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Real Estate Purchases From Nonprofits Can Pose Challenges

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Elliott B. Pollack
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We all know that Connecticut offers a panoply of real estate property tax exemptions to not-for-profit organizations of various stripes; in fact, that is one of the problems plaguing our larger cities. They simply have too much exempt property on their grand lists. This reduces tax collections and increases the burden for everyone else. While some exempts make voluntary payments in lieu of taxes (PILOT), it is not enough.

After the economy hit bottom in 2009-2010, the recovery that followed has led to a significant increase in real estate values fueled by the Federal Reserve's "quantitative easing" program, which pushed interest rates to historic lows.

As a result, many charitable organizations took a look at their real estate holdings. Where a well-located parcel could be vacated in favor of a less attractive but far lower-priced location, some organizations took that step. Other not-for-profits concluded that they were sitting on properties far too large for their current or immediate future needs and decided that market conditions made it wise to monetize their real estate. As a result, a number of prime properties are being sold by not-for-profits to non-exempt organizations. This mini-trend is likely to continue as long as interest rates remain competitive.

When a property moves to a for-profit entity, the exemption is cancelled at the date of transfer. This means, for example, that the sale of a social service agency's property to an office building developer on Nov. 10 will make that property liable for real estate taxes for the prorated assessment year beginning Nov. 10, 2014, through Sept. 30, 2015. Starting Oct. 1, 2015, the property will be liable for taxes for the full assessment year.

Equally important is the future assessment of the real estate. Many observers of the Connecticut tax scene know that property is valued on a five year cycle, which begins on the date of the most recent town-wide real estate revaluation. Thus, in the mythical town of Yukon which conducted its most recent revaluation Oct. 1, 2011, a property changing hands in late 2014 should be placed on the non-exempt list and its market value set as of Oct. 1, 2011.

Indeed, the mere fact that a property was determined by an assessor to be exempt does not mean that it was not assessed. Assessors are required to determine market value of exempt assets even though they aren't taxable.

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However, many assessors do not get very excited about the values they place on exempt properties because these values tend to be academic in most cases. Unless reimbursement for lost taxes from the state or another governmental entity is available, the assessment of an exempt parcel does not matter all that much.

All this is a long way of saying that a business person purchasing a property from an exempt organization should not assume that the assessor's valuation of the property, while it was on the exempt list, will carry over to the nonexempt list. (Whether an assessor has the legal right to increase value when a property loses its exemption has yet to be litigated).

What does this all mean? It means that shortly after the deed from the not-for-profit to the for-profit entity is recorded on the Yukon land records, the new owner should expect to get a notice from the assessor advising of the new assessment, calculated at 70 percent of market value, that the property will be asked to support. The new owner may also appeal the assessment. This right should be seriously considered because it is a precondition to challenging the new assessment in court. If the assessment board chooses not to reduce the value or simply refuses to consider the appeal if the property is valued over $1 million, a legal challenge may be warranted.

Understanding market value

Market value is a function of a property's "highest and best use." Highest and best use may not necessarily be the use being conducted by the not-for-profit on the date of sale, especially since the new owner may be thinking about repositioning the property to a different use. For example, consider the sale of a 2 acre parcel in an attractive suburb on which there is a 10,000 square foot building occupied by a social service agency. Not only does local zoning permit up to 35,000 square feet of building area on the site, it also permits commercial development, which would yield significantly more rental income.

This means that the price the new owner paid for the property may not in fact be its market value on the sale date. It could also mean that it would make more sense to demolish the existing structure. The likely issuance of higher and better land use approvals, which would increase the property value, might be taken into account by the assessor in determining the new assessment.

Where the difference between the purchase price and the assessor's new value is great, financial pressures may be created that were not anticipated by the purchaser.

Real estate acquisitions from not-for-profits by for-profit entities should be strategized in terms of their property tax implications during the negotiation of the sales contract. Planning for the inevitable new assessment and consequent tax burden before the assessor's notice is mailed not only makes sense but could save a purchaser much grief.

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Elliott B. Pollack is Chair of the Property Valuation Department at Pullman & Comley, LLC. Reprinted with permission from the November 10th issue of the Hartford Business Journal.

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Elliott B. Pollack

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