Hidden cost information will reduce real estate taxes - by Brad and Sean Cronin

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Brad Cronin

Sean Cronin

With real estate taxes increasing, owners are being barraged with hidden costs that, when properly analyzed, will decrease their real estate tax obligation. Recently, landlords have been forced to handle a variety of factors that diminish their net operating income (“NOI”). Many of these items are out of their control, but others are conscious investments necessary to maintain their revenue stream. The taxing authorities may view the revenue and presume that the property has successfully navigated the current economic environment. However, a closer examination shows that “but for” the owner’s expenditure, investment, improvements, amenities, etc., revenue would have declined significantly.

Below are a number of the costs associated with a successful property that may be overlooked if not brought to the attention of the assessor. Presenting this information can dramatically reduce property taxes in the near and long term.

• Build-out/landlord’s contribution to tenant improvements. Landlords previously had a typical range of the amount they would pay to “get a tenant in.” Now, the costs are exorbitant and being seen in asset classes where tenants previously bore the burden. This has been particularly striking in retail properties where, depending on the size of the space, landlords are paying up front costs higher than the first year’s rent! This type of build out shows the competition for dwindling tenants to fill spaces.

• Rising cost of labor and materials. It goes hand in hand with the above described build out costs, but it’s noteworthy that not only are landlord’s doing more, but they are paying higher prices as well. Skilled labor is in demand and that results in increased costs to perform these build outs and other work. Limited supplies impacted by demand or supply chain issues create a ripple effect that costs the Landlord money, not only in the performance of work, but delaying commencement dates and the collection of rent.

• Mortgage rates at all time highs. While it’s been well documented that rates exceeding 7% have crushed the volume of transactions in residential real estate, it’s been overlooked that commercial properties are on a more frequent refinancing schedule. Many commercial properties have begun to experience the new rate environment or are bracing for the impact on the immediate horizon.

• Legal costs and fees from lawsuits. When margins are thinned to the degree they are in the current economy, litigation becomes more prominent. Without the cushion of healthy profit margins, landlords, tenants, contractors, etc. are watching every invoice. This increased scrutiny has led to rising legal costs. The other way to avoid such a predicament is paying high legal fees at the outset to have the proper protections in place in each lease and contractor agreement. Either way, this is a cost that is rising.

• Broker commissions. Having a good broker to make a match with a building is more important than ever in the post-COVID market. While not a new cost, it’s a very necessary one that oftentimes is forgotten. The rent the tenant is paying still has a significant percentage going to a broker before it gets to the landlord’s NOI.

• Utilities tend to rise with inflation. Always a necessary cost to operate a building, but with inflation rising, the majority of utility costs are increasing as well. Furthermore, many asset classes like retail and office that would have the tenant cover or contribute to these costs on a net basis are finding they must pay these items as part of gross leases. Again, the format of the lease and increasing costs are a double hit for landlords.

• Fees. There are an abundance of real estate associated fees in Nassau and Suffolk County. Permit fees are the most common, but it’s the special uses, sign fees, etc. In fact, tax map fees became so exorbitant in Nassau County that a Judge struck down their cost. Now after having reduced their tax map fee, additional lawsuits are again in court claiming the fee is still disproportionate and is essentially another way to tax owners.

• Free rent. Landlords may have a signed agreement at a figure of $20 per s/f, but if they give a year of free rent on a five-year lease, the true rent figure is $16. This creates an illusion in the landlord’s operations, as the impact is not seen after year one. However, it cannot be ignored that the $20 the landlord is collecting was at a significant cost that impacted cash flow for the entire year.

The irony of all these hidden costs is that they are increasing at a time when the real estate market is as risky as ever. This underscores the importance of bringing these items to the attention of the assessor in order to have property taxes reduced so that at least one cost is headed in the appropriate downward direction.

Brad Cronin, Esq., and Sean Cronin, Esq., are partners at Cronin & Cronin Law Firm, PLLC, Mineola, N.Y.