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How to Fight Excessive Property Taxes Caused by COVID-19

BY J. KIERAN JENNINGS | DECEMBER 2020

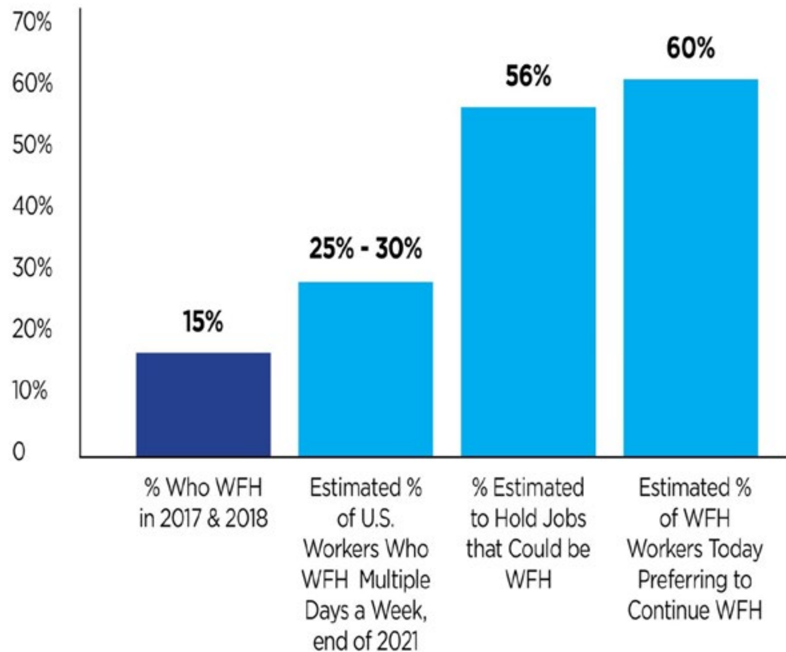
Although the shift to working from home (WFH) was intended to be a temporary response to COVID-19, many employees and employers have embraced the concept as a more permanent arrangement. The silent economic fallout is that office property values have fallen; however, there are little sales and lease data reflecting the shadow vacancy the trend has created. Thus, at a time when taxpayers desperately need tax relief, the modest market data available to support a tax-assessment reduction can be misleading and must be handled with care.

While a property assessment today presents a variety of issues, the two most prevalent are that an assessment's valuation date may pre-date COVID-19; and that it is difficult in a rapidly changing market to prove an assessment reduction is warranted. The latter is the only issue of the two that can be addressed without legislation.

In August 2020, the *Wall Street Journal* published an article highlighting how urban office and commercial properties face a threat that, like the coronavirus, is invisible to the naked eye. Decisions like those by Dell Technologies to review leases on 5.3 million square feet (492,386 sq. m.) of office space scheduled to expire in the next two years indicate the soon-to-be-recognized impacts on office properties. The article quoted Dell Chief Financial Officer Tom Sweet, who said the perceived increase in employee productivity in a remote-work environment led the company to more seriously consider reducing its space. "It's caused us to think through who really needs to be in the office."

Changing attitudes

During calendar years 2017 and 2018, only 15 percent of wage and salary workers had days in which they could work from home on a weekly basis, the Bureau of Labor Statistics reports. Contrast that with a recent report from Global Workplace Analytics, a consulting firm that found 56 percent of the U.S. workforce holds a job that could transition to a partial or full-time WFH schedule in a post-COVID-19 environment. The same report's authors estimate that 25 percent to 30 percent of the U.S. working population will be working from home multiple days a week by the end of 2021.



Additionally, a Gallup Poll conducted in March 2020 found that three in five U.S. workers who had been doing their jobs from home during the pandemic would prefer to continue to work remotely as much as possible once public health restrictions are lifted. The obvious implication is that the demand for office space – especially for high-density, urban space – has decreased and will continue to diminish.

The rapid changes in office space needs have hurt office building values. However, given that many pre-pandemic leases are still in effect, the economic data points that would help to quantify that impact are not yet visible.

That's not to say that the swell of office vacancy is any less rampant and damaging. To the contrary, it is all too real for property owners, who need to mitigate its effects. How, then, will taxpayers prove to assessors that they deserve, and need, assessment reductions?

Tools for taxpayers

Appraisers and attorneys have many different tools to aid taxpayers. Fundamental appraisal principles and sound judgment are always good places to start, and recent, arms-length transactions are the key to preparing an appeal. But it is imperative that the data represent the current market.

Taxpayers must be discerning in their use of data and be wary of adopting sales prices based solely on recency. In the beginning of the Great Recession, the market recorded transaction prices at or near historical peaks as investors fled to safe, high-quality investments backed by long-term leases. The same may be expected in today's market.

Additionally, prices may demonstrate the effects of economic stimulus efforts or other factors. Because properties tend to take longer to sell in a troubled market, the effects of the pandemic and the subsequent shifts in behavior are often hard to discern.

The best data to prove loss of value will be any transactions that have occurred in the post-pandemic marketplace, which reflect the current market. The parties to these transactions would have likely entered into the transactions knowing, at least partially, the degree of economic fallout from shifting workforce habits and the increased risks associated with purchasing high-vacancy office space.

Comparatively, unadjusted data generated prior to the market shift is of little use. The immediate past is what has changed, and older price data therefore cannot be taken at face value because it does not show conditions as of the date of valuation.

To better compare pre-pandemic sales to a post-COVID-19 market, the taxpayer's team can quantify excess vacancy caused by the new market trend of working from home to produce an annual rent-loss projection. The resulting rent loss can be applied as a discount factor to pre-pandemic comparable sales, helping to more accurately portray the impact COVID-19 has had on property values. Remember that rent loss is not limited to excess vacancy and can also include rent concessions or rent deferrals.

Additionally, an over-saturation of available office space in the market seems likely, as ongoing construction delivers new supply despite a decrease in leasing activity. This growing surplus of available space will translate into reduced property values as market participants perceive that the potential rate of return for office buildings has diminished. Decreases in rental income due to excess vacancy, rent concessions or rent deferrals – and even tenant bankruptcies – will similarly drive an increase in capitalization rates and a value reduction that must be reflected in tax assessments.

Not all recent changes point to decreasing values. Smaller satellite office space that supports a WFH environment may increase in value as demand for centralized, high-density spaces decreases. An open, judicious mind will help guide taxpayers in determining not only *how* to challenge their assessments, but *whether* they should challenge those assessments.

J. Kieran Jennings, Esq., is a partner in the law firm of Siegel Jennings, Co., L.P.A.

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