By Joel R. Marcus

Trouble Coming in 2010 Assessments

All New York City property will be revalued on Jan. 5, 2010. Although that date is not yet here, rest assured that trouble awaits commercial property owners in this revaluation.

First of all, tax assessors usually remain behind the curve of market trends because the Real Property Income and Expense form requires mandatory filing of income and expense statements, which show only the property's calendar year 2008 performance. Since the market fell off a cliff after September 2008, these operating statements don't demonstrate the dramatic loss in real estate value.

Adding to the burgeoning taxes is the five-year phase-in of actual assessments mandated by New York law, whereby each increase over the past five tax years is added to the transition assessment or taxable assessment in 20% increments. Therefore, even if the actual assessment remained the same or was lower, the transition assessment, to which the tax rate is applied, would still reflect the impact of the prior five years' increases.

Hotels took the worst hit in the recession, suffering a 50% decline in earnings. The horrible expense ratio they now exhibit compounds their plunging profits. Instead of expenses approximating 70% of income, hotels find that costs may equal or exceed gross room revenue.

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To create property tax assessments, the city employs a gross income multiplier, which ignores actual expenses. While the occupancy of many hotels has decreased along with their room rates, they still have to provide a level of service, staffing and other expenses that leaves marginal hotels or properties operating in the red. Hotels may find some degree of relief because the Tax Commission has expressed a willingness to consider expenses in setting tax assessments. However, even here the old 70% ratio method has more traction with the tax authority.

Owners of condo properties with many unsold units find themselves in a tough bind. Condos do not generate rental income and sales are at a virtual standstill, yet condos are valued as if they were rental properties. This squeeze of higher property taxes and little income throws owners into the hands of their lenders.

Since rental income from conventionally rent-producing apartment buildings has only declined 10% to 15%, not much relief in tax valuations can be demonstrated by objective calculations. Moreover, data from luxury rentals is also derived from the 2008 calendar year filings, which, as mentioned, are not yet showing the full measure of market fall-off. Often, too, the burnoff or expiration of abatement programs significantly raises taxes.

Office and other commercial properties will show their decrease in income more slowly because the 10-year lease, which is most common, often masks the drop in fair market rental value. The only reduction seen in the market comes from increasing vacancies and renewals at lower rents. The impact of reduced rents, loss of operating and tax escalation income associated with the signing of a new lease and establishment of a new base year will not be fully realized for several years. In the meantime, income statements mask the problem by showing lease cancellation income and, in the case of new leases, the straight-lining of free rent and the amortizing of leasing commissions and tenant work.

To bring real estate taxes down to a viable level, a difficult task even in normal times, owners will need sophisticated analysis and effective presentation. A compelling presentation to the assessor regarding the rise in capitalization rates is paramount.

Hotels need accurate data to reflect current conditions, including labor and staffing requirements. They must also show the assessor how the increase in new rooms and new hotels precipitates lower rates and higher vacancies.

Condos need to create valuation models using realistic market conditions, high capitalization rates and a broader mixture of comparable assessments and data. Showing condo price reductions will not prove your case.

Office and commercial properties must clearly demonstrate the lack of any net absorption of space, indicating a 15% vacancy and loss factor in a 100% occupied property. In addition, any large vacancy is likely to be sustained for the foreseeable future, thus, the need for downward adjustment of occupancy.—RENY

The views expressed here are those of the author and not those of Real Estate New York.

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