Spotlight on: SB Friedman

The Fiscal Fallout of Empty Office Space

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With growth in hybrid work and the flight to higher-quality office space, building owners in many communities continue to encounter significant declines in office occupancy. Even as companies search for new space and urge employees to return to the office in person, this is not enough to offset space vacated in the wake of the pandemic. Property owners and investors are not the only folks concerned about the impact of declining office performance. The shift in work patterns that contributed to higher office vacancy rates is going to result in decreases in the assessed value of some office buildings, especially those with less desirable Class B and C office space. Lower building values will lead to a reduction in property taxes for municipalities across the state. These changes pose a fundamental threat to the tax base as they are leading to major shifts in land use and development patterns.

While many of the post-pandemic economic impacts are already being felt, communities could continue to experience the fiscal impact in the coming years. It is a common property assessment practice for property values to be estimated based on the income generated from the building based on the prior year. This backward-looking approach may not reflect the full reality of the office market depending on the timing of when leases expire. The significant rise in office vacancies could be worse than it appears because many leased offices are not occupied or are under-occupied as tenants wait out long-term leases. However, as these leases expire, the income generated will decline and property tax declines will follow. Additionally, if office occupancy rates do not significantly improve as loans mature and leases come up for renewal, a lower valuation of properties is likely to occur that puts additional financial pressures on building owners and local governments.

While many communities are concerned about the loss of local taxes with increasing office vacancies, they can potentially unlock significant fiscal benefits by planning for the transformation of the obsolete space. With lower demand for office space that is built on valuable land, communities may need to consider repurposing for alternative uses which would have positive fiscal impacts. Assessing the potential fiscal impacts of a proposed redevelopment requires careful estimation of municipal revenues and costs. Several key factors drive fiscal impacts of redevelopment—land-use mix, development density, and whether infrastructure is adequate or must be upgraded to serve the development, among others. Depending on a community's unique mix of revenue

sources, some land uses will be more fiscally productive than others. This is further influenced by the size and quality of the redevelopment. Higher density, high-quality development, regardless of the use, will typically be more fiscally productive than the alternative. Additionally, different types of development have varying service needs which influence service costs.

If no action is taken, declining assessed values of underperforming office buildings could mean shifting the property tax burden to fall more heavily on residential taxpayers. However, communities that evaluate opportunities to transition to alternative uses, identify market-feasible uses for the future, and utilize the various tools available (e.g., TIF, Business Districts, Special Service Areas, etc.) to reimagine and restructure land use can achieve improved fiscal balance. The next generation of community planning is central to this effort, but it is not to be left only to the planners: managers, finance directors and economic development officials must all be engaged to shape communities to adapt to these trends and fiscal challenges.