

## TAX NOTES

## Taking Their Cue From Hotel Owners

Shopping center landlords successfully argue that business value differs from real estate value.

By Jim Popp, Esq.

Considerable debate swirls around the valuation of shopping centers for property taxation. The debate focuses on whether shopping centers contain business value. Owners pay excess property taxes when assessors refuse to deduct business value.

There are diametrically opposed points of view concerning the existence of business value in shopping centers. Owners argue that excess rent income offers evidence of business value and should be deducted from the income of the center to arrive at the property tax value of the real estate.

Excess rent is defined as the amount of rent above that which would be expected for typical real estate. The excess rent is created by the business acumen of the owner, such as the way the owner runs the business of the shopping center. Assessors argue that excess rent, and thus business value, do not exist in shopping centers and that no deduction is warranted.

### Hotel owners pave the way

Shopping center owners can learn from a similar debate over the proper valuation of hotels that has progressed over the past 25 years. It began with the same issue now facing shopping center owners: whether business value even existed in hotels.

Today, hotel owners and assessors discuss not the existence of business value, but rather the proper quantification of business value. Hotels convinced assessors that the “rent” paid for a room was for more than just the real estate; it was also for the business aspects of the hotel.

Similarly, shopping center owners should focus their discussions with assessors on the fact that tenants are paying

rent for more than just the real estate. They are paying for the owner’s ability to run a successful shopping center. They should devote time to educating assessors about the business aspects of shopping centers. The following real-life examples illustrate the information that needs to be imparted.

### The role of anchor tenants

Many retail centers have a single-anchor tenant. Owners know that the presence of the anchor enables them to charge other tenants excess rent. It is the ability of the owner to attract appropriate anchor ten-

## Owners pay excess property taxes when assessors refuse to deduct business value.

ants that creates excess rents; it is not the real estate that makes this possible.

For example, an owner purchased a retail center that contained a major grocery anchor. The grocery store went dark six months after purchase but continued to pay full rent for the term of the lease. As a result of the anchor leaving, leasing activity diminished, tenants left and rents declined. Why did this occur?

The answer lies in the fact that the side shops were unwilling to pay rents at the same level when they experienced a loss of traffic caused by the closing of the anchor grocery store. The physical presence of the anchor drawing customers to the shopping

center — rather than the economic presence of the anchor paying rent — is what ultimately created business value.

This is similar to the value a hotel flag creates. The flag, not the real estate, attracts renters. This is in contrast to an office tenant who pays rent strictly for the use of the space. If a tenant leaves an office building, it rarely affects the rent paid by other tenants.

The anchor concept also is illustrated clearly by tenant development in malls. A mall developer typically pays anchors an incentive fee to locate at the mall. In Texas, a mall developer paid \$55 million in inducements for six anchors to locate at the mall. In the case of hotels, the hotel owner may pay a franchise fee to induce a flag (such as a Marriott or Hilton brand) to connect with their hotel real estate.

Assessors now allow this as a deduction from the real estate value. In contrast, developers of office buildings do not pay inducements for others to locate nearby.

A further example is that in-line tenants in a mall are affected by proximity to particular anchors. Rent is higher in proximity to some anchors than others. In contrast, rent in office buildings is not calculated based on proximity to another tenant.

### Necessary plan of action

These examples help support the business value attributable to the anchors above and beyond the real estate, and they provide assessors with vital information.

The foundation of a successful property tax appeal rests on the ability to show how properties create business value, just as hotel owners have demonstrated. From a business perspective, owners must also show how their properties differ from offices. Taken together, this information provides a compelling case for reducing property taxes. ■



**Jim Popp** is a partner with the law firm of Popp Gray & Hutcheson based in Austin, Texas. The firm is the Texas member of the American Property Tax Counsel. He can be reached at [popp@property-tax.com](mailto:popp@property-tax.com).