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# A SECOND OPINION

LANDLORDS COULD SAVE MILLIONS BY APPEALING PROPERTY-TAX ASSESSMENTS

By Steve McLinden



FOR MUCH OF THE RETAIL REAL ESTATE WORLD, MARCH MEANS more than the start of spring. It marks the dawn of property-tax season. And many shopping center landlords operating on thin margins could find that such tax-saving strategies as an aggressive appeal of their assessments may well tip the balance sheet toward profitability.

"Property taxes are usually the largest expense of any real-estate-related company," said Joseph Calvanico, a director at Chicago-based accounting and consulting firm Crowe Horwath. "But for the most part, only 25 percent to 30 percent of owners appeal these taxes."

Commercial-tax specialist John Brusniak, of Dallas law firm Brusniak Blackwell, discovered that one property owner was being overtaxed between 11 percent and 14 percent across its entire retail portfolio. The firm was able to help that client save multiplied thousands of dollars in tax appeals.

The recognition of depressed property values on the part of tax assessors varies from county to county, says Brusniak. "Some of them are aggressive in recognizing the downturn, while others are responding to local pressure to hold the line in hopes the revenue bottom won't fall out," Brusniak said. "And because there's not enough capital out there to engage in transactions, there aren't many [value] benchmarks to look at, because there's very little selling going on."

As of a few years ago, most assessors valued properties through an income analysis that equated a retail center's tax liability with the average retail rents in the market, not with what that center's rent rolls reflected, Brusniak says. Now assessors are just starting to base values on actual income and such variables as lease expirations. But owners planning to use their centers' income in a tax appeal must take the lead and factor in such expenses as lost or departing tenants, renegotiated leases, rent concessions and tenant improvement dollars, he says.

Centers that were under construction during the boom and were completed during the bust face another set of valuation challenges; taxing districts typically try to assess them based on their construction costs, not necessarily on what they are worth now, says Brusniak. "The reality is that most



assessors are many months behind, because they are dealing with old data," he said.

Property owners attempting to manage their own shopping centers may be

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putting themselves in a precarious tax position if they are not filling spaces aggressively, says appraiser Jumana Judeh, of Dearborn, Mich.-based Judeh & Associates. Tax officials may simply decide such owners are not aligning properties to market and thus assess the higher value, she says. "If the average market occupancy is 60 percent occupancy, and their property is only 40 percent occupied, it may be taxed like it's 60 percent occupied," said Judeh. Some three-fourths of the Detroit-area properties Judeh has appraised in two decades of practice were overassessed, she says, and in better than nine out of 10 such cases, the owners were able to reduce the tax burden on appeal from 30 percent to 50 percent.

"Retail became the poster child of overassessed valuation because it's the only property type where assessors can roam through your business," said Frank Lima, Crowe Horwath's national tax director. Sometimes what assessors see is deceptive, Lima says. To remain occupied today, a mall must often execute several short-term leases or adjust leases with rent reductions. "Those aren't visible to the assessor on the walk-through, of course," Lima said.

Some owners will not contest their

valuations for fear that their lenders will re-evaluate loans and demand additional payments if values fall, or that they will offer less-favorable terms in a refinancing, says Cathy Harris, a director of Cost Segregation Group, Norfolk, Va. Harris specializes in cost-segregation study, which can create sizable tax savings. In such a strategy, an itemized property analysis is done that segregates costs for each of the property's components. In most cases, these expenses can be allocated into the most-advantageous tax category possible.

"This creates significant accelerated-depreciation deductions for owners," said Harris. In some scenarios cost-segregation studies will be useful when a center changes hands, because both buyer and seller can structure the sale to maximize depreciation benefits — savings of up to 22 cents on the dollar, Harris says. Frequently, the use of fewer tax-classification details in a sales transaction can actually benefit both parties, because each can judge which tax class to use for allocation.

A shopping center sale may also involve both a transfer tax and an increase in the property-tax assessment, so an owner may want to consider getting a deal-price analysis or a purchase-price allocation for additional tax savings, says D. Cameron Moore, a principal at Atlanta-based Paradigm Tax Group. "These tax savings typically range from 15 percent to 25 percent of the transaction's face value, depending on the type of shopping center sold," he said. Oddly, though, only relatively small numbers of center owners are jumping on the tax-appeal bandwagon, despite the potential savings, Moore says. In the Southeast commercial property values fell by about 25 percent between 2008 and 2010, based on transactions, he says. But in that span the number of appealed assessments, many of them based on pre-bust values, ranged from just 25 percent to 30 percent.

The tax relief measure enacted in December will give some center owners a delayed Christmas gift spread out over the next few years, tax specialists say. The legislation extended bonus depreciation — the deductions permitted beyond the normal depreciation allowance — through 2012 and also approved depreciation allowances for property improvements made from last September through this year.

Additional tax-saving opportunities remain available to owners under certain circumstances. Tax credits and incentives are available to expanding or relocating commercial property owners, but most are awarded only to projects that can demonstrably create jobs and boost revenue, says Moore. Brusniak concurs. "Tax-credit projects are quiet now — nobody is making any moves," Brusniak said. Legislatures are clamping down on tax incentives in part because of budgetary constraints, he says.

Tax firms can assist retailers and restaurants, too. Such firms can help chains with multiple stores of similar size and product to set up a flexible tax prototype, Lima says. "Retailers often have more assets on the books than what is actually on premises," he said.

Many big-box stores, pharmacies and restaurants still have above-market assessments driven by long-term leases that have since been adjusted and no longer reflect fair-market value, says Moore. For owners of anchored retail properties, a comparison of sales per square foot to median-occupancy cost may be the most useful tool for explaining in appeals court how the downturn should result in a lower assessment, he says, but time is of the essence.

"If owners don't give professional presentations," Moore said, "or [if they] fail to actively challenge assessments, they won't receive the relief they're seeking and will be required to wait another year before they can file a subsequent protest." SCT