This is done by first appraising the property for its market value. Then the equalization rate (AKA: the assessed value-to-market value ratio) is applied to determine the appropriate assessed value. This is an important analysis in any market.

The appraisal must be specifically prepared for property tax purposes. A mortgage or acquisition appraisal, for example, is rarely appropriate for property tax purposes, and in a rising market will probably indicate inappropriately high market and assessed values since these appraisals reflect upside potential from distant future years. While property tax appraisals often, appropriately do not reflect improvements in cash flow beyond those occurring in the very next year.

At first glance an owner may believe their new assessment, at $6 million, is appropriate. Its only up $1 million from the previous year. Their bank appraisal indicates a $13 million value, but their property tax appraiser is reporting that the market value is up $2 million to $11 million. Then the official equalization rate (say 50%) is applied to reveal that the equalized assessment is $12 million. The assessment is found to be too high ($12 mil v $11 mil). It should be appealed.

The Rising (or Falling) Market Appeal Strategy

If in the above example, the property tax appraiser concluded a $12 million market value, many would decide that no appeal is warranted. However that may be a premature and inaccurate decision, especially in a rising market. The official equalization rate used in the above assessment analysis may be inappropriate, and is more likely to be inappropriate in a changing market, like our current rising market. The equalization rate is set by local and state authorities and applies to large groups of properties and classes of properties. Even if a property is equitably assessed using the official equalization rate, assessment relief may be justified on the basis of uneven actual equalization. An owner may find that the competing properties are effectively equalized at a lower percentage of market value.

The ideal technique for analyzing equalization rates is a market value to assessed value comparison analysis. The analysis entails determining the market value and the assessed value-to-market value ratios on the property in question and on competing properties and then comparing them. Often this is a difficult analysis to complete due to a lack of quality data. Market data is often dated, incomplete, and less than ideally comparable. Changing markets worsen this problem. This is why assessor's equalization rates can be in error.

There are other techniques that are more easily completed. These include comparison analyses using assessed value per square foot, or assessed value per unit, or income multipliers. Instead of using market values, these multipliers use assessed values. The multipliers can be based on gross rent, gross income, or net income. Other techniques include statistical analyses, which are becoming more common.

Even in rising markets, property taxes remain an important issue. Luckily property owners, investors and managers have ways to address property tax issues. They need only avail themselves of these tools.

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