COVID-19’s effects on the economy, commercial real estate and property taxes - by Douglas Atkins

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COVID-19’s effects on the economy were generally devastating, mirroring the healthcare crisis itself. However, the economic impact on commercial real estate and property tax was uneven, hurting many while benefiting others.

Under New York State law, tax assessments are determined as of an annual valuation date. This requires each jurisdiction’s tax assessor to assign a value as of their respective date each year. This allows for yearly fluctuations in value, responding to market conditions. For example, a majority of the incorporated villages throughout the state have January 1 as their valuation date. A village tax assessor issues an assessment each year based on each property’s value as of January 1, and the tax bills will follow proportionately. If the village raises a property’s tax assessment, the tax bill will similarly increase. The opposite happens if the tax assessor decreases the assessment. This valuation process happens in counties, towns and cities throughout the state. It is the primary mechanism to fund local government: police, schools, waste removal, snow plowing etc.

The municipality’s annual tax assessment has a direct impact on what a particular property is going to pay in taxes, and this can change each year depending on market conditions. Consider the twelve months from January 1, 2020 to January 1, 2021. At the beginning, the U.S. economy was strong, and this included the vast majority of commercial real estate. The office market was steady, consistent with the region’s strong rate of employment of the time. The industrial real estate market was even better, with growth in warehouse and distribution centers. Retail was a mixed bag: big box stores were relatively strong, fueled by household spending, whereas some shopping malls were continuing a long decline.

Then COVID-19 hit and changed everything. The short-term losers were offices, restaurants, downtown retail and shopping malls. All were unoccupied for extended periods of time. Conversely, there were market segments which weathered the storm. “Essential retail” became as important as ever–supermarkets, Walmart, Home Depot, etc. Finally, the industrial market only got hotter, reacting to America’s desire to have everything delivered to our doorstep.

Where does this leave the real estate market and the tax assessor in the post-COVID world? It is a complicated question. The various segments of the commercial real estate market historically trend in the same general direction, even if at different rates. This made tax assessments more predictable and consistent in their annual fluctuations.

COVID-19 has thrown real estate market uniformity out the window. For sure, we know that industrial and distribution real estate is as strong as ever. It is also a safe bet that essential retail will come out stronger: it only stands to reason that if we are traveling less and staying home more, we will be buying more groceries and spending more on improving our homes. Accordingly, we should expect commercial taxes to increase on those properties. Two market segments which are prone to decreases are offices and shopping malls. Office space is in uncharted territory. Will employers embrace the work-from-home-model? If so, it does not bode well for office landlords. Regional shopping malls, already suffering from the Amazon effect, now have the added undesirable quality of being a place where COVID-19 can spread. If those segments of the market decrease, then their taxes should as well.

One consequence of this newly unbalanced market might be over-correction in tax assessments. Funding local government is expensive and if less property tax revenue is received from office buildings and shopping malls, then municipalities will try to make up the difference from industrial buildings and the other market winners. You can easily see this backfire if tax assessments are raised too high on the strong properties. If occupancy costs rise too steeply, the property values will be pushed down. Ironically, this could lead to a quick decline of tax revenue.

These valuation and tax questions will be revisited by municipalities each year. The market is always in flux, and thus so are commercial assessments. One thing is certain: property tax is a zero-sum equation. If taxes go down for shopping malls and office buildings, then someone else will need to make up for it. Accordingly, it may be industrial properties, big box retail and the surprising COVID market darling—single family homes.

Property owners need to stay diligent and pay attention to their tax bills in the upcoming post-COVID market. Each year, be sure to review your tax bill with a tax certiorari attorney. If you are over-valued or your taxes have increased, it may be time to challenge your assessment.

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