Seniors Housing Needs Long-Term Tax Care

Follow these steps to stop excessive property tax assessments.

By J. Kieran Jennings

In a nation that has faced a host of new challenges since the pandemic began, the seniors housing sector has carried one of the heaviest burdens. COVID-19-related mortality risk for those 85 years old or older is 330 times higher than for those 18 to 29 years old, according to the Centers for Disease Control and Prevention (CDC).

Notwithstanding those odds, 51 percent of all seniors housing properties including independent care, assisted living and skilled nursing reported zero deaths from COVID-19. Yet the industry continues to grapple with increased costs, worker burnout, hiring challenges and occupancy issues that have ravaged operations.

Like a vaccine that stimulates a stronger immune response, hard times can spur organizations to boost efficiency and fortify themselves against other threats, such as inflation. In this vein, seniors housing owners must identify ways to turn their troubles into positive influences.

As the industry seeks to allocate money from areas that don't compromise care, property tax strategy should be near the top of their lists for potential savings. Moreover, reduced taxes tend to have a long-term impact. When assessments are low, they tend to stay low, which may serve to insulate the industry from the impacts of inflation.

How to reduce property tax liability

Obtaining those property tax savings is not easy. Although it seems apparent that the industry has suffered, taxpayers that want a reduction in taxes must prove their property has lost value; they cannot rely on the good will of assessors to adjust the assessment.

Taxpayers must look at their tax challenges in a way that reflects the impact to the business. That said, assessors will want to concentrate on real estate value irrespective of the business. Many will reference sales of properties that were priced on the value of contractual leases to the operator, or assessors may look at the income to the owner based on contract rents. Taxpayers need well-documented arguments to counter these positions.

While separating the real property value from the business value, real estate assessments must also consider the negative effect that a struggling business exerts on the real estate.

Taxpayers can follow a three-step financial feasibility study to help prove the need for an assessment reduction.

1. Determine the net operating income (NOI) under COVID-19 and its legacy. It is important to document the new costs necessary to safeguard and serve residents in this new environment.

2. Separate income associated with services from real estate income. Be sure to remove from income any governmental stimulus that will not be ongoing.

3. Finally, use the resulting real estate NOI to show the effects of that income stream on real estate value.

Step 2 is critical, and it must start with the business. Conduct a forward-looking income analysis that includes all increased costs, from the added costs of employing and motivating a weary workforce to inflation and expenses associated with new health standards.

After documenting the new NOI from the independent living, assisted living or skilled nursing operation, determine whether that income is sufficient to justify the business. Taxpayers can do this by applying a return to the cost of services.

The expenses that are separate from normal real estate operations are associated with the service side of the business, and those outlays are expected to generate sufficient income to create a return on that investment. Remove the return from the overall NOI, thus separating the income from business and real estate. The result is NOI that reflects more closely that of the real estate.

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Perform a similar analysis to determine whether the net income attributable to real estate is sufficient to justify the real estate cost. It is important to remind the assessor that the operating business can only pay rent if there is money available, even if that rent is just a figure used in a formula to determine real estate value. At this point, the taxpayer can apply a capitalization rate to the net real estate income to arrive at the real estate value.

Apply to other valuation approaches

The financial feasibility study described above will also help taxpayers and assessors determine how to adjust the cost approach to valuing real estate. Likewise, the analysis can inform adjustments to comparable sales data. Indeed, that initial financial feasibility will help in all aspects of the tax challenge and should be well documented.

Assessors are not all-knowing, so unless the taxpayer shows them a good reason to change approaches, they will work with their normal procedures. Often, assessors look to the property's construction cost (less physical depreciation based on age), sales of similar properties and/or the income generated from contract rents to determine an assessed value.

Without an initial feasibility analysis, an assessor may focus on construction costs without regard to whether the property's use will justify those costs. Or they may use contract rents for the subject property or competing properties, either of which were likely established with pre-pandemic metrics.

Simplistic shortcuts, such as assuming a percentage of the total net income that should be attributable to business and the other to real estate, are not ideal and may lead to inflated values of taxpayers' properties.

In theory, there should be a greater impact on the value of those properties that require more service. But because of the variations between properties and nuances of seniors housing types, a fresh look is needed for all of them.

A good starting position for the taxpayer is to ask: "What would we pay to acquire the property, knowing what we know today?" Comparisons to sales of other properties are more complicated than in the past and should be adjusted with an eye toward the feasibility analysis. Properties that cannot achieve sufficient occupancy and income to justify operation are not directly comparable to optimally occupied properties.

There are states where a reduction in the assessment may carry forward indefinitely. Approaching assessed value with a strong team will pay dividends for years. Conversely, an approach that is not well thought out will make future attempts to reduce taxes more difficult.

By taking the proper steps, taxpayers can position themselves to drive the best result and be able to provide the service and living standards that our most vulnerable residents deserve.

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