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Gain Control of Property Taxes

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Local tax assessment rules and practices have a lasting effect on returns to developers and owners of affordable housing. Investors face many difficulties—uncertainty about property taxes should not be one of them. A developer who builds a property is subject to a different set of risks than a buyer who purchases a property as an ongoing project or for rehabilitation.

When a builder constructs affordable housing, in many cases, taxing authorities have reasonably good records regarding land sales and construction costs. Therefore the assessor's knee-jerk reaction is typically to value the property at the total cost of land and construction. For the assessor, it's fast, easy, and makes some sense; for the developer, it often means paying significantly more property tax than comparable properties. Affordable housing requires additional support to make the project viable, and an unfair tax burden can be the difference between a stable, viable property and one that fails

New projects

Prior to beginning a project, the developer should have a discussion with the assessor regarding the assessment laws and local practices. If aggressive, intervening taxing authorities, such as a local school district, exist in the jurisdiction, then prior to building it may be wise to seek payments in lieu of taxes (PILOT). Ideally the tax would be based on the prevailing taxes paid by like properties and incorporated into the budget for the project. In this way the developer has already agreed with the taxing bodies as to the amount of taxes to be paid, often over a period of five to 10 years.

Rehabilitated projects

Buyers who acquire property for rehabilitation may find that some taxing bodies tend to overreach. This tends to happen when a property is purchased at or below the assessed market value, and then the buyer immediately invests a large percentage of the project costs into refurbishing the property. These costs are public record, and because the tax credits are based on capital costs, the costs are known and well documented. What most assessors would like to do is simply add up all the land and construction costs to derive an assessment value. However, unless a fair PILOT agreement can be arranged, the property owner must not sit idly by and take costs as a measure of assessment.

Owners can make two arguments against this approach. First, assessed market value should be based on the income generated from the project. The concept of income as a measure of value enjoys almost universal acceptance in the assessing community, so the likelihood of success with this strategy is higher.

However, the second argument, "obsolesce," needs to be well-presented in order to persuade an assessor of its merit. Simply put, when buildings are rehabilitated, project costs include demolition and subsequent rebuilding of many building components. This drives the cost up significantly, yet at the end of the project the tenant can still only afford to pay what the market (subsidized or not) can bear. Therefore, for example, walls, plumbing, and wiring purchased initially, and later demolished, disposed of, and subsequently rebuilt are no more valuable to the tenant than they were initially. Finally, when discussing obsolescence with an assessor, don't use that term; merely explain that your costs do not necessarily equate to increased value. Assessors almost universally have an aversion to terms such as obsolescence.

Completed projects

Buyers of completed projects have potentially the most difficult assessment problem to overcome. In the eyes of the assessment community, the purchase price proves the market value of the property. Assessors tend not to take into account arguments such as 1031 tax deferral, purchase of reserves, or any host of non-real estate issues that actually drove the deal. As a result it may be better to set forth the argument in the closing statements by recording the properly allocated purchase price. For example, buying an operating housing project includes not only the purchase of the land and building, but also the in-place leases (no lease-up costs/concessions), the management contract, the HAP contract, and the reserves. All of these assets should be separately quantified, and only the land and building should be recorded as real estate. Note, however, that allocations and proper recording vary from state to state. Furthermore, changes in classifications may also affect federal taxes, so your federal tax adviser should be consulted prior to closing.

Or, an owner may acquire the business entity rather than the actual asset. In some jurisdictions it is permissible and advisable to buy the corporate shell, meaning the LLC or partnership interest. In such a transaction, the deed is not recorded, which may avoid the conveyance tax or transfer tax and also shield the purchase price from the public as well as the assessor. The assessor would be forced then to treat the acquired property in the same manner as any similar property. Of course, a number of states require buyers and sellers to disclose the purchase price regardless of how the property is acquired. On the other hand, some states do not require disclosure of the purchase price, even if it is a typical asset acquisition.

Finally, all owners, regardless of how they acquired or developed their properties, should understand the nuances of their taxing jurisdiction. Within the same state and county, there can be differences in how a taxpayer should plan. For instance, where the jurisdiction is friendly, it may be advisable to meet the tax authorities personally and discuss all aspects of the project. Conversely, you may be faced with aggressive assessors and equally aggressive school boards, where sales or new mortgages are sought out and records subpoenaed. By engaging local tax counsel, an owner can learn what to expect and can better plan for the long term. Assessments that go up tend to stay up and are

difficult to reduce and those that are low tend to stay low. Possessing knowledge about the taxing jurisdiction makes all the difference.

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