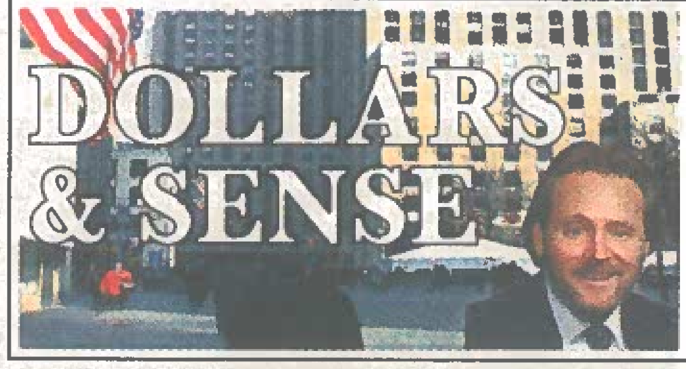

with Bob Knakal

Taxing times

Q: I just received my new real estate tax assessment and the city tells me that my property is worth much more than it ever has been. How can this be?

A: The inequities in the present real estate tax system are such that it is hard to comprehend and even harder for the Department of Finance to explain.

When we analyze the market, we do so from the perspective of volume and value.

It is clear that we are well past the market's low point in terms of sales volume.

Aggregate sales volume since the second quarter of 2009 has steadily increased on a market wide basis, although Manhattan has been recovering much more tangibly than the outer boroughs.

With regard to value, despite the general perception that values increased in 2010, the numbers tell a different story.

Large transactions involving "core" or "institutional" assets grabbed many of the headlines in 2010.

In that market segment, values did increase in 2010, particularly in the Manhattan market.

However, average prices per square foot dropped in 2010 by 8.4% from 2009 levels.

This is because there were only 49 sales with prices above $50 million in 2010 out of a total of 1,667 properties sold. These core assets, therefore, represented only about 3% of the total sales occurring last year. When all properties are included in the analysis, the 8.4% drop is derived.

Last year's value reduction brought market wide values to a level 38% below peak levels attained in 2007.

On a positive note, the rate of value decline in 2010 slowed dramatically as the year progressed, indicating that we are probably at or just past the value low point on a market wide basis. However, it is not possible, under any

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Taxing times

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circumstances, to not have observed significant reductions in value from 2008 through the present.

This is what makes real estate tax policy so difficult to understand.

According to the fiscal year 2012 tentative assessment rolls, Manhattan office buildings are valued at 15.94% above their peak 2007 levels. Multi-family apartment buildings are valued at 21.96% above their 2007 peak levels. This is absurd and simply cannot be the case.

Increasingly, legislators have relied on the real estate industry for tax revenue. And this trend is nothing new.

Today, we have seen values drop and property owners I speak to indicate that assessments have consistently increased throughout this most recent recession.

Currently, major office buildings in Manhattan can pay as much as 25% of gross revenue in real estate taxes.

"The system does not work and there is very little that can be done about it other than to constantly fight for reform."

Given the costs of building and the resultant required rents needed on a per square foot basis, real estate taxes can be as much as $25 to $30 psf on a new building.

This has created a tremendous impediment to new construction of desperately needed new office product in the city. On the multi-family front, real estate taxes are now targeted at as much as 33% of gross revenue which can eat up nearly half of net operating income, and that is before any debt service is taken into consideration.

Taxes per square foot on new rental buildings and condos can reach $20 to $30 while co-ops with similar values can have taxes of just $7 to $10 psf.

On top of these conditions, we have seen the Robert's decision on Stuyvesant Town/Peter Cooper Village obliterate any desire for owners to take advantage of the J-51 benefits and, last December, the 421-a tax abatement program expired.

Legislators opposed this benefit as they saw "rich" condo buyers as getting tax breaks. What they didn't see was the thousands of affordable housing units which were constructed based upon the program's existence which create the tax benefits for Derek Jeter, Alex Rodriguez and others.

They thought new 80/20 buildings would solve the problem but without 421-a benefits, it is challenging to build one of these properties.

These dynamics are strangling investment properties with massive real estate tax bills.

There already exists a significant bias against income producing properties in the calculation of tax burdens in the city. Single family homes, co-ops and condos represent about 49% of the total real estate value in the city, yet pay just 15% of the taxes. Multi-family rentals represent 24% of value but are saddled with 40 % of the tax burden. Class 3 and 4 properties and multi-family rentals contribute 68% of all real property taxes.

Perhaps the thing the Department of Finance is most concerned about is a lawsuit which forces them to uncover the methods used to determine tax assessments.

I understand that they make "adjustments" to real property income and expense forms (RPIEs) – randomly making assumptions about how much rents increased and how much expenses decreased since the forms were filed.

Can you imagine they could think expenses actually drop when taxes increase at a double digit rate and water and sewer bills have risen by 14 -15 percent for 5 years running?

Who are they kidding? Can you imagine what would be discoverable in the form of internal emails and other correspondence regarding how to make sure tax bills keep rising regardless of market conditions, income, expenses or additional regulatory requirements?

The system does not work and there is very little that can be done about it other than to constantly fight for reform.

What I have seen, however, is a growing number of investors getting fed up with the constantly increasing real estate tax levels who are deciding to invest outside of New York.