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How 2022 market adjustments will impact property taxes - by Brad and Sean Cronin

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As 2022 draws to a close, we've seen a number of shifts that have changed the real estate landscape. Many of these market changes directly impact property taxes, which in turn, can change an owner's bottom line considerably. As we move towards 2023, it's time to examine what changes can benefit an owner's property tax case.

Rising interest rates should lower property taxes

Rising interest rates to combat rapid inflation has resulted in a major impact on commercial properties. Professionals in the real estate industry have seen rising rates force buyers to walk away from sale transactions they were bullish on just months earlier. Buyers leaving seven figure deposits on the table is the most dramatic example of how much inflation has disrupted the market, but it is certainly not the only way. Increasing costs of goods and services influences operations in a manner that is not as obvious, but just as impactful on value.

Owners know they must pay property taxes when operating a commercial property. However, it's sometimes forgotten that property tax levies are the result of municipal budgets that must fulfilled annually. The biggest budget that must be satisfied each year is the school budget. On Long Island, there are 125 separate school districts all of which require significant funds each year to operate. The fractured nature of Long Island results in school tax payments that can be as high as 70% of an owner's property tax liability. These municipal budgets are navigating the same inflated costs which then is reallocated to owners in the form of increased tax bills.

This double hit of higher operating costs combined with increasing tax rates from higher budgets must be considered for tax purposes. When the inherent risk is greater, and cap rates reflect this change, the value must be reduced tax purposes.

Distribution centers and online commerce

You know there is a monumental shift when even proponents of “Shop Local” campaigns admit to buying more goods online. The market has responded to this by flooding the Long Island landscape with plans to develop millions of s/f in the form of distribution and logistic centers.

The rush to find development sites led to bidding wars the likes of which this property sector had never seen. The influx of new projects was so extreme that some have already begun to second guess the need for this much new space. One definite conclusion is that retail continues to change. The market has shown that brick and mortar retail will not go away entirely, but the contraction of overall retail space cannot be ignored. More vacant space and options to consider has directly impacted retail tenant’s willingness to pay top dollar rents. Sometimes this takes the form of increased tenant improvement allowance or free rent at the beginning of the term. When an owner’s NOI declines, the property tax burden should as well. Without the appropriate decrease in taxes, it will be difficult for many retail properties to survive.

Workers have returned to the office…sort of…

The office market is another sector that has seen a dramatic shake up. This change continues to unfold given the amount of pre-Covid leases that remain in effect, thus distorting the region’s true vacancy rates. Remote working changed the need for office space, but not for everyone. While many desolate office parking lots started to see stable activity this year, that activity is by no means back to pre-2020 levels. And what about the businesses that require office space, but don’t require a full in-person work week? Is this a business adjustment or a reaction to the labor market that may not last in a recession?

The office market has certainly taken a hit the past two years, but the majority of CEO’s continue to tell surveyors that productivity increases when their employees are on site. Still, office rent is often one of the top expenses for many companies and finding a way to discount that cost is prudent business. For this reason, office landlords find themselves competing with each other as well as the large amount of sublease space available. Each of these affects their NOI and increases their risk; the combination of which should be reflected in a reduced property tax burden.

As the complete picture of 2022 becomes evident and owners prepare for next year, these trends must be closely monitored. If they are impacting a property’s NOI, a grievance must be filed in 2023 so the tax burden is adjusted commensurately.

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