



How 2023 market adjustments will impact property taxes - by Brad Cronin and Sean Cronin

December 12, 2023 - Long Island



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As 2023 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 2024, it's time to examine what changes can benefit an owner's property tax case.

Interest Rates Increased

When interest rates rise, the cost of borrowing also increases for everyone. High interest rates to combat inflation are here for the foreseeable future. Last year we speculated about the impact of rising rates, but this year we've seen it reduce the volume of transactions in a meaningful way. Increasing costs of goods and services influences operations in a manner that is not as obvious, but just as impactful on value.

Property tax levies are the result of municipal budgets that must be fulfilled annually. Inflation affects the purchasing power of money for municipalities. Local governments may need to adjust their budgets to account for the decreased value of money over time. This means that just maintaining the same level of service could result in an increase in property taxes. 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.

Higher operating costs combined with increasing tax rates from higher budgets must be considered for deriving the correct assessed values. When the inherent risk is greater, and cap rates reflect this change, the value must be reduced for tax purposes. Higher rates have caused a slowdown in sales and impacted property values and assessors base property taxes on these values. If values decrease due to higher interest rates affecting demand, a greater number of properties will be entitled to reductions in their assessed values.

Is the Industrial Market Cooling?

The increase in online commerce saw the Long Island market flooded with plans to develop millions of s/f in the form of distribution and logistic centers. Many of these new spaces are being completed without tenants in place and leasing activity has not been as robust as expected.

The rush to find development sites led to bidding wars the likes of which this property sector had never seen. Large industrial spaces are needed for the increase in online sales, which negatively impacts the market for retail properties as well. 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.

The Office Market
Continues to Struggle

2023 saw a large group of pre-COVID leases come to an end. The true vacancy rate for office remains distorted as five- to seven-year leases that were agreed upon before 2020 are still on many rent rolls. However, when speaking to lenders and appraisers, they are aware that the trend for the office market continues downward. Very few office sales have occurred that are not done with plans to convert the space to another use.

Remote working changed the need for office space. While many desolate office parking lots started to see activity, that activity is by no means back to pre-2020 levels. Many businesses have decided that a modified in-person work week matches their business model. 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 2023 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 2024 so the tax burden is adjusted commensurately.

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