

Focus | Entertainment, Art & Sports Law

Cinematic Obsolescence in a Post-Pandemic World

BY ALEXANDER MAZERO

While the COVID-19 pandemic hit many industries hard—some near the point of collapse—the cinema industry was among the industries hit the hardest. Venues where the big screen once captured eager moviegoers fell lifeless and dark. Cinemas closed and film releases were deferred to future dates or delayed indefinitely. Ticket sales sank to their lowest levels in the last two decades as the pandemic wreaked havoc on the cinema industry, with some theaters going out of business permanently. The post-pandemic cinema space is only now recovering, albeit slowly, and many cinemas are still taking drastic measures to attract consumers to boost ticket sales and admissions.

Despite the mayhem that the pandemic caused, the properties where cinemas are located are generally trending upward in value. This in turn results in higher property taxes, which can be a problem for those cinemas still trying to make ends meet. It is important for these cinema owners to understand how tax assessors will value their properties in the coming year.

Generally, tax assessors utilize the cost approach to determine market values for properties in the entertainment sector due to their unique nature, lack of transactional sales data, and lack of comparable properties. The cost approach values property as equal to the cost of land, plus total cost of construction, less total depreciation. Assessors frequently use cost-estimating services and depreciation tables to determine total depreciation. But relying solely on depreciation estimates may lead to faulty assessments, which may result in inflated market values. It is important that tax assessors also consider whether economic obsolescence—i.e., external forces that cause a property's value to decline—or other forms of obsolescence should be considered and incorporated into the market valuation.

Market forces have a profound effect on property values, especially properties in the entertainment sector. Economic obsolescence is typically caused by elements external to the property itself such as market trends and economic shifts, particularly as it relates to cinemas. Property owners generally do not have control or influence over this form of obsolescence.

Before the pandemic, theaters were battling streaming services for consumer loyalty. When the pandemic struck, streaming services gained even more momentum and now command a greater following than in-person cinema. The consequential decline in ticket admissions resulted in a sharp decline in revenue, threatening the very existence of many cinemas. While cinemas begin to recover, the lingering effects of the pandemic's influence on the cinema industry still negatively impacts ticket sales and admissions. Studies show that consumers still prefer streaming movies at home without the theatrical element. Although the cinema industry is making a comeback to some degree, pandemic-related obsolescence should be given great weight when formulating depreciation and ultimately reducing assessments of cinema market values.

Functional obsolescence is another form of obsolescence. It is typically caused by factors internal to the property, specifically affecting the property's desirability and utility. Before the pandemic, many cinemas provided only the basic amenities including cloth or non-reclinable leather seats and basic concessions. Many cinemas, especially the more traditional venues constructed in the 1990s, lacked true dining services, commercial kitchens, or digital cinema. While the cinema industry slowly recovers in a post-pandemic world, the onslaught of streaming services continues. Large cinemas took note and began adding features to their cinemas such as fully stocked bars, dining options, commercial kitchens, premium luxury chairs,

larger screens, and digital cinema. Cinemas that did not innovate were left behind and the value of those properties declined.

The issue of whether a cinema is the highest and best use of the land should also be considered during an assessment of property value. The entertainment sector's current market conditions make cinema properties potential candidates for adaptive reuse, which is defined as the practice of taking an existing property and repurposing it for a new commercial use. The viability of adaptive reuse typically stems from the existence of functional and economic obsolescence. Shifts in other industries such as the retail industry further incentivize adaptive reuse. As online shopping becomes a norm, failing and vacant cinema properties provide a lucrative opportunity for real estate investors who wish to convert them into other commercial uses such as e-commerce warehouses, distribution hubs, or fulfillment centers.

While the U.S. domestic box office in 2023 was the highest since before the pandemic, the outlook for 2024 is bleaker with a predicted box office of 5 to 10 percent less than the preceding year. The uncertain economic climate of the cinema industry highlights the need to evaluate obsolescence during market value assessments. Even in times of cinematic growth, a cinema owner should always take note of economic and functional obsolescence as obsolescence provides ammunition for reduced tax liability.

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