STATE OF MICHIGAN
IN THE SUPREME COURT
Appeal from the Michigan Court of Appeals
Hon. C.J. Talbot, Hon. Hoekstra and Hon. JJ Shapiro, Presiding

MENARD, INC.

Petitioner/Appellant,

v

CITY OF ESCANABA,

Respondent/Appellee.

Supreme Court Docket No. 154062
Court of Appeals No. 325718
MTT Docket Nos. 00-441600
(Consolidated) 14-001918

MICHIGAN REALTORS®' CORRECTED SUPPLEMENTAL *AMICUS CURIAE* BRIEF IN SUPPORT OF THE SUPPLEMENTAL BRIEF OF APPELLEE CITY OF ESCANABA TO DENY THE APPLICATION FOR LEAVE TO APPEAL

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BASIS FOR SUPPLEMENTAL BRIEF

Appellant/Petitioner, Menard, Inc. ("Menard"), filed an Application for Leave to Appeal to this Court from the May 26, 2016 published per curiam opinion of the Court of Appeals (Talbot, CJ; Hoekstra; and Shapiro, JJ). *Menard, Inc v City of Escanaba,* 315 Mich App 512; ______ NW2d _______ (2016). Appellee/Respondent, the City of Escanaba ("City") opposed the Application. In an Order dated February 1, 2017, this Court directed the Clerk to schedule oral argument on the Application and requiring the parties to file supplemental briefs addressing the following issues:

(1) whether the Court of Appeals exceeded its limited appellate review of a decision of the Michigan Tax Tribunal; and, if so,

(2) whether the Michigan Tax Tribunal may utilize a valuation approach similar to that recognized in *Clark Equipment Company v Leoni Twp,* 113 Mich App 778 (1982).

Amicus Curiae, Michigan REALTORS® now submits this supplemental brief to address the issues before this Court.

STATEMENT OF QUESTIONS PRESENTED

I. WHETHER THE COURT OF APPEALS EXCEEDED ITS LIMITED APPELLATE REVIEW OF A DECISION OF THE MICHIGAN TAX TRIBUNAL?

The Court of Appeals answered, "Nos."

The Tax Tribunal answered, "Yes."

The Appellee, City of Escanaba, answered, "No."

The Appellant, Menard, Inc. answered, "Yes."

Amicus Curiae, Michigan REALTORS® answers, "No."

II. WHETHER THE MICHIGAN TAX TRIBUNAL MAY UTILIZE A VALUATION APPROACH SIMILAR TO THAT RECOGNIZED IN *CLARK EQUIPMENT COMPANY V LEONI TWP*, 113 MICH APP 778 (1982)?

The Court of Appeals answered, "Yes."

The Tax Tribunal did not answer this question.

The Appellee, City of Escanaba, answered, "Yes."

The Appellant, Menard, Inc. answered, "Yes."

Amicus Curiae, Michigan REALTORS® answers, "Yes."

I. INTRODUCTION/STATEMENT OF INTEREST

The Michigan REALTORS® is Michigan's largest non-profit trade association, comprised of 47 local boards and a membership of more than 28,000 appraisers, brokers and salespersons licensed under Michigan law. In fact, of the 3,400 total licensed appraisers in this State, the majority are members of the Michigan REALTORS®.

Each day, the Michigan REALTORS®'s members are involved in hundreds of real estate transactions, which involve the appraisal and sale of commercial property. Accordingly, one of the goals of the Michigan REALTORS® is to support good appraisal practices. To promote this goal and others, the Michigan REALTORS® support court decisions which advocate appraisal practices consistent with industry standards and Michigan law.

The present case involves issues of major significance to the Michigan REALTORS® and its members. The issues in this appeal include some of the most basic, yet significant appraisal concepts, such as highest and best use, the use of true comparables and use of the cost-less-depreciation method of valuation, which have, of late, been subverted and/or ignored to support the "Dark Store" Theory.

The "Dark Store" Theory involves property valuation by "big box" retailers like Menard in which vacant and abandoned (i.e., dark) stores are used as comparables to reach a valuation of a fully occupied and operational store. The "Dark Store" theory strays far from the course of good, sound appraisal practices advocated by The Appraisal Foundation and The Uniform Standards of Appraisal Practice ("USPAP").

One of the basic principles of appraising is valuing a property based on its highest and best use. Using comparables of properties that are vacant, neglected, occupied at a lesser use and/or use restricted does not result in a valuation of a property at its highest and best use. Rather, corporate entities are purposefully diminishing the value of their own, or formerly owned, real estate through the placement of artificial use restrictions and the use of non-comparable properties in the valuation process.

Here, the Court of Appeals found that the Tribunal committed an error of law by rejecting the City's cost-less-depreciation approach and adopting a sales-comparison approach that failed to account for the impact upon value of deed restrictions on use in the former "big box" comparables. COA Opinion, p 12, Exhibit 1. Menard claims that this ruling is erroneous. Menard is incorrect. The Court of Appeals Opinion constitutes a correct analysis and ruling on the application of appraisal methods and attendant valuation issues.

The Michigan REALTORS® believes that this is a case of important public interest, and that the outcome of this case is of continued and vital concern to the Michigan REALTORS®, its members and consumers. The Michigan REALTORS®'s experience and expertise could be beneficial to this Court in the resolution of the issues presented by this appeal. In *Grand Rapids v Consumers Power Co,* 216 Mich 409, 415; 185 NW 852 (1921), this Court stated: "This Court is always desirous of having all the light it may have on the questions before it. In cases involving questions of important public interest, leave is generally granted to file a brief as amicus curiae . . . ." The Michigan REALTORS®, therefore, seeks leave to file this supplemental brief amicus curiae in support of the position of the City of Escanaba (the "City").

II. STATEMENT OF FACTS

The Michigan REALTORS® accepts the Statement of Facts contained in the City's Brief on Appeal, as highlighted by the following:

1. In April 2008, Menard purchased an 18-acre site on the City's commercial corridor along highway US 41, near the cinemas and mall, for $1,150,000 and constructed a brand new 185,666 square foot store with a garden center (the "Menard Property").

2. Menard owned the Menard Property free of any deed restrictions, restrictive covenants, or other encumbrances upon its use.

3. At the August 14, 2014 Tribunal hearing, Menard presented one exhibit in support of its case: a valuation disclosure dated February 25, 2013 ("Valuation") prepared by Joseph Torzewski ("Torzewski" or "Menard Appraiser").

4. Torzewski testified that the Menard Property is a "big box," defined as a retail store between 10,000 and 100,000 square feet.

5. Torzewski determined the highest and best use of the Menard Property as improved was "for continued use of the existing improvements as a free-standing retail building use."

6. Torzewski rejected the replacement cost approach to valuation because he believed that in the case of "big box" stores, functional obsolescence is built into them and they are subject to external obsolescence, both of which he said affect the value but which are difficult to properly analyze.

7. Torzewski did not provide supporting analysis or research as to why he believed the replacement cost approach was inappropriate.

8. Torzewski used the sales comparison approach to appraise the Menard Property.

9. As stated by the Court of Appeals, the sales comparables used by Torzewski were:

   a. Comparable 1 was a former Home Depot built in 2006, located in Holland, Michigan, and had 103,000 square feet. The structure was sold in 2014. The record does not contain any information on the current or intended future use of the building, but does state that deed restrictions limit its ability to be used as a retail space;

b. Comparable 2 was a former Circuit City built in 1996, located in Westland, Michigan, and had 63,686 square feet. The structure was sold in 2013 to the City of Westland which turned it into a city hall. The property had been foreclosed;

c. Comparable 3 was a former Wal-Mart built in 1989, located in Alma, Michigan, and had 122,790 square feet. The building was sold in 2012 for redevelopment as industrial property. The property contained deed restrictions that prohibited use of the property as a grocery store over 35,000 square feet or a discount store over 50,000 square feet;

d. Comparable 4 was a former Sam's Club built in 1986, located in Madison Heights, Michigan, and had 113,262 square feet. The building was sold in 2012 for redevelopment as industrial property. The property had been foreclosed;

e. Comparable 5 was a former Wal-Mart built in 1995, located in Auburn Hills, Michigan, and had 151,017 square feet. The building was sold in 2011 for redevelopment as industrial property. The property contained deed restrictions that prohibited use of the property as a grocery store over 35,000 square feet or a discount store over 50,000 square feet;

f. Comparable 6 was a former furniture store built in 1986, located in Flint, Michigan, and had 53,474 square feet. The building was sold in 2010 and continues to function as a furniture store;

g. Comparable 7 was a former Kroger built in 1981, located in Dearborn, Michigan, and had 55,474 square feet. The building was sold in August 2010, but no detail is contained in the record about the current or future use of the building other than that it is intended for future retail use; and

h. Comparable 8 was a former Wal-Mart built in 1993, in Monroe, Michigan, and had 130,626 square feet. The building was sold in 2009 to be divided into multitenant space with current tenants being Dunham's Sports and Hobby Lobby. The property contained deed restrictions that prohibited use of the property as a grocery store over 35,000 square feet or a discount store over 50,000 square feet.

10. Torzewski admitted that five of the eight sales involved deed restricted property.

11. Torzewski made no adjustments for the difference in property rights involved in his "comparable" sales and disregarded the deed restrictions because he was told that the restrictions did not have any effect on the sale price.

12. Torzewski concluded that the Menard Property should be valued at $3,300,000 for each of the tax years 2012, 2013 and 2014.

13. In support of its assessment of value, the City submitted a valuation summary prepared by assessor, Diana Norden ("Norden" or "City Assessor").

14. Norden primarily used the cost-less-depreciation approach to value the property. She testified that she used the cost-less-depreciation approach because there were insufficient comparable sales and because the building being valued was a newer construction.

15. Norden opined that properties with deed restrictions should not be compared to the subject property, which had no use restrictions in place.

16. Nordon testified that she adjusted the value for depreciation, but that she did not adjust for functional obsolescence.

17. Norden opined that there was no functional obsolescence in the property because, if purchased for its existing use, other retailers would use the components of the existing building.

18. Norden opined that the true cash value for the Menard Property was as follows: $7,815,976 for 2012, $7,995,596 for 2013, and $8,210,938 for 2014.

19. The Tribunal concluded that the true cash value of the Menard Property for 2012 was $3,325,000, $3,490,000 for 2013, and $3,660,000 for 2014.

20. The Tribunal concluded that the City's cost-less-depreciation approach should be given no weight because Norden did not account for functional or external obsolescence.

21. The Tribunal concluded that the sales-comparison approach advanced by Menard was persuasive and meaningful to an independent determination of market value.

22. The Tribunal specifically found that the deed restrictions in Menard's comparables did not require an adjustment because Torzewski testified that the deed restrictions had no effect on the sales price of the deed-restricted comparables.

III. ARGUMENT

A. The Court of Appeals Applied the Proper Standard of Review

In the absence of fraud, the appellate courts of this state review decisions of the Tribunal for an error of law or the adoption of wrong legal principles. *Briggs Tax Serv, LLC v Detroit Pub Sch,* 485 Mich 69, 75; 78 NW2d 753 (2010). A decision of the Tribunal that is not supported by competent, material and substantial evidence is an error of law. Const 1963, art 6, §28; *Continental Cablevision of Mich, Inc v Roseville,* 430 Mich 727, 735; 425 NW2d 53 (1988).

If the appellate court is determining whether a method of valuation comports with the definition of "true cash value," the standard of review is *de novo.* MCL 211.27. Michigan constitutional law requires that real property be assessed uniformly, at its true cash value. Const 1963, art 9, §3. "The important constitutional objective is uniformity of assessment, regardless of the level at which property is commonly assessed." Const 1963, art 9, §3, Convention Comment. The Tribunal has a duty, independent of the parties, to determine true cash value and the most accurate valuation under the individual circumstances of the case. *President Inn Props, LLC v Grand Rapids,* 291 Mich App 625, 631; 806 NW2d 342 (2011). When the Tribunal fails to do so, the integrity of the appraisal process is compromised and an error of law occurs. In that instance, the Court of Appeals is compelled to reverse the decision of the Tribunal. *Id.*

Here, the Tribunal erred when it failed to determine the true cash value of the Menard Property using the most accurate valuation method under the circumstances. Therefore, the Court of Appeals applied the correct standard of review and, acting within that standard, reversed the decision of the Tribunal.

B. Overview of Appraisal Principles and the Importance of the Integrity of the Evaluation Process

The appraisal of real property follows a systematic procedure known as the valuation process. The valuation process demonstrates how the fair market value of a property is determined. The valuation process is adaptable to allow for its use in a wide variety of appraisal assignments, the most common of which is an opinion of fair market value. There are three general approaches to fair market valuation which have been approved by the courts in Michigan: (1) the cost approach; (2) the sales comparison approach; and (3) the income capitalization approach. *Antisdale v City of Galesburg*, 420 Mich 265, 276; 362 NW2d 632 (1985). In most cases, appraisers perform an analysis of all three methods of valuation with a reconciliation of the values reached at the conclusion of that analysis. However, in some instances, one or more of the valuation approaches may not apply due to the unique circumstances of the appraisal assignment or unique characteristics of the property to be appraised. In the end, no matter which methodology is used, the valuation must represent the fair market value of the property. *Meadowlanes Dividend Housing Ass'n v Holland,* 437 Mich 473, 484-485; 473 NW2d 636 (1991).

In Michigan, fair market value is referred to as true cash value. *Great Lakes Div of Nat'l Steel Corp v City of Ecorse,* 227 Mich App 379, 389; 576 NW2d 667 (1998). "True Cash Value" is statutorily defined as 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 . . . or forced sale." MCL 211.27(1). Thus, the terms "fair market value," "usual selling price," and "true cash value" as used in Michigan law, are synonymous. *WPW Acquisition Co v City of Troy*, 250 Mich App 287, 298; 646 NW2d 487 (2002). Again, however, the constitutionally required outcome, no matter the terminology used, is that the valuation represent the fair market value of the property.

1. Identify Property Characteristics

One of the first steps in the valuation process is to identify the characteristics of the property being appraised. These include:

- Location and physical, legal, and economic attributes
- Real property interest to be valued (e.g., fee simple, fractional interest, physical segment, partial holding)
- Items included in the appraisal other than real property (e.g., personal property or trade fixtures)
- Restrictions on land use.

Notably, and as relevant here, "special attention must be given to limitations on ownership rights," which include use restrictions. Appraisal Institute, *The Appraisal of Real Estate* (12th ed, 2001), p 55. In fact, it is required under USPAP. Stated otherwise, in order to achieve the constitutionally required outcome of determining fair market value, property use restrictions, or lack thereof, <u>must</u> be considered in the valuation process. USPAP, 2012-2013 Edition, pp U-17 and U-37.[1]

[1] USPAP is developed, interpreted and amended by the Appraisal Standards Board ("ASB") of The Appraisal Foundation.

2. Collect and Analyze Data

Next, an appraiser collects data. The types of data collected includes general data such as economic trends, demographics, government regulations, trends in building activity, current costs of construction, tax rates in the area and prevailing financing rates and trends. *The Appraisal of Real Estate*, pp 134-142. Data specific to the property being appraised is also collected. Specific data includes details about the qualities of the property being appraised, local market conditions and sales of comparable properties. Specific data is found in many sources including the Multi-Listing Services maintained and used by REALTORS® to market and sell real property. *Id.* at p 143. Speculative data, incomplete data and distorted data is excluded. *CAF Inv Co v State Tax Comm'n,* 392 Mich 442, 456; 221 NW2d 568 (1974).

Once collected, the specific data is analyzed through market analysis via comparison. Market analysis generates data and conclusions which are necessary for all traditional valuation methods. For example, in the sales comparison approach, market analysis delineates the relevant market and is therefore critical to identifying "comparable" properties. Similarly, the basis for adjusting the cost of the property for depreciation (that is, physical deterioration and obsolescence), as used in the cost approach, is derived through market analysis. And, in the income approach, income, expense and rate data are evaluated in light of supply and demand and market forces. *The Appraisal of Real Estate*, pp 59-60.

3. Determine Highest and Best Use

Under the three traditional approaches to valuation, true cash value can only be determined by assessing a property at its highest and best use. *Huron Ridge, LP v Ypsilanti Twp,* 275 Mich App 23, 33; 737 NW2d 187 (2007). In fact, highest and best use has been described "as the foundation on which market value rests." *The Appraisal of Real Estate*, p 305. Therefore, the appraiser's next step is to perform a highest and best use analysis.

Highest and best use is not determined through subjective analysis. Rather, highest and best use is determined "by the competitive forces within the market where the property is located." *Id.* The highest and best use of a particular property may also be its current use. *Id.* at 315.[2]

Highest and best use can be determined as vacant or as improved and is defined as follows:

> The reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, and financial feasible and that results in the highest value.

Id. Thus, broken down to its basic components, proper highest and best use analysis requires the consideration of:

1. physically possible;
2. legally permissible;
3. financially feasible; and
4. maximally productive,

along with the constant consideration of whether a use is reasonably probable. *Id.* at 307-308.

Relevant here is a determination of highest and best use as improved. In this context, testing the physical possibility of highest and best use addresses the physical and functional problems associated with certain physical characteristics of the property, such as condition, design, location

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[2] This is particularly true of properties identified as "special-purpose use" properties. *The Appraisal of Real Estate*, p 326. Special-purpose property is defined as a limited-market property with a unique physical design, special construction materials, or a layout that restricts its utility to the use for which it was built. *Id.* at p 25. Special-purpose properties include large manufacturing plants. *Id.* Thus, the highest and best use of a plant currently used for heavy manufacturing is probably continued use for heavy manufacturing. *Id.* at p 326. Only where the current use of a special-purpose property is physically, functionally or economically obsolete and no alternative uses are feasible, is the highest and best use of the land potentially realized by demolishing the improvements on the property. *Id.*

and size. This test may also reveal depreciation items, both physical and functional, and assist in whether or not these items are curable. These physical characteristics, and the analysis thereof, have some form of cost associated with them, particularly where a physical change is necessary to achieve highest and best use. These costs of, for example, curing physical deterioration or functional obsolescence, are obviously included in the analysis and, if the required changes would not be profitable, and the correlating expenditures would not be made, an appraiser should incorporate these facts into the highest and best use analysis. By contrast, where there are no significant physical modifications needed, the existing use is obviously physically possible. In these situations, the conclusion the appraiser should reach is that the existing use meets the physically possibility test. *Id.* at pp 317-318.

The legal permissibility component of highest and best use examines whether the property being appraised conforms with existing legal requirements and how said compliance or noncompliance affects the property's value. If the property is nonconforming, the appraiser must determine whether the property can be brought into conformity, considering codes, ordinances and private restrictions, and the modification thereof. This analysis may also involve an investigation of how rigorously a municipality or private organization such as a homeowner's association enforces its codes, ordinances and restrictions. If codes, ordinances and restrictions are generally not enforced, the appraiser may conclude that the nonconforming use has no negative impact on the value of the property. Obviously, however, the reverse is equally true. On the other hand, where the existing use of the appraised property conforms with all of the codes, ordinances and restrictions, the appraiser may simply conclude that the existing use is legally permissible and move on in his/her analysis. *Id.* at pp 316-317.

The financial feasibility component of highest and best use addresses market demand for the property in its as-is state. A property use is financially feasible if its existing use creates a positive return on the investment. *Id.* at 318.

The test of maximum productivity considers determinations made in the first three tests of physical possibility, legal permissibility and financial feasibility. Specifically, if, in any of the first three tests, the appraiser determines that actions must be taken resulting in correlating costs to be incurred, these factors must be considered in the test of maximum productivity. For example, if changes to the property result in a higher value or if they preserve the existing value, then those costs contribute to the most productive use. *Id.* 318-319.

In sum, all appraisal reports must contain statements describing the analysis undertaken and the conclusions reached pertaining to the highest and best use of the property either as vacant or as improved. The above-discussed tests should be considered in reaching that conclusion.

4. Analysis Under Three Valuation Methods

Having determined highest and best use, valuation of the subject property continues in accordance with three approaches to valuation previously identified. *Meadowlanes*, 437 Mich at 484-485. In general, these three approaches are described as:

1. The cost approach, in which value is estimated as the current cost of reproducing or replacing the improvements (including an appropriate entrepreneurial incentive or profit) minus the loss in value from depreciation plus land or site value.

2. The sales comparison approach, in which value is indicated by recent sales of comparable properties in the market.

3. The income capitalization approach, in which value is indicated by a property's earning power, based on the capitalization of income.

The Appraisal of Real Estate, p 50.

The three valuation approaches allow appraisers to examine market date and perform data analyses to derive three separate values. The concept is that with three valuation approaches available, the use and comparison of all three methodologies will more likely reflect the true cash value than if a just a single method were used. *Fisher-New Ctr Co v State Tax Comm'n,* 380 Mich 340, 369-370; 157 NW2d 271 (1968). In the normal course, all three approaches may be used to derive three separate values which are then integrated into a single estimate of value. *The Appraisal of Real Estate*, p 50. However, as here, there are instances in which, due to the unique characteristics of the property being appraised, one or more of the three conventional methods of valuation cannot, and should not, be used.

Under Michigan law, it is the Tribunal's duty, initially, to determine which approaches are useful in providing the most accurate valuation under the individual circumstances of each case. *Meadowlanes,* 437 Mich at 485. Here, the Tribunal rejected the City's cost-less-depreciation approach and adopted Menard's sales-comparison approach. COA Opinion, p 7, Exhibit 1. However, where the Tribunal fails to determine the most accurate valuation, it is incumbent upon the appellate courts to reverse the decision of the Tribunal. *President Inn*, 291 Mich App at 631. Therefore, as discussed below, the Court of Appeals correctly reversed the Tribunal's finding regarding the proper approach to valuation. COA Opinion, p 12, Exhibit 1.

C. The Sales Comparison Approach Does Not Yield an Accurate Fair Market Value in This Case

The sales comparison approach is one of three traditional methodologies used to determine fair market value. The sales comparison approach utilizes a comparative study in which properties comparable to the appraised property that have recently sold, are listed for sale or are in the process of being sold are analyzed. The sales comparison approach is based on the premise that the fair market value of comparable and competitive properties is related to the fair market value of the property being appraised.

In the sales comparison approach, certain elements may affect value where tested against market data such as:

1. Property rights appraised;
2. Motivations of buyers and sellers;
3. Financing terms;
4. Market conditions at time of sale;
5. Size;
6. Location;
7. Physical features; and
8. Economic characteristics, if the property produces income.

The Appraisal of Real Estate, p 417. Obviously, the more of these factors that are alike, as between the appraised property and the "comparable property," the more relevant the comparable property is to the valuation analysis.

For the type of properties that are bought and sold often and regularly, such as single-family residential properties, the sales comparison approach may be a reliable indicator of market value. This is because there are sufficient recent and reliable transactions to indicate value patterns which may be compared to the appraised property. When such data is available, the sales comparison approach may be the most straight forward manner in which to support an opinion of value. *Id.* at p 419.

By contrast, where few market transactions/comparables are available, the sales comparison approach may not be applicable as a reliable indicator of value.

> For example, the sales comparison approach is usually not applied to special-purpose properties because few similar properties may be sold

> in a given market, even one that is geographically broad. To value special-purpose properties, the cost approach may be more appropriate and reliable.

Id.

Where the sales comparison approach is applicable, more often than not, the properties used as comparables do not precisely line up with the appraised property as true "apples-to-apples." Thus, adjustments derived through a comparative analysis employing quantitative and/or qualitative techniques can be made to the sales prices of the comparables. *Id.* at p 429. The elements of comparison are, among others, those listed above, including property rights and location. Adjustments may be both positive and negative. *Id.* at p 430.

For example, when examining a comparable in which the real property rights were conveyed by a quit claim deed, that transaction may or may not include the total fee simple bundle of rights conveyed in the fee simple transaction of the appraised property. As a result, the appraiser must determine whether the rights conveyed in the comparable transaction were less than the total fee simple bundle of rights. If so, then the appropriate adjustment must be made – a positive adjustment to the comparable property because it is "less" than the appraised property. Or, the appraiser could conclude that there is no available adjustment for the difference in rights. In that instance, the quit claim deed transaction simply cannot be used as a comparable. *Id.* at p 431.

A similar conclusion can be reached due to the presence of use restrictions. Some contracts call for the sale of real property rights but add deed restrictions or other forms of limitation on the uses of the property. These use limitations render the transaction unusable for comparison because the rights conveyed are less than fee simple. Stated otherwise, where the seller retains some sticks from the total bundle of property rights by way of deed restrictions, the sale is not a transfer of a fee simple estate. *Id.* at p 431. The same analysis applies where property being valued is limited by use restriction imposed of record by a former owner.[3]

Also by way of example, an adjustment for location is required when the comparable property is located in a market area different from the appraised property. As with the real property rights conveyed analysis, excessive differences in location between the comparable property and the appraised property, such as the properties being located in different cities or states, may disqualify a property from being used as a comparable. *Id.* at p 435.

Overall, adjustments may be expressed as percentages, dollar amounts or in descriptive terms and fall into two general categories: quantitative and qualitative. *Id.* at p 429. If the appraiser is applying quantitative adjustments, the appraiser may perform the following steps:

1. Derive a net adjustment for each comparable based on the comparison of the factors discussed above;

2. Apply it to the sale price or unit price of the comparable property to arrive at a range of adjusted sale or unit prices for the subject property; and

3. Considering this array of values, determine the most probable position of the appraised property within that range.

An appraiser's adherence to this analysis should result in the comparables that are most similar to the appraised property, being given the greatest weight. *Id.* at p 429.

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[3] Torzewski testified he was told that the deed restriction did not have any effect on the sales price of his comparables. Of course the restriction had no impact on sales price as the buyers were paying a price equal to the value of a deed restricted property. No seller would expect to receive or buyer would expect to pay a higher price as if the property was not deed restricted.

In applying the qualitative analysis, the appraiser divides the adjusted comparables into two groups. The first group is comprised of those comparable properties that are qualitatively superior to the appraised property. The second group includes those properties that are qualitatively inferior to the appraised property. The adjusted prices of these two groups provide a bracket which indicates a probable range of values for the appraised property. *Id.*

The final step is reconciliation. In the end, the appraiser must determine a net adjustment figure by calculating the total positive and negative adjustments and subtracting the smaller amount from the larger amount. The greater the adjustment, the less comparable the property is to the appraised property. Precise arithmetic conclusions derived from adjusted data should support the appraiser's judgment. The property may have too high or too low of a net adjustment to be properly used as a comparable. *Id.* at p 447.

Here, Menard's "comparables" in its appraisal were not true "comparables." The Menard Property is not subject to any use restrictions. By contrast, however, at least half of the comparables selected by Menard's appraiser are subject to use restrictions.[4] These deed restrictions prevent the sale of an entire fee simple interest in the comparable properties. And, due to the deed restrictions, the highest and best use of the "comparables" is not the same as the Menard Property; that is, its not for use as a "big box" store. As a result, the Menard Property and the Menard appraiser's comparables are not "apples-to-apples." As stated by the Court of Appeals, "the anti-competitive nature of the deed restrictions means that the deed restricted

[4] For example, Comparable 1, a former Home Depot, contains a deed restriction limiting its ability to be used as retail space. Comparables, 3, 5 and 8, former Walmart Stores, similarly contain deed restrictions limiting their use as grocery and/or discount stores.

comparables could not be sold for their highest and best use." COA Opinion, p 8, Exhibit 1. Therefore, the comparables should not have been used.[5]

> Some contracts call for the sale of real property rights but add deed restrictions or other forms of limitations on the purchaser and/or future users of the property. Such title or use limitations may also reduce the transaction to use as a general market indicator that render the transaction unusable for direct market comparison because the rights are less than fee simple.

The Appraisal of Real Estate, p 431.[6]

Moreover, Menard's suggestion that its use of comparables with deed restrictions was justified because no other comparables exist is simply not a valid justification. Rather, the fact that no real comparables exist is proof that the sales comparison approach will not yield a true fair market valuation.

Moreover, in most cases, with respect to "big box" stores, the restrictions are self-imposed. Thus, "big box" stores created the very problem at issue here with using the sales-comparison method. Again, however, the answer is not to violate appraisal principles or abandon good appraisal practices, but, rather, to simply use a different methodology of valuation.[7]

In short, the comparables with deed restrictions are simply not comparables at all, are not credible as to value and should not have been relied upon by the Tribunal. By relying on

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[5] Potentially comparable properties that do not have the highest and best use are usually eliminated from further analysis. The Appraisal of Real Estate p 43.

[6] At a minimum, Menard's Appraiser should have made adjustments to the comparables as discussed above to at least attempt to account for the "square pegs" he was placing in "round holes."

[7] Similarly, Menard's assertion that the deed restrictions had no impact on value simply defies logic. Indeed, Menard's own evidence establishes that two comparables that were not subject to deed restrictions had higher sales prices than the comparables that were subject to deed restrictions.

these comparables, the Tribunal did not reach a conclusion of value of the Menard Property in accordance with Michigan law.

D. The Cost Approach Yields an Accurate Fair Market Value in Accordance with *Clark Equipment Co v Leoni Twp*, 113 Mich App 778 (1982)

The cost approach also derives evaluation based on comparison. However, when utilizing the cost approach, an appraiser compares the cost to develop a new property with the same utility as the subject property. Cost approach has been defined as:

> A set of procedures through which a value indication is derived for the fee simple interest in a property by estimating the current cost to construct a reproduction of, or replacement for, the existing structure plus any profit or incentive; deducting depreciation from the total cost; and adding the estimated land value. Other adjustments may then be made to the indicated fee simple value of the subject property to reflect the value of the property interest being appraised.

The Appraisal of Real Estate, p 349.

The cost approach can be used in any market. The cost approach is particularly useful where the lack of market activity or lack of comparables negates the usefulness of the sales comparison approach. *Id.* at p 353-354. The cost approach is also particularly important for valuing special-purpose properties. As stated in *The Appraisal of Real Estate*:

> The cost approach is also used to develop an opinion of market value . . . of proposed construction, special-purpose or specialty properties, or other properties that are not frequently exchanged in the market. Buyers of these properties often measure the price they will pay for an existing building against the cost to build minus depreciation or the cost to purchase an existing structure and make any necessary modifications. If comparable sales are not available, they cannot be analyzed to develop an opinion of the market value of such properties. Therefore, current market indications of depreciated cost or the cost to acquire and refurbish an existing

building are the best reflections of market thinking and, thus, of market value.

Id. at p 354.

The procedure used in the cost approach has been outlined as follows:

1. Estimate the value of the land as though vacant and available to be developed to its highest and best use.

2. Determine which cost basis is most applicable to the assignment: reproduction cost or replacement cost.

3. Estimate the direct (hard) and indirect (soft) costs of the improvements as of the effective appraisal date.

4. Estimate an appropriate entrepreneurial profit or incentive from analysis of the market.

5. Add estimated direct costs, indirect costs, and entrepreneurial profit or incentive to arrive at the total cost of the improvements.

6. Estimate the amount of depreciation in the structure and, if necessary, allocate it among the three major categories:

   - Physical deterioration
   - Functional obsolescence
   - External obsolescence

7. Deduct estimated depreciation from the total cost of the improvements to derive an estimate of their depreciated cost.

8. Estimate the contributory value of any site improvements that have not already been considered. (Site improvements are often appraised at their contributory value – i.e., directly on a depreciated-cost basis – but may be included in the overall cost calculated in Step 2.)

9. Add land value to the total depreciated cost of all the improvements to arrive at the indicated value of the property.

10. Adjust the indicated value of the property for any personal property (e.g., furniture, fixtures, and equipment) or any intangible asset value that may be included in the cost estimate. If necessary, this value, which reflects the value of the fee simple interest, may be adjusted for the property interest being appraised to arrive at the indicated value of the specified interest in the property.

Id. at p 356.

As indicated, land valuation is the first step in the cost approach. The land is valued at its potential highest and best use. *Id.* at p 356. Land value can be estimated using the sales comparison or income capitalization approach. *Id.* at p 335. Alternatively, the land can be valued through either extraction or allocation. Extraction involves extracting the land value from the sale price "by deducting the value contribution of the improvements, estimated at their depreciated cost." *Id.* at p 339. Allocation is useful when data on comparables is not available. Allocation is based on ratios of land value to improvement value. Land value can be inferred by the price range of properties in the immediate area. *Id.* at p 340.

Next, an appraiser determines the cost basis. There are two costs bases from which an appraiser, using the cost approach, may choose: (1) reproduction cost; and (2) replacement cost. Reproduction cost is the cost of an exact replica of the subject property. Replacement cost is the cost of a substitute property with similar utility as the appraised property. *Id.* at p 350.

An appraiser chooses between these two costs bases based on the market and physical condition of the appraised property. *Id.* Replacement cost is most commonly used because it may be easier to obtain the necessary data and can reduce the complexity of the depreciation analysis. Use of, at times, replacement cost can actually eliminate the need to measure many forms of functional obsolescence. *Id.* at p 357. The cost basis selected must be used consistently throughout the cost approach valuation. *Id.* at p 350.

Both direct and indirect costs must be considered by an appraiser to develop cost estimates. Direct costs include the following:

- Building permits
- Materials, products and equipment
- Labor used in construction
- Equipment used in construction
- Security during construction
- Contractor's shack and temporary fencing
- Material storage facilities
- Power line installation and utility costs
- Contractor's profit and overhead, including job supervision; coordination and management (when appropriate); worker's compensation; and fire, liability and unemployment insurance
- Performance bonds

Id. at p 359. Indirect costs include:

- Architectural and engineering fees for plans, plan checks, surveys to establish building lines and grades, and environmental studies
- Appraisal, consulting, accounting and legal fees
- The cost of carrying the investment in land and contract payments during construction
- All-risk insurance expense and ad valorem taxes during construction
- The cost of carrying the investment in the property after construction is complete but before stabilization is achieved
- Supplemental capital investment in tenant improvements and leasing commissions
- Marketing costs, sales commissions, and any applicable holding costs to achieve stabilized occupancy in a normal market
- Administrative expenses of the developer

Id.

Costs are estimated using one of three traditional methods:

1. The comparative-unit method;
2. The unit-in-place method; and
3. The quantity survey method.

Id. at p 369. The first two methods are less detailed but are the most used. The quantity survey method utilizes a detailed inventory of labor, materials and equipment used in the improvement of the appraised property. *Id.*

The comparative-unit method uses known costs from similar structures, adjusted for market conditions and physical differences, to develop a dollars per unit of area cost estimate. Unit costs vary with size because, typically, unit costs decrease as buildings increase in area. *Id.* at p 371. In the comparative-unit method, the contract prices for recently constructed buildings are compared to the appraised building to derive a total cost estimate. Adjustments may be made for differences between the appraised building and the comparable building for factors such as size, design characteristics, dates of construction and whether the buildings are in the same markets. *Id.* at p 375-376.

The unit-in-place method is also known as the segregated-cost method. This method employs a computation of unit cost based on the actual quantity of materials used plus the labor of assemblage for each square-foot area. Stated otherwise, the unit-in-place method is a "cost-estimating method in which total building cost is estimated by adding together the unit cost for the various building components as installed." *Id.* at p 376. Specific cost data for standardized structural components as installed are used. Examples of structural components include excavation, foundation, floor construction, interior partitions and roofing. Unit-in-place cost estimates are typically obtained from a service that provides monthly cost-estimating figures. *Id.* at p 376.

The quantity survey method is the most comprehensive of the three cost-estimating methodologies. In this cost-estimating method, both the quantity and quality of all materials used are estimated as well as all categories of labor, to arrive at the total cost estimate for labor and materials. *Id.* at p 379. Unit costs are applied to the labor and materials figures to develop a total cost estimate which is then adjusted for contingencies, overhead and profit.

An appraiser using the cost approach next estimates an appropriate entrepreneurial profit or incentive from analysis of the market; that is, an economic reward sufficient to induce a developer to take the risk associated with a building project. *Id.* at p 360. For a completed, stabilized project, the formula is: market value less total cost of development = entrepreneurial profit or loss. By contrast, entrepreneurial incentive is a market derived figure that represents the amount a developer expects to receive as compensation for his or her work and assumption of development risks. *Id.* at p 360. The range of profit will vary depending on not only the type of structure but also the amount of risk. These ranges of profit can be determined through market research. *Id.* at p 361. The entrepreneurial profit or incentive is then added to the estimated cost to arrive at the total cost of improvements. *Id.* at p 356.

Determining depreciation is the next step. Depreciation is reproduction or replacement cost less contributory value of improvement. *Id.* at p 363. Depreciation has been defined as:

> The difference between the market value of an improvement and its reproduction or replacement cost at the time of appraisal. The depreciated cost of the improvement can be considered an indication of the improvement's contribution to the property's market value.

Id. Depreciation is the result of physical deterioration (wear and tear from regular use), functional obsolescence (a flaw in the structure, materials or design that diminishes value) and/or external obsolescence (a temporary or permanent impairment of the utility of the property resulting from outside negative influences such as adverse market conditions). *Id.*

Depreciation attributable to these three causes is typically derived from the market in which case, the appraiser interprets "how the market perceives the effect of depreciation." *Id.* at p 364. Depreciation is then subtracted from total costs to arrive at depreciated costs. Next, the depreciated cost is added to the land value which then provides market value. *Id.* at p 364.

In this case, the City Assessor used the cost approach to develop her opinion of market value. The City Assessor used replacement costs of building components taken from the Michigan Assessor's Manual. The City Assessor used a comparative-unit method to derive a cost estimate. By using a replacement cost basis, the City Assessor was appropriately able to curtail the need to measure functional obsolescence in the depreciation analysis. *Teledyne Continental Motors v Muskegon Twp*, 145 Mich App 749, 755; 378 NW2d 590 (1985). In sum, the City Assessor correctly and appropriately used the cost approach to arrive at an accurate fair market value of the Menard Property in keeping with recognized appraisal standards. Therefore, the Opinion of the Court of Appeals should be affirmed.

IV. CONCLUSION/RELIEF SOUGHT

For all the foregoing reasons, the Michigan REALTORS® respectfully requests that this Court affirm the decision of the Court of Appeals and deny the Application for Leave to Appeal.

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STATE OF MICHIGAN

COURT OF APPEALS

MENARD, INC.,

Petitioner-Appellee,

v

CITY OF ESCANABA,

Respondent-Appellant,

and

MICHIGAN MUNICIPAL LEAGUE, MICHIGAN TOWNSHIPS ASSOCIATION, MICHIGAN ASSOCIATION SCHOOL BOARDS, MICHIGAN SCHOOL BUSINESS OFFICIALS, MICHIGAN ASSOCIATION OF COUNTIES, and MICHIGAN ASSESSORS ASSOCIATION,

Amici Curiae.

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May 26, 2016
9:10 a.m.

No. 325718
Tax Tribunal
LC No. 00-441600; 14-001918-TT

Before: TALBOT, C.J., and HOEKSTRA and SHAPIRO, JJ.

PER CURIAM.

This case arises out of ad valorem property tax assessments for the tax years 2012, 2013, and 2014. The subject property is a 166,196 square foot "big-box" store built on 18.35 acres and located in Escanaba, Michigan. After a hearing on petitioner Menard, Incorporated's challenge to respondent City of Escanaba's tax assessment, the Michigan Tax Tribunal (the tribunal) rejected Escanaba's assessment and found in favor of Menard. Because we conclude that the tribunal made an error of law and its decision was not supported by competent, material, and substantial evidence, we reverse.

I. FACTS

Menard filed a petition to appeal the ad valorem property tax assessments for tax years 2012, 2013, and 2014 for property located in the City of Escanaba. Escanaba made the following valuations of the property: (1) in 2012 the true cash value (TCV) was $7,815,976; (2)

in 2013 the TCV was $7,995,596; and (3) in 2014 the TCV was $8,210,938. Menard contended that the TCV for each year was only $3,300,000.

In support of its position, Menard submitted a valuation appraisal prepared by Joseph Torzewski, a commercial real estate appraiser. Torzewski opined in his report that the property's highest and best use (HBU) was "for continued use of the existing improvements as a free-standing retail building." Torzewski stated that he appraised the "fee simple interest" in the subject property.

Torzewski reached his opinion on the property's TCV by developing the sales-comparison and income approaches to valuation.[1] In his sales-comparison approach, Torzewski provided eight comparable sales. Because he found no other big-box stores in the Upper Peninsula, he used buildings primarily located in southeast Michigan. The record contains the following information on the eight comparables used by Torzewski:

1. Comparable 1 was a former Home Depot built in 2006, located in Holland, Michigan, and had 103,000 square feet. The structure was sold in 2014. The record does not contain any information on the current or intended future use of the building, but does state that deed restrictions limit its ability to be used as a retail space;

2. Comparable 2 was a former Circuit City built in 1996, located in Westland, Michigan, and had 63,686 square feet. The structure was sold in 2013 to the City of Westland which turned it into a city hall;

3. Comparable 3 was a former Wal-Mart built in 1989, located in Alma, Michigan, and had 122,790 square feet. The building was sold in 2012 for redevelopment as industrial property. The property contained deed restrictions that prohibited use of the property as a grocery store over 35,000 square feet or a discount store over 50,000 square feet;

4. Comparable 4 was a former Sam's Club built in 1986, located in Madison Heights, Michigan, and had 113,262 square feet. The building was sold in 2012 for redevelopment as industrial property;

5. Comparable 5 was a former Wal-Mart built in 1995, located in Auburn Hills, Michigan, and had 151,017 square feet. The building was sold in 2011 for redevelopment as industrial property. The property contained deed restrictions that prohibited use of the property as a grocery store over 35,000 square feet or a discount store over 50,000 square feet;

[1] The parties stipulated that, because the subject property was not income-producing, the income approach was inapplicable. In its final opinion and judgment, the tribunal gave no weight to the income approach. That decision has not been challenged on appeal.

6. Comparable 6 was a former furniture store built in 1986, located in Flint, Michigan, and had 53,474 square feet. The building was sold in 2010 and continues to function as a furniture store;

7. Comparable 7 was a former Kroger built in 1981, located in Dearborn, Michigan, and had 55,474 square feet. The building was sold in August 2010, but no detail is contained in the record about the current or future use of the building other than that it is intended for future retail use; and

8. Comparable 8 was a former Wal-Mart built in 1993, in Monroe, Michigan, and had 130,626 square feet. The building was sold in 2009 to be divided into multi-tenant space with current tenants being Dunham's Sports and Hobby Lobby. The property contained deed restrictions that prohibited use of the property as a grocery store over 35,000 square feet or a discount store over 50,000 square feet.

In his valuation report, Torzewski mentioned that Comparable 1 had deed restrictions. He did not reference deed restrictions with regard to any of the other comparables, nor did he make any adjustments for the existence of deed restrictions. At the hearing, however, Torzewski testified that most of the properties contained deed restrictions. Specifically, he acknowledged that Comparables 1, 3, 5, and 8 had use restrictions, but Comparables 6 and 7 did not.[2] He testified that he took the deed restrictions into account, explaining that in selecting comparables, he would inquire if the deed restrictions affected the sales price. He stated that if he could not get that information he would not use the sale as a comparable. He testified that "in many cases" deed restrictions did not "have any effect on the sales price because the restrictions that were in place aren't anything really out of the ordinary or would affect the secondary user of the property, so, therefore, we—in the conditions of the sales adjustment . . . grid there are no adjustments for that condition of sale factor." Torzewski explained that it was "pretty common for build-to-suit owners" to put deed restrictions on their property "to exclude any sort of use that might be a competitive use." He testified that, after speaking to the brokers, sellers, and buyers, he was satisfied that the deed restrictions had no impact on the price obtained for the comparables used in the valuation for Menard. However, Torzewski's appraisal report showed that Comparables 6 and 7, the ones he noted had no restrictions, had the highest selling price per square foot.

After making adjustments for other differences in the comparables, Torzewski concluded that the subject premises should be valued at $20 per square foot for tax years 2012, 2013, and 2014.

Diana Norden, the city assessor for Escanaba, opined that the comparables used by Torzewski were "not great." She testified that, after researching Menard's comparables, she learned: Comparable 1 was subject to a building easement and had use restrictions, Comparable 2 was not a freestanding unit but had multiple storefronts, Comparable 3 looked like someone

[2] According to Torzewski, the "larger, more big-box-type stores did have some deed restrictions in place" as opposed to "a couple of the smaller [comparables]," which did not have restrictions.

buying themselves out of a lease, Comparable 4 had been foreclosed on, and Comparables 5 and 8 had use restrictions. Criticism of Menard's comparable selection was also offered by Miles Anderson, an expert in appraisal review. He, like Norden, testified that Comparable 1 had use restrictions. More generally, he criticized Menard's appraisal for failing to state, explain, or make adjustments for use restrictions on the sales comparables.

In support of its assessment of value, Escanaba submitted a valuation summary prepared by Norden. Norden primarily used the cost-less-depreciation approach to value the property. She testified that she used the cost-less-depreciation approach because there were insufficient comparable sales and because the building being valued was a newer construction. She opined that properties with deed restrictions should not be compared to the subject property, which had no use restrictions in place. She testified that she adjusted the value for depreciation, but that she did not adjust for functional obsolescence. Norden, who was admitted as an expert in appraisal, opined that there was no functional obsolescence in the property because, if purchased for its existing use, other retailers would use the components of the existing building.

By contrast, Torzewski testified that he did not use the cost-less-depreciation approach because functional obsolescence is built into built-to-suit big-box stores, and because, in a down market, a property like the subject property would have external obsolescence. He testified that both the functional and external obsolescence need to be accounted for in depreciation under the cost-less-depreciation approach, but that with this building, accounting for the obsolescence would be difficult. Torzewski also stated that the buyers of similar buildings do not use the cost-less-depreciation approach and that owners of properties like the subject property are typically not concerned with reselling, but are instead looking to maximize their floor space. Torzewski did not, however, identify any specific features of the building that created functional obsolescence, nor did he identify any economic factors in the subject market that would account for external obsolescence.

Following a hearing, the tribunal concluded that the TCV for 2012 was $3,325,000, the TCV for 2013 was $3,490,000, and the TCV for 2014 was $3,660,000. In its reasoning, the tribunal concluded that Escanaba's cost-less-depreciation approach should be given no weight because Norden did not account for functional or external obsolescence. The tribunal also credited Menard's assertion that the cost-less-depreciation approach should not be used to value the subject property because (1) functional obsolescence is difficult to calculate and (2) first-generation users are concerned with optimizing sales, not with optimizing market value to the property. The tribunal also concluded that Norden's sales-comparison approach did not provide sufficient data for the tribunal to arrive at an independent conclusion because Norden did not make any analytical adjustments for differences in the properties. By contrast, the tribunal concluded that the sales-comparison approach advanced by Menard was persuasive and was meaningful to an independent determination of market value. On reconsideration, the tribunal specifically found that the deed restrictions in Menard's comparables did not require an adjustment because it found credible Torzewski's testimony that the deed restrictions had no effect on the sales price of the deed-restricted comparables.

II. STANDARD OF REVIEW

In the absence of fraud, our review of Tax Tribunal determinations "is limited to determining whether the tribunal made an error of law or adopted a wrong legal principle." *Meijer, Inc v City of Midland*, 240 Mich App 1, 5; 610 NW2d 242 (2000). "The tribunal's factual findings are upheld unless they are not supported by competent, material, and substantial evidence." *Id.* Substantial evidence is "evidence that a reasoning mind would accept as sufficient to support a conclusion." *Kotmar, Ltd v Liquor Control Comm*, 207 Mich App 687, 689; 525 NW2d 921 (1995). "Substantial evidence must be more than a scintilla of evidence, although it may be substantially less than a preponderance of the evidence." *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 352-353; 483 NW2d 416 (1992). "Failure to base a decision on competent, material, and substantial evidence constitutes an error of law requiring reversal." *Meijer, Inc*, 240 Mich App at 5. The entire record, "not just the portions that support the agency's findings," must be reviewed when evaluating the tribunal's final determination. *Stege v Dep't of Treasury*, 252 Mich App 183, 188; 651 NW2d 164 (2002). Further, cursory rejection of evidence is also erroneous. *Jones & Laughlin Steel Corp*, 193 Mich App at 354.

The petitioner, Menard, bears the burden of proving the true cash value (TCV) or the property. MCL 205.737(3).

> The burden of proof encompasses two concepts: "(1) the burden of persuasion, which does not shift during the course of the hearing; and (2) the burden of going forward with the evidence, which may shift to the opposing party." *Jones & Laughlin Steel Corp*, [193 Mich App at 354-355]. Nevertheless, because Tax Tribunal proceedings are de novo in nature, the Tax Tribunal has a duty to make an independent determination of true cash value. *Great Lakes Div of Nat'l Steel Corp*[*v City of Ecorse*, 227 Mich App 379, 409; 576 NW2d 667 (1998)]. Thus, even when a petitioner fails to prove by the greater weight of the evidence that the challenged assessment is wrong, the Tax Tribunal may not automatically accept the valuation on the tax rolls. *Id.* at 409. Regardless of the method employed, the Tax Tribunal has the overall duty to determine the most accurate valuation under the individual circumstances of the case. *Meadowlanes Ltd Dividend Housing Ass'n v City of Holland*, 437 Mich 473, 485–486, 502; 473 NW2d 636 (1991). [*President Inn Props, LLC v City of Grand Rapids*, 291 Mich App 625, 631; 806 NW2d 342 (2011).][3]

[3] Menard asserts that Escanaba, as the appellant, now bears the "burden of proof" in establishing the TCV of the subject property. This is not strictly accurate. On appeal, in order for the appellant to receive relief, it has the burden to demonstrate that the lower court erred as governed by the relevant standard of review. However, at the tribunal, initially and on remand, the burden of proof to establish TCV is on the petitioner. *President Inn Props*, 291 Mich App at 631. Menard relies on *Drew v Cass Co*, 299 Mich App 495; 830 NW2d 832 (2013) in suggesting that the "burden of proof" is on the taxing authority when it is the appellant. Indeed, in *Drew*, we stated, "[t]he appellant bears the burden of proof in an appeal from an assessment, decision, or order of the Tax Tribunal." *Id.* at 499 (quotation omitted). In that case, however, the petitioner,

III. APPROACHES TO VALUATION

"The Tax Tribunal is under a duty to apply its expertise to the facts of a case in order to determine the appropriate method of arriving at the true cash value of property, utilizing an approach that provides the most accurate valuation under the circumstances." *Great Lakes*, 227 Mich App at 389. TCV "means 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 . . . or forced sale." MCL 211.27(1). TCV is the equivalent of the property's fair market value. *Great Lakes*, 227 Mich App at 389.

"[T]o determine true cash value, ***the property must be assessed at its highest and best use***." *Huron Ridge, LP v Ypsilanti Twp*, 275 Mich App 23, 33; 737 NW2d 187 (2007) (emphasis added). The concept of "highest and best use . . . recognizes that the use to which a prospective buyer would put the property will influence the price that the buyer would be willing to pay for it." *Great Lakes*, 227 Mich App at 408. "The concept . . . is fundamental to the determination of true cash value." *Detroit Lions, Inc v Dearborn*, 302 Mich App 676, 697; 840 NW2d 168 (2013). "Highest and best use" is defined as " '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.' " *Id.*, quoting *Detroit/Wayne Co Stadium Auth v Drinkwater, Taylor & Merrill, Inc*, 267 Mich App 625, 633; 705 NW2d 549 (2005). The tribunal is required to make a determination of a subject property's highest and best use. *Detroit Lions*, 302 Mich App at 697.

The parties agree that the highest and best use of the property is as an owner-occupied freestanding retail building.[4] Their disagreement lies in the valuation methodologies to be

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not the respondent, was the appellant. *Id.* at 496. The *Drew* Court cited *ANR Pipeline Co v Dep't of Treasury*, 266 Mich App 190, 198; 699 NW2d 707 (2005) in support of the proposition. The petitioner, not the respondent, was the appellant in *ANR Pipeline. Id.* at 191. The *ANR Pipeline* Court cited *Dow Chem Co v Dep't of Treasury*, 185 Mich App 458, 463; 462 NW2d 765 (1990) in support of the proposition. In *Dow Chem*, however, the petitioner was also the appellant. *Dow Chem Co*, 185 Mich App at 459. The *Dow Chem* Court cited *Holloway Sand & Gravel Co Inc v Dep't of Treasury*, 152 Mich App 823, 831 n 2; 393 NW2d 921 (1986), another case where the appellant and the petitioner were the same party. *Id.* at 831. Critically, the *Holloway Sand & Gravel* Court relied on MCL 205.7, which, at the time had already been repealed by 1980 PA 162. Prior to its repeal, MCL 205.7 provided that "[t]he burden of proof in any appeal from any assessment, decision or order shall rest with the appellant," but, critically, the statute referred to the appellant and the taxing authority as separate entities. See 1941 PA 122, § 7, now codified at MCL 205.22. Accordingly, we conclude that the statement in *Drew* that the burden of proof is on the appellant does not shift the burden to establish TCV from petitioner to respondent. Rather, in its proper context, it is apparent that the reference to "appellant" in *Drew* and its progeny actually refers to petitioner.

[4] Escanaba and the amicus argue that the tribunal failed to make an explicit determination of the property's HBU. However, we find that such a finding is implicit in the tribunal's decision, which recounted in the findings of fact that the parties did not dispute the HBU. Given that the

employed and the data relevant to the valuation. The three valuation methodologies that have been "found acceptable and reliable by the Tax Tribunal and the courts" are the cost-less-depreciation approach, the sales-comparison or market approach, and the capitalization of income approach. *Meadowlanes Dividend Housing Ass'n*, 437 Mich at 484-485. While, if possible, all three methods should be used, the "final value determination must represent the usual price for which the subject property would sell" irrespective of the specific method employed. *Id.* at 485.

As noted, the parties and the tribunal agreed that the income approach does not apply in this case. The tribunal also rejected the cost-less-depreciation approach advanced by Escanaba, but found the values in Menard's sales-comparison approach to be meaningful.

A. SALES-COMPARISON APPROACH

We first examine whether the tribunal's reliance on the sales-comparison approach advanced by Menard was supported by competent, material, and substantial evidence.

Menard owns a fee simple interest in the subject property. The property, as it currently exists, is not subject to any use restrictions. However, half of the comparables in Torzewski's sales-comparison valuation contained deed restrictions that limited the use of the properties for retail purposes, thereby preventing sale of an entire fee simple interest in the property. Torzewski failed to mention all the deed restrictions in his valuation report, did not make any adjustments for their existence, and, during his testimony, he insisted that the restrictions did not affect the value of the comparables because the parties involved in the comparable sales told him that the restrictions did not affect the sale price. The tribunal accepted Torzewski's testimony and used the deed-restricted comparables in its determination of value. We conclude that the tribunal's finding was based on an error of law and was not supported by competent, material, and substantial evidence.

In *Helin v Grosse Pointe Twp*, 329 Mich 396, 407-408; 45 NW2d 338 (1950), our Supreme Court recognized that deed restrictions in property that prohibited its use for an "apartment house, multiple residence, or institutional purposes" would have an effect on the value of the property. Accordingly, it would be error to fail to consider "deed restrictions in establishing assessments[.]" *Kensington Hills Dev v Milford*, 10 Mich App 368, 372; 159 NW2d 330 (1967). This Court emphasized further in *Lochmoor Club v Grosse Pointe Woods*, 10 Mich App 394, 397-398; 159 NW2d 756 (1968), that all factors, including "restrictions imposed" on property must be considered in determining a property's TCV.

Although Torzewski testified that he considered the deed restrictions, the record is insufficient to support his assertion that they had no effect on the sales price for the restricted comparables. His testimony is that he consulted the brokers, sellers, and buyers of the comparables. Thus, that testimony is only sufficient to establish that ***to the parties involved in the actual transaction***, the deed restrictions did not affect the sales price they were willing to

matter was not contested and that the tribunal recognizes the agreed-upon HBU, we conclude that the tribunal did not err by not expressly stating the HBU.

pay. In other words, the market for sale was limited to those purchasers who were willing to accept the restrictions and so did not reflect the full value of the unrestricted fee simple.

However, in assessing TCV, the property "must be assessed at its highest and best use," *Huron Ridge*, 275 Mich App at 33, which in this case is as an owner-occupied freestanding retail building. Deed restrictions that limit the ability of prospective buyers to use the comparable properties for the subject property's HBU necessarily limit, if not eliminate, the willingness of those buyers to purchase the restricted property. Those who would be interested in buying the property *with restrictions* would need to make modifications to convert the building from retail to something else, like industrial use. Given the need to convert, the buyers would necessarily pay a lower price.

For the same reasons, the anti-competitive nature of the deed restrictions means that the deed-restricted comparables could not be sold for their HBU. The potential buyers of the comparables were therefore limited to buyers willing to accept the use restrictions. Further, because of the prevalence of the self-imposed deed restrictions on big-box stores, there is essentially no market for big-box stores being sold for the HBU of the subject property. Thus, half of Torzewski's comparables were not evaluated at the HBU of the subject property because the deed restrictions expressly prohibited their use as a freestanding retail center.

On this record, there is no evidence to account for the impact of the deed-restricted properties being sold for purposes other than the HBU of the subject property. It is plain that no adjustments were taken for this major difference in the subject property and the restricted comparables. Accordingly, we conclude that the tribunal erred in finding Menard's sales-comparison approach meaningful to its determination of the subject property's TCV. The tribunal did not value the subject property at its HBU, an owner-occupied freestanding retail building, but instead valued it as a former owner-occupied freestanding retail building that could no longer be used for its HBU and could best be used for redevelopment for a different use. In doing so, the trial court made an error of law by failing to value the subject property at its HBU.

B. COST-LESS-DEPRECIATION APPROACH

The tribunal rejected the cost-less-depreciation approach advanced by Escanaba. However, because the deed restrictions imposed by other big-box store owners drastically limited the actual market for such properties, it is appropriate to look at the cost-less-depreciation approach.[5]

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[5] Menard argues that use of the sales-comparison approach over the cost-less-depreciation approach is supported by this Court's two recently issued unpublished opinions on the valuation of similar "big-box" stores in *Lowe's Home Ctrs v Twp of Marquette*, unpublished opinion per curiam of the Court of Appeals, issued April 22, 2014 (Docket Nos. 314111 and 314301), and *Lowe's Home Ctrs Inc v Grandville*, unpublished opinion per curiam of the Court of Appeals, issued December 30, 2014 (Docket No. 317986). We disagree. In those cases, the salient issue was whether, using the sales-comparison approach, comparables should be to the fee simple

"The adjusted-cost-of-reproduction-less-depreciation method is most suitable for industrial facilities for which no market, an inadequate market, or a distorted market exists." ***Tatham v Birmingham***, 119 Mich App 583, 591; 326 NW2d 568 (1982). Here, although there is evidence of a market for big-box stores when they are sold for secondary purposes, there is limited evidence as to whether there is a market for big-box stores at the subject property's HBU. Instead, Torzewski testified that large big-box stores commonly had deed restrictions for anti-competitive purposes, and Norden testified that she could not locate a sufficient number of unencumbered comparables to make adjustments in her sales-comparison approach. As such, the cost-less-depreciation approach is appropriate to value the TCV of the property.

In *Clark Equip Co v Leoni*, 113 Mich App 778, 782-783; 318 NW2d 586 (1982), this Court approached the problem of determining the TCV of an industrial facility. In that case, all of the property's appraisers determined that the industrial property's current use was "also its highest and best use." *Id.* at 782. This Court described the difficulty in determining the TCV to such property and the appropriate solution as follows:

> The reality is that these types of industrial plants are rarely bought and sold . . . . However, as we construe MCL 211.27; MSA 7.27, to the extent that an industrial plant is not so obsolete that, if a potential buyer did exist who was searching for an industrial property to perform the functions currently performed in the subject plant, said buyer would consider purchasing the subject property, the usual selling price can be based upon value in use. . . . To construe MCL 211.27; MSA 7.27, as requiring the taxing unit to prove an *actual* market for a property's existing use would lead to absurd undervaluations. Large industrial plants are constructed to order, in accordance with the exact specifications of the purchasing user. . . . It is ludicrous to conclude, however, that such a brand new, modern, industrial facility is worth significantly less than represented by its replacement cost premised on value in use because, in actuality, such industrial facilities are rarely bought and sold. Thus, we hold that, to the extent a large industrial facility is suited for its current use and would be considered for purchase by a hypothetical buyer who wanted to own an industrial facility which could operate in accordance with the subject property's capabilities, said facility must be valued as if there were such a potential buyer, even if, in fact, no such buyer (and therefore no such market) actually exists. [*Id.* at 784-785 (emphasis in original).]

In other words, *Clark* provides that (1) when the HBU of the property is its existing use and (2) when because the property is built-to-suit there would be little to no secondary market for the

alone or the fee simple plus the value to an occupier of an already existing leasehold or operating business. We determined in both cases, over the objection of the taxing authority, that because the subject premises was owner occupied, it must be valued as if vacant and available. ***Lowe's Home Ctrs v Twp of Marquette***, unpub op at 1, and ***Lowe's Home Ctrs Inc v Grandville***, unpub op at 7. In other words, those cases held, as do we, that what must be valued is what would actually be sold. In those cases, the sales would be of the property without an existing lessee or operating retail business. In this case, what is being valued is the property without deed restrictions limiting its use.

property where it would still 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.

In *Great Lakes*, this Court elaborated that "valuation can be determined strictly on a hypothetical basis, with the hypothetical buyer looking at the costs of building a new facility to determine the usual price of an existing facility even if a real buyer would not consider building such a facility." *Great Lakes*, 227 Mich App at 403. However, the hypothetical buyer need not "be presumed to have considered building an industrial facility as an alternative to purchasing an existing one when no such facility would be built ***and*** that hypothetical buyer has the ability to see what is occurring in the marketplace of existing facilities." *Id.* (emphasis in original). Thus, *Great Lakes* states that the holding of *Clark* should not be applied when (1) no facility like the subject facility would actually be built, and (2) a buyer has the ability to see what is occurring in the marketplace of existing facilities. In the present case, there is no indication that "big-box stores" like the subject are not being built. Additionally, because such big-box stores are not typically sold on the marketplace for use as "big-box stores," a buyer does not have the ability to see what is occurring in the marketplace of existing facilities. Thus, the limitation in *Great Lakes* does not apply and this case is governed by *Clark*.

In the present case, given that multiple valuation methods should be used when possible, *Meadowlanes*, 437 Mich at 485, and that the analysis in the first issue shows that the comparables that the tribunal used in this case were not appropriate, the tribunal committed error in refusing to consider Escanaba's evidence under the cost-less-depreciation approach. The evidence demonstrates that owner-occupied freestanding retail buildings like the subject, which Menard describes as "big-box stores," have many similar qualities to the industrial properties that this Court addressed in *Clark*. Both are constructed or built to order to conform to the specifications of the purchasing user and are rarely sold on the open market for their current use. Similar to the plant at issue in *Clark*, there is no indication in the record that the subject premises is not a new, modern facility capable of fully functioning as a freestanding retail center just as the industrial center in *Clark* was modern enough for continued use of the industrial purpose it was designed for. *Clark*, 113 Mich App at 782-783. Therefore, like the industrial plant in *Clark*, it would not be appropriate to value the subject property significantly less than its replacement costs simply because owner-occupied freestanding retail spaces are rarely bought or sold for use as owner-occupied freestanding retail spaces on the open market. Like the industrial plant in *Clark*, the subject premises is well-suited for its current use and would be considered by a hypothetical buyer who wished to own a freestanding retail building in accordance with the subject's capabilities, and, therefore, the property must be valued "as if there were such a potential buyer, even if, in fact, no such buyer . . . actually exists." *Id.* at 785.

Additionally, Menard's and the tribunal's reliance on the concept of functional obsolescence to discredit using the cost-less-depreciation approach is misplaced. The tribunal rejected the cost-less-depreciation approach advanced by Escanaba in part because it concluded that Norden failed to adjust for functional obsolescence.[6] Norden, however, testified that she did not adjust for functional obsolescence because there was none in the subject property. She explained that, considering the property's HBU, the same building would be built by Menard if it were to build a new store. Further, she testified that the existing building would be used in essentially the same fashion if a competitor were to purchase the property. Although Torzewski testified that it would be difficult to value functional obsolescence, he did not identify any functional obsolescence presently in the subject property, other than to suggest that the building was automatically functionally obsolete the moment it was completed. He also suggested in general terms that there was external obsolescence because the market for big-box stores was a "down market" because there was little to no demand for the properties.

There was no evidence in the record of any deficiency in the subject premises that would inhibit its ability to properly function as an owner-occupied freestanding retail building. The functional obsolescence to which Menard refers appears to be the fact that, due at least in part to self-imposed deed restrictions that prohibit competition, such freestanding retail buildings are rarely bought and sold on the market for use as such but are instead sold to and bought by secondary users who are required to invest substantially in the buildings to convert them into other uses, such as industrial use. However, as stated in ***Clark***, to read MCL 211.27 "as requiring the taxing unit to prove an ***actual*** market for a property's existing use would lead to absurd undervaluations." ***Clark***, 113 Mich App at 785 (emphasis in original). Therefore, the tribunal erred by failing to consider evidence under the cost-less-depreciation approach.[7]

IV. CONCLUSION

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[6] To determine the present TCV of property under the cost-less-depreciation approach, depreciation must be subtracted from the replacement costs. ***Teledyne Continental Motors v Muskegon Twp***, 145 Mich App 749, 755; 378 NW2d 590 (1985). Depreciation includes functional obsolescence. ***Id.*** "Functional obsolescence is a loss in value brought about by failure or inability to deliver full service." ***Id.*** It can include loss of value due to "shortcomings or undesirable features contained within the property itself. . . . such as poor floor plan, inadequate mechanical output, or functional inadequacy or superadequacy due to size or other characteristics." ***Id.***

[7] Escanaba also argues that the tribunal's decision should be reversed because it accepted a non-authoritative definition of the phrase "big-box" store. Menard's expert relied on a definition of "big-box store" from the Dictionary of Real Estate Appraisal, whereas Escanaba's expert in appraisal review relied on definitions from Investopedia, Wikipedia, and businessdictionary.com. However, the closest the tribunal came to addressing the debate over the definition of the term "big-box" store was when it criticized Escanaba's expert's use of "internet definitions." The tribunal did not, however, adopt the definition of "big-box" store advocated by Menard or base its conclusions regarding the sales-comparison approach or the cost-less-depreciation approach on Menard's definition of "big-box" store.

The tribunal committed an error of law requiring reversal when it rejected the cost-less-depreciation approach and adopted a sales-comparison approach that failed to fully account for the effect on the market of the deed restrictions in those comparables. Given this error, and the fact that there is little if any evidence in the record as to the impact of the deed restrictions on the comparables, we conclude that it is inadequate to simply remand to the tribunal for a new determination as to value. Instead, on remand, the tribunal shall take additional evidence with regard to the market effect of the deed restrictions. If the data is 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.[8] After allowing the parties the opportunity to present additional testimony in light of the deficiencies identified in this opinion, the tribunal shall make an independent determination of the property's TCV using correct legal principles. In doing so, the tribunal must "apply its expertise to the facts of a case in order to determine the appropriate method of arriving at the true cash value of property, utilizing an approach that provides the most accurate valuation under the circumstances." *Great Lakes*, 227 Mich App at 389.

Reversed and remanded. We do not retain jurisdiction.

/s/ Michael J. Talbot
/s/ Joel P. Hoekstra
/s/ Douglas B. Shapiro

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[8] As noted above, the parties agree that the income approach is inapplicable.

STATE OF MICHIGAN
IN THE SUPREME COURT
Appeal from the Michigan Court of Appeals
Hon. C.J. Talbot, Hon. Hoekstra and Hon. JJ Shapiro, Presiding

MENARD, INC.

Petitioner/Appellant,

v

CITY OF ESCANABA,

Respondent/Appellee.

Supreme Court Docket No. 154062

Court of Appeals No. 325718

MTT Docket Nos. 00-441600
(Consolidated) 14-001918

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STATE OF MICHIGAN)
) ss.
COUNTY OF INGHAM)

Cassandra A. Jackway, being first duly sworn, deposes and says that she is employed with McClelland & Anderson, L.L.P. and that she served a copy of Michigan REALTORS'® Corrected Supplemental *Amicus Curiae* Brief in Support of the Supplemental Brief of Appellee City of Escanaba to Deny the Application for Leave to Appeal upon counsel of record by placing same in envelopes addressed as above, with proper first class postage affixed thereto, and by causing the same to be deposited in a mail receptacle maintained by the U.S. Government in Lansing, Michigan on May 2, 2017.

Cassandra A. Jackway

Signed and sworn to before me in
Ingham County, Michigan on May 2, 2017.

COLLEEN K. OXBY
NOTARY PUBLIC - STATE OF MICHIGAN
COUNTY OF INGHAM
My Commission Expires April 17, 2020
Acting in the County of Ingham

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May 2, 2017

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Michigan Supreme Court
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Lansing, MI 48915

Re: *Menard, Inc. v City of Escanaba*
SC Docket No. 154062
COA Docket No. 325718
MTT Docket Nos. 00-441600 & 14-001918 (consolidated

Dear Clerk:

Enclosed for filing, please find Michigan REALTORS®' Corrected Supplemental *Amicus Curiae* Brief in Support of the Supplemental Brief of Appellee City of Escanaba to Deny the Application for Leave to Appeal with Proof of Service of same in this matter. Thank you.

Very truly yours,

Melissa A. Hagen

MAH/caj
Enclosure
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