

CONTROLLING UNEXPECTED INCREASES IN REAL ESTATE TAX

The last thing a business wants to encounter, especially in this economic climate, is an unexpected increase in operating expenses. If you own, or lease property under a triple net lease, you pay property taxes. Property tax liabilities can increase unexpectedly and some of these increases are shockingly large.

Most business owners budget for their property tax liability and for increases as a result of statutory reassessments. However, there are a number of other factors that can produce unexpected and frequently large tax increases that can impact the taxpayer. Property owners generally have a better understanding of when to expect increases in their property taxes (or at least they should have!). Lessee's on NNN (triple net) leases on the other hand are much more likely to be surprised by unexpected tax increases. Under a triple net lease the tenant pays not only base rent but also the real estate tax, insurance and maintenance. It is these taxpayers that are the primary focus of this article.

THE POTENTIAL PROBLEMS

Real Property tax increases can result from a number of factors including;

- **Re-assessment** - the timing and frequency of reassessments is set by statute and varies by state. Who has the right to appeal? Typically it is vested with the owner. If you are a NNN tenant and your landlord does not care if taxes go up since they are a pass thru, where does that leave you?
- **Abatements** – there are many types of tax abatements. Some, known as exemptions, are conditional. A change in the status of the property can result in loss of the abatement resulting in a increase in your tax liability. Or the abatement may simply expire.
- **Change in ownership** – The sale of a property can establish a hard to refute indication of fair market value. If there was a recent sale you need to address any potential impact on the RE tax. Steps can be taken when a lease is signed to address how an increase resulting from a sale will be treated.
- **Budgeting** – budgeting for property tax is difficult. Taxpayers frequently rely on the prior year tax liability or on an estimate from your landlord or other third party professional who may not be fully knowledgeable about the property or potential factors that can result in tax increases. Budgeting without full knowledge can be the source of an unexpected increase in your anticipated liability.

THE SOLUTIONS

Taxpayers can take steps to minimize the risk of incurring unexpected increases in their property tax expense. Asking the right questions and staying informed are critical to this process. Taxpayers can do this on their own or by using the services of a third party professional such as a Property Tax Consultant, Real Estate Broker or Attorney who is *knowledgeable* about property taxes.

Steps that can be taken that will aid in minimizing large unexpected increases include;

- **Appealing a Re-assessment- Who has the right to appeal is critical.** This right vests with the property owner unless it has been contracted to another party. If you are a tenant you depend on your landlord to appeal excessive or inequitable assessments. Your greatest fear should be a landlord that is not concerned about an assessment increase since they just pass the tax expense thru to the tenant(s). Triple net tenants that lease all or a majority of a property have an interest in the assessment of the property and should consider requesting an exclusive right to appeal or at least the right to appeal if the landlord takes no action.

Abatements – One of the most common sources of unanticipated tax increase results from the loss or expiration of an abatement. Abatements are typically secured by the property owner. Some abatements last for a period of time, generally a number of years. Other abatements are conditional and may result from vacancy or reduced rental income resulting from vacancy. Once vacant space is rented the abatement is lost. Tenants that rely on prior year taxes as an estimate of their tax liability leave themselves open to the surprise of higher taxes. It is up to the tenant to find out if an abatement exists and when it will expire. Tenants need to specifically ask their

advisors in the lease transaction or the lessor to determine if an abatement exists and if it is lost how it will impact their RE tax expense. If you decide to rent space based on a certain tax per square foot you don't want to find out that that rate doubles now that you have rented it based on the landlord or broker's failure to disclose that a current abatement will be lost.

- **Change in ownership** – The sale of a property can result in a large increase in the property tax expense. If a property is under assessed a sale price can provide an assessor with strong evidence of value for a greater assessment and higher tax. However, a sale price may not reflect taxable market value. Even in this recession some taxpayers are seeing large increases in their assessment. Of course you try to appeal them but sometimes that is not effective. This increase can be the result of a sale when the market was appreciating three years prior or may just reflect an increase because the property was previously under assessed. Some jurisdictions, such as California, statutorily limit AV increases from one year to the next and catch up when a property is sold. A practice frequently referred to as “welcome stranger”. In some states and industries it is common to have a lease provision that limits the impact of an increase on the tax liability of the tenant resulting from an action of the owner. In other words, should my tax liability as a NNN tenant sky rocket because of the action by the owner?

Many landlords have agreed to eliminate or phase in such increases to the tenant. In this economy some landlords that would not otherwise agree to this type of limitation may be willing to agree to it to secure a desirable tenant and eliminate a vacancy. After all it does not affect their cash flow as the impact on recoverable expenses will not occur during their ownership period. Furthermore, it may have limited impact on a property's salability or market value depending on how effectively a buyer does his due diligence.

- **Budgeting** – While budgeting is not a direct assessment / valuation issue, it is a critical factor to avoid large unexpected tax increases and is involved in each of the above factors. Be informed. That means, if the landlord provides you with an estimate of the property tax expense you need to also find out;
 - What it is based on?
 - When was the last reassessment?
 - When is the next reassessment?
 - Are there any abatements?
 - If so when do they expire?
 - When they acquired the property, and for how much?
 - Are there any appeals pending?
 - If you are one of multiple tenants is your prorata share of the tax based on the actual tax paid or some adjusted amount, also if there is a tax refund do you have a right to your prorata share of it?
 - Is the property on the market for sale or is there a sale pending?

- If there is a vacancy abatement will you share in it or will the landlord realize the full benefit?

Leases favor the landlord and need to be carefully negotiated to limit the amount of and size of increases in not only the base rent but also the ‘Other rent’ ie Real Estate tax. While it is easier for large tenants to secure limitation to their reimbursable tax expense, smaller tenants have an equally vested interest in limiting unexpected property tax increases. This gives them, at the very least, a sense of comfort that they are only paying their fair and equitable share of the property tax.

ETC...ETC...ETC....

Here's a few interesting tidbits from the world of property tax:

Florida—The Florida Supreme Court upheld a lower court ruling removing Amendment 3 from the November 2nd general election ballot. The lower court found the ballot title and summary misleading.

Amendment 3 was a proposed constitutional amendment to lower the assessment cap on business and other non-homestead properties from 10% to 5% as well as an additional tax exemption of at least 25% for homeowners in the first year.

Michigan—The Michigan Tax Tribunal is taking on the classification system to weed out misclassified industrial properties. They recently began hearings on 10,000 property tax classification appeals against potentially misclassified industrial properties.

Although they have admitted that the definition of an “industrial parcel” is vague... where manufacturing or industrial processing takes place...officials say most often it is quite clear where a company fits.

Companies losing the industrial classification stand to lose substantial tax breaks resulting in higher real and personal property taxes.

It's Back!!!!!!
Kickoff 2010!

