Self-Storage Property Taxes: How Assessments are Made and Ways to Potentially Lower Your Bill

Self-storage has become a hot investment and values are up, but many owners find themselves with excessive property-tax bills that eat into their cash flow. Here's an overview of how tax assessments are made and some ways to potentially lower your bill.

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Self-storage facilities continue to command great cash flow, but many owners find themselves funneling more of their income toward exorbitant property-tax bills. Those who take the time to review their assessments and liabilities with a local expert often discover they're being taxed unfairly. This is why you should identify and question your assessor's methods, assumptions, data and calculations. By exercising your right to contest your assessment and presenting a convincing argument, you might be rewarded with a lower tax bill.

Self-storage is especially vulnerable to errant valuations by assessors who fail to differentiate taxable from non-taxable value. Key questions include whether the sale of a self-storage facility is completely subject to transfer tax and if the price directly equates to taxable value for real property tax. It can be argued that much of the value associated with self-storage is business value and personal property, which is typically exempt from transfer or property taxes.

Let's examine how self-storage tax assessments are made and arguments you can use to contest one assigned to your own property. A successful appeal can save significant money, so it's worth pursuing.

The Trouble With Assessment

Arguing that the value of your self-storage facility is largely derived from non-real-estate sources can be problematic. Much of the difficulty comes into play when the assessor obtains a copy of the finance appraisal, or when a purchase and sale agreement includes an allocation separating the real estate from non-realty items.

Assessors want to believe that all the value in a sale or from financing is derived from real estate. In the Ohio case *St. Bernard Self-Storage LLC vs. Hamilton County Board of Revision*, the state supreme court stated that although the purchase and sales agreement carved out goodwill in the acquisition price, it was unconvinced that the sale of a self-storage facility had any goodwill. Conversely, lenders are often unable to lend on value that isn't attributable to real estate.

For property owners, the first step toward minimizing taxes and maximizing their financing is watching definitions; the definition of the interest being appraised is paramount. Appraisers can properly find for two different values on the same property, depending on whether they're valuing for the purpose of financing or tax assessment, so it's important to establish the interest being appraised.

When it comes to financing, lenders can and do lend on the stabilized value of a property performing as a going concern. In other words, they're appraising the property's *leased fee value*. So, for financing, appraisers can rightfully take into consideration the income from the operation at stabilization, but that isn't necessarily true for tax assessors.

Many states require assessors to value the *fee simple interest* in the real property only. The fee-simple appraisal is based on the real estate value alone and excludes value from the return of and on personal property. When it comes to self-storage, the assessor's calculation of taxable value must ignore value associated with units, computer systems, national marketing and so on, based on circumstances. Individual units are capable of being assembled and disassembled, which means they are at best a business fixture and not real estate.

Many assessors and appraisers recognize the removal of the depreciated value of personal property, which means they must also remove the personal property—and any income attributable to it—from the going-concern value. The comingling of values from multiple sources is especially evident when there's a sale.

Arguments in Your Favor

When the assessor cites a tax assessment based on the sale of your self-storage property, you can make several arguments. First, look at the building's construction and acquisition costs without factoring in things like security, computer systems, marketing and individual units.

If your facility was recently converted from a different type of building, that too can give you an advantage. Properties like those transformed from big-box retail space often trade at much lower price before lease-up and stabilization, and the conversion costs are typically associated with the personal property and eventual occupancy. So, as the owner, you can present sales of comparable pre-conversion properties to support an argument for a reduced assessment. It's better than using the sales of operating self-storage facilities as comps because there's no need to remove the personal property from the equation.

In cases when there are few comparable sales of big-box properties to reference or your self-storage facility truly isn't comparable to others that have been sold, it's appropriate to assess the property based on the replacement costs associated with building new. However, the appraiser should stop short of including costs specific to individual units, otherwise they'd need to apply depreciation from *all sources*, including age and any economic or functional depreciation.

The last line of counterargument is based on the income approach to valuation. Income-based assessment is the most complex when it comes to removing non-realty income. The easiest and cleanest way to respond is to look at examples of same-generation retail or light-industrial rents.

That said, when trying to defeat a sales price, it may be necessary to look at the actual income and then determine the appropriate amount for the non-realty value. Appropriate income will be based on the initial investment to install personal property as well as the return from that personal property. The income derived from that non-realty component is then removed from the actual net income. This is an activity easier said than done, but appraisers can establish the return. After removing the non-realty income, they should apply an appropriate capitalization (cap) rate to arrive at the property value.

Preferably, the cap rate used by the appraiser or assessor should be created from a mortgage constant and equity returns rather than from sales of comparable self-storage facilities because cap rates from this industry have comingled interests.

As you can see, it's appropriate for self-storage owners to use different values for their property, including one for financing and another for taxable or assessed value. These will differ because the appraisals that produce them are truly measuring different property interests.

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