ALLEGHENY INSTITUTE FOR PUBLIC POLICY

May 15, 2024 **Policy Brief: Volume 24, Number 19**

Higher office vacancy rates impacting Pittsburgh's suburbs

Introduction: Several previous *Policy Briefs* have discussed the lingering high office vacancy rates in Pittsburgh's central business district (CBD), especially since the pandemic, and how they are impacting the coffers of taxing bodies as building owners are winning lower assessments through the appeals process. Successful appeals of commercial property values that lower assessments and reduce property tax payments are a problem that is not confined to the City of Pittsburgh but has also begun to affect taxing bodies around the county as other commercial property owners follow suit.

This *Brief* looks at the office vacancy rates in the markets outside of Pittsburgh's urban area. All data comes from real estate firm Jones Lang LaSalle (JLL).

The issue

As mentioned in *Policy Brief, Vol. 24, No. 3*, the high office vacancy rates seen in Pittsburgh's CBD lowered the value of office buildings causing many owners to seek reductions in their assessed values. Those values are based on profitability, which depends heavily on rent collections and occupancy. With a lower rental income due to vacant (unleased) space, the buildings aren't worth as much. Compounding the issue is the common level ratio (CLR) (*Policy Brief, Vol. 22, No. 27*).

In absence of an up-to-date assessment, which hasn't happened in Allegheny County since 2012, the CLR is used as a basis for assessment appeals. The CLR is calculated by the State Tax Equalization Board (STEB) for each county for each year based on property sales reported by the county. The county report includes the assessed value and sales price for each transaction. STEB finds the median value of the ratio of assessed value to sales price for the sales for a given year, after removing extreme outlier ratios in the transactions.

The CLR for a county with a new, accurate and complete assessment of all properties would be 1.00 or 100 percent. As each year passes beyond a countywide reassessment—and as market values of a property tend to rise—the CLR will decline. Moreover, as shown in the *2022 Policy Brief*, the use of the CLR as a means of correcting inequity in taxation through the appeal process is a costly, unwieldly and grossly unfair endeavor.

For 2024 appeals, the CLR in Allegheny County is 54.5 percent. It was 87.5 percent in 2021, before falling to 63.5 percent in 2022 and 63.6 percent in 2023. Thus, the owner of a property with an assessed value higher than its market value would certainly be overtaxed—or who has an assessed value to market value ratio significantly above the CLR—and would appeal their assessment.

With market values of properties falling owing to the reduction in profitability and the new, lower CLR, building owners are appealing the assessed values of their office buildings and in many cases have been successful. Not only are they able to get lower property tax bills for the upcoming years but they are also able to receive refunds for past years when they were over-assessed—from not only the county but from the school districts and municipalities.

In a recent Tribune-Review article, it is estimated that Allegheny County has lost $1.4 billion in property values from all sources with $570 million coming from outside of Pittsburgh. The article notes that suburban school districts such as West Allegheny lost $105 million in commercial property value, Montour lost $89 million and Gateway lost $69 million. While the focus of this *Brief* is on office buildings, retailers are also appealing their assessed values, blaming lost sales to online shopping, contributing to the substantial loss of commercial property value.

Office vacancy rates

For this study, the focus will be on all classes of office space, not just class A space.

In the Pittsburgh area, the vacancy rates in the suburbs are consistently higher than those in the urban area. Pittsburgh's urban area is defined by JLL as the CBD, the fringe area (Strip District, North Shore, etc.) and the Oakland/East End. The suburban area is comprised of regions in the north, northern I-79/Cranberry, the east, the south, west and Southpointe. Since the Cranberry and Southpointe areas are outside of Allegheny County, they will be excluded from the study.

In the fourth quarter of 2016 the urban vacancy rate (percent of space not leased) was just 13.5 percent while the average suburban rate was higher at 19.5 percent. In the fourth quarter of 2019 the urban rate had increased to 16.1 percent while the suburban rate fell to 17.9 percent. The pandemic changed things dramatically.

In the fourth quarter of 2021, those rates were 21.0 percent for the urban area and 21.5 percent for the suburbs. As is well documented, the pandemic brought about the work-from-home culture and, as a result, many firms looked to save money on rent by shrinking their office space footprint. In the fourth quarter of 2022, the suburban area improved the office vacancy rate a bit, falling to 19.7 percent, while the urban area was relatively constant at 21.5 percent. By 2023's fourth quarter, both rates bounced up again as the urban area reached 22.3 percent and the suburban area hit 21.5 percent. The most recent data, for the first quarter of 2024, shows the urban rate dropped to 21.8 percent while the suburban rate ticked up to 22.4 percent.

The suburban area with the highest vacancy rate over the years has been the east, where the Gateway School District is located. Monroeville is Gateway's largest municipality and has a large office and commercial sector. In 2016, that rate was 36 percent. It has dipped some, dropping to 26.2 percent in 2019 before bouncing back up to 30.5 percent in 2021 and then 33.6 percent in 2023 but remains the highest in the county.

The area with the second highest suburban vacancy rate is the west where both West Allegheny and Montour are located. These school districts cover Findlay Township and Robinson Township, respectively. Both are known for a high concentration of office and commercial property. The rate in the west for 2016 was 21.8 percent before rising to 25.2 percent in 2021 and 23.3 percent in 2023.

Net absorption rates

Net absorption rates track how much space becomes leased—positive absorption—and how much space becomes unleased—negative absorption. As a percentage of total office space inventory, in 2016 the absorption rates were negative for both sectors, implying that firms were giving up space. In the suburbs it was greater than in the urban area, -1.23 percent vs. -0.21 percent. In 2019, those percentages were much smaller, -0.07 percent for the suburbs and a positive 0.32 for the urban area.

In 2021, the negative absorption rate in the suburbs fell to -2.5 percent while the urban rate creeped closer to negative one percent (-0.97). In 2023, the rates reversed as the suburban rate was -0.84 percent but the urban rate was -2.11 percent. Thus far through the first quarter of 2024, the suburban rate is positive (0.09 percent) but the urban rate is still negative (-0.20). While it is still early to say with any certainty, it appears that the trend of firms giving up office space seems to be continuing, which will further drive down the values of office buildings. This, in turn, will likely have even more building owners appealing their assessments.

Conclusions

The impact of not having frequent assessments has been magnified by the persistently high vacancy rates in commercial and office space. Firms have reduced the need for space as the work-from-home culture seems entrenched. Subsequently, empty buildings bring in less and less rental revenue, driving down their market value. It has become so dire that some Downtown properties, such as the Grant Building in the CBD, are facing possible foreclosure. Owners are seeking to have their assessments lowered to reflect this new reality, which reduces their property tax obligations.

School districts, which rely so heavily on property tax revenues, are not only seeing future revenue streams decline but are also responsible for refunds for past collections. It is likely that for districts that have been hit hard by this office vacancy problem, they will raise millage rates on all classes of property, which will shift more of the tax burden from office and commercial to residential.

Frequent countywide reassessments provide the most accurate and up-to-date information on the true taxable value of all properties so owners, buyers and sellers can make better-informed decisions and plan accordingly.

This is not just an Allegheny County problem but could be an issue for any county with a mix of high vacancy rates and old assessments. This could cause building owners to seek lower assessments to reflect current market values and impact the property tax revenues upon which many taxing bodies have become so reliant.

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