Difference between market value and assessed value? - by David Wilkes

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The determination of one of the largest annual costs of New York real estate ownership, the property tax, is often poorly understood by even the most sophisticated real estate professionals. The result is that many property owners inadvertently pass on opportunities to reduce their operating expenses.

The common “ad valorem” standard used for property taxation is simple in concept but riddled with nuances that can lead to big differences between an owner’s notion of potential “market value” and what ought to be a lower tax assessment value. The assessed value of real estate is not necessarily what the property might sell for.

Credible asset valuations require a clear understanding of what I refer to as the “rules of the game” for the intended purpose of the appraisal; the ultimate value determination may be dramatically different – and result in a massive swing in tax liability – depending on the assumptions the appraiser made. Did the assessor consider some future potential the property may possess, or did she restrict her analysis to the existing use? Did she go beyond valuing just the real estate? Valuation assumptions are governed by differing rules for each appraisal assignment, whether tax assessment, mortgage financing, eminent domain, investment purposes, or selling a business.

Yes, the same property could be properly appraised with multiple values on the same date, and each might be valid for a different purpose.

Assessors sometimes knowingly or unintentionally conflate alternate notions of value with the standards that govern tax assessment. This is particularly true for properties that involve a “going concern,” such as hotels, self-storage facilities, big box retail stores, gas stations, and shopping malls, where the real estate serves a larger business need of the user.

For virtually all commercial properties with an existing improvement, the governing standard in New York for property tax is the value of the property in its existing use, rather than some potential higher-value use. A 50-year-old bowling alley that barely breaks even but that sits on a prime site zoned to permit the construction of a high-rise condominium must still be valued by a tax assessor as the bowling alley that it is, warts and all.

The law prohibits the assessor from considering what a developer with grander visions might pay, and a smart owner, and their advisor, will spot this distinction.

While the legal standards for assessing based on current use rather than potential value don't always seem fair (especially to neighboring owners), they are a product of meeting a Constitutional standard of fairness in tax assessment that requires all similarly situated owners to be treated the same, rather than attempting to generate higher values for some properties where the assessor thinks there may be an opportunity to do so without recourse. The assessor's job is to treat all property owners equitably, not to raise taxes as much as possible.

Similarly, some tax assessors neglect to consider that their mandate is to value real estate alone, and ignore other components of value that may be present. So, while a hotel may sell for a premium price, the assessor is required to recognize that the sale includes valuable non-real estate assets such as furniture, fixtures, and equipment; franchise business value; the value of a trained workforce; non-realty contracts, and other items that must be separated before the property can be fairly assessed. Therefore, a sale of a going concern, or the sale of an interest in a leased property where the value of the lease is tied to the business and not the real estate, must be disregarded for tax assessment purposes. In sum, while some real estate-based sales may provide premium evidence of market value for tax assessment purposes, each sale must be evaluated on its own circumstances.

Owners are well-advised to review their tax assessments long before the bill arrives, and go beyond a mere reflexive consideration of the value based on what a sale might bring. Look under the hood at whether that value, even if seemingly reasonable by market standards, may fail to meet the legal standards for a legitimate assessment and provide an opportunity to reduce the annual tax.

David Wilkes, Esq., FRICS is member-owner at Wilkes Law Group, PLLC, New York, N.Y.