

A05-1069

STATE OF MINNESOTA
IN SUPREME COURT

Kmart Corporation,

Relator,

vs.

County of Becker,

Respondent.

BRIEF OF RESPONDENT BECKER COUNTY

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LEGAL ISSUES

I. **WHETHER THERE WAS SUFFICIENT EVIDENCE PRESENTED AT TRIAL TO SUPPORT THE TAX COURT'S USE OF A 10.25% CAPITALIZATION RATE.**

Yes. Even with the tax court's memorandum explaining that Relator's experts' *analysis* was "persuasive", the tax court was not bound to accept the expert's suggested capitalization rate, and the evidence presented supported the tax court's finding of a 10.25% capitalization rate.

II. **WHETHER THERE WAS SUFFICIENT EVIDENCE PRESENTED AT TRIAL TO SUPPORT THE TAX COURT'S ARRIVAL AT \$35.00 PER SQUARE FOOT UNDER THE SALES COMPARISON APPROACH TO VALUE.**

Yes. The tax court was justified in arriving at \$35.00 per square foot based on the information and evidence presented by both experts and based on the tax court's adjustments to that evidence.

STATEMENT OF THE FACTS

Certain allegations made in Relator's "Facts" section are unsupported by the evidence presented at trial. Relator claims that it purchased three Kmart stores to buy its way out of disadvantageous leases. Relator's Brief at 4. No Kmart representative testified to that assertion as a fact. It was not a finding made by the tax court.

Prior to October 14, 1999, Relator leased the subject property. Relator purchased the subject property on October 14, 1999 in an arm's length

transaction for \$3,696,000 from Kenneth B. Karl. Although Relator tried desperately at trial to claim that this sale was an “allocation” and therefore not reflective of a true sales price, the evidence presented at trial clearly refutes that contention Exhibit 101, Addendum p. 5-6 (Affidavit of Kenneth B. Karl, owner of subject property at time of sale to Kmart), p. 14 (Exhibit C to Affidavit; letter from attorney for Kenneth B. Karl). In addition, the Certificate of Real Estate Value filed with the Becker County Recorder’s Office unequivocally demonstrates that the sale price was not an allocation. Id. at 2 (line 7 of second page to CRV).

Though the opening of the Wal-Mart store west of the subject property had an impact on Relator’s sales, the testimony at trial from both experts clearly showed that the store remained profitable, which was evident when Kmart chose not to close this particular store as a result of Kmart’s bankruptcy proceedings. Trial Transcript, pp. 166, 178, 278, 279. Competition between discount retail merchandise stores is inevitable. Additionally, increased competition resulting in a reduction in sales does not automatically translate into a decreased real estate market value. Prior to Wal-Mart entering the Detroit Lakes market, Relator performed extremely well in retail sales. After Wal-Mart’s entrance into the market, Relator’s sales reduced dramatically, and yet that reduction resulted in a yearly gross sales amount commensurate with other out state Kmart stores in similar markets. Relator simply had the

corner on the market in the Detroit Lakes area until Wal-Mart opened. Wal-Mart's entrance does not justify a reduction in the value of the real estate.

Finally, contrary to Relator's assertion (Relator's Brief at 4), the tax court did not specifically find that Mr. Dahlen's analysis and conclusions were not credible. Instead, the court simply found that Respondent had not provided the court with clear and convincing evidence on the sole issue of whether certain leases were at market rent. Relator's Appendix at 26.

STANDARD OF REVIEW

Minnesota Statute Section 271.10, Subdivision 1 limits this Court's review of tax court decisions to determining: (1) whether the tax court lacked jurisdiction; (2) whether the tax court's decision was supported by the evidence or in conformity with law; or (3) whether the tax court committed an error of law.

This Court is being asked to review the tax court's factual findings. "In reviewing questions of fact this Court's review is limited 'to determining whether there is reasonable evidence to sustain the findings.'" Morton Bldgs., Inc. v. C.I.R., 488 N.W.2d 254, 257 (Minn. 1992). "This Court does not substitute its judgment for that of the tax court on questions of fact, leaving the factual findings undisturbed where the evidence, as a whole, supports the decision." Manthey v. Commissioner of Revenue, 468 N.W.2d 548, 550 (Minn. 1991). "The inexact nature of property assessment necessitates that

this Court defer to the decision of the tax court unless the tax court has either clearly overvalued or undervalued the subject property, or has completely failed to explain its reasoning.” Equitable Life Assurance Society of the United States v. County of Ramsey, 530 N.W.2d 544, 552 (Minn. 1995).

ARGUMENT

I. **THE EVIDENCE PRESENTED AT TRIAL CLEARLY SUPPORTS THE TAX COURT’S FINDING THAT A 10.25% CAPITALIZATION RATE IS REASONABLE.**

Relator cannot meet its heavy burden of showing that there was no reasonable evidence to sustain the tax court’s finding of a 10.25% capitalization rate. The tax court noted in its memorandum to its written Findings of Fact and Conclusions of Law that it considered both expert’s capitalization rates. The tax court found Relator’s expert, Mr. Lierness’ *analysis* persuasive. However, this analysis included the band of investment method, which indicated a rate of 10.25%. Furthermore, the tax court did not expressly reject Mr. Dahlen’s entire analysis, as claimed by Relator. Relator’s Brief at 11. In arriving at a capitalization rate of 10.25%, the Court considered the analysis used by Mr. Lierness, which included the band of investment method, and compared it to Mr. Dahlen’s suggested capitalization rate of 9.5% in light of the methodology he used.

Moreover, the issue of capitalization was thoroughly discussed at trial by both experts, and that testimony was considered by the judge in addition to the written appraisals and exhibits. The trial consisted of two days worth of testimony. Using the analyses, methods, and data presented by the experts at trial and comparing the two suggested rates, the court was more than justified by arriving at a capitalization rate of 10.25% - a value between the ranges provided by the experts. Trial Transcript, pp. 315-16, 90. The tax court is entitled to make findings based on the evidence and analyses presented, and is not limited to the figures suggested by the experts. See American Express Financial Advisors, Inc. v. County of Carver, 573 N.W.2d 651, 658 (Minn. 1998) (“the tax court was not bound to accept the valuation of either appraiser”); Equitable Life at 558 (finding that the tax court has the authority to reconcile conflicting opinions of value and arrive at a compromise value as long as that value is supported by the evidence).

In American Express, this Court did not second guess the conclusions of value made by the tax court. Instead, it came to a different legal conclusion about the classification of the property, which, in turn, affected the valuation and assessment of the property in that case. Id. at 654. Consequently, this Court reversed the legal conclusion of classification and remanded the case for the tax court to determine a value using the data available. Id. Clearly, this is not the case with Relator. In contrast to American Express, Relator is asking this Court to second guess the judgment of the tax court with respect

to the factual issue of what capitalization rate is appropriate. Considering the range of information and data available to the tax court from both experts, the 10.25% capitalization rate is plainly reasonable and supported by the evidence.

The tax court also had the opportunity to reconsider this issue when Relator moved for Amended Findings of Fact and Conclusions of Law, which was heard on January 19, 2005. Notwithstanding the arguments made by Relator, the tax court again concluded that the evidence supported a finding of a 10.25% capitalization rate, and again explained its reasoning in a written memorandum accompanying the Order. Relator's Appendix at 39. Clearly, this demonstrates that the tax court fully considered the issue and concluded it was justified in its analysis. Relator is unable to meet its burden of demonstrating that the tax court was illogical or that the evidence, as a whole, does not support finding of the 10.25% capitalization rate. See Id. at 658 (holding that certain findings of the tax court were not clearly erroneous and stating: "[i]n light of [the] conflicting testimony, we cannot state that the tax court's determination was against the weight of the evidence.").

II. THE EVIDENCE PRESENTED AT TRIAL CLEARLY SUPPORTS THE TAX COURT'S FINDING THAT \$35.00 PER SQUARE FOOT UNDER THE SALES COMPARISON APPROACH TO VALUE IS REASONABLE.

A. Although The Tax Court Determined That Comparable Leased Fee Sales Required Adjustment, The Tax Court Was Not Bound To Accept Relator's Expert's Suggested Downward Adjustment of 15%.

Relator alleges that the tax court's arrival at \$35 per square foot failed to account for the leased fee nature of the comparables. In doing so, Relator contends that the tax court failed to apply a downward adjustment in its square foot analysis under the sales comparison approach and asserts that the tax court was required to accept the 15% adjustment made by Relator's expert. Relator also states that the tax court *expressly* accepted Mr. Leirness' leased fee adjustments and expressly rejected Mr. Dahlen's entire testimony. Relator's Brief, pp. 14, 18. These assertions are incorrect.

The tax court noted that based upon the evidence, the comparable leased fee sales involved higher than the market rent and that adjustments were necessary. However, it did not accept and find Relator's suggested 15% downward adjustment to be the appropriate level of adjustment, nor was it bound to. The tax court is not required to accept the figures presented by either expert; rather, the tax court considers the evidence presented and can make its own conclusions based on that evidence. This is entirely justified, so long as the conclusions are based on the evidence and supported by written findings. See supra, pp. 6, 7. Here, the tax court demonstrated its reasoning

in its Findings of Fact, Conclusions of Law, and Order for Judgment dated December 1, 2004 and accompanying memorandum (Relator's Appendix at 15) and its Order denying Relator's post-trial motions, dated April 1, 2005 and accompanying memorandum. Relator's Appendix at 37. The tax court stated that it made adjustments for the leased fee nature of the comparable sales to reflect the market rent for aging stores which was less per square foot than the contract rent when the stores were new. Id. at 27 (12-1-04 Order); Id. at 40 (4-1-05 Order). See Equitable Life at 550 and 558 (acknowledging that the tax court did not fully adopt the variables and analysis of either expert appraiser, but instead used the data available to prepare its own analysis and arrive at a value, and finding that to be appropriate and justified).

Relator also mischaracterizes the tax court's findings and orders when it alleges that the tax court specifically found Mr. Dahlen's testimony lacked credibility. There were no such findings made by the court. The tax court stated that Mr. Dahlen had failed to present clear and convincing evidence of market rents; not that his analysis was incredible. Furthermore, Relator makes much ado about the fact that there was an error in Mr. Dahlen's comparable sale #1 fact sheet (in that it first included and then omitted the Fashion Bug parcel's square footage) even though this error was corrected in Mr. Dahlen's testimony. Relator's Brief at 16. The error was attributable to the fact that Relator, two weeks before trial (and the very day appraisals were to be exchanged), suddenly dismissed the Fashion Bug portion of its appeals. In

an effort to adjust his appraisal to comport to only the Kmart parcel, Mr. Dahlen inadvertently omitted this correction. However, as noted, the error was corrected in testimony and the judge was supplied the data necessary to evaluate the expert's methodologies and arrive at a value.

B. The Tax Court Did Not Find That Relator's Expert's Suggested 15% Downward Adjustment Must Be Applied To Arrive At A Range Of Values.

Value figures provided by the experts gave the tax court the framework in which to make a conclusion as to the ultimate price per square foot. The experts indicated a range of \$28.28 per square foot to \$46.78 per square foot. The upper range was based on the appraisal, research, and testimony of Mr. Dahlen. Mr. Dahlen testified that he used 4 techniques to determine market rents. Trial Transcript at 293. Mr. Dahlen made various adjustments to his comparable sales in order to reach an adjusted sales price per square foot, in turn providing a framework for the court. *Id.* at 293-295; 303-309; 312; Relator's Appendix, pp. 73-79. Based on his research he formed the opinion that Kmart had been paying market rent. The tax court disagreed with this conclusion, but did not discount the other adjustments made by Mr. Dahlen. Consequently, the tax court was justified in using Mr. Dahlen's figures for sales per square foot in its framework to then determine an appropriate sales price per square foot. The tax court was then free to evaluate those figures and make the adjustment it found necessary to accommodate the nature of

the leased fee interest. Certainly, this evidence, in addition to all of the evidence submitted regarding square footage price ranges, supports the tax court's ultimate determination of \$35.00.

In summary, Relator has not met its burden of demonstrating that the tax court's findings are unsupported by the evidence as a whole, that the findings are illogical, or that they are completely unexplained. Based on the record, the tax court's findings must be sustained.

CONCLUSION

Respondent respectfully requests that this Court affirm the Minnesota Tax Court's April 1, 2005 Order denying Relator's post-trial motions, and its December 1, 2004 Findings of Fact, Conclusions of Law, and Order for Judgment.

Dated: *July 18, 2005*

RESPECTFULLY SUBMITTED,

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CERTIFICATE OF COMPLIANCE

WITH MINN. R. APP. P 132.01, Subd. 3

The undersigned certifies that Relator's Brief submitted herein complies with the type/volume limitations of the Minnesota Rules of Appellate Procedure 132. This Brief was prepared using a proportional spaced font size of 13 pt. and contains 2,298 words and 246 lines. The word count is stated in reliance on Microsoft Office Word 2002, the word processing system used to prepare this Brief.


Gretchen D. Thilmony