Vacant Commercial Property in New Jersey: Causes and Solutions

Authors:
Michael S. Hayes
Pengju Zhang
Vacant Commercial Property in New Jersey: Causes and Solutions

February 2022

Suggested Citation:


Retrieved from https://policylab.rutgers.edu/projects/

We would like to thank the New Jersey State Policy Lab for funding this work. The New Jersey State Policy Lab is an independent research center operated by the Bloustein School of Planning and Public Policy and the School of Public Affairs and Administration at Rutgers University. The Lab thanks the New Jersey Office of the Secretary of Higher Education for its support and funding. The contents of this report do not necessarily represent the policy of the Office of the Secretary of Higher Education and you should not assume endorsement by elected leadership or other employees of the State of New Jersey. Any omissions or errors are the sole responsibility of the author(s).
The COVID-19 pandemic has accelerated ongoing changes in business investment decisions and customer behaviors throughout the economy (Federal Reserve Bank of Atlanta 2021). For example, the growth in virtual work and e-commerce has likely impacted the demand and supply of commercial property in New Jersey. A significant increase in vacant and under-occupied commercial property across New Jersey can cause many social problems, including increasing crime and violence in local communities, putting downward pressure on economic growth, and reducing governmental revenues (Shlay and Whitman 2003; Seo and Von Rabenau 2011; Cui and Walsh 2015).

It is vital that state and local policymakers are aware of the recent trends in commercial property vacancy rates in New Jersey and presented a critical analysis of potential public policies to address vacant commercial property issues. This policy report is designed specifically to provide this information by addressing the following three research questions:

1. How significant of a problem is vacant and under-occupied commercial property in New Jersey?
2. What are the primary causes of vacant and under-occupied commercial property?
3. What current and future public policies are available to reduce the likelihood of vacant and under-occupied commercial property in New Jersey?

The reminder of this policy report is organized into four sections. Section 2 reports basic facts about the prevalence of vacant commercial property in New Jersey. Section 3 describes the primary causes of vacant and under-occupied commercial property. Section 4 provides a critical analysis of the current and future public policies that may be used to reduce the likelihood of vacant and under-occupied commercial property in New Jersey. The last section summarizes key takeaways and policy recommendations.

---

1 Michael S. Hayes, Ph.D. is an Associate Professor in the Department of Public Administration at Rutgers University-Camden.
2 Pengju Zhang, Ph.D. is an Assistant Professor in the School of Public Affairs & Administration at Rutgers University-Newark.
In this section, we determine the prevalence of vacant commercial property in New Jersey. However, this is not straightforward to determine for at least three reasons. First, there is very limited publicly available data on commercial property vacancy rates, especially on the extent to which a non-vacant commercial property is under-occupied. Second, there are multiple classes of commercial property. It is possible that some metropolitan areas in New Jersey have strengths in one commercial property sector (e.g., industrial/warehouse), but weaknesses in some other sectors (e.g., office). Therefore, it is vital to examine all sectors when completing this analysis. Third, there is no obvious comparison group of cities to use as a baseline because many of New Jersey’s metropolitan areas are significantly different from a socioeconomic perspective. This study uses the national average as the comparison group.

We compile publicly available data on commercial property vacancy rates that addresses the many data challenges mentioned above. The National Association of REALTORS Research Group publishes commercial property vacancy rates for all metropolitan areas in the United States across four classes of commercial property: multifamily, industrial/warehouse, office, and retail. There is data on the seven metropolitan areas in New Jersey: Atlantic City, Jersey City, Newark, Ocean City, Philadelphia-Camden, Trenton, and Vineland.

The data suggests that vacancy rates for commercial property in New Jersey are significantly lower compared to the national average, especially for industrial and multifamily commercial properties. For example, as shown in Figure 1, all seven New Jersey metropolitan areas have a lower vacancy rate for multifamily commercial properties compared to the national average in the third quarter of 2021. Figures 2, 3, and 4 below report vacancy rates for the industrial/warehouse, office, and retail classes of commercial property, respectively.
**Figure 1. Multifamily Commercial Property Vacancy Rates by Metropolitan Area**

Data Source: National Association of REALTORS Research Group

**Figure 2. Industrial Commercial Property Vacancy Rates by Metropolitan Area**

Data Source: National Association of REALTORS Research Group
Figure 3. Office Commercial Property Vacancy Rates by Metropolitan Area

Data Source: National Association of REALTORS Research Group

Figure 4. Retail Commercial Property Vacancy Rates by Metropolitan Area

Data Source: National Association of REALTORS Research Group
These four figures above provide two key takeaways. First, most New Jersey metropolitan areas have lower vacancy rates than the national average across all four classes of commercial property. In fact, at least six of the seven metropolitan areas in New Jersey have a lower vacancy rate for multifamily, industrial, and office commercial property classes. Second, there appears to be strengths and weaknesses across the classes of commercial property within a single metropolitan area in New Jersey. For example, the Newark metropolitan area has a higher vacancy rate than the national average in the office commercial property sector, but it has one of the lowest commercial property vacancy rates for the retail and industrial sectors. At the same time, the Vineland metropolitan area has one of the lowest vacancy rates in office commercial property but has a significantly higher vacancy rate for industrial commercial property compared to the national average. This suggests the policy tools needed to address vacant commercial property problems will depend on the local context.

Additionally, we conducted in-depth phone call interviews with property tax assessors across five New Jersey cities. The opinions of the property tax assessors match the quantitative data reported in the figures above. While they acknowledged that vacant commercial property has been a long-term challenge for some sections of urban areas in New Jersey, they expressed an optimistic view of the current and future demand for commercial property in the state, especially for industrial and multifamily commercial properties. For example, our interviewees suggested that there has been significant positive spillover demand from New York City investors for commercial properties in the northern section of New Jersey. Additionally, the interviewees suggested that apartment rents are surging now, and most mixed-use commercial property buildings on urban main street corridors are being fully utilized right now. The one caveat is that the demand for office space has not fully recovered since the beginning of the COVID-19 pandemic, but this is an issue facing many metropolitan areas across the United States. Overall, both the quantitative and qualitative suggest that the commercial property market in New Jersey is in a relatively better shape than the overall nation.
Our review of prior research on the factors that contribute to vacant and under-occupied properties in central cities suggests the most common explanations are urban population decline, suburbanization, rise of e-commerce, speculative behaviors, and the COVID-19 pandemic (Hoylman 2017; McGowan 2019; Talen and Park 2021). Our study adds to this prior research by examining whether commercial property owners strategically under-utilize their property to reduce their property tax liabilities, based on qualitative surveys of public finance practitioners.

First, urban decline, suburbanization and demographic changes are commonly believed to explain the existence of abandoned and empty buildings in some central cities. For example, urban retail markets tend to be bifurcated into high versus low end consumption, reflecting the loss of an urban middle class to the suburbs (Lobaugh et al. 2018; Kickert 2021). The loss of neighborhood-based retailing has also been found to be racially driven in Chicago area (Immergluck, 1999).

Second, the growth of e-commerce also contributes to the vacancy rate of properties in many cities, domestically and abroad. Specifically, the retail market has significantly shifted so that consumers tend to purchase many of their goods online instead of in stores, directly causing harms to the storefront retail market.

Third, according to a report by New York State Senator Brad Hoylman (2017), landlords pursue higher rent in Manhattan, pushing out mom and pop stores. Instead of renting to another independent and small business, landlords usually take a strategy of holding out for a large corporate chain that is able to pay significantly more in rent than the previous tenant. This renting strategy helps explain the existence of high-rent blight in New York city.

Fourth, another reason for vacant or under-occupied buildings is that those buildings are not owned by local residents but by people who don’t live in them – that is, out-of-town and foreign buyers. A high-profile example is Vancouver where investors own nearly half of condominiums (Gold 2019).4

Fifth, another possible reason is related to the ongoing COVID-19 pandemic. According to an investigation by the Federal Reserve Bank of Atlanta (2021)5, besides online shopping, the current pandemic has shuttered thousands of restaurants, office buildings, malls, gyms, hotels, etc, as reflected by a clear divergence between

non-store retail sales growth and retail sales growth after the onset of the pandemic. The increasing trend of office buildings during the pandemic is also demonstrated by the upward line of national average in Figure 3 above.

Sixth, our study contributes to the prior research mentioned above by examining whether commercial property owners intentionally under-utilize their property to minimize their property tax liabilities. For example, one potential strategy is to “activate the first floor only” of a commercial property building and not leasing out the top floors to potential renters. However, our research suggests this is not a viable business strategy and therefore not an important explanation for vacant and under-occupied property in New Jersey. Below are some specific statements from our interviewees:

- “… I speak to investors, and they don’t ever say they buy a property to [under-utilized it] in order to reduce their property tax bill…”
- “… commercial property owners will always try to find ways to reduce their property tax bill whether they are fully utilizing or under-utilizing their property…”
- “… the subtraction from the assessed value is usually not large enough to justify under-utilizing the property…”
- “… definitely not done on a widespread level…”
- “… vacant problem is not a big problem here…”
- “… very rare [for owners] to ‘underutilize’ their space to lower tax bill…”
- “… don’t see ‘only activating first level’ as a strategy …”
Considering that each city has different reasons for vacant commercial properties, city governments need to carefully choose the set of policy tools that fit best with their local communities when addressing the issue of vacant or under-utilized commercial properties. This section first reviews the existence of policy tools in other places and then discusses progress in cities within New Jersey.

### 4.1. Policy Lessons from Jurisdictions Outside of New Jersey

First, several big cities have attempted to address the issue by imposing extra taxes on vacant properties. For example, Washington D.C. enacted the “Fiscal Year 2011 Budget Support Act of 2010”, through which D.C. created a Class 3 tax rate for vacant commercial and residential properties and a Class 4 tax rate for blighted properties in 2011. Specifically, as shown in Table 1 below, a vacant property of Class 3 will be taxed at $5 per $100, while a blighted vacant property of Class 4 will be taxed at $10 per $100. Both tax rates are substantially higher than those in other classes.

<table>
<thead>
<tr>
<th>Class</th>
<th>Tax Rate per $100</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$0.85</td>
<td>Residential real property, including multifamily</td>
</tr>
<tr>
<td>2</td>
<td>$1.65</td>
<td>Commercial and industrial real property, including hotels and motels, if assessed value is not greater than $5 million</td>
</tr>
<tr>
<td>2</td>
<td>$1.77</td>
<td>Commercial and industrial real property, including hotels and motels, if assessed value is greater than $5 million but not greater than $10 million</td>
</tr>
<tr>
<td>2</td>
<td>$1.89</td>
<td>Commercial and industrial real property, including hotels and motels, if assessed value is greater than $10 million</td>
</tr>
<tr>
<td>3</td>
<td>$5.00</td>
<td>Vacant real property</td>
</tr>
<tr>
<td>4</td>
<td>$10.00</td>
<td>Blighted real property</td>
</tr>
</tbody>
</table>


---

6 A vacant property (i.e., Class 3) refers to a property which has not been occupied continuously, while a blighted vacant property (i.e., Class 4) refers to a vacant property which is determined to be unsafe, insanitary, or which is otherwise determined to threaten the health, safety, or general welfare of the community.
By the same token, a vacancy tax was also approved in San Francisco on March 3, 2020 and it became effective on January 1, 2022. The whole idea is that a landlord has to pay extra taxes if he/she keeps certain commercial space vacant for more than 182 days (approximately half year) of a calendar year. And the tax is calculated based on a building’s frontage (the total length of commercial space facing the Public Right of Way). A similar tax policy has also been used in foreign counties. In 2017, Vancouver implemented a tax on homes left vacant for more than six months per year. Such properties are subject to a tax of 1% of the property’s assessed taxable value. And in 2021, the vacancy tax rate increased to 3% of the property’s assessed taxable value.

Second, different from the “extra tax” policy tools above, an opposite approach has been adopted in some other jurisdictions - that is, a local government may consider providing tax exemption or abatement to encourage the redevelopment of obsolete buildings. For example, in Michigan, the OPRA Act of 2000 allows a community to freeze the existing taxable value on a designated facility for up to 12 years. By freezing the taxable value, it incentivizes the developer to make significant improvements to a building without increasing the property tax burdens.

Third, local governments may take advantage of data science and information technology to optimize their decision-making process in code enforcement. For example, city government of New Orleans developed BlightStat, a data-driven performance management program that uses data from the Department of Code Enforcement and other agencies. This program was designed to primarily help identify properties that are most likely to have the best code enforcement outcomes by taking account of the physical condition of a property, the owner’s history of tax payment, the housing market in that neighborhood and other factors.

Fourth, another increasingly popular tool is local land bank, which usually refers to a governmental or quasi-governmental entity that acquires, holds, and manages vacant, abandoned, and tax-delinquent properties. The properties are acquired primarily through tax foreclosure, and then the land bank develops or, more likely, holds and manages the properties until a new use or owner is identified (Brachman, 2005). Land bank has been used in St. Louis, Cleveland, Atlanta, and cities in Michigan, Ohio, New York, and so forth (Alexander, 2015).

Fifth, there are some other legal and administrative policy tools that local government can use to reduce property vacancy. For example, a local government may try to reform tax foreclosure laws, exercise eminent domain powers, and pass a receivership law or encourage municipalities to use existing receivership powers.
4.2. Current New Jersey Policies

In general, we believe that "tax" policies (e.g., property tax surcharges used in Washington D.C.) may not be promising under current New Jersey context and legal framework. Instead, localities may consider "non-tax" policies such as vacant property registrations, tax abatements, code enforcement policies, land banks, better case law in tax courts, lower capitalization rates, and better training for tax court judges.

As a matter of fact, local governments are making progress towards that direction. For example, Trenton has adopted a vacant property registration ordinance that requires all owners of vacant commercial property to register with the city and to pay an increasing annual fee. The initial vacant property registration fee is $250, but the annual renewal fee increases to 5% of the assessed property value by the fourth year. This increasing renewal fee will likely serve as a significant incentive for property owners to fully utilize their property. In addition, Newark has become the first city to use land bank to combat neighborhood blight in March 2021. Invest Newark, a quasi-governmental nonprofit, was selected by the city council as land bank entity to facilitate converting abandoned buildings, empty lots, and blighted areas into empowered neighborhoods and communities in Newark.

Another common approach to reduce the likelihood of vacant commercial property are building code enforcement penalties. Property owners that fail to comply with local building codes face significant fines that can add up to a significant portion of the building’s value over time. The most common code violations include overgrown lots, improper installation of appliances and detectors, inadequate fire rating, inadequate roofing, and other safety concerns. These penalties discourage the likelihood of poor property management and increase the likelihood of the fully utilization of the property. According to our interviews, New Jersey tax assessors argue that this is the most effective tool to reduce the amount of vacant and blighted properties in the state.

4.3. Potential Future Challenges

There are at least three significant challenges that limit the abilities of state and local officials to reduce the likelihood of vacant or under-occupied commercial property in New Jersey. The biggest policy challenge facing New Jersey state and local officials that want to pursue changes to tax policy is the Uniformity Clause within the state constitution. The Uniformity Clause restricts government officials from applying special tax rules for vacant or under-occupied commercial properties. For example, unlike the Washington D.C. policy example mentioned above, New Jersey cannot apply a higher tax rate for vacant or blighted real property. The citizens of New Jersey would need to amend the state constitution to make these special tax rules. It is not clear that there will be political support for this kind of constitutional amendment.

A second significant policy challenge facing New Jersey local governments are future restrictions on code enforcement penalties. As mentioned earlier, local government officials often use code
enforcement and penalties to incentivize property owners to maintain and fully utilize their commercial property. However, some of the property tax assessors we spoke to mentioned recent courts that ruled against what the court determined as “excessive” code enforcement fines. It is possible that a blighted commercial property could face a sizable fine for several code violations over several years. If future New Jersey courts are more likely to overrule code enforcement penalties, it is possible that local governments will lose a powerful tool to combat blighted and under-maintained commercial properties.

A third significant policy challenge facing New Jersey tax assessors are tax assessment appeals where the property owner asks for a lower tax assessment based on the income approach. The income approach is one of three methods used by property tax assessors to determine the fair market value of commercial properties. Property tax assessors will collect information on the net operating income of the commercial property and divide the net operating income by a capitalization rate to calculate the fair market value of the property. The capitalization rate is the expected annual return on investment from buying the property. For example, imagine there is a commercial property generating $100,000 annually after expenses. Using a capitalization rate of 6%, the income approach suggests the assessed value of the property is $1,666,667. The problem with the income approach is it assumes that all property owners are fully utilizing their properties to maximize the net operating income from the property, which is not likely the case for all property owners.

Table 2 below illustrates this problem through an example. Imagine there are two commercial properties that have identical physical and neighborhood characteristics. However, the first property is fully utilized with all the building’s units being leased out to tenants, whereas the second property only has 50% of the building’s units leased out due to poor management. If the local tax assessor would value the properties using the comparable sales approach, both buildings would have an assessed value of $1 million. Unlike the income approach, the comparable sales approach does not consider the income earned from the commercial property. Instead, the comparable sales approach collects data on the physical and neighborhood characteristics of the property and assigns a value of those characteristics based on the sale price of similar properties that sold in the past. Since both properties in the example from Table 2 have identical characteristics, both buildings are assumed to have the exact same assessed value based on the comparable sales approach.
Table 2. Example of Two Identical Commercial Properties with Different Assessed Values

<table>
<thead>
<tr>
<th></th>
<th>Property #1 – Fully Utilized</th>
<th>Property #2 – Half Utilized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessed value based on comparable sales</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Net Operating Income</td>
<td>$100,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Capitalization Rate</td>
<td>6%</td>
<td>6%</td>
</tr>
<tr>
<td>Assessed value based on income approach</td>
<td>$1,666,667</td>
<td>$833,333</td>
</tr>
</tbody>
</table>

Interestingly, these two identical commercial properties would have drastically different assessed values if the income approach was used. As shown in Table 2, the assessed value of the first property would be almost $1.7 million, and the assessed value of the second property would be 50% lower at $833,333. These figures are based on dividing the net operating income by the capitalization rate. The sole reason for this difference is that the second property is under-occupied due to poor management, which lowers the net operating income for the property owner. Further, imagine that the township currently assesses both properties at $1 million each using the comparable sales approach. Under that scenario, only the owner of the second property could successfully appeal his or her current assessed value by claiming that the income approach suggests a lower assessed value.

As illustrated by the hypothetical example described in Table 2 above, tax assessment appeals could potentially cause a perverse incentive for some property owners to under-occupy their properties. Fortunately, based on our interviews with tax assessors across New Jersey, this potential perverse incentive is rare and not widespread. However, it can exist sporadically and cause challenges for state and local officials. One potential solution to this problem is better training for tax court judges. Not all judges have significant experience or expertise in commercial real estate. For example, judges tend to permit a standard 6% or higher capitalization rate during property tax appeal cases. Better training may allow judges to understand the nuisances within the commercial real estate industry, especially regarding under-occupied properties. For example, there could be a better understanding of the fact that not all properties should be given a standard capitalization rate. Those owners that underutilize their properties could be assigned a lower capitalization rate when the income approach is applied, which would provide a more reliable assessment of the property. Better training for judges will likely lead to better case law over time to give more flexibility to tax assessors in the future.
This policy report explores the recent trends in commercial property vacancy rates, the causes for vacant commercial property, and the potential policy solutions and challenges to reduce the amount of vacant or under-occupied commercial properties in New Jersey. Overall, we find both quantitative and qualitative evidence that supports an optimistic view of current and future demand for commercial property in New Jersey. For example, vacancy rates for commercial property in New Jersey are significantly lower than the national average, especially for multi-family and industrial commercial property in the state. Our in-depth phone call interviews with property tax assessors across several New Jersey cities confirm this optimistic view.

Our review of prior studies suggests there are several factors that impact the likelihood of vacant or under-occupied commercial properties. Common factors include urban population decline, suburbanization, rise of e-commerce, and speculative investing. Our study adds to literature by examining whether commercial property owners strategically under-utilize their property to reduce their property tax liabilities. Our research suggests this is not a viable business strategy and not an important explanation for vacant and under-occupied properties in New Jersey. In fact, our interviews with tax assessors suggest the causes for vacant and under-occupied commercial property vary across New Jersey cities.

Given that the reason for vacant commercial property varies across cities, city governments need to carefully choose the policy tools that fit best with their local communities in addressing vacant and/or under-utilized commercial properties. In general, we find that “tax” policies (e.g., property tax surcharges used in Washington D.C. and vacancy tax adopted in San Francisco) may not be feasible or promising under current New Jersey laws. However, there are several “non-tax” policies that could be implemented across the state, including: vacant property registrations, tax abatements, code enforcement policies, land banks, better case law in tax courts, lower capitalization rates, and better training for tax court judges. Indeed, Newark has already become the first city in New Jersey to use land bank to combat vacant properties and neighborhood blight and since March 2021. Additionally, Trenton adopted a vacant property registration ordinance that requires all owners of vacant commercial property to register with the city and to pay an increasing annual fee. Local governments may also take advantage of data science and information

8 https://www.trentonmi.org/375/Vacant-Property-Registration-Maintenance
technology to optimize their decision-making process in code enforcement, as what New Orleans has done via BlightStat. It is worth mentioning that each of these tools has its own strengths and weaknesses and therefore, a combination of them may better address the vacant commercial property issue.

References


The New Jersey State Policy Lab assists the State of New Jersey and its many communities in the design, implementation, and evaluation of state policies and programs by conducting rigorous evidence-based research that considers equity, efficiency, and efficacy of public policies and programs in holistic and innovative ways.

The lab leverages input from a robust network of multidisciplinary scholars, members of the community, and outside policy experts in New Jersey to craft innovative and equitable policy solutions that are sensitive to the needs of our state’s diverse population.

By utilizing the combination of strong ties to New Jersey’s diverse communities and significant expertise in collecting, cleaning, and analyzing data, the New Jersey State Policy Lab engages and collaborates with stakeholders such as community groups, the state government, and municipal governments to create high quality datasets and evidence that reflects our state’s diversity and empowers state policy makers to address the needs of New Jersey communities more effectively, innovatively, and equitably.