

Property Taxes Explode in Downturn

There's no doubt that the credit markets have tightened and the number of financial services companies has shrunk. New development has been stopped in its tracks, and rents and sales have fallen from their highs. How will all this affect property taxes?

New York City depends heavily on the financial, insurance and real estate business, and a significant portion of the city's budget relies on non-real-estate taxes generated by these industries. Add the real estate effect of bankruptcies and consolidations, which will cause vacancies in hundreds of thousands of sf of Downtown and Midtown office space, and you have a bleak picture for next year.

What many people might interpret as a recipe for relief may well turn out to be the very factors that cause an increase in real estate taxes.

WHY TAXES MAY INCREASE

First, New York City relies heavily on non-real-estate taxes and aid from New York State to make its budget work. Any budget shortfalls on the state level make it very difficult for the city to meet its needs by going to the legislature for help. Therefore, New York City's default tax becomes the real estate tax because it is the one tax the city alone has the power to increase. Clues from the past suggest this will happen again.

Several years ago, when the city faced a budget shortfall, the property tax rate was increased by 18.5% across the board. More recently, thanks to a better economy, the tax rate was lowered by 7%. But those days are likely over. Already, a movement is afoot to reinstate the original 18.5% increase. Further, additional tax rate increases are being reviewed for the 2009/10 fiscal year beginning July 1, 2009.

The continuing increase in the levels of assessments for all types of property represents another significant factor on the New York City real estate scene. Add to this the fact that the assessor develops real estate tax valuations for property tax purposes based on one- or two-year-old data. Thus, all the data the city reviews in setting property tax assessments will probably show increased market value, when no such increases exist today. Real estate owners are in for some particularly bad news indeed.

If this appears hard to believe, just look back to the Downtown office market after 9/11. Despite the devastation and total disruption of commerce there, assessments actually went up in

2002. Why? Because even though businesses scrambled to find temporary space or operated from remote locations for months, landlords continued to charge and escalate rent, pushing tax collections higher.

This same phenomenon will occur again when landlords report earnings for calendar 2008, showing continued growth and profits, certainly not a formula for a tax reduction. Because the city bases assessments on income and expenses, a drop in sale price does not always translate to a decline in assessed values.



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WHAT TO DO

Taxpayers can do something now to achieve tax relief in this challenged economic climate. Effective immediately, they need to focus on carefully assembling recent data to demonstrate changed market conditions in their buildings: increasing vacancy rates, reduced rents on new leases, additional rent concessions, delinquencies, bankruptcies and larger than usual subletting activity.

Some landlords have conducted surveys on existing tenants to identify credit risks and potential insolvencies. Even if some of these factors have not yet occurred in your building, you can show that

asking rents have been lowered in competitive buildings.

Capital expenditures need to be documented because the city neglects to look into this important area, focusing instead on operating income and expenses. Even future planned capital costs can be used to show the need to establish expenditure reserves. Reforecast fuel and labor costs as well. All of these factors will reduce your potential net income before capitalization. You can also argue that lending costs and increased risk require substantially higher capitalization rates.

A well-organized and documented presentation of the changed economic condition of your property will be very effective in reducing your assessed valuation. —RENY

The views expressed in this article are those of the author and not those of Real Estate New York.

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