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OHIO REAL ESTATE CONSULTANTS, INC.

JUNE/JULY 2014 NEWSLETTER

This letter will update you on our current assignments, the trends we see in the industry, staff accomplishments, community service and other current information.

TWO WORLDS COLLIDE

On May 15th a Slip Opinion was issued by the Ohio Supreme Court that makes a strong statement about how condominiums must be treated for Real Estate Taxation purposes in the State of Ohio. The Court used one of my reports to help define the new appraisal guidelines. This ruling should get the attention of every condominium developer in Ohio. It represents a significant impact on the financial feasibility of this type of development and a stark contrast to how lenders are allowed to consider the same unit.

Ever since the 1980s Savings and Loan collapse, lenders can't consider a condo individually when lending to a developer who owns 5 or more units in the same development. Federal lending guidelines require that a discount be applied to account for sales costs, profit and the time value of money during the sell-out period. This discount is based upon the reality of supply and demand which creates higher prices when you are selling one unit versus lower prices for multiple units sold at the same time. (i.e. Bananas are \$0.25 a piece when you have 10 and only 2 buyers. They are \$1.00 a piece when you have 2 bananas and 10 buyers.)

Developers holding units for top price helps support the investment every individual owner has made in the community. The converse would be the price drop resulting from too much supply needing to sell in a short amount of time. We experienced the falling price phenomenon recently. Because of this reality lenders are required by the federal government to loan on collateral of 5 or more commonly owned condo units as a single asset or a single economic unit. In these cases, the amount that a lender is allowed to lend, on a finished unit, is invariably far less than the future sales price. If the unit is unfinished then the costs to finish are a further deduction. The bulk or discounted value is usually allocated per unit so the acquisition and development loan allows for partial releases as the units are sold.

According to the Supreme Court ruling R. C. 5311.11 is the basis for taxation.

5311.11 Each unit is separate parcel for taxation and assessment purposes.

Each unit of a condominium property and the undivided interest in the common elements appurtenant to it is deemed a separate parcel for all purposes of taxation and assessment of real property, and no other unit or other part of the condominium property shall be charged with the payment of those taxes and assessments.

Effective Date: 07-20-2004

The definition does not define how the value must be determined only that it is a separate parcel implying a separate value. This definition doesn't concern itself with the number of commonly owned units or stage of construction, whether the unit can realistically be sold separately or whether the time to sell the units individually for full price will take longer than a "normal" marketing time or the supply of units on the market on the tax lien date.

This is a landmark ruling for several reasons. Not only does it highlight the **discrepancy between federal lending requirements and state taxation law** and the departure required from The Uniform Standards of Professional Appraisal Practice, it also puts some great minds, at every level of the appeal process, on separate sides of the table. My executive summary of the six year appeal process is that the Franklin County Board of Revision agreed the discount was reasonable due to the marketing period needed to sell the units. The Board of Tax Appeal disagreed, but didn't have other evidence to draw another conclusion. The Supreme Court initially agreed with the Board of Revision, but the School Board was granted reconsideration. The Supreme Court rarely grants motions for reconsideration and this one left the Justices divided with a 4-3 decision ultimately putting the responsibility back on the BTA.

With this ruling the Supreme Court set more rules as to how this type of real property must be treated legally for taxation valuation purposes. Appraisers need legal instruction and this ruling gives it. It is clear that if an appraiser uses the same approach **required** for lending and other purposes it is now **"illegal" methodology** for this type of tax valuation.

This case marks the beginning of more rulings and future changes in how this type of property will be taxed. According to the School Board Attorney there are more of these cases in process than ever. These appeals are all market driven. Before the 2008 market collapse the real estate taxes for these properties were not an issue. Units sold fast enough that the developer wasn't holding multiple units long enough to be fully assessed. After the market collapse developers have had to hold properties longer because they are not selling, so they are paying penalizing holding costs. One of the biggest holding costs is the real estate tax.

I firmly believe that the tax world will have to align with the developer/lender world in order to help bring the residential construction industry back. I am told that the State of Illinois doesn't assess taxes on a condo unit until it is occupied. The theory is that **without the occupant the condo doesn't require the same services** (schools, EMS, Roads, Etc.) and therefore doesn't have the same costs to the community.

As a side note the East Bank Condos still owns 2 of the 21 units addressed in the 2008 tax case. None sold in 2008, 7 in 2009, 4 in 2010, 5 in 2011, 2 in 2012, 2 in 2013 and 4 year-to-date in 2014. All sale prices have been less, some far less, than the original list prices. Furthermore the two additional condo buildings that were proposed at this location will never be built. Apartments are now proposed by another developer. Apartments typically pay lower taxes per unit and often cost the communities more than condominiums.

I sincerely hope that this tax issue is minimized by a return to a more robust housing market. I also hope that this tax issue will prevent developers from carrying more inventory than the market can absorb in a reasonable time frame. But the optimum inventory is difficult to predict with the changes in market demand.

In my appraisal opinion the fundamental question in this case has become;

What is the true value today of an individual condo that won't be finished or occupied for years because of an oversupplied situation?

Is the answer

- 1.) the price a buyer would pay today for the rights to own the condo but can't take physical possession for years but still has the holding costs liabilities, or
- 2.) the future price the condo will bring years after the tax lien date?

A link to the Supreme Court opinion follows,

<http://www.supremecourt.ohio.gov/rod/docs/pdf/0/2014/2014-ohio-1940.pdf>

Current Assignments

- Two LIHTC Communities, Cincinnati
- Apartment Community, Athens, Ohio
- Apartments, OSU Campus Area
- Single-Family Subdivision, Delaware County
- Portfolio of 7 Special-Use Properties
- Multi-Parcel Eminent Domain Assignment, Cuyahoga County
- 15 Property Tax-Appeal Portfolio, Franklin County
- Specialty Industrial Property, Port Columbus
- Historic Preservation Project, Cuyahoga County
- Conservation Easement, Southwest Ohio
- Industrial Property, Westerville
- Rural Housing Community, Southeast Ohio
- Apartment Community, Dayton MSA
- Eminent Domain Assignment, Allen County, Ohio
- Federal Land Acquisition Assignment, Central Ohio
- Timberland Appraisal, Southeast Ohio
- 2 Industrial Properties, Union County, Ohio
- Single-Tenant Industrial Building, Columbus CBD

You and/or your clients may benefit from information we have used in our current assignments, as well as the assignments we have completed within the past 12 months.

Company News

Thomas R. Horner, MAI, completed two (2) courses in May: the National 7 Hour USPAP Update class offered by the Ohio Department of Transportation (ODOT) and the Appraisal Day Seminar presented by the International Right-of-Way Association.

Timothy S. Geiger also completed the National 7 Hour USPAP Update class offered by the Ohio Department of Transportation (ODOT) in May.

We hope you found this newsletter information. If you would like additional information, please visit our website at www.ohiorealestate.org or call us at 800-536-0038.