

California Property Tax Alert

In the localized world of property tax, every state is unique. However, none may be quite as difficult to manage or quite as important to a portfolio owner's bottom line as California, where a failure to control some of the highest property values in the nation can have a dramatic impact on operating budgets, particularly in today's uncertain economic climate.

As the downturn continues, many institutional real estate companies including REITs are coming under increasing pressure from shareholders to achieve the returns promised on large property acquisitions that have been consummated over the past several years. With most commercial owners choosing not to market their properties, there is little relevant direct market evidence of diminution in value. This absence of solid anecdotal market evidence creates an especially difficult environment in which to appeal property taxes and instead leads to the continuation of properties being assessed at their original Proposition 13 base year acquisition values trended upward annually, by the 2% California CPI. Add to this the confusion often created by the state's two annual appeal deadlines which vary by county; some are on September 15th and others are on November 30th, and the fact that supplemental assessment notices and bills can be issued at any time and carry a 60-day appeal window.

At Paradigm Tax Group, we have recently engaged several large California property owners for real estate tax reviews of their properties acquired over the past 2-3 years. Our analysis examines the relationships between the anticipated performance and purchase criteria at the time of the acquisition versus the current financial performance of the property. We rely on a number of criteria such as:

- Cost of capital
- Cap rates (especially absent of any risk component)
- Slow growth in rental rates
- Absorption of vacant space
- Credit-worthy tenants versus risky tenants

Paradigm Tax Group has developed resources that can make comparisons between:

- Acquisitions completed using extremely low cost of funds, no risk premiums in the cap rates, and aggressive rental growth assumptions
- vs:
- Actual financial performance analyzing real income, expenses, and rent rolls.

Based on our sophisticated evaluation and analysis, we can often draw conclusions that there has been a significant deterioration in the financial performance of many office and retail properties in various markets where there are not yet sufficient open market sales indicating declining values.

To compound the situation, the minimal growth in both lease rates and returns on investment have caused some investors to put pressure on REIT executives to bolster cash flows and increase property values. With no further action to reduce operating costs before the upcoming appeal deadline, some portfolio owners may be forced to divest properties below their original purchase price or risk losing



them to lenders, if heavily leveraged. While at that point, we will have the market evidence to justify lower tax assessments, property owners can ill afford to wait until then.

Thus, in today's economic climate, with little market transaction evidence to support tax assessment reductions, making a case for tax relief requires a demonstration of trends and a difficulty in meeting the original acquisition proforma assumptions supported by the type of analysis described above. For more information on specific county appeal deadlines, or to schedule an initial review of your California portfolio performance, please contact Paradigm Tax Group at any of our offices listed below:

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