

# Protesting Commercial Property Taxes



by Pat O'Connor

Are you accustomed to seeing large numbers in the “property taxes due” column of tax statements? Property owners in Texas, a state with notoriously high property taxes, may be forced to budget a “big chunk” of their operating budgets each year for property taxes. You should always be looking for a way to increase the return on your investment, and reducing property tax expenses can have a significant impact on your bottom line.

## Market Value vs. Assessed Value

Many self-storage investors have asked why Texas property taxes keep increasing even though their revenue has declined and operating expenses have increased. Since appraisal districts value so many properties, they are often not aware of “softness” in a submarket. In addition, some appraisal districts have been slow to recognize the huge increases in insurance expenses. Since property taxes are such a material expense, self-storage investors have realized they need to review assessments annually. **Most Texas real estate investors appeal their property tax assessment annually.**

## Why Property Taxes are Important

Property taxes are one of the largest line item expenses incurred by self-storage owners. When attempting to cut excess property taxes, even sophisticated property owners may not know all their rights. For instance, the current Texas Property Tax Code allows property owners to seek an equity adjustment based on comparable properties that are appropriately adjusted.

## Does Unequal Appraisal Apply at Informal Hearings?

The legislature also introduced a provision in 1997 attempting to allow property owners to appeal on unequal appraisal during the administrative hearing process (informal and appraisal review board hearings). Unfortunately, the wording of the statute was not clear. Some appraisal districts have chosen not to consider appeals based on unequal appraisal at the administrative hearings. It's a shame that many appraisal districts rebuff administrative appeals based on unequal assessment. Property owners become very angry when they feel they have been taxed unfairly. Fortunately, most cases of inequitable assessment can be resolved through a judicial appeal.

## Why Aren't Properties Assessed Equally?

You may be wondering why properties aren't assessed equitably. Reasons include data errors, focusing on recent sales and inconsistencies in the informal and appraisal review board hearings due to the personal element. Since an appraisal district may track over a million real property accounts, it is unrealistic to expect all of the data to be accurate (the large number of properties also affects their ability to accurately estimate your property's value). Overstating the quality of one self-storage facility while understating the quality of another facility could lead to an inequitable assessment. At times, some appraisal districts have focused on recent sales without reassessing all the properties in the surrounding area. Once the preliminary research is completed, the owner should determine the market value of the

property and whether it is in line with the total assessed value. There are three approaches that are employed in concluding market value: cost, income and market. **For self-storage facilities, the appraisal district primarily relies upon the income and market approaches to value.** Therefore, the property's occupancy rate, rental rate, operating expenses, net operating income and other factors, as well as sales prices of comparable properties, are valuable sources of information in determining market value. If the property owner determines that the assessed value is higher than the market value of his property, he should file a protest with the local appraisal district. This can be done either by the property owner or his designated agent. **Property tax protests must be filed by May 31 in Texas; deadlines vary by state.**

## Preparing for Your Hearing

Once a protest has been filed, a protest hearing will be scheduled. Four types of data should be compiled for the hearing: pictures of the subject property, an income analysis, comparable sales data and assessment comparables. Pictures of the subject property should indicate the quality and condition of the improvements on the property. If there is deferred maintenance, document it with pictures and bids. An income analysis should include a profit and loss statement for the previous year and a rent roll for a date near January 1 of the current tax year (most states use January 1 as the effective date for assessment.) The analysis should also detail market rent, market vacancy and market expenses (including reserve

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for replacement) to derive net operating income for the property (neither depreciation nor debt service should be deducted when calculating net operating income).

If your property has above-market occupancy or rental rates or below-market operating expenses, you should make adjustments when calculating net operating income. If you operate your own property, your income analysis should include an allowance for labor and management fees (if they are not in the profit and loss statement). Revenue not directly related to real estate rental (box sales, truck rentals, etc.) should be excluded. Related expenses should also be excluded. The net operating income is then capitalized to derive an indication of value for the property.

An appraisal may be appropriate to support the value conclusion. Comparable sales are given strong consideration at the hearing because they are an indication of market value. Data from sales of comparable properties for the past year or two should be collected and reviewed. Assessment comparables are given strong consideration at some appraisal districts but not considered at others. Pictures of competing self-storages that are assessed for less than your property can be an effective tool for cutting your property taxes. Prepare a table summarizing your property and the assessment comparables.

### Attending Your Hearing(s) (Informal and Appraisal Review Board)

Once all the pertinent data has been collected and analyzed, the protest hearing process begins. The initial protest hearing is called an “informal” hearing. The informal hearing involves a meeting between the owner, or his designated representative, and an appraiser from the appraisal district. If the owner is not satisfied with the offer made by the appraiser, he may proceed to the next level of the protest process, an appraisal review board hearing (in some states this is referred to as the *board of equalization*). The appraisal review board hearing, also referred to as the “formal” hearing, involves a meeting with members of the appraisal review board, an appraiser from the county appraisal district (who may be different from the appraiser at the informal hearing) and the owner or his designated representative. The Appraisal Review Board panel may set a value which is equal to, lower than or higher than the level proposed by the staff appraiser at the informal hearing; therefore, the offer made at the informal hearing deserves careful consideration.

The majority of protests are resolved during the informal and formal hearings. However, in a small portion of protests the property owner believes the assessed value can be cut further by filing a judicial appeal. Although few owners pursue the final opportunity to reduce their taxes,

owners have the option to file a lawsuit to contest the assessed value. It is probably financially feasible to file suit if the judicial appeal will reduce the assessed value by at least \$200,000 to \$300,000. This rule of thumb is for Texas; it may be higher or lower in other areas. In Harris County (Texas), for example, about 500 to 800 property owners annually determine there is still enough discrepancy after completing the informal and formal hearings to further pursue an adjustment in the assessed value by filing suit.

Litigation in Texas must be filed within 45 days of receiving written notification of the value set at the formal hearing. This process can result in additional reductions in the assessed value; however, it typically takes 12 to 24 months and requires services from both an attorney and an appraiser. Although relatively few owners understand how to pursue judicial appeals, they can be a very effective tool in lowering property taxes.

With property taxes making up such a large percentage of operating expense, a commercial property owner I know was recently pleased when his consultant informed him that the company saved over \$123,000 in property taxes. Some owners will realize less savings than those, but every little bit helps your bottom line.

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## About the Author

Patrick O'Connor, author of “*Cut Your Texas Property Taxes*” and president of O'Connor & Associates. O'Connor & Associates handled 25,000 property tax protests in 2002 – more than any other firm in Texas. The firm is currently

supervising approximately 450 property tax lawsuits. Mr. O'Connor has been involved in commercial/residential appraising, cost segregation and market research and consulting for 20 years.



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