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Student Housing Business:
Property Taxes & Assessments: Protecting Your NOI

Watching the ever-shifting needle of the tax assessors' schedule can pay off. — By Lynn Peisner

High tax bills are a potential reality for any commercial property that brings in revenue. Sometimes, a high tax payment can dramatically affect net operating income and reduce the value of a property. As counties and cities become more cash-strapped and in need of funding sources for public services, student housing operators keep a close eye on how and why their properties are valued the way they are, and what action can be taken when an operator believes an assessment may not be accurate.

Tax assessments vary in how often properties are valuated and what criteria influences the outcome, but most owner operators agree that monitoring the scheduling and knowing how to compare your property with others using accurate data is a crucial part of ensuring a fair tax bill.

SHB spoke with Joseph Green, chief financial officer of The Preiss Company, Ari Rosenblum, president of The Woodlark Companies, and Amish Gupta, chief operating officer of Real Estate Tax Consultants, a Texas-based property tax consulting firm with offices in Dallas, Houston and Austin. In their own words, they share insights about the nature of property taxes in today's economy and methods for protecting NOI.

Generally, the frequency with which a municipal body considers property tax reassessments is the same, regardless of the asset class. It also holds true that the criteria used by such bodies to determine the amount of any reassessments are the same. However, some jurisdictions may have their own ideas about other aspects of the process. For example, in Texas, property tax values are recalculated every year. In other jurisdictions, the process may occur every five years barring special events such as the sale of a property, which typically will cause a revaluation that year.

We have been in situations where a property's real estate tax has increased substantially over the prior year without any rational basis. One of our properties was valued at $30 million the prior year and $35 million the next without any material change in the property's net operating income. The $5 million difference created a significant increase in the amount of the property tax, which in turn reduced the property's net operating income and hence the value of the property. Fortunately, we were able to appeal the revaluation and achieve a meaningful reduction of the revised tax amount.

An increase in the amount of property tax can create a material adverse economic consequence for a property owner. Any such increase would reduce the property's net operating income, a critical component of determining value. One of the primary criteria used to determine a property's value is capitalization rate, which together with net operating income is employed by many property tax jurisdictions to determine the value of a property.

For example, assume that a property owner has accepted a quote from a lender to refinance a $20 million loan at par based in part on a property tax of $500,000. One month after agreeing to the lender's terms, the property is revalued and the new tax liability is $600,000. In that case, the additional $100,000 in tax liability likely would reduce the amount of the loan proceeds by approximately $1.1 million based on a 7 percent cap rate. That means the property owner would have to come out-ofpocket about $1.1 million to pay off their $20 million loan.

But a property owner can appeal an assessment. And it is easy to see why the ability to appeal a property tax assessment is a very important part of this process. The property owner usually has 30 to 45 days from the date of the revised tax to file an appeal. There are several firms, such as Marvin Poer, The Ryan Company and Paradigm, that specialize in working with the applicable governmental bodies to reduce property taxes. Approximately half of the appeals we have filed resulted in significant tax savings and a corresponding increase in the value of the project.

The dispute in an appeal usually revolves around cap rates. In some cases, taxing authorities use the same cap rate without distinguishing the projects. For example, the same cap rate may be used for a newly constructed property that is located next to a university and for a 20-year-old project located three miles from campus. Of course, the same cap rate should not apply to all properties.

Many cities and counties cannot provide the same level of basic public services such as fire and police protection today as they once did, and they are struggling to make their budgets work. As a result, they often turn to their real estate tax base and increase tax rates to provide more revenue. Perhaps instead of taxing a property at 75 percent of its fair market value, they might tax it at 85 percent. It seems likely that more of these problems may arise over the next several years, as loans that were originated before the most recent financial crisis will be coming due at a time when cities and counties that have lost revenue from a dwindling tax base are looking for ways to increase their revenues. Accordingly, owners need to be educated on the best ways to reduce their property taxes in general and to appeal the decisions of local governments effectively.

- Joseph Green

Tax assessments bearing a negative impact on NOI is an incredibly important issue in student housing. It's hard to make blanket statements about property taxes and assessments because of how much the process varies in different taxing jurisdictions, but there are certainly some markets that have looked to property taxes to make up for other losses in revenue since the economy has slowed down.

Whether you do it in-house or use an outside firm, you have to stay on top of assessment and appeals schedules. They are different in each jurisdiction and the rules differ as well, so it is a fairly complicated process. But if you keep your eye on changes in assessment, you'll be ready to appeal them by the deadline to make sure you're not paying more than you have to.

Assessments are appealed quite often. In our experience, that process has usually come out in our favor, but that is because we typically only appeal when we think we have a strong case.

As far as appeals go, assessors often don't have the most accurate or up-to-date information about every property, so they often make assumptions about your property based on general market data. When these assumptions are incorrect, your assessment can be way off, so presenting the assessors with accurate data is very important.

Sometimes assessors follow a strict schedule of reassessment intervals, while others reassess after a sale or an improvement to the property. This is totally market specific.

Some jurisdictions follow regular timed intervals without paying much attention to events such as sales or improvements, but others are quick to reassess after a property changes hands. In general, however, you are more likely to see a reassessment after a sale or improvements.

Assessments determine what the property tax bill will be, and this has a huge impact on NOI. Significant changes in assessment have the potential to drastically change a property's capped value. Buyers have to take this into account when going through their analysis and creating projections, and sellers have to take it into account when setting their pricing expectations. In that same vein, changes to the capped value of a property can change how much debt the owner is able to put on it.

—Ari Rosenblum

Since the economy has faltered, cities and counties have had a more difficult time balancing their budgets. Since they rely heavily on property taxes, they have attempted to maintain revenue streams, and they can only accomplish that by increasing millage rates or increasing values. Over the past few years, multi-family, and in particular student housing, has seen significant transactional and development volume. This has given jurisdictions valid reasons to maintain and increase assessed values.

Due to the increased activity, jurisdictions have become more comfortable in their knowledge of how to assess values. Additionally, they have more information on market rents, cap rates and expense ratios. Therefore, they are able to defend their values armed with this information.

The higher the NOI, the higher the saleable value of a property. As with other line item expenses, sellers attempt to minimize property taxes before the property is put for sale, so they can claim higher NOIs in the offering memorandums.

For financing purposes, banks are usually concerned with debt service coverage ratios. The increased cash flow allows bankers to provide more financing to owners as long as the coverage ratios are maintained. Buyers on the other hand must be aware that real estate taxes will most likely increase after they purchase the property. As such, they must have a good understanding where the assessed values will be in relation to their purchase price and also where the numbers will be through the hold period.

Values are assessed depending on the state and jurisdiction, and most likely there is some minimum requirement on the frequency of the revaluation. However, in some states, they can and will revalue more often than the requirement.

The two biggest occurrences that trigger reassessments are transactions and improvements (when a permit is taken out). Owners can almost be assured that a new assessment will be coming. The exact timing of when that occurs depends on the property location. Some are done with random timing, while others are done at the same time every year.

The most common misconception is that values are based solely on the market value in all jurisdictions, or what a property would sell for. In some jurisdictions, they have some type of "equal" clause. In certain scenarios, properties can be assessed for lower than the market value as long as they are "equal" with other comparable properties.

Hypothetically, a property can be newly built and the local authorities assess it based on cost of construction. If, however, the demand factors are lower than expected leading to less than expected revenues, the authorities will keep the assessed value based on cost since it is higher. It is up to the owner or their agents to appeal and convince them otherwise.

Owners should stay ahead of situations like these. Although nobody has a crystal ball, owners should anticipate how values will be assessed and should draft appeal strategies throughout the hold period. Hiring tax consultants who have local market and tax knowledge can help you in both budgeting and appealing; they are the ones who are most likely to get the best results.

The frequency of appeals depends on the local laws. Some appeals are completed every year; others such as California are done only at the change of ownership. Although not every appeal is successful, assessed values almost never increase. Therefore, there is no downside for owner-operators.

There has to be some valid reason for a positive outcome in an appeal. Most often, the reasoning is based on the NOI potential of a property. In certain jurisdictions, properties must be valued "equal" to other comparable properties. For student housing, this would be on a price per door basis. Usually, taxing authorities will lower values as long as they are given some valid argument. It is up to the owner and their agents to discover and highlight that reasoning.

—Amish Gupta