



**House
Legislative
Analysis
Section**

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VALUATION OF INDUSTRIAL PROPERTY

House Bill 4375 as introduced
First Analysis (3-31-87)

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Sponsor: Rep. H. Lynn Jondahl
Committee: Taxation

Mich. State Law Library

THE APPARENT PROBLEM:

The constitution requires the legislature to provide for a system of general ad valorem property taxation, and a method of determining the true cash value of property for taxation purposes. However, the property tax act provides very little specific direction for assessors to use in determining true cash value. Case law and generally accepted appraisal principles have evolved to resolve the uncertainty in the law as it applies to residential and commercial property, but there is still no generally agreed upon approach to valuing large, special purpose industrial property. Of the generally accepted methods of valuing property, the "income" approach is usually not applicable to large industrial properties, leaving the "cost" approach and the "market", or comparable sales, approach. The use of these approaches in valuing large industrial property is subject to many questions.

The major problem in using a market approach to valuing large industrial property is that because of the specialized nature of the property, there may be no truly "comparable" sales to rely on in determining value. Large industrial taxpayers have argued successfully in some appeals that, because no buyer existed who would use the property for its current use, a "comparable" sale would be one in which industrial property was sold for a lesser use, such as for a warehouse, at an obviously reduced selling price. Essentially, they argued that the property they occupied and used for manufacturing purposes was worth no more than a warehouse, and should be assessed accordingly. The law is unclear as to whether a property's value to its current occupant can be considered for assessment purposes, and appraisal literature and Michigan Tax Tribunal and judicial decisions can be found to support either opinion. However, in Clark v. Leoni Township (1982), the Court of Appeals held that requiring an assessing unit to prove an actual market for a property's existing use "would lead to absurd undervaluations," because large manufacturing plants are constructed to the exact specifications of the occupant. The court said that it may be necessary to value such property as if there were a hypothetical buyer who would purchase the property for its current use.

The cost approach is used more frequently for valuing large industrial property, but it, too, has many associated problems. The cost approach involves determining the reproduction cost of the facility (the cost to exactly duplicate the facility at current construction prices) and then deducting for functional obsolescence. The result is the replacement cost of the facility, defined as the cost to construct a facility with equal utility to the occupant but using modern materials and design. Critics claim that replacement cost models used by large industrial taxpayers as the basis for requesting substantial reductions in assessments may not be realistic models the taxpayer would actually build, and propose to set statutory standards for using a replacement cost model to establish functional obsolescence.

THE CONTENT OF THE BILL:

The bill would amend the property tax act to specify that, under certain conditions, when there were few comparable sales available for use in determining the value of an industrial property because of the property's large size or its specialized improvements, the property would be valued as if there were a hypothetical buyer who would use it for its current use or a higher use.

When the "sales comparison" (or "market") approach was being used to value such industrial property, a sale would not be considered comparable unless 1) the property was sold for the same use, an equivalent use, or a higher use than the subject property, and 2) the comparable property was being put to the same use as the subject property at the time of the sale or was put to the same use, an equivalent use, or a higher use after the sale. In the latter case, the sale price would have to be adjusted to reflect the costs of making the property usable.

When the "cost" approach was being used to value specialized industrial property, the property used or available for use by the taxpayer would be presumed to have value to a prospective (hypothetical) buyer at least equal to the value of the property to the seller or occupant.

Further, when a replacement cost model or similar facility was employed to establish the functional obsolescence of industrial property, the following information would be required: the costs of land and improvements, a description of the productive process, the time needed to bring the model to operation, information establishing where the model could be accommodated on a single site, any claimed operating expense advantages and disadvantages as compared to the subject property, and other details necessary to evaluate the model.

The bill would also provide that if a taxpayer challenged the true cash value of industrial real property and intended to rely on a model or similar type replacement facility to establish functional obsolescence, the assessor, in establishing the true cash value of associated personal property, would have to consider the cost of acquiring, installing, and making operative the personal property in the model facility needed to replace the personal property in the subject facility to bring the model to actual operating completion (MCL 211.27).

FISCAL IMPLICATIONS:

The Department of Treasury described a similar bill last session as having no fiscal implications for the state (6-5-86).

BACKGROUND INFORMATION:

House Bill 4375 is part of a package of bills, including House Bills 4379 and 4380, that is very similar to a package of bills developed in the last session by a subcommittee of the House Taxation Committee (House Bills 5268, 5266,

H.B. 4375 (3-31-87)

and 5269, respectively) and passed by the House. The bills are not tie-barred but all deal with problems associated with the assessing of large industrial property.

ARGUMENTS:

For:

The lack of legislative guidance on how to value large industrial property creates uncertainty for taxpayers and assessing units alike, and has lead to a confusing array of case law that is unlikely to be untangled in any definitive manner in the foreseeable future. In recent years corporate taxpayers have become increasingly willing to use their resources to pursue assessment reductions in order to lessen their tax burden, forcing local governments to devote substantial effort to defending assessments for which the revenue stakes are very high. Under the current state of affairs, a local government must either go to great lengths to disprove what it considers to be the inappropriate use of isolated sales, or attempt to verify a taxpayer's claim of functional obsolescence with no knowledge of the basis of model used. The bill would give statutory authority to the holding of the court in Clark v. Leoni Township and provide a definition of a comparable sale, thereby establishing in law the reasonable thesis that a property has some value to the user even if no market exists for the property at its current use. Further, the bill would set minimal standards for the use of a replacement cost model to establish functional obsolescence, allowing an assessing unit the tools necessary to establish in litigation whether the model is a realistic substitute for the property in question.

Against:

The market approach is a universally recognized method of valuing property that is based on actual data regarding the behavior of buyers and sellers in the marketplace, rather than the subjective judgment of the appraiser. The comparison of actual sales is considered a sound method of determining the value of property by the courts and generally accepted appraisal principles. House Bill 4375 would severely limit the use of the market approach in valuing one type of property by excluding many sales from even being considered as comparable. The taxpayer, on whom the burden of proof falls, should have the opportunity to provide all existing information that could affect value, in light of factors such as supply and demand, buyers' purchasing power, and the utility of the property. The triers of fact should have access to all relevant information to determine whether the examples of sales provided were indeed comparable.

POSITIONS:

The Michigan Assessors Association supports the bill (3-23-87).

The Michigan Townships Association supports the bill (3-23-87).

The Michigan Association of School Boards supports the bill (3-23-87).

The Michigan Education Association supports the bill (3-23-87).

The Michigan Municipal League supports the bill (3-25-87).

The Michigan Federation of Teachers supports the bill (3-23-87).

The Michigan Out-of-Formula School Districts Association supports the bill (3-23-87).

The Middle Cities Education Association supports the bill (3-23-87).

The Department of Treasury has no position on the bill (3-25-87).

The Michigan State Chamber of Commerce opposes the bill (3-27-87).

The Michigan Manufacturer's Association opposes the bill (3-27-87).

The Michigan Association of Realtors opposes the bill (6-5-86).

The Michigan Merchants Council opposes the bill (3-27-87).

The Greater Detroit Chamber of Commerce opposes the bill (3-27-87).

The Grand Rapids Area Chamber of Commerce opposes the bill (3-27-87).

The Michigan Association of Homebuilders opposes the bill (3-27-87).

The National Federation of Independent Business, Michigan Chapter, opposes the bill (3-27-87).