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The Impact of COVID-19 on Commercial Property Taxes & What to Do About it

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The COVID-19 pandemic, even months after government-ordered shutdowns and as restrictions on businesses lift, will continue to have a profound impact on commercial property owners. Income-producing properties are experiencing revenue shortfalls, tenant closures and evictions, bankruptcies, and changes in consumer habits and industry trends.

Weakened demand for retail shopping for goods and services because of the pandemic not only caused an immediate disruption, but it may lead to long-term changes on occupancy rates and market rents, leading to lower property values. While these factors may negatively impact property owners in several ways, they can also open the door to some financial relief in the form of lower taxes by challenging property values through tax assessment appeals.

For some owners, a successful tax appeal can result in substantial sums of money, consisting of refunds and reduced expenses for years to come.

COVID-19's Impact on Retail

It remains a difficult time to own a shopping center and other income-producing properties. At the height of the pandemic, even some of the largest retailers stopped paying rent altogether or attempted to negotiate abated or deferred rent. Some of these trends continue today. Meanwhile, property owners must continue to meet their debt, maintenance, and other obligations on reduced rents.

Some large retailers, already struggling pre-pandemic with the continued rise of online shopping, filed for bankruptcy and announced store closures. It is expected that more retail bankruptcies will follow. When a major anchor tenant closes, it has the potential to have a ripple effect throughout a shopping plaza. Tenants who are struggling, but have a co-tenancy clause requiring the presence of an anchor tenant, may try to seize on these closures as a golden parachute and opportunity for an early exit from their lease obligations.

For many small businesses, even federal assistance in the form of Paycheck Protection Program loans and other emergency programs may not be enough for them to survive extended closures or weakened consumer demand.

As a result, commercial property owners are likely looking at increased vacancies, a longer period of time to fill vacancies, and the potential of having to accept reduced rents in order to do so.

Together, these and other factors make it less certain that owners of income-producing properties can maintain a certain level of occupancy and profitability and suggest a reduction in property value. Reduced property values can lead to lower assessed values and lower property taxes.

Is a tax appeal worth it?

Based on the way that income-producing properties are valued, the lasting impact of COVID-19 can lead to commercial properties becoming good candidates for lower property taxes. In many instances, the actual costs of hiring a professional to assist with a commercial real estate tax appeal are small when compared to the potential savings that may be achieved, particularly where a property owner may enjoy reduced property taxes for many years.

How do appeals work?

A tax appeal must be filed by the deadline established by each county. Most tax appeals involve a first level administrative hearing, where a government official decides if an adjustment is needed based on the evidence presented. This decision is final if not properly appealed.

On appeal, property owners will be required to share economic and other details about their properties so that the taxing authorities can reach their own conclusions and make their own arguments on a proper assessed value. There is an opportunity for all involved to settle on an agreed assessed value. However, if no agreement can be reached, the matter is scheduled for a trial or evidentiary hearing, and a judge decides the property's value based on the evidence and testimony at trial.

How do you establish a value in a tax appeal?

The burden of proof is on the party seeking to change the assessed value. Property owners typically look to establish the property's value based on one of three methods: the income approach, the sales comparison approach, and the cost approach. The income approach is the most common appraisal methodology for valuing commercial properties.

The income approach values the property as an investment, and looks at factors such as income, expenses, vacancies, and investment risk in determining a property's value. The fallout of COVID-19 will likely lead to lower profitability expectations for a "stabilized property" — and we've already been seeing this trend — leading to reduced property values.

Stabilization occurs when a property reaches a projected range of "normal" occupancy for the property. The economic impact of COVID-19 has the potential to materially impact what constitutes a stabilized property. Further, some properties which are no longer stabilized may be entitled to an additional reduction until stabilized.

As an example, consider a shopping plaza which typically was considered stabilized when it was 85% occupied, prior to the pandemic. Today, shopping centers may be looking at an entirely different ratio with more vacancies. Decreased occupancy rates at the property at issue and the overall market are just a couple of factors that will help property owners obtain lower property tax bills.

What will the future hold?

The days to come, more than ever, are uncertain, but it appears that the impacts of COVID-19 will be felt long after the world returns to "normal." The experience of the past year also highlights just how fragile the commercial real estate is and remains. Small business owners and large retail establishments alike may be hesitant to open new stores.

Property owners are seemingly getting hit on all sides, so any potential benefit must be explored. There is a real opportunity to reduce property tax bills in this environment, but it may require property owners to file tax appeals ASAP if they want to preserve a challenge to next year's assessed value.

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