

# EFFECT OF COVID-19 ON REAL ESTATE TAXATION

MARK J. WITKIN

**The article examines changes that have occurred – or are expected to occur – in statutes and regulations and in municipal *ad valorem* tax decisions. It also examines an existing opportunity to contest valuations of property as a result of the pandemic and the possible political implications for society resulting from probable dysfunction in our property tax assessment and payment structures.**

The purpose of this article is to examine the effects of the COVID-19 pandemic on the assessment and taxation of commercial and multi-family residential real estate.

The significance of the health crisis in this context cannot be overestimated. Late payment or nonpayment of real estate taxes can have numerous negative consequences for the taxpayer, including interest charges of 14%, loss of opportunity to contest property valuation, and breach of mortgage covenants and lease terms. Conversely, wholesale failure to pay taxes timely by a significant number of taxpayers will affect a municipality's ability to furnish essential services, maintain municipal property, and participate in credit markets.

This analysis focuses on the effects of the pandemic in Massachusetts because Massachusetts exhibits most of the characteristics and attributes affecting and common to other states.

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portunity to contest valuations of property as a result of the pandemic and the possible political implications for society resulting from probable dysfunction in our property tax assessment and payment structures.

## I. Statutory framework

In Massachusetts, as in other states, real estate taxation is a creature of statute. With some exceptions not relevant here, the following statutory provisions are most relevant and illustrative. Massachusetts General Laws c. 59 mandates the date of valuation G.L. c. 59 §2A(a), 11 and when payment is due c. 59 §57, 57C. The assessment can be no greater than a taxpayer's just proportion nor in excess of its fair cash value G.L. c. 59 §38, 59.

Taxpayers aggrieved by their property assessments have an abatement remedy, which includes the right to apply to city or town assessors for a reduction in the assessment. If a reduction is not forthcoming or is not satisfactory, then they have the further right to appeal to the legislatively created Massachusetts Appellate Tax Board (ATB or the Board) G.L. c. 59

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'59, 64-65. Most importantly, the respective dates for payment, filing of the abatement application, and appeal to the ATB are jurisdictional and require strict compliance. Failure to: (1) pay the exact amount owed; or (2) make the payment or a required filing by the respective deadline results in the loss of any right to contest the tax for the fiscal year.

The above outline serves as a backdrop to the current crisis. Presently, real estate tax payments are due or coming due just as the financial conditions or property operations of many taxpayers are in shambles. Owners and operators of many parcels of real estate are sheltering in place, retail tenants are closed, mortgage payments and rent payments have been missed, businesses are facing bankruptcy, municipal budgets are asunder, and the federal government – through its Federal Reserve System and other agencies – is attempting to provide enough liquidity to preserve our economic and financial system.

Present statutes provide little relief. Under G.L. c. 59 '65 B, a taxpayer with an existing appeal at the ATB who is unable to make the final tax payment in fiscal year 2020 may petition the Board for permission to extend the deadline to pay the tax, however that extension is available only to taxpayers who have filed applications for abatement at the municipal level, and have taken appeals to the ATB and paid a statutorily required amount without incurring interest. Moreover, the deferred tax accrues interest at the statutory rate of 14%.

In response to present economic conditions, Massachusetts and other states have offered only limited relief. On 4/3/2020, the Massachusetts legislature passed and the Governor signed emergency legislation, which, among other things, extended the deadline for payment of the final installment of the fiscal year 2020 levy from 5/1 to 6/1. However, not all taxpayers took advantage of that extension, as the new legislation only granted municipalities the *option* to extend the deadline. Many communities extended the deadline while others did not. Consequently, some taxpayers were granted limited relief; others were not as fortunate. Thus, in the present economic and financial crisis affecting everyone, some taxpayers, under existing legislation, have had dissimilar opportunities to achieve some relief. As of this writing, no other legislation offering extended payment delay or moratoriums has been proposed.

## II. Case law

Clearly, the effects of the pandemic will extend far beyond when tax payments are due. Most importantly, COVID-19 will affect the amounts of the levies. Here, any change will not occur in the statutory framework but rather in the case law created by the ATB and the appellate courts tasked with the duty to oversee municipal property valuations. Like Massachusetts, most jurisdictions define property value (fair cash value or fair market value) as what a willing buyer would pay a willing seller, neither being under a compulsion to buy or sell. G.L. c. 59 '38. Prior to the pandemic, case law and the rules of engagement were well established. The value of a property must be determined after consideration of all the uses to which it could be adapted; and it had to be valued

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at its “highest and best use” (i.e., the use for which it would engender the highest price).<sup>2</sup> The three traditional methods of valuation are (1) the depreciated reproduction or cost method, (2) the capitalization of income method, and (3) the market or sales method.<sup>3</sup>

The concept providing the foundation of almost all valuation in Massachusetts case law, especially the capitalization of income and sales methods, is the concept of an existing market (i.e., there exists a collection of individuals who are active in the buying, selling and leasing of properties that pay similar prices and rents for comparable properties and premises).

How each of these important determinants of property value might be treated under present economic stress by our ATB and appellate courts will be examined next.

### A. Highest and best use

Typically, this issue is raised in valuation litigation when the Appellant claims the subject property in its present use is worth less than its assessment, and the Municipality argues that the present use is not the property's highest and

<sup>1</sup> *Boston Gas v. Assessors of Boston*, 334 Mass 549 (1956); *Waltham Watch and Clock Co. v. Waltham*, 272 Mass 396 (1930).

<sup>2</sup> *Irving Saunders Trust v. Assessors of Boston*, 26 Mass. App. Ct. 838 (1989).

<sup>3</sup> *Correia v. New Bedford Redevelopment Authority*, 375 Mass. 360, 362 (1978); G.L. c. 59 '38.

best use and, therefore, the property should be valued as used for a different purpose. Simply put, the issue is present use versus potential use. At trial, the proponent of a proposed use must prove it to be sensible and reasonable<sup>4</sup> and not unduly speculative.<sup>5</sup> Frequently, the argument focuses on the possibility of a change in zoning<sup>6</sup> and whether there was a reasonable prospect that a present bar to a different use would be removed.<sup>7</sup>

At present, the possibility of litigation featuring that issue has become a probability. Even before the pandemic, certain property uses were changing under stress. Properties used for retail sales, including shopping centers, lost customers to online shopping and were closing or being repur-

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posed, and malls were converted to entertainment centers, distribution outlets, or offices.

Other segments of the real estate spectrum (such as nursing homes buffeted by rising costs, rate cuts, and competition from other senior housing) were converted to other uses.

Now, COVID-19 has transformed real estate problems into catastrophes. Undoubtedly, many owners of empty buildings will seek new uses for their properties and will petition local authorities for zoning changes, variances, and other approvals. The ATB and our courts will have to decide whether the possibility of change in specific cases is reasonable or speculative. Certain owners trapped into a present use by either contract, debt, or other circumstance will no doubt contest the value of their property based on present use. Again, the ATB will have to decide if a change in use under present conditions is possible or probable, both economically and/or legally.

## B. Methods of valuation

The most obvious effect of the present crisis will be seen in the possible evolution of the ATB's use of the traditional methods of valuation. No method will be untouched.

## 1. The cost method

The cost method is not favored at the Board. Its use is restricted to "special situations" where reliable data is not available using the other two methods.<sup>8</sup>

In present circumstances, litigation will probably arise regarding the viability of construction projects halted prior to completion. Obviously, many projects will be completed after delay, but others will never be finished. The foundation for use of the cost method in valuation litigation is the belief that cost translates into value. Presently, that is not always true. In fact, some projects might have a negative value if construction loans or other contracts require completion of a project for which there is limited or no use. Consider the partial completion of a hotel in an area where economic activity, including business and leisure travel, has ceased. Consider also if a hotel operation that is currently closed can survive for the unknown number of years it would take for economic activity to attain normal levels. In many cases, completion of a construction project will depend on the financial strength of the owner or the construction company. But, will the ATB permit the viability of a property owner to affect the intrinsic value of a parcel of real estate? The question will be asked; the answer is unknown.

Similar questions can be raised for construction projects of other types of real estate, and in all such matters, there exists an underlying dilemma. Our *ad valorem* tax system mandates the determination of value on a date certain based on a property's use, yet at this time, the use of a particular parcel, especially for one not yet completed, is uncertain at best. Similarly, it is uncertain how the ATB will treat this issue.

## 2. The capitalization of income & market (sales) methods

For purposes of this article, these two distinct methods will be discussed together, as they ultimately rely on the same hypothesis that:

1. There is a collection of participants who are active in the purchase and sale, as well as the rental and use of parcels of real estate; and
2. Generally, these participants will pay comparable purchase prices for comparable properties and similar rental rates for similar premises.<sup>9</sup>

That activity, and the prices and rents participants pay, is the so-called "market." The

pandemic brings to mind the famous philosophical question – “If a tree falls in the forest, but no one hears it, does the tree make a sound?” Or, in our present context, if there are no or few participants and little or no sales or leasing of properties, is there a market? Or, more to the point, if there are limited participants and little activity, are the prices and rents paid market price and market rents?

In pre-pandemic times, to establish values using the sales or leasing of other properties, the ATB required not only comparability of properties but also similarity in time and place of sale or lease.<sup>10</sup> Moreover, transactions must be made without compulsion, in a free market.<sup>11</sup> Yet current conditions include lack of sales activity in commercial mortgage-backed securities, failed merger and acquisition transactions, and more stringent lending requirements. Activity in some real estate sectors remains strong while others are near collapse.

The Board’s reaction to these factors is difficult to predict. Historically, the ATB has not treated what it saw as temporary conditions as stabilized, longer-term reflections of market movement based on intrinsic value. When the credit markets saw the prime rate rise to 19% or 20% in the 1980s, ATB capitalization rates rose but not nearly to that higher level. More recently, sales of property at low prices during the Great Recession were not always treated as market benchmarks but as temporary aberrations engendered by compulsion. Board decisions reflected market change, but its valuations typically did not fall to those price levels.

At present, it is uncertain how the ATB and appellate courts will permit changes in appraisal and valuation definitions to reflect present economic conditions. What is more certain is where the valuation battles will take place (i.e., the concepts of property use, methods of valuation, and definitions of market, compulsion and comparability).

### III. G.L. C. 59 ‘2D(e)

Under the present statutory framework, many if not most assessors take the position that present market conditions have no effect on property values for fiscal year 2020, which has an assessment date of 1/1/2019 or 6/30/2019 (for new construction); nor for fiscal year 2021, which has an assessment date of 1/1/2020, as the shock to our markets did not occur until dates in 3/2020. However,

a little-used statutory provision G.L. c. 59 ‘2D(e) might well provide a more immediate avenue for taxpayer relief in all but the few municipalities that have “opted out” of its effect G.L. c. 59 ‘2 D(f).

G.L. c. 59 ‘2D was designed to allow municipalities to capture increases in value resulting from new construction that occurred after applicable assessment dates. Thus, in any fiscal year whenever new construction improves the real estate assessed value by over 50%, excluding the value of the land, and a temporary or permanent occupancy permit issues after 1/1 in any year, the city or town shall tax the owner on a pro rata basis to the end of the applicable fiscal year for that increase in value. Moreover, the city or town may assess the increase in value in the succeeding year when the issuance of the occupancy permit takes place between 1/1 and 6/1.

Little noticed and rarely used is section (e) of the statute, which provides that whenever in any fiscal year the value of real estate is decreased by over 50%, excluding the value of the land, as the result of fire or natural disaster, then the city or town shall abate or refund taxes, as the case may be, in an amount calculated in the same manner as the real estate tax increase is calculated pursuant to the provisions of that section. A property owner aggrieved by the failure of the assessors to so abate may, within one year following the fire or natural disaster, apply to the assessors for the abatement. The term “natural disaster” is not defined by the statute. Although not mentioned specifically, the obvious statutory attempt to mirror increases and decreases in value after the 1/1 assessment date would seem to require similar treatment and abatement in the succeeding year as well.

The effect of the statute is obvious. Assuming the coronavirus to be a natural disaster, all

<sup>4</sup> *Wenton v. Commonwealth*, 335 Mass 78, 81 (1956).

<sup>5</sup> *Acelbekian v. Massachusetts Turnpike Authority*, 341 Mass. 398, 400-401 (1960).

<sup>6</sup> *Roach v. Newton Redevelopment Authority*, 8 Mass. App. Ct. 618 624, 625 (1979).

<sup>7</sup> *Skyline Homes Inc. v. Commonwealth*, 362 Mass 687 (1972).

<sup>8</sup> *Correia v. New Bedford Redevelopment Authority*, 375 Mass. At 362 (1978); *Foxborough Associates v. Assessors of Foxborough*, 385 Mass. 679 (1982).

<sup>9</sup> *McCabe v. Chelsea*, 265 Mass. 494, 496 (1929); *Congregation of the Mission of St. Vincent de Paul v. Commonwealth*, 336 Mass. 357, 359 (1957) *Correia v. New Bedford Redevelopment Authority*, 5 Mass. App. Ct. 289, 293-294 (1977) rev’d on other grounds 375 Mass 360 (1978).

<sup>10</sup> *New Boston Garden v. Assessors of Boston*, 383 Mass 456 (1981).

<sup>11</sup> *Westwood Group, Inc. v. Assessors of Revere*, 391 Mass. 1012, 1013 (1984).

taxpayers, whether or not they had previously filed abatement applications and/or appeals, where damage from the pandemic would qualify as over 50% of assessed value, excluding land value, may file for a refund or abatement. Although the statute contains hurdles, its provisions seem to provide a clear link between the assessed value of property and the effects of the pandemic now available to all taxpayers who have suffered the qualifying loss in value.

#### **IV. The political unknown**

The extent of present and future economic loss to our country, individual states, and each property

owner is unknown. However, there is a possibility of a vicious circle of enormous proportion. Many taxpayers will be unable to pay their respective levies. Without these funds, cities and towns will not be able to provide essential municipal services, nor retain all staff. The ranks of the unemployed have already swelled. Those individuals with no other alternative will demand relief. Public outcry and common sense already dictated legislation extending the deadline to pay the last quarterly tax bill of fiscal year 2020. However, tax bills never cease. Continuing economic distress will require additional action from local, state, and federal governments. Our property tax system will be one of the fields on which that action will occur. ■