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Big-Box Stores Battle Local Governments Over Property Taxes.

The retailers are deploying a 'dark store' strategy that's hurting cities and counties around the country.

On Michigan's sparsely populated Upper Peninsula, big-box stores are a modern necessity. Where towns are spaced far apart and winters are long, one-stop shopping to load up on supplies adds a crucial convenience to what can be — at least for many — a rugged existence.

Landing one large retailer is a coup. Having more than one can make a city or town a regional shopping destination. Marquette Township, a small community adjacent to the larger city of Marquette, is in the unique position of having a handful of big-box chain stores. Taking advantage of the fact that the city of Marquette was mostly built out, the township began encouraging large-scale commercial development on its western edge early in the 2000s.

The town now boasts the only Lowe's on the Upper Peninsula, and the only PetSmart, Target and Best Buy. A Menards home improvement store and a Walmart Superstore are there as well. The flurry of new building and retail was so great that the township's tax revenue never took a hit during the Great Recession, even at a time when most small towns on the peninsula and elsewhere in Michigan were struggling.

But recently, the township suffered a dramatic drop in its property tax revenue. It had to cut back on spending, trim employee benefits and reduce library hours. The impact has reached up to surrounding Marquette County, which earlier this year closed a youth home to save money. The reason for the lost revenue isn't declining consumer demand. It's a series of rulings by the Michigan Tax Tribunal that have allowed large retailers to reduce their property tax assessments, in many cases by as much as half.

Big-box retailers argue that the market value of their commercial property should be the sale price of similarly sized but vacant retail buildings. They point out that these buildings are extremely hard to sell as-is once the retailer moves out. They tend to sit empty for long periods. Thus, the assertion is, they aren't worth nearly as much as local tax assessors have traditionally assumed in valuing the property.

This appeals approach was first largely successful in the Detroit area following the recession, when nearly all retailers were dealing with depressed property values. But since then, it has spread across otherwise thriving areas in Michigan to the point where it is difficult to find a county that hasn't been challenged on the issue. The assessment community has even given it a name, dubbing it the "dark-store" strategy.

Local governments, needless to say, aren't buying this. "When you get your house appraised, they're going to look at properties that are occupied," says Steve Currie of the Michigan Association of Counties. "They're not going to look at the foreclosed one because that's not an equitable property. It's the same case here."

Michigan is far from alone in seeing localities take dark-store hits to their property tax base. Counties in Alabama, Florida and Indiana are seeing widespread challenges that make use of the dark-store method. The National Association of Counties says it's an emerging issue in Iowa, North Carolina, Ohio, Tennessee, Washington and Wisconsin.

Still, while these cases have been proceeding for the better part of a decade, it's only been recently that county organizations and public officials have realized the geographical magnitude of the challenge. County assessors forced to respond to it aren't always aware of similar controversies outside their jurisdiction. This is particularly true in places that are geographically isolated and where assessors are part-time employees.

Getting policymakers clued in to the problem has also been tricky. The world of property tax assessments is loaded with definitions and methodology that, to the average outsider, can seem overwhelming. Property appraisal laws vary by state, and arguments that hold water in one state might not in the next. So it's not always clear to lawmakers what — if anything — they can do legislatively to help counties respond to the threat.

Even in places where counties have pieced together a coordinated effort to fend off challenges, response on the state level has varied. The Indiana General Assembly took arguably the strong-est action, passing two laws last year that essentially banned the dark-store tactic. But those laws were repealed and replaced with a weaker law this year. Alabama passed a law that amounted to an administrative change giving counties more legal resources. The Michigan Legislature has considered but not approved bills dealing with how the Tax Tribunal hears assessment challenges. In these places and elsewhere, many are concerned that the longer it takes for a concerted state response, the more money counties and local governments will lose.

Big-box retail stores aren't the first to complain that their property's uniqueness should afford them special consideration when it comes to their taxable value. Nearly a century ago, the owners of the New York Stock Exchange tried to get the building's appraisal value lowered by arguing that the building's unusual — and expensive — design would be of no value to any future buyer. In fact, the argument went, the building actually lowered the value of the land itself because a future buyer would be forced to shell out the money for demolition costs. While the court rejected that argument in 1928, it has become a popular case to make ever since, with varying levels of success.

There are different nuances and different case law in every state, but it can be generally said that appraisers look at three factors in determining the taxable value of property: the sale price of comparable properties, the current cost to build minus depreciation and the income generated by rents charged to tenants. Appraisers can apply a blend of these approaches to arrive at a property's value, or place most of the weight on just a single approach.

When it comes to unique properties like big boxes, finding comparable sales is difficult. Property values differ by market and it's simply not often that an oversized retailer in a market area sells its property. For this reason, appraisers prefer giving more weight to building costs.

But big-box retailers say using the construction costs of a building to determine the assessment artificially inflates the value. And they insist it's unfair to value their retail properties based on their worth to the current user (referred to as "value-in-use") instead of the value the property would have on the open market (called "value-in-exchange"). The appropriate use of the competing valuation methods is a topic of seething debate in the appraisal world. Retail representatives fall decidedly on value-in-exchange. "It's easy to be confused by the presence of a business," says Florida real estate broker Sheila Anderson, whose firm Commercial Property Services has represented owners in scores of appeals. "But a business is not [what needs to be] assessed." In her view, it's only the resale value

of the empty building that matters for taxation. And that is nearly always a much smaller amount.

Complicating the matter are deed restrictions the big-box retailers place on the properties they do sell. Typically, a retailer closes a location to open up another store close by, or leaves because the market isn't viable anymore. But just to be sure a competitor doesn't move in and fare better, the deed bars the new owner from operating a similar business. Assessors say this limitation artificially depresses the market value of the property. The retailers consider it insignificant.

The debate leads to real questions about the fairest way to value these prolific but unique properties, says Allen Booth, a former city assessor in Rhode Island without any affiliation to a dark-store case. "The reality is there are very few tenants that will move into the custom building when you're dealing with these big-box situations," he says. But, he adds, officials are leery of retail attorneys' motives because they can profit greatly from the challenges by taking a cut of the tax refund if they win. "You have to wonder," Booth says, "are these people just being obnoxious or are the properties really overvalued and it's just that now someone's looking at it?"

Tax courts in Michigan have generally agreed with retailers that properties were being overvalued. In Marquette Township, Lowe's successfully used this argument in a 2012 challenge to its property assessment and succeeded in reducing its taxable value from \$5.2 million to less than \$2 million, even though the store alone cost \$10 million to build. The township spent several hundred thousand dollars in legal costs but failed to win in the appeals process. As a result, the ruling applied to other pending challenges. All told, the township's total property tax collections have fallen nearly 22 percent in just a few years.

Statewide, the results have been similar. According to the International Association of Assessing Officers, the valuation on large retailers across the country is anywhere from \$45 to \$75 per square foot, depending on the market. After five years of litigation in Michigan, says tax attorney Jack Van Coevering, the average per-square-foot value in the state is \$20.

The big-box retailer Meijer brought a case at one of its most successful Indiana locations, in Marion County, after winning reduced assessments in Michigan. The attorney for Meijer went so far as to tell the Indianapolis Business Journal that the appeal in Marion County was a test case because "whatever the value is there would be the upper limit of the value across the state." The retailer won in late 2014 and got its assessment slashed from \$83 per square foot to \$30 per square foot. The decision applied retroactively, requiring Marion County to refund Meijer \$2.4 million for nine years of back taxes. Indiana county officials estimated that if the decision were to be extended to the more than 17,000 commercial properties across the state, it would mean a loss of \$120 million in property tax revenue statewide.

Indiana lawmakers responded quickly. In 2015, the legislature passed two bills: One effectively banned using the dark-store method to value existing businesses, and the other required using the cost method for properties over a certain square footage. But those laws were repealed this year under concerns they violated the uniformity clause in the state's constitution, which requires all property to be assessed on an equal basis. The Indiana General Assembly then passed a new law that requires assessments to be based on the value of properties that are "similarly situated in the marketplace."

Other states have tried other tactics. Alabama passed a law this year that allows counties to remove these cases from their district attorney's jurisdiction and hire outside attorneys to fight them. In Michigan, a bill passed the House that would require the Tax Tribunal to consider all three valuation methods (rather than just the one the retailer is arguing for). It will be considered in the Senate later this fall.

In short, the legislative authority of lawmakers to intervene is murky. “It’s always appropriate for the legislature to try to clarify and remedy a situation when appropriate,” says Joan Youngman, a property tax expert with the Lincoln Institute of Land Policy. “But you want to be sure this is a problem with the existing law.”

In the end, the best way to beat back the challenges is to win in court. But that’s a tough task for counties that don’t have a lot of resources. In Tampa, Fla., Hillsborough County’s director of valuation, Tim Wilmath, says counties in his state have caught on early to the dark-store challenge and have for the most part been able to mount successful defenses. Wilmath co-authored an article in an industry magazine last year advising county assessors on how to challenge the tactic, which has made him a de facto adviser to smaller counties across the country. “They’re looking for advice on how best to go at it,” he says of the calls from outside Florida. “But even when they know all the right things to do, they still settle because they just don’t have the money.”

In Michigan, a recent Court of Appeals ruling may prove to be a turning point. In May, the court overturned a 2015 decision by the Michigan Tax Tribunal that had favored the retailer Menard against the city of Escanaba in a property tax dispute. The court found that Escanaba’s cost-based approach was more reasonable than the retailer’s comparable sales method, which included using dark stores. The case was remanded back to the tribunal with directions to consider all the assessment methods. It may end up setting a precedent for cases in Michigan that are currently open.

Still, for counties and townships that have already lost or settled cases, the damage has been done. And because of limits on how much localities can increase the property tax each year, the previous losses in tax revenue will never be made up. In Marquette Township, that means officials will have to figure out how to replenish the reserves that were drained to pay back Lowe’s, at the same time adjusting permanently to a shrunken tax base.

“The long and short of it,” says Marquette Township Manager Randy Girard, “is that we will not recover.”

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