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# Tracking Municipalities' Reliance on Top Taxpayers

*Exploring Commercial Real Estate Positions in 33 Major U.S. Cities*

February 10, 2022

## The Potential "Long Covid" Problem for Big Cities

Commercial real estate properties—especially office and hospitality spaces located in downtown central business districts—are among the top generators of property tax revenue for cities across the country.

Yet over the past two years, COVID-19-related disruptions have cast a pall on downtown real estate.

Vacancy rates are running well above historical averages and commercial, retail, and hotel occupancy traffic is down considerably. In light of these trends, it would not be surprising if we soon observe a significant increase in property tax assessment appeals.

From coast to coast, it is not uncommon for a cluster of a specific city's largest taxpayers to be found in that city's central business district. Much is at stake if big cities suffer a real estate version of "Long Covid."

The potential for lower property tax assessments—or non-payments—raises the question of whether city tax rolls are broad enough to mitigate the effect of downward readjustments and a corresponding loss of revenue.

The weakened posture of downtown commercial office and hotel space throughout America's big cities deserves close watch.

## Back and Forth

Although economic growth in 2021 (particularly in the 4th quarter) was impressive, the emergence of the Omicron variant in 2022 took the wind out of the economy's sails. Furthermore, the public's growing concern over local crime rates—related to real and perceived dangers involving violent attacks and car hijackings in downtown commercial areas—added yet another layer of uncertainty and unease.

Developers, who are notorious optimists by nature, are generally hopeful about recovery prospects. In some cases, they have used the lull to take advantage of lower valuations—either by adding properties to their portfolios or announcing plans for new developments.

On the other hand, analysts who assess risk on tax-supported municipal general obligation bonds are skeptical. From their point of view, there's reason to be concerned if property owners challenge current assessments and use low occupancy rates as justification to lower their tax bills. Tax reallocations caused by lower commercial valuations would lead to increases on residential or industrial taxpayers.

In worst-case scenarios, marginal taxpayers who are deep in debt may be pushed over the edge into foreclosure, which would also contribute to lower tax collections on budgeted levies.

Between the effects of the pandemic, concerns about public safety, and the natural volatility of a real estate market in flux, it is difficult to predict how long it will take for downtown real estate to revert to pre-Covid activity levels. It is even possible that we may witness some sort of "restructuring" of city life as we have known it, in response to these pressures.

## Focus on Top 10 Taxpayers

In line with a potential revaluation of property tax assessments, Merritt Research Services has examined the 33 largest cities in the U.S. (population base of 500,000 or more) to determine which ones are most dependent on a concentrated list of big taxpayers. By analyzing top ten taxable property taxpayer lists, commonly found in municipal bond documents and audits, we are able to gauge whether a city's tax base is more vulnerable to exposure to standout properties that have been hit hard as a result of recent conditions.

Ideally, the less impact the top ten taxpayers have on a city's the total taxable assessment (as a percentage), the more diverse and resilient that city's tax base is.

As a risk factor, the use of top taxpayers lists to assess municipal credit quality is grounded in an era when cities were often dominated by one industry or even one company. Although the commercial property owners are among the largest taxpayers in many cities, they don't individually represent the same level of dependency on city tax bases as they did sixty years ago.

Regardless, the measure remains useful in sizing up the economic resilience of municipal entities to withstand unexpected shocks to companies or adverse economic impacts created by cyclical or structural changes in the local economy.

Getting a handle on the ten largest property taxpayer lists sheds light the ability of local government and school districts to withstand a serious shock to their revenue projections should one or more of these payors find themselves unable to pay their tax bill.

A renewed focus on the biggest generators of property tax dollars makes sense today, especially when considering the burst of expensive commercial building construction that has taken place over the past few decades. In major cities, these projects have positioned real estate alongside utility assets as substantial sources of property tax revenue.

Residential high-rise development has also increased its importance to the big city tax landscape but not to the same degree as commercial properties. Manufacturing, except in the cases of large buildings that house corporate headquarters, has moved to the sidelines as a significant contributor of tax revenue.

## Measuring Full Value Per Capita

When noting a city's over-reliance on a short list of taxpayers, we can accurately identify local governments that are most at-risk: those with less-wealthy total property tax bases. In other words, those are least able to shift the burden to other taxpayers without imposing serious strain and resistance.

A simple way to determine overall real estate wealth is to compare the full market value[1] of a city's total taxable property base with its population (Full Value Per Capita). The ratios are listed in Table 1.

Full market value is the local assessor's best approximate appraisal of the market value used to figure the assessed value and applicable tax rate. In Fiscal Year 2020, the estimated Full Value per capita median for the 33 largest cities in the nation was $113,327.

Currently, the highest Full Value per capita ratios belong to cities rich with technology-headquartered companies: Seattle ($350,004 per person), followed by San Francisco ($338,017) and Boston ($253,647). At the other end of the spectrum are older rust belt industrial cities such as Detroit ($28,979) and Milwaukee ($51,534).

Cities with higher full value per capita measures should be able to withstand property downshifts as long as their wealthy tax bases are evenly distributed—meaning that wealth is not concentrated among the top taxpayers.

## Findings and Highlights

Using Merritt Research Services data , we examined America's 33 largest cities and their dependency on their top ten taxpayers, with particular emphasis placed on the three largest.

Cities with populations over 500,000 have a median Top 10 taxpayer dependency rate of 5.4% of the total taxable proper assessment base. The median rate for all U.S. cities regardless of size is 8.1%.

Big cities are generally less dependent on a concentrated list of taxpayers that could potentially expose them to cash flow shocks that can't be recovered in due time. However, maintaining reserves to cover short term delinquencies remains an important strategy to handle any disruptions.

*1. The full value is directly or indirectly reassessed each year depending on the local assessment practices as adjusted for inflation and recent sales of similar representative properties to calculate the taxable assessed value. An office building that was purchased for $10 million carries an initial full value of the same amount. Depending on state assessment laws, taxable assessed values may represent a percentage of the full value (e.g., 33% of full value). The assessed value is then multiplied by the tax rate to calculate the tax bill.*

## Most Diverse Tax Bases

Cities with the most diverse tax base—those least dependent on their top ten taxpayer list—are:

| | |
|---|---|
| Los Angeles | 1.7 % |
| Philadelphia | 2.5 % |
| Jacksonville | 2.6 % |
| Austin | 3.1 % |
| Chicago | 3.2 % |
| Albuquerque | 3.3 % |

Of the 33 analyzed, Los Angeles leads the list as the city least reliant on its top ten taxpayers. Note: It is also less dependent on its top 10 than all but seven of 1,340 U.S. cities of all sizes tracked by Merritt Research Services.

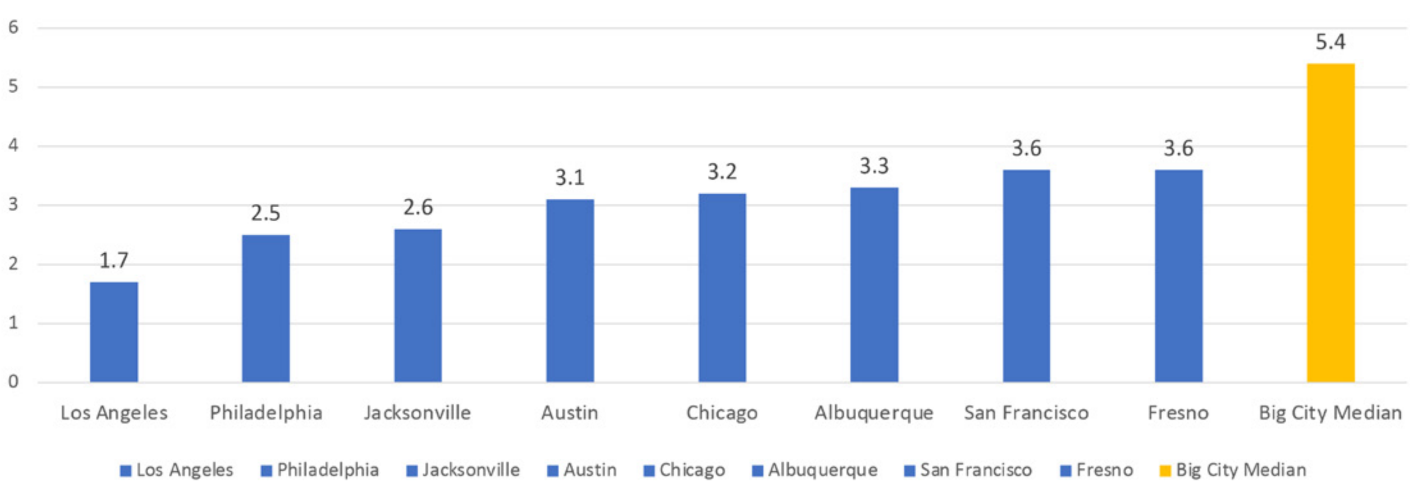
Even though L.A.'s top ten taxpayer list is led by real estate payors, its top three taxpayers represent less than 1% of the city's taxable property. As with other cities, L.A. vacancy rates are high, with unoccupied office space exceeding 20% since the pandemic began according to real estate services company, JLL.[2]

TABLE 1

### Big Cities* with Lowest Dependency on Top 10 Property Taxpayers

Assessed Value to Total City Taxable Assessed value (%)

FY 2020




*Source: **Merritt Research Services, an Investortools Company**. *Big cities include those with populations of 500,000 or more. Compiled from Annual Comprehensive Financial Reports.*

*2. JLL, Los Angeles, Q4 2021*
*3. JLL, Philadelphia CBD,Q4 2021.*

Like Los Angeles, Philadelphia's top three taxpayers are all relatively small real estate-oriented properties. Its 2.5% percentage reliance on its top ten list has gradually moved higher than the 2.0% share notched in 2014 but is still low relative to other large cities. Office vacancies in Philadelphia's central business district have creeped up during the pandemic but were lower in the central business district (14.4%) than the entire metro area (18.2%) in the fourth quarter of 2021.[3]

Richer tax bases have built in cushions that help in the face of falling real estate values. However, that view has a big caveat: reduced cash flow from these properties carries an even greater risk if the properties are more leveraged with debt than their market values.

## Over-Reliance on Top Taxpayers

Six of the nation's largest cities have a total Top 10 Taxpayer assessment valuation of eight percent or more. They are:

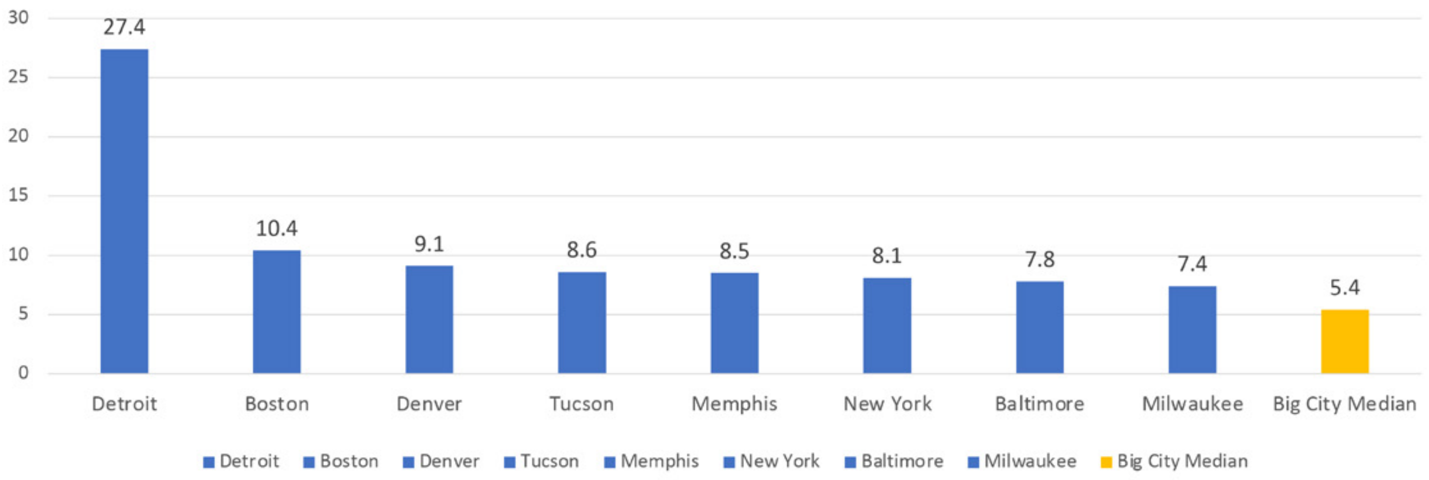
| | |
|---|---|
| Detroit | 27.4 % |
| Boston | 10.4 % |
| Denver | 9.1 % |
| Tucson | 8.6 % |
| Memphis | 8.5 % |
| New York | 8.1 % |

**TABLE 2**

## Big Cities* with Highest Dependency on Top 10 Property Taxpayers

Assessed Value to Total City Taxable Assessed value (%)

FY 2020




*Source: **Merritt Research Services, an Investortools Company**. *Big cities include those with populations of 500,000 or more. Compiled from Annual Comprehensive Financial Reports.*

Beleaguered Detroit, which exited bankruptcy in late 2014, is the most dependent on its top ten taxpayers with a 27.4% valuation. It also has the heaviest reliance on a single taxpayer.

DTE Energy topped the list at 9.5 percent of Detroit's total taxable assessed valuation. It's second and third largest taxpayers are Vanguard Health Center, owner of for-profit hospital/health care facilities, and MGP LLC, a gaming and hotel company. They represent 4.8% and 3.4% of the city tax base, respectively.

Detroit's vulnerability has more to do with its limited economic strength and diversity and less to do with the commercial real estate risks impacting the other cities, although it is not entirely insulated from the downturn in central business activity.

The city's heavy reliance on its top ten taxpayers stems mainly from its lack of a robust high value commercial and residential tax base. Its Full Value per capita ratio was only $29,979 in 2020, much lower than the median of $113,327 of all 33 cities analyzed in this report.

Weaknesses stemming from its lack of commercial taxpayers cannot be easily transferred to its much less wealthy property valuations citywide. In the short term, the city has rebuilt its cash reserves since its bankruptcy.

Boston's top ten taxpayers represent 10.4% of the city's total taxable assessed valuation. Two out of the top three taxpayers are real estate entities, while the third is a utility. Boston had enjoyed healthy economic growth and rising property values over the past ten years. Total office vacancy levels in the fourth quarter of 2021 stood at 13.7% in the city, and higher in the metro area[4].

New York City is the sixth most dependent city on the list due largely to the enormous size and valuation of its electric utility, Consolidated Edison, which represents 6.1% of the city's tax base. Historically, utilities have ranked among the leading (and more stable) taxpayers for many cities.

After Consolidated Edison, the city's next largest taxpayer is the General Motors building (0.3%).

According to the JLL Office Insight Report for fourth quarter 2021, the office vacancy rate in Manhattan has been on the rise and stood at 14.6% in its last tally[5]. However, JLL's Q4 office statistics report for New York also reports over $20 billion in new property under development.

Currently, no city stands out as a clear loser on all corners of evaluation relative to their dependency on their largest taxpayers.

Several cities, such as Detroit, Boston, Denver, Tucson, Memphis, and New York, have at least 10% of their tax base valuation concentrated in their ten largest taxpayers. Of these cities, Boston has the highest single exposure to a commercial real estate property at 2.4%. Detroit has a 3.4% reliance on a gaming and hotel taxpayer (MGP, LLC).

Memphis and Tucson both have weaker per capita full market valuations that reduce their resilience to taxpayer reallocations.

Cities like New York, Chicago, and Denver, to name a few, are likely to be in the headlines because of their high office vacancy levels and will remain an analytical challenge until we learn whether there has been a permanent restructuring of the workplace environment. If so, these cities will likely suffer potential reassessment allocations and tax resistance;

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*4. JLL, Boston, Office Insight, Q4 2021.*
*5. JLL, New York, Office Insight, Q4 2021.*

# Top Taxpayers for Cities with Populations over 500,000 in Fiscal Year 2020

| Credit Name | State | Population | Estimated Full Value per Capita [2020] | Top 10 Taxpayers AV/ Total Taxable AV %[2020] | Taxpayer 1 - Name [2020] | Type 1 | Taxpayer 1 - % of Total Taxable AV [2020] | Taxpayer 2 - Name [2020] | Type 2 | Taxpayer 2 - % of Total Taxable AV [2020] | Taxpayer 3 - Name [2020] | Type 3 | Taxpayer 3 - % of Total Taxable AV [2020] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Detroit | MI | 677,379 | 28,979 | 27.42 | DTE Energy Company | Uitlity | 9.5 | Vanguard Health Systems - Hospitals | Health Care | 4.8 | MGM Grand Detroit LLC (now, MGP) | Gaming | 3.4 |
| Boston | MA | 680,218 | 253,647 | 10.37 | Boston Properties | Real Estate | 2.4 | Eversource | Utility | 1.6 | Oxford Properties | Real Estate | 1.1 |
| Denver City & County | CO | 704,869 | 232,283 | 9.14 | Brookfield Properties | Real Estate | 1.7 | Public Service Co. | Utility | 1.6 | Invesco Realty Advisers Inc. | Real Estate | 1.2 |
| Tucson | AZ | 537,596 | 74,297 | 8.62 | Unisource Energy Corporation | Uitlity | 3.9 | Southwest Gas Corporation | Utility | 1.0 | SMSJ Tucson Holdings LLC | Health Care | 0.7 |
| Memphis | TN | 653,026 | 61,556 | 8.46 | FedEx Corporation | Transportation | 5.8 | Wolfchase Galleria, LTD | Real Estate | 0.4 | BNSF Railway Company | Transportation | 0.4 |
| New York | NY | 8,468,954 | 157,727 | 8.08 | Consolidated Edison | Uitlity | 6.1 | General Motors Building | Real Estate | 0.3 | Verizon | Telecom | 0.3 |
| Baltimore | MD | 616,542 | 71,961 | 7.76 | BGE (Baltimore Gas & Electric Company) | Uitlity | 2.5 | Harbor Point Parcel D | Real Estate | 0.9 | Amazon.com | Technology/ \ Retail | 0.7 |
| Milwaukee | WI | 594,154 | 51,534 | 7.42 | Northwestern Mutual Life Insurance Company | Financial Services | 1.7 | Mandel Group | Real Estate | 1.1 | U.S. Bank | Financial Services | 0.8 |
| Indianapolis | IN | 873,824 | 55,278 | 6.95 | Eli Lilly and Company | Pharmaceutical | 3.0 | Citizens Energy Group | Uitlity | 1.1 | Federal Express Corporation | Transportation | 0.6 |
| Oklahoma City | OK | 640,010 | 84,976 | 6.43 | OG&E | Uitlity | 2.7 | Devon Headquarters LLC | Energy | 1.0 | Hobby Lobby Stores Inc. | Corporate Retail | 0.8 |
| Fort Worth | TX | 855,947 | 95,250 | 6.22 | Winner LLC | Real Estate | 2.0 | AMR Corp/American Airlines, Inc. | Transportation | 1.0 | Oncor Electric Delivery Co LLC | Utility | 0.6 |
| Phoenix | AZ | 1,612,303 | 106,016 | 6.01 | Arizona Public Service Company | Uitlity | 3.4 | Southwest Gas Corporation | Utility | 0.7 | Century Link (Qwest Commu-nications) | Telecom | 0.4 |
| Louisville-Jefferson County Metro Government | KY | 767,770 | 129,803 | 5.85 | Louisville Gas & Electric Co. | Uitlity | 3.0 | Humana Inc. | Health Care | 0.5 | Galt House Inc. | Real Estate | 0.5 |
| San Antonio | TX | 1,488,500 | 90,132 | 5.61 | H.E. Butt Grocery Company | Food | 1.1 | Microsoft Corporation | Technology | 0.8 | United Services Automobile Association | Financial Services | 0.7 |
| Las Vegas | NV | 626,952 | 92,033 | 5.55 | World Market Center Las Vegas | Gaming | 1.0 | Golden Entertainment Inc. | Gaming | 0.7 | Howard Hughes Corporation | Real Estate | 0.7 |
| Charlotte | NC | 843,989 | 162,544 | 5.51 | Wells Fargo | Financial Services | 1.2 | Duke Energy Corporation | Utility | 1.2 | Bank of America | Financial Services | 1.1 |
| El Paso | TX | 679,001 | 61,891 | 5.34 | Western Refining Company LP | Energy | 1.4 | El Paso Electric Co | Utility | 0.8 | Walmart Stores Texas LLC | Corporate Retail | 0.7 |
| Portland | OR | 643,065 | 233,464 | 5.33 | Port of Portland | Transportation | 1.0 | Portland General Electric Co | Utility | 0.7 | Alaska Airlines Inc | Transportation | 0.7 |
| Columbus | OH | 882,253 | 63,641 | 4.87 | Ohio Power Company | Uitlity | 2.6 | Columbia Gas of Ohio, Inc. | Utility | 0.6 | Nationwide Mutual Insurance Company | Financial Services | 0.4 |
| Nashville & Davidson County | TN | 686,420 | 178,867 | 4.69 | Electric Power Board (1) | Uitlity | 2.3 | Columbia/HCA | Health Care | 1.1 | AT&T Telephone/BellSouth | Telecom | 0.6 |
| Dallas | TX | 1,323,587 | 139,722 | 4.07 | Oncor Electric Delivery | Uitlity | 0.7 | Northpark Land Partners | Real Estate | 0.5 | Texas Instruments | Manufacturing | 0.5 |
| Seattle | WA | 729,644 | 350,004 | 3.88 | Amazon | Technology/ Retail | 1.3 | Union Square Limited | Real Estate | 0.5 | GC Columbia LLC | Real Estate | 0.3 |
| San Jose | CA | 1,034,851 | 196,919 | 3.86 | Essex Portfolio LP | Real Estate | 0.7 | Cisco Technology Inc. | Technology | 0.6 | FRIT San Jose Town & Country Village LLC | Real Estate | 0.4 |
| San Diego | CA | 1,400,130 | 194,960 | 3.79 | Qualcomm, Inc. | Technology | 0.9 | Irvine Co., LLC | Real Estate | 0.6 | Host Hotels Resorts, LP | Real Estate | 0.5 |
| Houston | TX | 2,306,360 | 138,318 | 3.72 | Centerpoint Energy, Inc. | Uitlity | 0.9 | Chevron Chemical Company | Energy | 0.4 | ONE TWO THREE ALLEN CENTER | Real Estate | 0.3 |
| Fresno | CA | 520,305 | 72,838 | 3.64 | River Park Properties | Real Estate | 0.6 | Amazon.com Services Inc. | Technology/ Retail | 0.5 | Gap Inc. | Corporate Retail | 0.4 |
| San Francisco City & County | CA | 871,343 | 338,017 | 3.63 | Sutter Bay Hospitals | Health Care | 0.6 | Transbay Towers LLC | Real Estate | 0.6 | HWA 555 Owners LLC | Real Estate | 0.4 |
| Albuquerque | NM | 559,350 | 88,664 | 3.26 | Public Service Co. of New Mexico | Utilty | 1.7 | New Mexico Gas Company | Utility | 0.3 | Comcast of NM Inc. | Telecom | 0.3 |
| Chicago | IL | 2,710,456 | 117,656 | 3.18 | Willis Tower | Real Estate | 0.6 | One Prudential Plaza | Real Estate | 0.3 | Blue Cross Blue Shield Tower | Health Care | 0.3 |
| Austin | TX | 939,778 | 209,306 | 3.10 | Samsung Austin Semiconductor LLC | Technolgy | 0.7 | Applied Materials Inc. | Manufacturing | 0.4 | Columbia/St. Davids Health Care | Health Care | 0.3 |
| Jacksonville | FL | 881,502 | 108,999 | 2.57 | St. John's Town Center LLC | Real Estate | 0.5 | Vistakon/Johnson & Johnson Vision | Manufacturing | 0.5 | Bellsouth Telecommunications | Telecom | 0.3 |
| Philadelphia | PA | 1,576,604 | 106,197 | 2.49 | Liberty Property Phila | Real Estate | 0.3 | EQC Nine Penn Center Prop. | Real Estate | 0.3 | NG 1500 Market St. LLC | Real Estate | 0.3 |
| Los Angeles | CA | 3,957,520 | 163,941 | 1.69 | Douglas Emmett LLC | Real Estate | 0.4 | Essex Portfolio LP | Real Estate | 0.2 | Century City Mall LLC | Real Estate | 0.2 |
| **Median for Big Cities (500,000 or more)** | | **843,989** | **108,999** | **5.3** | | | **1.4** | | | **0.6** | | | **0.5** |

Cities Ranked in Order of City's percentage reliance on it top 10 taxpayers in its 2020 fiscal year.

(1) In Nashville, the Electric Power Board Percentage represents a payment in lieu of taxes based on assessed value.

Source: **Merritt Research Services, LLC, an Investortools Company**. Compiled from annual financial report audits or other city documents.

**Top 10 Taxpayer Diversification**

**MOST** **LEAST**

## Conclusions

Cities dominated by commercial real estate taxpayers at the top rung of tax rolls carry a proportionately higher risk due to the downturn in business activities, especially in central business districts.

Los Angeles and Philadelphia are the only cities which have all three of their top three taxpayers associated with real estate. Yet, their top three taxpayers represent less than 1% combined of each city's tax rolls, and the overall risk of Los Angeles and Philadelphia's top ten taxpayers is well below the big city median.

Boston has the largest single real estate type taxpayer (Boston Properties), accounting for 2.4% of the city's total valuation. It's top ten total exposure is the second highest of the largest cities.

The most dominant type of taxpayers represented on the complete list of the top three taxpayers for all 33 cities were tied to real estate in one form or another. Utilities and telecom, in combination, were the second most common category.

Utilities and telecom are considered less vulnerable to the current crisis, even though their own credit strength might be impacted if the dislocation was considered more permanent.

If office space demands shrink due to structural changes that allow more flexible work at-home policies or if downtown environments become less attractive, widespread devaluations related to commercial real estate properties could accelerate. At best, downward market valuations are more likely to trigger reassessments that shift property taxes to other types of taxpayers, especially residential property.

Widespread unused office and hospitality space carries the risk that some building owners won't be able to make timely property tax payments and could face the reality of potential foreclosures[6]. Chicago's Central Business District 18.5% office vacancy rate in the fourth quarter of 2021 bears monitoring, especially in relation to older Class B types of properties since so many new Class A properties are being added to the rolls[7].

Slow recoveries will place stress on market values and taxable assessed values used to levy and collect property taxes. Failure to recapture business activity will in the worst case shift the burden of bearing the costs of debt, pensions, and operations for local governments to residential, utility, non-real estate corporations and trade properties.

*6. More Loop landlords are on the brink, Crain's Chicago Business, Danny Ecker*
*7. JLL, Chicago CBD, Q4 2021*