WHEN TO APPEAL

Combating Excessive **Property Tax Valuations**

By Gilbert D. Davila, Esq.

Property tax expenses can have a huge impact on a self-storage project's bottom line. Given the current economic climate, developers and owners must constantly monitor their property tax valuations in order to make a decision about whether to appeal the assessment. Once the valuation is appealed, the owner must decide how to combat the excessive valuation. An overview of the common mistakes and misconceptions of assessors can help self-storage owners develop arguments for lower tax assessments

Should I Appeal?

In most jurisdictions, the assessor's maintain a statutory responsibility to value a property at its "market value" as of a particular valuation date. A self-storage owner should most definitely appeal an assessment if the assessor's value exceeds the owner's estimate of the property's market value. The following factors should be considered before making an appeal:

1. Procedural and valuation laws vary from state to state. For example, an owner should understand the definition of market value for property taxation in use in the state. Therefore, owners should discuss the procedures for appeal and the possibility of success with a tax specialist in the state where the property is located.
2. The costs associated with an appeal and the potential tax savings from such an appeal should be evaluated to ensure that the protest makes economic sense.
3. The practical aspects of the appeal must be considered, such as the time and resources required for the appeal and the documents needed to make an effective case to the assessor.

After working through these three issues, most self-storage owners find it worthwhile to proceed with an assessment appeal. Once the appeal decision has been made, the next step calls for organizing the valuation arguments and gathering the documents which support the property owner's opinion of value. Most often, a successful assessment appeal is based on outlining and attacking errors made by the assessor in the valuation process.

Is My Property Data Correct?

Assessor's records commonly contain errors in a property's age, total square footage, net leaseable area, number of units, unit mix, and facility amenities. An error in the property's basic data can significantly increase a property's overall assessment as evidenced by the following example of how simple errors cost taxpayers big money.

Let's say that an assessor's records indicate a facility's net leaseable area as 175,000 square feet and the facility has been valued at $45 per square foot, which equates to a total assessment of $7,875,000. In reality, the facility only contains 160,000 square feet, and, thus, should be valued at $7,200,000. This one error alone results in a significant $675,000 over assessment. If the owner found a second mistake in the records, such as the valuation of $150,000 worth of recreation vehicle spots that did not exist at the property, the excessive valuation based on errors in basic data would be even more egregious. The two recording errors in this scenario would amount to $825,000 in excessive valuation, or more than 10 percent of the initial valuation. A simple review of the assessor's records in this example would have netted the owner almost $25,000 in tax savings in a jurisdiction with a $3 tax rate for every $100 of value.

Did your property receive an unfair tax assessment? Be sure to weigh all the relevant factors before you appeal your valuation.

Providing a current rent roll to the assessor can help correct mistakes in a property's square footage, net leaseable area, number of units, and unit mix. An owner may also wish to produce a site plan for the property along with the most recent marketing materials which show the facility's amenities. Correcting basic errors in the assessor's records remains the simplest path to lower a tax assessment.

Determining Value

Assessors will commonly derive a market value using one or more of the three classic approaches to value: cost, income, or sales comparison. The cost approach is arguably the least reliable approach to value if the property is more than several years old, especially given the difficulties of estimating depreciation and obsolescence factors for older properties. An assessor will most likely rely on an income and/or sales comparison approach when determining a self-storage property's valuation. Value reductions can be gained by disputing how the assessor has applied a valuation methodology to a specific property.

The Income Approach

In a direct capitalization income approach, assessors in most states use market rent, vacancy, and expense factors to arrive at an annual net operating income, which is then capitalized using a market capitalization rate to arrive at an indicated market value. Conversely, self-storage owners, for purposes of financing and purchase, typically estimate market value based on the actual cash flow generated by the property. The differences between actual cash flows and market factors can often support a value reduction. Thus, owners should challenge the market factors used by the assessor and support the challenge with data taken directly from the property's current and previous year's operating statements, if such data is in the property owner's favor. Often, the market factors used in the assessor's income approach rely on data taken from properties that are not truly comparable to the property being assessed. A property's operating statement can help distinguish the owner's property from "comparable" properties that lead to higher assessments. Pointing out specific income and expense items can show trends in rental rates, occupancy, and expenses that differ from the market trends alleged by the assessor.

Many times, in an income approach the assessor will understate the allowance for vacancy and for concessions provided to tenants. Owners can present assessing authorities with rent rolls and monthly occupancy reports to portray the property's occupancy trends, compare the property's occupancy levels with market comparables, and outline concessions and allowances given to maintain occupancy.

Finally, assessors often apply artificially low capitalization rates to net operating income in order to support a higher valuation. The capitalization rates are usually derived from sales of comparable properties that are either not truly comparable or have unique characteristics that do not qualify the sales as true market transactions. Self-storage owners should push the assessor to provide the data that supports the capitalization rates being used and, thus, distinguish the comparable sales as not truly comparable.

The Sales Comparison Approach

Aggressive assessments often result from the assessor's reliance on the recent sales prices of comparable properties. A property owner can usually discredit "comparable" sales by outlining the physical and economic differences between the properties sold and the assessed property. More specifically, the owner can point out to the assessor that the factors influencing a buyer's decision to purchase a property are generally not known to the assessor. For example, a purchaser may have obtained below market financing or might have been motivated by time constraints or income tax consequences when acquiring the comparable property. The assessor cannot categorize a sale as comparable unless all the purchasing factors are known. Self-storage owners must make sure that assessors understand the meaning of comparability.

A common mistake made by assessors is assuming that a purchase price equals market value. A self-storage owner should not avoid a tax appeal simply because the recent purchase price of their facility was higher than the taxable value of the property. Owners pay for properties based on their analysis of factors beyond real estate. As a result, a purchase price should provide no more than a touchstone for an assessor. Taxpayers arguing against a purchase price as the basis for value should outline for the assessor the factors that were considered in purchasing the property, such as special financing considerations and how the actual performance of the property differs from projections made at the time of purchase.

Equality And Uniformity

Some taxing jurisdictions require that assessments among comparable properties be equal and uniform. The fact that assessors often value self-storage facilities without considering the assessment of like properties presents an additional opportunity for owners to argue for a reduced assessment.

A taxpayer's assessment should fall within a uniform range of values when compared to other comparable properties. Self-storage owners should compare their property's assessment to other comparable properties on a square footage basis. The search for comparable properties should begin with those facilities that a self-storage owner competes with for tenants within a close proximity to the subject property. If an owner's property is assessed disproportionately higher than the comparable properties, an argument can be made for a value reduction based on equality and uniformity, regardless of the assessor's "market value" claims.

The decision to appeal a project's property tax assessment can lead to significant tax savings when owners evaluate the mistakes made by assessors in the valuation process and become proactive in showing the assessors the error of their ways.

Gilbert Davila is a partner with the law firm of Popp, Gray & Hutcheson, LLP. He is a Registered Senior Property Tax Consultant and is a member of the Texas Association of Property Tax Professionals, the American Property Tax Counsel and several bar associations.