

The Changing Face of Property Tax Appeals...

**Rubenstein Real
Estate**

April 19, 2015

Unseen Costs of Development ...

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Vocabulary–

- ▶ ADOR – Arizona Department of Revenue
- ▶ ATC – Arizona Tax Court
- ▶ FCV – Full Cash Value
- ▶ LPV – Limited Property Value
- ▶ SBOE – State Board of Equalization

Calculation –

$$\text{LPV} \times \text{Assessment Ratio} / 100 \times \text{Tax Rate} \\ = \text{Property Tax } \$\$$$

Topic For Today:

Impact of Arizona's Proposition 117

Proposition 117

- Implemented as of January 1, 2014 for the 2015 tax year
- Changes how property taxes are calculated
- As of the 2015 tax year, property taxes are calculated on the Limited Assessed Value (“LPV”)
- Limits the annual increase of LPV to 5% subject to 4 categories of exceptions
- Primarily A.R.S. 42-13301, et al.

► Arizona Revised Statutes Title 42, Chapter 13

Article 7 Limitation on Valuation Increases

42-13301 Limited property value

42-13302 **Determining limited value in cases of omissions and changes**

42-13304 Exemptions from limitation

A.R.S. 42-13301

Limited property value

- A. The limited property value of property for property taxation purposes is the limited property value of the property in the preceding valuation year plus five per cent of that value.
- B. The current limited property value of a parcel of property shall not exceed its current full cash value.
- C. The limited property value of a parcel of property shall be determined and shown on notices and tax rolls as the total limited property value of the property. Separate determinations shall not be made for the limited property value of land and for the improvements on the land in reference to property parcels.

A.R.S.42-13302 (A)

Determining limited value in cases of omissions and changes

- ▶ A. In the following circumstances the limited property value [LPV] shall be established at a level or percentage of full cash value [FCV] that is comparable to that of other properties of the same or similar use or classification:

Prop 117 Exceptions...

A.R.S. 42-13302(A) 1-4

Exceptions to 5% CAP on LPV

- 1. Property that was erroneously totally or partially omitted from the property tax rolls in the preceding tax year.
- 2. Property for which a change in use has occurred since the preceding tax year.

Prop 117 Exceptions...con't.

- 3. Property that has been modified by **construction, destruction *or* demolition** since the preceding valuation year.
- 4. Property that has been **split, subdivided *or* consolidated** from January 1 through September 30 of the valuation year, *except for* cases that result from an action *initiated* by a governmental entity.

In a Nut Shell...

When there is a Prop 117 exception...

- ▶ If an exception occurs, the LPV is not capped at a 5% increase.
- ▶ If an exception occurs, the LPV will be reset to a percentage of the FCV by what is called the 'Rule B Factor'.
- ▶ The Rule B Factor is set each year and was 93.5% of the FCV for Class 1, commercial property for the 2015 tax year.

► Hypothetical #1 –

- A 10,000 SF office building valued in the 2014 tax year with a FCV of \$500,000 and a LPV of \$500,000.

Scenario #1:

No changes to the property,
no Prop 117 exceptions,
only revalued by assessor

Scenario #1:

What happens to LPV in Scenario #1?

– 5% LPV increase –

Tax Year	Full Cash Value (FCV)	Limited Property Value (LPV)	Est. Tax (based on 2014 tax rate)	Taxes Per Square Foot
2014	\$500,000	\$500,000	\$15,510	\$1.55
2015	\$1,100,000	\$525,000	\$16,285	\$1.63

– *Minimal Actual Tax Increase – \$775.*

Same Hypothetical –

- A 10,000 SF office building valued in the 2014 tax year with a FCV of \$500,000 and a LPV of \$500,000

Scenario #2:

Property had a parcel split,
Prop 117 exception triggered
&
revalued by assessor

Scenario #2:

What happens to LPV in Scenario #2?

- Prop 117 Exception Triggered -

Tax Year	Full Cash Value (FCV)	Limited Property Value (LPV)	Est. Tax (based on 2014 tax rate)	Taxes Per Square Foot
2014	\$500,000	\$500,000	\$15,510	\$1.55
2015	\$1,100,000	\$1,028,000	\$31,903	\$3.19

- LPV recalculated using a 'Rule B' Factor
- Prop 117 Exception - Tax Increase - **\$16,393.**

Hypothetical #1 & Impact of Prop 117 –

- ▶ **Scenario #1 – No Prop 117 Exceptions**
 - Estimated Property Tax increase based on 2014 tax rates with no Prop 117 Exception = \$775

- ▶ **Scenario #2 – Property Split for 2015 tax year**
 - Estimated Property Tax increase based on 2014 tax rates *with Prop 117 Exception* = \$16,393

 - Estimated Property Tax impact is more than doubling the burden from \$1.55/SF to \$3.19/SF

Hypothetical #2

New Construction:

- ▶ Developer XYZ is constructing Class “A” apartment complexes throughout Pima County.
- ▶ In 2013 an 85 unit complex is built (pre-Proposition 117).
- ▶ For tax year 2014 the property is valued at \$75,000/unit or \$6,375,000. Both FCV and LPV are equal.
- ▶ Because of sales reaching \$150,000 per unit, the assessor determines that this property type should be valued at \$130,000/unit and increases the FCV for tax year 2015 to \$130,000/unit or \$11,050,000.

Class “A” Apartment Complex – Built 2013 – 85 units – Developer XYZ

Tax Year	Full Cash Value	Limited Value	Estimated Tax	Tax per unit
2014	6,375,000	6,375,000	\$106,891	\$1,257/unit
2015	11,050,000	*6,693,750	\$112,235	\$1,320/unit

***5% increase on the Limited Value (LPV). Minimal increase in tax- \$63/unit.**

Built 2013 –

- ▶ First complex is a **SUCCESS!**
- ▶ Developer XYZ decides to build a second complex in 2014 (tax year 2015).
- ▶ The assessor values the complex at \$130,000/unit same as the other complex.
- ▶ Because of the ‘new construction’ post Prop 117 how does that impact the taxes? *As compared to the complex built in 2013?*

New Construction –

Built 2015

Class “A” Apartment Complex– – 85 units – Developer XYZ

Tax Year	Full Cash Value	Limited Value	Estimated Tax	Tax per unit
2015	11,050,000	10,519,600*	\$176,384	\$2,075/unit

New Construction LPV is calculated using a Rule B factor of 95.2% (using 2015 factor for residential income) of FCV.

Full cash values for both projects are equal at \$130,000/unit but because of Proposition 117 the first complex is limited to a 5% increase on LPV.

New Construction –

Built 2013

Class “A” Apartment Complex – 85 units – Developer XYZ

Tax Year	Full Cash Value	Limited Value	Estimated Tax	Tax per unit
2014	6,375,000	6,375,000	\$106,891	\$1,257/unit
2015	11,050,000	*6,693,750	\$112,235	\$1,320/unit

Built 2015

Class “A” Apartment Complex– 85 units – Developer XYZ

Tax Year	Full Cash Value	Limited Value	Estimated Tax	Tax per unit
2015	11,050,000	**10,519,600	\$176,384	\$2,075/unit

* 5% increase on LPV.

**Limited Value calculated with Rule B 95.5%

Difference in taxes
\$755/unit

\$64,149/annual

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NOTE –

- ▶ These two apartment complexes generate the same Potential Gross Income.
- ▶ Located one mile apart and attract the same tenant pool.
- ▶ The property built in 2015 is estimated to pay \$755 more per unit in property taxes.
- ▶ Hypothetically it will take 11 years for LPV for the complex built in 2013 to catch up to the one built in 2015.

→ assuming the FCV stays the same, which it *will not*.

Takeaways on Prop 117



- ▶ It does not limit tax rate increases
- ▶ It does not limit increase in actual taxes to 5%
- ▶ A simple change in the property can have significant financial implications
- ▶ It limits the LPV – a component of property valuation
- ▶ Exceptions do exist and should be planned and closely monitored
- ▶ Maintaining property valuation vigilance can reduce overall tax burden
- ▶ Keeping FCV accurate matters

Remember...

- ▶ **Prop 117 *did not* limit tax rate escalations.**
 - It merely limited the increase in a component of property valuation.
- ▶ **Taxing districts are able to set higher tax rates each year based on their budgets and voter-approved bonds and over-rides.**



- ▶ Under the new law, an appeal filed in calendar year 2015 for the 2016 tax year may result in limiting the increases in the LPV for the 2017 tax year.
- ▶ This means successfully appealing a valuation for tax year 2016 now, potentially provides savings over a two year period or more.

Q & A

Just Ask...

Final Takeaways...

Significant exceptions and pitfalls
do exist and continue to emerge.

Prop 117

- ▶ implementation introduced a new methodology to property taxation in Arizona as of January 1, 2014.
- ▶ A well-informed property tax attorney or adviser may assist in:
 - The planning process
 - Anticipating exception implications of Prop 117

- ▶ Maintaining a tight spread between FCV and LPV is advantageous – especially when facing a Prop 117 exception.
- ▶ Property tax advisers – attorneys and tax representatives – often work on a blended fee, many with a contingency component.
- ▶ A reduction in property valuation may noticeably reduce overall taxes and a key expense burden.

Arizona Revised Statutes:

42-13301. Limited property value

A. The limited property value of property for property taxation purposes is the limited property value of the property in the preceding valuation year plus five per cent of that value.

B. The current limited property value of a parcel of property shall not exceed its current full cash value.

C. The limited property value of a parcel of property shall be determined and shown on notices and tax rolls as the total limited property value of the property. Separate determinations shall not be made for the limited property value of land and for the improvements on the land in reference to property parcels.

42-13302. Determining limited value in cases of omissions and changes

A. In the following circumstances the limited property value shall be established at a level or percentage of full cash value that is comparable to that of other properties of the same or similar use or classification:

1. Property that was erroneously totally or partially omitted from the property tax rolls in the preceding tax year.
2. Property for which a change in use has occurred since the preceding tax year.
3. Property that has been modified by construction, destruction or demolition since the preceding valuation year.
4. Property that has been split, subdivided or consolidated from January 1 through September 30 of the valuation year, except for cases that result from an action initiated by a governmental entity.

B. In the case of property that is split or consolidated after September 30 through December 31 of the valuation year, except for cases that result from an action initiated by a governmental entity, the total limited property value of the new parcel or parcels shall be the same as the total limited property value of the original parcel or parcels. For the following valuation year, the limited property value shall be established at a level or percentage of full cash value that is comparable to that of other properties of the same or similar use or classification. The new parcel or parcels shall retain the same value—adding characteristics that applied to the original parcel before being split or consolidated, except as provided in subsection A, paragraph 3 of this section.

C. In the case of property that was split, subdivided or consolidated from January 1 through September 30 of the valuation year as a result of an action initiated by a governmental entity, the limited value is the lower of either:

1. The level or percentage of full cash value that is comparable to that of other properties of the same or similar use or classification.
2. The total limited value for the original parcel or parcels as determined under section 42-13301, and in the following valuation year, the limited property value shall be established pursuant to section 42-13301.

D. In the case of property that was split, subdivided or consolidated after September 30 through December 31 of the valuation year as a result of an action initiated by a governmental entity, the total limited value for the resulting parcel or parcels is the same as the total limited value for the original parcel or parcels as determined under section 42-13301, and in the following valuation year, the limited property value shall be established as the lower of either:

1. The level or percentage of full cash value that is comparable to that of other properties of the same or similar use or classification.
2. The limited property value established pursuant to section 42-13301.