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Minimizing property tax increases for retail construction by being proactive - by David Wilkes

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If misery loves company, retailers nowadays will find bittersweet agreement with this trio of bleak adages:

“No good deed goes unpunished;”

“Everything costs more than you thought it would;” and

“It’s easier to get into something than out of it.”

No need to recount the grim details of the retail sector’s downward tumble over the last half-decade culminating with the explosive lights-out induced by the 2020 Coronavirus. That’s old news. Particularly for malls aimed at leisure shopping, by late 2019 cap rates were soaring and values plummeting with major retailers sucking wind in Amazon’s wake. The biggest losers have been department stores, power centers, cinemas, class B/C malls, dine-in restaurants, and lifestyle centers.

Of greater interest is the question, “What will owners who choose to hold on do now?” The answer from most advisors is: Reposition. It is anathema to think that many retail bricks and mortar have no useful economic purpose or viability, so the next best option is to create an experience not found online. The answer for each property will be unique and depends on local demographics, existing lease dynamics, surrounding property types and where the demand lies. Whatever the individual solution, the common denominator will be an infusion of capital at a time when rent collections may be minimal or non-existent (especially during construction) and risk highest.

Unfortunately, the sweetest sound to property tax assessors is that of a building permit landing on their desk. An owner’s cost to invest in the future of a property (and enhancing the overall economic value of the community) is viewed as a proxy for immediate value-added today, according to many assessors. That means that a retail owner’s best intentions are often met with an unjustifiable tax increase long before hoped-for rent revenue materializes. In New York, tax assessments are supposed to reflect current value of existing space, not some potential future value, but this basic legal standard is often ignored by municipalities anxious to capture assessment and minimize politically-damaging tax rate increases.

Owners can take several proactive steps to manage the impact of repositioning-induced tax increases.

Identify Tenant Improvements

Arguably, many tenant improvements, especially for well-branded chain stores, add value to the individual business and not the real estate itself and therefore are not taxable. Assessors tend to ignore this distinction and adopt cost in total. Segregating and documenting capital required to fit up for a particular tenant that does not inure to the realty’s long-term value may go a long way toward persuading the assessor to limit the amount of an assessment increase.

Timing Equals Deferral

Construction often proceeds based on considerations that ignore tax valuation dates, incurring tax increases prematurely. Knowing your local valuation and taxable status dates equates to dollars in an owner’s wallet. Each property is valued annually based on its physical condition as of a specified date; defer your construction one day beyond that date and the assessor will need to wait a year before tagging the property for an increase.

Construction Exemptions

Some but not all municipalities offer a property tax exemption that phases in at least a portion of the value of new construction. You will need to verify that the property’s location offers the exemption and make sure to apply for it in advance of commencing construction.

Consider Meeting with the Assessor

Especially in suburban markets, owners may not need to lose sleep at night wondering how an assessor may react to a building permit in connection with a repositioning strategy. Some assessors are willing to meet with property tax counsel and owners to review plans and offer a candid tax projection, or even negotiate a plan. While forward-looking tax agreements may not always be legally enforceable, the parties usually abide in practice.

Don’t get Frozen

Many New York State jurisdictions do not reassess annually, and in those a resolution of an earlier tax appeal often leaves the assessment “frozen” for the next three years. That level is likely much too high in the current economy. However, the moratorium is broken where there is a change in the use of the property, a significant drop in occupancy, or where the assessor (perhaps in response to a new building permit) increases the assessment, among other factors. Owners should take advantage of the opportunity to re-open an otherwise frozen assessment especially in this precipitously declining retail market.

Is a PILOT Available?

New York property taxes are often simply too much to justify new construction even once the project is stabilized. Consult with counsel to determine whether the proposed project may qualify for a local payment in lieu of taxes program or a related incentives abatement (such as New York City's Industrial & Commercial Incentive Program (ICIP) – often tied to job creation and location – that may offer significant property, sales, and other types of tax benefits that will make the project economically viable.

If New York's state and local governments really wanted to stimulate our economy they would take a hard look at the state of the retail sector – both leading up to and into its current distress – and simply offer a complete property tax holiday. A hard pill to swallow, no doubt, but it would allow smart owners with vision to pick themselves up and eventually thrive. For now, that's wishful thinking and owners should at least seize on ways to minimize the tax impact on their well-intentioned efforts.

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