nyrej

Appraisal: It will continue to be a brave new world for appraisers in the coming years

January 27, 2014 - Spotlights

In 1931 Aldous Huxley wrote the novel, Brave New World, which portrayed negatively a futuristic society governed by a type of new world order. Real estate development is creeping slowly to a brave new world which appraisers must adapt to. This is exemplified by downtown areas having a renaissance with tax credits, tax abatements, grants, low interest loans, etc. The suburban areas are not eligible for nearly the same amount of incentives but receive some of them none the less. Most of the these incentives ultimately come from the tax payers on a local, state and federal basis and have to be made up in the respective governmental budgets with additional taxes; almost like an endless loop. The rationalization behind these incentives is that the development subject to these incentives will produce real estate taxes, income taxes, payroll taxes, etc. in future years. The problem with that thinking is the local, state and federal governments become the middlemen. Because there is so much overhead in regards to bloated public employee benefit packages, government building operating expenses, other inefficiencies and sometimes incompetency; for every $1 of tax revenue is collected by government(s); there is a substantial discount of that $1 when allocated to incentive programs. In a perfect world if all tax rates were lowered across the board, the private sector would be able to more efficiently use each $1 not paid in tax to directly expand or invest most efficiently without the governmental middleman.

In the past I've written articles about the many abatements, incentive programs, etc. available in New York State which have contributed to increased development. These types of programs are especially important to the northeast states such as New York and Massachusetts because of the extremely high level of real estate taxes and other taxes. This will not change because entrenched politicians appear to be in favor of Keynsian "tax and spend" policies with no meaningful reduction of the government bureaucracy. Therefore, without these incentive programs there would be much less development; and areas such as Upstate New York, western Massachusetts and northwestern New England would become substantially more depressed. Within the last year, New York State has implemented a program established by governor Cuomo to create tax-free zones for a ten year period on the 64 public campuses outside of N.Y.C. Eligible companies who relocate to 120 million s/f or 2,754 acres of designated areas will have no business, corporate, state/local taxes, sales and property taxes or franchise fees for 10 years. The downside is there may be some restrictions on movement by existing businesses in the same market area but open to new businesses from outside the area. Thus, some existing businesses could be put at a competitive disadvantage. There has already been some recent purchases of properties near these zones in anticipation of business expansion.

Also, in Cuomo's State of the State address in early January he proposed income tax free zones for any Upstate manufacturer. Thus, industrial properties which are suited for manufacturing may see an abnormal increase in value. So the reach of the various tax incentives and government subsidies will continue to expand and result in more complications for the appraisers.

Appraisers typically have been trained to handle market value scenarios without the abatements and other incentives. The biggest pitfall for the appraisers is the finite nature of the various incentives. As an example, many of the abatements expire after 8-13 years. Thus, the appraiser must weight the benefit on a declining basis similar to a declining balance method through income discounts or adjusting the overall rate. Another credible way to measure the impact of the finite abatement is to use the true annual taxes in the Income Approach assuming there is no tax abatement; then add through a discounted cash flow analysis the present value of the benefit of the tax abatement schedule. The problem with that method is that the appraiser must be careful not to underestimate the positive impact to present value made especially in the first 75% of the incentive period. In regards, to tax free zones, the best way to measure that is by a paired sales analysis. The difficult part of that method is that in the early years there may not be enough sales. Thus, an abstraction method may have to be completed based upon the average company's income tax payments and capitalize the difference with high risk rates.

In summary, many appraisers have the tools to adapt because of their knowledge of present value concepts and discounted cash flow models. However, it will certainly continue to be a brave new world for appraisers in the coming years.

John Rynne, MAI, SRA is the president and owner of Rynne, Murphy & Associates, Inc., Rochester, N.Y.