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Manhattan's Real Estate Market
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Tax Strategies

Tax Appeal

Owners Highlight Building Warts To Ward Off Higher Tax Bills

By David Bodamer

Roseland, NJ—With state budget deficits continuing to mount across the country, commercial property owners should be very, very concerned. Many states and municipalities are striving to close their budget gaps by any and every means necessary.

An option that is becoming increasingly irresistible for many local governments is to assess a building's value at the absolute maximum realistic amount—so that the property tax its owner must pay is as high as possible.

"In my opinion, from some of the reassessments I've reviewed, governments recently have been very aggressive in the values on properties. ... Properties are being assessed at a multiple of what they were previously assessed at," said Michael Schneck, a director & head of the real estate tax appeal group at Brach, Eichler, Rosenberg, Silver, Bernstein, Hammer & Gladstone P.C.

It is in this context that owners across

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Property Tax Bills Mount Owners Pay Price of State Budget Woes

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the country have significantly stepped up their efforts to reduce the rising tax burdens they face by challenging the values that tax assessors have placed on their properties.

When the real estate market is in one of its boom cycles, owners tend to neglect the assessments being placed on their buildings—assessments that rise right along with the building's market value.

"In good times, property assessments are not looked at as they are looked at now," said Stan Schiller, executive vice president with Property Assessment Advisors Inc., a Chicago-based tax consulting firm. "A company may get hit with taxes in a down market, going up millions of dollars. That's ludicrous."

And once those assessments are set, it takes a big fight to get them reduced when a market deflates.

Indeed, many owners today are in the midst of battling tax agencies as they face sky-high valuations based on where the market was two or three years ago—a time of miniscule vacancy rates and record rents. In today's depressed leasing climate, when buildings are generating far less cash flow, owners everywhere are mounting major campaigns to have valuations lowered to reflect market realities.

"I have a client who owns a shopping center that has fallen on difficult times, and we've been at the board of a

review each of the past two years because the assessor has been reluctant to acknowledge that this center is vacant," said Jim Jacobson, senior vice president of real estate with Property Assessment Advisors. "It's a ghost town. Everybody in town knows it, yet the assessor continues to post its former fair-market value. I don't think we have a single client who does not want to be a good corporate citizen, but this is about paying your fair share, and, in this instance, the client is being asked to pay the fair share of the value three years ago."

In some jurisdictions, assessors can be so aggressive that they reach valuations beyond market conditions.

"Most of our appeals center on when we buy something. Oftentimes the property has been assessed at more than what we paid," said David Moore, senior vice president for MBK Northwest, which develops and owns shopping centers.

In recent months, there has been a significant rise in tax appeals across the country. The level has not yet reached the heights it did in 1993—the last time real estate foundered—but local jurisdictions are facing many more times the number of appeals this year than in the recent past.

San Francisco, one of the nation's hardest-hit real estate markets, has seen a marked spike. The Assessment Appeals Board has received more than 2,100 applications from property owners disputing their most recent assess-

ment, a more than 70 percent rise from the year before.

Owners of buildings in the Bay City's battered office market are seeking reductions in excess of 50 percent of the assessed values. For example, Sony is striving to cut taxes on its Sony Metreon Center by 63 percent. And Shorenstein Co. is trying to lower the assessed value of Bank of America Tower from \$685 million down to \$355 million, according to the San Francisco Assessment Appeals Board.

In all likelihood, the assessments will not be dropped that much, but a rule of thumb is that appeals courts tend to split the contested difference. That is, if the city's assessor says a property is worth \$100 million and the owner says \$50 million, the judgment will often be in the neighborhood of \$75 million—if the owner presents a compelling case, according to John Cahill, vice president of the Los Angeles-based law firm of Rodi, Pollock, Pettker, Galbraith & Cahill L.L.P.

Savings Strategies

One of the first tactics owners battling for a tax break should pursue is to have their case removed as far as possible from the maelstrom of local politics. The appeals board of a tax-strapped city is a lot less likely to reach an owner-friendly decision than a state-level board or court judge.

"As governments are scratching for money, it's becoming harder to win appeals, but people higher up are not under as much pressure as, say, the local tax assessor is," said Tom Flanagan, a managing partner with Flanagan/Bilton, a law firm that specializes in commercial property tax.

Tax professionals concede that municipalities are generally fair in determining assessments. But with pressure building from the budget crisis, municipalities are not eager to lower assessments without a challenge.

"What you're seeing is that, from the assessor's perspective, (building owners) are the white knights of the tax rolls," said John Dyslin, a national director for Deloitte & Touche. "That's where the majority of local revenue comes from."

Most property tax lawyers were loathe to specify the precise savings their clients are realizing in the current market. But they did report that, in general, buildings that have been especially hard hit by vacancies or rent drops, as well as properties in cities whose suffering has been well documented (like San Jose), have the best shot at winning reductions.

Winning reductions is also about building relationships with the assessors and judges. If owners come off as

confrontational or bring up appeals that have little chance of winning, they can acquire "crying wolf" reputations and end up hurting themselves later.

To avoid creating such bad will, most lawyers vet owner complaints to weed out the ones in which landlords may be overreacting. This widespread practice of appealing only those cases backed by a legitimate gripe means owners whose pleas reach an appeals board usually succeed. For example, more than 70 percent of appeals in California are victorious.



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Most arguments challenging assessments focus on the traditional guides to a property's worth: vacancy, rent and market conditions. Another popular approach is comparing like-buildings to make sure the assessments are in line with market averages.

"If there are 18 office buildings in your submarket, and you are valued at \$200 per square foot while every other building is at \$100 per square foot, obviously something is wrong," said Joe Dondiego, a managing director for Cushman & Wakefield Inc.

An additional situation to look at is whether items that do not fall under the designation of property tax are being accounted for in the value of a building. Malls, for example, have many income streams that are not real estate related but sometimes are added to the building value. Also, when buildings are bought in a merger, part of the cost is meant to recognize the intellectual capital of the acquired management team, but here too assessors try to account for the full transaction cost in the real estate.

The assessment challenges, of course, create the ironic situation of owners highlighting the negatives of their properties and/or their markets. For owners accustomed to singing the praises of their buildings, this can be a bitter pill to swallow.

But can fighting to lower a property assessment come back to haunt an owner down the road? Most tax professionals say that is highly unlikely. For one thing, property tax assessments are just one valuation tool. When a property is up for sale, it is usually appraised by prospective buyers, which is a more up-to-date and accurate valuation. ■