by Benjamin A. Blair, JD

Recent Court Decisions on Real Estate and Valuation

Unadjusted sales of leased properties are not comparables in property tax valuation of grocery store

Kroger is a grocery store chain that owns, in fee simple, a parcel of land and improvements in Georgetown, Kentucky. The property consists of 12 acres of land and a 130,000-square-foot retail building primarily occupied by a Kroger grocery store.

For the 2015 tax year, the Scott County Property Valuation Administrator (PVA) valued the property at $15.2 million. Kroger disputed this valuation, initially seeking review with the County Board of Assessment Appeals, then with the state Board of Tax Appeals (Board). Kroger asserted that the PVA's valuation was arbitrary, because it was not based on admissible evidence of value and was improperly based on a value-in-use methodology. In opposition, Kroger offered an appraisal opinion of fair cash value of $6.7 million—$4.1 million for the improvement and $2.6 million for the land. Kroger's appraiser used the sales comparison and income approaches to value the property.

Before the Board, Kroger's appraiser explained that he valued the property at its fair market value for the fee simple title because no lease was in place. Therefore, he searched for sales of properties being sold in fee simple and large enough to be comparable to the grocery store. Although those properties were primarily outside the local area, they were all sales of large single-occupant properties.

Kroger's appraiser also addressed the comparable properties provided by the PVA. Those properties, according to the appraiser, were purchased subject to a lease, rather than in fee simple. Also, the PVA's comparables included properties sold as part of a portfolio and a Section 1031 exchange, which the appraiser explained would affect the parties' motivations in negotiating a sale price.

In response, the PVA's chief deputy explained that he relied on Kroger's actual construction costs in setting the assessment, but that he also identified sales of purportedly comparable properties. He did not make adjustments to account for vacancy or occupancy at the time of the sale, because, in the chief deputy's opinion, the sale price represents each property's fair market value and thus no adjustment was needed.

The Board entered a final order upholding the PVA's assessment, because the PVA's sales were transactions of occupied properties, which the Board found to be more comparable to the subject property than Kroger's vacant property sales from outside Kentucky. Kroger appealed to the county circuit court, which denied the appeal, and then to the court of appeals.

On appeal, Kroger argued that there was insufficient evidence to support the Board's final order. Kroger contended that the PVA's use of unadjusted sales of leased properties and original construction costs did not constitute substantial evidence, and that Kroger's appraiser had explained why each sale was not a reliable indicator of the property's value. The court of appeals agreed with Kroger.

The court observed that all of the PVA's comparable sales were subject to leases. A lease has its own value. Under prior case law, the fair market value of a leasehold could be ascertained by subtracting the fair market value of the land if sold subject to the lease from the fair market value of the land as if sold free and clear of the lease. Furthermore, additional information is needed to value properties with leases, including the terms of the lease, requirements for maintenance and improvements, fixed or percentage rent, length and duration of the lease, options for increases or decreases, and "the type of tenants and his financial stability."

Because the PVA did not introduce any evidence to apply the necessary adjustments to the sales of leased properties, the court agreed with Kroger that the evidence it presented to counter the PVA's assessment compels a finding that the property was overvalued. As Kroger's appraiser explained, each of the sales the PVA relied on was not truly comparable to the subject property. Therefore, those sales could not provide a basis for the PVA's assessment, and the circuit court erred in affirming the Board's final order.

The court of appeals reversed the Board's decision and remanded the case for reconsideration of the proper assessment using proper evidence.

Kroger Ltd. P'ship I v. Jenkins
Kentucky Court of Appeals
July 17, 2020
No. 2019-CA-001133-MR

Approved final development plan not subject to ordinances that have the effect of a zoning change

Shipyard Associates LP (Shipyard) owns several pieces of waterfront property abutting the Hudson River in Hoboken, New Jersey (City). In 1997, the City Planning Board approved Shipyard's proposal to develop several luxury high-rise apartment buildings, commercial retail units, parking garages, a park, and a waterfront promenade on the property. The proposal also included three tennis courts and a tennis pavilion available to the fee-paying public, which would be built on a platform extending into the river. Shipyard developed most of the property in substantial accordance with the agreement. But in August 2011, Shipyard filed an application with the planning board seeking to amend the site plan approval and replace the tennis facilities with two eleven-story residential buildings. The City was dissatisfied with the proposed changes and attempted to block Shipyard from moving forward. Notwithstanding the City's opposition, the state Department of Environmental Protection issued a waterfront development permit to Shipyard.

Following several lawsuits and administrative proceedings, the planning board voted to deny Shipyard's new application without holding a hearing. Shipyard filed suit seeking automatic approval of its application under the Municipal Land Use Law (MLUL), and a trial court agreed with Shipyard that the failure of the board to hold a hearing compelled automatic approval of the plans. This decision was upheld on appeal.

In late 2013, while these proceedings were pending, the City passed two ordinances affecting Shipyard's proposed plans. The first was a zoning ordinance that prohibited new construction or substantial improvement of existing structures on piers or platforms projecting into the river. The second, passed under the City's police powers, required all construction to be "landward of the mean high tide" except for port and shipbuilding facilities and "open space and outdoor passive and active recreational uses." Shipyard's pier was seaward of the mean high tide, and its proposal would not satisfy either of these permitted uses.

Shipyard filed suit challenging the City's proposed application of the ordinances to its approved plans. Shipyard argued that the prior appellate decision finalized its application, thereby insulating it from any zoning ordinances passed within two years of its final approval, by operation of the MLUL. The City, in response, argued that the second ordinance was a general environmental regulation, not a zoning ordinance, and therefore not subject to the two-year protection. In 2017, the trial court agreed with Shipyard, finding that the ordinance was functionally a zoning ordinance because it fundamentally changed the zoning of the land where the project was to be built. The City appealed.

On appeal, the City emphasized that it had enacted the ordinance under its police power to amend the City's flood-damage-prevention requirements, not the zoning requirements, and that therefore the two-year protection did not apply. In response, Shipyard emphasized that the ordinance established a new permit requirement and contained provisions regulating construction, utilities, subdivisions, and new development, and thus, no matter what the City called it, the ordinance operated as a zoning ordinance and subverted the two-year protection.

The court agreed that zoning is a police power vested in the legislative branch, but that the MLUL assigned zoning powers to municipalities so they could regulate land development in a manner that promotes public health, safety, and welfare. But in evaluating an ordinance, the court considers not only how the city characterizes it, but also how the ordinance functions in practice. Here, the court agreed with Shipyard that the ordinance was a zoning ordinance. Before the enactment, Shipyard could build residential high-rises on the pier, but the ordinance eliminated any possibility of moving forward with the project. It was thus a fundamental change to the zoning of the land.

The City also argued, in the alternative, that the MLUL contains various exceptions for the application of regulations pertaining to public health and safety. The City thus suggested that the court read the public health and safety exceptions into the two-year protection, which was in a different section of the statute. The court declined such a reading. Because the legislature included public health and safety exceptions only in the sections applying to preliminary approvals, not final approvals, the court interpreted the plain language of the statute as contemplating greater protections for developers at successive stages of the approval process.

Having determined that the MLUL provided the holder of a final approval with vested rights for two years against even those changes in zoning pertaining to public health and safety, the court concluded that the two-year period of protection had been tolled while the litigation progressed. Therefore, the court concluded that the City could not use either of the ordinances to amend the zoning requirements for Shipyard's project.

Shipyard Associates LP v. City of Hoboken
New Jersey Supreme Court
May 5, 2020
230 A.3d 278

Home renovation breach of contract award may include both out-of-pocket and benefit-of-the-bargain damages

Justin Moore could not afford a home in the San Francisco neighborhoods he preferred. He contacted Richard Teed, a real estate agent who promoted himself as a building contractor with an extensive background in historic renovations and quality construction. Teed told Moore that he could locate a lower-priced fixer-upper home in a choice neighborhood and renovate it in a cost-effective manner. After touring examples of other homes Teed had renovated, Moore retained Teed as his real estate agent.

In May 2011, Moore bought a large fixer-upper for \$4.8 million. Moore borrowed significantly from his father and a bank to purchase the house, and Teed received a commission on the sale. Teed proposed renovating the basement to create a "below-ground floor Grade A living space," as well as modernizing and expanding other rooms in the house. Teed and Moore had in-depth discussions about the costs of construction. Moore expected that for \$900,000, Teed would deliver the home renovated to the same high-end standard as the other projects they had toured. The parties did not sign a written contract, but Moore nonetheless believed the parties had an oral agreement.

Based on his interactions with Teed and Teed's promotional materials, Moore believed Teed was a general contractor in addition to a real estate agent. In fact, Teed was not a licensed contractor. Teed's team gutted large parts of the house and built a defective foundation that lacked waterproofing despite the property's high water table. After Moore became aware of the defects, he halted all work on the project, and his father engaged consultants who concluded that the foundation had to be torn out and replaced. Moore hired a new architect and contractor who completed the promised work at a much higher cost than Teed had estimated.

In August 2013, Moore filed suit against Teed. Moore alleged that he was fraudulently induced to purchase and renovate the property based on false representations. Moore eventually expanded the renovation beyond what Teed had originally proposed at a cost of $9 million, but Moore did not seek damages for those additions.

At trial, Moore offered the testimony of a construction cost estimator who opined that Teed's estimates had been unrealistically low and that construction costs had increased in the time it took to replace the foundation. Moore sought damages in the amount of the difference between Teed's promised renovation cost of $900,000 and the estimated $4.47 million cost to do that work. Teed argued that there was no promised remodel, and that Moore's alleged damages did not represent any loss that was actually sustained by Moore. The jury found for Moore on most of his claims, awarding "benefit-of-the-bargain" damages of $900,000 and out-of-pocket damages of $822,904 for the actual cost to replace the foundation, plus additional damages for delay and attorney fees. Teed appealed.

Teed challenged the damages award on several grounds. First, he claimed that benefit-of-the-bargain damages cannot be awarded alongside out-of-pocket damages as a matter of law and that benefit-of-the-bargain damages are not a permissible form of recovery for fraud actions involving purchases of real estate. The court of appeal found no merit to these contentions.

There are two measures of damages for fraud: out-of-pocket and benefit-of-the-bargain. Out-of-pocket damages are intended to restore the plaintiff to the financial position enjoyed prior to the fraudulent transaction, awarding the difference in actual value at the time of the transaction between what the plaintiff gave and what he received. Benefit-of-the-bargain damages are concerned with putting the plaintiff in the position he would have enjoyed if the false representation relied upon had been true. Teed contended that these two types of damages cannot both be awarded on a tort claim, but the court concluded that where the defrauding party has a fiduciary duty to the victim of fraud, a broader measure of damages than just out-of-pocket losses may be awarded.

Teed also argued that the benefit-of-the-bargain damages award was improper because the scope of the promised work and the actual value received were not definite and concrete. According to Teed, Moore's damages were too speculative because the project that Teed said would cost $900,000 was never built due to extensive revisions Moore made to the plans over time. Teed also argued that the cost estimation expert could not re-create the cost of building such a project under 2011–2012 rates, and the estimator had not relied on the actual costs to complete the project. On both arguments, the court disagreed with Teed. The court concluded that the estimator's testimony established the projected costs with reasonable certainty, based on floor plans and specifications directly tied to Teed's original proposal. The jury's award was thus not improperly speculative, and the court affirmed the jury's award of damages.

Moore v. Teed
California Court of Appeal, First District
April 24, 2020
48 Cal. App. 5th 280

Property appurtenant to golf course qualifies for conservation easement deduction

Pollard Land Company bought over 2,000 undeveloped acres along the Savannah River north of Augusta, Georgia. In 2002, Pollard conveyed 463 acres of the land to Champions Retreat Golf Founders LLC (Champions). On the land, Champions built a golf course consisting of three nine-hole courses, each designed by a celebrated professional golfer. The course opened in 2005 and remains a private course open only to club members and their guests.

The golf course occupies roughly two-thirds of the 463 acres. Champions also sold 66 homesites on 95 acres on the west side of the course, away from the Savannah River. Thus, roughly 57 acres, consisting of bottomland forests and wetlands, remains undeveloped. This includes land on an island in the river that consists of both undeveloped land and six holes of the golf course.

The property is home to several species of birds, some of which are rare, and to the regionally declining southern fox squirrel, and to rare plant species. Although the land is not accessible to the public, the property is observable to members of the public who kayak or canoe on the river.

In 2009, the Champions golf course was struggling financially. After hearing of another case involving a deduction for conservation easements over golf course property, Champions contributed a conservation easement to the North American Land Trust (Trust). The easement covers 348 acres, including both the undeveloped land and the golf course and driving range, but not the golf course buildings or homesites. The Champions easement runs to the bank of the Savannah River; on the other side, 700 feet away, is a large national forest. Champions claimed a charitable deduction for the contribution, but the Internal Revenue Service (IRS) disallowed the deduction. The tax court upheld the IRS's decision, and Champions appealed.

The parties agreed that the easement met the requirement that the restriction be granted in perpetuity, and they agreed that the Trust was a qualified organization. There also was no question that the protection of "a relatively natural habitat of fish, wildlife, or plants" and the "preservation of open space… for the scenic enjoyment of the general public" constitute conservation purposes. The parties disagreed, however, about whether the contribution was made exclusively for those conservation purposes.

The Internal Revenue Code allows a deduction for an easement contributed for the protection of a habitat for rare, endangered, or threatened species or if the easement contributes to the ecological viability of a nearby national forest. These standards apply despite the presence of a golf course on part of the property.

The IRS's expert agreed that many birds use the property but explained that the habitat itself is not "relatively natural" on account of the fairways and greens, which consist of non-native grasses. But the court observed that the birds do, in fact, live on the property and "apparently find the habitat quite suitable." Furthermore, while the golf course itself is comprised of non-native grasses, the remainder of the easement property is natural and includes a rare species of plant. The court held that the IRS offered no theory why protecting that plant is not an appropriate conservation purpose. In total, the court agreed with Champions that the easement protected "a relatively natural habitat of fish, wildlife, or plants" consistent with the statutory requirements.

The IRS also argued that the land was not open to the general public, and thus could not be used for the scenic enjoyment of the property. The relevant regulation explains that preservation of land may be for the scenic enjoyment of the public if development of the property would impair the scenic character of the land or would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, or waterbody that is open to or used by the public.

Indisputably, members of the public canoe and kayak alongside and through the easement. And while the golf course itself might not provide scenic enjoyment, the natural areas covered by the easement do, and the golf course detracts little, if at all, from that visibility. Ultimately, therefore, the court concluded that the record established that Champions was entitled to a deduction in the proper amount. Because the tax court upheld the IRS's disallowance of the deduction, the tax court did not address the amount of the deduction, so the court remanded the case for the tax court to address that issue.

Champions Retreat Golf Founders LLC v. Commissioner of IRS
Eleventh Circuit Court of Appeals
May 13, 2020
959 F.3d 1033

Assessment of taxes on lessee-owned improvements is proper regardless of exempt lessor's revisionary interest

Yavapai County, Arizona, (County) owns and leases land to the Sedona Oak Creek Airport Authority (Airport Authority) to operate the Sedona Airport. In 1982, the Airport Authority subleased several acres to Sky Ranch Operations LLC (Sky Ranch), on which Sky Ranch would build and operate a lodge and resort. The sublease has been extended through 2050.

The Sky Ranch sublease provides that all buildings installed by the lessee "shall be and remain the property of Lessee during the term of this lease" but that upon termination of the lease, all buildings would become the property of the Airport Authority and the County.

For the 2016 and 2017 tax years, the County assessed and taxed Sky Ranch for the resort buildings as improvements on possessory rights. Sky Ranch sought a refund of the taxes paid, arguing that the taxes were illegal because the County actually owned the improvements. Following briefing, the state tax court concluded that Sky Ranch owned the improvements and upheld the tax. Sky Ranch appealed.

In Arizona, the general rule is that a permanent structure placed upon and attached to the realty by a tenant is real property belonging to the lessor. Parties may alter this rule, however, by specifically agreeing to treat the improvements as owned by the lessee. The question was whether Sky Ranch's ownership of the improvements during the term of the lease qualified as ownership of the improvements for assessment purposes.

Sky Ranch cited several cases which held that lessors owned improvements built by the lessees, but the court observed that the lease agreements in those cases did not expressly recognize that the lessee would own the improvements for the term of the lease.

Beyond that "plain term" in the lease, the lease confirmed that Sky Ranch enjoyed the traditional rights of control and disposition of improvements, for example by preserving Sky Ranch's right to convey or encumber its interest in all buildings situated on the leased premises. And Sky Ranch had relied on that language to offer the improvements as collateral under a loan agreement. To the court, this supported the conclusion that the parties intended the lease to abrogate the general ownership rule and provide that Sky Ranch owns the improvements.

As further evidence that Sky Ranch owns the improvements, the County noted that the lease extended to the "premises," which is described as only the raw land. Although a lease extending only to land is "unremarkable" when no improvements had been built, the present lease had been amended three times since the improvements were constructed, yet the lease description remained the same.

Finally, Sky Ranch argued that its interest was merely a leasehold interest in the improvements because the County owns the improvements when the lease terminates. But the court concluded that a lessor's reversionary interest in improvements did not determine who presently owned the improvements. And since the lease here expressly granted a present ownership interest in the improvements to Sky Ranch, the reversion provision does not control.

Because the court agreed that Sky Ranch owned the improvements on leased ground, it affirmed the tax court's decision. Accordingly, because Sky Ranch owned the improvements, the assessment of taxes on those improvements was proper.

Sky Ranch Operations LLC v. Yavapai County
Arizona Court of Appeals
May 12, 2020
2020 WL 2393785

For qualified tax deduction, donation must be for conservation purposes in perpetuity

Hoffman Properties owns the historic Tremaine Building in Cleveland, Ohio. In the mid-2000s, Hoffman donated an easement in the facade of the building, as well as certain airspace restrictions, to the American Association of Historic Preservation (AAHP). Through a written donation agreement, Hoffman agreed not to alter the historic character of the facade or to build in the airspace. Hoffman treated the donation as a qualified conservation contribution, and claimed a $15 million tax deduction for its donation.

The donation agreement described certain actions that Hoffman could take as long as AAHP approved, which the parties referred to as "conditional rights." Hoffman reserved the right to alter, reconstruct, or change the appearance of the facade contrary to the regulations of the Secretary of the Interior on the rehabilitation of historic buildings. Under the agreement, if Hoffman sought to act upon this right, it was required to submit the proposed changes to AAHP, which would review them and either approve or reject them. But AAHP's failure to act within 45 days of receipt of a proposed change would be deemed an approval of the change, and Hoffman would be permitted to undertake the proposed activity.

Based on the language of the donation agreement, the Internal Revenue Service concluded that Hoffman was not entitled to a deduction. The tax court agreed, holding that Hoffman's donation did not qualify for a deduction because it was not "exclusively for conservation purposes." Hoffman appealed.

As a general rule, the Internal Revenue Code does not allow taxpayers to take a charitable deduction for a donation of a partial interest in property, like an easement. But qualified conservation contributions are an exception to that general rule. To qualify, the donation must be "exclusively for conservation purposes," a term which includes the preservation of historic buildings.

Among the requirements for a donation to be considered exclusively for conservation purposes is that the donation must protect the conservation purposes in perpetuity. To satisfy this requirement, the donation must be enforceable in perpetuity, meaning that it must include legally enforceable restrictions that will prevent the donor from using its retained interest in the property in a way that is inconsistent with the donation's conservation purposes.

The court of appeals observed that the donation agreement gives AAHP a 45-day window in which to prevent certain changes to the facade or airspace. If AAHP were to miss that window for any reason, it would lose the ability to stop Hoffman from making the change. The court further noted the "world of difference" between restrictions that are enforceable in perpetuity and those that are enforceable for only 45 days.

Hoffman offered an alternative theory of the perpetuity requirement, namely that the restrictions are perpetual because the restrictions themselves will always be a part of the agreement. The court dismissed this theory because the Internal Revenue Code is not concerned about the mere existence of restrictions; rather, it requires that the donation protect the conservation purposes in perpetuity. Once the 45-day provision is triggered, Hoffman's donation no longer protects the historical character of the building.

The court also distinguished Hoffman's donation agreement from other cases where courts have upheld tax deductions for similar donations. In those cases, the parties included clauses that allowed the donee to give its consent to changes in the facade or to abandon some or all of its rights in the donation. Those terms are consistent with the perpetuity requirement because "any donee might fail to enforce a conservation easement, with or without such a clause." But the court noted that Hoffman's 45-day clause goes much further. It does not simply allow AAHP to abandon the protections in the agreement; it divests AAHP of the power to enforce the protections if it fails to act within a limited window of time. Accordingly, the donation was not considered to be exclusively for conservation purposes in perpetuity, and the court of appeals affirmed the tax court's denial of the deduction.

Hoffman Properties II, LP v. Commissioner of Internal Revenue
Sixth Circuit Court of Appeals
April 14, 2020
956 F.3d 832

Deed restriction for below-market rent should be considered in market value appraisals

Poplar Bluff Associates LP (Poplar Bluff) developed two housing complexes funded by low-income tax credits in Butler County, Missouri. The first project, developed in 1999, included 48 units, while the second project, developed in 2005, included 40 units. Both developments are subject to low-income housing tax credit land use restriction agreements (LURA) made between Poplar Bluff and the Missouri Housing Development Commission (MHDC). The terms of the LURA state that restrictive covenants governing use and occupancy run with the land and bind subsequent owners of the properties for the terms of the agreements. The mandatory compliance period for both properties was fifteen years, plus an extended low-income use period of fifteen years.

Under the terms of the LURA, the properties had to be rented to qualified low-income tenants, and rent could not be increased without prior approval of MHDC and subject to limitations. The properties could also not be sold without the consent of MHDC.

The county assessor assessed the properties at values between $2.4 million and $3.6 million for the 2009, 2011, and 2013 tax years. Poplar Bluff appealed and requested review by the State Tax Commission. At trial, two appraisers testified on behalf of the assessor and two appraisers testified on behalf of Poplar Bluff. The main distinction between the appraisers' methodologies was whether or not they considered the LURA while preparing their appraisals. The assessor rejected a valuation approach that relied on actual income and expenses. To the assessor, the owner's decision to enter into LURA was a choice made when deciding to own low-income housing, and assessors are to value the property, not the business of the owner.

Both of the assessor's appraisal witnesses testified that they looked at market income levels and did not consider the restrictions on the property. The first appraiser evaluated Poplar Bluff's property rights as an owner of the fee simple title under the hypothetical condition that no government contracts were in place. The second appraiser did not consider the deed restrictions associated with the properties, instead choosing to look at the rents on four comparable properties.

Both of Poplar Bluff's appraisal witnesses, on the other hand, testified that they valued the properties with restrictions in place. The first appraiser stated that he had to value the property with the deed restriction in place and using the current low-income housing tax credit rents established by MHDC. The second appraiser compared the market rents from other rent-restricted properties, inherently valuing the property as rent-restricted.

After the trial, the Commission's hearing officer found that Poplar Bluff had presented persuasive evidence that the true market value of the properties was significantly lower than the assessor's valuations. The hearing officer agreed that properties funded by low-income tax credits are unique in that their owners have willingly accepted various restrictions in exchange for economically desirable benefits. The assessor appealed, eventually to the state court of appeals.

On appeal, the assessor argued that the Commission erred by ruling that low-income housing should be valued using its actual income and expenses rather than market income and expenses, because this method failed to value the fee simple estate and otherwise undervalued the property. The court, however, noted that prior case law held that the "better reasoned approach" is to consider actual as well as potential income in determining true value. It said that this approach was more realistic with regard to economic conditions that cause property to have lower actual rents than could be obtained if the property was unrestricted.

The court agreed that prior case law held that low-income housing tax credits themselves are intangible property, and thus they could not be considered in the valuation of a rent-restricted apartment complex. Here, however, it was not the credits themselves that were at issue; rather, both properties were covered by LURA that restrict the amounts the owner could charge for rent, and a well-informed buyer would consider the existence of a deed restriction associated with a property when making a decision on whether to buy the property. To calculate the value of the properties without considering the restrictions imposed by virtue of the LURA would hypothesize an unrealistic market and assume facts that do not exist.

Therefore, the court held that unlike tax credits, which have no direct contribution to the market value of subsidized housing, below-market leases have a direct effect on the income of the property, and thus its market value. Therefore, the Commission's adoption of Poplar Bluff's appraiser's opinions was both reasonable and lawful, and the decision was affirmed.

Tibbs v. Poplar Bluff Associates I, LP
Missouri Court of Appeals
April 14, 2020
599 S.W.3d 1

Tax assessment valuation not valid where methodology did not remove all intangible business value

In 1990, Walt Disney Parks & Resorts (Disney) constructed the Disney Yacht & Beach Club Resort on 65 acres adjacent to Epcot near several other hotels. The resort features 1,197 guest rooms, a 70,000-square-foot conference center, dining and retail outlets, a spa, and other recreational amenities.

In 2015, the County Property Appraiser (County Appraiser) assessed the value of the property at $336.9 million, an increase of 118% over the prior year's assessment. Disney filed a complaint against the County Appraiser, arguing that the County Appraiser's assessment failed to comply with Florida law and accepted appraisal practices because it exceeded market value and included the value of certain intangible property.

At trial, Disney offered first the testimony of a business appraiser who valued the intangible assets on the property as if a hypothetical investor was buying the property. He specifically identified cash, favorable operating licenses, assembled workforce, brand, and goodwill as intangible assets implicated. He determined that the business enterprise value of the property was $341.9 million.

Disney also presented the testimony of a real estate appraiser. For his analysis, the Disney appraiser used the income capitalization approach. He started with the actual average daily rate achieved by the resort, then made adjustments to account for nontaxable items that were part of the value of the rooms. He also adopted hypothetical conditions and calculated the hypothetical lease income for the property's retail, restaurant, and spa spaces that were leased to third parties, which he explained had the effect of extracting business value. After capitalizing the net operating income, he deducted tangible personal property value, ultimately arriving at a real estate value of $180.9 million.

The County Appraiser presented a valuation expert from the County Appraiser's office. As operating expenses, he deducted management fees and franchise fees but made no other adjustments to revenue for any amenities or for the fact that the property is Disney-branded. He explained that the operating expense deductions removed all business-related income from the gross figure. The result was the final assessed value of $336.9 million.

In rebuttal, Disney presented the testimony of an economist who opined that the County Appraiser's methodology was inconsistent with economic theory and market behavior, underestimated business value, and failed to account for a return on the investment in furniture, fixtures, and equipment. Overall, he opined that there was "no scenario" in which simply deducting franchise and management fees would remove all intangible value.

The trial court found that the County Appraiser improperly considered income from the business activities conducted on the property in establishing the just value of the property, and rejected the County Appraiser's contention that the intangibles identified by Disney's experts did not qualify for removal. The trial court ruled that, even if the methodology used by the County Appraiser was accepted in the appraisal profession, it could not be used in a manner that violated Florida law by assessing more than real property value. After adjusting Disney's appraised values, the court concluded to a value of $209.2 million. The County Appraiser appealed.

On appeal, the County Appraiser argued that the trial court should not have rejected its method of removing intangible value and should not have performed its own assessment rather than remanding the case for reassessment.

The court of appeal began by noting that the Florida Constitution specifically prohibits counties from taxing intangible property. Real property, which is subject to tax, includes only land, buildings, fixtures, and improvements to land. The court agreed with the trial court that the method used by the County Appraiser impermissibly included Disney's intangible business value in its assessment.

The court concluded that, because the County Appraiser's method does not provide for adjustments to the gross income for intangible business value prior to making management and franchise fee expense deductions, the method "does not remove all business value from an assessment." To the contrary, the court concluded that the method "ignores the fact that an intangible business value may be directly benefiting a business's income stream." Therefore, the court held that the method itself "violates Florida law because it does not remove the non-taxable, intangible business value from an assessment." The court did, however, order the trial court to remand the dispute to the County Appraiser for a reassessment.

Following the first court of appeal decision in this case, the County Appraiser moved for a rehearing by the court of appeal, arguing that the court's first decision was overextended by rejecting the method used by the County Appraiser in itself, rather than as applied by the County Appraiser in this case. The court granted the motion for rehearing, withdrew its first decision, and issued a substitute opinion. In the substitute opinion, instead of using sweeping language rejecting the method used by the County Appraiser, the court concluded that the manner in which the County Appraiser applied the method impermissibly included intangible business value. The outcome of the decision was the same, but the substitute opinion gave counties leeway to properly apply the method used by the County Appraiser here.

Singh v. Walt Disney Parks & Resorts US, Inc.
Florida Court of Appeal, Fifth District
June 19, 2020, and August 7, 2020
2020 WL 3394725 and 2020 Fla. App. LEXIS 11180*

Highest and best use analysis supports valuation in taking of landfill

The New Jersey Sports and Exposition Authority (NJSEA) is the zoning and planning agency for the Hackensack region. NJSEA is authorized to acquire any real property in its jurisdiction if it is necessary or convenient to do so for any authorized purposes, including the provision of solid waste disposal and recycling facilities.

The Keegan Landfill consists of approximately 110 acres located in Kearny, New Jersey (Kearny). The majority of the disposal activity occurred at the site in the 1960s and 1970s, and the landfill was not properly remediated. NJSEA or its affiliates leased the landfill from Kearny. According to a 2016 appraisal report, the estimated market value of the fee simple interest in the landfill was $1.88 million. By letter NJSEA offered to purchase the landfill from Kearny precondemnation at market value, which Kearny declined. NJSEA therefore filed a condemnation complaint in the trial court. Following a challenge and appeals, the courts authorized NJSEA to exercise its eminent domain powers.

Proceeding to trial, both parties offered expert opinions of value. Kearny's appraiser estimated the value of the entire landfill, not just the subject property, at $23.4 million. He assumed assemblage, i.e., that a new buyer would also buy the portion of the property already owned by NJSEA. Because zone landfills are legally permissible and because the property is an operating landfill, the appraiser opined that its current use was its highest and best use. Further, based on his review, the appraiser testified that the property will generate $14 million to $16 million per year for the next seven years, so the landfill was the maximally productive use.

NJSEA's appraiser, in contrast, based his appraised values on the property's highest and best use at the termination of the lease between NJSEA and Kearny, at which time the landfill operations would cease. Thus, he calculated the property's value under the assumption that the landfill operations would cease. Further, in his highest and best use analysis, he emphasized that due to the large mound of garbage sitting in the middle of the landfill, in a tidal marsh, with steeply sloped sides, the landfill had virtually no practical utility. Thus, given the limited potential uses, he concluded recreational use was the property's highest and best use.

In October 2018, the trial court held a bench trial, hearing from eight witnesses, including appraisers and other experts. The court found that NJSEA's expert's valuation of the property was correct and held that the fair market value at the time of the taking was $1.818 million. The preponderance of the evidence supported NJSEA's appraiser's assumption, while Kearny provided no reason to assume cooperation between NJSEA and a new purchaser. Because a landfill could not be operated solely on the Kearny portion without significant alterations, the court agreed that the property was best suited for passive recreation.

Kearny appealed, arguing that the trial court erred in finding its appraiser's use of assemblage was speculative. Considering the history of cooperation and the lease agreement between the parties, Kearny argued it reasonably incorporated the value of the property already owned by NJSEA into its just compensation calculation. The appellate division rejected this argument summarily.

Kearny also argued that two of NJSEA's nonappraisal expert reports set forth inadmissible "net opinions" that failed to explain the reasons or calculations that led to their conclusions. The net opinion rule forbids the admission of an expert's conclusions that are not supported by factual evidence or other data. Thus, the expert must "give the why and wherefore" that supports the opinion, rather than a mere conclusion.

Contrary to Kearny's assertions, though, the appellate division noted that the expert reports in question were not appraisals or opinions of value. Rather, one expert simply discussed New Jersey's regulations and the permitting process for solid waste landfills. Any reference to the sale of the property was within the context of describing the process of transferring the permit. In addition, the second expert discussed the factors a buyer would consider in purchasing the property and why a hypothetical buyer would not be interested in doing so. Both experts sufficiently supported their conclusions. Accordingly, the appellate division affirmed the trial court's judgment.

New Jersey Sports and Exposition Authority v. Town of Kearny
Superior Ct. of New Jersey, Appellate Division
April 9, 2020
Docket No. A-2487-18T2

Change in specifics of city redevelopment plan did not negate public taking

Fred Eychaner owned vacant land in the River West area of Chicago. In 1999, the City of Chicago (City) proposed creating a planned manufacturing district (PMD) there, aimed at protecting industrial jobs and preventing residential encroachment on existing manufacturing facilities. Residential uses were thus not permitted within PMDs.

A large chocolate factory was located two blocks south of Eychaner's property. The factory's owner initially opposed its factory's inclusion in the PMD, but eventually the owner dropped its opposition in exchange for the City's willingness to help it expand its industrial campus by acquiring nearby property to create a buffer between its operations and proposed residential development. The City intended to fund the project through a tax increment financing (TIF) plan.

Although Eychaner's property was not deemed blighted, a study commissioned by the City stated that it met the requirements of a conservation area, which may become a blighted area. The factory's owner submitted a redevelopment proposal seeking to acquire 4.2 acres surrounding its factory, including Eychaner's land. Initially the factory offered to buy Eychaner's land, but he refused to sell, so the City notified Eychaner of its possible taking of his property with the intent of conveying it to the chocolate factory. The city council passed an ordinance authorizing the taking to achieve the objectives of the TIF.

In 2005, the City filed a complaint to condemn Eychaner's property. The case eventually proceeded to a jury trial on just compensation, which resulted in an award of $2.5 million. Eychaner appealed, and the courts ultimately concluded that the use of eminent domain to expand the chocolate factory's campus passed constitutional muster, but the case was remanded for a new trial on just compensation.

Meanwhile, the City was undertaking a comprehensive review of the industrial corridors in the City, to address the modern realities of the industrial marketplace and its evolving role in the economy. The first corridor to be reviewed included Eychaner's property and the chocolate factory. A mix of uses, including high-density, mixed-use development, was proposed as the best use of the area.

At the second just compensation trial, the City and Eychaner presented experts who agreed that the highest and best use of the property would be high-rise residential development with ancillary commercial use. Although the property would have to be rezoned, the experts agreed that approval of the zoning change was reasonably probable. The jury returned an award of $7.1 million to Eychaner. Eychaner filed a post-trial motion not challenging the compensation award, but renewing his argument that the City's exercise of eminent domain was unconstitutional. He also asserted that the taking no longer served a permissible public use since the City had changed its plans for the area surrounding Eychaner's property. The trial court denied the motion, and Eychaner appealed.

On appeal, Eychaner argued that the TIF and the City's plans for the area were inconsistent. He asserted that the City no longer intended to preserve industrial uses in the area; Eychaner argued that the City would relocate the chocolate factory rather than expand its campus, and therefore the taking was for private, not public, use and "nothing more than a naked transfer from Eychaner to the factory owner in the name of economic development." Because the trial court did not reconsider the judgment, Eychaner argued that the judgment should be reversed.

The court found that Eychaner failed to demonstrate that the purported new evidence would change the outcome. While it was true that the earlier decisions relied on the City's TIF, the court disagreed that the City's review proposal was the "sole expression" of the City's plans for the area, and that it did not supersede the TIF, which continued to remain in effect. Further, the City's current plan to redevelop the area around Eychaner's property seeks to preserve the industrial character of the corridor while also attracting innovation and technology-oriented businesses, a valid public use.

Finally, the court held that Eychaner presented no evidence of changes to the plan for the area, and that his assertion that the current plan no longer supports the taking was false. Residential uses remain prohibited under the current zoning, and Eychaner cited no evidence that the factory's owners intend to use the property for a residential purpose or a use otherwise inconsistent with the TIF's goals. Rather, the acquisition of Eychaner's property would allow the factory to expand into a self-contained campus, thereby maintaining its workforce in the City while reducing conflicts with neighboring uses. Because these are all legitimate goals and part of the City's larger plans for the area, the court held that the trial court did not err in denying Eychaner's post-trial motion to reconsider.

City of Chicago v. Eychaner
Illinois Appellate Court, First District
May 11, 2020
2020 IL App (1st) 191053

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