

**Dark Store Theory:
How Big Box Retail Establishments Employ It to Challenge Property Tax Assessments, Its
Impact on Municipalities, and How Three State Legislatures Have Responded**

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Dark Store Theory came into being early in the 21st century, when Big-Box (BB) retail establishments began using the theory to challenge their property tax assessments. At least 12 states, including Wisconsin, are now experiencing property assessment challenges based on DST and where applied successfully, municipal officials are faced with its impact. This paper examines the Dark Store Theory (DST) assessment method, its impact on municipalities, and how three state legislatures have responded.

Whether or not DST is an appropriate method for valuing certain retail properties, it is a new method and new methods mean change. Change can have both positive and negative impacts and typically affects more than one stakeholder. The stakeholders impacted by utilizing the DST method of appraisal include: all property taxpayers, municipal officials, and the community as a whole. The stakeholders that benefit from employing DST, however, are the few property owners (primarily BB) who are able to successfully argue for a lower property assessment. This positive impact for these few property owners has a negative impact on others by increasing the share of the tax burden for all other tax-paying property owners who are left to pick up that difference when levies remain constant. Also negatively impacted are municipal employees such as city assessors, city managers/administrators, and city attorneys which will be discussed in greater detail later in this paper. Lastly, the community itself can also be impacted if services are cut when levies are lowered.

Dark Store Theory is an appraisal method which asserts that a currently operating BB store should be valued based solely on the sales of similar-sized businesses that have recently sold; in some cases, hundreds of miles away (Pettypiece, 2016). The premise of DST appears logical since homes and most other property types are typically valued using the comparable sales approach. The comparable sales approach, however, also factors in the “highest and best

use” of the property. In the case of BB stores, current sales of comparably-sized stores are predominantly stores that are vacant and closed (aka “dark stores”), rather than ones that are currently operating. At the heart of DST is the assertion that these dark stores are “comparable” for assessment purposes because they better reflect the fair market value of the property.

Pettypiece attributes Michael Shapiro, a Detroit real estate tax attorney, as the pioneer of DST. Shapiro’s career has spanned more than 40 years helping businesses challenge their property tax assessments and in 2010, he helped Target lower its assessed valuation by 50% in his first successful case utilizing DST in Michigan. The National Association of Counties (NACo) says that “Michigan is considered the founding father” of DST and that since 2013, Michigan counties have refunded approximately \$78 million because of DST. Michigan may be the first state, but research indicates that Indiana and Alabama have also seen a fair share of court cases utilizing DST to reduce property assessments. Valuation appeals are on the rise across the country and, according to NACo, it is an emerging issue particularly in Iowa, North Carolina, Ohio, Tennessee, Washington, and Wisconsin. (Griffith, Joel, Harris, Jonathan, & Istrate, 2015)

There are two very different issues at the heart of the matter: 1) whether dark stores are “comparable” for assessment purposes, and 2) whether the sales approach to valuation is always the appropriate valuation method. Municipal assessors are guided by state statute in how real property is assessed and because property valuation methods may vary from state-to-state, this paper utilizes Wisconsin’s valuation methods as its basis for analysis. Wisconsin Statutes §70.32(1) specify that “real property shall be valued by the assessor in the manner specified in the Wisconsin property assessment manual” (WPAM) and it will be referred to frequently during the valuation analysis.

The first issue revolves around the concept of “comparable.” The Meriam-Webster Dictionary defines comparable as “capable of or suitable for comparison.” Proponents of DST argue that a “dark store” is a suitable comparison because it more accurately reflects the true cash value of the subject property at the time of sale. David Charles Lenhoff, who provides expert testimony in appraisal methodology, argues that the issue comes down to “market value” and that municipal assessors confuse that with “value in use.” Value in use he says, assumes that the current use of a property is its highest and best use, which may not be the case. Many municipal assessors disagree. (Lenhoff 2014)

Municipal assessors who disagree with DST argue that a property’s highest and best use is a primary factor in determining valuation and that a dark store is not comparable to a store that is currently operating, and in many cases thriving. They point out that a fair number of dark stores have restrictive covenants placed on them by the owner that prevents the property from being used by another BB retailer. In these cases, the property owner and not the market has eliminated the possibility that the property’s highest and best use continues to be as a BB store thereby effectively impacting the property’s use and value. While the market may not support a particular BB retailer at that location, it cannot be assumed that the market would not support a different type of BB retailer in that same location (e.g., Lowes vs. Target). Assessors in Wisconsin are cautioned in the WPAM (2017) to avoid using dark stores as comparable sales “unless the subject property is similarly dark” based on a previous court decision (p. 13-12).

Another factor of concern is that these “comparable sales” are often in a different state or region and the communities they are in may not be similar economically to the subject property, although this isn’t so much the case in Wisconsin according to Wauwatosa city assessor, and past president of the Wisconsin Association of Assessing Officers, Shannon Krause. When asked if

Wauwatosa would ever consider comparables in other cities that are far way if the dynamics were the same, and of similar size, Krause said, “Sure, but you need to understand how comparable the cities are in areas like dynamics, traffic flow, and access. You need to make adjustments for those things, because obviously Menasha is not Wauwatosa. Typically, we try to stay in state or the mid-west.” So while these sort of comparables can be used, you would still need to make a number of adjustments to account for the differences.

The second issue, whether the sales comparison approach is the most appropriate, requires looking at the different valuation methods available to Wisconsin assessors. Chapter 13 of the WPAM (2017) governs commercial valuation in Wisconsin. It provides specific information on what an assessor needs to take into consideration when assessing a commercial property and directly quotes (in part) Wis. Stat. §70.32(1), that states:

“the assessor shall consider recent arm’s-length sales of the property to be assessed if according to professionally acceptable appraisal practices those sales conform to recent arm’s-length sales of reasonably comparable property; and all factors that, according to professionally acceptable appraisal practices affect the value if the property to be assessed.”

The WPAM (2017) defines an arm’s-length sale as “A sale between two parties neither of whom is relates to or under abnormal pressure from the other.” The manual indicates three acceptable approaches for estimating “market value” of commercial property: sales comparison, cost, and income. Assessors are to consider all factors that “affect the value of the property to be assessed” using acceptable appraisal practices. While there is a clear directive that the sales comparison approach is the preferred approach to valuation, the WPAM (2017) notes that new construction is often valued using the cost approach. Lastly, land and improvements are valued separately.

(p.13-7,8)

The idea that land is to be separately valued is an important element in this analysis. In Wisconsin, commercial land is valued “as if available for development to its highest and best use.” The value of land is dependent on a number of factors including its physical attributes of size, shape, depth, and topography, as well as its access, parking, utilities, and exposure. The most common valuation approach and the one that provides the most accurate valuation is sales comparison, according to the WPAM (2017), provided there are vacant land sales available. Properties are considered comparable when they are similar in size and “economic characteristics,” making it difficult to find truly comparable sales. For this reason, WPAM (2017) indicates that “the assessor should be aware of the sales information and be able to apply the cost and income approaches, when applicable.” (p. 13-7)

As just mentioned, the cost approach to assessment is a common and valid approach in Wisconsin for new construction. Assessors factor in the cost paid for the land, the cost of construction, and when applicable, factors in depreciation to determine the valuation. The three types of depreciation that need to be factored in are: physical, functional, and economic. According to the WPAM (2017), physical depreciation is primarily due to normal wear and tear over the useful life of an asset, but can also include negligence and the effects of nature. Functional obsolescence is “the loss in value, due to a lack of or excessive utility. Functional obsolescence *occurs over time* (emphasis added) because of changing needs, technology, design, promotion/marketing, and cost/construction.” Lastly, economic obsolescence occurs when factors other than the property cause it to lose value, such as changes in the economy, population, and or the government. (p. 9-32)

Functional obsolescence is the main argument DST proponents use to argue for lower assessments. The functional obsolescence argument asserted by property owners is that BB are

built to suit a specific retailer and incorporates its image and marketing strategies into the construction making it unsuitable for another owner without substantial renovations. Shapiro posits that the market says that after a custom built store is sold it will either be demolished or be substantially remodeled by the new owner, making its current market value less than the cost of constructing it as soon as it is built (Shapiro, 2015).

“There is no functional obsolescence, it’s brand new. What they try to do is say that there is functional obsolescence when they pull it from a dark store but it’s really an economic one, not functional,” says Krause. Krause indicated that it is not uncommon for stores to come in with their own assessments that are even lower than what they paid for the unimproved land. She asks how is it logical that a property owner would be willing to pay what they did for the land and constructing the buildings, etc., if they weren’t certain it was a good investment? Functional obsolescence is a legitimate concern for many property owners, not just BB, but as stated in the WPAM (2017) it is something that occurs over time. Both functional and economic obsolescence are factors with dark stores, but they do not appear to be legitimate factors in a newly built property or one that is thriving in the marketplace.

Municipal officials in Wisconsin and across the country are feeling the effects of DST. In Wisconsin, the assessment function is at the municipal level, but in most other states it is a function of the county. City/Village/County assessors, managers/administrators, city/county attorneys, as well as elected officials are dealing with the fallout of DST. According to NACo (Griffith, Joel, Harris, Jonathan, & Dr. Istrate, Emilia, 2015), even if a county can financially take on the appeals, they do not have the human resources needed to challenge them. Smaller communities in Wisconsin do not have a city assessor and contract out for those services. Contract assessors really just “put out a value” according to Krause and can’t really afford to put

in the same amount of effort into an assessment that an in-house assessor can. That is because of the low price of their contract they can't really afford to fight it at a board of review. This exacerbates the problem because when assessments in one community are successfully appealed, those are then used as a basis to make comparisons in other communities that do have the resources and will to fight.

Wauwatosa City Administrator Jim Archambo indicated that when a municipality contracts out for assessing services, they solicit bids to assess X number of properties. Krause added that they typically net out to around \$6 a parcel. Archambo said, "Cases that they have to fight become expensive to their contract." Municipalities with in-house assessors, who have the backing of their municipality, are more likely to fight an appeal. That is not to say that all appeals are fought or that adjustments are not made. Krause indicated that she is always open to reviewing additional information that would affect that value, but that she is also prepared to "fight it all the way down the line" when appropriate. When asked about contract assessors, Archambo believes that elected officials can be inadequately educated in the assessment process. He also said that "it is often the case that contract assessors are simply getting rid of cases; just agreeing with the lower value and being done with it. It's fairly rare that the elected body, or even the board of review, would be even be aware to ask the kinds of questions that lead toward 'Is the appraisal system fair?'"

In Wisconsin, chapter 21 of the WPAM (2017) outlines the process for assessment appeals and the first step is the municipality's Board of Review whose size depends on the community but is between five and nine members (Wis. Stat. §70.46(1)). The entire proceedings for the Board of Review are laid out in Wis. Stat. §70.47. Except in a 1st class city (population over 150,000 per Wis. Stat. §62.05(1)(a)), the make-up of the board is governed by local

ordinance in accordance with state statute. In Wauwatosa, the board has five members and is appointed by the mayor. Members serve five year terms and can be citizens or elected officials and are not required to have any formal background in real estate or appraisal, but at least one is required to attend state training. All of Wauwatosa's board members have attended the state training.

The fiscal impact of using DST to lower assessments is varied. Michigan has seen devastating effects in some of their communities, particularly in the Upper Peninsula (UP). The Township of Marquette, Michigan, with a population of 14,000 has several BB stores and is the only township in the UP to have a Lowe's, Pet Smart, Target, and Best Buy in addition to a few other retailers. Lowe's and Target were successful in getting their assessments lowered substantially. Lowe's successfully argued that their two-year old store that cost \$10 million to build was only worth \$3.5 million resulting in a \$450,000 refund in back taxes. Now, Walmart is looking to reduce their assessment by \$286,000. After several years of trying to work with Walmart, including lowering their assessment by \$100,000 in an effort to compromise, Walmart is asking to have their assessment reduced again from \$63 a square foot to \$16 based on DST. Marquette has been hit so hard by these appeals in recent years that the lost value has resulted in cutting numerous services, including senior meals, library hours, and trimming employee benefits. Marquette County also was affected and had to reduce their support to the town as well, resulting in the closing of a county supported group home for troubled teens.

In Indiana, Marion County alone had 29 BB property assessment appeals in 2015 totaling more than \$182 million dollars and has seen DST spread to medium sized stores there as has been seen in other states, including WI. In Hamilton County, IN, there are 11 BB stores under appeal valued at \$102 million. Lowe's is now starting to make appeals in Alabama and Texas.

One Indiana assessor advocates for compromise rather than fighting the appeals. The problem with compromising, according to Krause, is that the BB comes in with such an “absurd” number to start with that even if you meet in the middle it still means a drastic drop in value. Krause said that “back in the day, they would come in and at least be reasonable.” The decrease in value must be either born by other property owners, results in service cuts, or some combination of the two.

Municipalities also spend hundreds of thousands of dollars fighting DST appeals, which could be spent providing other services or just keeping up with inflation. When asked about the impact of these appeals, Krause said “It’s huge! Now I need to do just litigation and have somebody else run my office. About one-third of my year is spent on litigation between gathering the data, supporting it, attorney time, mediations presenting to counsel so they know what’s going on.” She also indicated that DST has become a cottage industry with many law offices now having a separate litigation team just to handle DST cases and that she heard that one law firm in town had recently hired six associates just for this purpose.

Archambo says DST has changed the way city officials need to approach new development in their community. It is important to ask if the municipality really wants that business that is approaching them because the businesses all have a great sales pitch. ““We’re going to create this tremendous value and number of jobs, etc’ and then a couple years down the road they’re appealing their value for a much lower amount. If it had been at that value from the start, you may not have been so eager for them to come, especially if, in those cases where any of these different dynamics are in a TIF district, you could really be in trouble.”

Tax Incremental Financing (TIF) districts rely on the additional value, or increment, of the district to either pay off loans the municipality took out to pay for public improvements in the district or they fund public improvements in a pay-as-you-go manner. Municipalities in

Wisconsin typically bond to pay up front for public improvements such as sewer, water, and roads in TIF districts to attract new development with the expectation that these improvements will add economic value to the property as new development occurs. If the new development comes in and then is successful in using DST to appeal its assessment it can completely undermine the ability of the TIF district to raise the needed revenues to pay off the bonds.

The more wins they have, the more aggressive chain stores like Lowe's, Best Buy, and Menard's are in pursuing assessment appeals. This may be because the cottage industry that has sprung up around DST in at least the states of Michigan, Missouri, Ohio, and Wisconsin. Two Janesville, WI council members indicated that their businesses received cold calls or blind mailings from tax lawyers indicating there is no fee to the business unless they are successful in lowering their assessment (Hughes, 2016). A business trying to reduce their bottom line has nothing to lose in making an appeal on contingency. They tend to target small communities knowing limited resources make it unlikely that the municipality will fight an appeal or be more willing to make an acceptable compromise, which then become precedents they can rely on to bolster their appeals in larger communities. According to a Larry Clark, director of strategic initiatives at the International Association of Assessing Officers in Kansas City, MO, "it probably costs \$50,000 or more to litigate one BB chain," making it cost prohibitive for some to fight (Pettypiece 2016).

The University of Alabama Law school provided a continuing education course just on DST as "Lowe's has brought a massive onslaught" of assessment appeals to their state that threaten to impact county budgets. The author's assert that a well prepared municipality can be successful in defending its assessment. They referred to lawsuits in Ohio that had the same experts for the BB retailer but received different outcomes and attributed it to the preparation of

the municipality to provide alternate data. The BB retailer who lost its case appealed it to the Ohio Supreme Court but was unsuccessful getting the Board of Tax Appeal ruling overturned. Similar successes and losses were found in Indiana and Oregon. They also found that the State's statutes left some states more vulnerable than others to DST challenges. The law school found that Michigan has some of the most vulnerable language, while Iowa and Florida's were favorable. (Webb & Willis, 2016).

Many states are fighting back through legislation but not all have been successful. In the 2015-16 legislative session, Michigan State Representative David C. Maturen introduced House Bill 5578 that attempted to make changes to the Michigan Tax Tribunal. The bill set out to make clear the criteria to apply in a disputed assessment, and in what order it must be applied and had two key components. The first required the tribunal to make an independent determination and laid out specific criteria for doing so, including how to define comparable sales. The second component of the bill addressed what the tribunal's determinations were subject to, making it clear that there must be substantial evidence to support their determinations. The bill passed the House but did not make it through the Senate during that session. One source covering the legislation indicated that opponents to the legislation argued that this was a tax increase on one segment of the business community, that this could migrate to other industries, and would be unconstitutional (Hirten, 2017). Rep. Maturen has not given up and has introduced a similar bill, HB 4397 for the 2017-18 legislative session.

Indiana successfully passed two pieces of legislation back in 2015 to address DST and the cost approach to valuation for certain properties, but both were later repealed and replaced based on uniformity concerns. The new legislation passed in 2016 was much weaker but does provide more direction on what constitutes a comparable sale. An article in the Indiana State Bar

Association's newsletter indicated that the bill is expected to make litigation more costly because of the requirements on market segmentation analysis and expert testimony which may cause fewer cases to settle. They also asserted that parts of the bill would be litigated but did not say by whom (Auberry, Mandell, & Stanley, 2016).

Wisconsin Representative Rob Brooks has drafted two pieces of legislation to address DST and held a press conference on May 3, 2017 to discuss drafts of his bills that will soon be formally introduced; one bill draft is co-sponsored by Senator Roger Roth (LRB-0373/9) and the other by Senator Duey Stroebel (LRB-0372/6). Both bill drafts address valuation methods but LRB-0372/6 is specific to leased property, that Walgreens and other medium sized stores are using with similar results. According to the Legislative Reference Bureau's analysis of LRB-0373/9, the bill draft: addresses comparables for property tax assessments, defines "real estate market segment," does not consider properties with deed restrictions on the highest and best use or dark properties as comparable, and defines "dark property." According to the League of Wisconsin Municipalities (League) website, approximately 37 municipalities and Washington County have passed resolutions supporting legislation to close tax loopholes that cause a property tax burden shift from commercial to residential properties.

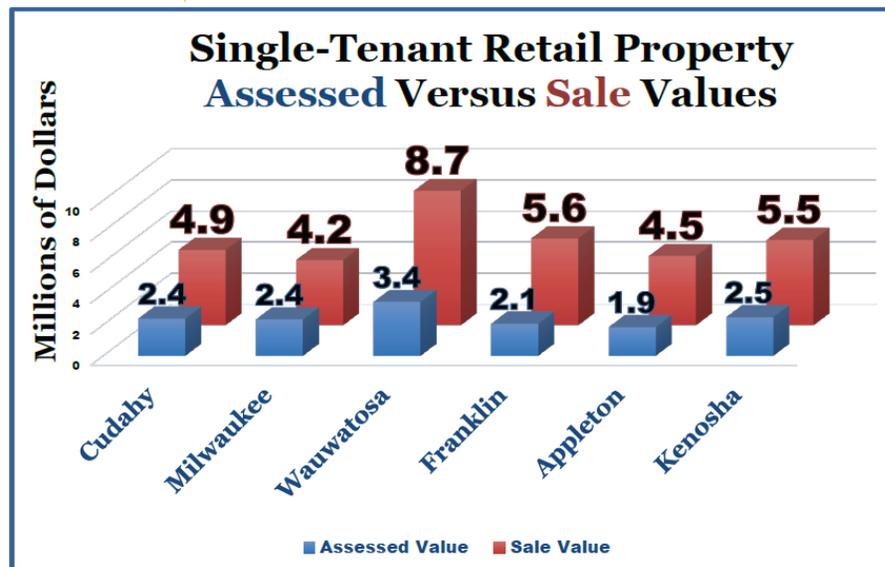
During the press conference, Assembly author Brooks said that the legislation "simply clarifies the best practices outlined in the WPAM, we are not proposing any new reforms to the tax code. The intent is to provide clarity to the board of review and to the courts to arrive at fair and equitable assessments of property in this state." Brooks also noted that "the courts rely on what is in state statute and prior court cases when rendering court decisions on disputed valuations they don't rely on best practices or the user's manual." Sen. Roth said that "For me, it's all about fairness. I don't want to see that shift to our residential taxpayers. That is

fundamentally why I support this bill. We are just going back to the status quo from before all these court cases.”

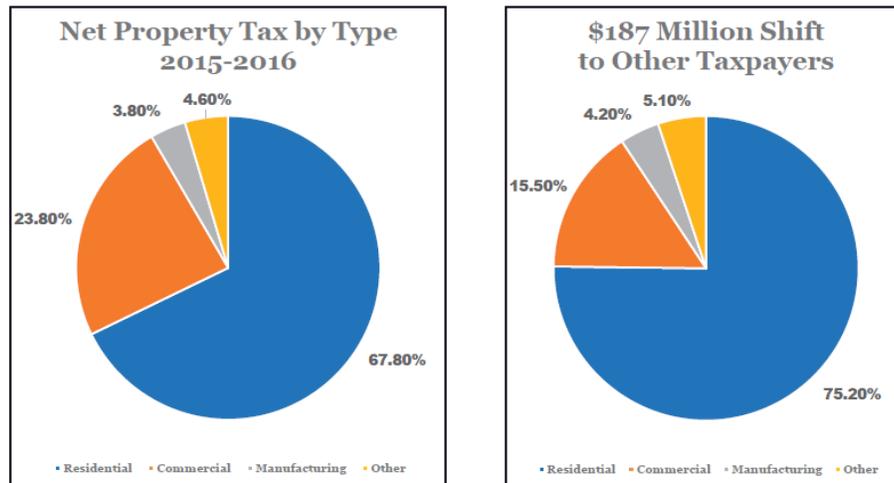
Wisconsin Manufacturers & Commerce (WMC) asserts these bills are a tax hike. Their website has a two-minute video and a press release that claim that the bills will “dramatically change how property is valued in Wisconsin.” As advocates of large business, their clientele would be adversely impacted should these bills pass since most of the assessment appeals are large chain retail stores. WMC claims that these bills could have unintended consequences and that some retailers have seen a property tax increase of over 500%. They pointed to the improved business climate in Wisconsin and that passage of these bills could “dramatically increase the cost of doing business in Wisconsin” and would be a “big step backward.” (WMC, 2017)

Several mayors and one village administrator also spoke out on the bill during the press conference: Mayor Tim Hanna (Appleton), Mayor Kathy Ehley (Wauwatosa), Craig Sadownikow (West Bend), and Village Administrator Michael Pollocoff (Pleasant Prairie). Mayor Ehley gave specific examples of DST related assessment appeals in Wauwatosa. Ehley indicated that they had 5 appeals in 2013 and in 2016 that rose to 12. One such appeal that is still unsettled revolves around a major shopping center and Ehley explained that the shopping center’s most recent financing appraisal claimed the value of the property was \$665 million dollars, but when it comes to their assessment they asserted a \$299 million dollar valuation. That is a 55% decrease in value and according to Visit Milwaukee, “Wisconsin’s most successful shopping center.” Ehley said that if DST related appeals continues it will mean a \$386 increase in individual tax bills. Explaining to her constituents that their tax bill is going up \$386 when not raising additional revenue or providing additional services is difficult, she said.

The League is supporting the bills and provided additional information on the impact of DST in Wisconsin. They claim that there is “a carefully-orchestrated wave of hundreds of lawsuits” in Wisconsin and the impact will shift millions of dollars in property taxes to “local mom and pop shops and to their home-owning customers.” The League provided data for seven Wisconsin communities (Brookfield, Hudson, La Crosse, Oconomowoc, Pleasant Prairie, Wauwatosa and West Bend) that was “based on amount of national chain retail, 2015 mill rates, and median home values.” The smallest estimated tax increase was 5% in Brookfield and the largest was 17% in Pleasant Prairie and indicated that the average increase per home would be \$233.50 and \$892.50 respectively. The league provided the additional graphs below to illustrate the potential impact of the shift in taxes:



The Big Shift



When asked about the legislation, both Archambo and Krause said it was needed. The main reason was to get clarity for everyone. Krause said that most judges do not understand tax assessment information, that it isn't in their arena, and it is difficult to educate them. On the large shopping center case in Wauwatosa, they just lost their judge due to rotation and now have to start all over with a new judge so having clarity in the statutes is critical. Archambo said fairness is the goal and that not having a legislative fix has become "exceptionally expensive" as they have had to contract out for legal services for some of their more complicated cases. If this was fixed statutorily that would not be the case. Archambo's parting comment was that statewide, his understanding was that homeowners are now footing in the neighborhood of two-thirds of the property tax bill when it used to be 45-50% in the 1970's and it has only gotten worse in the last few years. Fairness among classifications has never been a bigger issue.

Fairness is a subjective concept, but three Wisconsin state legislators believe that current state statutes need further clarification for the courts to render fair decisions when it comes to property assessment appeals. The assessment process in Wisconsin, and likely in other states as

well, can be challenging to follow for those unschooled in its finer points. Having clarity in state statutes means that those less familiar with the process will not be making their own interpretations of fairness.

Dark Store Theory in a relatively short time has had negative impacts on both municipalities and other property taxpayers who must absorb the shift in property taxes from those who successfully employ DST to lower their property assessments. Municipalities have only a few choices when this occurs: reduce the overall tax levy to keep other taxpayers whole, keep the levy the same and shift the tax burden from one property owner on to others, or some combination of the two. In any scenario, there is only one (or a few) who benefit while the majority loses. Millions of dollars in property valuation and property taxes are at stake. In Wauwatosa, one property owner alone has the potential to negatively impact that municipality by nearly \$495 million dollars for a multiple year assessment appeal and the number of appeals has grown each year. Legislation is needed to provide clarity and fairness for all taxpayers, not just the ones who can afford to fight it out in court. The legislation recently announced in Wisconsin would do just that.

The impact of DST on municipal government and other property tax payers is growing and has begun to bleed over into other commercial sectors. Unless legislation is enacted to clarify the process, the outlook for homeowners and their communities could be devastating as it has been in other states.

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