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Law Report

WHAT DROVE UP 2009 TAX BILLS IN COOK COUNTY?

by Michael J. Elliott

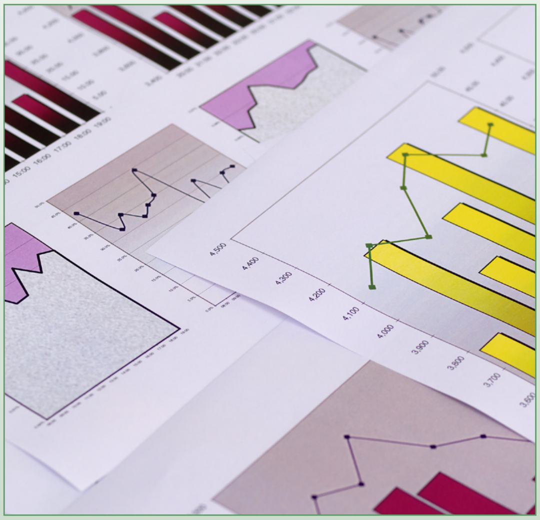
Our county continues to limp along through a prolonged recession. Media reports indicate that property values have fallen dramatically from 2007 highs.

2009 tax assessments in Cook County generally fell, partly because the Assessor voluntarily reduced home assessments in response to falling sales prices and partly because taxpayers filed tax appeals and won. These events gave taxpayers the impression that their 2009 tax bills (payable in 2010) would fall. But, many actually saw them rise. We have been inundated with phone calls from taxpayers asking why this occurred. Permit us to explain.

- ***The 2009 Cook County Equalizer Increased Over 13%.*** This was an unprecedented event that affected each and every taxpayer in Cook County. The equalizer is one of four factors that determine the tax bill. When the equalizer rose by 13%, it pressured tax bills upward by that percentage; however, tax bills are also affected by assessments, tax rates and exemptions. Many taxpayers saw their assessments reduced as a result of aggressive tax appeals; however, the increase in the 2009 equalizer was tremendous and it forced tax bills up. Why did the 2009 equalizer increase so much?

  Legislative Manipulation. The Cook County equalizer is a factor imposed by State law to adjust Cook County assessments so that after equalization they will be on par statistically with the rest of the state. This is a constitutional mandate because Cook County has a different assessment system than elsewhere in Illinois.[1] Prior to the 2009 tax year, Cook County homes were assessed at 16% of market value and commercial property at 38%. When assessment percentages are below 33-1/3%, an equalizer must be applied to raise them to 33-1/3%: the more assessments are below 33-1/3%, the greater the equalizer.

  Beginning with the 2009 tax year (taxes payable in 2010), the law was changed and assessment percentages for ***all*** property types in Cook County were reduced. Homes were reduced from 16% to 10% and commercial property from 38% to 25%. It is a mathematical fact that when assessment percentages are reduced, there will be an offsetting increase in the equalizer. This was likely the single largest factor in the 13% increase.



  Assessment Manipulation. The Assessor voluntarily reduced assessments of most (but not all) homes for the 2009 tax year. Reductions typically ranged from 5% to 12%. This caused the residential tax base to contract. The contraction likewise forced the equalizer and tax rates to rise as tax levies were spread among a shrinking tax base.

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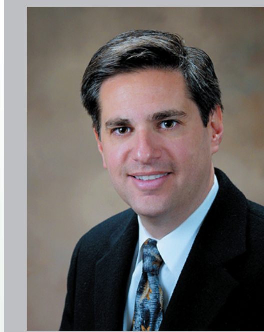

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"All in all this has been a hectic and confusing year. But, there is a silver lining in this cloud: taxpayers who diligently review their assessments and aggressively contest them should come out on top."

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Record Numbers Of Assessment Appeals. Curiously, while the Assessor reduced residential assessments due to declining property values, he did not do the same for commercial properties. On the contrary, in the re-assessment areas, the Assessor typically increased commercial assessments substantially. In the non-reassessment areas, he tended to leave them alone. Commercial property owners appealed in record numbers contesting their property values and requesting that an assessment percentage of 25% (versus 38%) be applied to the reduced values. Commercial property owners were overwhelmingly successful in their appeals. This caused a dramatic contraction of the commercial tax base and a concurrent increase in the Cook County equalizer and local tax rates.

- ***Phase-Out Of 7% Assessment Cap.*** Several years ago, the Illinois legislature adopted the so-called "7% assessment cap". This law provides a larger than usual homeowner exemption to provide relief against skyrocketing property values. This law was intended to be a stopgap measure that would gradually phase down and out. The phase down is in progress and will be completed in a few years. As the law phased down, 2009 tax exemptions shrunk causing 2009 tax bills to rise.

Winners And Losers

The cumulative effect of these factors was the creation of winners and losers. The winners saw their tax bills decline from 2009 levels. The losers saw their bills increase, sometimes dramatically. And many people saw their taxes stay relatively constant despite the expectation that they would pay less as their assessments fell.

- ***Winners.*** Commercial property owners who successfully contested their 2009 assessments and caused a 25% assessment percentage be applied to a diminished value were usually big winners. In and of itself, a reduction in assessment percentage from 38% to 25% could cause the assessment to fall by 34%. When combined with a reduction in property value, the assessment reduction would be even greater. Some of this reduction was offset by the 13% increase in equalizer, but tax bills for these property owners decreased nevertheless.

- ***Neutral.*** Property owners who received a 13% assessment reduction in 2009 would have seen that benefit offset by the 13% increase in equalizer causing their 2009 tax bills to be about the same as 2008.

- ***Losers.*** Property owners whose 2009 assessments were the same as in 2008 or fell by single digits were typically losers. This included taxpayers who did not contest their 2009 assessments, homeowners who received modest assessment reductions and homeowners who saw their homeowner exemption shrink as the 7% assessment cap was phased down. These taxpayers paid more because their equalizer increased more than their assessment fell. The reduction in homeowner exemption further exacerbated the problem.

Lessons Learned

Property taxation is a sum-zero game. When one taxpayer contests his assessment and wins, other taxpayers automatically pay more to offset.

Many taxpayers were lulled into inaction when their 2009 assessments remained constant or were voluntarily, yet modestly, reduced by the Assessor. Inaction ultimately caused them to pay higher taxes because the equalizer and tax rates rose to offset the reductions obtained by their neighbors who contested aggressively.

Those taxpayers who aggressively contested their taxes were rewarded for their efforts. They were able to demonstrate that their property values fell and that reduced assessment percentages should be applied to those reduced property values.

Property taxes are a substantial operating expense. Educated property owners review them regularly and aggressively contest when the facts permit. Inaction can be costly.

[1] *All Counties in Illinois are required to assess property at 33-1/3% of market value. Cook County is permitted to have a classification system where residential property is assessed at 10% of market value and commercial property at 25%. Illinois law requires imposition of an equalizer to all assessments in Cook County so that from a statistical point of view post-equalized assessments will be at 33-1/3% of market value.*

CONTESTING ASSESSMENTS IN A DOWN MARKET

Property taxes are supposed to be based on property values. Falling property values create opportunities to obtain meaningful assessment relief. Following are some of the opportunities we are seeing in this down market and our strategies for obtaining relief.

Commercial Property

Vacancies are at or near all time highs. Rents have fallen. Rental concessions are abundant. Tenant improvement costs and leasing commissions have generally remained constant. Property operating income has diminished greatly. Based on these facts, commercial property values and assessments should be declining.

Until recently, we have seen few sales to help us establish value in the current market. Because of the decline in fundamentals, buyers are not willing to pay inflated prices for commercial property. Many have cash on hand, but are only willing to buy at bargain prices. Sellers are often hopelessly underwater and have little motivation to sell at prices buyers are willing to pay. This stalemate makes for a shortage of current sales transactions.

Our response is to assemble income, expense, vacancy and cap rate data from the market and to value our clients' properties the way a buyer would. We value based on rents achievable today, not using above-market leases signed in a better market. This is what the law provides. We then look for current sales comparables to confirm our value assertions.

In cases where an appraiser is involved, we make sure he is aware of these facts so his appraisal properly reflects value.

It is also important to monitor vacancy because many Assessors will provide relief when substantial vacancy exits.

Hotels

The hotel industry was flying high in 2006 and 2007. There was much sales activity at high prices justified by revenues in place at that time. Assessments tended to follow those inflated sales. But the recession has taken its toll on the hotel industry. Revenues are typically down 20% to 35% from 2007 highs. Assessments, on the other hand, have typically only fallen modestly. This suggests opportunity.

We analyze income generated by our clients' hotels over the last three years. We also examine trends in the local and regional market, including review of STAR reports and earnings claims contained in the franchisor's Uniform Franchise Offering Circular, to demonstrate that the problems are not just with our clients' hotels but in the larger market. We make adjustment for the value of non-taxable items, such as goodwill, FF&E and intangible property. The purpose is to determine the value of the taxable real estate (land and building) apart from the value of the non-taxable items (FF&E, goodwill and intangible assets). Many assessing officials chase sales transactions, which reflect the sale of all hotel assets – taxible and non-taxible.

We are currently finding some sales to help confirm our value estimates. The sales are most helpful when we can extract a gross rent multiplier because that is how buyers tend to value limited service hotels. A market-derived gross rent multiplier when applied to current hotel revenues can help confirm our value estimate.

Condominium Associations

Many Assessors value condominium units by analyzing sales in the development over the past three years. In the current market, however, sales prices are falling and use of older sales necessarily overstates value. But, this is exactly what most Assessors do in the collar counties and, as a result, overstate value.

We examine sales within the development over the last three years to determine trends (decreases in median sales prices, number of transactions, etc.). We give most weight to sales occurring within one year before and after the January 1st valuation date. In a declining market, older sales need to be adjusted downward and post valuation date sales need to be adjusted upward. Valuation this way gives a much clearer indication of value on the January 1st valuation date.

Some County Boards of Review understand the law and are willing to reduce assessments consistent with an analysis of current sales activity. Others are not willing to do so making an appeal to the Property Tax Appeal Board a necessity.

Single-Family Homes

Homes are supposed to be assessed at market value and uniformly assessed with similar homes.

As with condos, many assessors value homes using three prior year sales and overstate value. We either obtain current appraisals or look for current sales of comparable homes to establish value. Some Assessors and Boards of Review properly follow the law and are willing to reduce assessments based on this evidence and others are not, requiring an appeal to PTAB.

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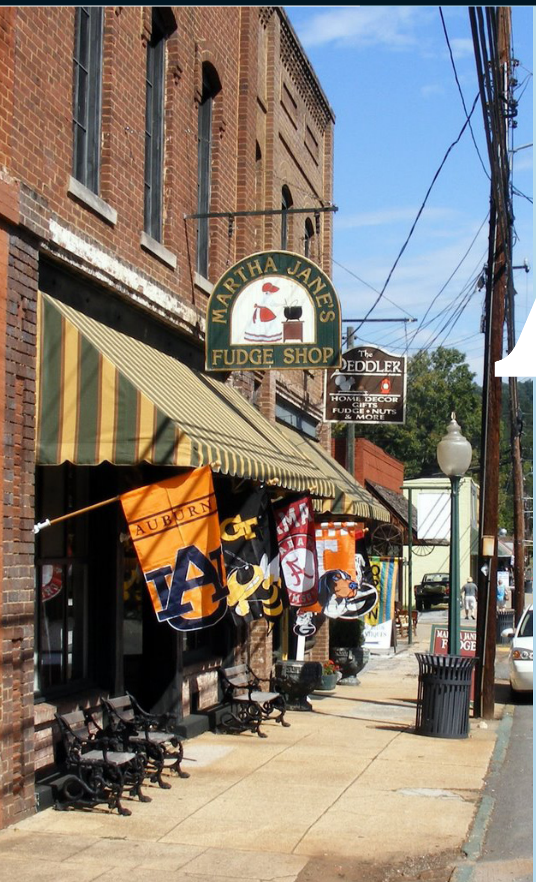

SOUTH SUBURBS TO BE REASSESSED IN 2011

All property in the southern suburbs of Chicago (south of North Avenue) will be reassessed during 2011 as part of the Assessor's ongoing triennial (3 year) reassessment process.

We expect the 2011 assessment season to begin in late Spring and continue through December. Taxpayers will have 30 days from the date their township assessment notices are mailed to file complaints with the Assessor. Time frames are tight and an effective appeal requires thoughtful preparation. Therefore, we like to begin our work before assessment notices are mailed.

It is important to note that the Assessor is willing to grant substantial vacancy relief when the facts warrant. In order to obtain this relief, the Assessor must be provided with income and expense data and be advised of the vacancy at the time the complaint is filed. A field inspection will be conducted to verify that vacancy exists.