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Assessments, damages, declining values, tax burdens - What next?

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One of the key aspects of location is the municipality to which taxes are paid. This matters now more than ever since rents are not increasing and increased costs can no longer simply be passed through to a tenant. Higher taxes will not be passed through to tenants in the form of higher rent. Even NNN tenants are negotiating from a new base and that means that if a property is over assessed for the area, and especially on the margin, it will be damaged. A property is considered "damaged" if the value declines from some factor. In the properties that can serve the same market, the one with the lower tax burden will sell for more, because lower taxes mean more income to the bottom line, which in turn means higher value. More in taxes rarely means more in services when it comes to commercial and industrial property. Taxes have become the ultimate necessary evil.

Take office buildings in West Hartford versus Hartford. All other factors the same, it has been the case for quite some time that the West Hartford building sells for more. It is not just the address of West Hartford. It is the fact that two properties of similar size and utility would have such varying tax burdens. The Hartford property tax burden is double or even more in most cases. There was a time when a Hartford address mattered and tenants would pay the premium, so to speak, to be in Hartford. The tables have turned. In addition to increased parking costs, higher tax burdens have damaged property values in Hartford. Buyers simply can't pass through the rent so the expense of taxes decreases the bottom line, which in turn decreases the value.

For comparison sake, Class B and C office buildings in Hartford are selling from $30 to $70 per s/f with most between $50 to $60. In turn, similar office buildings in West Hartford are selling from $100 to $150 per s/f, which is quite a big difference. Now granted one can argue that some of the West Hartford buildings may have been getting more upgrades, more capital infusion, but the vital factor is that holders of real estate don't keep putting money into a building if it does not get returned either in the form of rent or sale price.

The comparison between Hartford and West Hartford happens often on lines between cities and suburbs. This occurs over time due to city flight as more people leave the city, and the suburbs Grand List grew while the city Grand List fought to maintain. This trend is reversing itself to some extent in recent times as younger people are not convinced of the "American dream" of home ownership, especially big country homes. Many cities are regaining population but this will take time after years of residential (and commercial) flight out of the city.

Within most towns, properties are over assessed. This has occurred after years of decline or stable and declining markets and revaluations have not caught up with new prices. In economics, there is a term "wages are sticky downward." In real estate, assessments are "super glue" sticky downward. That being said, assessments are often higher (the 100% assessment is supposed to equal market value or selling price) than market value. So if the assessment is higher, the property may be damaged. And I say "may" because if all the other properties in town are equally over assessed, then everyone is just paying more in taxes but the property is not necessarily damaged. The damage occurs if one property is unfairly high. So that is a source of recovery for some property owners going forward.

In business, in home budgets and in real estate, costs must be sustainable or they must decrease. Unless revenue can increase, costs must decrease. Put another way, if cost increases, the value comes down. Government marches to its own drum, but in private enterprise revenue needs to be greater than the cost or the boat can't float. As it relates to real estate, take the office building example. Variable costs are going to be similar (utilities, insurance, management, grounds, maintenance). The difference from one town to the other, is real estate taxes. In markets where rent can simply be increased to offset increased taxes, no problem. But when that does not happen, not only does Humpty Dumpty fall, but the entire wall falls. In the past few yeas, rents have fallen and taxes have increased. Net income got a double whammy. As long as interest rates (capitalization rates) are being somewhat falsely held down, this somewhat offsets the problem. But low interest rates are going to rise in time. Hopefully by then, the economy will be on the upswing. So time will tell. The only way the boat stays floating (or Humpty Dumpty stays on the wall) is for the value to come down. If taxes don't decline, value must. In the mean time, prices will continue to retrench to meet the new bottom line of increased taxes, increased utilities and other higher cost of operation. So the next time a property does not "appraise out" don't blame the real estate appraiser.

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