Why your property must be taxed less than you think it’s worth - by Brad and Sean Cronin

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From time to time, a property owner tells us that they did not grieve their property taxes because they believe they could sell their property for more than the assessed value. After explaining the benefits and legal obligations under which the assessor must value the property, those same owners are often surprised when we are able to produce significant tax refunds for that location.

There are a number of reasons why a property may be entitled to a reduction in assessment even if the owner thinks the value on his property tax bill is fair. Below are some of the circumstances under which a property's value for taxation purposes may differ, sometimes drastically, from what that same property might trade for in the marketplace.

Commercial Valuation Very Different than Residential

Owners should be aware that the valuation approach applicable to commercial properties is unlike that of single-family homes. The difference is logical: an analysis of home sales, with adjustments to their comparable sales, provides guidance as there are similarities of the most important factors considered by home buyers. Sales on the same street share similar locations, matching school districts and neighborhoods, while allowing adjustments like size and age to be calculated mathematically. The courts have acknowledged that greater sophistication is necessary when appraising commercial properties and therefore sales of comparable properties are rarely used; rather the property is valued using the income approach.

Value Methodology: Income Approach Preferred

When a purchaser acquires a property, they anticipate the value will appreciate. One of the simplest reasons a hypothetical sale price fails to indicate value for taxation is because this sales price includes the purchaser's bet that the property will increase in value. Therefore, for tax certiorari purposes, the courts have consistently ruled that an income approach is the preferred method of valuation.

The courts have recognized that the income produced by commercial properties can vary greatly despite the appearance of similarity. For this reason, the courts have chosen to analyze the rents that the property has generated as the basis of the income that informs a conclusion of value. No two properties are alike, so the rental amounts a tenant and landlord are willing to agree upon provides the best empirical guidance as to the true market value for a given building.

Capitalization Rates Can't Include Future Potentialities

Knowledgeable owners understand an income approach should be performed when arriving at an assessment. But that same owner frequently does not realize the cap rate applied to the analysis cannot integrate less risk due the elimination of future potential at the property. This is true as well for possible conversion, expansion, and appreciation of the property. However, all this must be ignored because the law requires the property to be valued as it exists on taxable status date.

Many cap rate surveys rely upon data from banks which lend based upon the future potential of a property, in addition to its current status. Whereas a bank may see less risk to lend on an asset because of the ability of future additions and conversions to add value, the assessor is obligated to value what is currently at the property. The reasoning is understandable: the future development may never occur and owners should not have to pay taxes for something that is not yet, or may never be, in existence. The result is an upward movement in the cap rate which then produces a lower value for tax purposes in that particular year.

Assessors Must Tax Real Estate Only, Not the Business Value

There are a variety of properties that have additional value due to the business associated with a location. One example is a brand name hotel: A Marriott or Hilton flag are known quantities that command more income than a similar building branded “John’s Hotel.” A portion of the income generated by a Marriott is due to their reputational business value. Some brands have institutional value built up over decades. That component must be separated and deducted from the bricks and mortar valuation for assessment purposes. The same is true for many other property types: golf courses, self-storage facilities, catering halls, restaurants, gas stations, auto dealerships, marinas, and many others. All these properties must undergo a separate apportionment where the business component is excluded from the value they can be taxed upon.

These are just a few of the areas where we see frequent (and understandable) misconceptions around the distinction between property valuation for assessment purposes versus market purposes. There are many other intricacies and avenues where value should, for tax purposes, be adjusted from what a typical investor might conclude as market value. For these reasons, a tax professional can often add value for property owners, regardless of their well-informed opinion of its commercial or market value.

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