by Benjamin A. Blair, JD

Recent Court Decisions on Real Estate and Valuation

Stadium assessment does not include deduction for funding reserve to prevent functional obsolescence

China Basin Ballpark Company LLC (CBBC) owns improvements consisting of a major league baseball stadium (the Ballpark) used by the San Francisco Giants. The Ballpark sits on public land leased to CBBC. The Ballpark was completed in 2000, and starting in 2001, the property tax value of the Ballpark improvements—assessed as a possessory interest by the San Francisco County Assessor (Assessor)—has been contested.

Settlements for the 2001–2010 assessments applied the cost approach to determine value. The 2011–2014 assessments were the subject of a twelve-day hearing in which both parties relied on a cost approach and income approach. In the decision for those years, the San Francisco Assessment Appeals Board (County Board) found that the Ballpark had no functional obsolescence, but nevertheless found that a $300 million deduction was warranted for expected capital improvements and renovations beyond ordinary maintenance. The County Board reconciled the two approaches, and neither party sought judicial review of the decision.

CBBC next returned to the County Board to contest the Ballpark's value for the 2015–2017 tax years. CBBC and the Assessor stipulated that the cost approach alone would provide a reliable indicator of value and that they would rely exclusively on the cost approach.

In its written decision after a four-day hearing, the County Board agreed that the cost approach was most appropriate for the case. Using the cost approach, the County Board made findings as to land value, replacement cost, and physical deterioration. With regard to functional obsolescence, the County Board agreed with the parties that the Ballpark experienced no functional obsolescence as of the lien dates. But as with the prior findings, the County Board deducted the cost of "substantial capital expenditures" that it believed would be "necessary to prevent functional obsolescence in the future."

CBBC showed that fan and advertiser expectations would require ongoing capital improvements and renovations beyond ordinary maintenance, and that a reasonable and prudent buyer would anticipate those costs during the term of possession. Thus, the County Board assumed a buyer would account for that future cost by funding a contingency reserve through the anticipated term of possession, which the County Board described as a reserve to prevent functional obsolescence. The County Board calculated the deduction at $180 million per year. The Assessor appealed, first to the superior court, and then to the court of appeal.

California law describes the cost approach as "applying current prices to the labor and material components of a substitute property capable of yielding the same services and amenities, and then applying a depreciation factor." In general, depreciation is thought of as the difference between the present value of the worn-out or outmoded subject property and the present value of a hypothetical, newly built, modern property of equivalent utility.

On appeal, the Assessor argued that the cost approach considers the replacement cost of a property at the time of valuation, and thus the County Board's consideration of future depreciation is inconsistent with the cost approach. The income approach is inherently forward-looking and may therefore be better suited to consider a factor like future expenses, but the cost approach values property as of a specific date. In response, CBBC argued that the ultimate question is what a prudent buyer would pay for the Ballpark's possessory interest, and substantial evidence supported the conclusion that a prudent buyer would consider the significant future expense of preventing functional obsolescence when determining how much to pay for the Ballpark.

The appellate court found the County Board's method to be fatally flawed because it was not likely to approximate fair market value.

The appellate court found the County Board's method to be fatally flawed because it was not likely to approximate fair market value. Depreciation does not refer to a decline in the original value of the subject property, but rather to a measurement of the extent to which the subject property is, at a particular point in time, worth less than a hypothetical new property. The County Board deducted the present value of funding a reserve to prevent functional obsolescence, but because there was no current functional obsolescence, a hypothetical new stadium would have the same features as the Ballpark. Moreover, because the need to fund a reserve would be known at the time the stadium was constructed, a hypothetical new stadium would also need to fund a reserve to prevent future functional obsolescence. Accordingly, simply deducting the present value of funding that reserve does not approximate the difference in value between the Ballpark and a hypothetical new stadium.

The court did not dispute that there may be a way to compare the current value of funding a reserve for the Ballpark with the current value of funding a reserve for a hypothetical new stadium. There may also be other means of measuring the future functional obsolescence to reasonably approximate market value. For example, using principles from the income approach, the metric could potentially be the net loss of income that would be caused by future functional obsolescence if not remedied. Although the court expressly did not "direct any particular means be used here," the court concluded that the County Board's approach failed to approximate fair market value, and thus the court remanded for the County Board to determine how to do that.

Torres v. San Francisco
Assessment Appeals Board No. 1
California Court of Appeal,
First Appellate District
March 15, 2023
2023 WL 2644016

Direct, definite evidence needed to demonstrate partiality by neutral appraiser in arbitration

A group of individuals (the Landlords) own a tract of land in downtown Houston, Texas, comprising the eastern half of Block 84. The rest of the land at Block 84 is owned by Bank of America Corporation (BAC). The Bank of America Center, owned by BAC, is located on Block 84.

The Landlords and BAC are parties to a lease agreement concerning the land occupied by the Bank of America Center. The lease provides for fixed rent for the first part of the lease term, ending on December 31, 2016, followed by six revaluation periods during which the parties are required to renegotiate the annual rent due in the latter part of the lease term. The revaluation process is set at 7.5% of the fair market value of the land as of the date one year prior to the commencement of the revaluation period.

To determine fair market value, the lease requires the parties to try to reach an agreement on the value of the land. If they are unable to agree, the lease provides an appraisal process to determine fair market value. The parties each appoint an appraiser, and if the two appraisers cannot agree on a value, they jointly select a "competent and impartial" third appraiser. The decision of two of the three appraisers establishes the fair market value, and the decision is final and binding.

BAC and the Landlords were unable to agree on a fair market value, so the Landlords initiated the appraisal process in May 2016. The Landlords' appraiser (LL Appraiser) arrived at a value of $14.4 million. BAC's appraiser (BAC Appraiser) arrived at a value of $8.25 million. Together, LL Appraiser and BAC Appraiser selected a third-party appraiser (Third Appraiser) employed by a national valuation firm (Firm). The Third Appraiser valued the land at $8.7 million.

The point of disagreement between the three appraisers concerned whether the land should be valued with or without access to the downtown tunnel system. The appraisers proposed that each prepare another appraisal to attempt to reach a majority decision, but BAC did not agree.

In November 2016, the Landlords filed a petition seeking declaratory judgment to determine whether the property was to be valued with or without access to the adjacent tunnel system. The next day, the three appraisers met, and BAC Appraiser and Third Appraiser agreed that the value of the land was $8,475,000 and confirmed the valuation to the parties. BAC filed counterclaims, and also sought declaratory judgment that the $8,475,000 valuation was binding on the parties. The Landlords then asserted additional claims, alleging that BAC and Third Appraiser did not disclose that they had negotiated Third Appraiser's services as BAC's party-appraiser or their significant business relationships. Specifically, the Landlords claimed that they obtained evidence of undisclosed communications and relationships between BAC, Third Appraiser, and the Firm.

After briefing, the trial court entered interlocutory orders granting BAC's motion to enforce the appraisal award that $8.475 million was the value of the land and granting BAC's motion for summary judgment on the Landlords' claims of breach and fraud. The Landlords appealed.

A court must vacate an award if the rights of a party were prejudiced by evident partiality of a supposedly neutral arbitrator.

On appeal, the Landlords first contended that they had offered evidence of "evident partiality"—the neutral's refusal to disclose critical information—that precluded confirmation of the award. A court must vacate an award if the rights of a party were prejudiced by evident partiality of a supposedly neutral arbitrator. Neutrals are required to disclose any facts that might to an objective observer create a reasonable impression of partiality, but information that is trivial will not rise to this level.

Here, the evidence showed that Third Appraiser had agreed to serve as BAC's party-appraiser, but he had travel plans that conflicted with the timeline for the party-appraiser's work. BAC's personnel told Third Appraiser that if the process were to extend to a third appraiser, he would be "at the top of BAC's list." The Landlords argued that a reasonable person could conclude that Third Appraiser might favor BAC in hopes of gaining additional business from BAC in the future, affecting Third Appraiser's partiality.

The appellate court disagreed. It found that the communications were not the type of direct and definite evidence required to demonstrate an improper motive on the part of the neutral. Instead, the communications regarding Third

Appraiser's availability and qualifications to serve were nonsubstantive; thus, they did not rise to the level of material fact requiring disclosure.

The evidence also showed that the Firm had ongoing business relationships with BAC and its affiliates, as well as with BAC's law firm in the case, totaling around $100,000 in fees. The Landlords argued that those transactions demonstrated an ongoing and meaningful client relationship between the Firm and BAC-affiliated entities.

The court again disagreed. It noted that arbitrators and other neutrals are not disqualified merely because of a past business relationship with a party—in part because often the most capable arbitrators will be those with extensive experience in the industry. All of the contacts about which the Landlords complained involved individuals other than Third Appraiser and concerned properties and matters unrelated to the land at issue in this dispute. Third Appraiser had no involvement in those projects and did not receive financial benefit from them. These remote contacts do not demonstrate evident partiality.

The Landlords next claimed that BAC committed fraud by nondisclosure of those same facts. A duty to disclose arises in four scenarios, including when a party voluntarily discloses information that gives rise to the duty to disclose the whole truth, and when a party makes a partial disclosure and conveys a false impression, giving rise to the duty to speak. The Landlords contended that BAC had a duty to disclose under both scenarios.

The court disagreed with the Landlords. The information BAC disclosed did not create a substantively false impression nor was it otherwise misleading with regard to whether some individuals at BAC might have had contacts with other individuals at the Firm unrelated to Third Appraiser. Also, the emails contained no words to create a false impression that BAC and Third Appraiser had never spoken about the matter. The Landlords failed to establish that BAC had a duty to disclose information about BAC's relationships or prior communications. Similarly, that BAC had a favorable impression of Third Appraiser such that he was "at the top of BAC's list" is not evidence that BAC intentionally withheld information intending that the Landlords rely on the alleged omission.

Accordingly, finding no evidence to support the Landlords' claims, and finding no error in the trial court's judgment, the appellate court affirmed.

Burke v. Houston PT BAC Office LP
Texas Court of Appeals, First District
January 3, 2023
2023 WL 17497

Acquisition of hotel with assignment of contract did not change PILOT agreement

In December 2000, the Town of Harrison, New Jersey (Town) entered into a financial agreement with Harrison Waterfront Urban Renewal LLC (Waterfront) in connection with the construction of a 170-room hotel in the Town's waterfront redevelopment area. As part of that agreement, the Town approved a long-term tax exemption (LTTE) under state law. The payment in lieu of taxes (PILOT) agreement provided that "the Entity shall make payment to the Town in lieu of taxes in an amount equal to the greater of [$170,000] or an Annual Service Charge equal to 15% of the gross revenue of the Entity."

In the agreement, the parties expressly acknowledged that an operating entity would lease the project from "the Entity," i.e. Waterfront, and a summary of the lease was disclosed to the Town as part of the LTTE application. The agreement thus memorialized an understanding that the "gross revenue of the Entity" would be based on the amount generated through the master lease. Since the agreement was in place, the Town consistently calculated the service charge based on the master lease rent revenues.

A reviewing court must consider the contract language in the context of the circumstances at the time of drafting and apply a rational meaning in keeping with the expressed general purpose.

In May 2018, Excel Holdings Urban Renewal LLC (Excel) and its parent company acquired the hotel. As part of the acquisition, Excel assumed all the rights and obligations of Waterfront under the agreement. The sale was completed with the consent of the Town. The master lease, however, was not assigned. Instead, Excel executed a new master lease with a new affiliated entity as the tenant-operator. The terms remained the same; the only change was the name of the party.

After Excel submitted audited financial reports to the Town in December 2018, the Town sent revised invoices to Excel, significantly increasing the annual service charge. One invoice for an additional $600,947 explained that "use of a Master Lease in an attempt to limit revenue is not valid under" New Jersey law. Because Excel's financial reports included only room rentals, and not any other income, the Town deemed Excel's payments insufficient. The Town stated that it would no longer confine the calculation of the annual service charge to the amount of the master lease, but would instead calculate the charge based on the gross receipts of the parent company.

Excel sued, seeking a preliminary injunction for the Town to stop demanding Excel make payments in excess of the December 2000 agreement, and seeking a default under the agreement pending a determination of the annual service charge calculation. The trial court granted summary judgment in Excel's favor, and the Town appealed.

It is well settled that courts enforce contracts based on the intent of the parties, the express terms of the contract, surrounding circumstances, and the underlying purpose of the contract. A reviewing court must consider the contract language in the context of the circumstances at the time of drafting and apply a rational meaning in keeping with the expressed general purpose.

Here, the agreement provided that "the Entity shall make payment to the Town" equal to either the minimum charge or "15% of the gross revenue of the Entity." The Entity, for purposes of the agreement, was defined as Waterfront and any subsequent purchasers or successors in interest. Because of the approved transfer of the agreement from Waterfront to Excel, the court concluded that Excel was the Entity within the meaning of the agreement.

The Town's argument was based on a court decision that was superseded by a statutory amendment which ratified and validated the terms and conditions of any tax exemption approved pursuant to the state law, including the methods used to calculate annual service charges. Thus, the 2018 assignment to Excel did not create a new PILOT agreement. Rather, the existing contract and its method of calculating annual service charges remained in effect. The only change from the assignment is the name of the entity obligated to perform the agreement's substantive terms.

Accordingly, Excel was deemed to be the contract "Entity," and thus only its gross revenues generated through the master lease were the basis for the annual service charge, not the revenues of Excel's parent. The judgment for Excel was affirmed.

Excel Holdings Urban Renewal LLC v.
Town of Harrison
Superior Court of New Jersey,
Appellate Division
December 6, 2022
2022 WL 17419615

Stormwater management charge is a tax, not a fee

The Borough of West Chester, Pennsylvania (Borough), owns and operates a small municipal separate storm sewer system. In 2016, the Borough Council enacted a stormwater charge as a mechanism by which it would raise revenue to further construct, operate, and maintain its stormwater management facilities. In relevant part, the Borough Code provides that a "stream protection fee" is imposed on every developed property within the Borough that is connected with, uses, or is serviced by the Borough's stormwater system. All sums collected from the stormwater charges are deposited into a stormwater management fund, which is used to construct and operate the stormwater system, service debt on capital projects, fund pollution remediation measures, and pay for other project costs. The charge owed by an owner of a developed property depends on the amount of impervious surface on the property.

The Pennsylvania State System of Higher Education (PASSHE), in the name of the Commonwealth of Pennsylvania, and West Chester University of Pennsylvania (collectively with PASSHE, the University) are the title owners of portions of the University's campus that lies partially within the Borough. The Borough asserted that all of the University's parcels are "developed" for purposes of the stormwater code and that they are connected with, used, and served by the Borough's stormwater system.

According to the Borough, there is a direct relationship between the amount of impervious surface in a given watershed and the health and quality of the watercourse in that watershed. The Borough contended that the impervious area of the campus lying within the Borough covers 32 acres, about 8% of the Borough's total impervious area. Accordingly, the Borough sent the University stormwater charge invoices in 2017, 2018, and 2019, which the University refused to pay.

Although the Borough did not dispute that PASSHE and the University are immune from local taxation, the Borough argued that the stormwater charge constituted a fee rather than a tax, and that therefore the University was obligated to pay it. The Borough filed a petition for declaratory judgment against the University in the Commonwealth Court seeking to establish that the Borough's stormwater charge was a fee for a service, not a tax from which the University is immune. Both parties filed for summary judgment.

A tax is broadly imposed, and it raises money to contribute to a general fund to be spent for the benefit of the entire community. A fee, conversely, is paid to a public agency for bestowing a benefit that is not shared by the general members of the community and is paid by choice.

The court began by analyzing the distinction between a tax and a fee. A tax is an enforced contribution to provide for support of government. A tax is broadly imposed, and it raises money to contribute to a general fund to be spent for the benefit of the entire community. A fee, conversely, is paid to a public agency for bestowing a benefit that is not shared by the general members of the community and is paid by choice. Additionally, a charge is a tax rather than a fee if it is not reasonably proportional to the value or benefit received in return for its payment.

Given that framework, the Borough maintained that the stormwater charge constituted a fee for service as opposed to a tax generally benefiting the public at large, because revenue generated by the charge funds projects providing specific, discrete benefits to owners of developed property. Owners of both developed and undeveloped properties in the Borough receive the general benefits from the projects funded by the charge.

The University countered that the Borough's stormwater system confers a general environmental benefit on all property owners within and around the Borough. As such, the charge constitutes a tax. The University maintains its own separate stormwater system to collect and manage stormwater runoff and therefore does not rely on the Borough's stormwater system for that purpose. The University has also borne the cost of implementing measures for preventing stormwater runoff, including adding trees, green roofs, rainwater gardens, and pervious paver systems around its campus. The Borough's pollution reduction plan, funded by the stormwater charge, specifically addresses issues at parks and streets away from the University's campus, and thus none of the projects will benefit the University's campus property.

The court agreed with the University. Although the Borough argued there is a direct relationship between the amount of impervious surface area and the extent of stormwater-related issues, the Borough conceded that it had no means of measuring the amount of stormwater runoff that flows from the campus. Thus, no direct measure of the University's purported use of the stormwater system exists.

Moreover, the impervious surface area of a property does not correlate to the level of benefit accorded the owner of that property. The Borough's stormwater charge therefore provides benefits that are enjoyed by the general public, such as decreased flooding, erosion, and pollution, rather than individualized services provided to particular customers. The work funded by the stormwater charge yields a common benefit shared by residents of the Borough generally. Additionally, the stormwater charge does not constitute a special assessment subsidizing a particular project of limited duration. Instead, the charge subsidizes an ongoing series of evolving tasks and projects.

Because the stormwater charge had the hallmarks of a tax rather than a fee for services, the court concluded that the University was immune from paying the charge. It is well settled that property owned by the Commonwealth and its agencies is beyond the taxing power of a political subdivision. Property owned by the Commonwealth or its agencies and instrumentalities is presumed to be immune, with the burden on the local taxing body to demonstrate taxability. Here, the Borough failed to demonstrate that the stormwater charge was a fee or that the University was taxable. Accordingly, the court granted summary judgment in favor of the University and against the Borough.

Borough of West Chester v.
Pennsylvania State System of Higher Education
Commonwealth Court of Pennsylvania
January 3, 2023
2023 WL 2486168

Easement of necessity denied by express language in contract

In 2018, Kevin and Pamela Albertson bought a lot in a new subdivision in Mooresville, Indiana. After construction of a home on the lot, the Albertsons contacted Richard and Lisa Cadwell, who owned a 24-acre lot behind and east of, and contiguous with, the Albertsons' lot. The Albertsons asked the Cadwells to sell them a portion of their property, and the Cadwells agreed. In June 2019, the parties executed a purchase agreement for one-half acre of the Cadwell property. The purchase agreement did not include a legal description of the new parcel but provided that a survey would be forthcoming.

The purchase agreement also contained other conditions. The Albertsons gave the Cadwells a 10-foot utility easement on the north end of their lot. And the Cadwells agreed to have "a neighborly agreement that will allow the Albertsons to have an occasional access through [the Cadwells'] remaining ground to access their property." The agreement expressly provided that it was not a "recorded easement or recorded agreement, just a friendly agreement between neighbors."

An easement of necessity is equitable in nature, and when the rights of parties are controlled by an express contract, recovery cannot be based on a theory implied in law.

The Albertsons hired a surveyor to prepare a legal description of the new parcel. The surveyor advised the Albertsons that he had discovered a small gap, less than three feet wide, between the Albertson lot and the Cadwell property. Although the Albertsons shared that information with the Cadwells, neither party addressed the gap issue before they closed on the sale of the new parcel on August 2, 2019.

In February 2020, the Albertsons submitted an application for a permit to build a pole barn on the new parcel. In the application, the Albertsons said that the barn would be accessed from their lot. Additionally, the Cadwells had constructed a driveway across their property that connected the Albertsons' barn to the County Road located east of the Cadwells' property.

Thereafter, the Cadwells found a buyer for their property, and after the Albertsons did not receive confirmation that the buyer would grant the Albertsons access as the Cadwells had done, the Albertsons sued, seeking an easement of necessity toward the County Road over the Cadwell property. Their theory was that the new parcel was landlocked by virtue of the gap parcel. The Cadwells executed a quitclaim deed to transfer title to the gap parcel to the Albertsons, which was not accepted, and then the Cadwells filed for summary judgment.

After a hearing, the trial court entered summary judgment for the Cadwells. The court concluded that no gap was intended, so no easement by necessity exists, and the parties agreed in their contract that no easement existed. The Albertsons appealed.

An easement of necessity is implied when there has been a severance of the unity of ownership of a tract of land in such a way as to leave one part without access to a public road. An easement of necessity may only arise at the time the parcel is divided and only because of inaccessibility then existing. Here, neither party disputed the unity of title element, but the necessity of the alleged easement was in dispute.

On appeal, the Albertsons contended that necessity contemplates vehicular access. While they can access the new parcel on foot by walking from the road fronting their home, across their parcel and the gap parcel, they argued that the focus of an easement by necessity is not just the ability to access the landlocked parcel on foot but also by vehicle. They also argued that the parties' intent is not relevant to the question of necessity.

The court of appeals agreed with the Cadwells. The parties agreed at the time of the conveyance of the new parcel that the Albertsons would not have an easement across the Cadwell property. An easement of necessity is equitable in nature, and when the rights of parties are controlled by an express contract, recovery cannot be based on a theory implied in law. Thus, the Albertsons' claim to an easement fails as a matter of law.

An implied easement of necessity will only be established where the parties' intent regarding access to real property can only be presumed. Put simply, the law will not support an implied easement where the parties' explicit intent is otherwise. Here, the undisputed evidence established the parties' intention that the Albertsons would not have an easement over the Cadwell property.

It was "just a friendly agreement between neighbors" that the Albertsons would have only "occasional access" across the Cadwell property. And the Albertsons did nothing to resolve the gap issue before they closed on the purchase of the new parcel. Thus, they knowingly bought a landlocked parcel without securing an access easement.

Therefore, the court concluded that the trial court did not err when it entered summary judgment for the Cadwells. Judgment affirmed.

Albertson v. Cadwell
Indiana Court of Appeals
December 14, 2022
200 N.E.3d 948

Assessment should not measure value attributable solely to owner's use

Walmart Real Estate Business Trust (Walmart) owns and occupies a 184,000-square-foot retail property in the City of Bad Axe, Michigan (City). Walmart challenged the 2019 property tax assessment of its property. Following an evidentiary hearing at which each party presented expert witness testimony regarding the value of the property, the Michigan Tax Tribunal (Tribunal) issued a written opinion concluding that the true cash value of the property was $4,270,000, essentially half of the value assessed by the City.

In its determination, the Tribunal found that the market analysis and methodology of Walmart's expert would be given weight and credibility in the Tribunal's independent determination of the property's market value. The Tribunal found the analysis of the City's expert was not credible, rejecting the City's method that was based on assuming a hypothetical lease for the property. The Tribunal opined that the property's "fee simple property rights in the context of market value does not contemplate the nonexistent lease as prescribed by" the City's expert. The City appealed.

In Michigan, assessments are based on the property's true cash value, which means the usual selling price that could be obtained for the property at private sale. Therefore, the assessment must reflect the probable price that a willing buyer and a willing seller would arrive at through arm's-length negotiation, and the final value determination must represent the price for which the property would sell irrespective of the specific method employed.

On appeal, the City first argued that the Tribunal committed an error of law by relying on the improper definition of "fee simple." The City argued that the fee simple ownership includes the right to lease the property. But the court of appeals concluded that the City "misunderstands the nature of the question at issue." The question is not whether Walmart, as owner of the property, has a right to lease the property to some other entity. Rather, the question is how to properly appraise the fair market value of the property.

The City next argued that the Tribunal erred by rejecting its valuation methodology that valued the property as if it would be sold subject to an existing lease. The court recited its past case law that what must be valued is what would actually be sold. The property was owner-occupied and not encumbered by a lease. Under those circumstances, the hypothetical sale would be of the property without an existing lessee or operating retail business, and thus the property must be valued as if vacant and available. The Tribunal did not err in rejecting the City's theory.

Furthermore, to the extent that the City contends that the Tribunal's approach prohibited any consideration of leased properties as comparables, the court held that the City "again misunderstands the issue." The City could have used sales of leased properties as comparables if appropriate adjustments had been made. But the City did not recognize the need for such adjustments since it believed that the property should be valued as if an inherent feature of the property is the existence of an allegedly successful business tenant that would transfer to a new owner along with the real property. The City's attempt to conflate the distinct concepts of Walmart's real property and Walmart's business did not demonstrate that the Tribunal committed an error of law.

Ultimately, the City's argument on appeal that the existing use of the property as improved should be as a continuously occupied, successful retail store attempts to include in the property's assessment a measure of value attributable solely to the owner and the owner's use of the property. Even if the property is in fact continuously occupied and successful, these characteristics of the property are not relevant. They are "accidents of ownership, not measures of value inherent to the property itself."

Because the Tribunal did not err in rejecting the City's theory that the property should be valued as though encumbered with a lease, the Court affirmed the Tribunal's judgment in favor of Walmart.

Walmart Real Estate Business Trust v. City of Bad Axe
Michigan Court of Appeals
October 20, 2022
2022 WL 12071984

Property need not be legally owned by immune entity to be immune from taxation; equitable ownership is sufficient

The Florida State University System is established by the Florida Constitution and governed by a Board of Governors. A Board of Trustees administers each state university in the system. Each Board of Trustees is a public body corporate and a public instrumentality. The University of Florida (UF) Board of Trustees is one such entity, responsible for setting university policies in accordance with state law. UF Health is an academic medical center that fulfills part of UF's function as a state university. UF Health is predominantly a collaboration between Shands Teaching Hospital and Clinics Inc. (Shands), two other medical centers, and related faculty practice plans, including Florida Clinical Practice Association Inc. (FCPA).

Shands was created by the Florida legislature to lease, manage, and operate the teaching hospital and clinics on UF's Gainesville campus. Shands—which is organized for the primary purpose of supporting the UF Board of Trustees' health affairs mission of community service and patient care, education, and training of health professionals—is a major tertiary care teaching institution licensed to operate as an acute care hospital.

Board of Governors' regulations authorize the establishment of faculty practice plans at state university academic health science centers. FCPA is a faculty practice plan corporation formed to administer the UF College of Medicine's faculty practice plan. FCPA holds title to medical office buildings constructed on land owned by Shands and leased to FCPA, in which UF College of Medicine clinical faculty practice, teach, and conduct research. FCPA has no employees of its own; rather, its functions are performed by UF College of Medicine employees.

Shands and FCPA requested refunds of ad valorem property taxes paid on properties they owned in Alachua County (County), but those claims were denied, so they filed a Complaint for Declaratory Judgment against the County property appraiser and tax collector. Shands and FCPA sought a declaration that their properties were immune from property taxation because they were instrumentalities of the state, and that they were immune from taxation because their properties were equitably owned by the state.

Both sides filed motions for summary judgment. The trial court denied judgment as to the first claim (that Shands and FCPA were instrumentalities of the state) but granted judgment on the second claim regarding equitable ownership. The trial court relied on the fact that both Shands and FCPA are recognized and relied upon by the state as virtually an arm of UF in fulfilling its health affairs mission. Because UF supervises, controls, and approves their governance and financial decision making, UF necessarily controls key property rights regarding the properties, enjoys the benefits of owning them, and bears the burdens of ownership. The trial court concluded that the state, through UF, holds virtually all the benefits and burdens of ownership of the properties; the properties were therefore immune from taxation. The County property appraiser and tax collector (collectively, the County Officers) appealed.

The County Officers challenged the trial court's determination that the properties at issue were legally owed by Shands and FCPA, but equitably owned by the State, and thereby immune from taxation. The concept of immunity from taxation connotes the absence of power to tax, while an exemption presupposes the existence of a power to tax. For purposes of property taxes, immunity for the state is limited to counties, public education entities, and agencies, departments, or branches of state government that perform the administration of state government.

Property need not be legally owned by an immune entity to be immune from taxation, but can instead be equitably owned. Earlier Florida cases concluded that it was unlikely that the Florida legislature intended that property being used for an authorized purpose should be denied a tax exemption solely because it did not hold bare legal title. Similarly, a nonprofit corporation that, as one of its charitable functions, assisted public universities in acquiring, developing, and operating student housing was found to be immune from taxation because UF directly and substantially benefits from the development, operation and management of the housing facility as an addition to the housing supply as well as to further its educational purposes and objectives.

The County Officers attempted to distinguish those cases, but the court of appeal rejected their attempt. Each of the cited cases involved a situation where the immune entity held both the benefits and burdens of ownership of the property at issue. Here, the same thing was true. Shands and FCPA are both nonprofit corporations that implement UF's health affairs mission. The properties are used by Shands or FCPA for the delivery of health care services, medical education, and scientific research in furtherance of that mission.

The court of appeal agreed with the trial court that because the state through UF holds virtually all of the benefits and burdens of ownership, it is the equitable owner of the properties at issue. The properties are therefore immune from property taxation. The trial court's judgment in favor of Shands and FCPA was affirmed.

Solomon v. Shands Teaching Hospital and Clinics Inc.
Florida Court of Appeal, First District
December 20, 2022
353 So. 3d 677

Party entitled to challenge condemnation where erroneously omitted from taking petition

Crescent Farms Canton LLC (Crescent) owned a 10.961-acre parcel running along the Etowah River in Cherokee County, Georgia. In 2008, the City of Canton (City) and the county water authority acquired a mitigation easement over 1.98 acres of the property directly abutting the river for conservation purposes. The mitigation easement required that the property be restricted from any further development.

At the time the mitigation easement was obtained, Crescent's entire property was covered by a security deed to Gilmer County Bank. As part of the easement transaction, the bank released from the security deed only the easement rights and restrictions conveyed in the easement. Sometime later, the bank foreclosed on and took the entire property, except "All that tract… being that area designated as 100' Mitigation Easement containing 1.98 acres."

The property was eventually conveyed to Community & Southern Bank, and then to Edgewater Hall Enterprises LLC (Edgewater). The deed to Edgewater conveyed "said tract of land that contains 10.961 acres… LESS & EXCEPT all that tract… being that area designated as 100' Mitigation Easement containing 1.98 acres."

In 2020, the City sought to acquire a permanent easement from Edgewater to construct and maintain a gravity sewer main and pedestrian trail through the area covered by the mitigation easement. The City had the easement rights appraised at $52,700 but offered Edgewater only $10,000—a figure purportedly based on other settlements it had reached for other easement rights. After negotiations, the parties could not reach an agreement.

The City filed a condemnation petition and declaration of taking in August 2021, but filed it only against Crescent and Bank of the Ozarks, a bank that was a successor in interest to Gilmer County Bank. The City sought to claim a permanent easement and maintained that Crescent and Bank of the Ozarks were the owners of the property at issue. The City deposited $3,800 in "just and adequate compensation." In accordance with the taking statute, the trial court ordered the property condemned for the City's use but stated that nothing in the order "is to be construed as depriving any person having an interest in, title to, or claim against said property of the right to appeal the estimated amount of just compensation or of the right" to petition to vacate or set aside the judgment.

Edgewater filed a petition to set aside the declaration of taking. According to Edgewater, it took title to the bank's entire property interest in 2012, making it the true fee simple owner of the property underlying the mitigation easement. Edgewater argued that the City's taking should be set aside for the City's bad faith in dealing with Edgewater and for deliberately failing to serve it with the petition, among other reasons.

The City then filed a second condemnation action for a temporary construction easement across the entire property so it could build the sewer main and walking trail. This time, the City named Edgewater and Bank of the Ozarks as defendants. The trial court again entered an order condemning the property, and Edgewater again petitioned to set aside the declaration of taking.

The court of appeals observed that the burden for establishing bad faith, which will cause courts to interfere with the discretion of a condemning authority, is a high one.

Following a hearing, the trial court denied both of Edgewater's petitions. The trial court found that Edgewater lacked standing to move to set aside the declaration of taking because it was not the owner of record of the property at issue, it was not the condemnee, and it had not shown it was an interested party who should be added to the action. In the second petition, the court concluded that the City did not act in bad faith or abuse its powers. Edgewater appealed.

The court of appeals observed that the burden for establishing bad faith, which will cause courts to interfere with the discretion of a condemning authority, is a high one: conscious wrongdoing motivated by improper interest or by ill will or fraud. Edgewater argued that the City's specific acts rose to that level: the City mislabeled the property's metes and bounds description, divided its taking into two cases, deliberately omitted Edgewater from the case where the larger amount of money was at stake, and failed to recognize Edgewater's status as owner despite the fact that the City had been conducting ongoing negotiations with it, all in an attempt to hide that Edgewater was not agreeing to the City's "lowball offers that were far below the appraised value of the easements."

The court concluded, though, that the record contained at least some evidence to support the trial court's conclusion. The City was negotiating with Edgewater under the assumption that it was the owner of the land, but an independent title search led to an erroneous conclusion that Edgewater was not the owner of the property. Thus, the City's change in position was not conscious wrongdoing. And the City's "lowball offers" were justified because of a comparable settlement the City had reached with a different property owner.

Edgewater also argued that the trial court erred in concluding that Edgewater was not the owner of the property and therefore lacked standing to challenge the taking. Edgewater emphasized that it paid taxes on the entire 10.961-acre tract and held title to the property by virtue of its deed.

The court agreed. When bringing a condemnation proceeding, the condemning entity is required to file a declaration of taking, which is self-executing in nature. Because a declaration of taking automatically transfers interest in land, to ensure due process to the property owner, the statute must be strictly conformed to by the condemning entity. One requirement of the statute is to set forth the names of the persons whose property or interests are to be taken.

Looking at the deed in question—the quitclaim deed from the bank to Edgewater—the language does not support the trial court's interpretation that the deed transferred 10.961 acres less the 1.98 acres underlying the mitigation easement. Reading the "less and except" language in its entirety, it is clear that it refers explicitly to the mitigation easement and not the fee simple entirety of the 1.98-acre tract underlying the easement. Nothing in the description says that it also excepts the fee simple underlying the easement. Thus, contrary to the City's argument, the land underlying the mitigation easement was deeded to Edgewater, and Edgewater is therefore the correct owner of the land.

Accordingly, Edgewater was entitled to be named in the petition, and its interest in the property was sufficient to entitle it to challenge the condemnation despite not being a named party. The court therefore vacated the trial court's order denying Edgewater's petition and remanded for a trial on the merits of Edgewater's petition.

Edgewater Hall Enterprises LLC v. City of Canton
Georgia Court of Appeals
November 1, 2022
880 S.E.2d 582

Privately imposed property restrictions not considered in determining property's assessed market value for tax purposes

The City of San Francisco (City) owned two office buildings (collectively, the Property) on Mission Street in San Francisco, California. The City decided to offer the Property for sale to finance the construction of a new building. The City did not include an asking price in its offering, but as a condition of the sale, the City required that the purchaser lease the Property back to the City for a period of up to five years: three years at specified below-market rates, followed by two one-year options at market rates.

290 Division (EAT) LLC (290 Division) submitted an offer to purchase the Property for \$52 million, which the City accepted. Prior to closing, 290 Division obtained a loan appraisal that valued the Property at \$52 million, expressly considering the leaseback. The City obtained an appraisal that valued the property at \$61,850,000 without the leaseback. In May 2017, the parties finalized the sale, entered into leases, and executed and recorded a Memorandum of Lease.

Following the transfer in May 2017, the City assessed the Property's new base year value at \$68 million for property tax purposes. 290 Division appealed that assessment, arguing that the assessor failed to consider the leaseback as an "enforceable restriction" in valuing the Property, a term that includes recorded contracts with governmental agencies. The City responded that the leaseback was not an enforceable restriction because the City negotiated the leaseback while acting in its proprietary capacity, rather than its regulatory capacity. The general rule is that when private parties enter into a below-market lease, the property tax calculation will generally be based on market rent rather than the contract rent.

> When private parties restrict a property's use, such as by encumbering it with a below-market lease, such privately imposed restrictions are not considered in determining the property's value.

The parties stipulated that the value of the Property was $52 million if the restriction statute applied and $63.1 million if it did not apply. Thus, in purchasing the Property, 290 Division reaped the benefit of a discount of $11 million in exchange for agreeing to the leaseback.

The Assessment Appeals Board (AAB) concluded that the statute did not apply and found the fair market value of the Property to be $63.1 million for tax purposes. 290 Division appealed to the Superior Court, which rejected 290 Division's "overly literal reading of the statute" and held that the lease was not an enforceable restriction because it lacked a governmental or regulatory component. 290 Division appealed to the court of appeal.

The court began by evaluating the plain language of the statute, as well as the statute's overall purpose. In California, all property is taxable and shall be assessed at the same percentage of fair market value, which means the price at which the unencumbered or unrestricted fee simple interest in the real property would transfer under typical conditions. Consistent with that principle, when private parties restrict a property's use, such as by encumbering it with a below-market lease, such privately imposed restrictions are not considered in determining the property's value.

California Revenue & Tax Code, Section 402.1(a) provides an exception, that the assessor shall consider the effect upon value of "any enforceable restrictions to which the use of the land may be subjected." A non-exhaustive list is then provided, which includes zoning, environmental constraints, and "recorded contracts with governmental agencies." Earlier cases found that term to describe "virtually any governmental restriction designed to serve the interest of public health, safety, morals, and/or general public welfare."

Looking at the other enumerated restrictions, the court concluded that all items on the list included a public interest requirement, meaning that government's entry into the contract must be for governmental purposes, not proprietary purposes.

290 Division's pleadings did address that scenario. It argued that the City's insistence on paying below-market rent advanced a governmental objective serving the public interest because it allowed City employees to continue working at the Property, while also allowing the City to receive funds to finance the construction of a new building. But while those allegations may be true, they do not demonstrate the City's exercise of its police power. And the City itself reaped the savings from the leaseback, not the public at large. For those reasons the court concluded that the City's exercise of its contracting power was not a police power regulation, and thus was not addressed by Section 402.1. The superior court's judgment in favor of the City was affirmed.

290 Division (EAT) LLC v.
City and County of San Francisco
California Court of Appeal,
First Appellate District
December 16, 2022
86 Cal. App.5th 439

Municipal water system is immune to suit involving conservation easement

In 2000, Harcourt Inc., a grantor, owned three tracts of land in Bexar County, Texas, two of which were later combined into what is referred to as the Restricted Property, with the remaining tract referred to as the Development Property. Harcourt intended to develop the Development Property as its corporate headquarters. However, the tracts were located above the Edwards Aquifer, which is the primary source of water for south central Texas. The Edwards Aquifer is vital to the residents, industry, and ecology of the region and Texas' economy.

In 2000, the Development Property was located in the extraterritorial jurisdiction of the City of San Antonio, which subjected the property to a 15% limit for "impervious cover." These impervious cover restrictions exist to protect the recharge of the Edwards Aquifer. As a practical matter, the 15% impervious cover restrictions rendered the Development Property incapable of being developed as Harcourt's corporate headquarters.

As a solution, Harcourt and the San Antonio Water System (SAWS) entered into a tripartite Deed of Conservation Easement for the three tracts. The easement combined the three tracts as a means of resolving the impervious cover restrictions, placing additional restrictions on the Restricted Property so that the purpose of the restrictions remained fulfilled even after development of the Development Property.

In 2012 and 2014, Matiraan Ltd. (Matiraan) acquired property burdened by the easement. Matiraan asserted it had no knowledge of the easement prior to the acquisition. In 2015, Matiraan sought to rezone portions of the property to allow for quarrying. San Antonio refused the zoning application based on the existence of the easement, so Matiraan filed a petition to terminate the easement, to which SAWS was a party. After a hearing, the trial court denied SAWS's plea to the jurisdiction, i.e. an assertion that SAWS was immune from suit. SAWS appealed the court's denial of its plea.

Municipal corporations exercise their broad powers through two different roles: proprietary and governmental. The governmental/proprietary dichotomy recognizes that immunity protects a governmental unit from suits based on its performance of a governmental function but not a proprietary function. Proprietary functions subject municipal corporations to the same duties and liabilities as those incurred by private persons and corporations. Determining which functions are proprietary and which are governmental is not always a cut-and-dried task.

To answer that question in this case, the appellate court was guided by four factors: whether SAWS's act of entering into the easement was mandatory or discretionary; whether the easement was intended to benefit the general public or only those within SAWS's corporate limits; whether SAWS was acting on the state's behalf or its own behalf when it entered the easement; and whether SAWS's act of entering the easement was sufficiently related to a governmental function to render the act governmental even if it would otherwise have been proprietary.

SAWS conceded the first factor weighed in favor of being proprietary. As to the second factor, SAWS argued that the easement was intended to primarily benefit the general public, and not just residents of San Antonio, because of the importance of the conservation of the Edwards Aquifer beyond San Antonio's boundaries. Matiraan argued that the easement was primarily entered into to facilitate Harcourt's private development of the Development Property. The court reviewed the language of the easement and concluded that SAWS's primary motivation for the easement was to benefit the general public. Development was merely a secondary concern for SAWS. Thus, the second factor weighed in favor of concluding SAWS's entry into the easement was a governmental act.

The same was true for the third factor. The easement did not confer any collateral benefit, like rent, to SAWS. SAWS was only granted a conservation easement and the rights necessary to enforce it. Thus, SAWS acted as an arm of the government in entering the easement.

For the fourth factor, SAWS asserted that its entry into the easement was related to three governmental functions specifically enumerated in the Texas Tort Claims Act: waterworks, reservoirs, and water and sewer service. The court agreed with SAWS that SAWS's entry into the easement was plainly related to at least one enumerated governmental function—reservoirs—because the Edwards Aquifer is an underground reservoir of water. Because conservation and protection of the aquifer is a key component of SAWS's provision of water service, its entry into the easement was related to a governmental function. Thus, the fourth factor weighed in favor of being a governmental act.

Given the balance of the four factors, the court agreed with SAWS that its entry into the easement was a governmental act for which SAWS was cloaked in immunity absent a waiver of such immunity, which was not asserted here. Accordingly, the court reversed the trial court's order denying SAWS's plea, and remanded so the trial court could render a dismissal judgment in SAWS's favor and determine if SAWS was entitled to attorneys' fees and costs.

San Antonio Water System v. Matiraan Ltd.
Texas Fourth Court of Appeals
March 1, 2023
2023 WL 2290301

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