DARK stores

BY ILENE WOLFF

A QUESTION OF VALUE
Courts may ultimately decide if big-box retail stores merit local tax breaks because their facilities are custom designed and of less value to anyone else.
Since the Great Recession, many big-box stores across the state have successfully appealed community assessments to the Michigan Tax Tribunal. As a result, there’s less money for infrastructure, public safety, and education.

It was 2010, and Michigan’s economy was still in a freefall due to the Great Recession. The future of the auto industry was shaky, mortgage companies were foreclosing on homeowners at unprecedented rates, and many businesses shrunk or shut down altogether.

At the same time, local communities watched helplessly as their property tax revenues dwindled. Consider the Michigan Tax Tribunal wiped out $5 million in assessed value from 2008 to 2010 for a Target store in Novi after the retailer’s lawyers used what has come to be known as the Dark Store Theory.

Novi lost out on hundreds of thousands of dollars in property tax revenue that day. Since then, use of the theory has caused towns across Michigan to forfeit hundreds of millions of tax dollars collected from big-box stores that had been used to provide services and fund infrastructure. Conversely, homeowners, small retailers, and other businesses couldn’t persuade the tax tribunal to extend the same treatment to their assessments.

“The Target store was really where it all started,” says Michael R. Lohmeier, Novi’s assessor since 2016 and a tax tribunal judge from 2005 to 2006. “Lots of assessors and private appraisers were shocked by it.”

The theory maintains that big-box stores like those owned by Target Corp. and its counterparts The Home Depot Inc., Lowe’s Cos. Inc., IKEA, Costco Wholesale, Meijer Inc., Menard Inc., and Walmart are chronically overvalued because they’re sized and built in such a way that any potential buyer would have to make a significant investment to make them suitable for another use. This lowers their value to anyone other than the current user, the theory goes.

“Across the country, retailers put properties up for sale priced around the assessed value, but those properties didn’t sell until the price was dramatically lowered,” says Amy Drumm, vice president of government affairs at the Michigan Retailers Association in Lansing. “They saw a pattern of over-assessment and started reviewing the assessed values on their other properties. When they appealed those high valuations, they were most often successful in lowering the valuation at the Michigan Tax Tribunal.”

The shock felt in the appraisal community was largely the result of the theory running counter to a basic tenet of the profession: that a property should be appraised at its highest and best use. In the case of the Target store in Novi, that would be as a thriving and income-producing store, and not as a location that had closed and gone dark.

Novi had assessed the market value on the property at $10.3 million, $10.1 million, and $9.1 million in 2008, 2009, and 2010, respectively. For the same years, Target says the market value was $8 million, $6.2 million, and $5.5 million (property taxes are computed using one-half of the market value).

The tax tribunal, an administrative court for appeals on all state taxes, set the market value at $8 million for 2008, $6.3 million for 2009, and $5.1 million for 2010. “You can see the tribunal pretty much went with Target’s values,” Lohmeier says.

Since that seminal Michigan case with Target, which had net earnings of nearly $3 billion in 2018 (FY), the tribunal has ruled on many more Dark Store Theory cases, and retailers and municipalities have settled tax assessment disputes in and out of court. At times, all a retailer had to do was threaten to go to the tribunal and assessors would settle, several assessors maintain.

For example, Macy’s appealed Troy’s 2018 market valuation of $14.4 million for its anchor store at Oakland Mall, maintaining the market value is $6.5 million. In a February consent judgment, the city and retailer settled on a market value of $10 million. For 2018, Macy’s had net income of almost $1.2 billion.

In Livonia, the city entered into a consent judgment with Walmart in 2016, knocking down the market value of a store to $10.3 million from $12.6 million in 2015, and to $9.7 million from $12 million in 2016. Walmart posted net income of nearly $9 billion in 2018.

In Sterling Heights, meanwhile, Lowe’s got its 2018 market value lowered to $5.5 million from $6.7 million in a consent judgment. Lowe’s reported net income of $3.4 billion in 2018.

To avoid a potentially lower judgment of an assessment, community assessors have learned to avoid decisions from the tribunal. In Michigan, commercial and industrial property assessments are appealed directly to the tax tribunal, bypassing the local Board of Review.

“Most of us settle cases with the best numbers we can get,” says Dean Babh, the assessor for Chesterfield Township. “I’m confident that every big-box settlement I’ve gotten is higher than I would have gotten from the Michigan Tax Tribunal.”

In addition to big-box stores, smaller retailers and even non-retailers have started copying the big-box formula.

As a result, Michigan municipalities lost out on at least $100 million of revenue from 2013 to 2017, according to the Michigan Association of Counties. According to an MAC blog post, “This...
process is shifting more of the burden onto homeowners to fund the basic public services all Michigan communities and businesses utilize each day."

What's more, a report from Standard & Poor's, titled "Dark Store Tactic by Big-Box Retailers Could Pressure U.S. Municipal Budgets and Credit Quality," offers additional perspective. "Many of the successful appeals that we have observed have resulted in tax settlements in the millions of dollars, and at comparatively little cost to the big-box retailers," the report states. "Furthermore, a few favorable court decisions upholding the validity of Dark Store Theory can reverberate throughout a state, as in both Michigan and Indiana, resulting in scores of in- and out-of-court settlements and compounding the potential gains to retailers many times over."

According to the Michigan Association of Counties, in 2015 smaller retailers in Oakland County were paying 72 percent more per square foot in property taxes compared with the rate paid by big-box stores.

Just as Michigan cities and towns have felt the negative effects of the Target-Novi court case, they've been eyeing another case for relief. The Michigan Court of Appeals ruled in 2016 that the tribunal had applied the law incorrectly, and said it must reopen a tax appeal case by Menards' parent company for its store in Escanaba.

The higher court ordered the tax tribunal to take additional evidence regarding the market effect of deed restrictions on parcels used as comparable properties in the appraisal used by Menards for its case. The appeals court judges also said the retailer and city must be allowed to submit additional evidence using a cost-lose-depreciation approach to valuation.

Cost-loss-depreciation starts with the cost of a new property and subtracts depreciation based on tables supplied in the state's Assessors Manual. It's the appraisal method historically used in Michigan, but there are two other options. One considers the rental income from a property, while the third method uses the sales prices of properties that, ideally, are comparable and have sold within the past year.

Among the eight comparable sales Menards submitted as evidence, four had deed restrictions to thwart competition by inhibiting their use in the future as retail sites. Menards' appraiser testified that he talked to brokers, sellers, and buyers, and was convinced the deed restrictions had no impact on their sales price.

The tax tribunal found the argument credible, even though other testimony from an expert appraisal reviewer criticized Menards' appraisal for not adjusting for the deed restrictions, according to the appeals court ruling. The appeals court also noted the Menards appraiser's report showed that two of the comps with no deed restrictions had the highest selling price per square foot. The judges ruled that if information from the effect of the deed restrictions is insufficient to reliably adjust the value of the comps, they shouldn't be used.

In a statement, Menards said, "These types of property tax appeals are quite common. We hired a consulting firm to handle these types of appeals and, in turn, make recommendations for all of our properties, including those in Michigan. The firm follows standards as outlined by state law and the Uniform Standards of Professional Appraisal Practices and the Appraisal Institute."

Robert Valentine, Escanaba's treasurer, says Menards' statement is what he would expect. "When you look at the higher Menards store valuations in neighboring states, it's easy to see that there's a problem in Michigan. I'm not an appraiser, and I don't know if such appraisals comply with industry and ethical standards, but I do know that the tribunal is charged with determining fair value, and part of that process involves assigning weight to the evidence presented by..."
both sides," he says.

"In my view, a reasonable, impartial person should not assign any meaningful weight to an appraisal which uses blighted, deed-restricted dark stores for sales comps. I also believe it's unreasonable to suggest that such deed restrictions have no effect of value, as has been argued by Menards."

In the Escanaba case, Menards disputed the city's opinion that the property had a market value of $7.8 million for 2012, $8 million for 2013, and $9.2 million for 2014. The retailer said the market value for each year was $3.4 million, or $20 per square foot.

The tax tribunal set the 2012 market value at $3.3 million, $3.5 million for 2013, and $3.7 million for 2014. Menards is appealing its 2016-2018 assessments, as well.

Valentine says the city has lost tens of thousands of dollars in revenue due to the lower market value set by the tribunal. The city also spent more than $100,000 defending the Menards case, although its expenditures have been offset by contributions from neighboring communities that joined in the case.

"We have lots of roads that could be getting paved with the lost money in the Menards case and other dark store cases," Valentine says, "but Escanaba has stopped short of saying we (let a librarian go) or we haven't paved the worst road in town because, at the end of the day, you reduce your budget to the revenue stream."

Babb, of Chesterfield Township, also has a Menards in his community. He had assessed its market value at $12.6 million for 2013. The retailer says it should be $3.5 million. Babb says, "They paid more than $3 million for the land," he says.

Babb was two weeks away from trial over the disputed Menards value when the tribunal's decision on Escanaba came out. His case was similar to the assessor's in the Upper Peninsula city. "All of the differences in the appraisals that we were going to hang our hat on, the judge said he was fine with it," Babb says.

As a result, Menards and Chesterfield Township settled on a market value of $5.3 million, meaning the retailer would pay taxes on $2.7 million — less than they paid for the land.

Julie Brixie became well-versed in the activities surrounding the Dark Store Theory during her 10 years as the treasurer of Meridian Township, just east of East Lansing. She scoffs at the idea that big-box stores have been overvalued by assessors.

"I think that's patently false," she says. "That idea is one that's been put forth by corporate lawyers in trying to take advantage of a tax loophole imposed by the Snyder administration."

The loophole came about because Gov. Rick Snyder's appointees to the tax tribunal "allowed different things than the law says," Brixie says. "There's been a court decision saying what they did was wrong."

Brixie got elected again in November, but this time to the State House of Representatives. One of the first things she did after taking office was to join with two colleagues, Rep. Beau LaFave and Sen. Ed McBroom, in introducing a package of bills to thwart the Dark Store Theory. LaFave and McBroom's districts are in the Upper Peninsula and include Escanaba.

The bills have been referred to committees, and Brixie says she's confident they'll move forward to the full legislative body before reaching the governor's desk for signing.

"I want to level the playing field, so mom and pop stores are taxed at the same level per square foot as the big-box stores," Brixie says. "In Michigan, the average assessment per square foot for a big-box store is $924.39."

In contrast, the average assessment for a Michigan mom and pop store is more in line with that of a Lowe's in North Carolina or South Carolina, where the company's properties are deemed to be worth $79 per square foot and $55 per square foot, respectively, or a Home Depot in Georgia, assessed at an average of $65 per square foot, or a Walmart in Arkansas, assessed at an average of $52 per square foot, Brixie says.

Dave Maturen, a certified general real estate appraiser and former state representative, introduced legislation to end the use of the Dark Store Theory and "special carve-outs for big-box stores" in 2015. His bill had more than 50 co-sponsors and gained approval in the House of Representatives by a vote of 97-11. "I was elated, I was ecstatic," he says. "Then it went to the Senate and basically died."

While his bill failed in the Senate Tax Policy Committee because the chairman didn't bring it up for consideration before the entire body, the current bills are being considered by two different committees.

Like Maturen's bill, the current bills have bipartisan support. "You would think that means something, but it would mean a lot more if it gets to the floor," he says of the proposed legislation. "If it gets out of committee and gets to the floor, I think it has a good chance of passing."

Still, the legislation, if passed, would have no effect on assessments that have already been lowered. And due to Proposal A, which was approved in 1994, growth on a property's taxable value is limited to the rate of inflation or 5 percent, whichever is lower (if the property is sold, it's reassessed).

As a result, "If taxable value has been reduced by half due to the Dark Store Theory, from $6 million to $2.5 million, it would take roughly 45 years at a 1.5 percent increase per year to get the taxable value back to $5 million," Maturen says. db