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Be on Guard over Shift to GIM

The Tentative Assessment Roll for 2008/2009 demonstrates a significant shift in assessments for class 2 properties (rented apartment buildings, cooperatives and condominiums). This is due to the New York City Department of Finance abandoning the time-honored approach of net income capitalization in favor of the gross income multiplier (GIM) approach, which for the very first time ignores age, condition, location and expense factors. The key question for owners is: are these new assessments as accurate as those produced before the new GIM technique was employed?

Different Methods, Different Results

First, what are the differences between past and present methodologies and where are the pitfalls in adopting one formula over another? Net income capitalization has been used by assessors and endorsed by New York State courts for more than a century. In 1962, the New York Appellate Division ruled that value arrived at by capitalization provides the surest ground for sound appraisal. In an earlier case, the New York Court of Appeals determined that "the net income of a property is more persuasive evidence of what a property is worth than using a sales price derived from a similar property. What an investor will pay for a property is measured in large part by the amount and certainty of the income that can be obtained."

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The Finance Department provided two reasons for renouncing the capitalization approach: 1) expenses for some buildings were higher than others, leading to lower assessments, while in some cases the expenses may have been overstated by the owner; 2) using the GIM eliminated the need to study expenses or expense ratios and offered a simpler, more predictable one-step method.

While GIM offers more predictability, it fails to provide more accuracy. GIM is not seriously employed by any major developer, investor, lender or appraiser today, nor has any New York court embraced it.

In the most recent edition of its handbook, the Appraisal Institute warned appraisers to be careful when using the GIM method. The handbook cautions that all properties used as a basis for this approach must be comparable to the subject property and to one another in terms of physical, location and investment characteristics. If properties have different operating expense ratios, this method may not be comparable for GIM valuation purposes.

The GIM approach presents one overriding problem. It is applied to all residential property regardless of location, age, physical condition or level of services. Also, using GIM often throws retail rents, antenna, signage or health club income into the mix, with the distinct possibility of grossly inaccurate and unfair assessments for many types of properties.

In addition, many substantial valuation disparities occur due to factors such as rent controls, rent stabilization and complexes composed of a large group of buildings. There may be substantially different expense ratios for an aging, multi-building housing complex and a 100-unit, mid-block, non-doorman apartment the West Village. These differences generate unfair tax assessments.

Legal Flaws in This Approach

Initially, the Finance Department used different GIMs depending on income level and whether the property is rental, co-op or condominium. This directly violates state law, which mandates that these properties must be assessed uniformly. Therefore, the New York City Law Department ordered the Finance Department to make changes; co-ops and condominiums had their assessments lowered and rentals saw their assessments increase.

The fact remains that for all rent-producing properties, the city possesses detailed real property income and expense information from legally mandated filings, and requires detailed statements by CPAs in all but the smallest assessment challenges. This surely provides a database for accurate net income capitalization and takes into account location, condition and other significant factors which ordinarily would render GIM suspect.

As the Finance Department begins to use the GIM to derive property tax assessments, owners need to be on guard against property tax increases. When these increases appear, an owner's only defense is filing a property tax appeal. Income capitalization may be down, but not out. —RENY

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