Retailers accused of bullying cities into lowering property tax assessments • Cudahy Walgreens building sells for twice its assessed value • Can Walgreens’ Stance On Property Tax Hurt Income Tax Position of 1031 Investors? • Walgreens and CVS Declare War on Property Taxes • City loses appeal in Walgreen tax dispute • Another Milwaukee area Walgreens store building sold • Appleton settles assessment claims filed by Walgreens • Case Involving CVS Pharmacy Says 2008 Walgreens Decision Continues to Rule the Day Despite Revisions to Wisconsin Property Assessment Manual • Walgreens' court decision may mean higher property taxes . . .
May 3, 2017

Dear Wisconsin State Legislator:

The League of Wisconsin Municipalities, the Wisconsin Counties Association, the Wisconsin Towns Association, and the Wisconsin Association of School Boards urge you to support legislation reversing the 2008 Walgreens v. City of Madison decision, LRB-0372, which Rep. Rob Brooks and Sen. Duey Stroebel are currently circulating for co-sponsors. The 2008 decision continues to control how assessors must value Walgreens, CVS, and other single-tenant retail stores, despite changes made to the Wisconsin Property Assessment Manual to counteract the effects of that decision. Walgreens and CVS are successfully using the decision to convince the courts that their assessed values should be less than half of the actual sale prices of the properties on the open market. As a result, more of the property tax burden is shifted to homeowners and other taxpayers.

Even though chain drugstores have become the most popular single-tenant properties in the national real estate investment market, regularly selling for $5 million or more in Wisconsin, attorneys for Walgreen and CVS argue that their actual sale prices don’t represent market value and the underlying leases are the wrong tool for determining the property’s value for property tax purposes.

**Real World Example from Oshkosh:** Walgreens challenged the City of Oshkosh’s assessments for two of its stores. The city based its assessment on the actual amounts for which the properties were sold. The court rejected the city’s approach and ordered the city to refund the two Walgreens for several tax years. The total amount of the refunds equaled $305,672. Other taxpayers in Oshkosh now have to pick up Walgreen’s former share of the tax burden.

**Real World Example from Appleton:** The Court of Appeals recently relied on the Walgreens v. City of Madison decision to affirm that a CVS property in Appleton should be valued at $1.8 million, much less than the City’s $4.4 million assessment, which was based on an actual sale of the property. Appleton is now looking at a $350,000 refund.

LRB 0372 restores common sense to how Walgreens and CVS stores should be assessed.

Wisconsin’s local government associations have prepared this packet of background information on why the Walgreens v. City of Madison decision needs to be overturned. We urge you take a look at the information and then sign on to the bill and help stop even more of the property tax burden from being shifted to homeowners.

Sincerely,

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Walgreens & CVS
Assessed Versus Sale Values

<table>
<thead>
<tr>
<th>City</th>
<th>Assessed Value</th>
<th>Sale Value</th>
</tr>
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<tbody>
<tr>
<td>Cudahy</td>
<td>2.4</td>
<td>4.9</td>
</tr>
<tr>
<td>Milwaukee</td>
<td>2.4</td>
<td>4.2</td>
</tr>
<tr>
<td>Wauwatosa</td>
<td>3.4</td>
<td>8.7</td>
</tr>
<tr>
<td>Franklin</td>
<td>2.1</td>
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</tr>
<tr>
<td>Appleton</td>
<td>1.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Kenosha</td>
<td>2.5</td>
<td>5.5</td>
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Millions of Dollars
## TAX SHIFT TO RESIDENTIAL

<table>
<thead>
<tr>
<th></th>
<th>Pleasant Prairie</th>
<th>Hudson</th>
<th>La Crosse</th>
<th>Onalaska</th>
<th>Fitchburg</th>
<th>Town Brookfield</th>
<th>Oconomowoc</th>
<th>Appleton</th>
<th>Wauwatosa</th>
<th>West Bend</th>
<th>Brookfield-City</th>
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<tbody>
<tr>
<td><strong>Total Ass'd Value</strong></td>
<td>2,667,459,100</td>
<td>1,532,694,370</td>
<td>3,078,582,790</td>
<td>1,653,232,040</td>
<td>2,592,798,500</td>
<td>973,532,803</td>
<td>1,893,455,895</td>
<td>4,891,842,500</td>
<td>5,268,420,900</td>
<td>2,402,808,300</td>
<td>6,619,514,680</td>
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<tr>
<td><strong>Value 'At Risk'</strong></td>
<td>777,923,700</td>
<td>261,258,000</td>
<td>409,067,500</td>
<td>240,293,900</td>
<td>302,327,900</td>
<td>126,409,500</td>
<td>273,821,500</td>
<td>410,106,100</td>
<td>716,864,200</td>
<td>390,962,800</td>
<td>668,682,200</td>
</tr>
<tr>
<td><strong>Value Loss</strong></td>
<td>14.6%</td>
<td>8.5%</td>
<td>6.6%</td>
<td>7.3%</td>
<td>5.8%</td>
<td>6.5%</td>
<td>7.2%</td>
<td>4.2%</td>
<td>6.8%</td>
<td>8.1%</td>
<td>5.1%</td>
</tr>
<tr>
<td><strong>Tax Rate Increase</strong></td>
<td>17.1%</td>
<td>9.3%</td>
<td>7.1%</td>
<td>7.8%</td>
<td>6.2%</td>
<td>6.9%</td>
<td>7.8%</td>
<td>4.4%</td>
<td>7.3%</td>
<td>8.9%</td>
<td>5.3%</td>
</tr>
</tbody>
</table>

### POTENTIAL PROPERTY TAX INCREASE IF DARK STORE STRATEGY AND WALGREENS LEGAL DECISION ARE FULLY IMPLEMENTED

PRESUMES A 50% REDUCTION IN COMMERCIAL PROPERTY VALUES
The Big Shift

Net Property Tax by Type 2015-2016

- Residential: 67.80%
- Commercial: 23.80%
- Manufacturing: 3.80%
- Other: 4.60%

$187 Million Shift to Other Taxpayers

- Residential: 75.20%
- Commercial: 15.50%
- Manufacturing: 4.20%
- Other: 5.10%
Issue Briefing: Dark Store and Walgreens Decision Tax Shift

Court rulings giving tax cuts to chain stores result in tax increases for homeowners

Property taxes for homeowners and main street businesses are increasing in Wisconsin as national retailers pay less. A carefully-orchestrated wave of 100s of lawsuits in Wisconsin is forcing assessors to slash the market value of thriving national retail stores, shifting their tax burden to local mom and pop shops and to their home-owning customers. If the Legislature fails to close these loopholes, we estimate that millions of dollars in property taxes will shift from large commercial properties to homeowners and other taxpayers over the next few years.

The table below shows what assessors estimate the tax increases that homeowners in select communities will experience when the Dark Store strategy and Walgreens’ decision is fully-implemented. Calculations are based on amount of national chain retail, 2015 mill rates, and median home values:

<table>
<thead>
<tr>
<th>City</th>
<th>Estimated Tax Increase</th>
<th>Average increase per home per year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brookfield</td>
<td>5%</td>
<td>$233.50</td>
</tr>
<tr>
<td>Hudson</td>
<td>9%</td>
<td>$374.58</td>
</tr>
<tr>
<td>La Crosse</td>
<td>7%</td>
<td>$197.12</td>
</tr>
<tr>
<td>Oconomowoc</td>
<td>8%</td>
<td>$360.96</td>
</tr>
<tr>
<td>Pleasant Prairie</td>
<td>17%</td>
<td>$892.50</td>
</tr>
<tr>
<td>Wauwatosa</td>
<td>7%</td>
<td>$382.12</td>
</tr>
<tr>
<td>West Bend</td>
<td>8%</td>
<td>$253.89</td>
</tr>
</tbody>
</table>

This is not a new problem, nor is it exclusive to Wisconsin. Wisconsin is merely the latest state to experience this coordinated legal attack on in-state taxpayers. Indiana and Michigan have already experienced it. In Indiana, the Legislature promptly slammed the door on this court-created loophole. A similar legislative fix is pending in Michigan. Wisconsin must do the same.

Loophole #1: It's just a big empty box. Tax attorneys for Target, Meijer, and other big box chains are using what is known as the “Dark Store Theory” to argue that the assessed value of a new, thriving store should be based on the value of vacant or abandoned buildings of similar size. They argue that regardless of their new location or how updated their building is the value for ‘property tax purposes’ should be based on the value of the buildings and locations they abandoned prior to moving into the new store at their new location.

Real World Example from Wauwatosa: The Lowe’s store at 12000 W. Burleigh St. is currently challenging the city’s assessed valuation. The City assessed the property at $13.6 million. The City’s expert believes the market value is actually $17.7 million. Lowe’s argues the property’s current value is $7.1 million of which $3 million is attributed to land. Yet, the land was purchased in 2007 for $9,012,800. Lowe’s built a 140,000 square foot building in 2006 for approximately $7 million, they then subsequently purchased the land after constructing the building. Altogether, Lowe’s spent in excess of $16 million to acquire the land and build the structure. Now, Lowe’s argues that the land was devalued from $9
million to $3 million because the big box store was constructed. Lowe’s insists that under Wisconsin law (based on the *Walgreens* decision) only vacant dark stores, such as the vacated big box stores near the former Northridge shopping area, can be used as comparables. The City disagrees, but their only options are costly litigation or settling with the property owner on a compromise value.

To learn more about the dark store tax strategy and its impact on other taxpayers visit the League’s Dark Store Loophole Resource page: [http://www.lwm-info.org/1279/Dark-Store-Tax-Loophole](http://www.lwm-info.org/1279/Dark-Store-Tax-Loophole)

**Loophole #2: Gold box on Wall Street, cardboard box on Main Street.** Walgreens and CVS stores use a different, but related strategy, to argue that the assessed value of their properties should be less than half of actual sale prices on the open market. The two have already sued more than 100 Wisconsin communities, claiming the rent they pay for their newly-constructed, highly-visible corner locations doesn’t accurately reflect its fair market value for property tax purposes. Walgreens and CVS have won dramatic assessment reductions since a 2008 Wisconsin Supreme Court decision, *Walgreens v. City of Madison*, upheld this tax strategy. These properties are developed to the retailer’s specifications and leased to them with no landlord responsibility other than collecting rent. More than 80% of Walgreen stores and 95% of CVS stores operate under a lease arrangement. Drugstores have become the most popular single-tenant properties in the national real estate investment market. But attorneys for Walgreen and CVS argue that their actual sale prices don’t represent market value and the underlying leases are the wrong tool for determining the property’s value for ‘property tax purposes.’ Instead, they say, the assessments should hinge on the amount the landlord could get if the drugstore moved out and a different retailer moved in.

**Real World Example from Oshkosh:** Walgreens challenged the City of Oshkosh’s assessments of two of its stores. The city based its assessment on the actual amounts for which the properties were sold. The court rejected the city’s approach and ordered that the two Walgreens be refunded for several tax years. The total amount of the refunds equaled $305,672. Other taxpayers in Oshkosh now have to pick up Walgreen’s former share of the tax burden. There are over 200 Walgreens located in Wisconsin’s cities and villages.

To learn more about the need to overturn the Walgreens v. Madison decision and that decision’s impact on other taxpayers visit the League’s Overturn the Walgreens Decision Web Page: [http://www.lwm-info.org/1468/Overturn-the-Walgreens-Decision](http://www.lwm-info.org/1468/Overturn-the-Walgreens-Decision)

**Other states have stopped this tax shift.** The Republican-controlled Indiana Legislature overwhelmingly passed bipartisan legislation in 2015 and 2016 prohibiting assessors from valuing new big box stores the same as abandoned stores in a different market segment. The Michigan legislature is considering similar proposals. In May 2016 the Michigan house passed a dark store fix bill by a vote of 97-11. The bill died in the Michigan Senate.

**Solution:** Follow Indiana’s lead and pass legislation in Wisconsin closing off these tax strategies and stopping the tax shift to homeowners. Pass legislation clarifying that:

1. **Reverse the *Walgreens v. City of Madison* decision by clarifying that leases are appropriately factored into the valuation of leased properties. Rep. Rob Brooks (R-Saukville) and Sen. Duey Stroebel (R-Saukville) are circulating LRB-0372 to accomplish this goal.**

2. **When using the comparable sale method of valuation, assessors shall consider as comparable only those sales within the same market segment exhibiting a similar highest and best use rather than similarly sized but vacant properties in abandoned locations. Rep. Rob Brooks and Sen. Roger Roth (R-Appleton) are circulating LRB-0373 to accomplish this goal.**
Case Involving CVS Pharmacy Says 2008 Walgreen's Decision Continues to Rule the Day Despite Revisions to Wisconsin Property Assessment Manual
By Claire Silverman, League Legal Counsel

The Wisconsin Supreme Court's 2008 decision in Walgreen Co. v. City of Madison[1] (Walgreen/Madison) continues to control how assessors must value Walgreens, CVS and other retail pharmacies for property tax purposes, despite changes made to the Wisconsin Property Assessment Manual to counteract the effects of that decision. CVS Pharmacy, Inc. v. City of Appleton, 2015AP876 (Ct. App. 12/28/16), unpublished per curiam.[2] Relying on Walgreen/Madison, the Wisconsin Court of Appeals affirmed the CVS Pharmacy's property in 2013 was $1,855,000, much less than the City's $4,459,500 assessment based on an actual sale of the property in 2009.

In Walgreen/Madison, the supreme court agreed with Walgreens that a property tax assessment by the income approach of retail property leased at above market rents must be based on fair market rents rather than the above market rent terms of Walgreen's actual leases and that the value added by an above-market rent constitutes a contract right, rather than a real property right. The Court said, "[W]hat really matters in income approach evaluation, is the fair market rent, not the particular terms of the subject lease." The Court emphasized that the above market rents paid as part of Walgreen leases were intentionally part of the "creative financing arrangements" made by Walgreen and the developer, which bought the land, built the building, and leased it to Walgreen and that the assessor must assess real property based on the value of the real estate, not the business concern which may be using the property.

The Walgreen/Madison decision was based on language from the Wisconsin Property Assessment Manual (Manual), with the Court finding "particular relevance" in the Property Assessment Manual's explanation that "[w]hen applying the income approach, the assessor must use the market rent, not the contract rent, of the property (unless valuing federally subsidized housing ... [] and its statement that "[m]arket rent is the rent that a property would receive based on the current, arm's-length rent commanded by similar properties in the marketplace." The Court noted the Manual adds that "[t]o value the fee simple interest of a property, market rent rather than the actual, or contract rent is to be used in estimating potential gross income." Id. 9-12."
Walgreen Co. v. City of Madison, 2008 WI 80, ¶ 26, 311 Wis. 2d 158, 175-76, 752 N.W.2d 687, 695.

Following the Madison/Walgreen decision, a provision was inserted in the budget bill requiring assessors to consider the actual rent and terms of a lease when determining the value of leased property using the income approach. The provision stated: "In determining the value of a leased property under sub. (1), the assessor, if applying the income approach, shall consider the effects of the actual rent and provisions of all leases affecting the property." 2009 Wis. Act 28, § 1520(d). The Governor vetoed this provision, stating: "I am vetoing this provision because I object to changing valuation methodology through the legislative process. Currently, property assessment methods and standards are set forth in the Wisconsin Property Assessment Manual. The manual is developed in accordance with professionally accepted appraisal practices and is researched and reviewed thoroughly by experts working in the appraisal field. Changes to property assessment practices should be pursued as updates to the manual to ensure sufficient review by property appraisal experts."

Following the Governor's veto, the Manual was revised to address the provisions relied on by the Court in Walgreens/Madison and counteract the decision. Despite these changes, the Wisconsin Court of Appeals recently held that under Wis. Stat. § 70.32, assessors must value real property in accordance with the Manual unless it conflicts with applicable law and that to the extent post-Walgreen/Madison revisions to the Manual conflict with that decision, courts are required to follow Walgreen/Madison. See CVS Pharmacy, Inc. v. City of Appleton at fn. 7.

The Bottom Line

It is apparent that legislation will be necessary to overrule Walgreen/Madison. The League is working closely with legislators on introducing and passing such legislation during the 2017-2018 legislative session.

[1] 2008 WI 80, 311 Wis.2d 158, 752 N.W.2d 687.
[2] CVS Pharmacy operates a one-store, single-tenant retail facility in the City of Appleton. CVS Pharmacy purchased the land for its facility in 2008 for $1,975,000. After acquiring the land, CVS Pharmacy tore down the existing building and hired a contractor to do site work and build a new retail store. The total cost to construct the new retail store amounted to $1,822,000. After constructing the new store, CVS Pharmacy sold the property in 2009 to a real estate investment group for $4,459,470. The property was sold as part of a bundle of 166 CVS Pharmacy stores in a sale-leaseback transaction. The long-term lease requires CVS Pharmacy to pay all taxes and maintenance costs associated with the property, and tied rental payments under the lease to the repayment schedule equal to the property’s mortgage payments. CVS Pharmacy’s parent corporation guaranteed compliance with all of CVS Pharmacy’s obligations under the lease. The City assessed the property at $4,459,000 for 2011, 2012 and 2013 based on the 2009 purchase price and CVS commenced an action under Wis. Stat. § 74.37(4)(d) alleging the City's assessments were excessive. The circuit court concluded that the City's assessments were not entitled to a presumption of correctness because the
assessments violated the principles set forth in Walgreen/Madison and CVS presented significant contrary evidence rebutting the City's assessment; the circuit court determined that the property's value was $1,690,000 in 2011, $1,760,000 in 2012 and $1,8555,000 in 2013. The City appealed and the court of appeals, applying the holding in Walgreen/Madison, affirmed the circuit court's decision finding the circuit court's valuations were not clearly erroneous.
Retailers accused of bullying cities into lowering property tax assessments

Legal challenges could ultimately cost homeowners

By Kevin Crowe of the Journal Sentinel
March 7, 2015

Community and business leaders often tout how new commercial developments will increase the local tax base. But two recent court rulings are eating into that idea — and other property owners may feel the tax bite.

In separate rulings, judges sided with Walgreen Co. and CVS Health in taxation cases that drastically reduced property assessments — and taxes — on their stores in Oshkosh and Appleton.

The decisions seem certain to erode the commercial property tax bases in communities around the state and increase the financial burden on residential owners, especially in areas with new development.

In some communities, such as Oak Creek or the City of Pewaukee, commercial properties account for roughly one-third of the tax base.

A Milwaukee Journal Sentinel investigation into assessment problems found that in dozens of communities across the state at least 20% of residential property taxes are being paid by the wrong people, in part due to lack of uniform taxation. Court rulings that lower some property assessments and not others create a similar dynamic on the commercial side.

Walgreen has been one of the principal drivers of a trend in which large retailers seek lower assessments, sometimes through lawsuits that small municipalities are ill-equipped to fight. The company and its lawyers have challenged assessments across the state, ultimately suing municipalities at least 50 times in the past decade.

"More companies are bringing them," said Amie Trupke, a Madison-based attorney who represents municipalities in assessment cases. "Walgreens was probably the pioneer. But now we have Sears, Target, Menards, Kohl's, Fleet Farm, Farm & Fleet and the fast-food chains bringing challenges."

Assessors and their attorneys point to the increasing number of legal challenges as evidence Walgreen and other companies with deep pockets are bullying cities, towns and villages into lowering property assessments.
Walgreen says it is simply fighting back against aggressive assessors who have overassessed its properties.

"We want to pay our fair share, and not that much more than our fair share," said Don Millis, an attorney who has represented Walgreen, Target, Sears and Farm & Fleet in dozens of assessment lawsuits.

From 2008 to 2014, Walgreen filed more excessive assessment claims against the City of Milwaukee than any other property owner, according to a Journal Sentinel analysis of data provided by the city attorney's office. The company has filed claims on all of its 18 stores almost every year, normally claiming the city owes it between $1.2 million and $1.4 million in excessive taxes.

The city has ultimately settled twice, paying out a total of $4.5 million.

**Leases at center of battles**

For more than a decade, the way Walgreen develops and leases its properties has been at the center of fights between the company and property assessors.

The company typically contracts with developers to buy land in high-traffic areas and then construct buildings to its specific standards. Walgreen then leases the land and the store for an amount that not only covers the monthly rent, property taxes and operating costs, but also the development and construction costs.

The contracts, called triple net leases, result in Walgreen paying more per square foot than other commercial renters because they are essentially financing the construction of stores through the leases. The deals also put the company in the role of challenging property assessments.

The company argues assessors shouldn't use its above-market leases to calculate the values of its properties. Instead, company attorneys say, assessors should use the wider commercial market rate, which is always substantially lower.

Walgreen has won two significant cases in Wisconsin courts, one in 2008 against Madison at the state Supreme Court, and another more recently against Oshkosh at the appellate level in December.

"They say, 'Value us like the Dollar Store,'" said Amy Seibel, an attorney who has represented municipalities in fights with Walgreen. "The courts have bought into that."

Walgreen isn't the only company that uses a triple net lease model.

"That's why this whole thing is going to mushroom," Seibel said. "If I'm the Dollar Store, then I'm going to say I'm overassessed."
In January, a judge in Outagamie County used similar rationale — and the same math — to cut in half the property assessment of a CVS store in Appleton.

**Skirmishes in the war**

The first key ruling came in 2008, when the state Supreme Court found Madison used Walgreen's "above market rent" inappropriately in calculating the assessments of its stores.

"The Wisconsin Property Assessment Manual does not contain language which similarly requires or allows appraisers to *increase* the market value of the property when the lease rate is *above* the market," the court wrote in its opinion.

The court found the city was not following the manual and was taxing *business value* instead of just *property value*. As a long-term, secure tenant, Walgreen adds value to a property.

"One of the things I argued back in 2008 at the Supreme Court is if Walgreens and I have properties across the street from each other and we pay the same rent, which property is worth more?" said Millis, the attorney for the company. "Walgreens is worth more. I'm not a billion-dollar company."

After that decision, the City of Milwaukee settled a set of claims with Walgreen by *refunding* $807,000 in taxes *paid by the company*. The city also agreed to keep the assessments for the stores low for 2008 and 2009.

The decision sent assessors around the state scrambling to find another way to accurately value Walgreen properties. Assessors from Milwaukee, Madison, Green Bay, Brookfield and other municipalities *got together to formulate a plan for assessing Walgreen's properties and other properties with triple net leases*.

In Wisconsin, there are three main tiers used in assessing the value of a commercial property. The first level deals with sales of the property itself, followed by sales of comparable properties. The third tier uses an income approach to determine value by focusing on the rent paid by the tenant and the rent paid by the rest of the market.

Since the Supreme Court had tossed out a Madison assessment that largely used the income approach, the assessors decided to home in on sales of Walgreens and properties.

Properties like Walgreen sell periodically on investment exchanges to real estate investment trusts, which are a vehicle for investors to park money for a period of time as an investment. The sales can involve 100-plus properties in multiple states.

The assessor figured these sales would better satisfy the first two tiers of the assessment hierarchy.
"They made a decision that 'We're going to include these sales and we're not going to factor out the triple net aspect of it,'" said Vince Moschella, an assistant city attorney in Milwaukee who handles assessment challenges.

In 2010, using the sales approach, assessors in Milwaukee doubled some of the assessments on Walgreens stores in the city.

In Oshkosh, assessors had already used the sales in part to calculate values for two Walgreens stores there. Walgreen sued Oshkosh, contending assessors incorrectly valued the property based on its leases.

This time, Millis argued the leases inflated sales prices, so such sales prices shouldn't be used to calculate the property value. The circuit court sided with Walgreen, awarding the company a $69,548.99 tax refund.

In December, the appellate court upheld the lower court's ruling.

The appellate decision has not yet been published, but it's having repercussions around the state — including the CVS case in Appleton.

"A lot of people were awaiting the outcome of this case," said Alan Marcuvitz, a Milwaukee attorney who has worked on taxation cases in Wisconsin for decades.

The state Department of Revenue has not yet updated the manual for assessors. In the meantime, assessors will have to decide if they'll use the full values of expensive leases in their calculations and risk a challenge, or apply the courts' decisions to their own cities, towns and villages.

Even as the Oshkosh case progressed, the City of Milwaukee settled with Walgreen in April 2014, this time for $3.7 million. The city also agreed to keep the assessments at a lower, agreed-upon level for 2015.

"The problem is these recent court decisions have pretty much got us, so it's time to settle up and move on," Moschella said. "As far as the future, it's a dead issue."

The decisions not only open the doors to other challenges, but might also give assessors pause as they work to value properties like Walgreens, said Russ Schwandt, the assessor in Green Bay. Ultimately, he said, it will lead to lower values and lower taxes paid on the commercial side.

"There will be an erosion of all commercial property because it becomes a uniformity issue," he said.

**Legal battles have a price**

There are more than 200 Walgreens stores in Wisconsin, and the company has been successful in getting judgments and settlements in its favor when it has challenged.
Defending assessments against challenges can cost municipalities $50,000 to $100,000. Smaller municipalities often must hire an attorney. Everyone has to pay for experts.

In Milwaukee, the number of claims of excessive assessment — including those on the residential side — have tripled since 2008. The city has two attorneys almost completely dedicated to handling assessment challenges.

Given the costs, attorneys and assessors say there's little incentive for smaller municipalities to fight big companies such as Walgreen when they challenge assessments.

"Communities can't afford to fight anymore," said Seibel.

In some cases, losses are compounded.

Milwaukee, for example, collects taxes on behalf of Milwaukee County, Milwaukee Area Technical College and the Milwaukee Public Schools. But the city alone is on the hook to pay the refund. To recover the portion of tax money that went to the other entities, the city has to file a charge-back request through the state Department of Revenue. There's no guarantee that will be approved.

"When commercial property owners start that process, how often is a community going to go through that?" said Rocco Vita, the assessor in Pleasant Prairie. "That's a lot of taxpayer money."

But assessors and city officials say there is a reason to fight the challenges.

If the assessments, and ultimately taxes, go down for Walgreens, Target and other big commercial properties, that burden shifts largely to residential owners.

"Their attorneys are not looking for fair taxation, but advantageous taxation," said Bob Lorier, a former assessor in Brookfield. "A lot of communities don't understand the value of having good commercial assessments."

Millis countered that some communities look at big commercial properties as an opportunity to lessen the tax load on residential owners — and overassess on the commercial side.

"I think for some communities it's about shifting the burden," he said. "Who would you rather have pay? People who live there or people who don't live there? I think there's a political motive in some places."
Walgreens and CVS Declare War on Property Taxes
How to slash your tax bill by 50 percent

Follow us on:
by Patrick Clark, Bloomberg Business
11:13 AM CST
March 5, 2015

Walgreens boasts convenient locations, a wide array of products, and a killer tax strategy.

When it works, local tax officials warn, kids and homeowners suffer.

In the fall of 2012, county tax officials in Kentucky began preparing for a clash with the pharmacy chain, which operates thousands of stores in the U.S. and has a market value of more than $90 billion. Walgreens was challenging its tax assessments at stores across the state. If the company won, the assessors feared, other national retailers would follow suit, threatening the budgets of already struggling school districts.

“If you start losing the tax assessments on all of these leases, the cost is going to be hundreds of millions of dollars,” said David O’Neill, the property valuation administrator in Kentucky’s Fayette County.

The tax people rallied. Workers in the state’s largest counties compiled a report on Walgreens’ strategy and circulated it to smaller tax offices. When the Deerfield (Ill.)-based chain asked a state court to half the taxes on a drugstore in Lexington, the assessors passed the hat. Kentucky school districts, which receive about two-thirds of property tax revenue, chipped in $26,000 so the county could afford to hire expert witnesses.

Last month, a Kentucky circuit court judge ruled in favor of Fayette County, which includes Lexington, concluding the latest skirmish in a long-running battle between national drugstore chains and tax assessors. Walgreens declined to say whether the company would appeal the ruling.

Walgreens, CVS, and other big drugstore chains have been challenging property tax assessments in courts around the country for the past decade, with little national notice. They argue, sometimes successfully, that the rent they pay their commercial landlords doesn’t accurately reflect property values. When they win, they get their tax bills slashed.

Here’s how it works:

Most national retailers would rather rent their stores than tie up billions of dollars in real estate. Walgreens leased 80 percent of its 8,300 stores as of August 2014, according to company filings. CVS owned just 5 percent of its 7,800 stores as of the end of last year.
The basic idea is to rent stores under contracts, called net leases, that make the tenants—the drugstores—responsible for property taxes and other expenses. To compensate the investors who sink cash into the real estate, Walgreens and other retailers pay rents that include a premium above the cost of building the store. Once the stores are occupied, net leases often trade among investors.

It’s a hefty market. About $45 billion in net leases for U.S. properties changed hands in 2014, according to Will Pike, a senior vice president at commercial real estate firm CBRE.

In tax board and judicial appeals that have sought to cut levies by more than 50 percent, Walgreens and CVS have argued that the price investors will pay to own a drugstore lease is the wrong tool for determining the tax. Instead, they say, the assessments should hinge on the amount the landlord could get if the drugstore moved out and another retailer moved in. That would lower the assessment, because the pharmacy chains have proved willing to pay higher rents than other tenants.

So the same premium that entices investors to buy the net leases gives the drugstores leverage in their tax arguments.

The chains complain that counties are taxing corporate debt instead of sticks, bricks, and mud—assessors’ slang for land and buildings.

“CVS Health is committed to being a good corporate citizen in the communities we serve and to paying our fair share of property tax,” said Mike DeAngelis, director of public relations for the company.

Walgreens, too, says it is committed to paying what's fair. “We’ve become more concerned in recent years with the use of valuation methodologies based on the value of our long-term leases in addition to the value of the real estate itself,” said spokesman Phil Caruso.

The strategy has met with mixed results. In Florida and New York, where Rite Aid has challenged its assessments, courts have rejected the net lease argument. Wisconsin has ruled in favor of pharmacies. Tax assessors scored in the Ohio courts but saw their points erased when the state’s legislature revised the tax law in the pharmacies’ favor.

More cases could be on the way. A Walgreens employee named Anna Pelts testified during the Fayette County case that the company was appealing the majority of its assessments over $3.5 million, according to legal briefs filed in the case.

Commercial property taxes fund public schools, roads, and other infrastructure in many states. Big-box stores and other national retailers have tried out the drugstores’ argument, said Tim Wilmath, a tax assessor in Hillsborough County, Fla., whose office won a state court case against CVS in 2013. But the pharmacy chains have the most at stake. That’s because of the premium they’re willing to pay for stores in busy locations, and because they lease a lot of stores, relative to other retailers.
“If they can sell the argument, they reap tremendous reward,” Wilmath said.

The Walgreens store located at 2290 Nicholasville Rd. in Lexington, Ky.

In 2005, Walgreens made a deal with a local developer to lease a drugstore on the site of a former Howard Johnson hotel on Nicholasville Road, a seven-lane thoroughfare that carries commuters past the University of Kentucky Medical Center and into the city’s downtown. Two years later, the developer sold the lease—which required the pharmacy to pay $33,500 a month for at least 25 years—to an investor for $6.3 million.

O’Neill, the tax assessor, used that price to value the store at $5.1 million in 2012. That figure was based on an agreement between Walgreens and a previous assessor to value stores below the sale price of the lease to avoid a formal appeal, O’Neill says.

But Walgreens argued that number was too high, because it included a return on investment for the developer. “Walgreens pays rent that is in excess of market because this business arrangement is, in essence, a financing mechanism,” the company argued in a legal brief.

Amid the disagreement, lawyers on both sides have sought the higher moral ground.

“In Kentucky, the school districts are hungry for money, big time,” said Robert Hill, a Maplewood (Minn.)-based lawyer who has represented both Walgreens and CVS in property tax cases. “The assessors want to make it so if you’re a national chain, you subsidize everyone else.”

Amy Seibel, a lawyer in Mequon, Wisc., who has represented tax assessors against the pharmacy chains, said homeowners can expect their tax assessments to rise as counties try to make up for lost revenue.

“The average homeowner is outraged when you tell them what’s happening,” she said.

The chains will keep fighting. Walgreens spent five years battling the tax assessment on a Madison (Wisc.) drugstore before winning a state Supreme Court judgment in 2008. In Fayette County, even if the recent ruling stands, the county probably won’t be done grappling with the pharmacy chains.

As Wilmath, the Florida assessor, put it: “Walgreens and CVS are very, very aggressive in their property tax appeals.”

—with assistance from Michael Novatkoski