by Benjamin A. Blair, JD

Recent Court Decisions on Real Estate and Valuation

COVID-19 pandemic not a basis for failing to pay rent for retail space

The Gap Inc. (Gap) operates a national chain of fashion-focused retail stores. In February 2005, Gap entered into a lease for the operation of two stores on East 59th Street in New York City. The term of the lease extended to January 31, 2021, unless terminated or extended. Several years later, Ponte Gadea New York LLC (Ponte) bought the property and the lease.

The lease had several significant clauses. It included a definition of a "force majeure event" that included, among other things, "governmental preemption of priorities or other controls in connection with a national or other public emergency." In a section titled "Casualty," the lease set forth obligations, termination rights, and rent obligations in the event of a "fire or other casualty that occurs in the premises." In such an event, Gap had the right to terminate the lease if the casualty occurred within the one year prior to the end of the lease, but otherwise Gap had the obligation to continue paying rent. Finally, the lease defined an "event of default" as occurring when Gap failed to pay monthly rent when due.

In December 2019 and the first quarter of 2020, COVID-19 spread throughout the world, resulting in a global pandemic. In March 2020, New York State declared a state of emergency and ordered nonessential businesses, including Gap, to reduce their in-person workforces by 100%. In April, Gap suspended rent payment under its leases for all its stores in North America, including the 59th Street stores.

In June 2020, Ponte served Gap with a notice of termination, which stated that Gap's failure to pay rent, if not cured, would constitute an event of default. At that same time, New York City entered phase one of its reopening, allowing retail stores to offer curbside pickup. Thereafter, Gap reopened certain of its New York stores to indoor shopping, but not the 59th Street stores. Gap sued Ponte for breach of contract and for rescission or reformation of the lease.

Gap's complaint asserted five arguments as to why the parties' lease terminated in, or should have been deemed to have been rescinded or reformed in, March 2020 as a result of the pandemic and associated governmental restrictions. The parties each moved for summary judgment.

The trial court examined the language in the lease and noted that it left no doubt that the term "casualty" referred to single incidents like a fire, which have a physical impact on the premises, rather than a pandemic occurring over a period of time outside the property.

Gap's first argument was that the pandemic and the resulting lockdowns constituted a "casualty" that rendered the entire premises unusable such that Gap was entitled to an abatement of its rent payment obligations. The trial court examined the language in the lease and noted that it left no doubt that the term "casualty" referred to single incidents like a fire, which have a physical impact on the premises, rather than a pandemic occurring over a period of time outside the property.

Hence, no reasonable reading of the lease's casualty provision would be triggered by the pandemic or its effects.

Gap's second argument was that the pandemic and the governmental restrictions frustrated the principal purpose of the lease. The doctrine of frustration of purpose discharges a party's duties to perform under a contract where a wholly unforeseeable event renders the contract valueless to one party. The court observed that the possibility of a government lockdown was referenced in the lease itself, defeating any claim that the possibility was wholly unforeseeable. Further, Gap offered curbside pickup from the stores during the pandemic, and it opened other retail locations to in-person shopping. Thus, "while undeniably unfortunate," the pandemic did not amount to a frustration of the lease's purpose of Gap operating a retail business on the premises.

In its third argument, Gap asserted that the pandemic and governmental lockdowns rendered the parties' performance of the lease impossible or impracticable. But again, the court pointed to the lease's own terms to show that the parties foresaw, and apportioned the risk associated with, the possibility of a governmental lockdown or public emergency.

Gap's fourth argument was that the pandemic led to a "failure of consideration," which occurs when someone who has promised to perform fails without fault to receive the agreed quid pro quo for that performance. The court found this defense unavailing because Gap had continued to receive what it was promised under the lease—its premises—and continued to house merchandise and offer curbside pickup from the stores. So even if the pandemic resulted, through no fault of the parties, in a partial failure of consideration, that partial failure would not be a basis to rescind the lease.

Finally, in its fifth argument, Gap asserted that the lease should be reformed because the parties made a mutual mistake in drafting the lease by failing to foresee and address the possibility of a global pandemic. Gap alleged that, had the parties been able to foresee in 2005 the events of the COVID-19 crisis, the parties would have provided language that Gap would not pay rent if the premises were rendered impossible or impracticable to use. The court disagreed, noting that mistaken assumptions about the future do not amount to mutual mistakes warranting rescission of a contract.

Because Gap's arguments were not persuasive or supported, the court granted summary judgment to Ponte, and it declared that the lease was properly terminated by Ponte in June 2020 due to Gap's nonpayment of rent. Moreover, Ponte was entitled to rent for holdover occupancy from that date.

The Gap Inc. v. Ponte Gadea New York LLC
US District Court for the Southern District of New York
March 8, 2021
Case No. 20 CV 4541-LTS-KHP

Relinquishment of LLC interests constitutes change in ownership of property

MI Moorings LLC (MIM) was established in 2014 for the purposes of purchasing, managing, and selling real estate. The Moorings of Leelanau LLC (TML) was later established by MIM, Robert Brick, and Edward Lockwood for the purpose of purchasing, developing, and selling 92 parcels of land adjoining Traverse City, Michigan (City). MIM owned a 42% interest in TML, while Brick and Lockwood each owned a 29% interest in TML. At all times, the property was owned entirely by TML.

A dispute arose between the members of MIM and the members of TML, resulting in a settlement agreement in which Brick and Lockwood agreed to relinquish their ownership rights in TML in exchange for payments totaling

$2,575,000. As a result of the agreement, MIM became the sole owner of TML.

Under Michigan's constitution, the taxable value of each parcel of property shall not increase each year by more than the lesser of 5% or the increase in the Consumer Price Index, until ownership of the parcel is transferred. When ownership is transferred, the parcel is reassessed at a percentage of its current true cash value.

Following Brick and Lockwood's relinquishment of their interests in TML, the City uncapped the taxable value of the property, which TML challenged before the state's Tax Tribunal. The Tax Tribunal granted summary judgment in favor of the City and ordered the taxable value of the property be uncapped. TML appealed to the Michigan Court of Appeals.

The court of appeals observed that the Michigan code provided a definition of "transfer of ownership" for the purposes of the capping and uncapping procedure. In relevant part, the statute provided that "transfer of ownership" means conveyance of title or an interest in property, the value of which is substantially equal to the value of the fee interest. The statute further provides that a conveyance of an ownership interest in a corporation or limited liability company occurs if the ownership interest conveyed is more than 50% of the entity. Thus, by the plain language of the statute, transactions that transfer ownership of membership interests in an LLC constitute a transfer of ownership of the property owned by that LLC.

Here, it was undisputed that at all relevant times, the property had belonged to TML. But prior to the settlement agreement, Brick and Lockwood had a combined 58% ownership interest in TML, and pursuant to the settlement agreement, they relinquished their interests in TML in exchange for payments of money. The transaction resulted in MIM becoming the sole owner of TML, and the 58% combined interest that was transferred exceeded the 50% statutory threshold. Hence, by transferring a 58% ownership interest in TML to MIM, Brick and Lockwood also transferred a 58% ownership interest in the subject property to MIM. Accordingly, the City properly uncapped the value of the property for tax purposes. The Tax Tribunal's decision was affirmed.

Moorings of Leelanau, LLC v. City of Traverse City
Michigan Court of Appeals
July 29, 2021
2021 WL 3233564

Tax foreclosure sale price deemed constructively fraudulent in bankruptcy court

City Wide Investments (City Wide) owns various rental properties in Milwaukee, Wisconsin (City). Prior to January 4, 2016, City Wide's holdings included an eight-family apartment building. When City Wide failed to pay more than $49,000 in property taxes and fines for the 2012 to 2015 tax years, the City initiated a tax foreclosure proceeding and succeeded in obtaining title to the property.

In March 2017, after the property had been vacant and placarded as unfit for human habitation for two years, the City sold the property to a third-party buyer for $150,000. While the recovery was greater than the $49,000 in property taxes and fines that City Wide had been forgiven in exchange for seizure of the property, the recovery was also lower than the $217,600 value the City had assigned the property for 2016 tax assessment purposes. Weeks later, in April 2017, City Wide filed for bankruptcy. In the bankruptcy court, City Wide began an adversary proceeding against the City to set aside the tax foreclosure as a constructively fraudulent transfer.

The primary issue at trial was the value of the apartment building. City Wide offered the testimony of an appraiser who opined that the fee simple market value at the time of the transfer was $340,000. In both his income and sales comparison approaches, the appraiser subtracted deferred maintenance costs of $10,000.

In response, the City offered testimony from a real estate specialist from the City's development department who contended that the best evidence of the property's value was its recent sale for $150,000. The specialist explained that the City does not market a property until an alderperson has agreed to support the sale along with an actual proposal. Thus, the City did not start marketing the property until a buyer was lined up. Here, the eventual buyer approached the City in October 2016, and after the local alderwoman agreed to sponsor the sale, the property was listed on the City's website with a sale price of $175,000 in December 2016.

The bankruptcy court issued a determination that City Wide had not received reasonably equivalent value for the City's seizure of the property. While the City obtained title to the property, City Wide received only the elimination of its $49,000 tax debt. As a remedy, the bankruptcy court concluded that City Wide was entitled to the value of the property, since the property had already been resold and could not be returned by the City to City Wide. The bankruptcy court accounted for more deferred maintenance, but otherwise largely accepted the testimony of City Wide's appraiser.

Section 548(a)(1) of the Bankruptcy Code allows courts to set aside a sale or transfer of an insolvent debtor's property if the transfer was constructively fraudulent. A transfer may be voided if it was made within two years before the debtor files for bankruptcy and if the debtor, insolvent on the date of the transfer, received less than a reasonably equivalent value in exchange for such transfer. As remedies, the court may order that the debtor-in-possession receive either the return of the property or the value of the property from the transferee.

The City appealed the bankruptcy court's order, specifically challenging the valuation conclusion. The City emphasized the alleged inequity of the bankruptcy court's determination because it provided City Wide with a "windfall of almost three times the profit" the City earned when it sold the property to a third-party buyer after the foreclosure. The district court disagreed with the premise of that argument. It said if the bankruptcy court followed the law and the valuation findings were factually supported, then there was nothing improper or inequitable about its decision.

The district court further agreed with City Wide that the $150,000 sale price was not a credible indication of the property's value.

The City's only substantive challenge to the bankruptcy court's order was a complaint that the court should have adopted the City's proposed valuation rather than City Wide's valuation, arguing that the third-party sale was the best evidence of the property's fair market value.

The district court noted that the bankruptcy court correctly noted that the "value" referred to in the Bankruptcy Code is fair market value, but also concluded that the bankruptcy court's decision was within its proper fact-finding role. The court expressly rejected the City's proposed valuation and instead adopted that of City Wide's appraiser with an adjustment of $20,000 to bring the property into rentable condition. The district court concluded that these factual findings were adequately supported by the testimony in the record.

The district court further agreed with City Wide that the $150,000 sale price was not a credible indication of the property's value. The court observed several issues with the City's procedures for the sale of tax foreclosed properties that resulted in not always realizing the best prices.

The City does not sell foreclosed properties at auction, and it does not typically list its foreclosed properties with a real estate broker; thus, "the City has only itself to blame for any problems arising from its own chosen procedures for foreclosing on and selling properties with overdue taxes." The district court affirmed the bankruptcy court's order.

City of Milwaukee v. City Wide Investments LLC
US District Court for the Eastern District of Wisconsin
January 8, 2021
2021 WL 71684

Tax exemption of facility on tribal land depends on whether facility is permanent improvement under federal law

South Point Energy Center LLC (Taxpayer) is a non-tribal entity that owns and operates an electrical generating plant in Mohave County, Arizona, on land it leases from the Fort Mojave Indian Tribe (Tribe). Under the lease, Taxpayer owns the facility and all improvements, but at the end of the term, it will have to remove all above-ground improvements from the leased land except for certain roads, foundations, and underground pipes.

Under 25 U.S.C. § 5108 (Section 5108), lands or rights taken in the name of the United States in trust for a tribe are exempt from state and local taxation. Under this federal statute, taxation of such property is preempted.

Taxpayer sued the Arizona Department of Revenue (ADOR) to recover property taxes paid on the facility for the 2010 to 2018 tax years. The state tax court ruled that the facility was not a permanent improvement exempt under Section 5108 because the lease requires Taxpayer to remove the above-ground improvements at the end of the term; thus, tribal sovereignty does not preempt taxation of the facility. Taxpayer appealed, arguing that the tax court erred by rejecting its contention that federal law categorically preempts property taxes on permanent improvements on leased tribal land and ruling that the facility was personal property instead of permanent improvements under state law.

Taxpayer pointed to a line of cases from the US Supreme Court and other federal courts on this issue. The first case addressing state taxation of permanent improvements on land held in trust as tribal lands arose in 1903, and it established that a state may not tax land held in trust by the United States and that the same rationale would apply to assessment and taxation of permanent improvements on that land. Congress enacted Section 5108 to codify that ruling.

Then, in 1973, the US Supreme Court addressed whether New Mexico could impose a use tax on permanent improvements owned by a tribal entity on trust land. Applying Section 5108, the Supreme Court held that the improvements, being permanently attached to the land, were immune from the state's property tax because use of permanent improvements upon land are intimately connected with use of land itself.

Finally, in 2013 and 2015, federal courts of appeal decided that Section 5108 applied to all permanent improvements on trust land, regardless of whether they are tribal owned, and that Section 5108 forecloses taxes on the bundle of privileges that make up property or ownership of property.

ADOR argued that three of those cases were inapplicable because the permanent improvements in those cases were owned by tribal entities, while Taxpayer is a non-tribal entity; the Arizona Court of Appeals disagreed. In one case the federal court concluded the opposite, and in another, the ownership was irrelevant because the tax on the lessee amounted to a tax on the tribe's exercise of one of the privileges of owning the land. The court of appeals further observed that Section 5108 does not limit its exemption to tribal-owned improvements.

The court of appeals then turned to the issue of whether the tax court erred by ruling that the entire facility was personal property, not permanent improvements to which Section 5108 would apply. In a second round of summary judgment briefing, both parties agreed that the facility contained both personal property and permanent improvements, but the tax court nevertheless concluded that the facility was entirely personal property based on the lease provision that requires Taxpayer to remove all above-ground improvements at the end of the term. The tax court reasoned that if Taxpayer retained the right to remove an improvement, then by definition that improvement is not permanent.

In making this ruling, however, the tax court disregarded the principle that federal law, not state law, determines whether specific property is a permanent improvement exempt from taxation under Section 5108. Whatever the test under Arizona law, the test under federal tax law of whether an asset is a permanent improvement or personal property turns on six factors primarily focusing on the permanence of the property and the damage caused to it or to realty upon removal of the property. Hence, although the existence of a contract requiring removal of the property is relevant, it is not determinative. Thus, the court of appeals concluded that the tax court erred in finding the Taxpayer's facility was "by definition" not a permanent structure without conducting an analysis under federal law.

Because the court of appeals concluded that Section 5108 establishes a categorical exemption for permanent improvements on tribal land held in trust by the United States, and the tax court erred by concluding the facility was entirely personal property without conducting the proper analysis, the court of appeals vacated the tax court's grant of summary judgment to ADOR and remanded the case to the tax court to conduct an analysis to determine which of the facility's assets are permanent improvements under federal law and therefore exempt from taxation under Section 5108.

South Point Energy Center LLC v. Arizona Department of Revenue
Arizona Court of Appeals, Division One
April 27, 2021
490 P.3d 372

Consent to amendment of sublease permitted termination of master lease

In 2012, Atlanta Life Financial Group Inc. (Atlanta Life) leased office space from 191 Peachtree Project LLC (Landlord) pursuant to a master lease. Beginning in November 2014, Atlanta Life subleased office space to two law firms (Subtenants).

Beginning in January 2018, the Subtenants failed to pay the full amount of rent required by the sublease, and by November 2018, they had ceased paying any rent to Atlanta Life. In April 2019, Atlanta Life sent a demand letter to the Subtenants demanding the unpaid rent. Shortly thereafter, in May 2019, the Subtenants entered into a lease agreement for the subleased premises directly with Landlord, and that same day, Landlord and Atlanta Life entered into an amended lease agreement that terminated the subleased portion.

Atlanta Life sued the Subtenants alleging that they had breached the sublease by failing to pay past due rent. The Subtenants countersued, claiming that Atlanta Life had terminated the master lease without their consent, which breached their sublease. The trial court granted Atlanta Life summary judgment.

The Subtenants did not contend that they paid the full amount of rent from January 2018 to April 2019. Instead, they admitted that they submitted only partial rent for ten months, and then failed to pay any rent to Atlanta Life for six months. They argued, however, that the trial court erred by granting summary judgment to Atlanta Life, because there was a genuine issue of whether Atlanta Life waived the terms of the sublease by not issuing a demand for the unpaid rent until April 2019.

Precedent from the Georgia Supreme Court provides that evidence of repeated late, irregular payments accepted by a landlord creates a factual dispute as to whether a quasi-new agreement is created. Atlanta Life did not object to the partial payment or nonpayment until sixteen months after the Subtenants first failed to pay the rent in full, and Atlanta Life did not claim that it notified the Subtenants of its desire to adhere to the sublease's terms until sixteen months had passed.

Thus, by repeatedly accepting payment or nonpayment in deviation from the terms stipulated in the sublease, a factual dispute arose as to whether a quasi-new agreement was created. Furthermore, the existence of an "anti-waiver" provision in the sublease does not preclude waiver, since acceptance of irregular payments raises a jury question as to whether the anti-waiver provision in the sublease was itself waived. Accordingly, the trial court erred by granting summary judgment to Atlanta Life on its breach of contract claim.

The Subtenants argued that Atlanta Life breached the sublease by executing an amended master lease with the landlord, which terminated the portion of the master lease regarding the subleased property. The Subtenants claimed that by signing the amended master lease, Atlanta Life breached a provision of the sublease that stated that Atlanta Life would not terminate the master lease without the prior express written consent of the Subtenants. The court of appeals found this argument meritless. First, all the parties had signed a document titled "Consent to First Amendment to Sublease," which provided that if the master lease expired or terminated for any reason, the sublease would simultaneously terminate or expire. The consent agreement also contained a provision stating that the consent agreement would prevail over the sublease in the event of a conflict. Therefore, Atlanta Life did not breach the sublease when it entered into an amended master lease terminating the sublease, because it was allowed to do so by the consent agreement. Accordingly, the appellate court affirmed the trial court's grant of summary judgment to Atlanta Life on that claim.

The Hatchett Firm, PC v.
Atlanta Life Financial Group, Inc.
Georgia Court of Appeals, 3rd Division
March 1, 2021
856 S.E.2d 1

Road subject to conservation easement not public without express access easement

Sieben Ranch Company (Sieben) owns property in northcentral Montana. Adjacent properties are owned by the state, Randall Adams and Lee McDonald, and the O'Connell family. Sieben installed a gate on Lyons Creek Road (the Road). The Road provides access to the Sieben property. The portion of the Road south of the Sieben gate was designated a public highway in 1923.

In 1996, Sieben entered into a conservation easement with the state's Department of Fish, Wildlife, and Parks (FWP). The conservation easement encompasses 4,040 acres with the dual purposes of preserving the conservation values of the land and limited use to certain agricultural and mineral exploiting activities. It further allowed FWP and the public the right of reasonable access for recreational hunting each autumn. Around the same time, the O'Connells also entered into a conservation easement with FWP for their land, which was also accessible from the Road.

Sieben allowed the public to recreate via the Road until 2000, when the public began to disregard the conservation practices on the property. Sieben thus closed the gate to all public access except during hunting season but granted permission to the O'Connells to use the Road north of the gate.

In May 2018, the O'Connells granted their successors an easement for use of the Road. They then sold three parcels of their land covered by their FWP easement to Adams and McDonald. In the agreement, the O'Connells indicated they could not guarantee legal access to the parcels due to the terms of their FWP easement. Although required by that easement to notify FWP of the purchase, Adams and McDonald did not, and they also conducted activities that were inconsistent with the terms of the FWP easement, including installing their own gate on Sieben's property and making improvements to Sieben's property without permission.

Sieben filed suit, asserting that Adams and McDonald had no legal access over Sieben's property via the Road or in any other manner. Sieben explained that it had historically granted access to the Road to Adams, McDonald, and their predecessors as a neighborly accommodation, but it never granted an easement to them for the purposes of accessing Sieben's property except during hunting season. The trial court found for Sieben, concluding Adams and McDonald had no right of access over Sieben's property. They appealed.

The Montana Supreme Court began by explaining that there are three ways by which a private road may become open and public, including adverse use, common law dedication by private owners, and statutory dedication by the county. Adams and McDonald asserted the latter, that the Road was statutorily designated as a public highway in 1923 by the county commissioners. The trial court concluded, based on a 1961 letter from the county attorney, that the public portion of the Road extended to the location of the Sieben gate and no further. After recounting the history of the Road, the supreme court concluded that the trial court did not err in granting judgment to Sieben.

The court found that this argument failed to appropriately distinguish express easements and conservation easements.

The supreme court next addressed an "apparent" contention raised by Adams and McDonald that the FWP conservation easements created an express easement for access in their favor. Thus, even if the Road was private, they had an express easement by virtue of the conservation easement that allowed them to cross Sieben's property. The court found that this argument failed to appropriately distinguish express easements and conservation easements.

An easement is a nonpossessory interest in land in which one person has the right to use the land of another for a specific purpose. An express easement is one that is created by an instrument in writing. An express easement by reservation arises when a property owner conveys part of its property to another but includes language in the conveyance reserving the right to use some part of the transferred land as a right of way.

Conversely, a state statute specifically allows for the creation of servitudes for conservation purposes. All conservation easements are considered to run with the land, whether or not such fact is stipulated in the instrument of conveyance or ownership. Conservation easements may be enforced by the owner of the dominant estate (here, Sieben) or by the public body holding the easement (here, FWP). Easements that do not benefit conservation are still enforceable by other means. Thus, another easement—e.g., an express easement—can be separately enforced from the conservation easement.

Sieben's conservation easement granted FWP the right to enter the land to monitor compliance and prevent any inconsistent activity on it, plus public access for hunting. And while the O'Connells conveyed parcels to Adams and McDonald, they did not convey the road easement that was granted to them by Sieben. Adams and McDonald also do not own any of the land burdened by Sieben's conservation easement nor are they the public body holding the easement. Therefore, they cannot enforce the conservation easement and their access is limited to the terms of the conservation easement, which is only during hunting season.

The Road is a public road only up to the Sieben gate, after which point it becomes a private road subject to the conservation easement and the road easement reserved by the O'Connells. Because Adams and McDonald did not have an express easement to access Sieben's property, and because they lacked the power to enforce or access the conservation easement, the Montana Supreme Court concluded that the trial court correctly granted judgment to Sieben.

Sieben Ranch Co. v. Adams
Montana Supreme Court
July 13, 2021
2021 WL 2935261

Party may accept *pro tanto* payment in eminent domain while challenging taking

In Massachusetts, eminent domain proceedings generally operate under a so-called quick-take statute. Upon the recording of an order of taking by an authority, title to the property passes immediately by operation of law to the taking authority, and the right to damages for the taking vests in the property owner unless otherwise provided by law. The taking authority must pay such damages within sixty days after the right becomes vested and, with limited exceptions, must be made available to the property owner.

Additionally, within sixty days of the order of taking, the authority must offer every person entitled to damages on account of the taking a reasonable amount either in settlement of all damages or as a payment *pro tanto* (meaning partial fulfillment of an actual or potential obligation). If the person accepts the offer as a *pro tanto* payment, that election is without prejudice to or waiver of any right to claim a larger amount through an appropriate proceeding.

Finally, another statute provides that a property owner may challenge the lawfulness of a taking within three years from when the right to damages has vested.

In October 2016, the City of Cambridge (City) effected an eminent domain taking of real property owned by Said Abuzahra. At the time of the taking, ownership of the property was in dispute in separate litigation. Consequently, the City withheld tender of the *pro tanto* payment and instead paid the full $3.7 million to the City treasurer.

In August 2017, Abuzahra sued to invalidate the City's October 2016 taking and either obtain an assessment of temporary damages or a determination of permanent damages. In its answer, the City stated it would tender the full *pro tanto* payment to the property owner once the separate litigation was resolved. In October 2018, Abuzahra secured a final judgment establishing his ownership over the property.

Two months later, Abuzahra filed a motion to compel the full tender of the *pro tanto* payment, simultaneously maintaining his claim challenging the validity of that taking. The trial court issued an order denying the motion to compel, reasoning that it was incongruous for Abuzahra to demand both payment of the *pro tanto* and the return of his property. Abuzahra appealed, and a single justice of the appeals court reversed the order, determining that, as a matter of law, the City must pay Abuzahra because the *pro tanto* payment is required by statute and there is no exception for cases in which the underlying taking is challenged. The City then appealed to the Massachusetts Supreme Judicial Court.

The court began by emphasizing that the taking of land from a private owner against his will under eminent domain is an exercise of one of the highest powers of government. Further, quick-take takings are especially significant because the rights of the parties vest upon the order of taking, so not only does the taking authority have the power to impose its will on the property owner, but the taking itself is swift and occurs automatically outside of judicial processes. Given this dynamic, the statutorily mandated *pro tanto* payment ensures that property owners receive some initial recourse following the deprivation of their property, and also incentivizes taking authorities to exercise their significant eminent domain powers with discretion.

The court noted that while prompt payment of the *pro tanto* amount is clearly required, the effect of challenging the taking itself is not addressed in the statute. The statute allowing property owners to challenge the validity of the taking is not cross-referenced elsewhere. Therefore, while the statutes are clear that the City must offer the *pro tanto* payment quickly, and acceptance of the *pro tanto* payment does not constitute waiver of one's right to challenge the amount of the taking, the statute is silent as to whether acceptance of that offer affects the plaintiff's other statutory right to challenge the taking itself.

The court discussed the history and text of the relevant statutes, ultimately concluding that those sources reflect a recognition that, given that title to the property passes immediately to the taking authority, such takings may impose sudden and heavy financial burdens on property owners. Without the *pro tanto* amount, a person of limited means may be forced to give up the family home, since without the payment, the person would have neither a place to live nor, potentially, the money to litigate. The court stated that if the legislature intended to condition acceptance of the *pro tanto* award on the waiver of one's right to contest the underlying taking, it would have written the statute to reflect this legislative judgment.

Balancing these concerns and the language of the statutes, the court concluded that a property owner may accept the *pro tanto* payment and simultaneously challenge the lawfulness of the taking. The court remanded the case back to the trial court for further proceedings.

Abuzahra v. City of Cambridge
Massachusetts Supreme Judicial Court
February 17, 2021
162 N.E.3d 653

Nursing home valuation dispute can be resolved despite dispute on building size where size is unrelated to divergent valuations

The Parc at Joliet (Parc) owns a skilled nursing home in Will County, Illinois. Most of the facility was built in 1969. The facility includes 203 beds, of which only 8 are private; the other 195 are semi-private. The facility also includes therapy and dialysis areas, nursing stations, a dining room, and various other administrative and utility areas. The Joliet Township record card for the property lists the building size as 63,894 square feet situated on 2.4393 acres; a 2007 deed lists the lot size as only 2.32 acres.

For 2014 and 2015, Will County (County) assessed the property at a market value of $4,369,977, of which $583,719 was attributed to land. Parc filed appeals with the Illinois Property Tax Appeal Board (PTAB) for its 2014 and 2015 assessments, contesting the value of the improvements. Joliet Township High School District 204 (District) intervened in the appeal.

At trial, Parc produced a nursing home consultant who testified that Parc was not more financially successful because of the age of the facility and the lack of bathing facilities in every room, which prevented it from attracting higher-paying residents, including Medicare recipients. Another witness attributed Parc's relatively low occupancy rate to the property's age, poor reputation, and lack of private rooms and bathing facilities for each resident.

Parc then offered the appraisal and testimony of an appraiser who had authored thousands of appraisals, including hundreds for nursing homes. The appraiser concluded to a total value of $2 million for the property. He found that the property had only 61,095 square feet on a 2.42-acre lot. He performed all three approaches to value but gave primary consideration to the cost approach because in his opinion nursing homes are special-purpose properties. His cost approach included an 87.5% deduction for depreciation. His income approach came to a similar value based on a per-bed daily rate and the property's current occupancy. He gave minimal weight to the sales comparison approach because sales of nursing homes often include intangible assets and personal property. In reconciling his values, the appraiser noted that the most important consideration in valuing a nursing home is not square footage but rather the number of beds.

The County and District, in contrast, offered the testimony of an employee of the township assessor who was not an appraiser and had only completed one full appraisal of a business, which was not a nursing home. This witness testified that the property had a value of $4.6 million in 2014 and $5 million in 2015. He concluded to a 50% depreciation rate based on a sixty-year life for nursing homes in Joliet and "buildings in general." He also completed an income approach and sales comparison approach using number of beds as the unit of comparison.

After hearing the evidence, PTAB determined that the county's assessments of Parc were too high, agreeing with Parc's appraiser's valuation of $2 million, or $9,852 per bed. PTAB credited the appraiser's experience and the credibility of his analysis, while giving little weight to the assessor's witness, who failed to address the unique characteristics of the property. The District appealed to the appellate court.

The court noted that PTAB observed a dispute concerning both building size and lot size, which was left unresolved during the hearing, but PTAB concluded that the disputes did not prevent a determination of the correct assessment of the property.

The appellate court noted that PTAB had valid reasons for relying on Parc's appraisal and not the valuation put forth by the County and District. But the District argued that PTAB's decisions were against the manifest weight of the evidence because PTAB did not determine the square footage of Parc's facility or the acreage of the lot, two facts about which there was conflicting information. The appellate court also disagreed with that assertion. The court noted that PTAB observed a dispute concerning both building size and lot size, which was left unresolved during the hearing, but PTAB concluded that the disputes did not prevent a determination of the correct assessment of the property. The appellate court agreed it was not necessary in this instance for PTAB to determine the precise sizes of Parc's building or lot. The evidence showed that regardless of the building's square footage and the lot's acreage, the County overvalued the property.

Moreover, both parties' witnesses valued the property using all three approaches. Under the sales comparison and income approaches, both witnesses determined the value of the property based on the number of beds in the facility, not its square footage. Unlike other buildings that are valued based on a price per square foot, it is appropriate to value a nursing home based on a price per bed because beds are "the basic units of income generation in a nursing home."

Also, the appellate court opined that while it was true that both parties' cost approaches used different square footages, it was the widely divergent depreciation rates used by the experts, rather than the size of the facility, that caused them to come to different opinions of value under the cost approach. Further, any dispute about the lot size was irrelevant because Parc did not challenge the county's valuation of its land, and Parc's appraiser concluded to a value of the land that was consistent with that assessment.

Accordingly, the evidence in this case established that regardless of the square footage of the facility or the acreage of the lot, the County's valuations of the property were too high and should be reduced. For that reason, the court affirmed the PTAB's decisions.

Joliet Twp. High School Dist. 204 v. Illinois Property Tax Appeal Board
Illinois Appellate Court, 3rd District
June 22, 2021
2021 IL App (3d) 190477

Nonpayment of rent pursuant to stipulated order terminates lease prior to bankruptcy

John Sakon is a real estate developer who owns three properties in the Town of Glastonbury, Connecticut (Town), which together comprise nearly all of Sakon's financial assets. The Town instituted foreclosure actions on the three properties owned by Sakon because he had not paid property taxes on them since 2009, resulting in a total of $900,000 in outstanding taxes, plus accrued interest. Following multiyear litigation in the foreclosure actions, the state superior court entered judgments of foreclosure by sale and ultimately set the sale date to September 21, 2019. Two days before the sales were to take place, Sakon filed for Chapter 11 bankruptcy.

In addition to the three properties, Sakon claimed to own a long-term leasehold interest in a fourth property, having entered into a 98-year ground lease in 1999. That fourth property is adjacent to his other three properties, and Sakon intended to pursue a development plan for the four properties together for a project known as the Shoppes at Avalon. The leased property was owned by A&F Main Street Associates (A&F).

The terms of the ground lease provided that nonpayment of rent constituted a default, upon which A&F would provide the tenant with a notice of default allowing fifteen days to cure. Failure to cure would allow A&F to terminate the lease.

In October 2018, A&F sent Sakon a notice of default for failure to timely pay rent, and thereafter sent a notice of termination of lease. In December 2018, A&F filed a process action in the superior court to evict Sakon. In August 2019, the superior court entered a stipulated order providing for an amended lease on the condition that Sakon pay $97,500 to A&F by November 30, 2019, in which case the ground lease would be reinstated as of the date of payment in full. Under the stipulation, the amended ground lease would not be operative or effective until payment was tendered; Sakon's failure to timely render payment would render the amended lease null and void. The final paragraph of the stipulation provided that if Sakon filed for bankruptcy, the agreement would not be construed as a judgment of possession.

Following Sakon's filing for Chapter 11 bankruptcy, A&F moved for relief from the stay because Sakon had failed to pay A&F pursuant to the stipulation and because the lease had terminated before Sakon's bankruptcy petition. Ultimately, the bankruptcy court held that Sakon's lease terminated in December 2018 when he received his eviction notice from A&F after failing to pay rent, and the stipulation did not reinstate the lease. Accordingly, the bankruptcy court granted A&F's motion for relief from stay on the grounds that the court could not assume a nonresidential lease that had already been terminated under applicable nonbankruptcy law.

Under Connecticut law, breach of covenant to pay rent does not automatically result in termination of the lease but does give the lessor a right to terminate.

The Town also moved to convert the Chapter 11 proceedings, which would allow for reorganization, to Chapter 7 proceedings, which would force liquidation. The bankruptcy court granted the Town's motion, holding that conversion was appropriate because, without the leased property as part of Sakon's estate, there was a substantial or continuing loss to or diminution of the estate without a reasonable likelihood of rehabilitation. In particular, Sakon's only source of income was Social Security, while his expenses were substantially higher, and the properties were loaded with more than $5.9 million in debt. Thus, the bankruptcy court concluded that Sakon had failed to demonstrate that he had any tangible capitalization or cash flow to support his current obligations or plan objectives. Sakon appealed both of the bankruptcy court's orders to the US District Court.

Regarding termination of the lease, the district court explained that a bankruptcy trustee may assume or reject any executory contract or unexpired lease of the debtor but may not assume an unexpired lease if that lease is of nonresidential real estate and has been terminated under applicable nonbankruptcy law. In other words, if a nonresidential lease has been terminated under state law, then the trustee may not assume or assign the lease but can only reject it.

Sakon argued that the bankruptcy court erred by finding that the lease had terminated before he filed his bankruptcy petition and that the lease had not terminated since no rent was due on account of A&F's violation of the terms of the lease. He further argued that in the stipulation the parties agreed the leasehold interest would not terminate prepetition and would become part of the bankruptcy estate. Thus, in Sakon's view, the stipulation "wiped the slate clean" as though the eviction had never commenced.

The district court disagreed with Sakon. Under Connecticut law, breach of covenant to pay rent does not automatically result in termination of the lease but does give the lessor a right to terminate. Service of an eviction notice is a typical unequivocal act notifying the tenant of the termination of the lease, so service of a valid notice terminates the lease and creates a "tenancy at sufferance." Moreover, the stipulation expressly provided that the lease would not be operative or effective unless Sakon paid $97,500 to A&F and would only be reinstated upon timely payment. Despite Sakon's argument that his obligation to pay rent was discharged, the stipulation states that the lease had been terminated. Plainly the parties understood that the lease had been terminated.

Sakon also argued that the anti-forfeiture doctrine should have prevented the bankruptcy court from finding the lease had terminated, because he had paid $350,000 to A&F over the course of the lease. Under Connecticut's anti-forfeiture doctrine, a court may enjoin a forfeiture of a lease based on technical grounds as opposed to the tenants' willful neglect and where the delay has been slight, the loss to the lessor small, and when not granting relief would result in hardship to the tenant. The district court opined, however, that the fact that at one point Sakon made his rental payments on time is not enough to excuse nonpayment in 2018, and his failure to tender payment pursuant to the stipulation with A&F.

Accordingly, the district court found that there was no merit to any of Sakon's challenges to the bankruptcy court's determination that his lease was terminated before he petitioned for bankruptcy, and thus the bankruptcy court did not err in granting A&F's motion for relief from stay.

With regard to the Town's conversion, Sakon argues that the court erred in converting his case to a Chapter 7 proceeding because, besides his "minor expenses," there was no other evidence offered by the Town as to a substantial and continuing diminution in value.

The district court disagreed. As an initial matter, Sakon's argument was predicated on the long-term ground lease being part of his estate. He did not dispute the Town's valuation of the three properties he owns, but he argued that the bankruptcy court erred by not relying on his appraisal concluding that the four properties together were worth $11.430 million as an assemblage. But, as the district court already explained, the bankruptcy court could not assume the previously leased property into the estate, and Sakon presented no evidence to show the sustainability of his estate without the leased property. Indeed, Sakon conceded that without the assemblage, the estate is "upside down."

In sum, the district court concluded that the bankruptcy court did not abuse its discretion in concluding that it was in the best interest of the creditors to convert the case to a Chapter 7 proceeding. For those reasons, the district court affirmed the decisions of the bankruptcy court.

Sakon v. A&F Main Street Associates LLC
US District Court for the District of Connecticut
January 19, 2021
2021 WL 165014

Cost-to-cure analysis in taking considers whether substitute property offered is adequate substitute for condemned land

The Bay Head Improvement Association (BHIA) is a nonprofit corporation that operates the local beaches in Bay Head, New Jersey. BHIA has never sold any of its property, but instead is dedicated to providing public access to the beach for the benefit of the Bay Head community. BHIA's activities paralleled those of a municipality in its operation of the beachfront, and in a 1984 case, the New Jersey Supreme Court concluded that, when viewed in its totality—its purposes, relationship with the municipality, activities, and virtual monopoly over the Bay Head beachfront—BHIA constituted a quasi-public entity.

As part of a storm damage reduction project, the New Jersey Department of Environmental Protection (NJDEP) took an easement over a parcel of BHIA beachfront property. NJDEP constructed new beach land adjacent to what was condemned and deposited hundreds of thousands of tons of sand to create the new beach. The court-appointed commissioners valued the property and fixed just compensation at more than $2 million. A jury, however, determined that BHIA was entitled to zero compensation for the taking, because NJDEP had offered substitute property to BHIA that was similar to what was taken and enhanced the value of the remainder of BHIA's property because it was larger and had greater storm protection.

BHIA appealed, arguing that the trial court judge improperly permitted the jury to consider whether BHIA mitigated its damages and that the valuation evidence did not comply with prior law.

The New Jersey Superior Court, Appellate Division, first addressed BHIA's argument that the judge erred by permitting the jury to consider the doctrine of mitigation of damages, because BHIA was not seeking severance damages. The judge instructed the jury that BHIA was entitled to just compensation, measured by the difference between the fair market value of BHIA's property before and after the taking. In determining value, the jury was instructed to consider BHIA's duty to mitigate damages from the taking by applying a cost-to-cure analysis, which considers the evidence of availability and use of similar replacement property.

New Jersey courts have two methods to compute severance damages. One method is to take the market value of the land taken, plus the difference in value of the remainder area before and after the taking. The second is to take the difference between the value of the entire tract before the taking and the value of the remainder area after the taking. But a condemnee seeking severance damages in a partial condemnation case has a duty to mitigate damages resulting from the taking, and in some instances, courts require a condemnee to accept substitute property instead of monetary compensation.

However, as BHIA emphasized, a different method of compensation is used when the condemnation involves the taking of public lands. In such circumstances, the property may be valued under the substitute facilities doctrine, which is based upon the inadequacy of a monetary award for compensation for the condemnation of public property. In such cases—which only occur when the condemnee is a municipality or other governmental entity—compensation takes the form of the cost of replacing the facility with an adequate, substantially equivalent, substitute facility.

Because BHIA maintained that the taking was total and not partial, BHIA never requested severance damages, which it contended should have prevented the jury from considering whether its damages were mitigated. But the appellate division disagreed with BHIA's characterization of the remainder property as an uneconomic remnant, as BHIA's expert valued the remainder to be worth $350,000 and therefore not worthless. Accordingly, even though BHIA did not formally request severance damages, the judge correctly instructed the jury to consider mitigation.

BHIA also argued that the judge erred by allowing NJDEP to present a substitute facilities theory under the guise of mitigating damages, but the appellate division disagreed. An analysis of mitigation requires consideration as to whether substitute property offered by a condemnor cures the loss caused by the condemnation. And while the substitute facilities doctrine is only available for the condemnation of public lands, the judge was clear that BHIA was not a public entity but instead a private nonprofit corporation. Thus, the judge's instructions to the jury were in conformance with the mitigation theory, not the substitute facilities theory.

In determining value, the jury was instructed to consider BHIA's duty to mitigate damages from the taking by applying a cost-to-cure analysis, which considers the evidence of availability and use of similar replacement property.

BHIA also argued that the judge erred by permitting the jury to consider whether the substitute property interests offered by NJDEP mitigated BHIA's damages. The judge instructed the jury to determine whether the property interest was an adequate substitute for the property taken, and whether the replacement would totally cure the damage caused by the condemnation. He noted that the availability of substitute property is not to be evaluated in terms of a like-kind exchange but rather strictly in a cost-to-cure analysis.

The appellate division disagreed with BHIA's arguments. A consideration of substitute property was a necessary part of the analysis as to whether BHIA's damages were mitigated. And while both theories use the term "substitute" for the land offered by a condemnor, the substitute facilities doctrine only applies to public lands, and thus could not apply here. Thus, the judge correctly instructed the jury that in a partial taking, a defendant must mitigate damages, and part of that cost-to-cure analysis is whether the substitute property offered by a plaintiff is similar and adequate to the land that was condemned.

Because the appellate division concluded that the judge's jury instructions were proper and supported by the facts of this case, the jury's verdict was affirmed.

New Jersey Dept. of Environmental Protection v. Bay Head Improvement Assoc.
Superior Court of New Jersey,
Appellate Division
July 12, 2021
2021 WL 2908994

About the Author

Benjamin A. Blair, JD, is a partner in the Indianapolis office of the law firm of Faegre Drinker Biddle & Reath LLP, where his practice focuses on state and local tax litigation for clients across the United States. A frequent speaker and author on taxation and valuation issues, Blair is licensed to practice law in Indiana, Oregon, and Washington. Blair holds a juris doctor from the Indiana University Maurer School of Law, where he also serves as an adjunct professor.
Contact: Benjamin.Blair@FaegreDrinker.com