

# 21st Annual GIS/CAMA Technologies Conference Chattanooga Convention Center

GIS/CAMA • Chattanooga, TN



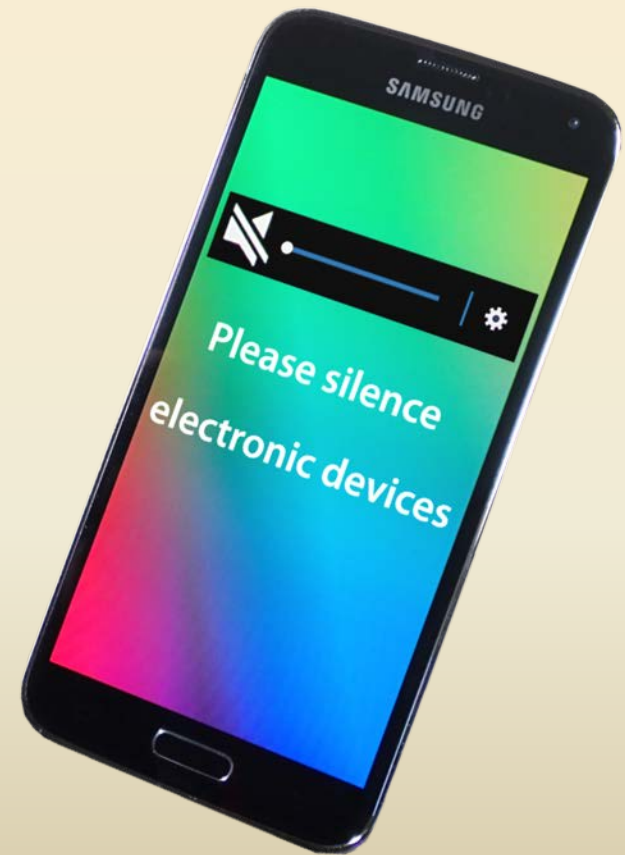
March 6-9, 2017

# Continuing Education (CE) Credit

Recertification Credit forms for CE credit can be collected from the Registration Desk on Thursday.

## Housekeeping

The conference proceedings will be available approximately 8 weeks after the conference.



# Dark Sales Theory: Is it the proper valuation method?

**21<sup>st</sup> Annual GIS/CAMA Technologies Conference,  
Chattanooga, Tennessee**

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# Dark Sales Theory

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**The Dark Sales Theory gets its name because it essentially promotes valuing stores as if the store is completely closed and empty.**

The “Dark Sales Theory” is essentially use by national or regional “Big-Box” retail stores.

# "Big Box"

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- ◆ A 'big box property' is any free standing building in excess of 50,000 square feet with minimal interior divisions that is used for retail purposes.

*Meijer Stores Ltd. P'ship v. Smith*  
926 N.E. 2d 1134 (Ind. Tax Ct. 2010)

- i.e. Lowes, Target, Menards, Meijer, Walgreens, CVS, Best Buys

# Dark Sales Theory


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- ◆ The dark sales theory stresses that big-box retail properties are specially built for the merchants who occupy them.
- ◆ Stores contain features that are limited to that owner and have no value on the resale market to the next owner.
  - Based on the assumption next owner will have to spend money on redesign to make property work and fit their needs and brand.

# Dark Sales Theory

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## FUNCTIONAL OBSOLESCENCE ARGUMENTS

- ◆ A flaw in the structure, material, or design that diminishes the function, utility, and value of the improvement. (Appraisal Institute)
  - ◆ Property has characteristics that a buyer will not pay for except the current owner.
  - ◆ Must value the property based on a secondary market.
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# “Dark Sales” Comparisons?


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# FUNCTIONAL OBSOLESCENCE

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- ◆ Appraiser must look to evidence of obsolescence recognized in the market.
  - ◆ Paired sales analysis.
  - ◆ Second generation property?
  - ◆ How much obsolescence is in a new store built for the current owner / user?
  - ◆ Land value?
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# Secondary Market

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- ◆ When the initial owner / user moves out
- ◆ Converted to secondary use
  - ◆ Smaller retail
  - ◆ Local stores
  - ◆ Offices
- ◆ **Not likely as a “Big Box” store**
- ◆ Is this truly a comparable?

# Secondary Market

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- ◆ Deed Restrictions / Restrictive Covenants
  - Enforceable if not unreasonable
  - No competing big box merchants
  - Items sold (i.e. groceries)
  - Reduce value by limiting pool of purchasers
  - Big Box stores may sit vacant

# Special Purpose Doctrine

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- ◆ Special Purpose Property: “A limited market property with a unique physical design, special construction materials, or a layout that **restricts its utility to the use for which it was built**; also called a *special-design property*.

*(Dictionary of Real Estate Appraisal, 5<sup>th</sup> Edition)*

- ◆ It can be a building with limited uses and marketability.

# Special Purpose Doctrine

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“The special purpose exception is applied to a building in good condition being used currently and for the foreseeable future for the unique purpose for which it was built,” a doctrine necessary to prevent “the owner of a distinctive, but yet highly useful, building” from “escap[ing] full property tax liability”

*Fed. Res. Bank of Minneapolis v. State*  
[Minn. 1981], 313 N.W.2d 619,623

*See also*

*First Federal Saving & Loan Ass'n of Flint v. City of Flint*, (305 N.W.2d 553)

*Shawmut Inn v. Town of Kennebunkport*, 428 A2d 384

# Highest & Best Use

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“The reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, financially feasible, and that results in the highest value.”

*The Appraisal of Real Estate, 14th Edition*

1. legal permissibility
2. physical possibility
3. financial feasibility
4. maximum productivity


# Highest & Best Use

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- ◆ Determining the highest and best use drives what types of other properties can be used as a comparable.
  - ◆ Comparable sales should conform to the subject's highest and best use.
  - ◆ More than likely on a “dark sale” the highest and best use has changed.
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# Hypothetical Buyer?

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- ◆ An actual sell is not needed
  - ◆ Most subject properties have not sold
  - ◆ Limited arms-length transactions
  - ◆ Specially used / designed properties
  - ◆ Is current owner / user a willing seller
  - ◆ Is current owner / user a willing buyer
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# Sales Verification is Critical

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- ◆ Assessment personnel must do a good job on getting and analyzing sales information.
- ◆ What is actually being acquired?
- ◆ If vacant, know why the property is vacant.
  - Vacant sale may not have the same HBU
- ◆ Are there deed restrictions?
  - Restrictions change the HBU

# Sales Verification is Critical

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- ◆ Look at demographics
  - Similar to subject (population, income, employment)
- ◆ Is it an arms-length sale?
  - Independent and equal footing
- ◆ Is the transaction a sale / leaseback?
- ◆ Depressed sale?
- ◆ **Highest & Best Use Analysis is Fundamental**

# Ohio – 2 cases 2 outcomes

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## ◆ Target v. Greene Cnty. Bd. of Revision

- Taxpayer's appraiser used second generation sales of a bankrupt Kmart and Ames store
- County failed to provide any evidence or rationale to support its value
- Ohio Supreme Court noted that without any controverting evidence from the county, it was left solely to decide the case with Target's data based on second generation stores and functional obsolescence

122 Ohio St.3d 142 (2009)

# Ohio – 2 cases 2 outcomes

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- ◆ **Meijer Stores Ltd. Partnership v. Franklin Cnty. Bd. of Revision**
  - Both Taxpayer and County had experts
    - ◆ Taxpayer – Dark Sales Theory
    - ◆ County – sales based on leased property of first generation users, prices of available properties, Meijer could be lessee and newness of the property
  - Ohio Supreme Court upheld Boards decision that County’s expert’s analysis had more probative value and that property could fall into Special Purpose Property Doctrine

122 Ohio St. 3d 447 (2009)

# Indiana

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## ◆ Meijer Stores v. Smith

- Taxpayer's appraiser used second generation sales and made adjustments for obsolescence based on limited number of buyers for properties of this size and an oversupply of big-box properties within the retail market.
- County did not provide any evidence and solicited no testimony on cross examination as to other sales.
- The Tax Court of Indiana held for the taxpayer reasoning:
  1. The county "needed to present some other market based evidence that impeached Meijer's appraisal and supported its own assessment."
  2. There is no *per se* relationship between a store's age and its obsolescence.

923 N.E.2d 1134 (2010)

# Michigan 1

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- ◆ **Lowe's Home Center, Inc. v. Township of Marquette**
  - Both Lowe's and Home Depot
  - Taxpayer – value should be limited to fee simple analysis
  - County – could use sales of stores subject to leaseback agreements, sales of leased properties and sales from landlord to the tenant to determine value
  - Court of Appeals held that the Michigan Supreme Court had previously held that the state constitution and statutes require property to be based on fee simple and could not consider value to the current owner.

Mich. Ct. App. April 22, 2014

# Michigan 2

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- ◆ **Lowe's Home Center, Inc. v. City of Grandville**
  - Taxpayer – should be limited to vacant and available big-box retail stores
  - County – could use sales of leased-fee property, income approach and cost approach.
  - Court of Appeals declined to consider the current owner's use in determining HBU because it was an attempt to consider the value-in-use. Assessments must consider what has a recognizable pecuniary value inherent in itself and not enhanced or diminished according to the person who owns or uses it.

2014 WL 7442250, Mich. Ct. App. Dec. 30, 2014

# Michigan 3

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- ◆ **Menard, Inc. v. City of Escanaba**
  - Taxpayer – used sales with deed restrictions but did not make any adjustments for the existence of deed restrictions
  - County – primarily used the cost-less-depreciation approach due to insufficient comparable sales and building is of newer construction
  - Court of Appeals held that deed-restricted comparable could not be used for HBU given the “anti-competitive nature” of the restrictions. The Court also determined the cost-less-depreciation approach is appropriate to look at because the deed restrictions drastically limited the actual market of the property.

**FOR PUBLICATION**, Mich. Ct. App. May 26, 2016



# Kentucky

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- ◆ **Wilgreens, LLC and Walgreen Co. v. Fayette County (KY)**
  - History – Land, building and long-term Walgreen’s lease purchased in 2007 for \$6,275,000
  - Taxpayer – \$2,600,000 value based on 2 sales outside of Fayette County and 5 sales of strip shopping centers in Fayette County and leases are intangible property
  - KBTA – “the existence of a long-term, build-to-suit lease on a commercial property adds measurable value” and must be considered.
  - Circuit Court affirmed a lease should be considered when using the income approach to valuation.

Fayette Circuit Court, Feb. 13, 2015

# Florida

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## ◆ **CVS v. Hillsborough County, Florida**

- Hypothetical Buyer in highest and best use (HBU)
- Taxpayer argued HBU was general commercial
- County argued HBU was drug store (present use)
- Court found that general commercial property was too broad and that current use must be considered when determining HBU because is “keeps the highest and best use determination **grounded in reality**, as opposed to conjecture of potential future uses”

(emphasis added)

(13t Cir Ct. Fla, July 3, 2003)

# Tennessee Experience

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- ◆ **Lowes Home Centers, Inc. (ALJ, Tax Year 2014, Appeal No. 96740, Coffee County)**
  - Attorney for Lowes argued decision from Michigan Court of Appeals – ALJ stated Michigan law and Tennessee law are fundamentally different.
  - ALJ cited *National Life & Accident Insurance v. Keaton* 1986 WL 4846 (Tenn. Ct. of Appeals) – any value attributable to the existing lease at the time of sale constitutes part of the “intrinsic” value of the property.
  - ALJ found income approach did not comport to Tennessee law and held that adjustments made to cost approach for external obsolescence were not supported.


# Tennessee Experience

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- ◆ Currently over 50 appeals pending before SBOE seeking values based on “Dark Sales” theory  
(Lowe’s, Target, Walgreens & CVS)
- ◆ 3 appeals (Lowe’s) pending before the Assessment Appeals Commission (2<sup>nd</sup> level of appeal)
- ◆ Lowe’s is seeking about a 73% reduction in value for each store

# Texas

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- ◆ Lowes / Bexar County, Texas
  - ◆ Arbitration panel rejected arguments by Lowe's Home Centers to value of its San Antonio area stores as if they were empty instead of a functioning businesses.
  - ◆ "Texas law does not support the notion that appraisals of the subject properties should be conducted as if they were vacant."
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# U.S. Supreme Court

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- ◆ *Rite Aid Corp. v. Huseby et al*, U.S., No 16-36, petition for certiorari denied 10/3/16)
  - Irondequoit and Williamson, New York
  - Claim of Equal Protection
  - Assessment was based on each respective drugstore lease.
  - Argument – Lease was above market so assessments were above market.
  - Argument of “Sub-Market”

# Solutions: Legislative

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- ◆ Indiana – Passed in 2015
  - Must use cost approach for buildings less than 10 years old
  - When using sales comparison approach
    - ◆ Can not use properties which have been on the market for more than a year
    - ◆ No substantial deed restrictions

# Solutions: Legislative

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- ◆ Michigan – Currently Considering
  - Must be assessed at property’s “highest and best use”
  - Do not consider private deed restrictions
  - Michigan Tax Tribunal must consider all 3 approaches to value
    - ◆ Cost less depreciation
    - ◆ Comparable Sales
    - ◆ Capitalization of Income



# Solutions: Rulemaking


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- ◆ State oversight agencies might be able to address the issue by
  - Regulation / rules
  - Appraisal Manuals
  - Guidelines




# Solutions: Coordinate Appeals

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- ◆ Standardize information requests (discovery)
  - ◆ Share information
  - ◆ Be uniform in valuation method
  - ◆ Use experts
    - Private Consultant
    - Review of Appeal Appraisal
    - Independent Appraisals
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# Economic Impact

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- ◆ Michigan Association of County Treasurers estimates Michigan communities have lost \$74 million in the last two years.
  - ◆ Indiana ad valorem losses are estimated at \$120 million.
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# Impact on Equalization

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- ◆ Assessments should be based on uniformity
- ◆ Same definition of value for everyone
- ◆ Federally protected classes
- ◆ Remember:

**Everyone wants to get on the bus!!**



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# Questions?

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Assessment Leadership  
Beyond All Limits

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