Overstating the Case

To Save on Property Taxes, Beware of Inaccurate Valuations

By Cynthia M. Fraser, Esq.

Every year, the dreaded property tax envelope hits the desk of tax managers and property owners. Despite the anxiety that accompanies this event, surprisingly few taxpayers take reasonable steps to learn whether or not their tax documents may be overstating their liability. Many property owners simply pop an antacid and write a check to cover the bill.

Property taxes are a necessary evil because in most jurisdictions, they are the primary source of revenue for funding schools, social services and other government functions. That said, of course, property taxes are also a major cost item. Approaching an assessment with a healthy dose of skepticism and an eye for common errors is a good way for owners to ensure that they are paying only their fair share of the tax burden.

Assessing property for taxation starts with determining real market value. The leased fee value of the property, or the going-concern value of a business, are inappropriate criteria for assessment and should raise red flags when they appear in a property tax review.

In a review, evaluate the origins of the property assessment to determine whether the assessed amount reflects the property's real market value. For example, if state law provides that a sale or other transfer resets real market value for tax purposes, the reviewer needs to evaluate the entire transaction.

The purchase price of a fully leased commercial building will typically reflect the value of a leased fee. The sale can reflect a higher value than it would if the property were vacant because the purchaser is achieving an immediate return on investment from in-place rents. If an asset's sale price is recorded as its taxable value, without an evaluation of market rents and lease-up costs to determine real market value, the owner will be overpaying taxes.

Similarly, the purchase of real estate within a business transaction may include compensation for goodwill, an in-place work force, management and other intangible assets that are not taxable in most jurisdictions. In order to properly reflect the value of the real property, the assessor must exclude these intangibles from the sale price, as only tangible real property is taxable.

Overlooked Issues

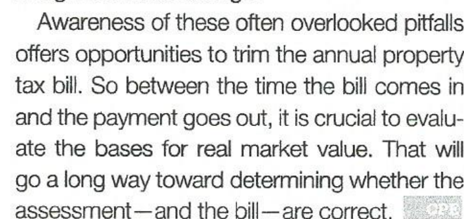
In a complex, multi-property transaction, the buyer's appraiser typically conducts a mass appraisal of the portfolio rather than analyzing each asset in depth. However, this practice may overlook issues that affect the value of individual properties.

An allocation appraisal of that nature may overvalue a property that is encumbered by governmental restrictions which limit its development potential. Likewise, a property that carries significant environmental liability can be overvalued, resulting in a tax assessment that exceeds the asset's real market value. Drilling down to the level of the individual asset prior to reporting the sale value to the assessor may help cut the tax bill significantly.

Another overlooked source of savings hinges on recognizing that construction costs do not necessarily equate with a property's real market value. Assessors like to use the cost approach to set real market value, because it is simple and relies on the property owner's documentation of costs. But what about added costs that don't affect value?

Suppose, for instance, that the design of a manufacturing facility calls for a stairway in a certain place, but because local regulations require the stairway to be farther from manufacturing activity, an inspector directs the builder to move it. The change adds $200,000 to the project's cost without adding to the facility's real market value.

Another kind of overstatement often results when an owner builds an addition. Temporary walls, electrical infrastructure and extra labor may be required in order for the occupant to keep functioning normally. These items increase the owner's out-of-pocket costs without adding to the property's real market value. Keeping track of such costs can result in significant tax savings.



Awareness of these often overlooked pitfalls offers opportunities to trim the annual property tax bill. So between the time the bill comes in and the payment goes out, it is crucial to evaluate the bases for real market value. That will go a long way toward determining whether the assessment—and the bill—are correct. CPE

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