The Evaluator Winter 2024: Valuation Analyses

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Lowe's Valuation Appeal Sparks Debate Over 'Dark-Store Theory' in Oregon Tax Court Decision

***Lowe's Home Improvement, Inc., v. Multnomah County Assessor* TC-MD 210216R (Oregon Tax Court; Magistrate Divisions; Real Property – Unreported October 2023)**

Lowe's recently lost a valuation appeal at Oregon Tax Court based on the "dark-store theory" for valuing big-box retailers, though the Tax Court did not outright reject the theory. However, the Tax Court's decision in the case likely indicates a standard requiring appraisers to make adjustments to comparable sales and leases, which will be an important factor for all commercial and industrial appeals going forward.

At issue was the real market value of Lowe's 135,008 square foot national big-box home improvement warehouse in Portland. Lowe's appraiser attempted to persuade the Tax Court to accept the dark-store theory of valuing big-box stores by focusing on the definition of the fee simple interest. Big-box retailers like Lowe's have championed the dark-store theory across the country in recent years.

The dark-store theory asserts that appraisers should consider failed and closed stores and secondary users, as well as open stores, as comparables when determining the market value of a big-box store. Appraisers justify this approach by showing that big-box stores lose much of their value after the original company leaves. There is plenty of market evidence to support the theory. Unfortunately, many states in the West have rejected this approach e.g., Oregon's neighbor to the north.

Although the subject property has a long-term lease with no known plans of vacating, the taxpayer's appraiser appraised its fee simple interest e.g., the value of the property as if vacant. The taxpayer's appraiser selected secondary users for his lease and sales comparables;

because, if it were vacant, secondary users would be the most likely tenants or purchasers of the property.

The Tax Court was not persuaded by either party's appraisal evidence because the, "comparable sale selection and/or lack of adjustments do not reflect the market evidence." The magistrate was focused on the weakness of depth and strength of the comparables and lack of adjustments, but did not definitively reject the dark-store theory.

Tennessee Appeals Court Sides with AT&T in Dispute Over Data Center's Valuation Following Sale-Leaseback Transaction

***Williamson Cnty. V. Tenn. State Bd. Of Equalization,* 2023 Tenn. App. LEXIS 492, M2021-01091-COA-R3-CV, in the Court of Appeals of Tennessee, November 28, 2023.**

AT&T recently convinced the Tennessee Court of Appeals to disregard the sale-leaseback price of its data center in Brentwood as evidence of the center's value. Following the 2013 sale-leaseback, which had a purchase price of $109,220,000 with base rent starting at $7,645,330, 2 percent bumps and a ten-year initial term with three ten-year renewal options, the county assessed the center at $85,850,000 for the 2013 tax year. The county argued that the sale-leaseback was indicative of the leased fee interest in the property and should form the basis of the valuation of the property. AT&T argued that the sale-leaseback was a financing transaction that should be ignored since it was above market rent and also argued about the outdated nature of the facility for use as a data center and the need for significant investment, including demolition, to update the facility to modern functionality as a data center. Through a series of appeals with presentation of expert and fact testimony, the Court of Appeals ultimately ruled in favor of AT&T, agreeing and holding that the sale-leaseback was a financing transaction above market rent. As a result, the Court determined that the sale-leaseback should be disregarded in the valuation of the data center and established a value of $45,700,000 for the property.

Appeals Court Finds School District's Application of Policy to Determine Properties to Appeal was not Facially Neutral and Violated Uniformity Clause

***The School District of Philadelphia v. Board of Revision of Taxes, et al*., Consolidated Cases, case numbers 195-224, 226-229, 252-266, 268-270, 272-288 and 419 C.D. 2021, Commonwealth Court of Pennsylvania (Oct. 6, 2023).**

An Appellate Court covering the City of Philadelphia found that a Trial Court did not err in holding that the Philadelphia school district violated the Uniformity Clause in the Pennsylvania Constitution when it appealed only commercial property assessments for tax year 2017.

For the 2017 tax year, the school district hired an outside consulting firm to identify properties to appeal. Its criteria for selecting properties was that the appeal would yield at least $7,500 in additional taxes, meaning the properties had to be under assessed by nearly $1 million. The School District appealed assessments for 138 commercial properties but did not appear at the hearings at the Board of Revision of Taxes explaining "that it did not have the information necessary to prosecute the appeals." The School District then appealed to the Trial Court.

After its initial rulings on the taxpayers' motions to quash, the Appellate Court required the Trial Court to conduct a two day evidentiary hearing. At the hearing, the School District confirmed that it relied upon its consultant's recommendations in filing the appeals and did not have time to evaluate the fair market value of the properties because of the "fairly compressed timeframe." The consultant testified that he took a list of 580,000 properties (including both residential and commercial), whittled the list down to 65,000 properties, and ultimately produced a list of 266 properties for final review. The consultant used services that provided data on non-residential properties and the properties that were appealed were all commercial properties. Indeed, the consultant did not recommend filing on 33 residential properties that met the monetary threshold.

The Trial Court noted that the decision in *Valley Forge Towers v. Upper Merion Area School District*, 163 A.3d 962 (Pa. 2017), left open the ability of the school district to target properties based on a monetary threshold but, it must be implemented without reference to type of property or owner. As a result, the Trial Court granted the taxpayer's motions to quash.

The Appellate Court agreed with the trial court that under *Valley Forge* and *GM Berkshire Hills LLC v. Berks County Board of Assessment*, the school district's policy for selecting properties for appeal was facially neutral (i.e. there was no issue with the monetary threshold), but that the way in which the policy had been applied was not facially neutral. Specifically noting that there were 33 residential properties that met the monetary threshold but were not considered for appeal, the appellate court determined that the School District's selection method was "neither objective nor neutral."

Massachusetts Tax Board Finds That Local Tribunal Was Permitted to Adopt Portions of Competing Appraisers' Respective Methodologies to Value Wal-Mart Store

***Wal-Mart Stores # 01-2128 v. Board of Assessors of the Town of Halifax*, Mass. App. Tax Bd. F337282, X309003 (Nov. 16, 2023), 2023 Mass. Tax LEXIS 39.**

Wal-Mart was recently forced to accept a partial valuation reduction involving one of its big-box stores for tax years 2019 and 2020. Both Wal-Mart and the town assessor submitted appraisal evidence to the Board of Assessors. Wal-Mart asserted an appraised value of $6,045,000 for 2019 and $6,003,000 for 2020, relying primarily on the income approach to value. Also relying on the income approach, the assessor submitted appraisal evidence supporting a value of $10,100,000 for 2019 and $10,000,000 for 2020.

On review, the Board of Assessors determined the same value of $8,100,000 for both years. The Board of Assessors did so by examining the vacancy, expense and capitalization rates used by both appraisers and adopting portions of each appraiser's conclusions. On further appeal, Wal-Mart asserted that the Board of Assessors should have adopted its expert's opinion in full. However, the Appellate Board stated that the Board of Assessors "was not required to believe the testimony of any particular witness or to adopt any particular method of valuation that an expert witness suggested. Rather, the Board could accept those portions of the evidence that the Board determined had more convincing weight." Here, the Board of Assessors selected from the various elements of value, the information it considered most reliable, and formed its own opinion of the subject property's value. The Appellate Board ruled this action was reasonable and thus upheld the Board of Assessors.

California Supreme Court is Urged by Council on State Taxation (COST) to Exclude Intangible Property from Property Taxation

***Olympic and Georgia Partners, LLC v. County of Los Angeles,* Supreme Court of California Case No. S280000**

In an amicus brief filed with California's highest court, the Council on State Taxation (COST) argued that a 1,000-room convention center hotel should not be assessed property tax on intangible assets that included financial incentives provided by the City of Los Angeles and franchise agreements with hotel operators. Representatives for COST state that "this case serves as a critical opportunity for the court to reinforce the importance of California's well-established exclusion of intangible assets from property taxation, and the court should uphold the Second District's decision, exclude the value of the cost reimbursement from the hotel's property tax assessment, and reject the County's Rushmore method."

In April of 2023, the Second Appellate District found that the cost reimbursement that the property owner received from the City of Los Angeles is considered an intangible asset that should be excluded from taxation and deducted from the property's valuation by the County of Los Angeles. The cost reimbursement, valued at $80 million, derives from a room tax that the City levies on hotel guests and then transfers a portion of those funds to the property owner. The cost reimbursement was proffered by the City to provide the original developer with a financial incentive to build the hotel for the purpose of revitalizing downtown Los Angeles. In its brief, COST argues that assessing financial incentives would inhibit investment that is not otherwise feasible and would stifle economic growth and development. They urged the Court to affirm the Second District's analysis and proper application of California law regarding the exclusion of the cost reimbursement from the property's valuation.

The Second District further found that the owner's franchise affiliations with Marriot and Ritz-Carlton, valued at $34 million, were intangible enterprise assets that should also be excluded from the property's valuation. In doing so, the Second District rejected the County's use of the "Rushmore method" to deduct the management and franchise fees from the owner's income stream as a way to value the hotel enterprise assets. COST emphasizes in its brief that the Second District's rejection of the County's Rushmore method is in line with State Board of Equalization rules and instructional guidance that is provided by the Board to county assessors via a formal handbook. Additionally, COST also argues that the Second District's treatment of the County's Rushmore method is consistent with precedent set forth by courts in California and in other states and reflects a sound understanding of how property tax assessment principles apply to hotel assets.

Georgia Appeals Court Rules that Income Approach was Inapplicable for Valuing Low-Income Housing Project

***Freedom Heights, LP v. Lowndes Cty. Bd. of Tax Assessors,* 369 Ga. Ct. App. (Oct. 26, 2023).**

The Georgia Court of Appeals recently affirmed that the income approach was not the proper methodology for valuing a rent-restricted apartment building that received federal tax credits. Interpreting recent state case law, the Court determined that the income approach can only be used to value low-income housing projects if it can be shown that the associated tax credits generate "actual income" (e.g., the credits result in a net payment to the owner). Because the tax credits that the property owner received

merely reduced the owner's tax liability, the Court found that the credits did not generate actual income. As a result, the Court determined that the income approach was inapplicable and upheld the county assessor's cost approach.

Ohio Board of Tax Appeals Grants Reduction for Unusable Commercial Land

***HPCP I, LLC v. Cuyahoga Cty. Bd. of Revision,* BTA No. 2020-589, 2023 Ohio Tax LEXIS 1504 (Sept. 26, 2023)**

The Ohio Board of Tax Appeals (BTA) determined that the value of vacant commercial land should be reduced by almost $1 million after evidence established that a large part of the land was undevelopable wetlands. The owner of the commercial vacant land filed a complaint seeking a reduction in value and submitted an appraisal in support that established a value of $450,000 for the subject property. The County had originally assessed the land at a value of $1,306,900. The appraiser testified that a portion of the property could not be developed because it was wetlands. In arriving at the value for the property, the appraiser considered a wide range of factors, in addition to the undevelopable land, to arrive at value on a per acre basis. The BTA determined that the analysis and comparable land sales supported the appraiser's valuation and granted a reduction to the appraiser's opinion of value.