A CINEMA HORROR

The pandemic is slashing movie theater property values. What can taxpayers do to get a fair shake on their tax assessments?

By Molly Luhrs

Diminishing tax liability may offer a silver lining amid a horror show of declining property values playing out for owners of silver screen properties across the nation. Many theater owners will pay more than their fair share in property taxes, however, unless and until they educate local tax assessors of the sinister influences that oppress their businesses.

Movie theaters have been one of the hardest-hit industries during the COVID-19 pandemic. Spaces where the big screen once lit the faces of attentive viewers fell dark and silent, to sit lifeless for months. Studios released only 23 films in 2020, the fewest since 2003, and box offices sold less than 225 million tickets.

As regulations eased, cinemas emerged far behind the pack of other businesses in a race to resume normal operations. Now, most states are allowing 100 percent occupancy in movie theaters; however, this does not mean movie-goers are rushing back to theaters. What is there to attract them? Some of the most anticipated new movies had their 2020 premiere dates pushed to middle or late 2021, with some even transitioning directly to streaming platforms like HBO.

On top of the lack of content, theaters are wrestling with new consumer preferences developed during quarantine. Streaming services such as Netflix and Hulu posed a threat to in-person cinemas long before COVID-19 ever indirectly accelerated the preference for home movie viewing. On the flipside, drive-in theaters saw an uptick in attendance during the pandemic, showing that consumers still enjoy watching a movie in an atmosphere specifically tailored for films.

While most industries are asking "Where do we go from here?" the big question for real estate professionals is "How does this shift in the economy affect property value?" As for movie theaters, there seems to be an opinion divide between optimistic hope for a rebound and a pessimistic expectation for further decline.

Cinemas were already difficult to value because of their unique usage and a lack of comparable transaction data across the country; now, weak ticket sales give appraisers and tax assessors a bigger hurdle in valuing movie theaters.

Theater amenities are evolving to match consumer demand with reclinable chairs, full dining and drinking experiences and higher-quality digital screening. Older theaters face design issues that deter conversion to modern cinemas. As a result, the total number of theaters in the United States has decreased by over 25 percent since the late 1990s.

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Theaters also present red flags to investors seeking properties for conversion to other commercial uses. Most theaters are constructed with sloped floors and high ceilings, for example. While those conditions are ideal for audiences to enjoy a film, few businesses would find those characteristics appealing for their own use. Most organizations would consider those building features detrimental and deduct the cost to remove them from the purchase price.

This illustrates a re-use utility issue with movie theaters — not many enterprises can utilize the real estate efficiently as is. To investors in any industry outside of cinema or live entertainment, modifications to the theater would be required to make the space usable, decreasing the price that they would pay to purchase the building. The appraisal industry describes this as a Highest and Best Use issue, because a movie theater is arguably not the most efficient or profitable use of the space.

An investor would expect the property to require a large and costly conversion to make the space suitable for its most efficient and profitable use. These renovations would entail many risks. Movie theaters tend to be a riskier investment in general due to the specialization of the industry, but adding on the unknowns of transitioning the building to a more efficient use increases the risk to an investor.

Give assessors the facts

A theater owner should be aware of these issues when reviewing their property tax assessments. As county assessors value buildings using mass appraisal methods or software, they are unlikely to consider all the pressing issues that cinema owners face.

While a shift in the current market is inevitable, not all hope is lost in the movie theater industry. In a *Bloomberg CityLab* article, K.C. Conway, chief economist of the CCIM Institute, shared some promising opportunities for the reuse of outdated theaters. As Conway observes, adaptive reuse can create affordable housing, reduce blight and put old retail stores back on the property tax rolls. Some of the adaptive reuse opportunities already put into action include turning former cinemas into offices, e-commerce warehouses and fulfillment centers. In Goodyear, Arizona, a nine-screen theater was repurposed to serve as the Arizona Department of Transportation's headquarters and Motor Vehicles Division office.

Although adaptive reuse offers some opportunities to reduce the number of vacant, outdated movie theaters in the market, the industry will still have a fundamental supply and demand problem — the supply of movie theaters surpasses the demand from moviegoers, operators and investors. Changes in movie viewing preferences were already in motion when COVID-19 accelerated those trends.

As many outmoded movie theaters currently sit, physical obsolescence inhibits their transitioning either to a modern cinema or to a new use. The theater industry will continue to face obstacles, including finding investors to take on the risk of purchasing vacant theaters. And owners must educate tax assessors using factual information to demonstrate the profound decline in market value that some movie theaters have sustained. ■

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