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No. A12-0542

STATE OF MINNESOTA  
IN SUPREME COURT

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Eden Prairie Mall, LLC,

*Relator,*

vs.

County of Hennepin,

*Respondent.*

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**BRIEF OF RELATOR EDEN PRAIRIE MALL, LLC 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 failed to follow the Supreme Court's express instructions on remand?**

#### How Issue Was Raised Below:

This issue was raised through the express directions of the Minnesota Supreme Court in its earlier decision in this case. Eden Prairie Mall, LLC v. County of Hennepin, 797 N.W.2d 186, 200 (Minn. 2011).

#### Trial Court's Ruling:

The Tax Court failed to follow this Court's express instructions on remand by:

- (1) failing to adequately explain the reasons for its value determinations and the grounds for reaching a conclusion of value higher than either of the experts (Id.);
- (2) failing to describe in detail the evidence in the record to support its value determinations (Id.);
- (3) failing to make any findings on the issue of effective market rent (Id. at 195);
- (4) failing to consider the terms of the actual leases or any market research to determine whether or not tenant improvement allowances are atypical (Id. at 196);
- (5) failing to adjust for rent concessions that affect future rent receipts (Id. at 195-196);
- (6) failing to adequately explain the reasons for rejecting the appraisal testimony of the experts on the issue related to net operating income (Id. at 196-197); and
- (7) failing to discuss whether changing one of Mr. Lennhoff's assumptions would impact his other revenue and expense assumptions such as tenant revenues (Id. at 197).

Preservation of Issue:

This issue was created by the Tax Court in its January 26, 2012 Order on Remand and, therefore, is automatically preserved for appeal. Evidentiary support in the record for the Tax Court's decision is also an issue that is automatically preserved for review on appeal. Gruenhagen v. Larson, 246 N.W.2d 565, 569 (Minn. 1976).

Most Apposite Authority:

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

Halverson v. Village of Deerwood, 322 N.W.2d 761 (Minn. 1982).

2. **Did the Tax Court err by adopting an argument made by Respondent in its remand brief, which was not supported by any evidence in the record, and which was even contradicted by the arguments Respondent previously made in its briefs to the Tax Court and to this Court prior to the proceedings on remand?**

How Issue Was Raised Below:

This issue was raised for the first time in this case through Respondent's post remand reply brief. (Respondent's Reply Memorandum on Remand, dated Nov. 15, 2011, pp. 7-8.)

Trial Court's Ruling:

The Tax Court changed its capitalization rate by adding the product of multiplying the effective tax rate by 6%. In its original decision the Tax Court added the product of multiplying the effective tax rate by 30% and 40% to its capitalization rate for the two assessment years in issue, respectively. The Tax Court based the change in the factor used in these calculations solely and exclusively on new arguments inconsistent with the

testimony of any of the three experts at trial and contained nowhere in the record, with the exception of Respondent's reply brief on remand.

Preservation of Issue:

This issue was created by the Tax Court in its January 26, 2012 Order on Remand and, therefore, is automatically preserved for appeal. Evidentiary support in the record for the Tax Court's decision is also an issue that is automatically preserved for review on appeal. Gruenhagen v. Larson, 246 N.W.2d 565, 569 (Minn. 1976).

Most Apposite Authority:

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

Brezinka v. Bystrom Bros., Inc., 403 N.W.2d 841, 843 (Minn. 1987).

- 3. Did the Tax Court fail to adequately base its value determinations on the evidence in the record when it rejected Mr. Messner's determination of the personal property value of furniture, fixtures and equipment after expressly finding Mr. Messner was more credible and persuasive?**

How Issue Was Raised Below:

This issue was raised through the express direction of the Minnesota Supreme Court in its earlier decision in this case. "Having concluded that it was appropriate to adjust net operating income for a return on and of furniture, fixtures, and equipment, the tax court's failure to actually make such an adjustment was clearly erroneous. We remand the matter to the tax court to allow it to correct this error." Eden Prairie Mall, LLC, 797 N.W.2d at 197.

Trial Court's Ruling:

Although the Tax Court expressly stated it found Mr. Messner more credible and persuasive, it nevertheless rejected Mr. Messner's determination of the value of furniture, fixtures and equipment in favor of the lower value for furniture, fixtures and equipment estimated by Petitioner's expert.

Most Apposite Authority:

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

Preservation of Issue:

This issue was created by the Tax Court in its January 26, 2012 Order on Remand and, therefore, is automatically preserved for appeal.

**4. Did the Tax Court err by including a number of mathematical computation errors in its final calculations of value?**

How Issue Was Raised Below:

This issue was not raised by either party below. The issue first arose upon the filing of the Tax Court's January 26, 2012 Order on Remand.

Trial Court's Ruling:

In its earlier decision this Court found that the original decision by the Tax Court "contain(ed) several mathematical errors," and found the Tax Court in error for failing to exercise its own skill and independent judgment. Eden Prairie Mall, LLC, 797 N.W.2d at 192. The Tax Court's final calculations of value as of January 2, 2005 and January 2, 2006 in the Order on Remand both contain a number of mathematical errors.

Most Apposite Authority:

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

Preservation of Issue:

This issue was initially created by the Tax Court in its January 26, 2012 Order on Remand and, therefore, is automatically preserved for appeal.

**STATEMENT OF THE CASE AND THE FACTS**

Eden Prairie Mall initiated this litigation to appeal the assessed values for property tax purposes of the super regional shopping center commonly referred to as the Eden Prairie Center Mall (the "Mall")<sup>1</sup>, located at 8251 Flying Cloud Drive and 400 Prairie Center Drive, in the City of Eden Prairie, Minnesota.

Trial commenced before the Honorable Judge Sheryl A. Ramstad at the Minnesota Tax Court facilities in the Minneapolis City Hall building on February 26, 2009, and concluded on March 11, 2009. Both parties presented expert appraisals regarding the valuation of the subject property. Relator's expert, David C. Lennhoff, MAI, CRE, FRCS, testified that the fair market value of the taxable real property of the Mall was \$68,750,000 as of January 2, 2005 and \$60,550,000 as of January 2, 2006. Respondent's primary expert, Jason L. Messner, MAI, testified that the fair market value of the taxable real property of the Mall was \$110,000,000 as of January 2, 2005 and \$115,000,000 as of January 2, 2006.

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<sup>1</sup> The January 2, 2005 and January 2, 2006 assessed value of the Von Maur department store located in the Mall was also in issue at trial but affirmed by this Court in its earlier decision. Eden Prairie Mall, LLC v. County of Hennepin, 797 N.W.2d 186 (Minn. 2011). Accordingly, the Tax Court's conclusions regarding the fair market value of the Von Maur store are not in issue in Relator's present appeal.

In its Findings of Fact, Conclusions of Law, and Order for Judgment dated October 13, 2009 (the “Original Decision”), the Tax Court based its decision upon, and adopted in its entirety, certain key calculations prepared by Hennepin County’s legal counsel in its post-trial brief, which calculations lacked any support in the evidentiary record. Ultimately, the Tax Court concluded the fair market value of the Mall was \$122,876,000 as of January 2, 2005 and \$120,142,000 as of January 2, 2006. The Tax Court’s fair market value conclusions relating to the Mall were many millions of dollars higher than the range of values opined to by both experts at trial.

Relator appealed the Tax Court’s Original Decision to the Minnesota Supreme Court on several grounds, including the ground that the Tax Court’s conclusions regarding the fair market value of the Mall were unsupported by the evidence at trial and, therefore, were error as a matter of law. In its decision on Relator’s original appeal, this Court “[r]emanded [the case] for further proceedings consistent with this opinion.” Eden Prairie Mall, LLC v. County of Hennepin, 797 N.W.2d 186, 200 (Minn. 2011). This Court concluded that the Tax Court erred because “the Tax Court’s valuation of the mall parcel was not reasonably supported by the record as a whole.” Id. at 199. The Supreme Court further concluded that the Tax Court did not adequately explain its reasoning or describe the factual support in the record. Id. at 199-200.

This Court remanded the case to the Tax Court, stating that “[c]onsistent with this opinion, the tax court may, if necessary, re-open the record and conduct a further evidentiary hearing.” In so doing, however, this Court specifically remanded the case “to allow the Tax Court to adequately explain the reasons for the value determinations and to

describe in detail the evidence upon which it relies to support its determinations.” Id. at

200. This Court carefully noted that

[t]he tax court . . . did not explain its reasoning for increasing the net operating income above the testimony of the parties’ appraisers, or describe the factual support in the record for its determination. Moreover, the tax court did not explicitly address whether changing one of [Mr. Lennhoff’s] revenue assumptions would impact other revenue and expense assumptions, such as tenant revenues.

Id. at 197. This Court therefore remanded the case “to allow the tax court to do so.” Id.

This Court provided extensive guidance and direction in its decision on several key issues in the valuation process, including a prominent discussion regarding one of the key valuation issues in dispute – the proper treatment of tenant improvements under the income approach. Specifically, this Court stated that “[w]here market conditions require rent concessions, an appraiser *must* further determine a property’s effective rent.” Id. at 195, *emphasis added*. Therefore, the Supreme Court directed that “in determining effective market rent as part of valuation under the income capitalization approach, the court *must* adjust for rent concessions that affect future rent receipts.” Id. at 195-196, *emphasis added*.

This Court ultimately concluded that “whether tenant improvement allowances should be deducted to arrive at effective market rents must be determined on a case-by-case basis.” Id. at 196. In doing so, however, the Supreme Court held that “[t]he determination of whether a tenant improvement allowance should be deducted is part of the overall determination of market rent. Thus, an appraiser *must* not only examine the terms of the lease, but also *must* conduct market research to determine whether or not

tenant improvement allowances are atypical, to determine effective market rents.” *Id.*, *emphasis added*.

Notwithstanding the arguments of Relator, the Tax Court did not re-open the record on remand. Instead, the Tax Court based its decision on remand upon the original evidentiary record at trial. The Tax Court also received and considered several informal letters, memoranda, informal telephone conversations with counsel for the parties, and a short oral argument. In its briefings and written submissions on remand, Relator identified the relevant evidence in the record and incorporated several necessary adjustments to its original position at trial in order to be consistent with the portions of the Tax Court’s Original Decision that were sustained by this Court. Because this Court sustained the Tax Court’s determination on some issues, the value consequently proposed by Relator was ultimately adjusted to be higher than Mr. Lennhoff’s opinion at trial. The Tax Court’s discussion of this issue in its Order on Remand at page 22 fails to fairly recognize Relator’s incorporation of adjustments that became necessary in order to fairly address the evidence in the record in light of this Court affirming some of the Tax Court’s original conclusions.

The Tax Court’s Order on Remand also failed in any manner whatsoever to give any meaningful consideration to the Supreme Court’s guidance or direction on the issue of tenant improvements. The Tax Court did not make any findings on the issue of effective market rent or the leases at the subject property. The Tax Court also failed to discuss whether rent concessions affected future rent receipts or whether the terms of the leases or market research suggested that the tenant improvement allowances in this case

were atypical. These issues, although mandatory in the directions and guidance of this Court, were admittedly not analyzed by or testified to in any manner by the Respondent's expert, Mr. Messner. (Tr., 1416-1419.) Yet, despite Mr. Messner having admitted to conducting no relevant analysis on the issue of tenant improvements, the Tax Court's stated basis for disregarding the guidance and directions of the Supreme Court on this issue was solely its conclusory finding that Mr. Messner was more credible on the very issue he himself admitted to have wholly ignored. The Tax Court in no instance reconciled its conclusory statement with the undisputed failure by Mr. Messner to analyze the issue of tenant improvements or to testify regarding these issues at trial.

Accordingly, under the undisputed circumstances, the Tax Court's stated basis for disregarding the guidance and directions of this Court has no evidentiary support in the record. Because Mr. Messner testified that he did not perform any analysis of leases and tenant improvements related to the valuation dates in connection with his determination of market rent, Mr. Messner could not have been more credible on those issues.

As a result of the Tax Court's errors, its new conclusions regarding net operating income remain outside the range opined to by the experts at trial despite the guidance and directions of this Court. Yet, the Tax Court still did not explain its reasoning for increasing the net operating income above the testimony of the parties' appraisers, or describe the factual support in the record for its determination. Moreover, the Tax Court did not explicitly address whether changing one of Mr. Lennhoff's revenue assumptions would impact other revenue and expense assumptions, such as tenant improvements, vacancy or capitalization rates.

Ultimately, the Tax Court’s conclusion regarding the fair market value of the Mall increased further to \$127,000,000 as of January 2, 2005 and \$127,500,000 as of January 2, 2006.

<b>Valuation Date</b>	<b>Petitioner’s Expert</b>	<b>County’s Expert</b>	<b>Tax Court’s Initial Decision</b>	<b>Tax Court’s Order on Remand</b>
January 2, 2005	\$68,750,000	\$110,000,000	\$122,876,000	\$127,000,000
January 2, 2006	\$60,550,000	\$115,000,000	\$120,142,000	\$127,500,000

These conclusions were even further outside the range of values opined to by both experts at trial. Moreover, the Tax Court’s calculations again contained significant mathematical errors. The Tax Court’s conclusions also ultimately contradicted the Tax Court’s Original Decision regarding the trend of values between January 2, 2005 and January 2, 2006. In its Original Decision, the Tax Court concluded that the fair market value of the Mall went down between January 2, 2005 and January 2, 2006. The Tax Court did not explain why it now concluded that the fair market value of the Mall should go up between January 2, 2005 and January 2, 2006, nor did it state its “grounds for adopting a . . . higher value [or] adequately describe the factual support in the record for its determination” as expressly directed by this Court. Eden Prairie Mall, LLC, 797 N.W.2d at 194.

Instead, while the Tax Court changed several of the numbers in its calculations, its decision was in substantial measure a verbatim repeat of its Original Decision with regard

to each of the concerns expressly voiced by this Court.<sup>2</sup> The Tax Court even adopted a new 6% factor argued for the very first time by Respondent's counsel in briefing on remand relating to the proper factor by which to increase the capitalization rate under the income approach to adjust for property taxes paid by the property owner, not by tenants. This 6% factor was neither used nor advocated by any of the three experts at trial nor is it found anywhere in the factual record. The 6% factor and its evidentiary basis are squarely contradicted by the Respondent in its briefs to the Tax Court and to this Court prior to remand, all of which used 30% for the years in issue. The first time this 6% factor appears anywhere in this case is in the Respondent's reply brief to the Tax Court on remand. The Tax Court's adoption of this factor of 6% in its Order on Remand instead of 30% is an error much akin to the Tax Court's original verbatim adoption in its Original Decision of calculations presuming evidence not found anywhere in the record, but instead found only in Respondent's Post Trial Brief.

### **STANDARD OF REVIEW**

While the standard of review of a Tax Court decision is deferential, this Court is not bound by decisions of the Tax Court. Eden Prairie Mall, LLC, 797 N.W.2d at 192; Bond v. Comm'r of Revenue, 691 N.W.2d 831, 835 (Minn. 2005); A&H Vending Co. v. Commr. of Revenue, 608 N.W.2d 544, 546 (Minn. 2000). This Court will not defer to the Tax Court when its decision is clearly erroneous, not supported by the evidence as a whole, clearly misvalues a property or the Tax Court fails to explain its reasoning. Eden

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<sup>2</sup> Relator is filing with this brief a redlined copy of the Order on Remand, prepared to highlight the very few substantive changes in the Tax Court's decision on remand as compared to the Original Decision by the Tax Court. (A-161-208.)

Prairie Mall, LLC, 797 N.W.2d at 192, *citing* Lewis v. County of Hennepin, 623 N.W.2d 258, 261 (Minn. 2001); Montgomery Ward & Co. v. County of Hennepin, 450 N.W.2d 299, 308 (Minn. 1990); and NW National Life Ins. Co. v. County of Hennepin, 572 N.W.2d 51, 52 (Minn. 1997). Moreover, the Tax Court's compliance with remand instructions is reviewed based on an abuse of discretion. Janssen v. Best & Flanagan, LLP, 704 N.W.2d 759, 763 (Minn. 2005); *citing* Halverson v. Village of Deerwood, 322 N.W.2d 761, 766-767 (Minn. 1982).

### ARGUMENT

#### **I. THE TAX COURT FAILED TO FOLLOW THIS COURT'S EXPRESS INSTRUCTIONS ON REMAND.**

On remand from this Court, the Tax Court must execute the instructions of this Court "strictly according to its terms" and may not "alter, amend, or modify" this Court's mandate. Halverson, 322 N.W.2d at 766. In its January 26, 2012 Order on Remand (hereafter the "Order on Remand"), the analysis and conclusions of the Tax Court failed to reflect any consideration of this Court's mandate at all, let alone execute this Court's mandate strictly according to its terms.<sup>3</sup>

Fundamentally, the Tax Court's Order on Remand only correctly identifies two of the many areas where this Court offered guidance and instructions to the Tax Court on remand. Specifically, the Tax Court stated the only two issues on remand were: (1) the factual support in the record for the Tax Court's determination of net operating income

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<sup>3</sup> The statements by the Tax Court on pages 8 and 22 of the Order on Remand stating its decision is supported by the record and consistent with this Court's directions on remand are not manifest in a careful comparison of the analysis and decision of the Tax Court with this Court's initial decision.

(hereafter “NOI”); and (2) the proper adjustment to NOI for a return on and of furniture, fixtures and equipment (hereafter “FF&E”). (Order on Remand, p. 7.) While those issues were certainly two of the issues discussed and remanded by this Court to the Tax Court, this Court’s first decision in this case addressed and gave guidance and direction to the Tax Court on many additional issues as well. This Court remanded the case for further proceedings by the Tax Court consistent with its *entire* decision, not only selected portions. Eden Prairie Mall, LLC, 797 N.W.2d at 200, *emphasis added*.

The Tax Court’s eventual failure to address in its Order on Remand many of the issues discussed by this Court in its first decision is wholly inconsistent with its earlier interpretations of this Court’s first decision. Prior to deciding whether to re-open the record on remand, the Tax Court directed the parties to submit letter briefs explaining their position on whether additional evidence was required and what additional evidence they intended to produce on each issue. The additional issues not addressed in the Order on Remand, as expressly identified by the Tax Court in detail before deciding to not re-open the record were as follows: (1) mathematical errors in the proposed calculation of market values and the effect those errors had on the calculations; (2) whether changing one of Mr. Lennhoff’s revenue assumptions would impact other revenue and expense assumptions such as tenant revenues; (3) the effective market rent for the Mall as of both valuation dates; (4) whether tenant improvement allowances were excessive or atypical, and whether it is appropriate to deduct tenant improvement allowances in the year spent; (5) the calculation of in-line rents for 2005 and the evidentiary support in the record; (6) the factual support in the record for the net operating income; (7) the appropriate

adjustment to net operating income for a return on and off the market value of FF&E; (8) capitalization rate; and (9) whether additional evidence was needed to support the value determination. (Relator's Letter Brief, dated June 13, 2011.) (A-23-31). In its letter brief, the Relator cited the portions of this Court's first decision in this case relating to each issue on remand and described why additional evidence either was or was not appropriate on an issue by issue basis. (Relator's Letter Brief, dated June 13, 2011.) (A-23-31).

To the contrary, Respondent argued that additional evidence was not required on any issue, based in large measure on its recurrent argument that it was not the Tax Court, but instead *this Court* that erred in its first decision.<sup>4</sup> (Respondent's Letter Brief, dated June 16, 2011.) (A-32-41.) See also, discussion on p. 16, *infra*.

After receiving the parties' letter briefs, the Tax Court apparently concurred with Respondent and determined it would not re-open the record on remand. (Order, dated

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<sup>4</sup> The statements by Respondent in its June 16, 2011 letter brief include the following:

The Supreme Court incorrectly stated that the Tax Court found the market rent generated by the in-line tenants and the AMC theater complex was \$9,588,820 and \$9,515,505 for the 2005 and 2006 assessment years.

(Respondent's Letter Brief, dated June 16, 2011 at p. 6; A-37.)

The Supreme Court incorrectly stated that the County's appraiser used the actual recent received as the estimated of market rent at \$8,856,518 for the 2005 assessment . . .

(Respondent's Letter Brief, dated June 16, 2011 at p. 7; A-38.)

The Supreme Court made an erroneous comparison when it stated that 'the tax court's recalculated net operating income for the mall was \$10,489,410 for the 2005 assessment, which is an increase of \$3,372,328 and \$1,134,410 over the respective appraisal testimonies of the parties.'

(Respondent's Letter Brief, dated June 16, 2011 at p. 8; A-39.)

August 24, 2011.) (A-42-44.) In that August 24, 2011 Order, the Tax Court erroneously stated that the parties:

agree that there are three issues to be addressed by the Tax Court on remand: (1) What market rent should be applied to the in-line tenants to derive the net operating income in the income approach to value for the mall; (2) What adjustment should be made to the net operating income for furniture, fixtures and equipment (FF&E); and (3) How tenant improvements and rent allowances should be addressed in the valuation.

(Order, dated August 24, 2011.) (A-44.) The record is indisputably clear that the Relator never agreed there were only three issues on remand. Rather, based on this Court's extensive discussion and guidance, Relator argued there were a total of nine issues on remand. (Petitioner's Memorandum on Remand, dated October 11, 2011.) (A-45-72.)

The Tax Court directed the parties to submit formal memoranda on the issues "as outlined in the Minnesota Supreme Court opinion filed May 11, 2011," which memoranda would discuss the whole of the evidence in the existing record. (Order, dated August 24, 2011.) (A-43.) In its memorandum, the Relator argued that because the Tax Court did not re-open the record, and the only evidence in the record on a number of the most significant issues on remand (such as market rent and the treatment of tenant improvements) was the testimony of Mr. Lennhoff, in order to reach a decision reasonably supported by the record as a whole, the Tax Court could only issue a new decision consistent in large measure with the testimony of Mr. Lennhoff. (Petitioner's Memorandum on Remand, dated October 11, 2011.) (A-45-72.)

Respondent, on the other hand, essentially disagreed with this Court's conclusion that the Tax Court's "valuation of the mall parcel was not reasonably supported by the

record as a whole.” Eden Prairie Mall, LLC, 797 N.W.2d at 199. Respondent repeatedly and vociferously argued that there was sufficient evidence in the record to support the Tax Court’s Original Decision, and that the Tax Court should merely issue a new decision consistent with its Original Decision (with the exception of adding a deduction for FF&E), albeit adding citations to the record. (Respondent’s Memorandum on Remand, dated October 10, 2011.) (A-73-79.) Although not actually found among the many issues discussed by this Court in its first decision and remanded to the Tax Court, Respondent also argued in its Reply Memorandum on Remand for the first time in the history of the entire case that the Tax Court should now also change the calculation of the effective tax rate additur to its capitalization rate by multiplying the effective tax rate by only 6%, instead of the 30% argued by Respondent at trial and used by the Tax Court in its Original Decision. Id. Relator will address that issue separately below.

In its Order on Remand, the Tax Court ultimately reduced the number of issues it would address on remand from its original conclusion that there were nine issues, then to three issues, and then to two issues. The Tax Court’s basis or reasoning for doing so is not apparent. The Tax Court’s failure, despite specific guidance and direction by this Court, to correctly identify the issues on remand resulted in the Tax Court issuing a decision, which aside from a few preliminary paragraphs reciting the procedural posture of the case, a short new section dealing with the deduction for FF&E, and new mathematical computations, is in most respects a verbatim recitation of its earlier decision.

Relator has included a redlined copy comparing the Order on Remand to the Tax Court's Original Decision in the Appendix to this Brief (the "Redlined Order"). (A-161-208.) A review of the Redlined Order identifies exactly how and where the Tax Court changed its Original Decision. The Tax Court did not: (1) explain its reasoning for or describe the evidence in the record for rejecting the appraisal testimony of the experts on the issue of net operating income; (2) explain its grounds for reaching a conclusion of value higher than either of the experts; (3) make any findings on the issue of effective market rent; (4) consider the terms of the actual leases or any market research to determine whether or not tenant improvement allowances are atypical; (5) adjust for rent concessions that affect future rent receipts; or (6) discuss whether changing one of Mr. Lennhoff's assumptions would impact his other revenue and expense assumptions such as tenant improvements. Each of these issues was expressly discussed by this Court in its first decision in this case with very express guidance and directions to the Tax Court. The Tax Court's failure to address these issues on remand was error as a matter of law.

**A. The Tax Court Concluded to an Even Higher Value Than Its Original Decision and Above That of Any of the Experts at Trial, Yet Failed to Adequately Explain Its Grounds for Doing So.**

In its first decision in this case, this Court held that the Tax Court was not expressly precluded from issuing a decision resulting in value conclusions higher than the appraisal testimony of the parties. Eden Prairie Mall, LLC, 797 N.W.2d at 194. However, this Court also held that when the Tax Court issues a decision concluding to a market value higher or lower than the appraisal testimony at trial, it must "carefully explain its reasoning for rejecting the appraisal testimony and the grounds for adopting a

lower or higher value, and adequately describe the factual support in the record for its determination.” Id.

Here, the Tax Court’s value conclusions on remand were even higher than its Original Decision and, therefore, even further outside the range of the appraisal testimony offered at trial. (See chart at page 10, *infra.*) The Tax Court’s new value conclusions also represent a reversal from its Original Decision regarding the trend in values between January 2, 2005 and January 2, 2006. In its Original Decision, the Tax Court concluded that the value of the Mall went down between January 2, 2005 and January 2, 2006. In its Order on Remand, the Tax Court now concluded, without explanation or reasoning, that the value of the Mall increased between January 2, 2005 and January 2, 2006.

Despite this Court’s express guidance and direction that the Tax Court explain its reasoning and grounds for adopting a value higher than the appraisal testimony, and direction to describe the factual support in the record for its conclusions, the Tax Court did not do so. There is no discussion in the Order on Remand addressing this Court’s explicit concerns or directions relating to the fact that the Tax Court’s final conclusions are outside the range of values as opined by the experts at trial. Likewise, there is no discussion by the Tax Court regarding the reversal of its conclusion regarding the trend in values between January 2, 2005 and January 2, 2006. The Tax Court’s failure to address these issues on remand was error as a matter of law.

**B. The Tax Court Again Determined a Net Operating Income Above the Net Operating Income as Opined by the Experts at Trial, Yet Failed to Explain Its Reasoning for Doing So or to Otherwise Describe the Factual Support in the Record for Its Net Operating Income.**

This Court also concluded that the Tax Court erred when it failed to “explain its reasoning for rejecting the appraisal testimony and the grounds for adopting a higher rent revenue figure” than either parties’ expert or to “explain its reasoning for increasing the net operating income above the testimony of the parties’ appraisers, or describe the factual support in the record for its determination.” Eden Prairie Mall, LLC, 797 N.W.2d at 196-197.

In its decision on remand, the Tax Court did change both its Minimum Rent Inline+AMC figures as well as its net operating income. However, the numbers the Tax Court used continue to be inconsistent with and outside the range of the evidence at trial.

In its Order on Remand, the Tax Court started its income approach analysis by using Minimum Rent Inline+AMC figures of \$8,856,518 in 2005 and \$9,385,935 in 2006. (Order on Remand, pp. 31, 33.) The Tax Court failed in any manner to explain where it found these figures in the record. Relator presumes that they equal the total of the 2004 and 2005 line item figures for “Minimum Rent-Mall Stores”, “Percentage Rent in Lieu” and “Overage Rent” found on the unnumbered page in Mr. Lennhoff’s appraisal

(Exhibit 1) following page 42, which purport to summarize the actual operating history of the Mall.<sup>5</sup> (A-56.)

The problem with the Tax Court using these figures as a starting point is not that they are not contained in the record. Clearly they are. The reversible error is that while these figures may represent the total of certain categories of revenue at the Mall in 2004 and 2005, *none of the experts at trial* testified that using these figures as a starting point under the income approach is appropriate or consistent with generally accepted appraisal practices when opining to the fee simple value of the Mall.

This Court concluded that when valuing the fee simple interest of a property, “effective market rents,” as opposed to actual rents must be used. Eden Prairie Mall, LLC, 797 N.W.2d at 195. None of the experts at trial testified that actual cash revenues were consistent with effective market rents, or that actual cash revenues should be used as a starting point in the income approach.

The evidence in the record is unmistakable. Mr. Lennhoff testified that the correct starting point was \$8,076,217 in 2005 and \$8,002,902 in 2006 based on his analysis and determination of effective market rent multiplied by the total square footage of the Mall. (Exhibit 1, pp. facing 40 and 57.) Mr. Messner testified that the actual income at the Mall was “lagging” market rents, because the “rental income reflected in those years was based on long-term leases that commenced during the 2000 to 2002 timeframe.” (Exhibit

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<sup>5</sup> Notably, the summary of the actual operating history of the Mall contained in Mr. Messner’s report (Exhibit 101, p. 76) does not report the same figures. The discrepancy between the two expert’s summaries of the actual operating history of the Mall was not addressed at trial, since neither expert relied upon actual Mall revenue in their analyses under the income approach.

101, p. 77.) However, Mr. Messner never opined to a market rent level at all. Instead, Mr. Messner entirely skipped the entire analysis of reviewing the leases and researching the market for tenant improvements, market rents and expenses. Instead, Mr. Messner starts his analysis with his conclusion of net operating income, which he estimated based on a combination of the Mall's historical net operating income and its projections. (Exhibit 101, pp. 79 – 80.) Mr. Lennhoff was found less credible by the Tax Court, despite performing an analysis highly consistent with this Court's guidance and directions. Mr. Messner was found more credible by the Tax Court despite virtually ignoring the generally accepted appraisal practices cited and discussed by this Court in its earlier decision.

Much like its Original Decision, the Tax Court's new conclusions regarding net operating income in the Order on Remand are similarly unsupported by and continue to be outside the range of evidence at trial. Respondent can only argue in its March 30, 2012 Statement of the Case that the Tax Court's net operating income for 2005 falls *between* the parties' respective expert opinions by critically distorting the record. First, Respondent quotes Mr. Messner's net operating income figure *before* he corrected it. Mr. Messner testified that his original income calculations contained an error, because he failed to deduct a management fee. (Tr., 1105:18 – 1106:9.) His corrected income approach calculations were submitted into evidence as Respondent's Exhibit 103 and disregarded in Respondent's argument. Second, Respondent adjusts the net operating income used by each expert and the Court by deducting for FF&E. The FF&E deduction

is a wholly separate step in the income approach and not a part of the net operating income calculation.

The unfortunate reality is that comparing the Court’s net operating income against the experts’ counterpart net operating income is not particularly helpful or relevant to a determination of whether the Tax Court’s decision is supported by the evidence in the record. That is because, under their respective analyses using the income approach, the Tax Court used one methodology; Mr. Lennhoff used a second slightly different methodology; and Mr. Messner used a third completely different methodology. To really compare apples to apples among the three valuation methodologies, one must look at: (1) the Tax Court’s net operating income or “NOI” (2) Mr. Lennhoff’s “Income to Real Property Before Adjustments,” and (3) Mr. Messner’s “Projected NOI Less Estimated Management Fee,” as follows:

<b>Assessment Date</b>	<b>Tax Court’s NOI</b>	<b>Mr. Lennhoff’s Income to Real Property Before Adjustments for Non-realty Items</b>	<b>Mr. Messner’s NOI Less Estimated Management Fee</b>
2005	\$10,027,313 <sup>6</sup>	\$8,584,955 <sup>7</sup>	\$9,655,000 <sup>8</sup>
2006	\$9,808,116 <sup>9</sup>	\$8,009,799 <sup>10</sup>	\$9,945,000 <sup>11</sup>

<sup>6</sup> Order on Remand, p. 32.

<sup>7</sup> Exhibit 1, p. facing 40.

<sup>8</sup> Exhibit 103.

<sup>9</sup> Order on Remand, p. 34.

<sup>10</sup> Exhibit 1, p. facing 57.

<sup>11</sup> Exhibit 103.

When the evidence is presented fairly and squarely, while the Tax Court's conclusion in 2006 falls just within the range of the evidence, its conclusion for 2005 continues to fall outside the range of the experts' respective opinions and the evidence in the record at trial.

Because the Tax Court failed to "explain its reasoning for rejecting the appraisal testimony and the grounds for adopting a higher rent revenue figure" than either parties' expert, or to "explain its reasoning for increasing the net operating income above the testimony of the parties' appraisers, or describe the factual support in the record for its determination" as required by the first decision of this Court in this case, the Tax Court erred as a matter of law. Eden Prairie Mall, LLC, 797 N.W.2d at 196-197.

**C. The Tax Court Failed to Adequately Address this Court's Express Directions on the Issue of Tenant Improvements and Capitalization Rates.**

This Court discussed the issue of tenant improvements in great detail in the section of its first decision in this case titled "Net Operating Income." Eden Prairie Mall, LLC, 797 N.W.2d at 195-197. Despite that detailed discussion, and this Court's express guidance and directions regarding the analysis of the issue of tenant improvements when capitalization the proper net operating income at the Mall into value, the Tax Court failed to substantively address the issue at all.

**1. Mr. Messner Could Not Reasonably Be More Credible on an Issue That He Testified He Did Not Even Analyze And About Which He Had No Apparent Opinion.**

As is evident from a review of the Redline Order comparing the Tax Court's Original Decision with its Order on Remand, the only additional discussion of the issue

of tenant improvements is the conclusory statement, for which there is no support in the record, that “the weight of the evidence presented supports Ms. Messner, who was most credible and persuasive in his testimony.” (Order on Remand, p. 27; Add-27.) In fact, the evidence in the record is that Mr. Messner admitted on cross examination that he did not even analyze the issue of tenant improvements.

Q: Mr. Messner, is there any analysis of tenant improvements or tenant allowances in connection with your determination of market rent?

A: No.

(Tr., 1417:20-23.) It is incomprehensible that Mr. Messner could possibly be more credible and persuasive on a topic he did not analyze or testify about at all at trial.

## **2. The Tax Court’s Income Approach Is Not Based on Market Rent.**

The Tax Court justified its decision to continue to ignore the issue of tenant improvements by pointing out that the rental revenue figure used by Mr. Lennhoff was less than the actual cash revenue received by the Mall. (Order on Remand, p. 27.) However, the Tax Court’s justification disregards this Court’s directions on remand in their entirety. The appraisal and evidentiary issue isn’t *whether* Mr. Lennhoff’s rental revenue figure was lower than the actual cash revenue received at the mall; the issue is *why* Mr. Lennhoff’s rental revenue figure was lower than the actual cash revenue received at the mall. That question highlights the difference between a fee simple analysis and a leased fee analysis, as this Court correctly identified in its first decision in this case. “In valuing a fee simple interest in property, the value of rentable space is estimated using *market* rent levels.” Eden Prairie Mall, LLC, 797 N.W.2d at 195,

*emphasis added.* The actual cash revenue reflects rents under the existing leases, no matter how old those leases might be or the market conditions when those leases were negotiated. Actual cash revenue does not reflect market rent levels. The direction from this Court on remand was to remind the Tax Court that the conclusion regarding market rent “‘reflect[ed] all conditions and restrictions of the typical lease agreement,’ including among other things, use restrictions, expense obligations, terms of the lease, renewal and purchase options, and *tenant improvement allowances.*” *Id.*, *emphasis added*, citing The Appraisal of Real Estate, 13<sup>th</sup> Ed. (2008).

The Tax Court, in simply using the cash revenue received at the Mall without consideration or discussion of the issues of market rent or tenant improvements as directed by this Court, effectively concluded to a leased fee valuation of the Mall in contravention of this Court’s clear mandate and in violation of the law. Minn. Stat. §273.11 requires that real property be valued for tax purposes in the fee simple. Continental Retail, LLC v. County of Hennepin, 801 N.W.2d 395, 401 (Minn. 2011). See also, Crossroads Center v. Commissioner of Taxation, 176 N.W.2d 530, 535-536 (Minn. 1970) (concluding that market rental rates, rather than actual revenue, should be used when calculating income under the income approach); TMG Life Ins. Co. v. County of Goodhue, 540 N.W.2d 848, 853 (Minn. 1995) (concluding that fair rental value must be used when calculating market value for property tax purposes); and Minn. Const. art. 10, Sec. 1 (providing that taxes must be uniform upon the same class of subjects).

**3. Ultimately the Tax Court Did Not Make Any Findings on Effective Market Rent.**

This Court focused much of its guidance and directions on net operating income and the concept of effective market rent. As this Court explained, “where market conditions require rent concessions, an appraiser *must* further determine a property’s effective rent.” Eden Prairie Mall, LLC, 797 N.W.2d at 195, *emphasis added*. This Court went on to explain that “effective market rent is the ‘total of base rent, or minimum rent stipulated in a lease, over the specified lease term minus rent concessions – e.g., free rent excessive tenant improvements, moving allowances, and other leasing incentives.’” Id., *citing The Appraisal of Real Estate*, 13<sup>th</sup> Ed. (2008). The evidentiary record is beyond reasonable dispute in confirming that market conditions at the Mall on the assessment dates in issue required rent concessions in the form of tenant improvements. (See e.g., Exhibit 1, pp. pp. facing 19, facing 26, facing 27, 27-28 and 30, 33 and facing 40.) (Add-47-55.)

The Tax Court wholly disregarded this Court’s guidance and directions regarding market rent. The Tax Court did add a sentence to its decision implicitly suggesting it agreed that a deduction for tenant improvements was required in order to calculate effective market rent.<sup>12</sup> Yet, the Tax Court did not make any findings or determination regarding the effective market rent at the Mall, nor did it discuss the issue of effective market rent in its decision at all. Instead, as discussed above, the Tax Court simply used

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<sup>12</sup> “The most significant difference in the parties’ valuation summaries result from the (*sic*) whether the cap rates derived before deducting tenant improvements are applied to an NOI using effective market rent (after deducting tenant improvements). (Order on Remand, p. 35.)

what it described as the “cash revenue actually received” for its starting point under the income approach. (Order on Remand, p. 27.) Ultimately, the Tax Court’s Order on Remand leaves virtually unchanged its initial decision to “adopt an income approach similar to that used by Mr. Messner in valuating the subject properties.” Order on Remand, p. 21. The Tax Court adopted the same approach as Mr. Messner, who admittedly performed no analysis of tenant improvements or market rents at all.

**a) The Tax Court Did Not Consider the Terms of the Actual Leases or Rely on Any Market Research in the Undisputed Evidentiary Record to Determine Whether or Not Tenant Improvement Allowances Are Atypical.**

The Tax Court’s stated reason for rejecting Mr. Lennhoff’s effective rent calculation led this Court to state,

the tax court concluded that reducing effective rents by tenant improvement allowances was inappropriate ‘because the allowances had already been spent prior to the dates of the valuation.’ But the court did not indicate whether the tenant improvement allowances were excessive or atypical, or explain why it was appropriate to deduct rent allowances in the year spent. Nor did the tax court explicitly determine effective market rent for the mall as of either valuation date.

Eden Prairie Mall, LLC, 797 N.W.2d at 196.

This Court did not hold that tenant improvements must be deducted in every case, but instead concluded that “whether tenant improvement allowances should be deducted to arrive at effective market rents must be determined on a case-by-case basis.” Id. This Court then went on to provide some guidance and direction to the Tax Court regarding the appropriate analysis in order to make that determination.

[t]he determination of whether a tenant improvement allowance should be deducted is part of the overall determination of market rent. Thus, an

appraiser must not only examine the terms of the lease, but also must conduct market research to determine whether or not tenant improvement allowances are atypical, to determine effective market rents.

Id.

The necessary evidence in the record in order to follow this Court's guidance was only provided by Mr. Lennhoff. This Court noted, "[t]he leases between EPM and the tenants are not part of the tax court's record, and the summaries of those leases that were made part of the record do not disclose what concessions were made." Only Mr. Lennhoff's detailed summaries of his analysis of the leases in his appraisal are in the evidentiary record. (Exhibit 1, pp. pp. facing 19, facing 26, facing 27, 27-28 and 30, 33 and facing 40.) (Add-47-55) (See also discussion *infra* at pp. 30-32.) Relator requested the record be re-opened so the Tax Court could consider additional evidence in order to answer this Court's queries. (Relator's Letter Brief, dated June 13, 2011) (A-23-31.) The Tax Court denied Relator's request and did not re-open the record. (Order, dated Aug. 24, 2011) (A-42-44.) As a result, only Mr. Lennhoff examined the terms of the leases and studied the market in order to determine whether or not tenant improvement allowances were atypical. In other words, only Mr. Lennhoff determined effective market rents as directed by this Court.

The evidence as a whole in these proceedings accordingly establishes that tenant improvements should be deducted when valuing the fee simple interest of the taxable real estate under generally accepted appraisal practices. While tenant improvements may be commonplace in the sense that they are required in many shopping center leases, they are "atypical" based on the testimony of Hennepin County's expert witnesses, since they are

not considered by market participants as part of the typical base rent. Instead, they are required as *an adjustment* that adds a component to the base rent otherwise commanded in the market for the use and occupancy of the retail space in the subject property in order to attract new tenants and maintain renewal tenants. Both Mr. Messner and Mr. Kenney (Respondent's review appraiser) acknowledged on cross examination that this is true and correct. (Tr., 1728:15-17; Tr., 1420:10-18; Tr., 1055:11-17.) This critical economic concession essentially validates and affirms Mr. Lennhoff's methodology, which fundamentally conducts the analysis presented by this Court. The Tax Court's failure to discuss this issue was error as a matter of law.

**b) The Tax Court Did Not Adjust for Rent Concessions that Affect Future Rent Receipts.**

Ultimately, this Court directed that "in determining effective market rent as part of valuation under the income capitalization approach, the court *must* adjust for rent concessions that affect future rent receipts." Eden Prairie Mall, LLC, 797 N.W.2d at 195, *emphasis added*. This Court's guidance and directions could not have been more unmistakable.

Nonetheless, the Tax Court's Order on Remand included no discussion or analysis of effective market rents, rental concessions or tenant improvements. As mentioned above, some of the language added by the Tax Court in its Order on Remand suggested it agreed that tenant improvement allowances were a rent concession that did, in fact, affect future rent receipts. (Order on Remand, p. 35.) The Order nevertheless failed to adjust for those rent concessions despite the guidance and directions from this Court ordering

that it *must* do. The Tax Court's failure to follow this Court's mandate on remand was error as a matter of law.

**4. The Tax Court Did Not Reconsider the Capitalization Rate Issues as Directed by this Court.**

The Tax Court also added a sentence at the end of its Order on Remand suggesting its decision to ignore this Court's guidance and directions on the issue of tenant improvements was justified by its capitalization rate analysis and selection.

The most significant difference in the parties' valuation summaries result from the (*sic*) whether the cap rates derived before deducting tenant improvements are applied to an NOI using effective market rent (after deducting tenant improvements). For the reasons set forth previously, we found Mr. Messner's methodology more persuasive and consistent with other evidence and Petitioners (*sic*) methodology significantly undervalued the Mal (*sic*).

(Order on Remand, p. 35.) This statement effectively acknowledges the Tax Court's agreement with Mr. Lennhoff that in order to calculate effective market rent, one must deduct tenant improvements. Yet, the Tax Court failed to do so.

Mr. Messner testified that he intentionally ignored the issue of tenant improvements in his analysis, because his capitalization rate selection came from the Korpacz reports, which he claimed are calculated before the deduction of tenant improvements. (Tr., 1419:04 – 1420:10.) Implicit in the sentences from the Order on Remand quoted above is the Tax Court's reliance upon Mr. Messner's testimony on this issue as the basis to effectively ignore this Court's guidance and directions, the evidence in the record taken as a whole, and the Tax Court's own apparent determination.

Moreover, this Court did not “affirm” the Tax Court’s selection of capitalization rates as the Respondent argued on remand. (Respondent’s Memorandum on Remand, dated Oct. 10, 2011, p. 5.) Rather, while this Court concluded there may be some evidence in the record to support the Tax Court’s original capitalization rate selections, this Court recognized that “the valuation of the mall is complicated and . . . the factors underlying the appropriate capitalization rate may be impacted by changes in the appraisal testimony.” Eden Prairie Mall, LLC, 797 N.W.2d at 199. Therefore, this Court suggested that it would be appropriate to reconsider the issue of capitalization rate on remand. Id. Despite Relator’s urgings to reconsider its decision regarding the appropriate capitalization rate, the Tax Court elected not to do so. (Tax Court Order, dated Aug. 24, 2011.)

Moreover, the Tax Court did not base its capitalization rate selection on any analysis of whether the Korpacz survey data was derived before or after the deduction of tenant improvements. Rather, the Tax Court’s selection of capitalization rates was based upon its determination regarding the level of tenant retail sales and the proper classification of the mall. (Order on Remand, pp. 29-30.)

This Court also did not hold that the Tax Court could ignore the issue of tenant improvements as long as its capitalization rate was derived before their deduction. Rather, this Court’s discussion of the capitalization rate focused on the experts’ disagreement at trial regarding whether the mall was a Class B or Class B+ mall, and whether the AMC theatre’s sales should be included or excluded when determining the Mall retail sales per square foot and applying the Korpacz grading scale when making

that determination. Eden Prairie Mall, LLC, 797 N.W.2d at 198-199. There was no discussion or conclusion by this Court that the capitalization rate selection was based on the issue of tenant improvements. Moreover, neither Court analyzed whether the surveys presented in the Korpacz reports considered similar market conditions relative to tenant improvements, and were thus reflective of similar excesses of supply over demand, so as to be similar to the market for the Mall on the relevant assessment dates.

This Court directed the Tax Court to deduct tenant improvements in its calculation of effective market rent if it determined that the tenant improvements constitute a rent concession. Mr. Lennhoff thoroughly studied the actual leases and concluded that tenant improvements constitute a rent concession. (Exhibit 1, pp. pp. facing 19, facing 26, facing 27, 27-28 and 30, 33 and facing 40.) (Add-47-55.) (Tr., 144:19 – 146:14.) Mr. Messner expressly agreed that amortized tenant improvements were a component of the total rent payable under many of the subject leases – an amount added to the base rent reflecting rent for use and occupancy of the generic demised premises. (Tr., 1420:10-18.) The Tax Court's determinations ignore the stark inconsistency that, although Mr. Messner performed no analysis tenant improvements for of the in-line shopping center leases, he did perform an analysis virtually identical to Mr. Lennhoff's when he analyzed the tenant improvements for his Von Maur department store rental comparables. In his analysis of department store leases, Mr. Messner did deduct amortized tenant improvements in a virtually identical manner to Mr. Lennhoff's analysis of the shopping center leases. (Exhibit 102, pp. 76, 87.) (Tr., 1728:15-17.) The contradiction and conflict

inherent in Mr. Messner's disparate treatment of tenant improvements drew nary a word from the Tax Court.

**5. The Tax Court Did Not Discuss Whether Changing One of Mr. Lennhoff's Assumptions Would Impact His Other Revenue and Expense Assumptions, such as Tenant Revenues.**

In the midst of its discussion of the Tax Court's failure to explain its reasoning for increasing the net operating income above the testimony of the experts, this Court also observed that "the tax court did not explicitly address whether changing one of EPM appraiser Lennhoff's revenue assumptions would impact other revenue and expense assumptions, such as tenant revenues. We therefore remand the matter to allow the tax court to do so." Eden Prairie Mall, LLC, 797 N.W.2d at 197. This Court's instructions on this issue could not be more appropriate or unmistakable.

A review of the Order on Remand reveals that here, too, the Tax Court ignored this Court's guidance and direction. The Order on Remand does not discuss or address in any material respect the question of whether changing one of EPM appraiser Lennhoff's revenue assumptions would impact his other assumptions.

The Court's observation and guidance inherently recognizes that the appraisal process involves "integrated, interrelated and inseparable techniques and procedures designed to produce a convincing and reliable estimate of value. . ." The Appraisal of Real Estate, 409, 10<sup>th</sup> Ed. (1992). See also, The Appraisal of Real Estate, 130, 13<sup>th</sup> Ed. (2008). The proper application of those techniques and procedures requires consistent application within permissible limits and in accordance with generally accepted appraisal practices. Consistent application is critical to reaching a fair and reasonable conclusion

in accord with generally accepted appraisal practices. *Id.* at 561. Mr. Messner expressly acknowledged this fundamental appraisal principal in his appraisal report when he expressly limited the use of his appraisal analysis, conclusions and opinion “for any purpose by any person . . . and in any event only with the properly written qualification and *only in its entirety.*” (Exhibit 101, p. 102, *emphasis added.*)

Mr. Messner appropriately restricts the use of his appraisal from partial or selective use of portions of his appraisal in any form other than in its entirety because of the inter-relationships between the various appraisal approach factors that he considered. Numerous adjustments and conclusions are subsumed into his analysis and opinion. For example, the level of total rent achievable in the market may change if there is a change in the amount of tenant improvements provided by the landlord or if the anticipated level of vacancy and credit loss is changed. A change in the operating expenses may also affect the level of market rent. The likelihood of achieving identified levels of market rent also constitutes an element of risk that is incorporated into the appraisal analysis and can impact the capitalization rate selection.

Ultimately, no evidence submitted at trial suggested that any partial selection of Mr. Lennhoff’s analysis and calculations, other than the figures and calculations included in his report, maintains the integrity of the many interrelationships between the various integrated factors or adheres to generally accepted appraisal practices. Thus, the Tax Court’s decision, which effectively incorporates assumptions not only wholly absent from Mr. Lennhoff’s analysis, but also totally absent from the record as a whole, violates

generally accepted appraisal practices. The Tax Court's failure to correct or even address this issue in its Order on Remand was error as a matter of law.

**6. The Interrelated Nature of the Appraisal Process Reasonably Concludes That Only Mr. Lennhoff's Capitalization Rate Selections Are Adequately Supported By the Evidence Taken as a Whole.**

While this Court did not expressly require that the Tax Court reconsider its base capitalization rate selection, it did state that it *could* do so. “[T]he valuation of the mall is complicated and . . . the factors underlying the appropriate capitalization rate may be impacted by changes in the appraisal testimony. . .” Eden Prairie Mall, LLC, 797 N.W.2d at 199. Accordingly, this Court suggested “on remand the tax court may also revisit the appropriate capitalization rates.” Id.

The interrelated nature of the appraisal process in this case highlights the appropriateness of reconsidering the base capitalization rate. As the Respondent concedes, the selection of the proper capitalization rate is inextricably intertwined with an appraiser's analysis of income. (Respondent's Letter Brief, dated June 16, 2011, p. 4.) (A-35.) As discussed herein, Mr. Lennhoff was the only witness to perform any detailed review or analysis of the actual leases at the subject property, a professional prerequisite to the appraisal analysis that this Court held necessary in order to conduct the appropriate analysis of income. Eden Prairie Mall, LLC, 797 N.W.2d at 196.

Mr. Lennhoff's extensive review of those leases included, among other things, a review of base rent, tenant improvements, overage rent and other lease clauses, costs of occupancy and tenant sales. (Exhibit 1, pp. pp. facing 19, facing 26, facing 27, 27-28 and

30, 33 and facing 40.) (Add-47-55.) Based on this analysis, which appropriately considered the level of sales at the movie theater comprising over 30% of the in-line space<sup>13</sup> at the Mall, Mr. Lennhoff concluded the Mall was a lower Class B or second tier mall. (Exhibit 1, p. 39.) Based on that conclusion, Mr. Lennhoff then considered a number of resources, including not only the Korpacz reports relied upon exclusively by Mr. Messner, but also the Real Estate Research Corporation reports, to conclude to a capitalization rate of 8.75% as of January 2, 2005 and 8.5% as of January 2, 2006. The Lennhoff capitalization rates, derived based on the only evidence in the record relating to what this Court held was the appropriate method of calculating income, are inextricably intertwined with the analysis and capitalization of that income. Mr. Lennhoff's capitalization rates are the only capitalization rates in the evidentiary record taken as a whole that are consistent with this Court's guidance and directions.

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<sup>13</sup> The theater is part of the in-line space and is not similar to the anchor department stores in the Mall. The theater has no exterior entrance, it does not sit on its own tax parcel, nor does it have reciprocal easement agreement or similar lease provisions, three primary characteristics held in common by all of the anchor department stores in the Mall. (Tr., 682:7-11.) Its co-tenancy clause is also very similar to many other in-line tenants at the Mall. (Tr., 1318:16 – 1320:12.) Moreover, if one looks at its actual location, the theater is in fact located “in-line” at the Mall. The theater physically sits on the second floor of the Mall directly above the following in-line stores: Fred Meyer's Jewelers, Kitchens, Talbots, Coldwater Creek, and Amy's Hallmark. (Exhibit 45.) The theatre has no parking of its own, but is treated like all other in-line tenants.

**II. THE TAX COURT CHANGED ITS EFFECTIVE TAX RATE ADDITUR TO ITS CAPITALIZATION RATE FROM THE ADDITUR IT USED IN ITS ORIGINAL DECISION BASED SOLELY ON RESPONDENT'S ARGUMENT, WHICH WAS INCONSISTENT WITH THE TESTIMONY OF ANY OF THE THREE EXPERTS AT TRIAL, CONTAINED NOWHERE IN THE RECORD EXCEPT FOR RESPONDENT'S REPLY BRIEF ON REMAND, AND IN VIOLATION OF THE LAW OF THE CASE DOCTRINE.**

In its Original Decision, the Tax Court added to its base capitalization rate a tax rate additur calculated by multiplying 30% by the effective tax rate in 2005, and similarly 30% multiplied by the effective tax rate in 2006. The evidence in the record for this additur derived from the testimony of Mr. Lennhoff as partially affirmed by Mr. Kenney.

Mr. Lennhoff testified that the appropriate additur in 2005 was 30% of the effective tax rate, and the appropriate additur in 2006 was 40% of the effective tax rate. (Exhibit 1, pp. 40 and 57.) Mr. Lennhoff explained that because he did not deduct real estate taxes as an expense, this adjustment to the capitalization rate was required to account for the portion of the real estate taxes paid by the landlord in the requisite tax neutral valuation process. In 2004, the landlord paid approximately 30% of the real estate taxes, while in 2005, the landlord paid nearly 40%. (Exhibit 1, pp. 40 and 56.)

Mr. Kenney agreed with Mr. Lennhoff's methodology of adding a percentage factor multiplied by the effective tax rate to the capitalization rate. However, Mr. Kenney disagreed with the amount of real estate taxes the landlord actually paid in 2005. As a result, Mr. Kenney testified that the proper tax rate additur was 30% of the effective tax rate in both years. (Exhibit 161, p. 12.) Mr. Kenney performed no analysis or study to support his deviation from Mr. Lennhoff's analysis.

Mr. Messner, on the other hand, used a completely different (and inappropriate) income capitalization methodology. He deducted the total amount of taxes actually paid in calculating his net operating income before capitalizing that income into value. Mr. Messner therefore failed to perform a tax neutral analysis. As a result, Mr. Messner effectively added 100% of the effective tax rate to his capitalization rate. (Exhibit 103.)

The Tax Court apparently agreed with Mr. Kenney while adopting a methodology similar to Mr. Lennhoff's. In its original decision, the Tax Court did not deduct real estate taxes as an expense (like Mr. Messner), but rather added to its base capitalization an additur of 30% multiplied by the effective tax rate in both years. This portion of the Tax Court's original decision was not in issue on Relator's first appeal to this Court. This Court's original decision therefore did not address the capitalization rate additur issue, rendering the Tax Court's original decision on the issue the law of the case. The doctrine of the law of the case, applies to situations, like here, where an appellate court passes on an issue and then remands the case to the court below for further proceedings. In such a situation, the issue effectively determined by the appellate court will not be re-examined on a second appeal of the same case. Brezinka v. Bystrom Bros., Inc., 403 N.W.2d 841, 843 (Minn. 1987).

Despite its previous concurrence with the Tax Court's determination of a tax rate additur to the capitalization rate based on 30%, and the clear application of the law of the case doctrine given the procedural posture of the case, in its Reply Brief on remand Respondent for the very first time in this case crafted a new argument out of thin air on the issue of the tax rate additur. Respondent argued for the first time that the proper tax

rate additur should be 6% multiplied by the effective tax rate in both years, rather than the 30% originally used by the Tax Court. (Respondent's Reply Memorandum on Remand, dated Nov. 15, 2011, pp. 7-8.) (A-95-96.) The Respondent argued without any supporting evidence in the record that using an additur of 30% multiplied by the effective tax rate was a leased fee analysis, and that in order to calculate the additur in the fee simple, the Court should multiply the effective tax rate by the market vacancy rate of 6%.

Id.

In its Letter Brief, dated December 9, 2011, Relator reminded the Tax Court that in both its Post Trial Brief to the Tax Court as well as in its Brief to this Court in the first appeal, Respondent had adopted the 30% additur calculation and had argued that 30%, not 6%, was the correct number. (A-121-122.)

Respondent's change of heart and new argument highlights this Court's admonition that shopping center valuation "is complicated and . . . the factors underlying the appropriate capitalization rate may be impacted by changes in the appraisal testimony." Eden Prairie Mall, LLC, 797 N.W.2d at 199. Use of a 6% figure based on the market vacancy rate, as Respondent advocated on remand, leads to an underestimation of the real estate taxes and their impact on the value of the Mall. That is because, as Mr. Lennhoff explained, *after reviewing the leases in question*, which he and he alone did in this case, a number of the leases were not actually pure net leases. As result, the landlord was not able to recover 100% of the real estate taxes, even on the occupied space. (Tr., 241:8 – 242:13.) Using a tax rate additur that ignores the reality that some of the leases negotiated *in the market* are not pure net leases is not a leased fee

analysis. It is an analysis that overstates market rent, understates property tax expenses and is just methodologically wrong leading to an excessive valuation that is not based on the evidence.

Despite the fact that (i) the Tax Court's original decision on the additur issue had become the law of the case, (ii) Messrs. Lennhoff and Kenney both relied on at least a 30% additur for taxes paid by the landlord, and (iii) none of the experts at trial testified that the proper generally accepted appraisal methodology was to multiply the effective tax rate by 6% of the effective tax rate, in its Order on Remand, the Tax Court, *without comment or discussion of any kind*, changed its tax rate additur from 30% multiplied by the effective tax rate to 6% multiplied by the effective tax rate. This significantly changes the overall capitalization rate and modifies the capitalized value without evidentiary support of any kind. The Tax Court's decision to amend its Order in this manner is error as a matter of law.

**III. THE TAX COURT FAILED TO ADEQUATELY BASE ITS VALUE DETERMINATIONS UPON THE EVIDENTIARY RECORD WHEN IT REJECTED MR. MESSNER'S DETERMINATION OF THE VALUE OF THE FURNITURE, FIXTURES AND EQUIPMENT AT THE MALL IN FAVOR OF MR. LENNHOFF'S LOWER DETERMINATION AFTER EXPRESSLY FINDING THAT MR. MESSNER WAS MORE CREDIBLE AND PERSUASIVE.**

The Tax Court expressly found that the "weight of the evidence presented supports Mr. Messner, who was most credible and persuasive in his testimony." (Order on Remand, p. 27.) Despite this finding, the Tax Court claimed that it agreed "with some of the adjustments Mr. Lennhoff made in his income approach." *Id.* at p. 21. This claim by the Tax Court regarding Mr. Lennhoff's methodology fails to withstand critical scrutiny.

The Tax Court did not “agree with some of his adjustments” under Mr. Lennhoff’s income approach. Rather, the Tax Court disagreed with each and every adjustment made by Mr. Lennhoff under his income approach, with the sole and solitary exception being the deduction for furniture, fixtures and equipment (“FF&E”). The FF&E deduction made by Mr. Lennhoff was lower than the FF&E deduction made by Mr. Messner. Accordingly, by adopting Mr. Lennhoff’s number, the Tax Court concluded to an even higher value.

The Tax Court’s stated reasoning for adopting Mr. Lennhoff’s deduction over Mr. Messner’s deduction is not consistent with the evidence and therefore, should be rejected by this Court. The Tax Court claimed it adopted the smaller of the two deductions, because both expert’s deductions were based on historical cost. Because Mr. Kenney testified that the use of historical cost figures overstates the deduction, the Tax Court claimed it used the smaller of the two numbers in order be consistent with Mr. Kenney’s testimony. (Order on Remand, pp. 30-31.)

The problem with the Tax Court’s reasoning is that the evidence in the trial record does not support a finding that Mr. Messner’s deduction for FF&E was based on historical cost. Rather, the written explanation of the FF&E deduction in Mr. Messner’s appraisal report sheds no light on the issue. (See Exhibit 101, p. 82.) Instead, his testimony at trial suggests that Mr. Messner based his FF&E deduction on historical *and anticipated* cost (Tr., 1461: 25 – 1461:3).

If Mr. Messner was most credible and persuasive, the evidence would indicate Mr. Messner’s \$300,000 deduction should have been adopted from the evidentiary record.

The Tax Court apparently selected only Mr. Lennhoff's adjustment for FF&E, when it expressly found Mr. Messner to be more credible and rejected Mr. Lennhoff's other adjustments in every other respect. The Tax Court's decision to base its FF&E deduction on the stated basis that it constituted the lower amount, thereby leading to a higher value, was error.

**IV. THE TAX COURT'S FINAL CALCULATIONS OF VAULE INCLUDE A NUMBER OF MATHEMATICAL COMPUTATION ERRORS.**

Finally, the Tax Court's Order on Remand continues to contain a number of mathematical errors. These errors are before correcting the numerous other incidents where the Order on Remand was not supported by the evidentiary record as a whole, failed to adequately explain the reasons for the Tax Court's value determinations, and failed to describe in detail the evidence in the record upon which the Tax Court relied. The Tax Court's mathematical errors are highlighted below:

January 2, 2005 Valuation

	<u>Tax Court's Number</u>	<u>Correct Number</u>
<b>Income</b>		
Minimum Rent Inline+AMC	\$8,856,518	
Less Vacancy & Collection Cost at 6%	531,391.08	
Effective Gross Minimum Rents-Inlines	8,325,126.92	
Overage Rent	-----	
Specialty Leasing	1,925,000	
Other Income	90,000	
<u>Total Base Rent</u>	10,340,126.92	
Expense Recoveries		
CAM	2,375,000	
Real Estate Taxes	In cap rate	
Utilities, HVAC, etc	1,850,000	
Other-Food Court	87,000	
Miscellaneous Revenue	75,000	
<b>Total Revenue</b>	<b>\$14,727,127</b>	
<b>Expenses</b>		
<i>Reimbursable</i>		
CAM	2,650,000	
Other-Food Court	258,000	
Real Estate Taxes	In cap rate	
Personal Property Tax	-----	
Utilities & HVAC	1,350,000	
<i>Owner's (Nonreimbursable)</i>		
Management Fee at 3%	441,814	
General & Administrative	145,000	
Bad Debt	-----	
<u>Total Expense</u>	<u>4,699,814</u>	<u>4,844,814</u>
Net Operating Income	10,027,313	9,882,313
FF&E	235,714	
Income to Real Property	9,791,599	9,646,599
Cap Rate to Real Property		
Real Property Rate-Korpacz cap b/4 adj.	7.50000%	
Tax Load – market vacancy 6% 3.455239%	.2073	
	7.7073%	
<b>Value as of January 2, 2005</b>	<b>\$127,043,180</b>	<b>\$125,161,847</b>

January 2, 2006 Valuation

	<u>Tax Court's Number</u>	<u>Correct Number</u>
<b>Income</b>		
Minimum Rent Inline+AMC	\$9,385,935	
Less Vacancy & Collection Cost at 6%	563,156	
Effective Gross Minimum Rents-Inlines	8,822,779	
Overage Rent	-----	
Specialty Leasing	2,070,000	
Other Income	96,000	
<u>Total Base Rent</u>	<u>10,988,779</u>	
Expense Recoveries		
CAM	2,400,000	
Real Estate Taxes		
Utilities, HVAC, etc	1,500,000	
Other-Food Court	100,000	
Miscellaneous Revenue	100,000	
<b>Total Revenue</b>	<b>15,088,779</b>	
<b>Expenses</b>		
<i>Reimbursable</i>		
CAM	2,658,000	
Other-Food Court	265,000	
Real Estate Taxes	-----	
Personal Property Tax	-----	
Utilities & HVAC	1,700,000	
<i>Owner's (Nonreimbursable)</i>		
Management Fee at 3%	452,663	
General & Administrative	205,000	
Bad Debt	-----	
<u>Total Expense</u>	<u>5,280,663</u>	
Net Operating Income	9,808,116	
FF&E	257,672	
Income to Real Property	9,550,444	
Cap Rate to Real Property		
Real Property Rate-Korpacz cap b/4 adj.	7.25000%	
Tax Load – market vacancy 6% 3.374732%	.2248%	.020248%
	7.4748%	7.45248%
<b>Value as of January 2, 2006</b>	<b>\$127,768,555</b>	<b>\$128,151,220</b>

The above-identified errors by the Tax Court in its mathematical calculations constitute error as a matter of law.

## CONCLUSION

For all of the foregoing reasons, the Relator respectfully requests this Court hold that the Tax Court's Order on Remand is not supported by the evidence in the record as a whole, is inconsistent with the evidence admitted at trial, fails to adequately explain the reasons for its value determinations and to describe in detail the evidence in the record upon which it relies. The Order on Remand fails to reasonably consider the guidance and directions of this Court in its previous decision in this case, and constitutes reversible error in violation of Minnesota law.

Relator therefore respectfully requests that this Court reverse the decision of the Tax Court and remand this case not again to the Tax Court, but to the Hennepin County District Court in which these petitions were originally filed, with directions to properly determine the value of the taxable real property components of the Mall in a manner consistent with the evidence in the record, the guidance and directions in this Court's previous decision, and its decision here. The Relator requests that the mandate on remand include express directions to make deductions for tenant improvements when calculating effective market rent consistent with the guidance of this Court and Mr. Lennhoff's testimony, and capitalizing the fee simple income into value based on the overall capitalization rate estimated by Mr. Lennhoff with the correct 30% effective tax rate additur based on the evidence in the record as recalculated below:

January 2, 2005 Valuation

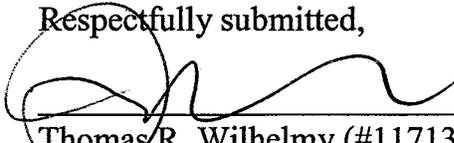
	<u>Correct Number</u>
<b>Income</b>	
Minimum Rent Inline+AMC	\$8,076,271
Less Vacancy & Collection Cost at 6%	(\$484,583)
Effective Gross Minimum Rents-Inlines	\$7,591,644
Overage Rent	-----
Specialty Leasing	\$1,925,000
Other Income	\$90,000
<b>Total Base Rent</b>	<b>\$9,606,644</b>
Expense Recoveries	
CAM	\$2,375,000
Real Estate Taxes	In Cap Rate
Utilities, HVAC, etc	\$1,850,000
Other-Food Court	\$87,000
Miscellaneous Revenue	\$75,500
<b>Total Revenue</b>	<b>\$13,993,644</b>
<b>Expenses</b>	
<i>Reimbursable</i>	
CAM	\$2,650,000
Other-Food Court	\$258,000
Real Estate Taxes	In Cap Rate
Personal Property Tax	-----
Utilities & HVAC	\$1,350,000
<i>Owner's (Nonreimbursable)</i>	
Management Fee at 3%	\$419,809
General & Administrative	\$145,000
Bad Debt	-----
<b>Total Expense</b>	<b>\$4,882,809</b>
Net Operating Income	\$9,170,835
FF&E	(\$300,000)
Income to Real Property	\$8,870,835
Cap Rate to Real Property	
Real Property Rate	8.75%
Tax Load – market vacancy 30% 3.455239%	1.03657%
	9.78657%
<b>Value as of January 2, 2005</b>	<b>\$90,642,942</b>

January 2, 2006 Valuation

	<u>Correct Number</u>
<b>Income</b>	
Minimum Rent Inline+AMC	\$8,002,902
Less Vacancy & Collection Cost at 6%	(\$480,174)
Effective Gross Minimum Rents-Inlines	\$7,522,728
Overage Rent	-----
Specialty Leasing	\$2,070,000
Other Income	\$96,000
<u>Total Base Rent</u>	<u>\$9,688,728</u>
Expense Recoveries	
CAM	\$2,400,000
Real Estate Taxes	In Cap Rate
Utilities, HVAC, etc	\$1,500,000
Other-Food Court	\$100,000
Miscellaneous Revenue	\$100,000
<b>Total Revenue</b>	<b>\$13,788,728</b>
<b>Expenses</b>	
<i>Reimbursable</i>	
CAM	\$2,658,000
Other-Food Court	\$265,000
Real Estate Taxes	In Cap Rate
Personal Property Tax	-----
Utilities & HVAC	\$1,700,000
<i>Owner's (Nonreimbursable)</i>	
Management Fee at 3%	\$413,662
General & Administrative	\$205,000
Bad Debt	-----
<u>Total Expense</u>	<u>\$5,241,662</u>
Net Operating Income	\$8,547,066
FF&E	(\$300,000)
Income to Real Property	\$8,547,066
Cap Rate to Real Property	
Real Property Rate-Korpacz cap b/4 adj.	8.50%
Tax Load – market vacancy 30% 3.374732%	1.01242%
	9.51242%
<b>Value as of January 2, 2006</b>	<b>\$89,272,647</b>

Dated: May 7, 2012

Respectfully submitted,

A handwritten signature in black ink, appearing to be "Thomas R. Wilhelmy", written over a horizontal line. The signature is fluid and cursive.

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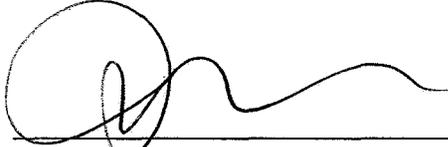
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**CERTIFICATE OF COMPLIANCE  
WITH MINN. R. APP. P 132.01, Subd. 3**

The undersigned certifies that Relator's Brief submitted herein contains 12,456 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 Edition 2003, the word processing system used to prepare this Brief.

  
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Judy S. Engel