

BEWARE OF NEW PROPERTY TAX LEGISLATION

Many states are attempting to change established law, causing commercial property taxes to skyrocket.

By Cynthia Fraser, Esq.

No one wants to be blindsided with additional tax liability. This is why many businesses belong to industry groups that closely monitor liability for income taxes. Unfortunately, these same companies rarely stay on top of legislation that may have a significant impact on their property tax liability. Tax legislation being passed and considered across the nation due to the COVID-19 pandemic does not appear to address the significant tax liability associated with property taxes for business.

Property owners may take for granted that key precepts assessors use in determining taxable value are so widely held and accepted as to be immutable. Almost every state's tax law holds that a property owner pays property taxes on the asset's "real market value." Real market value is the price a willing buyer and willing seller would agree upon in an open-market transaction.

Unfortunately, even with the COVID-19 pandemic, there will likely be little property tax relief this year for property owners unless special legislation is passed. This is due to the fact that the majority of states set the assessment date to Jan. 1 of each tax year. The COVID-19 outbreak was declared a "Public Health Emergency of International Concern" by the World Health Organization (WHO) on Jan. 30, 2020. However, it was not until March 11 that WHO declared the novel coronavirus outbreak a global pandemic and its impact reverberated across the United States.

In a retail real estate sector that has reeled from widespread store closures and mounting competition from e-commerce, the lease rate for a lease in place may not reflect market rent. Thus, it is the "fee simple" estate that is being valued for tax purposes: What rent does the market data support as of the tax assessment's date?

Valuing the fee simple estate at market rent is a significant taxpayer protection in the changing landscape of today's marketplace for retail spaces. Sales of brick-and-mortar stores have plummeted due to changing consumer spending habits, a decline in international tourism spending and a lack of investor demand for many big boxes.

It is no secret that internet sales have battered the department store sector. The resulting closures of large department stores have further dampened in-



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vestors' appetite for large-box spaces, and these effects have trickled down to impair the value of smaller retail spaces.

The stay-at-home executive orders issued by all state governors limited social gatherings to fewer than 10 people and malls and retail stores across the nation were shuttered. The full impact on the retail industry and the brick and motor store is yet to be known.

Questioning assumptions

In the past several years, some assessing authorities have pushed to change the definition of real market value to disregard the perspective of a willing buyer in an open market, and to instead create a false value as if the property were fully leased at market rates as of the assessment date.

In Oregon, recent rules are being proposed (and the theory tested in court) with the assumption that a property can always receive a stabilized rent in the market place. Thus, an assessor would use a property's expected occupancy and market rent in using the income approach to determine the fee simple interest. The costs to get to a stabilized rent, according to the new rules, cannot be applied to discount the stabilized rent. Thus, a vacated department store, or a brand new vacant building, will be assessed as if it is receiving full market rent without reflecting any of the costs associated to get there.

For example, the proposed rule states that it is implied in the cost approach that valuation reflect not only construction and materials but also all indirect costs, such as the cost of carrying the investment in the property after construction is complete but before stabilization is achieved, as well as all marketing costs, sales commission and any applicable holding costs to achieve a stabilized occupancy in a normal market. Thus, even though the taxpayer has not yet incurred all these expenses, they can be added to the taxable value and the taxpayer may not

subtract them in arriving at market value for property tax assessment purposes.

The result is that not only will a new vacant space be valued as if it is fully rented, but a second-generation retail space may be assessed under the cost approach as if it is fully leased. The reality of lease-up costs, including holding costs and tenant improvement costs, are simply to be ignored.

The International Association of Assessing Officers (IAAO) recently published a paper titled *Commercial Big-Box Retail: A Guide to Market-Based Valuation*. This paper appeared to ignore generally accepted appraisal methods for valuing these types of properties and to advocate for the changes in accepted definitions of property rights that taxing entities in many states are now seeking. Importantly, when American Property Tax Counsel reviewed the IAAO's paper, its lawyers found that many of the propositions cited in the paper were based on cases or laws that had been overturned and were clearly inconsistent with established case law.

These attempts by the assessing au-

thorities to change the definition of real market valuation for property taxation purposes should worry commercial property owners, and particularly owners of retail properties, given the continuing potential for prolonged vacancy with the COVID-19 pandemic. For these properties to remain viable, the owners need to mitigate all costs, including property taxes.

A reduction in property taxes can benefit a property owner significantly. Oregon has the benefit of a five-year statutory hold, with some exceptions, on a successful appeal to property taxes. Thus, a \$100,000 reduction in property taxes through the appeal process could result in a \$500,000 savings.

With the assessing authorities' proposed changes to the tax rules, however, market realities and real market value are compromised.

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