

By
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Just say 'no' to property taxes on non-RE items

Given the intense competition in the multifamily housing market, owners have become increasingly creative in finding new ways to maximize their net operating income (NOI). As new income sources are identified, the value of multifamily housing projects has increased and, as a result, so have real estate taxes. It is possible to maximize net operating income and value without raising the property taxes on a project. Because real estate taxes represent one of the largest operating expenses for real estate investors, owners and managers must continually try to minimize real estate taxes.

Property tax minimization can be accomplished by removing all income not attributed to the real estate from consideration of an assessment. When determining value based on a property's NOI, even small adjustments can result in significant reductions in your assessment. With the source and amount of ancillary income generated by apartment owners growing exponentially, this approach will become increasingly critical. Whether you generate income from cable television, telephone service, Internet service or maid service, it is imperative that your assessment not reflect this income from services.

In addition to the sources of ancillary income now available, certain subsidized income should also be removed from consideration when valuing your property. For example, if the government contract or voucher that subsidizes your building produces rents that would be above the conventional market rates for your property, this marginal value would be a leasehold interest.

Similarly, if, due to a subsidy, your property suffers from a lower vacancy or credit loss than similarly situated properties, this, again, would not be value subject to assessment. Instead, in many states, the assessor is required to value your property as if it generated market rents, expenses and vacancies. When determining market NOI, it is important to deduct a reserve for replacement of capital items and appliances.

Once you determine what income is attributable to the real estate, the issue then becomes how you can benefit from this distinction that the local assessor likely missed. If you al-

ready own the property and it is fully assessed, you obviously need to follow the appropriate appeals process in your jurisdiction. If, however, you are in the process of acquiring a property, this presents an ideal opportunity to preemptively establish the appropriate allocations.

Indeed, the fight to limit real estate tax exposure is often won at the time of purchase. Many assessments are established based on the sale price reflected in publicly available transfer documents. Again, you should determine what income is generated by the real estate and what income is generated by non-real estate items.

To the extent permitted by law in your particular locale identify the price paid for the real estate alone, and not the purchase price of the full-going concern, which includes non-real estate items.

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As an example, increasingly, purchasers in Ohio are assigning intangible value to the right to manage property that they are acquiring. Obviously, managing a property is closely tied to the bundle of rights that you acquire through ownership. This right is severable, however, and it represents a substantial income source that is available only to owner-managed properties. Therefore, there is a plausible argument that the value of the management contract should not be reflected in your assessment.

The leases that are in place at the time of purchase represent another area which should be analyzed to determine the intangible value of the lease-up. Obviously, an investor will pay more for a brand new, fully occupied building vs. the same building that requires a lease-up period.

The loss of rents and leasing fees are costs that the seller bore and eventually passed on to the buyer in the form of a higher purchase price. The occupancy should be considered a leasehold interest not subject to assessment as real estate.

The thinking and creative planning is the direct result of the collaboration of several American Property Tax Counsel (APTC) members and their national and regional multifamily housing clients. The concepts are continually evolving.

Although they have been successfully used to reduce property taxes for multifamily projects, they have yet to be challenged in the courts. Careful planning that fits both the property and management's risk tolerance will lead to greater profitability for the owners of multifamily projects.

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