Colorado Assessor's Study of the effects of the Covid-19 Pandemic on Non-Residential Property Valuation

Adams County
Arapahoe County
Boulder County
Broomfield County
Denver County
Douglas County
Eagle County
Jefferson County
Larimer County
Mesa County
Routt County
Weld County

Executive Summary

Introduction

Covid-19 was declared a global health crisis by the World Health Organization on March 11, 2020. On March 11, 2020, Colorado Governor Jared Polis reacted to the pandemic by declaring a Disaster Emergency due to the presence of Covid-19 in Colorado (D 2020-003). The Governor and CDPHE subsequently issued orders closing all public gathering places such as bars, restaurants, theaters, gymnasiums, casinos, ski resorts, and public/private elementary and secondary schools statewide. On March 22, 2020, the Governor ordered all non-essential Colorado employers to reduce their in-person work forces to 50%.

The Governor's Stay at Home Order (D 2020-017) was issued on March 25, 2020 and was immediately followed by Public Health Order 20-24 from the Colorado Department of Public Health and Environment (CDPHE). These orders mandated Coloradans to stay at home, addressed self-isolation measures, limitations on public/private outdoor gatherings, business restrictions, travel restrictions, and provided social distancing requirements.

The Covid-19 pandemic led to substantial economic, social and market occurrences, including:

- Disaster declarations were issued at the federal, state and local levels
- A statewide stay at home order was issued by the Governor of Colorado, along with many related Executive Orders that had significant social and economic impacts
- Downturns were observed in some -but not all commercial sectors
- Loss and/reductions in rental income for some commercial properties

Prior to the March shutdown, the Colorado economy was exceptionally healthy, and outperforming most of the Country, however beginning in April it followed the rest of the United States into the pandemic recession. These events made it clear to County Assessors in Colorado that potential impact on commercial real estate values merited investigation. Property valuation and assessment for ad valorem purposes varies from state to state, and on an international basis, from country to country.

In the State of Colorado, County Assessors value all real property in their jurisdictions every two years in odd numbered years. This requirement is dictated by Colorado Statute, along with methodology by which this is to be accomplished.

Real property is valued as of a specific date, known as the "valuation date", which is always June 30th of the year preceding the reappraisal, and is June 30, 2020 for the upcoming 2021 general reassessment. Assessors are to consider data from the preceding 18 months, known as the "study period", and rely heavily on transactions of real property to perform their valuation analysis. This said, it is important to acknowledge that most Assessors avail themselves of the statutory option to increase the study period in six-month increments for a total 24-month study period. According to the State Constitution, only sales of similar properties can be used to value residential property, however non-residential property valuation is valued with due consideration given to the Cost, Sales Comparison, and Income approaches to value.

In addition, Assessors are required by law to adjust all property sales to the June 30th valuation date, which is commonly known as “time trending”. This is accomplished through a thorough review of market evidence, particularly sales activity. As it sounds, sale prices are adjusted up from the date of sale to account for an appreciating market and adjusted down if the market is declining as of the valuation date. This time trending step is critical to the valuation process and is specifically analyzed as part of the annual State Board of Equalization audit process to ensure accurate and uniform valuations throughout Colorado.

The timing of Covid-19 global pandemic caused great concern to Colorado Assessors with respect to time trending --or adjusting sales. Sales activity was occurring with a typical volume of transactions throughout Colorado until the Covid-19 crisis emerged in March 2020. While a significant decrease in residential transactions was observed, commercial real estate transactions fundamentally ceased to occur between the onset of the pandemic in March, and the valuation date of June 30, 2020. The primary concern of the assessment community is that without transactions between the Covid-19 shutdown and the valuation date, it is very difficult to determine what, if any, impact the pandemic had on commercial property values as of the valuation date.

In a proactive effort to determine the impacts of the pandemic on the commercial real estate market in Colorado, a group of County Assessors came together and dedicated staff to conduct a comprehensive study on six commercial real estate sub-markets: Office; Retail; Warehouse; Apartments; Commercial Condominiums; and Lodging. Additionally, it was important for each team of Commercial Appraisers to identify sub-markets that required separate research and analysis and provide suitable recommendations. This report is the result of that exhaustive effort and contains specific recommendations and methodologies where adjustment may be appropriate to commercial property values for the 2021 revaluation.

We are grateful for the efforts of the County Assessors and Appraisers who have contributed to this important endeavor. This will have several outcomes, the greatest being a consistency in our recognition of the pandemic on commercial property valuation for tax years 2021 and 2022. This effort has been unprecedented in the history of the State of Colorado, and we credit those leaders and future leaders for the knowledge, skill and experience they have lent to this study.

Executive Summary

The following information is summarized findings from each of the six study groups. Recommendations are general in nature and specific local market information should always be relied on most heavily.

Office

A property that sold prior to the start of the pandemic may not have sold for that same amount on June 30, 2020. Therefore, a sale that occurred before the pandemic may need an adjustment to account for changes in market conditions that were present on the date of value. Sales data is very limited, and it is difficult to extract reliable market wide conclusions from such a small sample.

The various aspects of the income approach did provide some indication of changes in the market that could be used to calculate an adjustment to the pre-pandemic sales. The recommended range of impact is summarized below. Each county should review their individual markets and determine how it applies to them.

Rental Rates	No adjustment recommended.
Concessions	Depends on the individual market. In markets where 4-6 months free rent on a 64 to 66-month lease are common this represents a 6% to 9% reduction in revenue.
Vacancy	Depends on the individual market. Most markets saw 0.7-2.0% increase in vacancy. Other markets saw no change.
Collection Loss	No adjustment recommended.
Expenses	An increase of 3-5% in expenses is supported. This may also be reported as $0.25-$0.50 per square foot.
Cap Rates	Depends on the individual market. An adjustment of 0-.5% is supported.

Once a county has determined what adjustments apply to their markets, they should apply these adjustments to their base period sales for an adjusted sales price reflective of the market as of 6/30/2020. This adjusted sales price could then be used to support market values.

Retail

Small Retail, Restaurants & Entertainment Uses

A Covid-19 adjustment of approximately -11% should be made to the estimated income values for sit-down restaurants, bars, taverns, and entertainment venues. An adjustment for salons, barbershops, daycares, and fitness centers may also be appropriate when county-specific data reflects a measurable decrease in the income generating potential for these property types.

Anchored & Non-Anchored Shopping Centers

The most reliable data available for both the pre-Covid and post-Covid timeframes is most relevant to the Income Approach method of valuation, which is also the most common method used by market participants for Group B properties.

The movement of lease, vacancy and cap rates is slight as of the date of valuation. As of the date of valuation, lease rates were slightly decreasing, vacancy rates were slightly increasing, and capitalization rates had increased approximately 50 basis points. The combination of these factors potentially results in slight decreases in value for Group B properties. While a common myth is that retail property values plunged as impacted by Covid-19, the data does not support a drastic decrease in Group B retail property values as of June 30, 2020.

In terms of market sales activity and comparable sales data, this data also does not support a drastic decrease in retail property values. Sales data shows that sale prices and unit prices per square foot did not decrease on an overall basis. Investors continue to look for properties to purchase; although it is noted that the pool of potential buyers is smaller as lending requirements are more stringent, which is offset by fewer properties available for sale. The drop in the number of sales during the Covid-19 period is not attributed to decreasing property values, but rather to the uncertainty of market conditions moving forward. This is illustrated in the slight increase in capitalization rates reflecting the perceived inherent risk of future unknowns regarding Covid-19, including the unknown time frame when it will no longer negatively impact social and business activity.

Overall, our analysis found the following:

- Slight downward movement of lease and vacancy rates
- Slight increase of capitalization rates around 50 basis points
- No measurable change in sales prices or unit prices per square foot

We recommend as an alternative to paired sales analysis for pre-pandemic and post-pandemic sales that counties look at changes in the components of their submarket Income Approach parameters as a method of adjusting pre-pandemic study period sales.

Big Box Retail and Regional Malls

Big Box retailers were generally considered Critical businesses and did not close during the pandemic and by all accounts appear to have fared well through the study period. Thus, in general, we do not believe an adjustment to value is merited due to the pandemic. Nevertheless, there may be some properties within this category that were not considered critical that specifically experienced hardships related to the closure, we recommend that counties consider these properties during the protest period based upon the specific information provided by the property owner during the appeal process.

For Regional Malls we recommend focusing on the key components of the Income and/or Cost Approaches for the 2021 re-appraisal. Since the Income Approach parameters are highly variable from mall to mall, we believe that the valuation analyses should be based on the geographic and economic climate of each property. Special attention should be given to vacancy/collection losses and capitalization rates when using the Income Approach and determining if economic obsolescence is apparent in the marketplace when evaluating depreciation within the context of the Cost Approach.

Warehouse

First, regional sales data was gathered and combined from the participating counties to explore trends over the base period, and specifically, to identify any sudden changes after the pandemic started in March 2020. While there was a precipitous drop in sales volume, the sales rebounded in June 2020 to a level consistent with the overall trend observed from most of the base period data, from July 2018 to Feb 2020. Further stratification of this regional data to small and large warehouse properties, defined by building size, produced the same results as the entire data file. Overall, this analysis provided no basis for an adjustment based on warehouse sales.

The next two research and analysis sections focused on the variables pertinent to the income approach to value, cap rates, vacancy, and rent rates. To examine these variables, data was collected from CoStar and available research reports from national brokerage firms. Like the sales analysis, data was analyzed over the base period to measure trends occurring pre and post pandemic, as well as any abrupt changes after the pandemic began. Data from these analyses provided no clear indication of an immediate or measurable change directly related to the pandemic.

To summarize, no adjustment specific to the impact of the Covid-19 pandemic is recommended for the warehouse subclass from this report. It is recommended that each county verify the results of this report with county-specific data to validate and confirm similar conclusions.

Apartments

The Covid-19 pandemic's effect on values of apartments in Colorado was minimal as of the appraisal date, June 30th, 2020. With a moratorium on evictions and high unemployment, one would expect values to decline more severely. Government assistance to typical renters is a possible explanation for the minimal effect on values. On March 20, 2020, the Governor's executive order D2020-012 allocated $3 million from the Disaster Emergency Fund to provide short-term rental and mortgage assistance to low-income households facing financial hardship due to Covid-19. The US Congress passed H.R. 748, the CARES act, which provided an additional 13 weeks of unemployment benefits through December 31, 2020, and an additional $600 per week per individual. The benefit included workers not traditionally eligible for unemployment benefits (self-employed, independent contractors, etc.) who were unable to work because of Covid-19 issues. In addition, the CARES act created an advanced tax refund of $1,200 per individual, $2,400 per couple, and an additional $500 per child. These measures appeared to allow tenants to pay rents through June 30th, 2020 and in turn keep apartment values from plummeting. On April 24th, the Paycheck Protection Program and Health Care Enhancement Act became law which provided additional lending authority for the Small Business Administration to respond to payroll needs created by the Covid-19 outbreak.

Apartments are not out of the woods, in fact the modest decline in some areas of Colorado is indicative of the uncertainty looming due to eviction moratoriums and the eventual expiration of government assistance. Additionally, there are trends beginning to emerge including tenants migrating from downtown Denver to more affordable areas, teleworkers needing apartments with office space, and multiple households are coalescing which is creating a need for larger apartments.

Commercial Condominiums

In reviewing all of the data in the Multi-County study, the main conclusion is that commercial condominiums, regardless of type (Industrial, Office, Retail and Warehouse), had an increase in value from the previous base period; with the pandemic having little if any effect upon the property class value. While the volume of sales in the last quarter of the base period declined once the pandemic and lock down were in full effect, caution must be used in drawing conclusions about the impact of the pandemic. The majority of sales that did occur followed similar value increases and trends from the previous 7 quarters, with values increasing over the two-year data collection period as a whole.

Post-Covid trends in average sales prices for all property types vary between counties with Mesa, Weld, Larimer and Douglas showing a flattening out after March 2020, while Arapahoe, Eagle and Boulder Counties show ongoing growth in sales prices. Though some county condominium sales didn't increase in value as much as some of the other counties surveyed, a distinct rise in sales prices by June 30, 2020 was clear and evident, and followed the study's increasing trend of value overall for commercial condominiums through the two-year data collection period. As a check of reasonableness, a review of post study period sales indicates that there is a continuation of the increasing trend in sales prices and sale price per square foot in the surveyed counties.

Lodging

The adjustments summarized below provide a range of typical value adjustments resulting from the pandemic for three stratifications of lodging properties. The notion here is that hotel owners experienced this loss in value from December 2019 to June 2020 and does not reflect a reduction in the Assessor's Actual Value from the prior reassessment (June 30, 2018). To summarize, value reductions are more intensive in convention hotels and other group travel business properties. In addition, some of the typically strongest leisure travel properties have experienced the greatest value loss resulting from the collapse in the travel industry. Conversely, economy and midscale properties located in rural, mountain, suburban and drive-to destinations did not experience the same drop in average daily rate (ADR), occupancy, or revenue per available room (RevPar), and from a forward-looking point of view, are believed to have a greater chance of recovering in a shorter timeframe. The simple fact that lodging property performance is so directly tied to location, even without a pandemic in play, requires a specific analysis of the submarkets in each county. Lodging property performance has always been highly dependent on location. As a result, Colorado Assessors must evaluate their local markets to determine the specific effects of the pandemic on their market of hotels.

	Group A	**Group B**	**Group C**
Scale	Economy, Midscale	Upper Midscale, Upscale	Upper Upscale, Luxury
Location	Rural, Mountain, Suburban, Drive-to	Rural, Mountain, Suburban, Drive-to	Urban, Large City, CBD, Fly-to destinations
Service	Limited, Extended	Limited, Select, Extended	Full Service, Convention
Adjustment	0-20%	10-30%	20-30%