nyrej

The tax implications of repurposing commercial properties - by Brad and Sean Cronin

June 11, 2024 - Long Island

Brad Cronin

Sean Cronin

Repurposing commercial real estate is becoming an increasingly popular trend on Long Island, driven by shifts in market demands, economic pressures, and development strategies. As these properties are transformed from their original commercial uses into residential, mixed-use, or other forms of real estate, the impact on property taxes is significant and multifaceted.

The commercial real estate landscape has undergone dramatic changes, particularly in response to the COVID-19 pandemic. With the rise of remote work, demand for traditional office space has declined, prompting property owners and developers to consider alternative uses for their buildings. Repurposing often involves converting office spaces into residential units, mixed-use developments, self-storage, or even industrial use. This transformation not only revitalizes underutilized buildings but also addresses housing shortages and promotes more vibrant communities.

Property taxes are based on the market value of the property which is then converted into an assessed value by the assessor. The valuation process primarily involves evaluating the income potential of the property and other market factors. When a commercial property is repurposed, its assessed value is likely to change, reflecting its new use and income potential.

For example, converting an office building into residential units typically increases the property's value due to higher demand for housing. Consequently, the assessed value rises, leading to higher property taxes. Conversely, if the repurposed use generates less income than the original commercial use, the assessed value might decrease, resulting in lower property taxes.

Repurposing commercial real estate can generate significant economic benefits. Higher property values and increased property tax revenues are direct benefits. Additionally, repurposed properties can attract more residents and businesses, stimulating local economies and creating jobs.

However, the transition also poses challenges. Property owners may face substantial renovation costs and regulatory hurdles, such as zoning changes and compliance with building codes. Particularly on Long Island, the process of gaining approvals for converting a property can take years and is riddled with red tape and fees.

It is during this conversion process where the tax assessment must be watched closely. The key date for assessment purposes is “taxable status date” each year. This is the date by which the assessor must value the property. In Nassau County taxable status date is January 2nd each year and in Suffolk County it is March 1st. Even if a property is in contract to be converted to a much more valuable use, until that transition occurs, the property must be valued in its condition and use as of taxable status date.

Even after a project has begun to be developed, the assessor must look at the condition of the development each year and this often leads to partial assessments. Often overlooked, partial assessments are critical to developments and must be watched closely as the project is not yet generating any income and should not yet be fully assessed. It is not until the transition to the new use is complete when the property can be fully assessed for this new use.

The state and local municipalities have each recognized the potential of repurposing commercial real estate and have attempted to introduce policies to facilitate these transformations with varying degrees of success. Incentives such as tax abatements, zoning variances, and financial assistance programs aim to encourage property owners to repurpose underutilized buildings. The most notable vehicle utilized on Long Island are industrial development agencies (IDAs). One of the most critical benefits in an IDA agreement is the schedule of tax payments outlined in the payment in lieu of tax agreement (PILOT) within the IDA agreement. The vast majority of PILOT agreements result in greater tax payments to the localities starting from the first payment and ultimately phasing in to the full tax burden at the end of the agreement.

As the trend continues, policymakers must balance the need for increased tax revenues with the economic viability of repurposing projects. Ensuring that tax assessments accurately reflect the current use and value of properties is crucial for maintaining fair and predictable tax revenues. It promotes more efficient use of space, reduces the environmental footprint of new construction, and fosters more dynamic and resilient neighborhoods.

Repurposing commercial real estate presents both opportunities and challenges for property taxation. While it can lead to higher property values and increased tax revenues, the process requires careful management to address regulatory and financial obstacles. As municipalities adapt to changing market dynamics, the continued evolution of its real estate landscape will play a crucial role in shaping its economic future and development.

As the transformation of commercial properties continues, developers must stay in communication with their property tax expert to make sure the property is properly assessed as of taxable status date each year, before, during and after the conversion process is complete.

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