How Big-Box Retailers Weaponize Old Stores

ALAMY

▶ Merchants such as Walmart are using a novel legal tactic to lower their property taxes sharply

▶ "Whether it is unfair or not doesn't have anything to do with me"

Tucked away on the northern edge of Michigan's rugged Upper Peninsula, Sault Ste. Marie is bracing for the battle of its life. The tourist town is heading to court in early 2017 to fight **Walmart Stores**, which seeks to cut $286,000 off its annual property tax bill on a local store. Using what critics call the "dark store loophole," Walmart is following in the footsteps of big-box merchants including **Lowe's** and **Target** by arguing that its bustling store should be assigned about the same value for tax purposes as one that's been vacant for years, hundreds of miles away.

The financially strapped town of 14,000 faces legal bills of about $100,000 to take on the retailing giant. The cost of the battle that started in 2014 already has forced local authorities to slash budgets for everything from senior meals and the local animal shelter to police and fire pensions. Now its leaders have decided they've been pushed around long enough. "It is like David and Goliath," says Jim German, the county administrator in Chippewa County, which includes Sault Ste. Marie. "We are going to give it our best shot, because it isn't fair."

The city has tried for years to keep the dispute out of court to avoid the legal fees, agreeing with Walmart in 2014 and 2015 to lower the store's local taxes by a total of $103,000. This year, Walmart has gone too far, German says. It wants its store, currently assessed at $63 a square foot, to be valued at $16 a square foot based on sales of similar-size vacant properties across the state—less than what some local small businesses pay. Chippewa County is hedging its bets in case of a loss, freezing salaries for all nonunion employees.

Walmart, which annually pays $3.3 billion in property taxes, state income taxes, and franchise taxes plus $15 billion in state and local sales taxes, says it pays its "fair share" of property tax in Michigan based on standard appraisal methodology. "When we can't reach an agreement, we seek clarification through the legal process for a fair market value of our property," says Walmart spokesman Lorenzo Lopez.

The dark store tax argument has been gaining use since a Michigan court accepted it in 2010. In that case, the judge agreed that a Target store in a depressed Detroit suburb was worth about half the city's valuation. From that one ruling, which turns on its head the traditional way municipalities value businesses based on the cost of acquiring the land and building the structure, big-box retailers including Lowe's, **Best Buy**, and **Menards** have spread out across the country, taking to court more than 100 townships, ▶

Quoted

"In 2008 there were 12 electrified vehicles offered in the U.S. market, and it represented 2.3% of the industry. Fast-forward to 2016, there's 55 models, and year-to-date it's 2.8%."

Ford CEO **Mark Fields** on the mismatch between strong regulatory pressure for automakers to produce EVs and the weaker consumer demand for the cars

◀ cities, and counties in at least a dozen states over the past four years. In most cases the stores have prevailed, saving millions of dollars in property taxes, according to the National Association of Counties. Two-thirds of Michigan's counties have lost more than $75 million in property taxes since 2012 as a result of the ruling. Indiana estimates it could lose $120 million in tax revenue annually if the strategy takes hold.

That's left many municipalities scrambling to cope with lost revenue. Library hours have been curtailed, roads have gone unpaved, and police and fire departments have made do with aging equipment. County officials in Alabama and Texas, where Lowe's only recently began filing dark store suits, say they fear a similar fate.

"If the big-box folks do this, then you'll have it spill down to the banks, the fast-food places, the drugstores," says Don Armstrong, property tax commissioner for Shelby County, Ala., where Lowe's is pursuing a challenge. "It would just multiply and have a domino effect."

Target, noting that it wants to ensure its properties are assessed at fair market value, said in a statement that it "remains committed to supporting the communities in which we do business, and this includes paying a fair share of property taxes."

Michael Shapiro, a Detroit real estate tax attorney who pioneered the dark store argument, says he's not insensitive to the financial needs of communities, but "whether it is unfair or not doesn't have anything to do with me. I'm just looking at what the law is." For more than 40 years, Shapiro has made a career out of helping businesses challenge property tax bills. A lawyer with the Detroit firm Honigman Miller Schwartz and Cohn, he made a name for himself representing car companies, successfully arguing their plants' taxes should be based on the values of closed factories. Years later, he saw a similar opportunity in big-box stores. He made his first such successful case in 2010.

Typically, local property tax assessors set values of such stores based on the purchase price of the land plus the cost of construction, less depreciation. Shapiro believed a more accurate way to measure the value was to use comparable sales of similar properties, the way a house is valued for tax purposes.

He began amassing comparable sales data to make a case that the value of a big-box store on the market was far lower than what tax assessors had determined because they were built to suit the needs of a specific owner—the way "a suit would lose its value once it was tailored to a specific person," says Shapiro.

$120 million

Annual tax revenue Indiana says its local governments could lose if the "dark store" tax valuations take hold

"There's now a thriving cottage industry of lawyers, tax representatives, and appraisers helping retailers initiate dark store challenges. Larry Clark, director for strategic initiatives at the International Association of Assessing Officers in Kansas City, Mo., says lawyers and tax representatives typically target smaller towns that are less able to mount a vigorous defense. "They pick the low-hanging fruit," he says. "It probably costs $50,000 or more to litigate one big-box chain," says Jack Van Coevering, who's represented small towns in Michigan that have faced big-box valuation challenges. "If you are a township with a whole bunch of these properties, imagine that."

Towns can find it hard to attract companies to fill vacant buildings that bring down valuations. Often a closed store has deed restrictions that prevent another big-box retailer from moving in, sometimes for years, significantly limiting the pool of potential buyers. Buildings can sit vacant for years and deteriorate or end up repurposed for low-revenue uses such as roller-skating rinks or flea markets.

Probably no community has suffered more from Shapiro's brainchild than Marquette, a three-hour drive west of Sault Ste. Marie. In 2012, Lowe's argued that its two-year-old store there, which cost about $10 million to build, was worth just $3.5 million based on the resale value of shuttered big-box stores in other parts of the state. A judge with the Michigan Tax Tribunal agreed, and Lowe's tax bill was slashed by two-thirds, forcing Marquette to pay the company nearly $450,000 in back taxes and lowering its tax bill by more than $150,000 a year going forward.

"Lowe's pays property tax, income tax, sales and use tax, and, just like homeowners, we want to be taxed on the fair value of our buildings and land," the retailer said in a statement. "It's Lowe's intention to always pay our fair share of taxes."

The home center chain's suit opened the floodgates for Marquette's other retail chains. Even car dealerships made the same case. In the almost five years since, the timber and mining community on the edge of Lake Superior has lost more than $2 million in property tax revenue from retailers including Target, Best Buy, and **Kohl's**.

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Shortly after the ruling, a county-funded group home for troubled teens was forced to close, and the local library has slashed its hours. Ron DeMarse, the township's fire chief, worries his 23-year-old fire truck and battered two-way radios won't weather another winter. That would be a disaster, since he has no money left to replace them. DeMarse says the $56,000 he's lost in this year's budget from Lowe's tax challenge would have been enough to cover annual payments on a new engine to replace his aging one–the only truck the department has with a pump and ladder large enough to put out a fire at a building the size of Lowe's. Now his only option is a ballot initiative that would raise the needed money from the township's residents. "Maybe we just won't replace it," he says, and Lowe's might be forced to pay higher insurance premiums. "Maybe that would be fair."

Sentiments are equally raw in Sault Ste. Marie, where civic leaders are gearing up to keep its tax dollars in town rather than hand them back to Walmart. "It is an attack on all the services we provide: the sheriff's department, the health department, the schools, everyone is going to suffer here," Chippewa County Commissioner Jim Martin told residents at a recent county meeting. "That money will leave our community and go to their corporate offices."
—*Shannon Pettypiece*

The bottom line Big-box retailers are often thriving businesses. Now some are petitioning to pay the same property tax as shuttered stores.

Travel

Europe's Big Airlines Struggle for Altitude

▶ After years of mergers, full-service carriers remain inefficient

▶ "It is our only chance to survive the competition we face"

On the surface, the European airline industry doesn't look much changed from 20 years ago: National flag carriers such as **Air France, British Airways, Iberia, KLM,** and **Lufthansa** dominate a handful of giant hub airports. Dig a bit deeper, and you'll see that the market has shifted in a big way. Over the past decade or so, 10 legacy airlines across the region have combined into three huge groups, a consolidation that makes the market look a lot like the U.S.

But while restructuring at **American Airlines, Delta Air Lines,** and **United Continental Holdings** has led to record earnings in recent years, the Europeans remain far less profitable. Their workforces remain restive and strike-prone, they face a web of restrictions from regulators in multiple countries, and for reasons of national pride, the airlines in the big groups continue to operate as separate brands–with many of the associated costs.

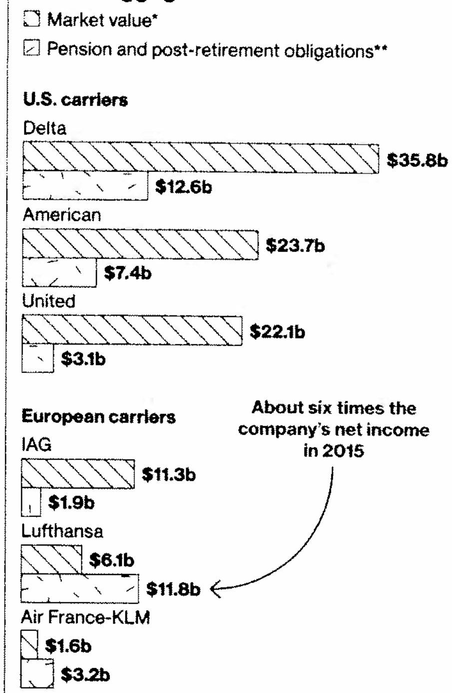
Nowhere is the difficulty of changing course clearer than at Lufthansa, which in late November was able to halt a strike that grounded 4,500 flights only after management offered a bonus topping €20,000 ($21,200) per pilot and a 4.4 percent raise and dropped demands for concessions on benefits. The walkout and others over the past three years have cost it more than $500 million, and executives say there's not a lot more they can give. "Walk with us and stop defending old-fashioned contracts," Harry Hohmeister, the management board member responsible for the Lufthansa brand, told the pilots at a rally at Frankfurt Airport on Nov. 30. "Help us create our future."

With annual salaries in excess of €255,000 for Lufthansa's most senior captains, the pilots are among the industry's best-paid. But with Delta's pilots getting a 30 percent raise, Lufthansa's are seeking 20 percent, and they may still reject the airline's offer. Just as important, the pilots strongly oppose a plan to more than double the size of Lufthansa's discount operation, Eurowings, to about 200 aircraft. They fret that the unit will hire lower-paid pilots in Austria, beyond the reach of German unions, and that management will expand it at the expense of Lufthansa jobs. "Eurowings is not your enemy," Karl Ulrich Garnadt, the Lufthansa board member responsible for the low-cost carrier, said at the Frankfurt rally. "It is our only chance to survive the competition we face."

A key reason for the European industry's woes: a surfeit of players, many of them still state-backed. The EU's top three full-service companies have a combined market share of about 29 percent, while the big three in the U.S. control 52 percent, according to researcher CAPA-Centre for Aviation. "Europe has too many airline groups for the size of the market," says CAPA analyst Jonathan Wober.

Low-cost operators have exploited the weakness. The three ▶

Extra Baggage



Lufthansa pilots at a rally during a November strike

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