

“Dark Store” Valuation Overview

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Introduction – What is the Dark Store Theory?

Operating big box commercial properties should be valued the same as vacant (dark) properties.

Property Tax Appraisal Requirements & Definitions

- The duty of our appraisers is to prepare appraisals for property tax purposes using recognized methods and techniques consistent with property tax law.
- California Constitution, statutes, and regulations require real property to be appraised at fair market value, which means that appraisals must be based on the most productive or highest and best use of the property.

Market Value Definition

- Under R&T Code Section 110, “full cash value” or “fair market value” means the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other and both having knowledge of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions upon those uses and purposes.
- As stated in Property Tax Rule 2, “fair market value” means the price that property would sell for in a transaction “ between parties who have knowledge of the uses to which the property may be put, both seeking to maximize their gains...”

Highest and Best Use Definition

The current definition of “highest and best use” provided in Assessor’s Handbook Section 502, pg. 201 is :

The most profitable use of a property at the time of the appraisal; that available use and program of future utilization that produces the highest present land value; must be legal, physically possible, financially feasible, and maximally profitable;....

Fee Simple Estate Definition

The current definition of “fee simple estate” provided in Assessor’s Handbook Section 502, pg. 199 is:

Absolute ownership unencumbered by any other interest or estate, subject only to the limitations of eminent domain, escheat, police power, and taxation.

The current definition of “fee simple estate” according to Black’s Law Dictionary is:

An interest in land that, being the broadest property interest allowed by law, endures until the current holder dies without heirs (Garner 2014, 733).

Divergence of Fee Simple Appraisal Definition

In 1984 the phrase “unencumbered by any other interest or estate” was added to The Dictionary of Real Estate Appraisal definition of fee simple estate.

The reason for the change is not clear. The prior appraisal definition was similar to the legal definition:

Fee simple. An absolute fee; a fee without limitations to any particular class of heirs or restrictions, but subject to limitations of eminent domain, escheat, police power, and taxation. An inheritable estate. (American Institute of Real Estate Appraisers 1983)

Interpretation Issue

“Unencumbered by any other interest or estate is a problematic phrase that has been interpreted to imply that unspecified interests and encumbrances will result in something other than the fee simple estate.”¹

A fee simple estate can only be encumbered by a freehold estate (life estate, etc.)

The presence of a lease (leasehold interest) does not diminish the underlying fee simple estate because the leasehold interest is a lesser estate.

Valuation Issue

Specific valuation issues (Dark Store Theory) arising from interpretations of the added terminology “*unencumbered by any other interest or estate*”:

- Whether a property should be valued as if vacant (“dark”) when it is not
- Whether the term assumes any encumbrances (such as a lease) on the property
- Whether fee simple implies market rent

Dark Store Theory – Operating Big Box Retail Properties Valued As If Vacant

Some big box retailers have asserted their operating commercial properties should be valued the same as vacant (dark) properties.

These vacant claimed comparable properties are often:

- Vacant for years
- Near the end of their economic life
- In fair to poor condition
- Located in inferior locations compared to the operating subject properties
- Deed restricted, which could change the property's highest and best use and therefore limit the demand for the property

Dark Details

- The “Dark Store Theory” is typically applied to owner-occupied properties or properties subject to a ground lease with the tenant constructing and owning their building
- The “Dark Store Theory” relies heavily on the market approach to value
- Proponents argue the income approach should be omitted as a valid approach to value because it is too “speculative”

Implications of “Dark Store” Valuations

- “Dark Store” appeals are being filed statewide now
- Income approach allegedly becomes unreliable or invalid
- Incompatible with BOE appraisal training and guidance
- Could result in inequity of assessed values
- Potential to spread to other property types (retail, office, apartments)
- Potentially significant property value reductions
- Dark store appeals are time consuming and costly for Assessors to defend
- R&T Code and/or Tax Rule changes may be needed to address the issues raised by this theory