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Appeal excessive office property tax assessments

Anemic transaction volume complicates taxpayers' searches for comparable sales data

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Evaluating the feasibility of a property tax appeal becomes increasingly complex when property sales activity slows. While taxpayers can still launch a successful appeal in a market that yields little or no recent sales data, the lack of optimal deal volume does require a thorough understanding of valuation methods beyond the sales-comparison approach.

This article will provide critical information for taxpayers in a low-transaction-volume market to successfully contest property tax assessments directly or to better vet industry experts to assist in those appeals. Many of the concepts are valuation-oriented, underscoring the need for an in-house or outsourced expert to guide appeals that venture outside the parameters of conventional, comparison-based valuations.

Brave new markets

The market for commercial office space changed, perhaps irrevocably, during the COVID-19 pandemic. Occupier demand in the sector has steadily decreased since then. The widespread adoption of remote work, space sharing, and similar practices have persisted and, as a corollary, physical and economic occupancy rates for office space have plummeted, along with rents.

Much of the recent transaction volume for office properties has been by distressed sellers forced to sell due to their inability to refinance. Moreover, assessment boards or courts generally reject these sales as poor evidence of fair market value.

Conversely, at the high end of the market there has been a flight to quality; historically, the top-scale properties have always found both buyers and tenants. Valuing buildings that occupy the middle space between these two extremes is perhaps the most challenging, however, and demands a more complex approach suited to the scarcity of comparable market transactions.

Dealing with data

The key to establishing value under these circumstances can be to expand the geographical area of the transaction search and to include less-recent sales for comparison. While those may seem like easy solutions, as in most nuanced situations, the devil is in the details.

These details include the need to vet the accuracy and defensibility of the appraiser's adjustments once a wider net has snared potentially comparable sales. Or more generally, how should the appraiser adjust expanded sales areas and older deals to demonstrate accurate value for the building in the current market?

There is no hard-and-fast rule that comparable sales need to be in the same city or, for that matter, same county.

In a sales-comparison approach, an appraiser can expand the geographic area for current sales beyond the immediate vicinity of the subject property. There is no hard-and-fast rule that comparable sales need to be in the same city or, for that matter, same county.

Real estate appraisers often establish a market area that includes not only the county of the subject property but also several surrounding counties, as long as they are "similar." For most commercial properties, similarity for valuation purposes depends on key geographic and demographic qualities.

The appraiser may use analyses of population data, household incomes and traffic patterns to justify adjustments to expanded sales areas for the current market. These are universally accepted valuation elements for retail properties but can also apply to other property types to aid in adjusting market areas.

Sales from previous calendar years, such as those going back five years or so, can still be relied upon to establish current market value if the properties share similar structural and geographic qualities. Using these older sales as a starting point, the appraiser must make critical adjustments for changes in the market conditions that have occurred since the date of the prior sales.

Needed adjustments typically include allowing for current market occupancy rates, both economic or leased rates and physical, onsite occupancy. Elevated levels of unleased space or leased but underutilized offices create a major risk to buyers, driving them to demand higher capitalization rates (and lower asset prices) to reflect increased risk.

In valuation, rising cap rates trigger downward adjustments in overall market value. Also, operational costs have increased markedly in the past few years, especially for insurance. Appraisers must reflect these additional costs in their adjustments to older transaction data.

Complementary approaches

Appraiser training teaches multiple valuation methods, providing alternative methods for establishing value when deal volume is low. These include surveying market participants and analyzing brokers' for-sale listing volumes, length of market exposure, and rent or net-income differentials. When taken together, this data will provide reliable information that enables an appraiser to make accurate adjustments and demonstrate current market value for a subject property.

In addition to the sales-comparison approach, commercial property owners can and should consider other valuation methods to establish the current market value of their property. With knowledge of current market rental rates, expense ratios, lending requirements and capitalization rates, an owner can value their commercial property using the income approach, for example.

The more recent the respective leases were negotiated and signed, the more indicative of the current market rental rate. Current expense statements and capitalization rates can be used to ultimately present a credible, current market value of the property.

Taxpayers deciding whether to appeal a property tax assessment might be frustrated or confused by the market's low deal volume. Property tax professionals are equipped to provide advice and assessment appeal strategies in any market type, however. That means tax relief might be available despite the difficulty the current market has placed on the sales-comparison approach to valuation.

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