

By  
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# How to reduce property taxes on assisted living facilities



In the assisted living market, costs and competition are forcing operators to look for new ways to reduce expenses and improve their bottom line. A good way to reduce overhead is to minimize real estate taxes.

Originally, assisted living and congregate care facilities catered to individuals whose needs could not be met in an independent living environment. As the industry has matured, operators are increasingly admitting and retaining residents who need a greater amount of care, offering assistance with eating, bathing, medical monitoring and other personal needs. Because some assisted living facilities have changed building designs to better serve these needs, and because some market to residents who require greater services, appraisal values of facilities vary greatly.

## Accurate assessment

In order to understand the potential for tax reduction, we need to examine how assisted living facilities are being assessed. Typically, assessors have determined the market value of assisted living properties based upon recent sales. Unfortunately, most sales that occur in the marketplace reflect acquisitions that include not only the underlying real estate, but the ongoing business interest as well. Because assessors use these sales to value the particular property sold and to determine the assessments of other "comparable" facilities, going-concern assessments inevitably influence entire regions.

Without sales of comparable properties, assessors alternatively rely on the net income produced at an assisted living facility. As is the case when the assessor relies on market sales, valuing an assisted living facility based upon its operating income also inflates the assessment by including non-real estate items.

Although not unique to assisted living projects, sale-leaseback transactions are a popular way to finance these facilities. Sale-leaseback transactions by their nature are financing tools, not arm's-length market sales. However, assessors regularly use these sales as a basis for taxation. Where it is consistent with other tax-planning measures, proactive steps should be taken to reduce the impact of sale-leaseback transactions by separating the business value from the real estate value prior to the deed being recorded.

Statutes in most states require that real estate be taxed based upon the fair-market value of the property. This seemingly simple requirement mandates that only the real estate be taxed. However, assisted living, congregate care and res-

idential care housing services are so intertwined with the operations of the real estate that it is often difficult for an appraiser to separate real estate and non-real estate income. Also, courts have been reluctant to accept appraisals based on highly subjective adjustments to historical operating statements. Therefore, the best approach is to remove the value of services from the equation.

In an Ohio Supreme Court case, Dublin Senior Community vs. Franklin County Board of Revision et al, the Court states that, when valuing only real estate, the business activities and real estate activities must be kept separate. The Court added that the separation of income and expenses is important not only when determining net income, but also when considering sale prices of comparable facilities.

## Fiction helps fact

Some courts have solved the problem of removing service income from the equation by using a legal fiction. This fiction permits a hypothetical change in use, so that rather than appraising an assisted living center, which has a high concentration of non-real estate income, the appraiser assumes the property is one that has a small amount of service income.

Courts have found that where the given property physically resembles an apartment building, appraisers should value assisted living properties as if they were apartment buildings. Using market rental, expense and occupancy rates for apartments, while disregarding the actual operations of the particular home, appraisers can determine a value for the real estate alone. However, facilities that do not meet the physical characteristics of apartments can create a problem.

For example, some assisted living facilities contain mostly one-room suites with limited bathroom and kitchen facilities. These homes are common-area intensive and resemble hotels. Where an argument cannot be made to value the home as an apartment (which removes most of the non-real estate value and results in the lowest value), an argument can be made to value the property as a limited-service or extended-stay lodging facility. By appraising the facility as a limited-service or extended-stay hotel, owners can reduce the amount of service value associated with the appraisal.

With the above methods, values of a number of assisted living facilities have been reduced by approximately 50%. Given the potential to significantly reduce the tax burden, an assessment review is necessary to stay competitive. □

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