THREE KEYS TO CONTESTING RETAIL PROPERTY TAX ASSESSMENTS

Shopping center owners need to be especially vigilant regarding unfair taxation in 2022.

By Sam Woolsey of Popp Hutcheson PLLC

Property owners should have received a Notice of Appraised Value from their appraisal district by mid-April. This year, it is imperative that retail property owners submit an assessment protest prior to the deadline and help to establish fair taxable valuations in the post-pandemic marketplace.

Since March of 2020, COVID-19 has brought uncertainty and ongoing challenges to real estate owners. People often discuss the commercial real estate "winners and losers" of COVID-19, and of the four commercial main real estate food groups, retail certainly suffered one of the heaviest initial blows.

But how has the property type recovered as the pandemic has evolved? This article explores where exactly the retail recovery falls and offers strategies to argue more effectively for reduced assessments.

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Evolving Trends

To develop a full picture of the current state of shopping centers, one must look back to 2019 and early 2020 before the pandemic. In 2018, approximately 5,800 retail stores closed nationwide and only 3,200 opened, for an overall deficit of 2,600 locations.

In 2019, the size of the annual store deficit nearly doubled with 5,000 more closures than openings. E-commerce sales volume rose steadily from 2010 through 2019, which, coupled with accelerating physical store closures, clearly indicated a slowdown in the need for traditional storefronts.

In 2021, county assessors were generally conservative in raising values, primarily due to pandemic-related issues such as tenants going out of business and owners being forced to defer and abate rent. Additionally, shopping center transaction volume dropped throughout 2020, which forced appraisal districts to rely on limited data to arrive at market rents and capitalization rates for their 2021 models.

County appraisal districts preparing assessments for 2022 will most likely attempt to significantly raise taxable values to reflect what they view as a retail rebound that occurred during 2021. While assessors may conclude that retail is recovering well as the pandemic evolves, the data and overall trends fail to support that position.

If an appraisal district takes an aggressive stance in raising values, citing the "booming return of in-person retail shopping," it will be crucial for appellants to show the lingering state of uncertainty in the retail real estate market. Toward that end, the following three strategies will be keys to successfully arguing for reduced assessments:

1. Consider the tenant mix. When appealing taxable assessed values, either during the administrative process or later in district court, property owners must consider the tenant mix of their shopping centers and how the pandemic affected their retailers.

For instance, a center containing a dry cleaner and a trampoline park will take much longer for those tenants to recover from the pandemic than many other properties. With working from home becoming more the norm than the exception, many people no longer need pressed clothes.

In addition, ball pits and trampolines crowded with children fail to appeal to a pandemic-conscious society. These trends are reflected in rents, with rates for specific uses such as these flattening or even declining since the onset of the pandemic.

2. Review the property's classification. The second strategy for appealing values is to review how the property is classified on the tax rolls. As many owners begin to utilize space in alternative ways, the center may no longer be operating entirely as a retail center. In other words, it may be more appropriate for it to receive either a light industrial or fulfillment center classification.

Amazon, for example, has been converting shopping malls into last-mile distribution centers steadily for the past six years. The Seattle-based e-commerce giant converted about 25 shopping malls into distribution centers between 2016 and 2019, according to Coresight Research.

Converting stores to distribution spaces in a shopping center will drastically reduce foot traffic for any remaining retail tenants and negatively affect the customer experience, resulting in a lack of desirability for retail investors.

3. Demonstrate shrinking retailer footprints. It is no secret that consumer visits to physical retail locations is nowhere near pre-pandemic levels. Black Friday foot traffic in 2021, for instance, was down approximately 28 percent from 2019 levels, according to Sensormatic Solutions data.

While in-person shopping will likely remain an element of the retail experience, there is a lingering sense of uncertainty surrounding its significance, especially with the strong adoption of curbside pickup.

Some major retailers have addressed this issue by downsizing stores. Target stores, for example, have historically averaged 130,000 square feet, but of the 30 stores the Minneapolis-based retailer opened in 2020, all but one used a smaller format, according to *pymnts.com*. These small-format and college campus stores average 40,000 square feet, while some are much smaller.

It is reasonable to suspect that other retailers will follow suit, rendering many larger anchor spaces within shopping centers obsolete and harder to fill with tenants.

As the tide shifts to a "less is more" philosophy when it comes to store footprints, both appraisal districts and taxpayers should incorporate this increased risk into value calculations by raising cap rates in their models.

Not only do shrinking store footprints and conversion of spaces to distribution uses bring an increased level of uncertainty to the asset class, but last-mile distribution centers also fail to command retail rents.

When shopping center owners receive assessed values for property taxation in the coming months, they should compare the assessments to values received in prior years, especially 2019.

If the valuation trend of a particular property fails to make sense — either due to the overall uncertainty and risk surrounding brick-and-mortar retail or due to property-specific issues such as tenant mix and use of space — it will be extremely important for the taxpayer to act by protesting the property's taxable assessed value.

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