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NORTHEAST REAL ESTATE BUSINESS®

Connecting Real Estate in the Northeast

NORTHERN ATTITUDE: REGIONAL OPTIMISM FOR RETAIL

Brokers and owners say that retail real estate in the Northeast is doing shockingly well in spite — or because — of limited availability and few development projects.

By Hayden Spiess

Though uncertainty — economic, political and otherwise — has been a theme of 2024, retail real estate markets throughout the Northeast have proven itself reliably strong. Even certain headwinds like high construction costs and minimal quality space to accommodate growth have ultimately helped fuel robust fundamentals throughout the region. Now, brokers, investors and developers in those markets are looking ahead with optimism and faith in persisting tailwinds.

Quality Space Shortage

Vacant retail space in Northeast markets has been hard to come by this year, and professionals in the region aren't expecting that to change anytime soon. The equation, they say, is simple. While retailers' appetite for expansion has remained healthy, new construction and deliveries have been very limited.

"Almost nothing has been built in the past 10 years," says Dan Zelson, principal with Charter Realty. "There's really just very little new product."

Steve Gillman, partner at The Shopping Center Group (TSCG), notes that while some smaller, single-tenant buildings may still be coming on line, "nobody is building a big strip center with 100,000 square feet."

"There's that imbalance of supply and demand: demand by the retailer and lack of supply of space," adds Daniel Taub, senior vice president and national director of retail and net lease divisions at Marcus & Millichap.

Research corroborates these observations of diminished levels of new construction. Colliers reports that of the top five metros nationally, New York City jointly ranked as the market with the least amount of new retail space under construction during the third quarter

Simon recently completed a 130,000-square-foot redevelopment at its Burlington Mall property in the greater Boston area. Almost 50 retailers and eateries were added to the tenant roster during the redevelopment, including Uniqlo, lululemon, Vineyard Vines, Aritzia and Marc Jacobs. This activity speaks to the reality that throughout the Northeast, demand is very strong for high-quality spaces in natural pathways of growth.

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BROAD PROBLEMS, NARROW SOLUTIONS FOR NYC REAL ESTATE

Can incentives cure the city's property market funk?

By Joel Marcus of Marcus & Pollack LLP

The City of New York's tax assessment valuations remain on an upward trajectory that compounds the burden on property owners. In stark contrast to this fiction of prosperity and escalating valuation, real estate conditions tell of a growing threat that menaces all asset classes across the city.

Pharmacies, retail stores and restaurants with deep roots in the community are vanishing at astonishing rates, victims to post COVID-19 changes in consumer habits, competition with e-commerce and rising costs associated with labor and supply chain disruptions.

Remote and hybrid work practices have taken a heavy toll on commercial office buildings. Submarket vacancy rates in the sector are cresting 20 percent, while individual office properties wrestle with vacancies ranging from 50 to 100 percent.

While hotels have improved due to demand for temporary migrant housing, they still have not fully recovered to pre-pandemic occupancy levels. Meanwhile, multifamily rents continue to rise, straining the budgets of long-term residents and driving many renters to an affordable housing sector where supply remains insufficient to meet the needs of an expanding population.

Despite the challenging market conditions, the city's property tax bills continue to increase, driven by a host of underlying factors.

Assessments Ascending

On a citywide basis, taxable, billable assessed values increased by 4.2 percent

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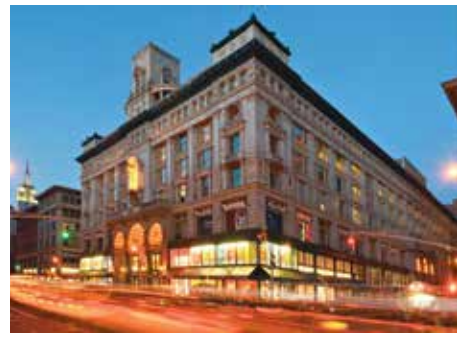

BROAD PROBLEMS, NARROW SOLUTIONS FOR NYC REAL ESTATE

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this year to $298.9 billion. Assessments climbed 4.5 percent for co-ops and condominiums, but also increased in hard-hit commercial sectors. Retail valuations climbed 1.6 percent, and total valuations for office properties grew 2.5 percent from the previous year.

Why the disconnect between challenges in the real estate market and the rising burden of property taxes? Several factors could be pressuring assessors to increase assessment values. Here are just a handful:

Need to raise revenue: Property taxes represent approximately 30 percent of the city's budget, and the municipality's financial obligations continue to grow. The city continually seeks additional revenue to fund employment agreements, pension obligations and expenses associated with homelessness and migrant populations, as well as other expanding costs.

Market myopia: Property taxes are based on annual valuation updates that may not accurately reflect the quick shifts a market is experiencing, such as skyrocketing vacancy rates and the need to make costly building improvements to attract and retain tenants. As a result, property owners may face tax bills that do not correspond to the current economic environment

Debt, disregarded: The city's property assessments ignore debt service, leading to overestimations of taxable value. Commercial real estate sectors are facing growing pressures related to renewing existing debt, especially at today's high interest rates. Debt service obligations on many commercial properties now exceed the asset's market value, making it increasingly difficult for property owners to refinance, operate or sell their properties at a profit.

Dated data: Even where there is increased vacancy, the assessors still use outdated estimates of market rents and occupancy to impute income for vacant spaces, thus keeping assessments artificially high.

Tax Relief Options

Amid these mounting challenges, a property owner can often mitigate their tax burden by contesting the assessor's conclusions and arguing for a reduced assessment.

Alternatively, or additionally, taxpayers can apply for relief under the city's abatement and exemption programs. An adviser experienced in the property tax law and local practices for the subject property's jurisdiction can be a valuable aid in identifying and pursuing tax relief options.

Here is a rundown of some of the major real estate tax programs that New York City offers to provide property owners with relief while incentivizing investment in the community:

The Industrial & Commercial Abatement Program (ICAP) provides property tax abatements for businesses that make capital improvements in commercial and industrial properties. For both renovations and new construction, the program provides a 10- or 12-year benefit for renovations in Manhattan below 59th Street, and 15 or 25 years of benefits above 96th Street and outside of Manhattan.

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By renovating and repurposing older, underutilized properties, ICAP helps deliver productive spaces and revitalize neighborhoods. Without these incentives, the cost of construction and renovation is often prohibitive for property owners.

ICAP was set to expire next spring, but the state legislature recently extended the program to April 1, 2029. While this is a great program to encourage property rehabilitation, it hinges on owners' ability to pay for substantial capital improvements and to secure tenants at market rents. Not all properties can fit that profile.

The Affordable Housing from Commercial Conversions program offers tax exemptions for owners who convert commercial properties into residential rental units. Also known as the 467-m program, this initiative seeks to increase the supply of residential housing and is a boon to owners of some outmoded office properties that seek to revitalize their buildings through a change in use.

The benefits are great — owners pay zero taxes during construction and 90 percent of normal taxes for 35 years after completion. However, 25 percent of the units must be offered at affordable rents.

The problem with this program is that many office buildings are poorly suited to residential conversion under current residential building and zoning codes. Achieving workable apartment layouts and window locations can be challenging, and in some cases, conversion may exceed the cost of new multifamily construction (*see pages 22-23 for more information on office conversions*).

The Affordable Neighborhoods for New Yorkers program, or 485-x, incentivizes the creation of affordable rental housing across the city and is the successor to the 421-a program. Developers of buildings with more than 11 rental units and that make 20 to 25 percent of the property's units affordable are eligible for property tax exemptions for up to 40 years.

The program that is 485-x represents a critical tool in expanding the city's affordable housing stock as rising rents displace long-time residents. The affordable component remains in effect beyond the benefit period, however, which deters many developers.

The snapshot of NYC's assessment quandary is this: The market is demonstrating lower valuations, but tax assessments remain stubbornly high. The incentive programs require substantial new capital outlays for construction, and the end product needs to be economically viable.

As in all stories, time will tell how New York addresses its property tax dilemma. But if market conditions continue to decline, the current incentives will not resolve the problem of excessive property taxation.

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