When the Sale Price and Assessment Differ

Lessons from a multi-tenant industrial assessment appeal

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Introduction

Section 1: the property, the sale, the enrolled value, and why the reassessment occurred

Introduction: The Property

The property

- Multi-tenant industrial park in the City of Los Angeles
- Three buildings on nine assessor parcels
- ~77,000 SF net rentable area in 18 suites
- Built 1959 to 1988; one metal building
- 100% leased at sale, many leases below market
- Sold with a companion property the same day



Introduction: Purchase Price vs. Enrolled Value

Purchase price

$16.0M

~$208 per SF

Originally enrolled

$26.0M

~$338 per SF

Revised for hearing

$21.7M

~$282 per SF

Under Property Tax Rule 2(b), a deviation of more than 5% is needed to set the price aside.

The Transaction

Section 2

Five Deeds Recorded the Same Day Total $16.0M, the Price Paid for the Property

Deed	Buildings included	Interest conveyed	Implied price
Deed A	1, 2, 3	27.5%	$4,300,000
Deed B	1, 2, 3	22.5%	$3,500,000
Deed C	1, 2, 3	7.5%	$1,550,000
Deed D	1, 3	42.5%	$2,050,000
Deed E	2	42.5%	$4,600,000
Total			**$16,000,000**

What the deeds show

- **The five prices sum to $16.0M,** the price paid for the property
- **A different net figure:** the buyer paid its broker's $164,500 commission directly, netting the price to $15,835,500
- Deeds A–C conveyed interests in all three buildings; one 42.5% interest was split into two deeds by building

The buyer's broker confirmed an arm's-length sale with competing offers



Competing offers

The seller received multiple offers and letters of intent in line with the final price.



Highest bidder

A sophisticated national investor, selected for offering the highest price.



Informed seller

A sophisticated owner of properties throughout the region.



Companion sale

A second park sold to the same buyer the same day.

Property Tax Basics – Legal

Section 3: who assesses, how appeals work, the legal definition of value, and the lifecycle

Property tax is assessed locally, under state law, on real and personal property

Real property

- Land
- Buildings and improvements

Personal property

- Business equipment
- Machinery, furniture, and fixtures

Exempt or preferential

- Government-owned property
- Religious, charitable, or educational uses

Who assesses

The local (county) assessor, under state statutes rather than federal law. Property tax rules differ by state, so start with the state code and the local rules.

In this case: real property only, a leased industrial park reassessed on a change in ownership.

An appeal challenges the assessed value, not the tax rate

What an appeal is

- A legal process to challenge the assessed value and correct errors
- Not a protest of the tax rate
- Governed by state and local law; in California, with guidance from the State Board of Equalization

Who can appeal

- Owners, or authorized agents such as attorneys and tax consultants, with a legal interest and a timely filing

Common grounds

- **Overvaluation:** The value is above fair market value
- **Unequal assessment:** Compared with similar properties
- **Incorrect property data:** Size, condition, use, or occupancy
- **Missed exemptions or caps:** Relief the law provides but was not applied

In this case: overvaluation after a change in ownership, plus incorrect property data, because the assessor did not inspect the buildings or verify their size

Appeals move from informal review to the appeals board, then to court

1

Informal review

Discussion with the assessor's office

2

Administrative hearing

Local board, the Assessment Appeals Board (AAB), or a hearing officer or panel

3

Judicial appeal

State court; some courts review de novo

Where this case sits: an Assessment Appeals Board hearing.

At the hearing, the Property Tax Rule 2(b) presumption, the Property Tax Rule 305.1 exchange, and the evidence each side brought were all at issue in this matter.

Property Tax Rule 2(b) – Purchase Price Presumption

- *"When valuing real property … as the result of a change in ownership … for consideration, it shall be rebuttably presumed that the consideration valued in money, whether paid in money or otherwise, is the full cash value of the property."*
- *"The presumption shall shift the burden of proving value by a preponderance of the evidence to the party seeking to overcome the presumption."*
- *"The presumption may be rebutted by evidence that the full cash value of the property is significantly more or less than the total cash equivalent of the consideration paid for the property."*
- *"A significant deviation means a deviation of more than 5% of the total consideration."*

Presumption

The consideration paid is rebuttably presumed to be full cash value.

Burden

The party seeking to overcome it must prove value by a preponderance of the evidence.

Threshold

A significant deviation is more than 5% of the total consideration.

California defines value as the fee simple interest exposed to the open market

RTC §110(a)

"...the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other..."

What it means

Value assumes open-market exposure and informed parties acting without pressure.

Property Tax Rule 2(a)

"...the price at which the unencumbered or unrestricted fee simple interest in the real property... would transfer for cash or its equivalent..."

What it means

The appraiser values the fee simple estate, so in-place leases are replaced with market rent.

In this case: the property was "marketed" to potential buyers, but not placed on listing databases. The buyer acquired the leased fee interest with below-market rents.

Property Tax Basics – Valuation

Section 4: approaches, adjustments, the appraisal unit, and cap rates

Parcels that function and sell together form one appraisal unit

AH 502 factors for treating multiple parcels as one appraisal unit

1. **Functional and economic integration**
   One industrial park, one rent roll, one operator
2. **Highest and best use as a unit**
   Continued operation as a single multi-tenant park
3. **Contiguity**
   Nine parcels form one contiguous 2.9-acre site
4. **Common ownership**
   Held by one seller group; bought by one buyer
5. **Combined sale**
   All parcels transferred together on one day

"The final decision as to the appraisal unit is a matter of judgment, and no single factor can be considered controlling."

Assessors' Handbook Section 502, p. 2

Why it matters here

All five factors point to one unit. Valuing a single parcel or one deed in isolation misstates the property that changed hands.

Property Tax Rule 4

"When reliable market data are available with respect to a given real property, the preferred method of valuation is by reference to sales prices."

Subsections (a) through (d) list what the assessor shall adjust for:

4(a) Cash equivalence

Convert a non-cash sale price to its cash equivalent

4(b) Property rights

Convert a sale encumbered by debt or a lease to its unencumbered fee price

4(c) Market conditions

Adjust each sale for price-level change to the valuation date

4(d) Comparison

Physical attributes, location, legal restrictions on use, and the income and amenities each property produces

Qualitative or quantitative adjustments?

Quantitative

- A percentage or dollar adjustment for each element
- Property Tax Rule 4 uses the language of conversion and adjustment
- Shows the math

Qualitative

- Rank each sale as superior, similar or inferior
- Common in practice and recognized in appraisal texts

Main & Von Karman Associates v. County of Orange (1994) 23 Cal.App.4th 337

- The assessor ranked unadjusted sale prices as superior, inferior or equal and made no adjustments. That differs from qualitative adjustments to elements such as location or size.
- AH 502 (p. 37): a value from a “range of values” or an “overall adjustment” is not in accord with Property Tax Rule 4. AH 501 (p. 89): adjustments “may be measured using a variety of quantitative and qualitative techniques.”

Takeaway: adjustments must be appropriately supported. Showing the work gives the report a better presentation.

Property Tax Rule 8

"The capitalization rate may be developed by either of two means…" The market-derived rate "is preferred when the required sales prices and incomes are available."

Subsections (d), (f) and (g) set the income to capitalize and how the rate is built:

8(d) **Income as if unencumbered**
Capitalize the income the property would yield if not encumbered by a lease

8(f) **Property tax component**
Load the rate with the estimated future tax rate times the assessment ratio

8(g)(1) **Market-derived rate**
Compare net incomes of recently sold comparable properties with their sales prices

8(g)(2) **Band of investment**
Weight debt and equity rates appropriate to the California money markets

Not in Property Tax Rule 8: investor surveys, broker opinions, national averages.

Property Tax Rule 305.1 – What Each Party Can Exchange

Comparable sales data, Property Tax Rule 305.1(a)(1)

- Parcel number or address
- Approximate date of sale
- Price paid and terms, if known
- Zoning

Income data, Property Tax Rule 305.1(a)(2)

- Gross income
- Allowable expenses
- Capitalization method
- Rate or rates employed

Property Tax Rule 305.1(c): once information is exchanged, a party may introduce evidence only on matters exchanged, plus new material that responds to the other side's data.

Property Tax Rules 305.1(a) and (b): a request for exchange must be made more than 30 days before the hearing, and the other party must respond at least 15 days before the hearing.

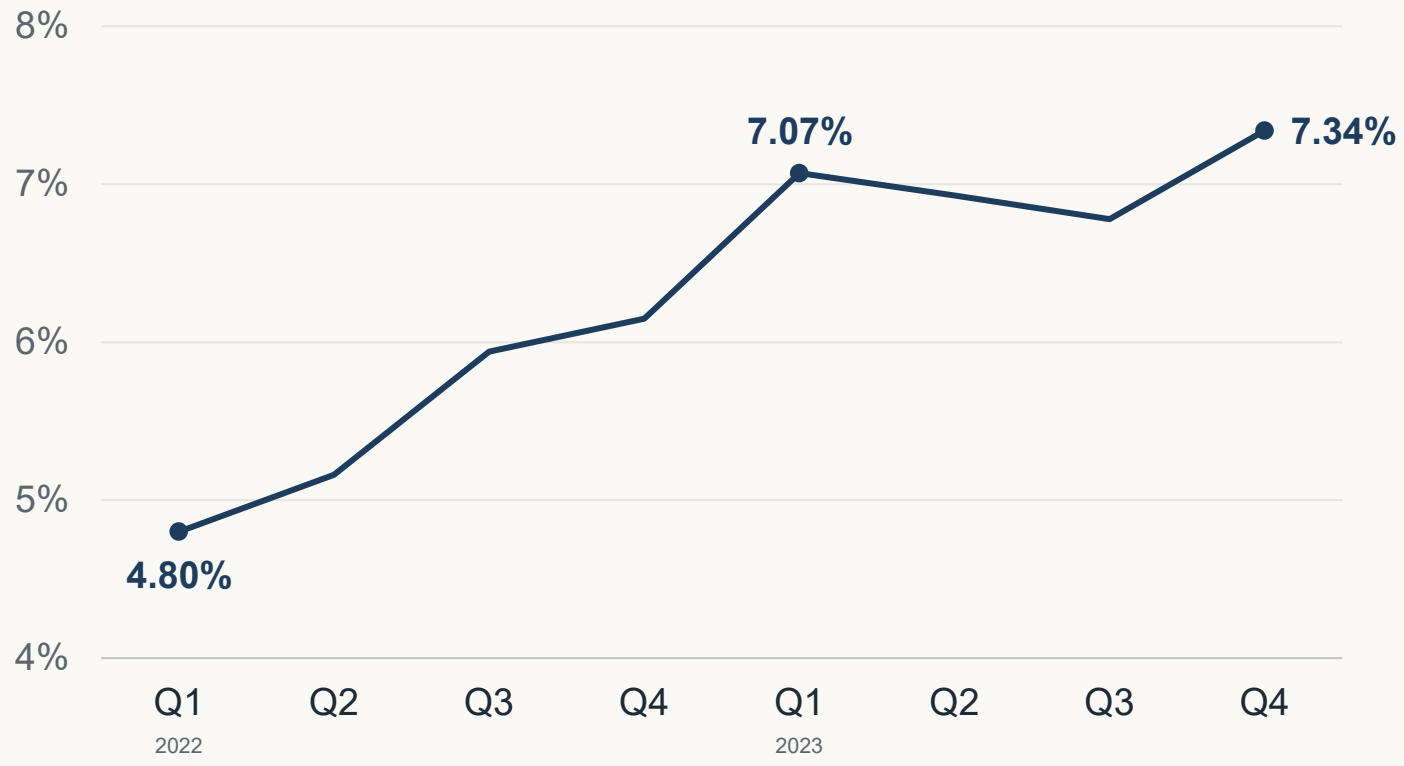
Practical effect: a cap rate must be traceable to exchanged sales with known incomes. Confirming the other side's sales becomes additional evidence.

Issue No. 1 – Market Conditions

Section 5

Industrial financing rates rose 53% in the two years before the sale

Permanent financing interest rate, industrial properties, %



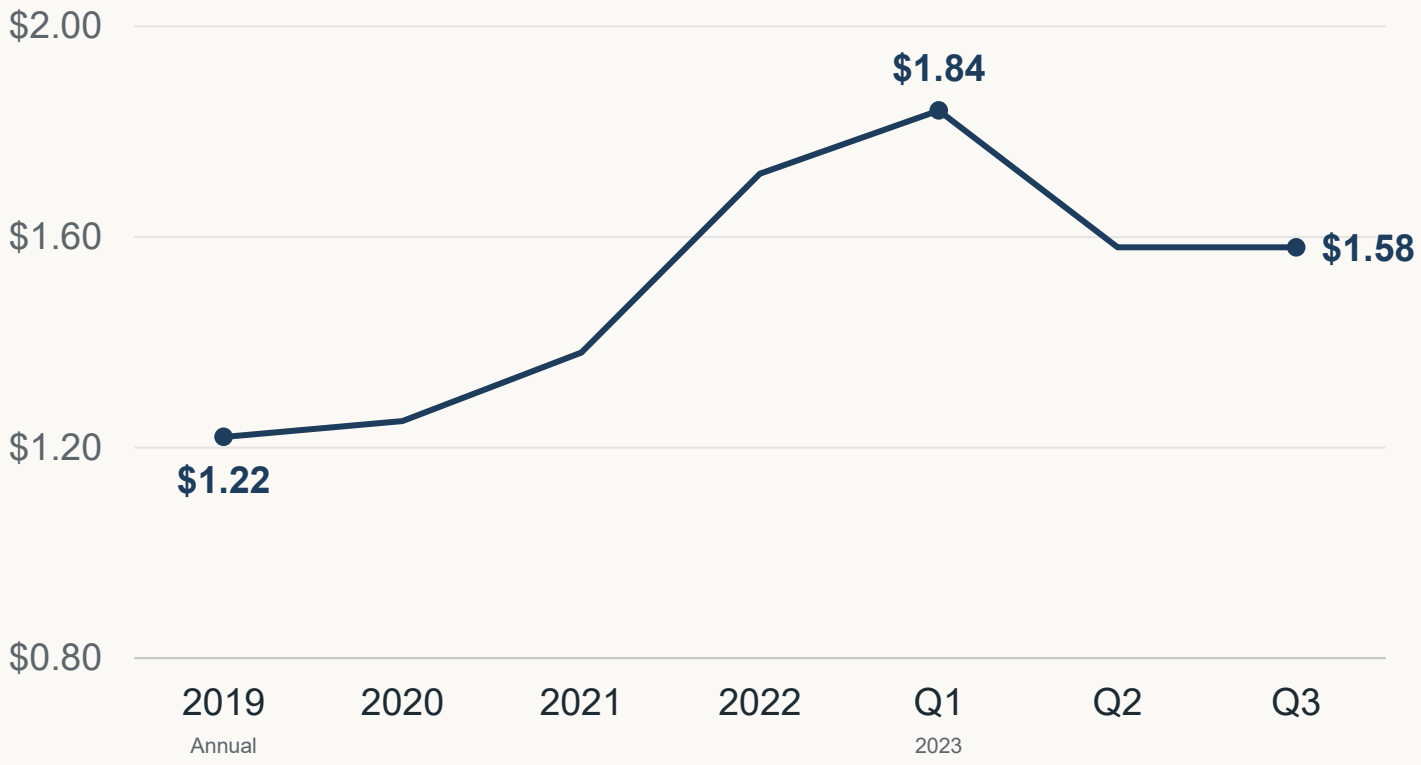
Why it matters for value

- **+254 basis points** from Q1 2022 to Q4 2023
- **Higher debt costs** raise the return investors require, which pushes cap rates up
- **Sales from early 2022** were priced with financing near 5%, not 7%

Source: RealtyRates.com Investor Survey, 4th Quarter 2023 (Class A and B properties, nationwide).

Submarket rents fell after Q1 2023 while vacancy increased

Average industrial rent, subject submarket, $ per SF per month

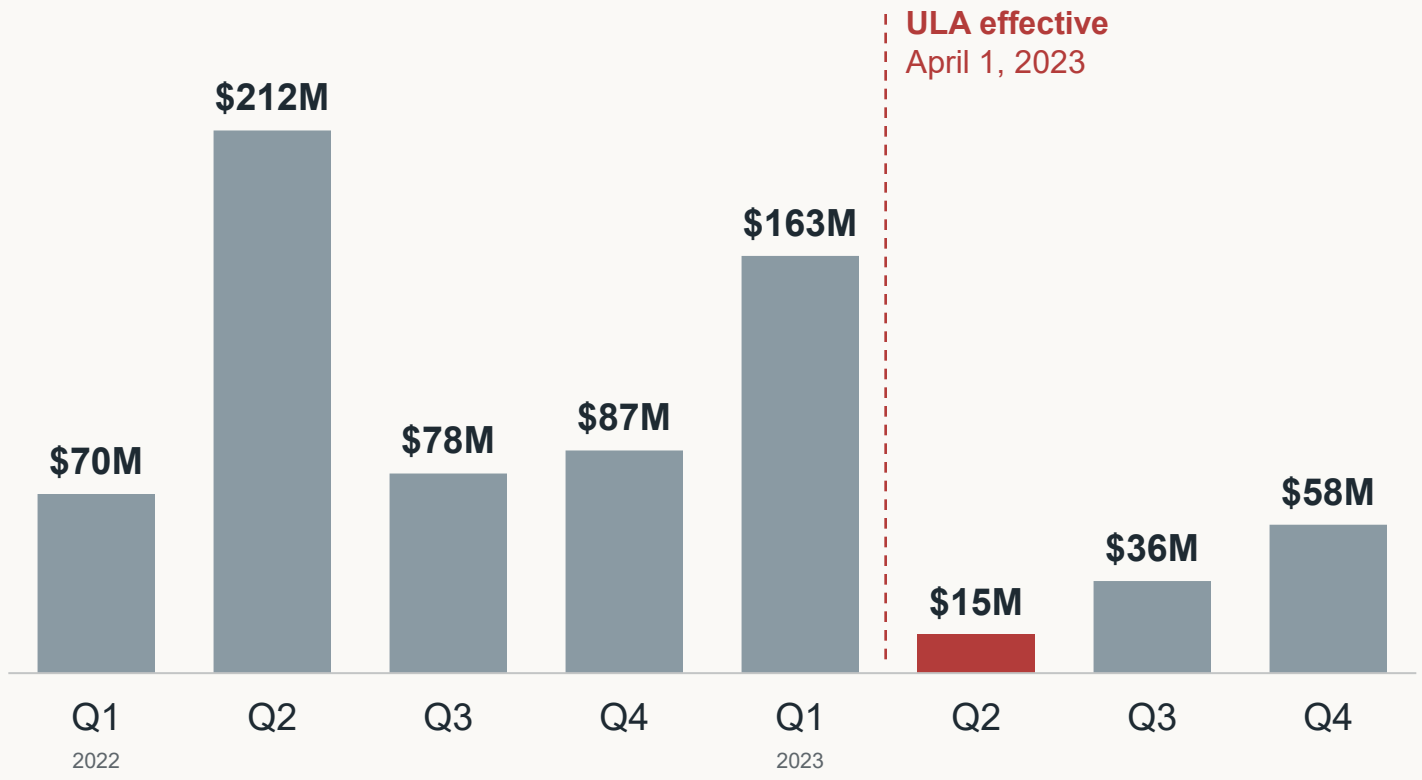


Vacancy moved the same way

- **Submarket:** 0.8% in 2022 to 2.3% in Q3 2023
- **LA market:** 2.2% to 3.7%
- **Net absorption:** negative in the submarket in Q1 and Q2 2023

Submarket sale volume fell sharply after ULA took effect in April 2023

Industrial sales volume, subject submarket, by quarter



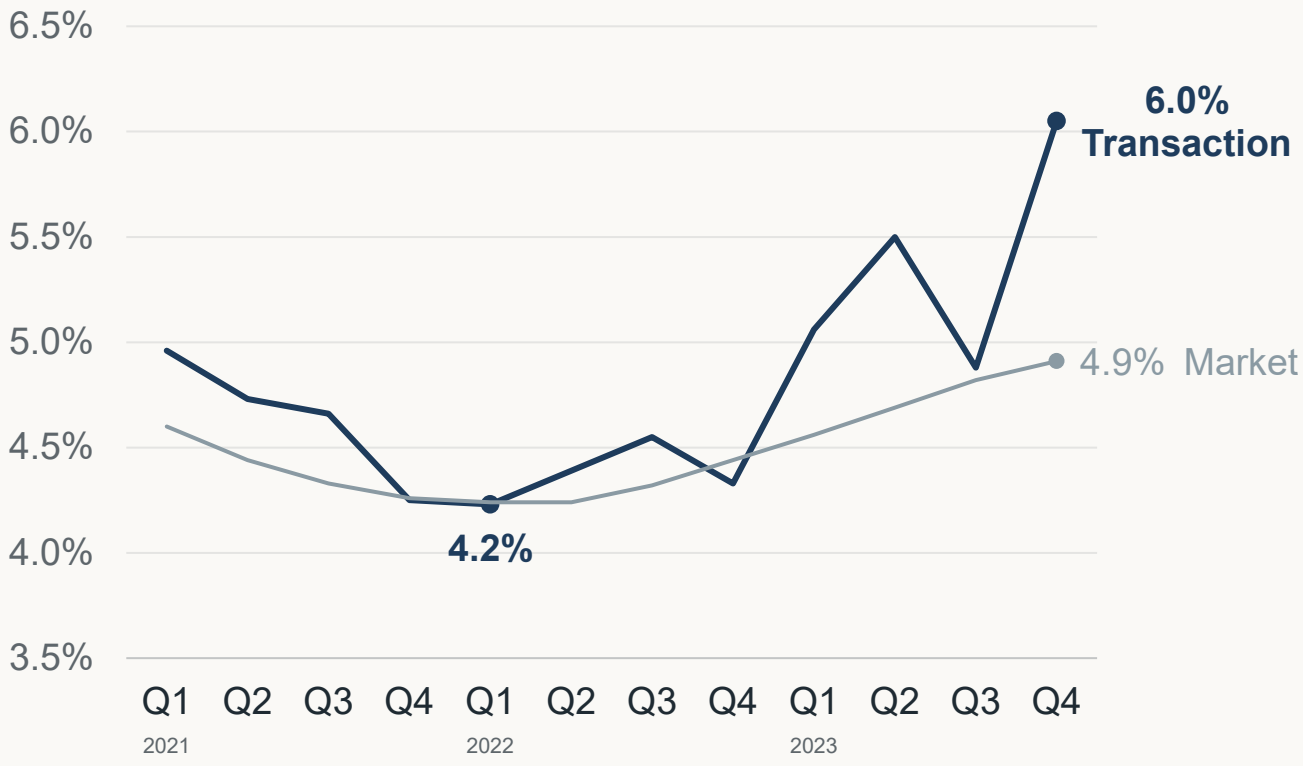
What changed in April 2023

- **Q1 2023:** $163M as sellers closed ahead of ULA
- **Q2 2023:** $15M, down about 90% in one quarter
- **Through Q4 2023:** volume stayed below every 2022 quarter

Few post-ULA sales required a wider search for market data, which the assessor criticized

Transaction cap rates rose from the 2021–22 low through the date of value

Industrial cap rates, Los Angeles market, %



What it means for a cap rate

- **Transaction rates** rose about 180 basis points from early 2022 to Q4 2023
- **CoStar's modeled rate** rose less; modeled rates lagged actual deals

Issue No. 2 – Sales Comparison Approach

Section 6

Highest and best use defines the use, the user and the timing

Use

Continued multi-tenant industrial use, leased to third parties

User

Investors who compete for leased multi-tenant parks of this size

Timing

Now, as improved; no redevelopment or owner occupancy implied

Relevance issue

Owner-users and buyers of small buildings compete for different properties. The assessor's file showed no interviews with brokers or buyers to establish otherwise.

Counsel's point

“The buyer was a sophisticated national investor. If they could have bought this property at a significant discount, they would have.”

Other Issues

1 **No adjustment for market conditions**
Seven of the eight sales closed before ULA took effect, as pricing fell through 2023.

2 **No adjustment for building quality**
The subject includes an older metal building, about 31% of its rentable area, which commands lower rents.

3 **No inspection of the subject**
The assessor did not inspect the property; actual deferred maintenance went unrecognized.

4 **Income on the sales unknown**
Cap rates and income for the sales were not known, so economic characteristics could not be compared.

5 **No basis for other adjustments**
Adjustments such as location were made without supporting data.

Issue No. 3 – Income Capitalization Approach

Section 7

Income Capitalization Approach: Appraisal vs. Assessor

	Appraisal	Assessor
Income	Market rent: industrial rents by building, plus office rent	Different figures in earlier discussions; ultimately adopted the appraisal's net income
Vacancy and expenses	Based on comparable data	Adopted the appraisal's figures
Net operating income	$1.11M	$1.11M (appraisal's)
Cap rate support	Comparable sales and band of investment; reflects changing market conditions through 2023	Based primarily on 2022 data
Base cap rate	**5.50% (6.70% loaded with tax)**	**4.30%**
Indicated value	**$16.28M**	**About $21M**

Band of investment: particularly helpful because it showed changing conditions through financing

Hearing and Takeaways

Section 8

Three Takeaways

1

Know the rules

- State and local rules: Property Tax Rules 2, 4, 8, and 305.1
- Appraisal unit: five deeds, one sale (AH 502)
- Highest and best use defines the marketplace and the comps
- Case law

2

Support the report

- Market conditions were a central issue
- Charts of pricing, volume, and cap rates over time were compelling
- Show the data behind each adjustment, so the reader can follow the conclusion

3

Verify the data

- Public records and online databases were not enough
- Confirm sales with buyers, sellers, and brokers
- Offering memorandums from the brokerage community explained the income characteristics

Questions

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