BIG BOXES & THE DARK STORE THEORY: A Taxing Issue for Communities

By **Marc Daneman**, *Daneman & Associates, Grand Rapids, MI*

Introduction

Tax assessments are down – good news or bad news? For some property owners, yes, especially for those large commercial retail buildings. But for the municipalities that must provide those establishments and their community with public services that may not be the case. Over the past decade there has been a movement that does not make sense to local governments and other taxing authorities; however, it does to some large commercial retailers like Lowes, Menards, Meijer and other so-called *"big box"* store owners, and maybe to other not-so-big retail establishments. These *"big box"* stores have argued to the Michigan Tax Tribunal (MTT or Tribunal) that because their stores are *so unique to their operations that they cannot sell them to another similar retailer or to other retailer unless they are completely revamped or demolished.* They argue this means that their stores are only worth what a vacant store shell is worth or less. Some big box store retailers have even argued that once built and operating, their assessments should be less than the cost of the land they acquired.

In contrast, local tax assessors say that these properties should be assessed as a going concern for at least as much as it cost to build, less any depreciation. The MTT to date has mostly held for the retailers, although the courts and some state legislatures are now questioning that theory. In Michigan, the legislature is caught in between the two.

Obviously the big box retailers employ a lot of people, and provide needed goods and services. But smaller retailers argue the big box retailers are not paying their fair share in taxes on their buildings. Municipalities are out millions of dollars in tax revenues and are left with empty buildings that are difficult to market and thus susceptible to blight when a big box retailer moves out. Other taxpayers want to know why big box retailers are allowed to deed restrict the empty buildings so they cannot be used for other purposes and why such anti-competitive behavior is legal. This article will look at the *"Dark Store Theory"* – that operating big box stores should be treated as vacant or *"dark"* stores – and the impact it is having on local governments, and by extension, other taxpayers.

Big Box or Not

So, what is a *"big box"* store? There is no legal or formal "Webster's" definition of this term. It has been stated in various published peer reviewed articles and other media reports that these are *buildings that can range from 20,000 to over 200,000 square feet.* (*Who's Afraid of the Dark?: Shedding the Light on the Practicality and Future of the Dark Store Theory in Big Box Property Taxation*, 38 **VA Tax Rev** 445, by Stephen W. Grant, Spring 2019). Although now, some are arguing that much smaller buildings could be treated like big box stores. They are all built for the retailer's specific use and not for speculation. The internal designs for sales, racking, storage, management, and operations are to meet the specific requirements of the retailer. Typically, the building facade and internal arrangement would be similar from store to store. Another important characteristic is ownership arrangement. Many are held under a fee simple ownership by the retailer. That is, the retailer owns the property completely. An alternative ownership arrangement would be a build-to-suit lease-buyback by the retailer. Here, the retailer buys the property and builds the store as described above and then sells the property/building to an investor who leases the property back to the retailer. That latter situation is an investment mode of ownership and avoids some of the actual property ownership arrangements (such as financing and taxation for income and business purposes). Also, many of these properties use deed restrictions or covenants on the property. These restrictions often limit or prohibit the use of the property in certain ways to avoid competition should the big box retailer move to another location. The restrictions can last for years and force the building to be used in a completely different manner than it was used by the original big box owner. These restrictions effectively result in a lower taxable value.

About the Author

Marc Daneman, Daneman & Associates, is an attorney and land use planning consultant serving public and private clients in the areas of zoning, land use and development, wireless telecommunications, and solar energy. He is a former township manager, planning and community development director, zoning administrator, and corporate leasing manager. Marc can be reached at marc@marcdaneman.com or 616-450-0110.

But as described above, the most significant attribute is their unique internal and/or external building design. The buildings' internal layout and accessory features make them distinctively different from other smaller single purpose retailers. For example, a Menards store may have a large main building for its general sales, and then have outdoor spaces for lumber and blocks, gardening, and storage. A Menards store in Wyoming has over 160,000 square feet of building area and another 155,000 square feet in outdoor retail yard area, some of which is partly enclosed. Home Depot and Lowes would be similar, even if they did not necessarily have large open areas. Physically smaller retailers like chain grocery stores (such as Kroger and Meijer), along with general retail establishments (like Kohls and Target), and even combined *"super-stores"* (like Walmart, Costco and Sam's Club) all have unique layout arrangements and requirements. Malls and large strip shopping centers with a large anchor tenant have also characterized themselves as big box-type developments. Even large commercial banks with their built-in safes and safety deposit boxes and other branded specialty stores are now arguing the same big box theory for their tax appeals.

The trend of this type of retail is not new. The first big box retailing was in the 1960s with stores like Kmart and the indoor shopping malls. But it was not until the 1990s that the concept really took off to serve the growth of suburban communities and smaller urban centers in more rural areas. The public and communities generally welcomed them. For the general public, these retail establishments provided a wide range of goods and services under one roof. Local governments also welcomed them since they brought in tax revenue and employment. Communities used that revenue to pay for public services such as road and utility improvements, public safety services, parks and recreation, schools and libraries and many other public services and improvements. Some of these community improvements were installed directly to benefit the retailer, such as road expansions and utilities. There was no question that these large buildings and their properties were a significant source of public revenues. But there were downsides too. Local small retail merchants were feeling the squeeze by not being able match the variety and pricing that these often national or regional retailers could provide and in smaller markets, many were effectively forced out of business.

These operations continued to grow at a significant pace into the 2000s. However, the 2008 Great Recession, along with the need for even larger stores in better locations, and the move to online shopping revealed there were too many of these large retail establishments. As a result, retailers began to close some of their less productive or poorly located stores. The 2019 law review article (*Who's Afraid of the Dark?)*, by Stephen W. Grant, cited earlier, suggested that within the next five years, the Amazons and other e-commerce retailers could force the closure of 20 to 25 percent of all malls and similar stores including big box retailers. And this was

Some "Official" & "Unofficial" Definitions

Dark Store Theory (from Microsoft Bing):

The dark store theory is a **tax strategy used by big box retail stores like Lowe's, Target, Walmart, and Menards to lower their property tax value**. These retailers contend that their fully operational, often thriving businesses should be assessed the same as vacant buildings or *"dark stores."*

"Big Box Store" (from Wikipedia -- https://en.wikipedia.org/wiki/Big-box_store):

"A big-box store (also hyperstore, supercenter, superstore, or megastore) is **a physically large retail establishment,** usually **part of a chain of stores.** The term sometimes also refers, by extension, to the company that operates *the store. Commercially, big box stores can be broken down into two categories: general merchandise (examples include Walmart, Kmart, and Target), and specialty stores (such as Home Depot, Barnes & Noble, or Best Buy), which specialize in goods within a specific range, such as hardware, books, or consumer electronics, respectively. In the late 20th and early 21st centuries, many traditional retailers and supermarket chains that typically operate in smaller buildings, … opened stores in the big box store format in an effort to compete with big box chains, which are expanding internationally as their home markets reach maturity. The store may sell general dry goods, in which case it is a general merchandise retailer (however, traditional department stores, as the predecessor format, are generally not classified as "big box"), or may be limited to a particular specialty (such establishments are often called "category killers"), or may also sell groceries. … In the U.S., there is no specific term for general merchandisers who also sell groceries. Both Target and Walmart offer groceries in most branches in the U.S. Big box stores are often clustered in shopping centers … . In the United States, when they range in size from 250,000 square feet (23,000 m) to 600,000 square feet (56,000 m), they are often referred to as power centers."*

"Value in Use" vs "Value in Exchange" (from **Dictionary of RE Appraisal**, 6th Ed):

Value in Use – The value of a property assuming a specific use, which may or may not be the property's highest and best use on the effective date of the appraisal.

Value in Exchange – A type of value that reflects the amount that can be obtained for an asset if exchanged between parties.

before the COVID pandemic shutdowns. Many of these closed stores have gone *"dark."* They have left vacant buildings that have substantially less tax value than when they were active. These *"dark stores"* in addition to being a blight on the community, have drawn additional public service needs such as fire and police. Yet their taxable value will not pay for those services. When these dark properties do sell, they are often for different, less taxable value uses. It is on that basis that this theory of dark stores is built.

Dark Store Theory and Use

The dark store theory started here in Michigan. Attorney Michael Shapiro is credited with this theory, which is based on his tax appeal arguments with large auto plants. There he claimed these plants should be assigned a true cash value for the property as if the ongoing and operating auto plants were vacant. His rationale was that since these plants were so unique, they could only be sold for a completely different use in a secondary market. As such, the property would have been vacated, demolished, or converted for the sale – thus becoming a new and different *"highest and best use"* (HBU). He took that theory in 2010 and began to make the same arguments for the big box stores. Again, arguing that they were so unique that they would only sell in a secondary market, equivalent to that of a vacant *("dark")* store sale. He was successful with the MTT here in Michigan and tax courts in other states. Now, big box retailer's appraisers contend that the best valuations are based on those comparable sales. Novi City Assessor Michael Lohmeier believes the "*comparable properties are often sold for far less than the construction cost of a big box's brand-new structure and sometimes even less than the sale price of its underlying vacant land.*" Former State Representative David Maturen, who was a leader in the legislative efforts to address this issue (as discussed below) says that "*many times these comparables are encumbered by deed restrictions.*" He also argues the better way to analyze this issue is by looking at a cost-less-depreciation. Maturen points out that issues of physical depreciation, functional obsolescence and external or economic obsolescence, and especially the latter two, are critical and are now the focus of the debate under the dark store theory.

Courtesy of the Michigan Municipal League.

Former Kmart in Grand Blanc.

To better understand the arguments, one must appreciate the methods of assessments and appraisal – which are similar, but done for different purposes. The Michigan Constitution requires property be assessed at 50 percent of the fair market value or True Cash Value (TCV). True cash value is the *"usual selling price at the place where the property to which the term is applied is at the time of assessment, being the price that could be obtained for the property at private sale, and not at auction sale except as otherwise provided in this section, or at forced sale."* MCL 211.27(1); MSA 7.27(1). See also Const 1963, art 9, § 3. To do this an assessor (or appraiser) first determines the HBU of the property. HBU is the most profitable and advantageous use the owner may make of the property even if the property is presently used for a different purpose or is vacant, so long as there is a market demand for such use. This involves valuing the land as if vacant, and the property as it is improved. The HBU of property must be legally permissible, physically possible, financially feasible, and maximally productive. Once HBU is determined, there are three generally accepted approaches to establishing TCV: looking at comparable sales; the cost of construction (reproduction), less any depreciation; and the income approach. A law review article analyzing the Dark Store Theory (44 ***Real Estate Taxation***, *Valuation of Big Box Stores and the Dark Store Theory – A Changing of the Tide*, Second Quarter 2017) describes the three approaches as follows:

The **Comparable Sales Approach** *"is use when there are numerous sales of similar properties in a fairly recent time frame. The appraiser compares the property sales and adjusts for different features and characteristics to determine a value similar to the subject property."*

The **Cost Approach** values *"new or nearly-new properties and those that rarely change hands. The value of a property is determined by valuing the land, adding the current cost to construct the property, and subtracting depreciation. Entrepreneurial profit may be included in the value indication. The depreciation may include physical depreciation and functional and/or external obsolescence."*

The **Income Approach** measures the present value of the property ownership. There are two ways of looking at income: *"direct capitalization"* and *"yield capitalization." In direct capitalization, the relationship between one year's income and value is reflected in either a capitalization rate or an income multiplier. In yield capitalization, the relationship between several*

years' stabilized income and a reversionary value at the end of a designated period is reflected in a yield rate." This is not often used for big box stores; but when used value is assessed at the market rent, rather than rent from a build-to-suit arrangement. Lease payments typically include financing terms and some form of profit. After considering all value determinations, the appraiser generally reconciles two or more indications of value to arrive at a value determination.

Assessments are used for tax purposes. Appraisals on the other hand are used to determine property values for sales and other purposes, those sales are also used as comparables for tax assessment purposes. The two approaches use somewhat differing standards and have different means to approach the *"value"* of the property. However, both generally use the same three approaches described above, especially as it applies to fee simple ownership.

In Michigan, the dark store theory, which has been called a *"loophole,"* has taken hold in several cases before the courts and MTT (see sidebar). It's a loophole because the retailers have been able to successfully argue the comparative sales approach is the most appropriate. Historically, the Tribunal and municipal assessors have argued that all three assessing approaches must be followed. But most recently the Court of Appeals and Supreme Court in **Menard, Inc. v City of Escanaba** are questioning the theory. They have directed the MTT to look at alternative methods, which may possibly close this loophole.

Significant Michigan Cases Addressing or Directly Impacting the Big Box Dark Store Theory

- **C.A.F. Investment Co. v. State Tax Comm'n**, 392 Mich. 422, 221 N.W.2d 588 (1974). Identifying the appropriate three-part assessment processes.
- **Target Corp. v City of Novi**, No. 0345523 (Mich. Tax Trib., 9/21/2010; Erratum issued 9/23/2010). Tribunal finds for Target in one of the first dark store theory cases.
- **Ikea Property, Inc. v. Twp. of Canton**, No. 0366639 (Mich. Tax Trib., 7/18/12). Finding for Ikea under the dark store theory.
- **Detroit Lions v. City of Dearborn**, 480 Mich 893; 738 N.W.2d 741 (2007). Supreme Court affirms the Court Appeals' finding in favor of Dearborn that the HBU is the current use.
- **Lowe's Home Centers, Inc. v. Twp. of Marquette**, (No. 314111) and **Home Depot USA, Inc v Township of Breitung** (No. 314301), Unpublished 4/22/14. Affirming Mich. Tax Trib. (No. 0385768, 12/13/12) finding for Lowes & Home Depot under the dark store theory.
- **Macy's Inc. v. City of Grandville**, No. 0436564 (Mich. Tax Trib., 3/24/14) holding for the dark store theory.
- **Menard, Inc. v City of Escanaba,** 315 Mich App 512; 891 NW2d 1 (2016) ("**Menard I**"), with leave to appeal denied in 501 Mich 899 on October 20, 2017). Remanding back to Tax Tribunal to address deed restrictions and cost-less-depreciation method. Cited in **Menard I**:
  - **Clark Equipment Co v Leoni Township**, 113 Mich App 778; 318 NW2d 586 (1982). Holding for cost-less depreciation approach for highly specialized uses which the **Menard I** court accepted.
  - **Great Lakes Division of Nat'l Steel Corp v City of Ecorse**, 227 Mich App 379; 576 NW2d 667 (1998) offering a different method of valuation which the **Menard I** court rejected.
- **Menard, Inc. v City of Escanaba**, No. 14-001918 (Mich. Tax Trib., 5/28/20). On Remand the MTT set a new assessment based on Menard, Inc.'s arguments.
- **Greenfield – 8 Mile Plaza v City of Southfield**, No. 346183, (12/12/2019) Unpublished. Finding for Southfield based on **Menard I**.

Fiscal Impact on Communities

The impact on local governments, schools and other local taxing agencies has been significant. Although there is little definitive information over the dollar amount of taxes lost by local taxing authorities, a 2016 article in ***Bloomberg Businessweek*** reported that between 2012 and 2016, two-thirds of Michigan's counties lost an estimated $75 million in property taxes (*How Big Box Retailers Weaponize Old Stores*, December 18, 2016). In addition to that, municipalities must refund any taxes already collected based on the decisions of the Michigan Tax Tribunal.

In Chippewa County for example, two appeals were lost in Sault Ste. Marie (with Walgreens and Walmart). There the county had to refund approximately $25,000. In Delta County, with the **Menard I** case, the county has refunded about $55,000 and Menard, Inc. has said it received over $421,000 in refunds throughout the Upper Peninsula (UP) in its other appeals. Other UP counties have lost or refunded hundreds of thousands of dollars in taxes as reported in a recent ***Rural Insights*** article (*Dark Store Theory in Michigan's Upper Peninsula: Impact and Predictions,* by Isabelle Karl, May 16, 2021). Rural communities have been harder hit with this theory because there are fewer or no comparables within the market the big box store is located. And because the retailers' attorneys take these cases on contingency, governments have scarce resources to defend the appeals.

In more urban areas the same is also true. Cases are taken on contingencies and comparables are still limited. In one Kalamazoo suburban community, Comstock Township claims that between 2018-2019, it lost about $60,000 in revenue from one retailer when the MTT found in favor of the big box store. In another Kalamazoo community, Costco was able to successfully argue that its value should be less than the land value alone. It purchased the property in 2014 for about $5.5 million and built a store for another $12 million. And even where the assessor gave it an $8.6 million assessment, the retailer argued its value should be $4 million.

The Michigan Municipal League cited 2015 testimony that big box stores were being assessed at an average of $55 per square foot before the dark store theory took hold. However, the Tribunal has dropped that dramatically to the $22-$25 per square foot range. In other states where the big box theory has not taken hold, the square footage rates for similar stores has been in the $60 to $80 per square foot range (see sidebar). When reduced, these rates will never return because of the impact of Proposal A and the Headlee Amendment. The new taxable values assigned by the MTT cannot increase more than the lesser of the rate of inflation or 5 percent, until they are sold. This will keep these values low.

What are Big Box Stores Valued Elsewhere?

Prior to the dark store theory, Michigan big box stores were assessed an average of $55 per square foot. Here is where they are now compared to states where various big box stores are located:

- In Michigan, Lowe's stores are assessed at $22.10 per square foot. In Lowe's home state of North Carolina, the same stores are valued at $79.08 per square foot.
- In Michigan, Menards and Target are valued at $24.97 per square foot. In Menard Inc.'s home state of Wisconsin, the same stores are valued at $61.23 per square foot.
- Sam's Clubs and Walmart now average around $25.68 per square foot in Michigan. Studies of those buildings in the home state of Arkansas are being done, but they are likely to be much higher than they are in Michigan.

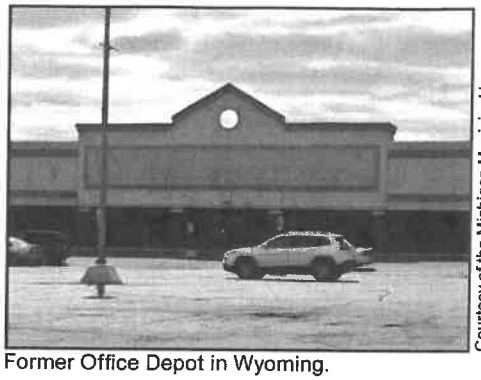
Source: Michigan Municipal League *"Dark Stores" Report* and Testimony from Jack Van Coevering, a Grand Rapids attorney, former Chief Judge and Chairman of the Michigan Tax Tribunal. Van Coevering now represents Michigan communities on tax assessment cases. (2015).

Further aggravating this situation for municipalities is when an appeal is taken, the legal fees can become significant. For the existing case between Menard, Inc. and the city of Escanaba, which is now into a second round before the Court of Appeals (and may go back to the Supreme Court again), the local paper reported the cost of the appeal has already exceeded $200,000. Sault Ste. Marie city manager Brian Chapman said their biggest loss came with a Meijer appeal which cost them over $800,000 in attorney and expert fees even before trial. Had it gone to trial, their attorney estimated it would be another $500,000 – so they settled. Too many smaller communities cannot afford to take these deep pocket retailers with their contingent attorneys to the MTT or to court. So, they often settle with a much lower value than what they believe is deserved. In 2019-2020 Sault Ste. Marie had nine cases appealed, four were settled and the remaining one went to the MTT. In all cases the retail petitioner prevailed, with an overall tax loss of over $111,000, and the city losing almost $45,000 in taxes. The difference in tax value for those two years was just over $1.8 million. Chapman said that the loss of *"$3 to $4 million represents the total taxable value loss since 2017 due to large box stores utilizing dark store theory, as well as medium to small sized facilities challenging their tax assessment."*

Larger communities have also seen similar appeals. The City of Novi believes it has had about a 25% reduction in property values over the past several years. They have generally settled issues; but even so, they are still being appealed. Michael Lohmeier, Novi City assessor said *"All of our big box stores and larger retailers have appealed including Target, Sams, Home Depot, JC Penny, Lord & Taylors, etc. ... Generally, I settle a case based on a value compromise between the valuations presented by both sides, the city's position and the taxpayer."* Like Novi, many municipal assessors believe they have come out better than had they gone to the MTT. But either way the communities lose tax dollars. See the data in Berrien County in the sidebar for another example.

Community Planning Impact

The community planning impact with the loss of tax dollars is also significant. Most often it has been the rest of the community's taxpayers who must pick-up the difference or public services are reduced. Communities have had to reduce library, recreation, police and fire and other community services, including community planning when the assessment reductions force cuts to keep their budgets in line. Planners have also long argued that when a big box store comes into a community that local merchants cannot complete with their pricing and variety. Walmart and other big box stores that have located at the outskirts of smaller towns, have forced closures of Main Street *"mom & pop"* stores and even smaller branded retailers. Communities have often made significant investment into infrastructure to service these high traffic businesses; then only to have their tax assessment reduced. One community asserted that their highest criminal complaints requiring a significant number of police trips, come from their local big box store, and now those stores are asking to lower their assessments (Northern Michigan University video *"Boxed In Web"* (9/2/16)). But the impact of large vacant big box stores that were "anchors" in a strip mall or commercial strip area may not only result in one blighted building, but the whole strip. When anti-competitive deed restrictions are added to these empty stores (see below), such a result is even more likely. See the photos of some long vacant big box stores scattered throughout this article.


Courtesy of the Michigan Municipal League.
Former Office Depot in Wyoming.

Role of Deed Restrictions

A principal reason these big box stores *"go dark"* is because of the deed restrictions often placed on the property. Those restrictions effectively make the building useless for a similar big box-type store use. *It is not uncommon that these deed restrictions or covenants will prohibit the same type of use or list the restricted or prohibited uses so no similar big box store or even smaller competitor could take the property over.* As an example, a Walmart near Monroe recorded a 20-year prohibition for these uses: grocery store or supermarket (over 35,000 square feet (sf) in leasable area), wholesale clubs (like Sam's Club or Walmart, over 50,000 sf in in leasable area); discount department store or other discount store; or pharmacy. Michigan Township Association's counsel, Robert Thall has suggested that the use of deed restrictions *"skews the use of the sales approach to value and provides support for why the cost approach is superior."*

The retail industry acknowledges that this is common and is done to protect the initial user should they leave the location for another in the same area. They also indicate that when a sale of the property is made there could be *"carve outs"* of those restrictions so the new, secondary user is not limited. But that does not account for the other potential retailers who gave no consideration of the property because the restrictions were of record.

Since deed restrictions will result in vacancies for long periods of time, the property generates limited tax revenues, if at all, when abandoned. The vacancy can also lead to a blighted situation. Depending on the location and surrounding businesses, this could bring down the value of the neighborhood or the whole community. For example, a 45,000 square foot Witmark catalog showroom

2018 Tax Appeal Impact for Small & Big Box Stores Using the Dark Store Theory in Berrien County

Property Owner	2018 SEV/TX	Property Address	Building SF	Price/SF	Potential SEV/TX	Total Rev. Loss	Twp Rev Loss	Twp Library	Twp Police	Twp Fire
Walgreens Co.	748,300	2485 W Glenlord Rd	15,018	$ 99.65	150,180	$ 26,758.45	$ 469.46	$ 673.84	$1,195.76	$ 104.49
Tractor Supply	691,300	5180 Red Arrow Hwy	18,966	$ 72.90	189,660	$ 22,442.17	$ 393.74	$ 565.15	$1,002.88	$ 87.64
Ace Hardware	306,100	1545 W John Beers	15,800	$ 38.75	158,000	$ 6,625.64	$ 116.24	$ 166.85	$ 296.08	$ 25.87
Martin's Supermarket	1,753,500	5637 Cleveland Ave	70,051	$ 50.06	700,510	$ 47,108.25	$ 826.49	$ 1,186.30	$2,105.14	$ 183.96
Walgreens Co.	584,700	1710 W John Beers	14,737	$ 79.35	147,370	$ 19,565.09	$ 343.26	$ 492.70	$ 874.31	$ 76.40
Totals	**4,083,900**		**134,572**	**$ 68.14**	**1,345,720**	**$ 122,499.60**	**$ 2,149.20**	**$ 3,084.83**	**$5,474.17**	**$ 478.36**
Meijer	3,969,000	5019 Red Arrow Hwy	192,214	$ 41.30	1,922,140	$ 91,571.60	$ 1,606.58	$ 2,305.99	$4,092.08	$ 357.59
Totals	**8,052,900**		**326,786.00**	**$ 63.67**	**3,267,860.00**	**$ 214,071.21**	**$ 3,755.78**	**$ 5,390.83**	**$9,566.25**	**$ 835.95**

Source: MML Dark Store Theory – *Menard v Escanaba* Presentation, 2017

and jewelry/electronics chain store outside of Grand Rapids has been closed since the late 1990s. It is now under negotiations for removal by Plainfield Township as a blighted structure. See photo on cover. If and when the dark stores do sell, the new businesses are most often not of the same value or tier as the national retailer that left – and do not represent the same highest and best use of the property. Yet in some cases, big box stores have been converted into mini-malls, amusement and recreation centers, split-up individual retail establishments, auto dealerships, and in at least one case, into a city hall. See sidebar below.

The retail industry defends their position, as noted above, saying they are only following the policy and law set by the state or local taxing authorities who have accepted the rationale behind the dark store theory and their use of comparative sales. Their technical appraisal arguments are based on what they have seen in practice – that there is significantly less value once the property is developed because of the unique characteristics of the buildings and the effect of depreciation. They also disagree that their businesses demand greater public services. Rather they argue they are community developers bringing jobs and benefits back to the community, often with discount pricing and variety of goods under one roof.

Communities are tackling this issue from two different directions — the courts (the tax tribunal and state courts) and the legislature. The earlier cases (as noted in the sidebar on page 6) have supported the dark store theory approach. But a recent Court of Appeals and Supreme Court case have questioned the validity of the theory. In addition, the legislature has also offered several solutions to this issue over the past several sessions.

Big Box Store Replacements – Not Too Dark

Although the big box retailers say that their build-to-suit stores are too unique and specialized and virtually useless to anyone else, they have been reused in marketable ways. A DBusiness.com article from August 2019 suggested that many of the closed big box stores are *"[f]ar from worthless…."* It cites these Michigan examples of reused stores:

- A Walmart in Dearborn was a Kmart.
- An independent grocery distributorship is in a former Sam's Club in Westland.
- Westland City Hall was a former Circuit City store.
- A Home Quarters in Royal Oak is now Beaumont's Health and Wellness Center.
- Former Macy's, Sears and Kmart stores have been converted into offices, apartment, and housing complexes.

Michigan Rep. Julie Brixie also cited several similar conversions in her Lansing area House District:

- A former Meijer Source Club Outlet that was converted to a Home Depot.
- A former L&L that was converted to a Tom's Grocery Store.
- A big box Little Caesars Play Land is now an Office Max.

Summary of Menard v Escanaba (Menard I & II)

One key to addressing the dark store theory issue will be the outcome of the **Menard, Inc. v City of Escanaba** case(s) [315 Mich App 512; 891 NW2d 1 (2016) (**"Menard I** where the Michigan Supreme Court remanded the case back to the Michigan Tax Tribunal (MTT) (at 501 Mich 899 on October 20, 2017).] It is now again back to the Michigan Court of Appeals in **Menard II** (case number 354900). These two cases address specifically how the courts will look at future big box cases and challenges to the dark store theory. This second try at the Court of Appeals, and another likely appeal to the Supreme Court, will guide the industry and municipalities alike.

The **Menard I** case is not overly complicated from a general perspective, but is from the technical standpoint. This case followed other appeals to the MTT, which began to side with the big box retailers based on *comparative sales* of similar big box stores that were vacant dark stores. The Tribunal was looking for comparative sales of *similar stores* and when it could not find them, it accepted *second generation dark store sales* for comparative purposes. The city of Escanaba challenged that position arguing that since the Menards store was a unique retail establishment, owned fee simple and was built-to-suit, it needed to be assessed at its *cost to reproduce less depreciation.*

In 2008, Menard, Inc. built a 237,728 square foot home improvement center on 18 acres at the western edge of the city. The main building was 162,340 square feet, with the additional areas being a lumber shed, garden center and other building supplies. In 2012 it first appealed its assessment which the city had placed on the property and continued the appeal through 2014. The city assessed the True Cash Value (TVC) of the property at $7,815,976 (for the tax year 2012), $7,995,596 (for 2013), and $8,210,938 (for 2014). Menard, Inc. claimed its TVC was $3,300,000 for all three tax years The local board of review rejected the claim and Menard, Inc. appealed to the Michigan Tax Tribunal.

On the initial appeal to the MTT, the appraiser for Menard, Inc. offered comparables and income assessments of similar big box stores from lower Michigan. He claimed there were none in the Upper Peninsula asserting that he was appraising the *"fee simple interest,"* and that the property's highest and best use (HBU) was *"for continued use of the existing improvements as a freestanding retail building."* He did not prepare an assessment using the cost-less depreciation approach. Most of the comparables had *deed restrictions that barred other competitive activities for the future use of the property.* The appraiser did not factor in his assessment the impact of these deed restrictions saying they did not affect the sale price of the other comparables. He explained that some had been placed after the sale of the property, and that the deed restrictions were not anything out of the ordinary for build-to-suit big box stores. *Based on the dark store theory, the property lost most of its value as soon as the construction was complete.* It could not be sold for the construction costs minus any depreciation because functional obsolescence (the buildings uniqueness) was built into these build-to-suit big box stores. Further there was also external obsolescence due to a down market, although he did not identify any specific features of the building that were functionally obsolete, nor did he identify economic factors that made the property externally obsolete in the local market. He asserted that most big box stores are appraised based on these type of sales comparables.

The city's assessor said Menard, Inc.'s comparables were *"not great"* with the deed restrictions and easements that limited their true comparisons. This Menards store had no deed restrictions or other property limitations or easements that restricted its use. She brought forward comparables based on a cost-less depreciation approach of similar stores. She adjusted for depreciation but not for functional obsolescence. She explained that if the store were purchased for its existing use, the buyer would use the existing building components.

The MTT accepted Menard's arguments and ordered assessments for the three years ranging from $3,490,000 to $3,660,000. It held the cost-less depreciation approach should be given no weight since the city did not account for functional or external obsolescence. They disclaimed the city's appraisals and supported Menard, Inc. because any obsolescence was difficult to calculate, and first-generation users are generally concerned with optimizing sales not with optimizing market value to the property. The MTT said the city did not provide enough data to support their comparables. They also accepted the Menard, Inc. position that deed restrictions had no effect on the sales of the deed-restricted properties they offered.

The city appealed to Michigan's Court of Appeals, which in a published opinion reversed the MTT decision and remanded the matter back to the MTT (**Menard I**). The Court ordered the MTT to address several issues. In particular, the Court found error of law when the MTT did not consider the impact of deed restrictions. It found no evidence to support Menard, Inc.'s position that deed re-

strictions have no impact on big box stores with the comparables they used. It stated that Menard, Inc.'s approach only looked at "'*purchasers who were willing to accept the restrictions and so did not reflect the full value of the unrestricted fee simple.' Because of the anti-competitive nature of deed restrictions, big box stores are not sold for their existing use, but instead are sold for some second-generation use.*" It held that property must be assessed at the property's HBU. Since deed restrictions will affect HBU, those restrictions could force a buyer to move to a different use. Here the Court could not determine if the HBU was achieved. It also said the Tribunal erred by valuing Menards as a second generation *"former"* owner-occupied retail use that was no longer being used at its highest and best use, rather than as the original owner-occupied use.

The Court said MTT also erred when it rejected the cost-less depreciation appraisals. Since there was no market for big box stores in Escanaba the cost-less depreciation approach was appropriate as a matter of law. The Court based its position on **Clark Equipment Co v Leoni Township**, 113 Mich App 778; 318 NW2d 586 (1982). "**Clark** *provides that (1) when the HBU of the property is its existing use and (2) when, because the property was built-to-suit, there would be little to no secondary market for the property to be used at its HBU, then the strict application of the sales-comparison approach would undervalue the property, so the cost-less depreciation approach is more appropriate."* Here, the Court found Menards as a specialized type of use in a market that would not support a similar competitive use or that the use was so specialized it could not be used by another party. Under those circumstances, the use should be assessed on the cost-less depreciation method. It also found no record of Menard, Inc.'s claimed functional deficiency.

The Court reversed the MTT based on its rejection of the cost-less depreciation approach and its' accepting Menard's sales comparisons. It also found little evidence to support either position on the impact of the deed restrictions. It therefore remanded the case back to the MTT to take further evidence of the market effects of the deed restrictions; and *"[i]f it is still insufficient to reliably adjust the value of the comparable properties if sold for the subject property's HBU, then the comparables should not be used. The tribunal shall also allow the parties to submit additional evidence as to the cost-less depreciation approach."*

Menard, Inc. appealed to the Michigan Supreme Court. The court scheduled oral arguments asking the parties to address whether the Court of Appeals erred in relying on **Clark**. After the arguments were submitted, the Supreme Court denied leave to appeal [501 Mich 899 (Oct 20, 2017)] and remanded both parties back to the MTT.

The Tribunal held a ten-day hearing with five witnesses. The arguments were substantially the same as made earlier, although they applied their analysis to the Court's directions. Menard, Inc. this time prepared a cost-less depreciation analysis and came to a replacement cost of $11.5 million. But it applied a combined functional and economic obsolescence at 65% which yielded a TCV of $3.8 million. It again argued the dark store theory where obsolescence occurs as soon as the store was built. Being a big box store, which was owner-built, its value should be if sold and converted by the new owner. The city's cost analysis applied obsolescence based on a six-factor market analysis adapted from the ***Appraisal Journal's*** peer reviewed study *"Highest and Best Use and Property Rights – Does It Make a Difference"* (Stephan F. Fanning, et al, Summer 2018). Many of their 30 comparables were from big box stores from out-of-state since there were no comparable sales in Michigan for the size of the Escanaba market. Because the Escanaba store was the first large home improvement store in the area, generating most of its sales from well outside of the city of Escanaba, the city argued that the Menards store captured 100% of the home improvement market. It asserted a TCV of approximately $13.7 million.

As for the deed restrictions, Menard, Inc. still argued that they did not apply. Their appraiser stated that since deed restrictions are generally determined after the sale price was established it would have no impact. And if there were restrictions that a new buyer would require, those limitations would be carved-out (by allowing the sales of items that would otherwise be restricted). The city on the other hand, asserted the anti-competitive nature of the deed restrictions was already in place and would affect the HBU of the property by forcing a new type of business (unlike the original) and thus creating a different HBU. The anti-competitive restrictions limited the pool of potential buyers so it would be impossible to know whether a potential buyer would have purchased it and the real impact of the deed restrictions.

The MTT again found Menard, Inc.'s arguments more persuasive. Its independent analysis found that Menard, Inc.'s cost-less depreciation approach was much closer to what it would find (only $400,000 difference in obsolescence). It held that because the city's comparables were primarily leased properties and not fee simple owned arrangements, they were not truly comparable. It did not give any weight to the city's analysis or their objections to the different HBU between the Menards property and their comparables. The Tribunal also rejected the city's claim that deed restrictions would impact any sale price or force a new HBU for the property. MTT found no impact of the deed restrictions, agreeing that the carve-outs and after sale restrictions were insignificant. In the end, the MTT assigned TCV for each of the three years at $5,000,000 (being about $1.13 million more than what Menard, Inc. asserted and about $8.8 million less than what the city valued). See sidebar.

The city has appealed again to the Court of Appeals (**Menard II**). Briefs from the city and Menard, Inc. have been submitted. The city argues that the Tribunal erred by finding that the deed restrictions had no impact; the MTT interpretation of the *"fee simple interest"* was too narrow; and it failed to follow **Menard I's** remand instructions (by not following **Clark**, addressing the secondary market sales, and failure to consider a market analysis by disregarding the city's evidence). Menard, Inc.'s response brief states the Tribunal complied with the remand order and followed a textbook cost approach in applying appropriate obsolescence. It still found no impact from the deed restrictions. In addition, this time the Tribunal applied an income approach, using a capitalized rent loss methodology, which the city did not address. In the city's Reply Brief, it addressed the *"continued use"* doctrine not a *"value in use"* from **Clark**. It also asserted that Menard, Inc. and the MTT still rejected the Court's HBU holding as a freestanding owner-occupied retail use; and that Menard, Inc. used uncited claims.

Menard v Escanaba TCV Decisions

Below are the various True Cash Values for the Menards property based on the positions of the parties and the decisions of the Michigan Tax Tribunal.

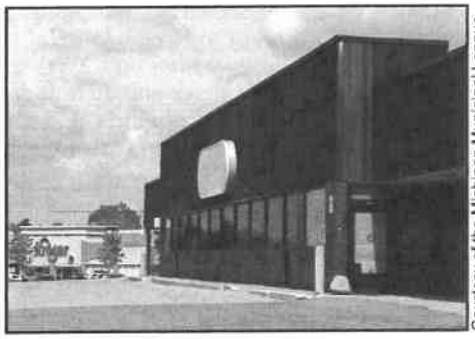
True Cash Value Determinations

Year	City Assessed	Menard Appraised	MTT Decision	City on Remand	Menard on Remand	MTT on Remand
2012	$7,815,976	$3,300,000	$3,325,000	$13,700,000	$3,870,000	$5,000,000
2013	$7,995,596	$3,300,000	$3,490,000	$13,880,000	$3,870,000	$5,000,000
2014	$8,210,938	$3,300,000	$3,660,000	$13,760,000	$3,870,000	$5,000,000

A hearing date has not been set. But even when addressed by the Court of Appeals, it is expected this will ultimately end up again in the Supreme Court. Until then it is unclear if anything will change, *absent legislative action to address the issue.*

In a more recent big box tax appeal, the Court of Appeals upheld a MTT decision for the city in an unpublished case, **Greenfield-8 Mile Plaza v City of Southfield**, case No. 345183, decided December 12, 2019. Here, the MTT held the TCV of a former Home Depot big box store which was converted to a membership club was accurately assessed by the city's expert. That case cited **Menard I's** positions regarding deed restrictions, use of cost and sales valuations, and other factors.

Specifically, the Court of Appeals found that Greenfield's use of the appraiser's **Uniform Standard of Professional Appraisal Practice** was not necessarily appropriate since this was a tax appeal and not an appraisal for sale. The *valuation disclosure* provided by the city, as required by the MTT, was appropriate for a property tax assessment. Just because the assessor did not do the kind of inspection required for a property appraisal for a sale, that difference was irrelevant. As for the deed restrictions, the Tribunal and Court found that the deed restrictions placed by Home Depot prohibiting any future home improvement or hardware use was properly considered, as required by **Menard I**. *There is no requirement that a value be reduced because of the deed restrictions; rather it only requires an independent evaluation by the Tribunal.* The Court also agreed with the city that because the property was zoned for a member-only retail use, it was properly zoned and assessed as retail. It was not zoned for a warehouse use, which was the basis for the petitioner's assessments. Finally, the income approach was not used as this was an owner-occupied property and not rented. The Court of Appeals affirmed the Tribunal's assessments.


Courtesy of the Michigan Municipal League.

Former Farmer Jack's in Grand Blanc.

Legislative Actions – in Michigan and Elsewhere

Over the past six years the Michigan legislature has made several attempts to address the big box store question and the dark store theory using two approaches. One on the land use (zoning) side and the other by addressing the property taxation process. None of the bills were enacted. Now in 2021, it appears attempts will again be made on both ends to address this issue.

Several bills have been promoted to address the zoning issue as relates to deed restrictions. HB 4909 was introduced in the 2015-2016 Session by then Representative Kivela and cosponsored by 12 other representatives from both parties. It was tied to SB 524 which addressed taxation issues. Rep. Kivela, speaking of both bills (in a TV6 FoxUP Upper Michigan's Source press report, released on September 24, 2015,) said:

> *"Large national retailers have used what's known as the 'dark store' argument to win huge tax refunds that will permanently decrease the property tax base in Michigan and are devastating to state and local government budgets, as well as local zoning ordinance and master plans, they've enacted to deal with developments. Our bills would ensure that all businesses are assessed equally regardless of who they are, how large their business is, whether they are a successful national business from outside of Michigan or whether they are a local retailer in Michigan."*

Rep. Kivela goes on to say that national retailers should not be able to cut their taxes by arguing that new big box stores are worth less than the purchase price of the land. Rep. Kivela said the approach in his bill had passed with unanimous support in Indiana the year before.

House Bill 4909 would have amended the MZEA by limiting the use of *"negative use restrictions"* in a zoning ordinance on a vacant single retail establishment or commercially zoned land. This means *deed or other real property restrictions could not prohibit or limit the use by an owner or occupant.* It would also have restricted commercial leases that prevents leasing to another retailer. The bill applied to single retail establishments of 7,000 square feet or larger and specifically calls out *big box* stores, which was not defined. Negative use restrictions would not be allowed in special land use approvals. And a special land use applicant would have to submit a plan for re-leasing or reuse in the event the property goes vacant. HB 4909 would have also established, as a public policy, that vacant single retail establishments lead to blight and that the reduction of these blighted establishments was in the public's interest.

To address the so-called loophole, which was established by the dark store theory, Senate Bill 524, introduced by Senator Casperson, would have amended the General Property Tax Act. The bill would require establishing the TCV of a property by considering the value of HBU as the value of the property as vacant and the structure as improved. For big box-type stores (over 25,000 square feet), the HBU would be the continued use as improved. The Tribunal would lean towards a rebuttable presumption that cost-less depreciation was the best evidence of the usual selling price. The bill also would limit the use of speculative evidence and assumptions. This would highly restrict the use of the dark store theory argument. ***Gongwer*** quoted Senator Casperson in 2015 as saying:

> *"big corporations should not be the force behind the state's tax policy – a policy that is devastating local units of government and unfair to local retailers and residents. Unfortunately, the tax tribunal is letting it happen … at the expense of our schools, libraries, seniors, public safety department, public transit agencies and residents."*

In 2016, Representative Dave Maturen, a licensed real estate appraiser and former local governmental official at the township and county level lead a study committee to introduce, HB 5578, which was co-sponsored by 27 other representatives from both parties. This bill went into much more detail on addressing the big box store and dark store theory concerns of local governments. It did not include the same language as in SB 524, rather it proposed to set new rules for the Tribunal for determining TCV by requiring an *independent determination of facts and conclusions of law to affirm their findings and valuation.*

Specifically, under Rep. Maturen's bill, the MTT would have to look within the market where the property competes; the reasonable probable use (being physically possible, legally permissible, financially feasible and maximally productive); look at the construction or reproduction costs for the HBU with the same utility, features and age; looking at comparable properties in the same market (and generally excluding comparables with different HBUs, substantially different economic conditions, and vacant); the impact and use of deed restrictions or other covenants (only allowing those that benefit the property and surrounding areas); and analyzing and adjusting for different comparables. The MTT should use all three methods of valuation — comparables, cost-less depreciation and capitalization of income. Weighting each method and not arbitrarily disregarding any of them. Parties' stipulations must have an evidentiary basis that is substantial and reliably verified. MTT's determinations must follow generally accepted appraisal principals of the Appraisal Foundations **Uniform Standards of Professional Appraisal Practice.** The bill's House Analysis indicated that it would likely result in higher assessments.

HB 5578 passed the House on a 97-11 vote. But, this bill was killed in the Senate when the chair of the Senate Finance Committee buried it, based on objections from the Michigan Chamber of Commerce, the Michigan Retailers Association, and others. The Committee Chairman explained that big box retailers bring

in jobs and other support to communities, which could be jeopardized by increasing their tax liability. The retailer's industry said they were doing nothing wrong. But from the municipal side, Judy Allen of the Michigan Townships Association said "*This is an issue of fairness, not politics*" based on the large bipartisan support coming out of committee with 97 in favor and 11 opposed (Joint Press Release by MTA, MML, MAC, June 8, 2016). As reported in various ***Gongwer*** Michigan Newsletters (2016), Rep. Maturen said "*HB 5578 (H-2) represents a narrowly tailored and practical approach. Adopting uniform and proven appraisal principals will result in more fair, transparent resolutions to assessment disputes before the MTT and tax equity across the board for all taxpayers.*" Rep. Maturen praised the bill as being "*good sound policy. … It provides equitable treatment for all properties. It requires an apples-to-apples comparison for appealed properties … rather than apples-to-onions.*" Nevertheless it went nowhere in the Senate.

In 2017, Senator Casperson again tried by offering SB 578. It would have required comparables to have the same HBU and as a part of the independent determination required by MTT, to disclose if there were private restrictions and covenants that impact the HBU and limit their use. It would also limit comparables whose restrictions did not assist in the economic development of the property and provide a continuing benefit, or that materially increases the likelihood of vacancy or inactivity of the property. That bill also failed to progress in the legislature.

Then in 2019, Senator McBroom introduced SB 39 which was identical to 2017's SB 578. As an alternative, he introduced a broader bill, SB 26 which addressed the same deed restriction and covenant limitations, in addition to the direct property tax loophole. Both failed to gain traction. Two more bills were also introduced that year. HB 4025 and HB 4074. Both were similar and generally followed Rep. Maturen's 2016 bill. The two bill sponsors, Rep. LaFave, a UP Republican (HB 4025) and Rep. Brixie, a Lansing area Democrat (HB 4074) co-sponsored each other's bill and were joined by over a dozen representatives from each party. Again, both bills never moved for the same earlier reasons. With Covid-19 lockdowns, the legislative efforts went quiet. But now in this current legislative session, a renewed effort may again come forward. Both Representatives Brixie and LaFave are now in discussions for resurrecting the issue in this session (as discussed more at the end of this article).

Activity in Other States

As mentioned earlier, the dark store theory is being argued in a number of other states, and courts and legislators there are also wrestling with the issue. This is because of the large negative fiscal impact on local governments.

The Northern Michigan University study, as reported in Isabelle Karl's article in ***Rural Insights*** earlier, addressed what some other states are doing legislatively. It highlights legislation passed by the New York State Assembly in 2020. The new law there requires assessment be based on similar properties being used in the same way as the assessed property. The law requires the comparable to be within the state, but it does not need to be in the same taxing district. The legislation specifically requires comparables for big box stores be assessed using properties of a similar size and that are actively being used as retail. The report also said similar legislation was under consideration in Wisconsin, North Carolina, and Indiana. The report summarized that these efforts provide

> *"specific and clear guidelines to local assessors, it creates less confusion for property owners and local assessors than the previous law did. This increased clarity has the desired result of reducing instances of commercial property value disputes as well as the loss of local revenue."*

An update on Indiana. The 2015 Indiana legislation noted by Rep. Kivela above was replaced. The legislature originally established special tax value rules for large retail properties, including sale-leaseback properties which were less than ten years old. It prohibited those properties from using certain comparables for their valuations that have been vacant longer than one year; have significant deed restrictions; were sold to a secondary user for a different purpose; or were not an arm's length transaction. The legislation also required big box retail properties be assessed under the cost-approach without considering the sales-comparison approach. But the next year, the legislation was repealed and replaced. It now allows use of comparables from different markets or submarkets from the subject property. It also specifies that the value in exchange of an improved property is not the True Tax Value of the improved property, and the True Tax Value does not mean the value of the property to the user. This has the effect of reducing the restrictions on big box appraisals.

Wisconsin has also attempted legislation. A 2008 case established the dark store theory there and has since seen hundreds of cases follow that direction. In 2018, legislation to overturn that case was rejected by the legislature. Wisconsin Governor Evers in 2019 made it a priority in his administration to close the dark store loophole; but he has not been able to move this forward in the legislature. The Wisconsin Municipal League is pushing its communities to continue to appeal their decisions. In other states like Texas, California, Ohio, Illinois, Minnesota, and North Carolina, big box stores have continued to push the theory. Some have won and others have not prevailed. So, the direction is unclear in other states as well.

What's Next?

Representatives Brixie and LaFave are both planning on introducing new legislation in 2021. Rep. Brixie, will be reintroducing her last bill (2019 HB 4074) to address the overall assessment process before the MTT. She hopes to have it out this fall. Rep. LaFave will move in a different direction by focusing on the deed restrictions issue. His bill will seek to limit their use where they will have the effect of creating disincentives to develop the property. The MML's Legislative liaison Chris Hackbarth, supports both approaches, but sees the LaFave approach as possibly being more acceptable in the current political climate.

In the courts, the Court of Appeals will hear **Menard II** sometime later this year, so an opinion is not expected for several months after that. With that decision, it would not be surprising to see the case go back to the Supreme Court. So, it may yet be several years before the courts set more direction.

At the local level, a few communities have also explored ordinances or restrictions on limiting the use of deed restrictions. The thought would be to limit them in zoning through the special use permit process or as a police power ordinance. This might help avoid long-term vacancies and promote blight control by limiting the amount of time a property owner can leave a building or property vacant. The regulations would require security deposits to clean up or remove blighted situations created by the deed restrictions. It would also limit the amount of time deed restrictions can be in place. However, the constitutionality of such restrictions could be questioned. Courts are very reluctant to limit the free use of property, which is highly coveted under the law. It is unclear how courts would treat these regulations on the free use of property.

Where does that leave the retailers – big box and now others – and communities? Until legislation or the courts settle this, retailers will have the upper hand and municipalities will have significantly less property tax revenues available to meet the needs of its citizens, leaving other taxpayers to bear those burdens. In the meantime, it will continue to be a taxing situation. ❑