



## The Impacts of *Menards Inc. v City of Escanaba*

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On May 26, 2016, the Court of Appeals issued a published decision in *Menards Inc. v City of Escanaba*, supra, reversing the Tax Tribunal's decision (MTT Dk Nos 00-441600, 14-001918). The Court of Appeals held that when a market contains anti-competitive deed restricted property, use of the sales comparison approach undervalues the property and the cost-less-depreciation approach to value must be considered. Concluding the Tribunal record was inadequate to reach a determination of value, the Court of Appeals remanded the case to the Tribunal to hear additional new evidence regarding the deed restrictions, the validity of the sales comparison approach and to consider the cost-less-depreciation approach.

The Court of Appeals' decision in *Menards Inc.* is published and, therefore, binding law. It is the first published "Big Box" decision since the Court of Appeals' earlier decisions in *Meijer v City of Midland*, 240 Mich App 1 (2000) and in *Thrifty Royal Oak v City of Royal Oak*, 130 Mich App 207 (1984). In general terms, the *Menards Inc.* decision affirms conclusions in the two earlier published decisions. In both of the earlier Court of Appeals' decisions, the Tribunal and the Court of Appeals had rejected sales of former big box properties, finding that the sales were distressed, that the market for big box stores was distorted, and, that the cost-less-depreciation method should be used to value the existing property. However, beyond this general affirmation of existing law, the Court's decision in *Menard's Inc.* outlines critical standards necessary for a valuation of specialty property, such as big box stores.

Though the Court of Appeals has reviewed other cases involving big box stores, all were unpublished, largely factual disputes and, importantly, none were designated as binding law. By contrast, the Court of Appeals *Menards Inc.* decision will have long-standing implications in Michigan and nationally.

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### **PRACTICE AREAS**

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## **BACKGROUND**

In the Tribunal, *Menard's Inc.* relied entirely on a sales comparison valuation of eight sales of former big box properties. Five of the sales were deed restricted by the seller to prohibit use of the store for big box retail as well as many other commercial uses. Three of these sales were converted to factories, one to a strip mall and another remained vacant. A sixth sale from a bankrupt big box retailer was converted to a City Hall. The remaining two sales were of stores that were nearly a third of the size of the Menards' store. The City, by contrast, had determined that the cost-less-depreciation approach was required to be used because of the lack of good sales data. The parties agreed that the highest and best use of the facility was as an owner-occupied freestanding retail building.

The Tribunal rejected the cost approach as inapplicable, reasoning that the approach would not be used by buyers and sellers of the property and finding that the property was too unique (functionally obsolete) for big box retail use. The Tribunal then accepted all of Menards Inc.'s sales without evaluation of the deed restrictions. In response to the City's Motion for Reconsideration, the Tribunal determined that deed restrictions had no impact because Menard's appraiser had determined that they had not impacted the sales.

## **SUMMARY OF THE DECISION**

An underlying theme of the Court of Appeals decision is that the Tribunal failed to apply standard highest and best use principles. The Court of Appeals first concluded that the Tribunal's use of a sales comparison approach was in error because sales of deed-restricted properties resulted in a highest and best use that was different from the subject property.

As a beginning point, the Court of Appeals noted that while Menards owned a fee simple interest in the property, deed-restricted comparable properties lacked "an entire fee simple interest." Moreover, the deed restrictions, according to the Court of Appeals, reduced the comparable property's purchase price. The Court of Appeals explained that since the deed restrictions imposed conversion costs to any potential buyer in order to comply with the restrictions, buyers would pay less to accommodate the costs and fewer buyers would be willing to assume the additional cost. Second, the Court of Appeals concluded that the near-universal use of anti-competitive deed restrictions by big box retailers meant that there was no market for the stores as big box retail. That is, comparable big box stores would not have the same highest and best use of the subject property; they would instead be sold to be redeveloped for a different use.

Citing existing Michigan case law, the Court of Appeals affirmed the requirement that when there is an inadequate or a distorted market for property, the Tribunal must use the cost-less-depreciation method of value. To require assessors to prove an actual market for unique property, when the market is distorted, would lead to "absurd undervaluations." The Court reasoned that "big-box stores are not typically sold on the marketplace for use as 'big-box stores' so buyers would not have ability to meaningfully use a sales comparison method." Since the subject property as a "new, modern facility [was] capable of fully functioning as a freestanding retail center", the Court of Appeals concluded that it was "not appropriate to value the subject property significantly less than its replacement cost simply because owner-occupied freestanding retail spaces are rarely bought or sold for use as owner-occupied freestanding retail spaces on the open market."



The Court of Appeals in rejecting the assertions that the property, as built for Menards, was “functionally obsolete” as unsupported, the Court of Appeals concluded that not only was there no evidence of functional obsolescence introduced at the hearing, the industry practice of imposing deed restrictions to prohibit the sale to other big box retailers undermined the validity of a functional obsolescence claim.

### **IMPACT TO HB 5578**

The Court of Appeals decision is a narrative legal explanation for HB 5578 (the “Maturen Bill”). The decision and the proposed bill are nearly identical.

Notably, much of the Court of Appeals’ decision concerns failures of the Tribunal Member, such as, the Tribunal Member’s failure to identify evidence, failure to consider evidence, failure to reach specific findings of fact, and, failure to follow standard appraisal methodologies required under Michigan law. Since the underlying theme in the *Menards Inc.* decision is failure to correctly apply a determination of highest and best use, the decision is notable for its finding that the Tribunal Member failed to state a highest and best use. The Court of Appeals excused this failure, concluding that the Tribunal may have “implicitly” determined a highest and best use since the parties had agreed to a highest and best use. The excuse made no difference. The Tribunal Member had failed to apply its “implicit” determination.

That is exactly the core of the Maturen bill, a concise distillation of 800 pages from the standard appraisal treatise, “The Appraisal of Real Estate,” and directing Tribunal Members to state specific appraisal determinations in their written decisions. For example, Tribunal Members would be required to work through each aspect of the four-part highest and best use test. They would be required to determine conversion cost when otherwise comparable property is sold for a different use. They would be required to state a determination of highest and best use and apply that determination of highest and best use to each method of value. As the *Menards Inc.* decision reveals, the Maturen bill fills an obvious gap. If the Tribunal Members are not appraisers, the Maturen bill provides a guide. If the Tribunal Members are not attorneys, the Maturen bill provides a checklist.

HB 5578 requires, consistent with Michigan law, that all approaches to value be applied and considered. Notably, the decision in *Menards, Inc.* twice recites this requirement. The Court of Appeals found error in the Tribunal Member’s failure to adhere to this requirement. Though the HB 5578 does not require any specific method of value, a much stronger conclusion, that in some instances the cost-less-depreciation-approach must be used, is found in the Court of Appeals’ decision in *Menards, Inc.*

The bill addresses in detail vacancy and restrictive deeds as those last two characteristics might apply to the selection of comparable sales and would impact a highest and best use determination. Notably, the bill does not prohibit either vacant comparable sales or restrictive deeds if they reflect typical exposure to and sales in the market under the same economic conditions as the subject property. The additional requirement that seller-imposed deed restrictions likely will differ from a subject property without deed restrictions is now found in the Court of Appeals’ *Menards, Inc.* decision. The method of applying that decision is found in the Maturen bill.



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As the *Menards, Inc.* decision also underscores, nothing in the Maturen bill is inconsistent with long-standing Michigan law or the historic definition of “true cash value” in MCL 211.27. The Court of Appeals’ decision provides an answer to wide-ranging claims from groups lobbying on behalf of big box retailers. The expansive legal principles argued to be found in the raft of unpublished decisions to support the use of dark stores as comparable sales was not and is not Michigan law.

HB 5578 does not address procedure, budget, selection of members or other structural aspects of the Tribunal. It does not seek to advantage or disadvantage any litigant group. HB 5578 provides the tools for Tribunal Members to apply the *Menards Inc.* decision.

If you have questions about how this case affects your municipality please contact Jack Van Coevering at 616.726.2221 or [jvancoevering@fosterswift.com](mailto:jvancoevering@fosterswift.com).