



LINCOLN INSTITUTE  
OF LAND POLICY

## Current Issues in the Valuation of Big-Box Stores for Property Tax Purposes

National Conference of State Tax Judges  
Joan Youngman November 1, 2019



# As Stores Wiggle Out of Taxes, Towns Bear Brunt

By **PATRICIA COHEN**

WAUWATOSA, Wis. — With astonishing range and rapidity, big-box retailers and corporate giants are using an aggressive legal tactic to shrink their property tax bills, a strategy that is costing local governments and school districts around the country hundreds of millions of dollars in lost revenue.

These businesses — many of them brick-and-mortar stores like

Walmart, Home Depot, Target, Kohl's, Menards and Walgreens that have faced fierce competition from online sites — maintain that no matter how valuable a thriving store is to its current owner, these warehouse-type structures are not worth much to anyone else, particularly as shuttered stores keep spreading across the landscape.

Therefore, the businesses argue in their tax appeals, the best way to appraise their property is to look at the sale prices of vacant

or formerly vacant shells in other places.

To municipalities, this argument amounts to a far-fetched tax dodge that allows corporations to wriggle out of paying their fair share.

Either way, homeowners and small businesses will have to pay more or live with smaller budgets for police, schools, garbage pickup and road repair.

Businesses, of course, appeal

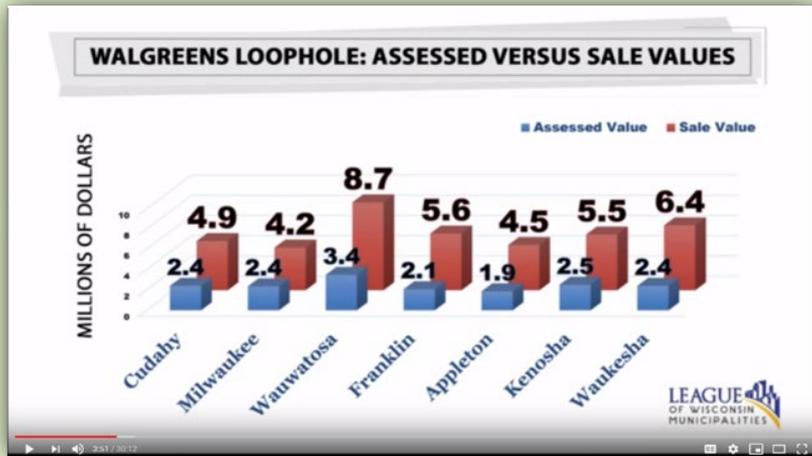
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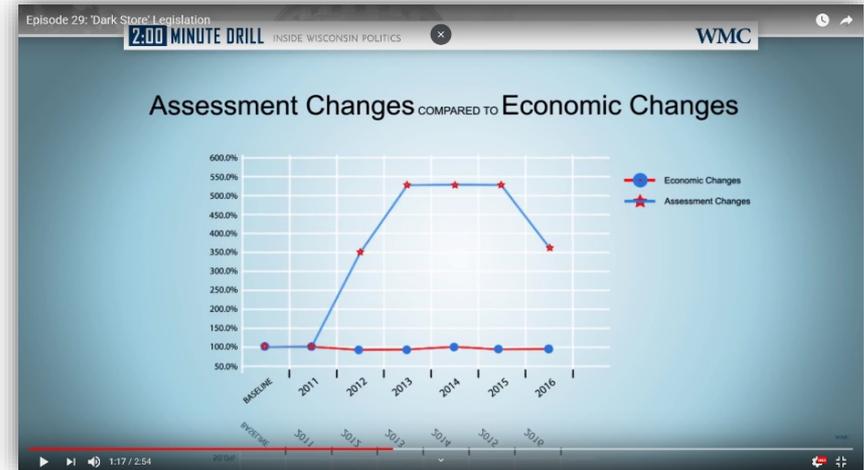
# Close the Dark Store Tax Loophole

Video by the League of Wisconsin Municipalities





“If this loophole is not plugged at some point in time ... before you know it homeowners already paying 68% of the property tax bill will pick up three quarters of it.”



“Activist assessors are hoping to change the law so that they can tax commercial properties by using things other than the property... This would ultimately hurt Wisconsin businesses.”

# A Simplified Representative Dispute

- May contain some or all of the following elements:
  - A currently operating big-box store
  - Built to suit the current user
  - Possibly leased to a creditworthy national firm
  - Possibly subject to deed restrictions

FEATURES

ABSTRACT

Market value opinions of the fee interest in custom-built commercial properties present challenging problems. In these assignments, appraisers must understand the nuances between value in use and market value, and fee simple estates and leased fees. These built-to-suit properties have rents, sale prices, and overall capitalization rates that are not representative of the market for second-generation users. The cost to build and worth to the initial owner or tenant well exceeds what the property would be able to command on the market for either lease or sale. This article reviews the three traditional valuation approaches and discusses the misconceptions that lead to the wrong value for the property fee interest.

## You Can't Get the Value Right If You Get the Rights Wrong

by David C. Lennhoff, MAI, SRA

Single-tenant, built-to-suit commercial real estate presents difficult valuation problems. One of the most challenging of these valuation problems arises when the assignment involves developing an opinion of the market value of the fee interest in the real property. This assignment condition requires the appraiser to value the property as if it sold, *available to be leased at market*. However, these custom-built properties are always occupied by the owner or tenant for whom the improvements were built, with any lease structured to recoup the original cost of the custom construction. If the properties were sold, they would sell as leased fees with rents well above the market rent. So, an estimate of the market value of what would actually sell would be the market value of the leased fee, which is inconsistent with the value premise. Because the value premise is inconsistent with what would sell if the property were offered for sale, appraisers frequently end up answering the wrong question: rather than the market value of the fee, they provide an opinion of the value in use of the leased fee estate based on the original lease. To properly approach such assignments, appraisers must suspend reality—as these properties never sell as if vacant and available to be leased at market—and value the properties under the assumption they are vacant and available.

These are fundamental issues in appraisal of custom-built commercial properties, and it is important to explore the root causes for the problems that appraisers may have with them. This article reviews how to approach such an assignment, considering all three traditional appraisal methods, and exposes related misconceptions that should be avoided.

### Custom-Built Commercial Properties

Properties such as bank branches, fast food restaurants, freestanding pharmacies, and fitness clubs are frequently built by the owners to their specifications or built-to-suit for them. In either situation, the building is designed to conform to

# Kohl's v. Frenchtown Michigan Tax Tribunal, 2013

“Mr. Lennhoff discusses the difficulty in appraising single-tenant, built-to-suit commercial real estate where the appraiser is required to value the fee simple interest in the property. Recognizing that such properties, if sold, would sell as leased fees, with rents well above the market rent, Mr. Lennhoff concludes that to determine the value of the fee simple interest, such property must be valued under the assumption that it is vacant and available.”

FEATURE

# Valuing the Leased Fee Simple Estate: The Answer for Ad Valorem Taxation Issues

BY THOMAS W. HAMILTON, Ph.D., CRE, MAI

# Thomas Hamilton, “Valuing the Leased Fee Simple Estate” (2015)

“On June 22, 1633, the Holy See of the Roman Catholic Church in Rome handed down the following order: ‘We pronounce, judge, and declare you, the said Galileo. . .of having believed and held. . .that the sun is the center of the world, and that it does not move from east to west, and that the earth does move, and is not the center of the world.’ Modifying one’s belief in a learned and universally accepted concept is difficult, regardless of how undeniably true the alternative may be. The same can be said how the leased fee interest is viewed in real property valuation.”



"Galileo facing the Roman Inquisition", 1857 painting by Cristiano Banti

## Billy Hamilton, *State Tax Notes* (2016)

“Still, does it really make sense to value a successful, operating property based on a vacant, failed one?”



# COMMERCIAL BIG-BOX RETAIL:

*A Guide to Market-Based Valuation*





# SETTING THE RECORD STRAIGHT ON FEE SIMPLE



# Property Rights Symposium Discussion Paper

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December 21, 2017

The purpose of the symposium was to consider differences of opinion relating to the valuation of fee simple estates. This Discussion Paper summarizes the issues discussed at the symposium, describes the proceedings at the symposium, sets forth ideas emanating from symposium attendees, explores some possible implications of these ideas and identifies a number of questions for individuals reading the Discussion Paper.

# Exposure Draft of Proposed Guide Note

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March 1, 2019

**In sum, “fee simple” may or may not mean a leased property is valued as though unleased and available for lease, depending on the definition of “fee simple” being applied as well as any underlying premises of the valuation regarding occupancy or tenancy.**

# Leased Fee Issues

- Above-market payments
- Standard leases and financing leases
  - Contract rent and market rent

# Above-Market Rent

*Walgreen Eastern Company, Inc.*, Connecticut, 2018:  
“[T]he properties support a single tenant with a triple net lease who ‘is willing to pay above market rents because its focus is on location, sales, and customer convenience rather than real estate costs and immediate profit.’”

# Financing Leases

*Prieb Properties*, Kansas App. 2012: “[T]hese rates are not reflective of market rent, but rather just reflective of the rate required in that specific situation to continue an agreed revenue stream to amortize the lessor's investment. . . .”

# Contract and Market Rent

- Differing state positions
  - Consistencies and inconsistencies
- Business income: not a “co-entrepreneur”

## New York

*Merrick Holding Corp.*, 1978: “The county was not a party to these plans; nor was it, or is it, a coentrepreneur who was required to share in Merrick’s good or bad fortune. Clearly, the county tax authorities need not depend for valuation purposes on the uncertain results of managerial banes or boons.”

# Wisconsin

*Darcel, 1987:* “From this analysis, it is clear that all of the ‘bundle of rights’ that made up the property were transferred in this sale. The new owners received exactly those rights possessed by the former owners. . . . We reject the invitation of the New York court to require businesspersons to be equipped with precognition. . . .”

# Wisconsin

*Walgreen Co.*, 2008: “[A]n assessor should consider the leased fee interest to be equal to the market value as long as the lease rate is not encumbered to the point of falling below the market rate. . . .”

# Factual Issues

- Location
- Quality
- Potential reuse

# Special Purpose Property

*Federal Reserve Bank, Minnesota 1981:*

“Neither our case law nor cases from other jurisdictions clearly establish the precise limits of the special purpose doctrine, nor, in the nature of things, is this possible.”

# New York Stock Exchange



# Special Purpose Properties

- The meaning of “market” in “market value”
  - The meaning of “highest and best use”
  - The current user as a potential purchaser

# Deed Restrictions

- Factual issue: impact on potential purchasers
  - Adjustments to comparable sales
- Recognition of deed restrictions in assessment

# Hudson Palisades



# Background Context

- Changing retail environment
  - Location incentives
  - Impact on local budgets
- Perceived disparity in representation

# Good Jobs First “Subsidy Tracker”

<http://www.goodjobsfirst.org/subsidy-tracker>



## Discover Where Corporations are Getting Taxpayer Assistance Across the United States

**SUBSIDY TRACKER 3.0** is the first national search engine for economic development subsidies and other forms of government financial assistance to business.

### Option 1: View Summaries by Parent Company or Subsidy Source

Parent Company Pages:  [Top 100 Parents \(Coverage\)](#)

State Summary Pages:  [Top States](#)

Federal Summary Pages:

### Option 2: Search by Company Name and/or Other Variables

Company:

Industry:

Text:   
Searches all text fields

Level of Government:

Subsidy Value:    
Enter amount in plain digits; e.g. use 1000000 for \$1 million

Loan/Bailout Face Value:    
Covers only federal loans, loan guarantees and bailout assistance (excluding repayment amounts).

Type of Subsidy:

Year:

Subsidy Source:   
Use this dropdown to limit your search to a specific state, locality or program. If you choose a state name from the Subsidy Source list, dropdown menus will appear populated with state-specific choices for programs, cities and counties. Click search immediately to get a complete list for the state or choose from the dropdowns to narrow the scope.

Choosing federal from the list above will generate dropdowns allowing you to narrow the search to a specific federal program or agency. Note that many state and federal entries do not include locality information and therefore will not be reflected in searches limited to a specific city or county.

[CLEAR](#)

[SEARCH](#)

# Thank you

JOAN YOUNGMAN

LINCOLN INSTITUTE OF LAND POLICY

[jyoungman@lincolninst.edu](mailto:jyoungman@lincolninst.edu)



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