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No. A12-1507

STATE OF MINNESOTA
IN SUPREME COURT

Kohl's Department Stores, Inc.,

Relator,

vs.

County of Washington,

Respondent.

**BRIEF OF RELATOR KOHL'S DEPARTMENT STORES, INC.
AND ADDENDUM**

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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LEGAL ISSUES

1. **Did the Tax Court err when it refused to adjust or “load” its capitalization rate by an incremental amount to account for property taxes paid by the owner on vacant space?**

How Issue Was Raised Below:

This issue was raised through Relator’s March 30, 2012 Motion for Amended Findings of Fact, Conclusions of Law or New Trial (hereafter “Relator’s Motion for Amended Findings”). (Relator’s Motion for Amended findings, ¶2, p. 2.)

Trial Court’s Ruling:

The Tax Court refused to adjust its capitalization rate by an incremental amount in order to account for property taxes paid by the owner on vacant space. The Tax Court refused to do so based on its statement that “[i]n considering both experts’ cap (*sic*) comparables, we arrived at a cap rate that included the property tax rate.” (Tax Court’s Order on Petitioner’s Motion for Amended Findings, dated June 27, 2012, slip op. at p. 4 (hereafter the “Final Order”).)

The Tax Court’s statement cannot be reconciled with the record, which is devoid of any evidence that the experts’ capitalization rate comparables already included a fee simple adjustment for the property taxes paid by the owner during periods of vacancy. To the contrary, the evidence is that, in a tax neutral fee simple valuation analysis under generally accepted appraisal practices, a factor for the property taxes paid by the property owner on vacant space should be added to the *base* capitalization rate concluded to by the Tax Court. Specifically, Respondent’s expert added .158% to her base capitalization rate solely and expressly in order to adjust her cap rate to account for property taxes paid by

the property owner on vacant space. Relator's expert concurred that it was appropriate to do so.

Preservation of Issue:

This issue was preserved on appeal through Relator's Motion for Amended Findings. (Relator's Motion for Amended Findings, ¶2, p. 2.)

Most Apposite Authority:

Eden Prairie Mall, LLC v. County of Hennepin, 797 N.W.2d 186 (Minn. 2011).

2. **Did the Tax Court err when it wholly ignored decisive evidence of the traditional and generally accepted methodology of estimating fee simple market rent based upon a percentage of retail sales, and instead estimated its market rent based solely on non-market rate and non-arm's length leases, which were not properly verified by Respondent's expert?**

How Issue Was Raised Below:

This issue was raised through Relator's Motion for Amended Findings. (Relator's Motion for Amended Findings, ¶3, pp. 2-3.)

Trial Court's Ruling:

The Tax Court ignored overwhelming evidence relating to the traditional and generally accepted methodology of estimating market rent for a department store based on a percentage of retail sales. Instead, the Tax Court concluded to a market rent of \$6.25 per square foot based solely on build-to-suit and other non-market leases.

The Tax Court's finding that the Kohl's Oak Park Height lease was not a build-to-suit lease finds no factual support in the evidentiary record. The Tax Court's decision instead contradicts significant evidence that the leases relied upon by the Tax Court were non-market and/or not arm's length transactions or otherwise not valid indications of fee

simple market rent under generally accepted appraisal practices. The Tax Court also incorrectly concludes that Respondent's expert properly verified the leases in question despite the testimony of Respondent's expert to the contrary.

Preservation of Issue:

This issue was preserved on appeal through Relator's Motion for Amended Findings. (Relator's Motion for Amended Findings, ¶3, pp. 2-3.)

Most Apposite Authority:

Eden Prairie Mall, LLC v. County of Hennepin, 797 N.W.2d 186 (Minn. 2011).

3. **Did the Tax Court err when it failed to consider in any manner whatsoever the un-rebutted evidence regarding the need to adjust its capitalization rate for locational risk associated with the subject neighborhood's excessive vacancy and perceived blight?**

How Issue Was Raised Below:

This issue was raised through Relator's Motion for Amended Findings. (Relator's Motion for Amended findings, ¶4, p. 4.)

Trial Court's Ruling:

In its Final Order, the Tax Court refused to amend its original capitalization rate conclusion. While the Tax Court tacitly acknowledged Relator's un-rebutted evidence that the subject neighborhood suffered from excessive vacancy and perceived blight, it failed to consider that un-rebutted evidence in its capitalization rate conclusion. Instead, the Tax Court merely confirmed this failure by making a specific reference to its only capitalization rate adjustment for an entirely unrelated factor; namely, the single tenant nature of the Subject Property.

Preservation of Issue:

This issue was preserved on appeal through Relator's Motion for Amended Findings. (Relator's Motion for Amended findings, ¶4, p. 4.)

Most Apposite Authority:

Eden Prairie Mall, LLC v. County of Hennepin, 797 N.W.2d 186 (Minn. 2011).

STATEMENT OF THE CASE AND THE FACTS

This matter was originally heard by the Honorable George W. Perez, Chief Judge of the Minnesota Tax Court, on October 25 through October 27, 2011. The disputes at trial related to the fair market value as of January 2, 2007, January 2, 2008 and January 2, 2009 (for taxes payable in the years 2008, 2009 and 2010) of the department store commonly referred to as the Kohl's Department Store located at 7990 Hardwood Avenue South, Cottage Grove, Minnesota.

At trial, the Tax Court was presented with greatly diverging opinions of value for the subject property from extremely different expert witnesses. Petitioner's expert, Michael F. Amundson, MAI, testified based upon his more than 25 years of relevant experience. He further testified that recently he co-authored the primary pertinent appraisal authority on retail valuation published by the Appraisal Institute,¹ and is nationally recognized as an appraiser with special expertise and experience in retail and shopping center valuation. (Tr., 250:3 – 253:19 [App. 18-21]; Exhibit 39 [App. 94-96].)

¹ Vernor, Amundson, Johnson & Rabianski, Shopping Center Appraisal and Analysis, 2nd Ed., Appraisal Institute (2009). This publication by the Appraisal Institute is reviewed and approved through the Appraisal Institute's peer review process as fairly presenting generally accepted appraisal practices. (Tr., 252:24 = 253:4.)

In contrast, Respondent's expert, Robin M. Swanson, testified that her appraisal analysis in the subject case constituted her first written appraisal of a single-user retail property over 80,000 s.f. in size, and that she was generally unfamiliar with the traditional methods of valuing department store properties. (Tr., 368:5 – 373-23 [App. 23-28].) Ms. Swanson expressly testified that she was not familiar with the authorities or reasons for the traditional methodology – a methodology long accepted by this Court and the Minnesota Tax Court – under which fee simple market rent is typically estimated, in whole or in significant part, as a percentage of retail sales. (Tr., 368:1-4 [App. 23].)

While both experts relied on the income approach to value, the significant differences in their conclusions can be primarily traced to their determinations regarding two key issues: (1) the appropriate level of market rent; and (2) the appropriate capitalization rates.

The Tax Court issued its Findings of Fact, Conclusions of Law and Order for Judgment on March 16, 2012 (hereafter the "Original Order"), relying exclusively on the income approach. In issuing its decision, the Tax Court made two critical errors: (1) the Tax Court failed to adequately explain the reasoning for its conclusions; and (2) the Tax Court's findings and conclusions were not reasonably supported by the factual record taken as a whole. Eden Prairie Mall, LLC v. County of Hennepin, 797 N.W.2d 186, 192 (Minn. 2011); 444 Lafayette, LLC v. County of Ramsey, 811 N.W.2d 106 (Minn. 2012). These critical errors primarily arose in the context of the following four erroneous conclusions in the Tax Court's valuation analysis: (a) the Tax Court failed to deduct for "other expenses" = specifically operating expenses paid by the property owner pertaining

to periods of vacancy – despite the fact that both experts agreed that such a deduction was required; (b) the Tax Court failed to adjust or “load” its capitalization rate to reflect the property taxes paid by the property owner during periods of vacancy as required by generally accepted appraisal practices and the evidence in the record taken as a whole; (c) the Tax Court wholly failed to consider the traditional and generally accepted method of estimating market rent based upon a percentage of retail sales, and instead estimated its market rent in total disregard for the overwhelming evidence in the trial record based solely on inadequately verified non-market rate leases; and (d) the Tax Court did not reasonably base its decision on the evidence in the record taken as a whole in choosing its capitalization rate when it failed to properly consider and adjust for the necessary and inherent incremental factor of risk associated with the subject neighborhood’s excessive vacancy and perceived blight.

On March 30, 2012, Petitioner brought a proper and timely Motion for Amended Findings, Conclusions of Law or New Trial (hereafter “Motion for Amended Findings”) asking the Tax Court to correct the four aforementioned errors. On June 27, 2012, the Tax Court issued its Final Order in which it corrected the error first described above with regard to its original failure to deduct for operating expenses on the vacant space. The Tax Court, however, erroneously refused to correct the other three identified errors contained in its Original Order.

With regard to the first error in the Final Order, the failure to adjust or “load” the capitalization rate for the property taxes payable by the owner on vacant space, the Tax Court failed to correct the error stating only that:

[i]n considering both experts' cap (*sic*) comparables, we arrived at a cap rate that included the property tax rate. Thus, we find a change in the cap rate is not warranted.

(Final Order, slip op. at p. 4.) The Tax Court failed to explain its reasoning for the above-quoted finding and conclusion in any manner whatsoever, which conclusion is not reasonably supported by the evidence in the record taken as a whole.

The reality is that *neither* expert testified at trial that *any* of their respective capitalization rate comparables included any adjustment for either vacancy or the property tax rate. Nor did either expert testify at trial that any such adjustment was included in any of the published capitalization rate studies relied upon by the experts. No evidence is found in the trial record supporting the Tax Court's finding and conclusion that the experts' capitalization rate comparables already included a fee simple adjustment for the property taxes paid by the owner during periods of vacancy.

To the contrary, the evidence at trial and generally accepted appraisal practices established that, in a tax neutral fee simple valuation analysis, a tax rate factor related to the vacant space should be added to the base capitalization rate concluded to by the Tax Court. Specifically, Respondent's expert expressly added .158% to her base capitalization rate in order to adjust or load her capitalization rate for property taxes paid the property owner on vacant space. (Tr., 470:8-16 [App. 45]; Exhibit 101, p. 107 [App. 101].) Petitioner's expert concurred that it was appropriate to do so. (Tr., 113:19-22 [App. 13].)

Under the circumstances, the Tax Court's finding and conclusion on this issue constitute reversible error. This Court has reversed the Tax Court where the Tax Court's

conclusions “appear[ed] to [be] unsupported by the factual record.” Eden Prairie Mall, LLC v. County of Hennepin, 797 N.W.2d 186, 192 (Minn. 2011). This Court has specifically directed the Tax Court to “carefully explain its reasoning for its conclusions.” Id., at 194. The Tax Court committed both of these reversible errors in the present controversy.

The second crucial erroneous conclusion in the Final Order was the Tax Court’s failure to consider the traditional method of estimating market rent as a percentage of retail sales. In failing to consider this traditional method, the Tax Court “agree[d] with Respondent” that “non-reliance on ‘percentage of retail sales’ method is not contrary to law,” and “therefore, [it did] not give any weight to the percentage of stores retail sales method.” (Final Order, slip op. at p. 5.) The Tax Court then supported its reliance solely on Respondent’s rent comparables, because it claimed they “were verified by [Respondent’s] expert and are reflective of market rent.” (Id.) The Tax Court’s decision is not supported by the record. The un-rebutted evidence established that the leases relied upon by the Tax Court were not reflective of market rent and, contrary to the Tax Court’s erroneous finding, were not properly verified by Respondent’s expert.

The ultimate question before this Court is whether the Tax Court’s conclusion to intentionally ignore the most credible and probative evidence in the trial record – from a highly experienced, nationally recognized appraisal authority on retail valuation regarding the traditional method of estimating market rent, which has been long accepted by Minnesota appraisers and Courts – was a conclusion supported by the evidence in the record taken as a whole. It was not. The overwhelming evidence admitted at trial was

that under generally accepted appraisal practices, experienced appraisers and market participants regularly estimate market rent as a percentage of retail sales, because it is the most reliable method available. (Tr., 82:8 – 83:7 [App. 5-6]; 165:20 – 167:24 [App. 14-16].)

This same issue was addressed by this Court in Montgomery Ward & Co. Inc. v. County of Hennepin, 450 N.W.2d 299 (Minn. 1990).

Although the Court discounted this figure to \$2.75, there appears to be no evidence that either figure was an appropriate *market* rent for department stores. By contrast, Ward's appraiser's estimated rent value of \$1.83 per square foot and the resulting value estimate of \$2,900,000, based on the *Dollars and Cents* publication that was found to be reliable in the *Eden Prairie Donaldson's* case, is the only income approach estimate based on probative evidence of the market rent for large department stores. Given the inherent weaknesses of the cost approach and the absence of truly comparable sales (large, poorly performing department stores located away from the freeway system), it seems that the relator's income approach estimate should have been given over-riding weight.

450 N.W.2d at 307, *emphasis in original*.

Moreover, the preponderance of the evidence in the trial record was that the leases relied on by the Tax Court were not qualified market rate or arm's-length market transactions, nor were they properly verified by Respondent's expert. (Tr., 364:3-19 [App. 22]; 375:19 – 376:7 [App. 29-30]; 376:8-10 [App. 30]; 377:3-8 [App. 31]; 377:12-14 [App. 31]; 377:15-21 [App. 31]; 383:10-11 [App. 32]; 383:25 – 384:10 [App. 32-33]; 386:21 – 387:16 [App. 34-35]; Exhibit 29 [App. 58-62].) Ultimately, the Tax Court relied on non-market build-to-suit financing transactions or renewals of much older leases, lease comparables which have previously been rejected by the Tax Court as not constituting fee simple indicators of market rent in other recent Tax Court cases. Id.

Relator does not argue that the Tax Court, or any lower court acting as trier of fact, must discuss each bit of evidence in the trial record. However, when reasonable consideration is given to the evidentiary record considered in its entirety, the Tax Court's error becomes clear. Relator's expert was the only expert with any substantial background and experience in valuing similar department stores. (Tr., 250:3 – 253:19 [App. 18-21]; 368:1 – 373-23 [App. 23-28]; Exhibit 39 [App. 94-96].) Indeed, Relator's expert is a published author who is nationally recognized for his experience and expertise. Relator's expert testified that the percentage of retail sales method was the most reliable method of estimating market rent and the method regularly used by participants in the market. (Tr., 82:8 – 83:7 [App. 5-6]; 165:20 – 167:24 [App. 14-16].) His testimony is entirely consistent with the long-standing affirmation of Minnesota courts, including this Court, and even a decision previously issued by the same Tax Court judge himself. Under the circumstances, it was reversible error for the Tax Court to refuse to consider the substantial evidence in the record regarding the percentage of retail sales method for estimating market rent in favor of its reliance on unverified, non-market comparable leases.

Finally, the third crucial erroneous conclusion in the Final Order relates to the Tax Court's failure to properly consider the inherent risk associated with the subject neighborhood's excessive vacancy and perceived blight in choosing its capitalization rate. The Tax Court's suggestion that it did properly consider this risk is not reasonably supported by the evidence in the record taken as a whole. Instead, the Tax Court only stated that its capitalization rate selection included an upward adjustment to account for

the single tenant nature of the subject property. (Final Order, slip op. at p. 5.) In response to Relator’s argument that the capitalization must be adjusted further for the inherent risk associated with the subject neighborhood’s excessive vacancy and perceived blight, the Tax Court simply claimed its capitalization rate “already includes an upward adjustment based on the cap (*sic*) comparables used and the weight given.” (Final Order, slip op. at p. 6.) This statement is a *non-sequitur* that fails to explain, in any manner at all, how the Tax Court gave any specific consideration to any incremental upward adjustment necessary to reasonably account for the inherent risk associated with the excessive vacancy and the perceived blight in the neighborhood of the subject property. In the face of substantial and un-rebutted evidence in the record that such an additional incremental adjustment was needed, the Tax Court committed reversible error when it failed to explain its reasons for disregarding this credible, meaningful and unimpeached evidence regarding the need to adjust the capitalization rate for locational risks not identified whatsoever in the capitalization rate comparables or published studies relied upon by the parties’ respective experts.

Set forth below are the assessor’s original estimated market values, the experts’ opinions, the Tax Court’s original decision and the Tax Court’s amended decision regarding fair market value on the assessment dates at issue:

	<u>AEMV</u>	<u>Petitioner’s Expert</u>	<u>Respondent’s Expert</u>	<u>Tax Court Initial Decision</u>	<u>Tax Court Amended Decision</u>
January 2, 2007	\$6,322,200	\$5,600,000	\$8,038,000	\$6,977,800	\$6,834,700
January 2, 2008	\$6,455,300	\$5,400,000	\$8,038,000	\$6,977,800	\$6,834,700
January 2, 2009	\$6,455,300	\$4,450,000	\$7,338,000	\$5,908,500	\$5,773,900

STANDARD OF REVIEW

In reviewing findings of fact, this Court applies a clearly erroneous standard. This standard is to be applied whether the findings are based on oral testimony or documentary evidence. Minn. R. Civ. P. 52.01. Conversely, in reviewing legal issues and statutory interpretations, this Court is not bound by the trial court's ruling. Rather, the reviewing court reviews the lower court's application of law on a *de novo* basis. See e.g., Doe v. Minnesota State Bd. of Medical Examiners, 435 N.W.2d 45 (Minn. 1989); Matter of Welfare of M.J.M., 416 N.W.2d 142 (Minn. Ct. App. 1987).

In many cases, valuation determinations are factual. Accordingly, this Court defers to Tax Court's valuation determinations on appeal unless such determinations are clearly erroneous. Eden Prairie Mall, LLC, 797 N.W.2d at 192; Montgomery Ward & Co. v. County of Hennepin, 450 N.W.2d 299, 308 (Minn. 1990). A decision is clearly erroneous, and this Court will not defer to the Tax Court, where the Tax Court's decision is not reasonably supported by the evidence as a whole, where the Tax Court has clearly improperly valued the property, or where the Tax Court has failed to adequately explain the reasoning for its decision. Eden Prairie Mall, LLC, 797 N.W.2d at 192; Montgomery Ward, 450 N.W.2d at 308; Northwestern Nat'l Life Ins. Co. v. County of Hennepin, 572 N.W.2d 51, 52 (Minn. 1997); 444 Lafayette, LLC, et al. v. County of Ramsey, 811 N.W.2d 106 (Minn. 2012).

In the present controversy, some of the Tax Court's errors are clearly erroneous factual determinations, including the Tax Court's demonstrably erroneous finding that the respective experts' capitalization rate comparables included an effective tax rate

adjustment to the base capitalization rate, or that the Respondent's expert properly verified her comparable leases.

However, the Tax Court's overriding errors in this case rise to the level of errors of law. Specifically, the Tax Court completely failed to consider or even acknowledge primary issues and arguments comprising the most probative evidence in the record on significant issues. These issues include the Tax Court's failure to reasonably explain its refusal to consider the percentage of retail sales method of estimating market rent, and the Tax Court's failure to consider the inherent risk associated with the excessive vacancy and perceived blight in the neighborhood of the subject property when selecting its capitalization rate.

The Tax Court, as an executive branch agency exercising quasi-judicial authority, has a duty under Minn. R. Civ. P. 52, and constitutional prerequisites of due process, to not selectively consider or, worse yet, utterly fail to consider, significant credible evidence in the record. The Tax Court has a duty to evaluate *all* the evidence and testimony before it. See e.g., Southern Minn. Beet Sugar Coop. v. County of Renville, 737 N.W.2d 545, 556 (Minn. 2007), citing McNeilus Truck & Mfg. v. County of Dodge, 705 N.W.2d 410, 413 (Minn. 2005), *emphasis supplied*. While the Tax Court has discretion to determine evidence is unpersuasive, this Court has held and should hold here that the Tax Court commits a reversible error of law when it fails to reasonably consider significant evidence at all. Id. (concluding that the Tax Court's failure to make any findings or to reach conclusions regarding the taxpayer's evidence of comparable

sales violated the Tax Court's duty to independently judge and evaluate *all* the testimony and evidence before the Court).

ARGUMENT

I. THE TAX COURT ERRED WHEN IT FAILED TO ADJUST ITS CAPITALIZATION RATE BY AN ADDITUR FOR THE AMOUNT OF PROPERTY TAXES PAID BY THE OWNER ON VACANT SPACE.

In the Original Order, the Tax Court failed to increase its capitalization rate by an additur for the amount of property taxes paid by the owner of the property on the vacant space. Relator initially assumed that this was a simple oversight, because the evidence supporting this necessary adjustment was unambiguous and uncontroverted. As the Relator explained to the Tax Court in its Motion for Amended Findings, the need to make this adjustment is similar to and consistent with the need to deduct for operating expenses on the vacant space, an error which the Tax Court appropriately did correct in its Final Order.

This adjustment is necessary because both experts and the Tax Court estimated market value based on triple net rents, wherein the tenant(s) pay the real estate taxes for the leased portion of the property only. Thus, when there is no tenant in place for a portion of the leased premises due to vacancy, that portion of the real estate taxes must be paid by the property owner. In such a case, in order to determine market value based on generally accepted appraisal practices, a portion of the real estate tax rate representing the level of vacant space must be added to the capitalization rate before capitalizing the income stream into value. See e.g., The Equitable Assurance Society of the U.S. v. County of Ramsey, 530 N.W.2d 544, 551-552 (Minn. 1995).

In Response to Relator's Motion for Amended Findings, Respondent argued that the Court did not have to adjust its capitalization rate for an additur due to taxes attributable to vacancy, because the Court did not utilize the band of investments or debt coverage ratio methods for selecting the capitalization rate. Respondent's argument was a *non-sequitur*, making no sense whatsoever. The band of investments and debt coverage ratio techniques for identifying capitalization rates have absolutely nothing to do with the need to increase the capitalization rate by an adjustment for taxes on vacant spaces. There is nothing in the record or in generally accepted appraisal practices linking the concepts together in any manner whatsoever. The band of investments and debt coverage ratio methods for selecting a capitalization rate, along with the comparable sales method and reliance on authoritative published reports, are all generally accepted methods for identifying a *base* capitalization rate. (Tr., 473:9-18 [App. 48].) Whether an incremental factor for taxes on the vacant space should be added to the *base* capitalization rate identified is a wholly separate and different issue. Respondent either deliberately ignored the evidentiary record and generally accepted appraisal practices, or did not genuinely comprehend the issue.

The Tax Court did not adopt either parties' argument on this issue in its Final Order. Rather, the Tax Court refused to increase its capitalization rate by an incremental factor representing the effective tax rate as applied to the vacancy level, stating only that:

[i]n considering both experts' cap (*sic*) comparables, we arrived at a cap rate that included the property tax rate. Thus, we find a change in the cap rate is not warranted.

(Final Order, slip op. at p. 4.) However, the Tax Court failed in any manner whatsoever to explain its reasoning for the above-quoted findings and conclusion, and its conclusion is not reasonably supported by the evidence in the record taken as a whole.

The experts' respective capitalization rate comparables and their discussions of the same are found in the record at Exhibit 1, p. 71 [App. 54]; Tr., 95:17 – 98:12 [App. 7-10]; Exhibit 101, p. 99 [App. 100]; Tr., 339:6-19; 474:15 – 484:22. A review of the aforementioned Exhibits and transcript pages establishes that the evidence admitted at trial fails in any manner to support the Tax Court's finding that the experts' capitalization rate comparables include an adjustment for the property taxes paid by the property owners on vacant space. Nor is there any suggestion anywhere in the record that either expert analyzed any of their respective capitalization rate comparables with regard to the existence of vacant space in the comparable, nor made any comparison of the level of vacancy in the comparable to the projected vacancy at the subject. The record is simply devoid of any such discussion or analysis.

Similarly, the experts' respective analysis and discussion of the other methods for selecting their capitalization rates, including the band of investments method, the debt coverage ratio method and the capitalization rate surveys are found in the record at Exhibit 1, p. 71 [App. 54]; Tr., 98:13 – 101:5 [App. 10-12]; Exhibit 101, pp. 102-106; Tr., 339:04 – 340:20; 484:23 – 504:22; 519:6 – 520:9. Again, there is nothing in the record to support any finding or conclusion that these other methods of selecting a capitalization rate or surveys analyze or consider the levels of vacancy, who pays the

property taxes or who pays the taxes on the vacant space. The record is once again simply devoid of any such discussion or analysis.

In fact, contrary to the Court's finding and conclusion, under generally accepted appraisal practices, the capitalization rate should be increased by an incremental amount representing the amount of property taxes paid by the owner of the property on the vacant space. See The Appraisal of Real Estate, 13th Ed., The Appraisal Institute, (2008), p. 485. At trial, Respondent's expert increased her capitalization rate by .158% for property taxes paid by the property owner due to vacancy. (Exhibit 101, p. 107 [App. 101]; Tr., 470:8 – 473:8 [App. 45-48].) Petitioner's expert affirmed that it was appropriate to do so. (Tr., 113:19-22 [App. 13].)

Similarly, increasing the capitalization rate by a factor representing the percentage of real estate taxes attributable to vacant space is consistent with numerous recent Minnesota Tax Court decisions. See e.g., Geneva Exchange Fund XXVII, LLC v. County of Hennepin, File Nos. 27-CV-06-08694, *et al.* (Minn. Tax Ct. Feb. 11, 2010), slip op. at p. 23-25; Eden Prairie Mall, LLC v. County of Hennepin, Court File Nos. 27-CV-06-04210, *et al.* (Minn. Tax Court, Jan. 25, 2012) slip op. at pp. 33-34; Continental Retail, LLC v. County of Hennepin, Court File Nos. 27-CV-07-06549, *et al.* (Minn. Tax Ct. Dec. 21, 2010), slip op. at p. 19; and Estate of Marion Levine aka Levine Investments aka Penn Lake Shopping Center, LLC v. County of Hennepin, Court File Nos. 27-CV-10-09272, *et al.* (Minn. Tax Court, Oct. 31, 2011) slip op. at p. 19.

Although this Court has held that Tax Court decisions are not strictly precedential, they do provide significant guidance to Tax Court litigants. See, Kmart Corp. v. County

of Stearns, 710 N.W.2d 761, 766 (Minn. 2006). If this Court determines the Tax Court need not increase its capitalization rate for property taxes paid by the owner on vacant space in cases where Respondent's expert did so, and Relator's expert validated the practice, it will (i) encourage the Tax Court to reach decisions that ignore the evidence in the record and generally accepted appraisal practices; (ii) lead to inconsistent results at the Tax Court; (iii) create confusion among Tax Court litigants; (iv) deter informed parties from reaching settlements in Tax Court cases in the future; and (v) increase the demands of litigation on the Tax Court's scarce resources.

II. THE TAX COURT ERRED IN ITS CONCLUSION REGARDING THE SUBJECT PROPERTY'S FAIR MARKET RENT.

The Tax Court initially concluded to a fair market rental rate of \$6.25 per square foot "based on the market rent comparables presented by *both* experts. . ." (Original Order, slip op. at p. 12, *emphasis added*.) In its Motion for Amended Findings, the Relator argued that the Tax Court erred when it failed to consider the percentage of retail sales method of estimating market rent, and instead relied solely upon comparable leases despite evidence establishing that such leases did not constitute arm's length transactions reflecting a market level of rent. In its Final Order, the Tax Court refused to amend its decision stating that it "agree[d] with Respondent" that "non-reliance on 'percentage of retail sales' method is not contrary to law," and "therefore, [it did] not give any weight to the percentage of stores retail sales method." (Final Order, slip op. at p. 5.)

The Tax Court then supported its reliance solely on the Respondent's rent comparables, purportedly because they "were verified by [Respondent's] expert and are

reflective of market rent.” (Id.) For the reasons detailed below, Relator respectfully submits the Tax Court’s findings and conclusions on this issue are factually incorrect, legally deficient, and not supported by the evidence in the record taken as a whole.

A. The Tax Court’s Failure to Consider the Method of Estimating Market Rent Based on a Percentage of Store Retail Sales Is Contrary to Law, Because the Tax Court Failed to Adequately Explain the Reasoning for its Conclusions and its Findings Were Not Reasonably Supported by the Evidence in the Record Taken as a Whole.

1. The Evidence Establishes that the Traditional Method of Estimating Market Rent Based on a Percentage of Store Retail Sales Is the Most Reliable, Probative and Generally Accepted Appraisal Methodology for Estimating Market Rent for a Department Store and the Method Used Most Often by Market Participants.

Relator’s expert, Mr. Amundson, included a discussion of the generally accepted appraisal method of estimating market rent based on a percentage of store retail sales as an integral part of his appraisal analyses and conclusions. Ultimately, he relied upon this methodology as the “*more reliable*” approach in concluding to his fair market rent figures. (Exhibit 1, pp. 67-70, *emphasis added* [App. 50-53].) As Mr. Amundson explained, the percentage of retail sales method of estimating market rent is more reliable because “the sales are actual -- actual sales observations from this store. We don’t have to compare it to comparables.” (Tr., 83:1-3 [App. 6].)

Mr. Amundson went on to explain that the percentage of sales methodology is the traditional method used by market participants such as tenants, buyers and brokers.

“[w]hen retail sales information is available . . . [because] it’s a very strong analysis for an estimate of market rent. And it’s based on, in part, a profitability for the tenant. What can they really afford to pay based on their actual sales experience.”

(Tr., 83:11-18 [App. 6].) As Mr. Amundson also explained, the preference and reliability of this approach over the comparable rental analysis approach is confirmed by Shopping Center Appraisal and Analysis, 2nd Edition, a resource published by the Appraisal Institute after full editorial peer review, and for which *Mr. Amundson himself actually wrote the chapters* addressing the income approach. (Tr., 167:4-24 [App. 16].) See also, Vernor, Amundson, Johnson & Rabianski, Shopping Center Appraisal and Analysis, 2nd Ed., Appraisal Institute (2009), pp. 214-217.

Mr. Amundson specifically cited the International Council of Shopping Centers (ICSC) publication Dollars & Cents of Shopping Centers (“Dollars & Cents”) as the leading and widely recognized published authority for identifying the necessary market survey information from which to derive the proper range of percentage rent factors to apply to the subject’s retail sales. (Exhibit 1, p. 67 [App. 50].) See also, Montgomery Ward & Co., Inc., 450 N.W.2d at 308. As Mr. Amundson explained, the subject property is a freestanding department store that competes with discount stores such as Target and Wal-Mart, but also with more traditional department stores such as J.C. Penney’s, Macy’s and Herberger’s. (Exhibit 1, p. 67 [App. 50].) Dollars & Cents provides information regarding the subject property’s competitive set of retail operators within both the discount department store and traditional department store categories. (Id.)

As detailed in Mr. Amundson’s report, the indicated ratio of total rent as a percentage of retail sales for suburban discount department stores and suburban traditional department stores ranged from a low of 1.59% to a high of 2.86%. (Id. at pp. 68-69 [App. 52-53].) Based on the age and performance of the subject store, Mr.

Amundson concluded that 2.5% of the subject's retail sales was the proper ratio for estimating market rent. (Id. at p. 69 [App. 53].) By way of comparison, the Court's market rent conclusion of \$6.25 per square foot equates to 3.6% to 3.8% of store sales at the subject property.

The Tax Court's indicated ratio of total rent to retail sales is far outside the range of the authoritative market evidence regarding what is reasonable and sustainable for a retail operator as established by Mr. Amundson's testimony, the actions of actual market participants, and the widely regarded survey and resource authority, *Dollars & Cents*. This Court has reversed the Tax Court when the evidence in the record taken as a whole failed to support the Tax Court's findings. See e.g., Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, 741 N.W.2d 880, 892-893 (Minn. 2007) (concluding the evidence in the record did not support the Tax Court's finding that tuition was at or just below market rates).

2. The Tax Court's Failure to Consider the Method of Estimating Market Rent Based on a Percentage of Store Retail Sales Ignores the Admitted Deficiencies in Respondent's Expert's Competency, Experience and Appraisal Analysis in These Proceedings.

The testimony of Respondent's expert stands in stark contrast to the testimony offered by Relator's expert regarding the methodology of estimating market rent based on a percentage of retail sales. Specifically, while acknowledging that she had no experience whatsoever in appraising a department store like the Subject Property, Ms. Swanson also testified that she was not even familiar with the generally accepted appraisal practice of estimating a department store's market rent based on a percentage of

its retail sales. (Tr., 368:1 – 373-23 [App. 23-28].) Ms. Swanson’s lack of experience in valuing department stores similar to the Subject Property, and admitted lack of familiarity with the most widely used methodology and generally accepted appraisal practices for doing so, may be characterized as a violation of the Competency Rule of the Uniform Standards of Appraisal Practice (“USPAP”), which highlights the lack of reliability of her testimony.

Specifically, the Competency Rule requires any appraiser preparing any appraisal to have the knowledge and experience necessary to perform the appraisal “competently.” (Exhibit 9 [App. 55-57]; Tr., 13:24 – 14:6 [App. 2-3].) The required competency applies to factors such as, but not limited to, “an appraiser’s familiarity with a specific type of property or asset.” (Exhibit 9 [App. 55-57]; Tr., 371: 23 – 372:1 [App. 26-27].) If an appraiser determines at the outset of an appraisal assignment that he or she does not possess the requisite skill or experience, then the appraiser *must* “disclose this lack of knowledge and/or experience. . .prior to accepting the assignment” and “take all steps necessary or appropriate to complete the assignment competently.” (Exhibit 9 [App. 55-57] ; see also Tr., 13:4-7 [App. 2].) Such steps may include “personal study by the appraiser, association with an appraiser reasonably believed to have the necessary knowledge and/or experience, or retention of others who possess the necessary knowledge and/or experience.” (Exhibit 9 [App. 55-57]; Tr., 372:3-10 [App. 27].) While there is some discretion in *how* to address the lack of experience, the requirement that lack of experience be addressed is *mandatory*, not permissive.

Disregarding these mandatory requirements, Ms. Swanson testified that she took none of the steps identified by requisite appraisal standards as necessary prior to the completion of her assignment. Prior to cross examination, no disclosure was made to the Tax Court of her lack of experience and expertise. Ms. Swanson admittedly did not undergo a personal study of department store valuation methodologies. (Tr., 372:11-14 [App. 27].) In fact, Ms. Swanson testified that she has never taken a class on the valuation of department stores or other large single user retail properties, and surprisingly, she has not even read the Tax Court's most recent opinions analyzing the value of department stores. (Tr., 369:3 – 370:8 [App. 24-25].) Ms. Swanson further testified she did not retain any outside appraiser with experience in the valuation of department stores. In her testimony she stated that she simply spoke to her supervisor, Mr. Huber, from time to time, but she certified in her appraisal report that no one provided any significant professional assistance to her in the preparation of her report. (Tr., 370:11-14 [App. 25] and 373:6-23 [App. 28]; Exhibit 101, p. 112 [App. 102].) Instead, Ms. Swanson relied on a computer program that automatically filled in the information for her appraisal report, which she then edited. (Tr., 373:13-17 [App. 28].)

Despite the clear and unambiguous differences between the respective experts' credibility and reliability on this issue, the Tax Court, in reaching its conclusion regarding fair market rent in both the Original Decision and in the Final Order, did not explain its reasoning or consider in any manner whatsoever the fundamental basis for Mr. Amundson's appraisal analysis and testimony relating to the estimate of fair market rent based on a percentage of retail sales. The Tax Court's failure to consider this

evidence rises to the level of an error of law. See, Southern Minn. Beet Sugar Coop., 737 N.W.2d at 556.

3. The Tax Court's Failure to Consider the Method of Estimating Market Rent Based on a Percentage of Store Retail Sales Is Inconsistent with Recent and Recurring Decisions of the Minnesota Courts, Including Decisions by this Court and by the Same Tax Court Judge.

The Tax Court's conclusion regarding market rent is inconsistent with this Court's decision in Montgomery Ward & Co., Inc., *supra*, and also inconsistent with each of the other four Minnesota Tax Court decisions addressing the fair market rent for a department store, which were issued by the other two Tax Court Judges within the past year. In each of those decisions, and in numerous prior decisions as well, including decisions by the same Tax Court Judge in this case, the Minnesota Court concluded to a market rent either directly based upon a percentage of sales or equating to a percentage of sales ranging from 2.4% to 2.5%. See e.g., Montgomery Ward & Co., Inc., 450 N.W.2d at 308; Federated Retail Holdings, Inc. v. County of Ramsey, Court File Nos. 62-CV-08-5061, *et al.* (Minn. Tax Ct., Aug. 23, 2011) (confirming that Tax Court customarily uses a market rent equivalent to 2.5% of retail sales, but finding that a 2.4% market rent factor was consistent with the evidence in that case); Bon Stores Realty Two, LLC v. County of Ramsey, Court File Nos. 62-CV-08-3921, *et al.* (Minn. Tax Ct., Aug. 8, 2011) (adopting market rents equivalent to 2.4-2.5% of the store's retail sales); Macy's Retail Holdings, Inc. v. County of Hennepin, Court File Nos. 27-CV-07-07762, *et al.* (Minn. Tax Ct., Nov. 28, 2011) (expressly concluding to market rents equivalent to 2.5% of retail sales); Macy's Retail Holdings, Inc. v. County of Hennepin, Court File Nos. 27-CV-07-07774;

et al. (Minn. Tax Ct., Nov. 28, 2011) (expressly concluding to market rents equivalent to 2.5% of retail sales); J.C. Penney Properties, Inc. v. County of Hennepin, Court File Nos. TC-26456, *et al.* (Minn. Tax Court Dec. 18, 2000) (expressly determining market rent to be equivalent to 2.5% of retail sales).

The percentage of retail sales methodology has been applied to estimate market rents for department stores and discount department stores ranging from anchors to super regional malls (i.e.: the Herberger's Rosedale, Macy's Rosedale and Macy's Ridgedale cases cited above); to anchors to smaller shopping centers, Montgomery Ward & Co., Inc., 450 N.W.2d at 303 and 308 (valuing the Montgomery Ward at the Terrace Mall); and to freestanding discount department stores, Kmart v. County of Becker, Court File Nos. CX-02-410, *et al.* (Minn. Tax Ct., Dec. 1, 2004), slip op. at p. 14. These decisions provide (i) affirmation of the widely recognized credibility of the percentage of retail sales methodology; (ii) the general acceptance of this methodology by appraisers and market participants; and (iii) the probative and credible nature of the market analysis testified to by Relator's expert.

Although not strictly precedential, prior decisions by this Court and the Tax Court further provide significant guidance to Tax Court litigants. See, Kmart Corp. v. County of Stearns, 710 N.W.2d 761, 766 (Minn. 2006). The Tax Court's conclusion here, ignoring this traditional appraisal methodology while reaching a conclusion equating to a percentage of retail sales ranging from 3.6% to 3.8%, is directly contrary to and inconsistent with the analysis of the long line of Minnesota cases cited above. As a result, if not corrected, the Tax Court's decision in this case will encourage decisions that

disregard the evidence in the record, fail to reasonably explain the reasoning for conclusions, lead to confusion among Tax Court litigants, deter informed parties from settling cases, and increase demand for litigation on the Tax Court's scarce resources.

B. The Tax Court's Conclusions that the Comparable Leases It Relied Upon Were Valid Indications of Market Rent and Were Verified by Respondent's Expert Are Contradicted by the Evidence in the Record Taken as a Whole.

Despite the overwhelming authority and evidence in the record supporting an estimate of market rent based on a percentage of retail sales, the Tax Court, in reaching its conclusion regarding fair market rent, did not even mention or apparently even consider this generally accepted appraisal methodology at all. Instead, the Tax Court relied solely upon comparable rents that Mr. Amundson testified were less reliable, and in particular comparable rents supplied by Ms. Swanson. In doing so, the Tax Court summarily stated "the three rent comparables were verified by Respondent's expert and are reflective of market rent." (Final Order, slip op. at p. 5.) The Tax Court's conclusions are contradicted by the evidence admitted at trial, and therefore should be reversed. See, Under the Rainbow Child Care Ctr., Inc., 741 N.W.2d at 892-893.

1. The Evidence Established that Ms. Swanson Did Not Properly Verify Her Lease Comparables.

The Tax Court's conclusion that Ms. Swanson verified her lease comparables is directly contradicted by the evidence admitted at trial. Specifically, Ms. Swanson initially testified that she verified her lease comparables with a party to the lease transactions. (Exhibit 101, p. 87 [App. 98].) On cross examination, however, Ms. Swanson admitted that her testimony was false, and that while she read some of the

leases in question, at no time did she actually verify the leases with any party to the lease transactions. (Tr., 364:3-19 [App. 22].) Upon further cross examination, Ms. Swanson later admitted that even her recanted testimony was false, at least with respect to her lease comparable number four, because she never actually reviewed that lease at all. (Tr., 400:24-25 [App. 39]; 405:4-22 [App. 40].) Moreover, later cross examination, as detailed below, established that Ms. Swanson's actual review of the leases was incomplete and inadequate, and that her understanding and recitation of many of the lease terms were decisively wrong.

Ms. Swanson's failure to fully review and verify the leases she relied upon is significant, because the evidence directly contradicts the Tax Court's finding that she did verify the leases. Moreover, Ms. Swanson's multiple recantings and correction of her earlier testimony is significant, because it calls the credibility and reliability of all Ms. Swanson's testimony regarding her lease comparables into question, particularly in light of her lack of requisite experience and expertise. For example, whether a lease negotiation was an arm's length indication of market rent – or otherwise based on circumstances suggesting inconsistencies with market conditions – might not be found within the express language of the lease itself. Rather, such information is often only discovered through verification of the lease terms with a party to the transaction.

One of the purposes of verifying transactional data is to gain insight into the motivation behind the transaction. The Appraisal of Real Estate, The Appraisal Institute, 13th Ed. (2008), p. 304. Without such verification, an appraiser cannot know whether the transactions are reflective of the market, as determined by the Tax Court in this case.

Here, because Ms. Swanson did not properly verify or even carefully review the leases in issue, she was unfamiliar with the circumstances surrounding those leases and repeatedly reached erroneous conclusions regarding the lease terms.

Under the circumstances, the Tax Court erred when it concluded that Ms. Swanson verified her leases and that her testimony regarding her lease comparables was a reliable analysis of fair market rent.

2. The Tax Court's Finding that the Kohl's Oak Park Heights Lease Is Not a "Build-to-Suit" Lease Is Unsupported by the Evidence, Contrary to Generally Accepted Appraisal Methodology and Inconsistent with Several Recent Decisions of the Minnesota Tax Court.

In its Original Order the Tax Court specifically found that the Kohl's Oak Park Heights lease relied upon by Ms. Swanson as a lease comparable was reliable, because it was *not* a "build-to-suit" lease. (Original Order, slip op. at p. 11.) The Tax Court's conclusion is factually incorrect and inconsistent with the evidence in the record taken as whole.

The undisputed facts, as the Tax Court correctly noted, are that the property was originally built as a Kohl's department store to Kohl's design specifications for occupancy by Kohl's, and that the lease expressly specified that the landlord would pay the sum of \$3.7 million to Kohl's for construction work done to Kohl's specifications. (Id.) Those facts, in and of themselves, by definition confirm the lease is a build-to-suit lease. As Ms. Swanson herself testified, a build-to-suit lease is a lease where "the landlord pays for construction, he (*sic*) then leases back to the tenant." (Tr., 383:10-11 [App. 32].) A built-to-suit lease is "an arrangement whereby a landowner offers to pay to

construct on his or her land a building specified by a potential tenant, and then to lease land and building to the tenant.” Dictionary of Business Terms, 4th Ed., Barron’s Educational Series (2007).

The fact that the Kohl’s Oak Park Heights lease did not expressly state that the rental rate was intended as a return on the construction costs does not contradict the unequivocal economic conclusion that the lease was build-to-suit, like the Tax Court erroneously concluded in its Original Order. (Original Order, slip op. at p. 11.) The landlord paid \$3.7 million for the construction of a Kohl’s store for Kohl’s and to Kohl’s design specifications and then received the rent as the only return on that investment for the costs of construction.

More importantly, a review of Ms. Swanson’s testimony on this issue establishes that she did not carefully review the entire lease, and as a result, her understanding of the lease terms was wrong. Ms. Swanson’s erroneous conclusion that the Kohl’s Oak Park Heights lease was not build-to-suit was not premised on the fact that the landlord’s contribution to the construction costs was located in a separate section of the lease from the section specifying the rental amount, like the Tax Court found. (Id.) Rather, Ms. Swanson’s belief that the lease was not built-to-suit was based on her erroneous belief that Kohl’s paid its own construction costs without contribution or payment from the landlord. (Tr., 383:25 – 384:10 [App. 32-33].) This erroneous belief was formed by Ms. Swanson because she admittedly reviewed only one “whereas” clause at the beginning of the lease, but did not confirm the terms of the lease with any of the transaction participants, and was totally unaware of the later provisions of the lease

specifically describing the landlord's payment. (Tr., 386:21 – 387:16 [App. 34-35].) Despite her misunderstanding, as the Tax Court correctly noted, the landlord did pay \$3.7 million for the construction of the Kohl's Oak Park Heights store.

Accordingly and unequivocally, under the definition of build-to-suit as acknowledged by Respondent's own expert, the Kohl's Oak Park Heights lease was build-to-suit. The fact that the earlier Kohl's – Oak Park Heights decision cited by the Tax Court did not expressly recognize that lease as build-to-suit is not pertinent, since the evidence submitted and arguments made in that earlier case simply did not bring up the issue. See, Kohl's Department Stores, Inc. v. County of Washington, Court File No. C0-06-8287 (Minn. Tax Ct. Jan. 3, 2008).

The Tax Court has in other recent cases repeatedly held that "build-to-suit" leases are financing structures and not valid evidence of market rent. See e.g., Federated Retail Holdings, Inc. v. County of Ramsey, Court File Nos. 62-CV-08-5061 & C0-07-4069 (Minn. Tax Ct. Aug. 23, 2011), slip op. at p. 31 ("Rent Comparables...were all leases of brand new build to suit properties developed for the tenant [and] may not be indicative of market rent as they are intended as a return on the construction costs."); Bon Stores Realty Two LLC v. County of Ramsey, Court File Nos. 62-CV-08-3921 & 62-C0-07-4475 (Minn. Tax Ct. Aug. 8, 2011), slip op. at p. 24 ("Rent Comparables...were all leases of brand new build to suit properties developed for the tenant [and] may not be indicative of market rent as they are intended as a return on the construction costs. Thus, we give these rent comparables little weight."). The leases discussed in these quoted passages expressly reference the Kohl's Oak Park Heights lease and similar leases. Under the

circumstances, both Ms. Swanson and the Tax Court erred in relying upon the Kohl's Oak Park Heights lease as a reliable rent comparable.

3. The Tax Court's Finding that the Kohl's Woodbury Lease Is a Reliable Lease Comparable Is Not Supported by the Evidence at Trial.

The Court also erred in failing to reject the Kohl's Woodbury lease as a reliable lease comparable. The evidence established that the Kohl's Woodbury lease relied upon by Ms. Swanson was not the result of an original arm's length lease negotiation, but rather the renegotiation of an older existing lease. (Exhibit 31 [App. 63].) More significantly, however, while Ms. Swanson testified that she reviewed the lease itself, her testimony confirms that she did not. Ms. Swanson testified that she did not carefully review the lease. Instead, Ms. Swanson admittedly based on her analysis and opinion only on a line in a rent roll, which rent roll she notably was unable to produce to the Court. (Tr., 421:22-25 [App. 43].) As a result of Ms. Swanson's false testimony that she received the lease, and consequently her failure to carefully review the actual lease, she lacked any foundation for her recitation of the details of the lease, which details, including the date the rent was negotiated, the rental amount and the size of the store, were *all* wrong.

Specifically, Ms. Swanson testified that the Kohl's store in Woodbury was 92,781 square feet in size and that the parties to the Kohl's Woodbury lease had negotiated a rental rate of \$8.93 per square foot in 2002. (Exhibit 101, p. 93 [App. 99]; Tr., 398:21 [App. 37].) None of these facts are correct. To the contrary, the evidence establishes that the Kohl's Woodbury lease was originally negotiated in 1992 and amended five times

thereafter. (Exhibit 31 [App. 63-91].) The third lease amendment, which was negotiated in 1997, contemplated the construction of additional store square footage and established a new rent schedule. (Id. at 70-78) The total square footage of the store, including the 1997 addition, was 92,781 square feet, the same square footage as cited by Ms. Swanson in her analysis and report. (Id.; Exhibit 101, p. 93 [App. 99].) Under the third amendment, the rental rate as of January 2, 2007 (the first assessment date in issue) was scheduled at \$771,000 per year, or \$8.31 per square foot. (Exhibit 31 [App. 72].) The April 10, 2002 date relied upon as the lease date by Ms. Swanson in her analysis and report related to the fourth lease amendment. (Id.; Exhibit 101, p. 93 [App. 99].) However, the fourth amendment did not negotiate the rent schedule at all. Rather, the fourth amendment contemplated an addition of 5,000 square feet to the store. (Exhibit 31 [App. 79-86]; Tr., 394:2-11 [App. 36].)

Ms. Swanson's report did not include this additional 5,000 square feet, presumably because she was relying upon a rent roll and not the actual lease itself. When asked to produce a copy of the rent roll she was relying upon, she was unable to do so. (Tr., 399:8-13 [App. 38] and 421:22-25 [App. 43].) Regardless, with the contemplated addition of the 5,000 square feet in 2002, as of January 2, 2007 (the first assessment date in issue) the Kohl's Woodbury store would have been 97,781 square feet in size. Thus, the lease rate of \$771,000 per year negotiated in 1997 (ten years prior to the first assessment date in issue, in a far different market) would equate to \$7.88 per square foot, not the \$8.93 per square foot relied upon by Ms. Swanson and the Tax Court. Moreover, the rental rate relied upon by Ms. Swanson and the Tax Court was not negotiated in 2002,

but rather was negotiated in 1997, many years before the assessment dates in issue in this case.

As a result, the lease in question, under the evidence in the record taken as a whole, is not reflective of market rent at any point in time relevant to the assessment dates in issue. Under the circumstances, it was error for the Tax Court to rely upon Ms. Swanson's testimony, which was without adequate foundation, in reaching its findings, especially in light of Ms. Swanson's admissions regarding her misunderstandings of her own data and factually incorrect lease summary.

4. The Court's Finding that the Kohl's Burnsville Lease Is a Reliable Lease Comparable Is Not Supported by the Evidence at Trial.

Similarly, the Tax Court also should have rejected the Kohl's Burnsville lease that was relied upon by Ms. Swanson. The Tax Court's failure to do so was error. The evidence established that the Kohl's Burnsville lease relied upon by Ms. Swanson was not the result of an original arm's length market rent lease negotiation, but rather the renegotiation of an existing 1992 lease with only four years remaining on the lease extension term. (Tr., 375:19 – 376:7 [App. 29-30].) Therefore, the lease was not arm's length, since Kohl's was a captive tenant who derived a significant financial benefit from not having to relocate its business operations after almost 20 years of customer identification at that precise location. Thus, the original 1992 lease called for rent of \$12.21 psf in the last four years, but the parties reduced that rent by \$4.18 psf (a reduction of 34.2%) to a compromise rent of \$8.03 psf. (See, Exhibits 29 [App. 58-59, 61] and 33 [App. 92].)

Also, several other factors were also wholly ignored by Ms. Swanson. Ms. Swanson admitted that she did not conduct any analysis of the costs or financial detriment, which Kohl's would incur if required to relocate. (Tr., 376:8-10 [App. 30].) Ms. Swanson failed to inquire into the substantial amount by which retail sales per square foot at the Kohl's Burnsville exceeded those at the Kohl's in Cottage Grove, or to make the requisite adjustment for location. Additionally, the lease included Kohl's agreement to terminate its former option to purchase the store at the conclusion of the lease term. (Exhibit 29 [App. 58-62]; Tr., 377:3-8 [App. 31].) This agreement was an immediate benefit to the landlord, since it made the store marketable and enabled the landlord to sell the income stream under the lease to a new investor. (Tr., 377:15-21 [App. 31].) Regardless, Ms. Swanson did not adequately understand this lease renewal, or consider any adjustment to rent stated in the lease amendment. (Tr., 377:12-14 [App. 31].)

5. The Court's Finding that the Kohl's Shakopee Lease Is a Reliable Lease Comparable Is Not Supported by the Evidence at Trial.

The last lease comparable relied upon by Ms. Swanson and the Tax Court was the Kohl's lease in Shakopee. Again, however, Ms. Swanson did not actually review the lease as she initially testified, and as a result, her analysis and opinion were without foundation and based on factually incorrect information.

Specifically, Ms. Swanson initially testified that she did review the Kohl's Shakopee lease contract. (Tr., 400:25 [App. 39].) On cross examination, however, she admitted that she did not in fact review the lease contract itself, but rather had reviewed what she described as a "rental summary report." (Tr., 405:4-8 [App. 40].) However,

because she had not reviewed the actual lease, and had not confirmed the lease with any of the parties to the transaction, Ms. Swanson had no knowledge of many of the lease terms, including whether the lease contained provisions indicating it constituted a build-to-suit transaction. (Tr., 412:12 – 413:7 [App. 41-42].) Under the circumstances, Ms. Swanson's recitation of the terms of this lease are without foundation, and ultimately not reliable. Accordingly, the Tax Court's finding that the lease is reflective of market rent is not supported by the evidence in the record taken as a whole.

III. THE TAX COURT ERRED WHEN IT FAILED TO CONSIDER THE UNREBUTTED EVIDENCE IN THE RECORD REGARDING THE NEED TO ADJUST THE CAPITALIZATION RATE FOR LOCATIONAL RISK ASSOCIATED WITH THE SUBJECT NEIGHBORHOOD'S EXCESSIVE VACANCY AND PERCEIVED BLIGHT.

In its Original Decision, The Tax Court failed to account for or even acknowledge the several undisputed property factors related to location. These undisputed locational factors compel an incremental upward adjustment in the capitalization rate from what otherwise might be appropriately derived by the surveys cited by the two experts and relied upon by the Tax Court in reaching its capitalization rate conclusions. Specifically, there were location specific factors that increased the risk associated with the subject Kohl's store including key vacancies in the immediate neighborhood as of the assessment dates. These vacancies included the former Home Depot and Hollywood Video retail stores located directly across the street from the subject store. (Tr., 28:1-13 [App. 4].) These vacancies confirmed the lack of demand at the retail market in the subject's specific location, while also negatively impacting the subject store by creating a perceived blight in the area. (Id.)

The Tax Court's Original Order failed to discuss or even acknowledge these significant factors evidencing additional risk and weighing in favor of an incremental increase in the capitalization rate in each of the three assessment years. Instead, the Tax Court admitted that it based its capitalization rate selection solely upon the "cap rate comparables and surveys presented by both experts." (Original Order, slip op. at p. 13.) In its Final Order, the Tax Court refused to amend its capitalization rate selection, implying that it did properly consider the issues of locational risk. The Tax Court's reasoning for this finding and conclusion is not reasonably supported by the evidence in the record taken as a whole.

The Tax Court expressly stated that its capitalization rate selection included an upward adjustment to account for the single tenant nature of the subject property. (Original Order, slip op. at p. 13; Final Order, slip op. at p. 5.) The Tax Court made no such assertion, nor did it reach any such conclusion with regard to the additional upward adjustment necessary and appropriate to account for the excessive vacancy at the subject's immediate neighborhood or the corresponding perception of blight. Instead, in response to Relator's argument that the capitalization must be adjusted for those factors, the Tax Court simply stated its capitalization rate "already includes an upward adjustment based on the cap (*sic*) comparables used and the weight given." (Final Order, slip op. at p. 6.) However, this statement fails to explain the Court's reasoning in any manner at all. There is no reasoning or explanation of how the Tax Court gave any specific consideration to any additional upward adjustment necessary to account for the inherent risk associated with the excessive vacancy and the perceived blight in the neighborhood

of the subject property, despite substantial evidence in the record that such an additional adjustment was required. Moreover, the Tax Court's implication that it did somehow consider these factors is not consistent with the evidence in the record taken as a whole.

The Tax Court found that the Petitioner's expert "used national surveys, including a Korpacz Survey, that listed average cap rates for similarly situated properties, including neighborhood strips, community centers, strip shopping centers, power centers, and retail. . . ." (Final Order, slip op. at p. 5.) The Tax Court then found the averages of those five categories ranged from 6.8-7.2% in 2007, 6.6-7.24% in 2008 and 7-7.89% in 2009 to suggest that its capitalization rate selections of 8%, 8% and 9% included an appropriate upward adjustment. (Final Order, slip op. at pp. 5-6.) The above-cited Tax Court's findings are not supported by the evidence in the record as a whole.

While it is true that Ms. Amundson included a reference to the cited surveys in his report, he did not "use" them to derive his capitalization rate like the Tax Court states. Rather, as Mr. Amundson explained, none of the survey data related to properties similar to the subject. While the subject is a single tenant property, the survey data all related to multi-tenant properties. Accordingly, as Mr. Amundson explained, the subject property experienced significantly more risk than the properties included in the surveys. (Tr., 100:2-15 [App. 11].) Thus, Tax Court correctly made an upward adjustment to the survey averages to account for the increased risk of a single tenant property. (Original Order, slip op. at p. 13; Final Order, slip op. at p. 5.) The uncontroverted locational risk, however, is a completely separate adjustment for physical facts unrelated to the single tenant feature. (Tr., 101:1-5 [App. 12].)

Similarly, the Tax Court found that the “Petitioner’s expert also used 5 cap rate comparables ranging from 7.0-8.3%, excepting an outlier property abandoned by its tenant Wal-Mart with a cap rate of 11.83%” (Final Order, slip op. at p. 6), again implying that its capitalization rate selections of 8%, 8% and 9% included an appropriate upward adjustment. Again, however, the Tax Court’s implication is not supported by the evidence in the record taken as a whole.

Mr. Amundson did not simply rely upon an average of the capitalization rates from his comparable sales, let alone ignore the Wal-Mart sale. Rather, as Mr. Amundson explained, the four sales identified by the Tax Court as having capitalization rates ranging from 7.0-8.3% were all leased fee sales where there was a substantial contractual term left on the leases at the time of the sales. (Tr., 96:13-16 [App. 8].) As Mr. Amundson explained, once the term of a lease is less than ten years, capitalization rates go up substantially, by “at least 50 basis points, sometimes more.” (Tr., 96:17-20 [App. 8].) As Mr. Amundson explained, the Wal-Mart sale excluded by the Tax Court as an outlier was the only sale somewhat similar to a fee simple transaction, because Wal-Mart had vacated the space at the time of the sale. (Tr., 96:7-12 [App. 8].)

The law is long settled that property must be valued for ad valorem tax purposes on a fee simple basis. Minn. Stat. § 273.11, subd. 1; TMG Life Ins. Co. v. County of Goodhue, 540 N.W.2d 848 (Minn. 1995). The Minnesota Tax Court has acknowledged that a leased fee capitalization rate is, by definition, lower than a fee simple capitalization rate. See e.g., IRET Properties v. County of Hennepin, File No. 30776 (Minn. Tax Ct., Aug. 25, 2005). Under the circumstances, the Tax Court erred as a matter of law in

excluding the Wal-Mart sale. When the Wal-Mart sale is properly included in the average, Mr. Amundson's capitalization rate comparables averaged 8.43%. (Exhibit 1, p. 71 [App. 54].) Thus, the Tax Court's capitalization rate selections of 8%, 8% and 9% did not expressly include an additional upward adjustment to Mr. Amundson's capitalization rate comparables for location, and mathematically could not have considered the location factors in an adjustment not reasonably described or explained.

Finally, the Tax Court states that the Respondent's expert's capitalization rate comparables ranged from 7.3% to 7.77%, with an average of 7.61%, once again implying that its capitalization rate selections of 8%, 8% and 9% included an upward adjustment for location. (Final Order, slip op. at p. 6.) Once again, however, the Tax Court's implication is not supported by evidence the record taken as a whole.

Ms. Swanson analyzed only three comparable sales in her capitalization rate analysis. However, one of those sales involved a multi-tenant shopping center, as correctly acknowledged by the Tax Court. (Final Order, slip op. at p. 6.) Accordingly, the *average* cited by the Tax Court already required an upward adjustment for the single tenant nature of the subject. Furthermore, Ms. Swanson failed to perform any reliable study of market rents to determine whether the leases for the other two putative capitalization rate comparable properties she used were reflective of market rent. As a result, Ms. Swanson did not have any foundation or any adequate basis from which to knowledgeably determine whether these sales were the fee simple or leased-fee transactions in accordance with generally accepted appraisal practices. (Tr. at 482:20 –

484:20.) Under the circumstances, Tax Court's reliance upon these sales in concluding to a fee simple capitalization rate in this case was wholly misplaced.

The Tax Court's failure to adequately explain its reasoning for disregarding the meaningful and un-rebutted evidence regarding the need to adjust the capitalization rate for locational risks not identified in the capitalization rate comparables or published studies, constitutes reversible error.

CONCLUSION

For the reasons outlined herein, Relator respectfully requests that this Court reverse the Tax Court's decision and remand the case with instructions to: (1) adjust its capitalization rate upward by a factor sufficient to account for the amount of property taxes paid by the property owner on the vacant space; (2) reasonably consider the traditionally accepted appraisal practice of estimating market rent based on a percentage of retail sales as the most probative evidence when concluding to the fair market rent for the subject; and (3) adjust its capitalization rate by an incremental upward adjustment in order to account for the un-rebutted evidence in the record relating to locational risk.

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Respectfully submitted,



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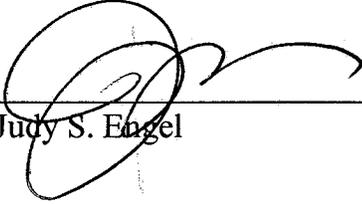
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**CERTIFICATE OF COMPLIANCE
WITH MINN. R. APP. P 132.01, Subd. 3**

The undersigned certifies that Relator's Brief submitted herein contains 11,323 words, exclusive of the pages containing the table of contents and table of authorities, and 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. The word count is stated in reliance on Microsoft Office Professional Plus 2010, the word processing system used to prepare this Brief.



Judy S. Engel