

NO. A11-345

State of Minnesota
In Supreme Court

Continental Retail, LLC,

Relator,

v.

County of Hennepin,

Respondent.

RELATOR'S REPLY BRIEF

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RELATOR'S STATEMENT OF THE ISSUES

1. Did the Tax Court err in allowing Respondent's expert to testify and adopting her report as an expert and then err again in relying on her nonexistent experience?

Result below: The Tax Court ruled incorrectly.

Most apposite authorities: City of Minnetonka v. Carlson, 298 N.W.2d 763, 766 (Minn.1980); Marquette Bank v. County of Hennepin, 589 N.W.2d 301, 304 (Minn. 1999)

2. Does Respondent's presentation of "red herrings" support the Tax Court's decision?

Result below: The Tax Court ruled incorrectly.

Most apposite authorities: City of Minnetonka v. Carlson, 298 N.W.2d 763, 766 (Minn.1980); Marquette Bank v. County of Hennepin, 589 N.W.2d 301, 304 (Minn. 1999)

3. Did the Tax Court err in concluding that the fee simple and leased fee can never be the same?

Result below: The Tax Court ruled incorrectly.

Most apposite authorities: City of Minnetonka v. Carlson, 298 N.W.2d 763, 766 (Minn.1980); Marquette Bank v. County of Hennepin, 589 N.W.2d 301, 304 (Minn. 1999)

4. Did the Tax Court err in adopting Stoerzinger's seriously flawed income analysis?

Result below: The Tax Court ruled incorrectly.

Most apposite authorities: City of Minnetonka v. Carlson, 298 N.W.2d 763, 766 (Minn.1980); Marquette Bank v. County of Hennepin, 589 N.W.2d 301, 304 (Minn. 1999)

ARGUMENT

A. RESPONDENT CONCEDES THAT ITS “EXPERT” LACKED THE EXPERIENCE AND FACTS FOR THE TAX COURT TO RELY UPON.

One of the primary reasons that reversal is required in this case is the Tax Court’s mistaken reliance on supposedly expert testimony by an appraiser who was not qualified to render a valuation opinion for the Subject Property. Respondent’s brief pays scant attention to this critical issue.

Indeed, by its silence, Respondent concedes the following undisputed facts about its “expert” appraiser, Shelagh Stoerzinger (“Stoerzinger”):

- a) She is not a licensed commercial real estate appraiser (TT 972);
- b) She never appraised a retail center in Brooklyn Park before this case (TT 972-73);
- c) She never prepared a formal appraisal prior to the one she prepared for this case (TT 972);
- d) She has no personal experience in commercial real estate (TT 1003);
- e) She used hypothetical numbers for rents and vacancies, not the actual numbers that she had for the Subject Property (TT 1005);
- f) She ignored the actual vacancy rates of 27%, 34% and 38% (TT 968-70);
- g) She admitted the building is sinking, which is a detrimental condition that should be considered in valuing property (TT 968, 1027);
- h) She admitted that sinking causes a negative stigma and that the stigma is another detrimental condition (TT 989-90);
- i) She did not know if excessive vacancy is a detrimental condition (TT 989);
- j) She had no experience appraising properties with detrimental conditions (TT 838);

- k) She admitted that she has no qualifications as to sub soils (TT 988);
- l) She did not take any steps to ascertain the cost to correct the Subject Property's deficient sub soils (TT 988);
- m) She did not analyze or even consider cash flow, although cash flow is of utmost importance to buyers of commercial property (TT 1014-15);
- n) She did not know of a single sale of a retail center with a negative cash flow in Brooklyn Park during 2006-2008 (TT 1010);
- o) She assessed the Subject Property as of January 2, 2009 using mass appraisal methods at \$2,216,000 – the same assessed value for January 2, 2006, 2007, and 2008 – but came up with much higher values for the same property on the same dates for trial (TT 974);
- p) She knew there were only three investment properties in Brooklyn Park during 2007 that sold, but she did not know if any of them were retail centers (TT 1020);
- q) She admitted that the Subject Property would not be purchased by an institutional investor (TT 1035);
- r) She admitted that she never spoke to an institutional investor (TT 1035);
- s) She did not have any facts about whether the Subject Property would qualify for a loan with an institutional lender (TT 1035-36);
- t) She did not know that an 85% occupancy rate was needed to obtain financing (TT 1037);
- u) Failed to research into what investors would want as a return to invest in a small strip center (TT 1049-51);
- v) She admitted she that did not use the market cap rate (TT 1052);
- w) She knew that the Subject Property was actually listed for sale at \$1,100,000 and that the only offer was \$900,000 (TT 966-67);
- x) She did not obtain the rent rolls for her comparables (TT 993);
- y) She did not talk to any buyers of commercial properties in connection with the preparation of her report (TT 1010); and

- z) She never spoke with or asked to speak with the key representatives of the property owner, Brad Hoyt and Traci Tomas (TT 993).

In response to these facts, the Respondent only puts forth a single sentence on page 10 of its brief: “However, Respondent’s expert also indicated and testified that she undertook the appropriate steps to complete the assignment competently, thus complying with the Competency Rule of USPAP and her testimony was accepted by the Tax Court.” In other words, the self-serving testimony of Stoerzinger herself that she became competent and complied with USPAP is the only evidence the Respondent can muster to rebut the overwhelming facts from A to Z above that she is not competent. (See TT 837-845). In this regard it is important to remember that Stoerzinger was admittedly not competent when she undertook the assignment.

Respondent concedes that the only thing Stoerzinger did to become “competent” to value real estate with detrimental conditions was to read a single book by a Mr. Bell. Stoerzinger admitted that she had never met Mr. Bell, never spoke to him and that all she knew about him was that he wrote a book. (TT at 893). Respondent’s attorney, realizing that her expert witness lacked the facts necessary to opine about valuing property with detrimental conditions, asked a very important question at page 897 of the trial transcript: “Ms. Stoerzinger, do you know whether this book is a book that appraisers rely upon in determining detrimental conditions?” Stoerzinger’s answer was “I don’t know.” (Id.).

The record is clear. Stoerzinger disclosed that she “does not have experience appraising properties with detrimental conditions.” (Trial Exhibit 102 at p. 11). The only step she took to become competent was to read a book by an unknown author.

B. THE RESPONDENT'S RED HERRINGS ARE LAME EXCUSES FOR A LACK OF EVIDENCE.

At the top of page 11 of Respondent's brief is Respondent's first attempt of many to misdirect the court with red herring arguments and clear misstatements of the record. The Respondent states, "There is no evidence in the record to support Relator's assertion that a portion of the subject needs to be torn down and, in fact, the property owner, Mr. Hoyt, did not testify that any structural defect was apparent as of January 2, 2006 or January 2, 2007." This statement is simply untrue. First, Stoerzinger stated in her report, "I am also assuming that the building would need to be demolished to the fire riser room. This would encompass Suites 8560, 8564 and 8568 or 9,513 SF." (Trial Exhibit 102 at pp. 81-82). In addition, Stoerzinger testified that she believed a buyer would value the property by demolishing that portion of the building. She also testified that she included in her analysis the costs of demolishing that portion of the building, the lost rental income, and the cost to rebuild the walls. (TT 926). Relator's expert also testified to the razing of that portion of the building. Therefore, the evidence not only supports Relator's assertion that a portion of the building needs to be demolished, it compels that conclusion. Why would Respondent's own witness consider the costs associated with demolition if it wasn't needed?

Next, Respondent attempts to distinguish Lowertown Five Ltd. Partnership v. County of Ramsey, 2002 WL 1453736 (Minn. Tax Ct. June 26, 2002) to explain away Stoerzinger's failure to consider whether the property could qualify for market financing. Here again, Stoerzinger lacked any factual basis for her naked assumption that the

property qualified for market financing, an assumption that defies commercial reality during the tax years under consideration. She admitted she did not know what was necessary to qualify for market financing. (TT 1037). Simply assuming a property could obtain market financing does not provide a factual basis for the assumption. The Respondent only response is that the irrelevant fact that Mr. Hoyt had at one time obtained a construction loan somehow proves the property could qualify for financing in the subsequent years at issue. Again, there simply is no factual support for Stoerzinger's assumption and the Tax Court's wholesale adoption of her analysis.

The Tax Court's decision was not reasonably supported by the evidence. The Tax Court and Stoerzinger ignored that Hoyt was required to give a personal guaranty to obtain the construction loan because the value of the property was insufficient. As Mr. Hoyt testified:

Q Could you, based on what existed on January 2, 2006, if you were a buyer, get financing for that?

A In '06 to buy the building from me for that price get financing for that? No.

Q And that's because of the –

A Because it's 40 percent vacant.

Q And again, just so we leave no confusion, that's what the numbers work out to. Would it be financeable?

A Definitely not, no. '07, no....

Q And I believe you testified earlier by 2008, the market -- the ability to get loans had become more difficult. So was this financeable as of January 2, 2008?

A No.

(TT 706-07).

At pages 711-12, Hoyt testified that he was required to give his full personal guaranty:

Q Mr. Hoyt, let's go back. In addition to the mortgage based on the value of the property, what other collateral did you give the bank?

A My full personal guarantee....

Q Did you volunteer your personal guarantee or was it required?

A It was required. The property had no income.

In addition, Respondent failed to rebut the evidence provided by Mr. Phillips that he continually attempted to help Hoyt obtain permanent financing for the property throughout the time relevant periods but was not successful due to the large vacancy rates – the very rates that were ignored by Stoerzinger and the Tax Court

C. RESPONDENT ADMITS THAT THE TAX COURT'S ERRED BY DISREGARDING RELATOR'S ANALYSIS THAT THE FEE SIMPLE WAS THE SAME AS THE LEASED FEE

Respondent admits that the fee simple may be equal to the leased fee at page 12 of its brief. A fair reading of the Tax Court's decision leaves no doubt that it simply disregarded the Relator's expert analysis when it read the words "leased fee." The Respondent does not dispute that the existing rents were at market. The problem is the vacancy. Stoerzinger assumed that this property should have a market vacancy of 10% and not the 27% to 38% it actually experienced. The market had spoken, so to speak, in determining these vacancy rates. In other words, for the Subject Property, with its deficiencies, leasing space at market rents resulted in substantially higher vacancy rates,

which are in effect the “market” rates for this property.

The inexperience of Stoerzinger plays a significant role. She violated a clear appraisal requirement that the Tax Court paid lip service to but then proceeded to ignore. The Tax Court states unequivocally at page 20 of the decision, “Thus, an expert must look at the actual rent, expenses and vacancy rates and make a determination as to whether these are at “market” for the subject property.” (emphasis added). Stoerzinger admitted ignoring the actual rent, expenses, and vacancy. Nor did Stoerzinger make a determination as to whether vacancies were at market “for the subject property.”

Despite its own statement and Stoerzinger’s obviously deficient analysis, the Tax Court did not make any finding concerning the existing leases and whether they were at market for the Subject Property. Although an expert is required to look at actual rent, expenses, and vacancies, Stoerzinger admitted she did not even consider them in her analysis. The fiction employed by Stoerzinger that was swallowed whole by the Tax Court was that market vacancies for properties without a detrimental condition are the same for this property with detrimental conditions. There is no factual support in the record for that conclusion, let alone reasonable support.

The Supreme Court will sustain the Tax Court’s valuation of property for tax purposes unless the Tax Court’s decision is clearly erroneous in the sense that the evidence as a whole does not reasonably support the decision. Harold Chevrolet, Inc. v. County of Hennepin, 526 N.W.2d 54, 57-58 (Minn. 1995). The Supreme Court defers to the Tax Court’s decisions unless the Tax Court has clearly overvalued or undervalued the property, or has completely failed to explain its reasoning. The Tax Court decision on

valuing property will be reversed when the Supreme Court is left with a definite and firm conviction that a mistake has been committed. City of Minnetonka v. Carlson, 298 N.W.2d 763, 766 (Minn.1980). These well-recognized standards require reversal here.

Relator is aware that reading valuation appraisals, appeal briefs, and transcripts can cause even the sharpest intellects' eyes to glaze over, but this is the exceptional case where the fact findings of the Tax Court are not entitled to deference. The Tax Court made a serious mistake in valuing the Subject Property that lacked adequate evidentiary support. Accordingly, this Court should reverse the Tax Court's decision.

IV. THE TAX COURT'S DECISION TO RUBBER STAMP STOERZINGER'S ASSIGNMENT OF ONLY MINIMAL WEIGHT TO THE INCOME APPROACH LACKS THE REQUISITE REASONABLE FACTUAL SUPPORT.

In its decision, the Tax Court states, "Ms. Stoerzinger gave the income approach to value only 10% weight because of the Subject Property's actual vacancy and shell space, concluding that a potential investor would give the income approach to value minimal consideration. We agree with the minimal weight she accorded the income approach." (APP 022). There simply is no factual support for the Tax Court's adoption of Stoerzinger's conclusion. How would Stoerzinger know what weight a potential investor would give the income approach when she never met with nor spoke to any potential investor in commercial real estate? Further, she admitted doing no research into what potential income investors do or think. She simply has no experience dealing with what a potential investor would do. She admitted that although it is important to buyers of commercial property to consider and analyze current cash flow, she did not analyze or even consider cash flow.

She failed to conduct even minimal research into what investors would want as a return on an investment in a small retail strip center.

The Tax Court knew of Stoerzinger's inexperience but nonetheless agreed with her assignment of a minimal 10% weight to the income approach to value based on her "experience in verification of sales of commercial properties that buyers do not use the income approach to value if a property has as high a vacancy rate as the subject." (APP 18). But there is no evidence that Stoerzinger had any such experience. The Tax Court's valuation needs to have meaningful and adequate evidentiary support. Montgomery Ward & Co. v. County of Hennepin, 482 N.W. 2d 785 (Minn. 1992). It lacks that support in this case.

The Tax Court disregarded Relator's expert report after seeing the words "leased fee." The Tax Court ignored the over 30 years of experience that Mr. Kramer had dealing almost exclusively with commercial real estate. In sharp contrast to Stoerzinger, Kramer correctly rated the income approach as most important and gave it 50% weight. He determined that buyers and investors concerned with income-producing real estate are primarily interested in the net income to be realized through the years from their investment. By applying the discounted cash flow method, he then valued the stream of income by using a present value analysis. He did not use the direct capitalization method since it is only appropriate if there are stabilized incomes. The Subject Property did not attain stabilized incomes on any of the valuation dates at issue. (Trial Ex.1 at p. 84).

This Court in Montgomery Ward & Co. v. County of Hennepin, 482 N.W. 2d 785 (Minn. 1992) recognized that the primary appraisal method to be utilized for income-

producing property was the income approach. This Court mandated it for the obvious “principle of anticipation, that a buyer of an income-producing property asset will pay an amount equal to the income that the property should reasonably be expected to generate, minus expenses, divided by a capitalization rate that investors would reasonably expect to obtain.” Id. Here, the Tax Court disregarded that reality.

Finally, Stoerzinger and the Tax Court failed to understand that a buyer would be concerned when a building is being constantly monitored for sinking and not wait until the building collapsed before considering its condition in arriving at a value. As Kramer stated, “The buyer would perceive that he would either have to do some significant correction to this building or raze it.” (TT at 384). Clearly a buyer would realize there was a problem that could and would at least require expensive repairs.

The Tax Court must be reversed if the evidence as a whole does not reasonably support the decision. Marquette Bank v. County of Hennepin, 589 N.W.2d 301, 304 (Minn. 1999). That is exactly what has happened in this case. There simply is no competent or credible evidence in the record to support the Tax Court’s valuations. The main issue is whether the evidence sustains the Tax Court’s findings of fact and conclusions of law. Despite the deference given to the Tax Court, “even, if there is evidence to support factual findings, this Court may, however, order a reversal if, upon reviewing the entire evidence, it is left with a firm conviction that a mistake has been made.” Montgomery Ward & Co. v. County of Hennepin, 482 N.W. 2d 785 (Minn. 1992); City of Minnetonka v. Carlson, 298 N.W. 2d 763, 766 (Minn. 1980). Stoerzinger did not have the expertise or competence necessary to support her opinion about what a buyer

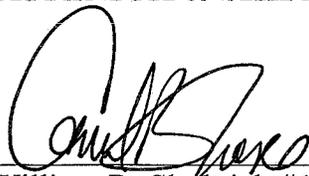
would think and when. She failed to obtain the facts that were necessary to give evidentiary support for her conclusions. Likewise, the Tax Court's decision is a mistake. The owner has already paid the price for building a defective retail structure in a nonretail location. The building cost over \$2,000,000 to build and within a year was worth much less. That is how the market works. By increasing the assessed valuation, the Tax Court's decision aggravated an already unfair property tax situation. That decision must be reversed.

CONCLUSION

The Relator does not own a property that could be sold as though it was 90% occupied at market rents without defect. The idea that real property is always worth at least what it cost has in recent years been proven to be a myth – an expensive, devastating myth. The Tax Court was required to have adequate evidentiary support for its decision, but that support was not provided by an inexperienced assessor. For the reasons set forth above and in its opening brief, Relator respectfully requests that this Court reverse the decision of the Tax Court.

Date: May 2, 2011

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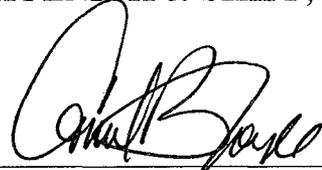
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I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01. subds. 1 and 3, for a brief produced with a proportional font. The length of this reply brief is 3,100 words, and the font size is 13 point. This brief was prepared using Microsoft Word 2003 software.

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