

New Method to Reduce REIT Property Taxes Stock price offers a reliable indicator for assessed value.

By: Stephen Paul, Esq.

Assessing the value of REIT assets for property tax purposes has historically been an ordeal for assessors, as well as for owners challenging their work. Published data indicates that property values have dropped over the past two years, but the lack of sales leaves relatively little to prove the declines. Without an active market of REITs buying and selling property, the sales comparison approach to value loses its usefulness. Even if taxpayers and assessors agree that properties in most REIT sectors are best valued under the income approach, decisions about estimates of future income streams, capitalization rates, and other factors required under the income approach often breed intense discord. These difficulties are amplified in today's market due to lower predictability of occupancies, lease terms, and percentage rents. Thus, REIT owners need new ways to substantiate for the tax authorities the decline in their property values.

Stock prices are telling

In many REIT sectors, declining stock values actually have the potential to provide suitable proof of decreasing property values. Since the trend in a REIT's stock price represents the market's prediction of the direction in which the capitalized funds from operations of the REIT likely will move, readily available stock market data could be used to show an assessor that assessed values should be reduced.

This methodology is particularly appropriate for REIT properties. The stock price for any ordinary non-REIT company, in effect, states how the market values the company's assets, but any indication of the value of the real property itself is unclear.

REITs are different. By definition, REIT assets comprise investments in real property. To qualify as a REIT, at least 75% of income must come from real estate sources, and at least 95% of income must be derived from interest, dividends, and the property itself. The trend in the value of a REIT stock thus reveals how the market values the income-producing capability of the REIT's real property. Prediction of a property's ability to generate income is precisely what the income approach to value in property assessment attempts to accomplish. The income approach estimates future benefits from ownership of the property. But this estimate requires extensive market research to evaluate risk factors in order to accurately predict income streams and expenses.

Examples of these risk factors include whether tenants and locations are favorable, whether acquisitions were prudent, the likelihood that locations will go dark, and the extent to which rent collections might be in jeopardy. Evaluating such risks is problematic during a deep recession like that experienced currently.

In setting the stock price, however, the market already has evaluated the risk factors associated with the properties of a particular REIT. The market has performed the research that is so troublesome in a difficult economic climate. Because the trend in a REIT's stock price represents a statement by the market in direct relation to the real property itself, the trend in value of the stock price can provide valuable support for reduced assessments and input for analysis under the income approach. Understanding that REITs generally own many properties, often in multiple states or even worldwide, it should be acknowledged that stock price cannot determine with precision assessed values of individual properties. But the correlation between a REIT's stock price and its property value can be employed to demonstrate the necessity for some assessment reduction on individual properties.

Here's how

A simple linear regression analysis provides an ideal tool to prove the correlation between a REIT's stock price and the value of its properties. To illustrate the point, let's use data from an actual REIT property in the Midwest.

Assume the REIT appeals the 2008 assessment of one of its properties. That property is assessed for 2008 at \$5.6 million when the REIT's stock is trading at

\$11.50 per share. Assume further that the assessed values and stock quotes have been as follows over the last six years:

Assessed Value

Year	Stock Quote (\$millions)	Assessed Value (\$millions)
2002	\$9.95	\$3.74
2003	\$11.99	\$4.07
2004	\$14.51	\$4.42
2005	\$15.3	\$4.96
2006	\$18.00	\$5.26
2007	\$22.16	\$5.40

Plotting the stock quotes on the x-axis and assessed values on the y-axis of a graph produces a scatter diagram as shown in the accompanying chart. Using a simple linear regression formula, a trend line can be drawn through the data.

Because the trend line so closely matches the assessments across the six year period, it clearly illustrates that the stock price correlates very closely to the assessed values. Thus, stock price is a reliable predictor of assessed value.

This demonstrated correlation is not exhibited, however, by the 2008 assessment on which the REIT has filed an appeal. During the period illustrated in the chart, the increase in stock price from \$9.95 in 2002 to \$22.16 in 2007 had been matched by increases in assessed value from about \$3.7 to \$5.4 million.

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But a further increase in assessed value to \$5.6 million for 2008 is inconsistent with the stock losing nearly 50% of its value and falling to \$11.50 per share.

Therefore, the REIT owner should urge the assessor to reduce the property's 2008 assessment.

In the current market, demonstrating that assessed values should be reduced demands resourcefulness. Absent comparable sales and easily identified factors under the income approach, analysis of the correlation between stock performance and assessed value can help demonstrate a necessary reduction in assessed value.

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