STATE OF MICHIGAN

COURT OF APPEALS

J C PENNEY COMPANY INC, Petitioner-Appellee,	UNPUBLISHED March 11, 2010
v	No. 288536 Michigan Tax Tribunal
CITY OF ANN ARBOR, Respondent-Appellant.	LC No. 00-301999

Before: FITZGERALD, P.J., and CAVANAGH and DAVIS, JJ.

PER CURIAM.

Respondent appeals as of right from the judgment of the Michigan Tax Tribunal holding that the true cash value of petitioner's leasehold property for the 2003 through 2006 tax years must be determined on the basis of actual rents received. Petitioner brought the instant tax appeal because it contended that respondent improperly valued its property by using market rent rather than actual rental income. The Tax Tribunal concluded that petitioner was correct. We affirm.

This Court's review of the Tax Tribunal's decision is limited to determining whether the Tax Tribunal misapplied the law or adopted a wrong legal principle, and its factual findings are "conclusive if they are supported by 'competent, material, and substantial evidence on the whole record.'" *Liberty Hill Housing Corp v City of Livonia*, 480 Mich 44, 49; 746 NW2d 282 (2008), quoting Const 1963, art 6 §28. Evidence is "substantial" if, after a thorough review of the entire record, a reasonable person would find the agency's factual findings legitimately supported by "more than a scintilla" of evidence. *In re Payne*, 444 Mich 679, 692-693; 514 NW2d 121 (1994). The amount of evidence necessary to require this Court to affirm "may be substantially less than a preponderance" thereof, and this Court may not reverse "merely because alternative findings also could have been supported by substantial evidence on the record." *Id*., 692. An agency's interpretation of law is entitled to "respectful consideration," but it is not binding on this Court, and this Court remains obligated to review statutes de novo. *In re Complaint of Rovas Against SBC Michigan*, 482 Mich 90, 102-109; 754 NW2d 259 (2008).

The parties have not explicitly stipulated to the facts in this case. However, a careful review of their briefs shows that they are in effective agreement as to the salient underlying facts and the controlling documentary evidence. The parties accuse each other of misrepresenting the contents and significance of the documents–in particular, the purchase offer provision in

petitioner's lease–but they both ultimately rely on the documents themselves. There is no assertion of fraud and no genuine dispute as to the facts.

Prior to 1974, a wholly owned subsidiary of petitioner owned a parcel of property and several buildings thereon in respondent city. That property would eventually become part of the Briarwood Mall. On March 1, 1974, petitioner's subsidiary simultaneously (1) leased the land to, and subleased the land back from, an independent and unrelated entity called PennArbor; (2) sold the buildings to, and leased them back from, PennArbor; and (3) assigned its interests to petitioner. Both leases ran until March 31 or April 1, 2004, and both made similar extensions available. The ground lease and its extensions run one day longer than the building lease and extensions. The building lease gives petitioner a repurchase option. The leases have not been renegotiated,[1] and the leases have been extended and are presently still in effect.

For the 2003 through 2006 tax years, respondent valued petitioner's property at several times the value petitioner believed its property was worth. The reason for the disparity in values was that respondent utilized a "market rent" valuation method, whereas petitioner utilized an "income capitalization" valuation method. In a nutshell, this means that respondent valued the property by calculating its theoretical value, based on comparisons to the income other properties could generate; whereas petitioner valued the property based on actual rents received under the lease. Both parties contend that their valuation methodology is the most accurate. But more significantly to this appeal, petitioner contends that the lease is a "long-term, economically disadvantageous" encumbrance, thus triggering a legal requirement to value the property using actual rents (the "*CAF* doctrine"[2]). Respondent argues that the lease is not an "unfavorable long-term" lease because of the purchase option available to petitioner.[3] Notwithstanding the other matters discussed by the parties, whether the lease is an "unfavorable long-term lease" is the only issue on appeal.

The leading case law on point held that the income-producing property in that case, which was subject to "an existing unfavorable long-term lease with an actual rate of return which is substantially less than the present 'going rate,'" must have its true cash value[4] determined on

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[1] An amendment to MCL 211.27 would have changed the applicable law, but the amended version of that statute "does not apply to property subject to a lease entered into before January 1, 1984 for which the terms of the lease governing the rental rate or tax liability have not been renegotiated after December 31, 1983." *Carriage House Co-op v City of Utica*, 172 Mich App 144, 149; 431 NW2d 406 (1988), abrogated on other grounds by *Georgetown Place Co-op v City of Taylor*, 226 Mich App 33, 44-46; 572 NW2d 232 (1997). The parties do not dispute that the lease here was "grandfathered."

[2] *CAF Investment Co v Mich State Tax Comm* (*CAF I*), 392 Mich 442; 221 NW2d 588 (1974); *CAF Investment Co v Saginaw Twp* (*CAF II*), 41 Mich 428; 302 NW2d 164 (1984).

[3] Respondent argued in the Tax Tribunal that the sale-leaseback arrangement was a disguised mortgage, but the Tax Tribunal rejected that argument and on appeal respondent "accepts the Tribunal's ruling on the mortgage argument."

[4] Const 1963, art. 9, §3; MCL 211.27.

the basis of the property's *actual* rental income. *CAF Investment Co v Mich State Tax Comm* (*CAF I*), 392 Mich 442; 221 NW2d 588 (1974); *CAF Investment Co v Saginaw Twp* (*CAF II*), 41 Mich 428; 302 NW2d 164 (1984). The "true cash value must equal the fair market value of the property *to the owner*." *CAF II*, *supra* at 459 (emphasis added). Valuing the property as if "the property was available to rent in the marketplace" was impermissible because that valuation would ignore "the fact that the piece of property in question is not available in the rental marketplace by virtue of existence of a long-term lease." *CAF I*, *supra* at 451-452. Our Supreme Court discussed the general principle that the Tax Tribunal simply could not "consider and give weight to evidence of valuation based upon a rate of return which comparable, unencumbered property could earn in the present marketplace" if, due to an unfavorable long-term lease, the property was not, in fact, actually available to the marketplace. *CAF I*, *supra* at 447; *CAF II*, *supra* at 459-460.

Our Supreme Court left open the possibility that actual rental income might not be the most appropriate valuation methodology under some circumstances. See *CAF I*, *supra* at 455-456; *CAF II*, *supra* at 460-461. The Tax Tribunal is required "to determine which approaches are useful in providing the most accurate valuation under the individual circumstances of each case, so long as "the final value determination [represents] the usual price for which the subject property would sell." *Meadowlanes Ltd Dividend Housing Ass'n v City of Holland*, 437 Mich 473, 485; 473 NW2d 636 (1991). The gravamen of the *CAF* cases is that theoretical market value of income-producing property cannot be used to value that property if the property is in some way not practically available to the market. If the property is not practically marketable, its value should be based on its actual income. The actual income of rental property is its rent, unless there is some reason why the rent is speculative or otherwise shown not to be truly reflective of the property's value.

The outcome of this matter is governed by the purchase option and what effective rights it actually gives to petitioner. The purchase option, found in §15(b) of the building lease, as follows:

> On any Basic Rent Payment Date on or after March 31, 1994, Lessee shall have the option, exercisable by notice to Lessor not less than 90 days prior to the date of purchase, to purchase Lessor's interests in the Leased Premises. The purchase price payable by Lessee upon the purchase of such interests pursuant to this paragraph 15(b) shall be an amount equal to the greater of (i) the then applicable purchase price determined in accordance with paragraph 3 of Schedule C hereof, or (ii) the fair market value as of the date of such notice of the Leased Premises, considered as encumbered by this Lease with the right to all Extended Terms exercised by Lessee (whether or not such right to extend shall, in fact, have been exercised), as determined by an appraiser or appraisers selected in the following manner: [procedure for selecting appraisers omitted].
>
> On such Basic Rent Payment Date, Lessor shall convey and assign its interests in the Leased Premises to Lessee in accordance with paragraph 16 and Lessee shall pay Lessor such purchase price, together with all instalments [sic] of Basic Rent and all other sums then due and payable under this Lease to and including such Basic Rent Payment Date. On such Basic Rent Payment Date this Lease shall terminate except with respect to obligations and liabilities of Lessee

> under this Lease, actual or contingent, which have arisen on or prior to such Basic Rent Payment Date, but only upon payment by Lessee of all Basic Rent and other sums due and payable by it under this Lease to and including such Basic Rent Payment Date.

The above purchase option would terminate the ground lease as well.

Respondent makes the interesting argument that despite the purchase price being the *greater* of a scheduled price *or* fair market value, "fair market value" must be "considered as encumbered by this Lease." Respondent also argues that this case is distinguishable from the *CAF* cases simply because petitioner *has* a purchase option that it can use to get out of the lease. Respondent concludes that the effect of the purchase option is that petitioner has the right to become the fee owner of the entire property for a paltry sum at any time it wishes. Therefore, the property is not truly encumbered by a long-term disadvantaged lease, because it is not really encumbered at all.

The Tax Tribunal did note the limitation on how "fair market value" should be appraised, and it recognized that the existence of the purchase option was a distinguishing characteristic of this case. But the Tax Tribunal made additional, independent factual findings that under the circumstances of this case, the purchase option did not add anything to the value of the property to petitioner. We decline to overturn the Tax Tribunal's findings. The record contains enough evidence for a reasonable mind to support the conclusion that petitioner cannot economically get out of the lease and that a potential purchaser of the property would be interested in the property's income-producing potential rather than its theoretical value in fee.

This Court must not "'invade the province of exclusive administrative fact-finding by displacing an agency's choice between two reasonably differing views.'" *In re Payne*, *supra* at 693, quoting *MERC v Detroit Symphony Orchestra, Inc*, 393 Mich 116, 124; 223 NW2d 283 (1974). The Tax Tribunal's record in this case contains evidence from which a reasonable mind could conclude that petitioner's property is encumbered by a disadvantageous long-term lease and that petitioner's technical ability to purchase the property is of no practical value. Respondent has at most shown that the record might also support an alternative conclusion. The Tax Tribunal therefore did not err in concluding that the only basis for calculating the property's value was its actual rental income.

Affirmed.

/s/ E. Thomas Fitzgerald
/s/ Mark J. Cavanagh
/s/ Alton T. Davis