STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

Home Depot USA, Inc.,
Petitioner,

v | MTT Docket No. 366428

Township of Breitung,
Respondent.

Tribunal Judge Presiding
Marcus L. Abood

# OPINION AND JUDGMENT

## INTRODUCTION

Petitioner, Home Depot USA, Inc., through its amended Petition in the above-captioned case, is appealing the ad valorem property tax assessment levied by Respondent, Township of Breitung, for the 2009, 2010, and 2011 tax years. A hearing was held in the matter on September 27, 2012. Michael B. Shapiro and Daniel L. Stanley, attorneys at Honigman Miller Schwartz and Cohn, LLP, appeared on behalf of Petitioner. Ross K. Bower, II, and Stacy L. Hissong, attorneys at Fahey Schultz Burzych Rhodes, PLC, appeared on behalf of Respondent. Laurence G. Allen, MAI, was Petitioner's valuation witness. Bruce Closser was Respondent's valuation witness.

## SUMMARY OF JUDGMENT

The property's true cash value (TCV), state equalized value (SEV), and taxable value (TV) as established by the Board of Review for the tax years at issue are as follows:

Parcel Number: 2202-005-002-10

| Year | TCV | SEV | TV |
|---|---|---|---|
| 2009 | $5,846,800 | $2,923,400 | $2,923,400 |
| 2010 | $5,850,200 | $2,925,100 | $2,914,629 |
| 2011 | $5,850,200 | $2,925,100 | $2,925,100 |

The property's TCV, SEV, and TV as determined by the Tribunal for the tax years at issue shall be as follows:

Parcel Number: 2202-005-002-10

| Year | TCV | SEV | TV |
|---|---|---|---|
| 2009 | $2,850,000 | $1,450,000 | $1,450,000 |
| 2010 | $2,660,000 | $1,330,000 | $1,330,000 |
| 2011 | $2,375,000 | $1,187,500 | $1,187,500 |

## GENERAL PROPERTY DESCRIPTION

The subject property, commonly known as The Home Depot, consists of a 17.69-acre parcel of property located at West 8141 US Highway 2, Breitung Township, Dickinson County, Michigan. It is classified 201- Commercial, zoned C-2, Commercial/Light Industrial, and improved with a freestanding, single-story, class C commercial building originally constructed as a build-to-suit in 2003 for Home Depot. The building has a total gross area of 94,984 square feet. The property is owner-occupied and has no history of an income stream.

## SUMMARY OF PETITIONER'S CASE

Petitioner contends that the subject property is assessed in excess of 50% of its true cash value. Petitioner's contentions of TCV, SEV, and TV are as follows:

Parcel Number: 2202-005-002-10

| Year | TCV | SEV | TV |
|---|---|---|---|
| 2009 | $2,700,000 | $1,350,000 | $1,350,000 |
| 2010 | $2,400,000 | $1,200,000 | $1,200,000 |
| 2011 | $2,200,000 | $1,100,000 | $1,100,000 |

In support of its value contentions, Petitioner offered the following exhibits, which were admitted into evidence:

P-1: Appraisal Report prepared by Laurence G. Allen, MAI.
P-2: Appraisal Report prepared by Bruce Closser, MAI.

Petitioner presented testimony from its appraiser, Laurence G. Allen, MAI. Mr. Allen has appraised big box stores for Wal-Mart, Target, K-Mart, and Lowe's on behalf of property owners, for tax appeals, and for the Michigan Department of Treasury. Based on his experience and training, the Tribunal accepted Mr. Allen as an expert appraiser.

Mr. Allen's appraisal of the subject property sets forth a sales comparison and income analysis for each of the tax years at issue in this appeal. The cost approach was considered and analyzed, but not developed, for reasons that will be explored in greater detail below. All approaches are indicated as being conveyed on the foundation of a fee simple interest. Mr. Allen explained that the fee simple interest, by definition, is acquisition of a property as unleased, vacant, and available for sale. It includes both the right of ownership and right of possession, and as such, is not affected by occupancy, or lack thereof. Contrarily, a leased fee interest is based on the value of a property subject to an existing lease. Value

indications can be impacted by the interest being appraised, and the results can be dramatically different for the same property. (TR, Vol 1-B, pp 89-90)

Mr. Allen concluded the highest and best use of the subject property as improved to be retail use. In determining the highest and best use, he indicated that he considered the existing use of the property, but did not consider the identity of the actual user of the subject property. Mr. Allen explained that big box stores are built to fulfill a specific business model and plan. This is done to penetrate a particular market and to maximize sales and profits for the store and company; big box retailers are not motivated by the resale value of the stores. (TR, Vol 1-B, pp 105-107) Accordingly, construction costs are incurred without regard to whether they add to the true cash value of the property. They also typically include costs of improvements made to enhance the retailer's business/image as well as a profit to the developer. When sold, these properties are often renovated or converted to a multi-tenant building, though the latter option tends to be very costly. (TR, Vol 1-B, pp 107-109) Mr. Allen further explained:

> The changes would vary a lot by user, but would include such things as…chang[ing] the façade so it doesn't look like a Home Depot façade. They would probably paint the building a different color than orange, and interior—often retailers have a specific plan as far as where they want the restrooms. Often they'll move the restrooms. They have different loading needs and they may or may not find the loading adequate. They also have different amounts of backroom space. They have a different configuration of lighting because they have different types of inventory. They need different amounts of office space and training space for employees. And typically when a

> property is sold those kinds of modifications are made to meet the business model of the new retailer. (TR, Vol 2, p 29)

Frequently, however, the cost to demolish is less than the cost to retrofit the property to a different business model, notwithstanding that the existing structure is suitable for retail use. Mr. Allen gave several examples of circumstances in which the properties were torn down and completely redeveloped after purchase by another big box retailer, including a seven-year-old Super K in Canton and a ten-year-old Super K in Sterling Heights. (TR, Vol 1-B, pp 109-110)

SALES COMPARISON APPROACH

Mr. Allen's sales comparison analysis focused on big box stores that were vacant and available at the time of sale. It examines seven sales of such properties for each of the tax years at issue. Write-ups and photographs of each comparable sale are included in the appraisal report. A summary of the sales is as follows:

| Sale # | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|---|
| Development | Super K | Target | Target | HQ/BS | Wal-Mart | Wal-Mart | Home Depot |
| Location | Dearborn MI | HollandTwp MI | Kentwood MI | Sterling Heights MI | FrenchtownTwp MI | DentonTwp MI | Milwaukee WI |
| Sale Date | Jan-06 | May-04 | Nov-05 | Mar-06 | Dec-09 | Jul-05 | May-09 |
| Year Built | 1993 | 1990 | 1989 | 1996 | 1992 | 1989 | 2003 |
| Building Area (SF) | 192,000 | 80,953 | 103,086 | 111,285 | 124,631 | 94,559 | 102,083 |
| Sale Price | $9,650,000 | $2,350,000 | $7,100,000 | $4,500,000 | $2,765,000 | $1,425,000 | $6,000,000 |
| SP/SF | $50.26 | $29.03 | $68.87 | $40.44 | $22.19 | $15.07 | $58.78 |
| Adj SP/SF | | | | | | | |
| (2009) | $28.75 | $21.55 | $34.09 | $30.57 | $27.45 | $22.38 | $38.97 |
| (2010) | $26.54 | $19.40 | $30.68 | $27.17 | $24.40 | $20.14 | $34.17 |
| (2011) | $23.53 | $17.46 | $27.62 | $24.52 | $22.02 | $18.13 | $29.26 |

The comparable sales data indicates differences in various elements of comparison, with the two biggest factors being market conditions and location.

(TR, Vol 1-B, pp 120, 141) Mr. Allen indicated that the age and condition of a comparable are less significant because most purchasers are anticipating major modifications to the property. (TR, Vol 1-B, pp 120-121) With respect to his location adjustments, Mr. Allen testified that population, income levels, traffic count, access, and visibility were the primary factors considered. (TR, Vol 1-B, p 123) In that regard, the demographics of Dickinson County and the surrounding area indicate a small and declining population, high unemployment rates, below average household incomes, income growth less than inflation, and traffic counts. Comparatively speaking, this suggests that the subject property is located in a very small market with limited purchasing power and potential. (TR, Vol 1-B, pp 93-101, 136-137) Mr. Allen's market condition adjustments varied by location and the concluded impact of the 2008 nationwide economic collapse in each individual market. (TR, Vol 1-B, pp 135-136)

More generally, Mr. Allen testified that he utilized the multiplier method for calculating both his transactional and characteristic-specific adjustments, a technique which has an inherent rounding effect. (TR, Vol 2, pp 60-80) He acknowledged that using the additive methodology advocated by Mr. Closser could produce a different result. Mr. Allen asserted that the multiplier method was more appropriate for commercial properties like the subject. He explained:

> [O]ne dilemma we have, say, for instance, we're using additive and the comparable is 50% better in location and its 50% better in age and condition, so we would say the indicated value of that comparable is

> zero. Well, it's not zero, and the additive method doesn't give you the right answer. A multiplier would give a more accurate consideration of those factors. (TR, Vol 2, pp 78-79)

In addition to the sales, Mr. Allen also examined and provided summary information for 16 comparable listings located in Michigan. The summary indicates, among other things, the listing price per square foot for the years the properties were listed. The listings indicate price per square foot ranges as follows: $36.27/SF to $57.65/SF in 2008, $13.20/SF to $49.75/SF in 2009, and $10.92/SF to $49.75/SF in 2010. Additionally, Comparable Listing 4 sold in June 2010 for $2.10/SF, Comparable Listing 5 sold in April 2011 for $14.87/SF, and Comparable Listing 7 sold in March 2012 for $19.42/SF. Similar information was provided for nine listings of big box properties throughout the states of Minnesota and Wisconsin, as well as three Wisconsin sales. The price range indicated by the listings is $15.00/SF to $49.07/SF, while the sales provide a range of $8.62/SF to $22.63/SF.

After analyzing the comparable sales, adjusting for difference in amenities, and reviewing the supplemental listings and out-of-state sales, Mr. Allen concluded to final true cash value indications for the subject property as follows: $2,659,552 as of December 31, 2008, $2,374,600 as of December 31, 2009, and $2,137,140 as of December 31, 2010.

INCOME APPROACH

Mr. Allen's income approach is based on a direct capitalization methodology. He testified that there are three distinct rental markets for big box stores: the existing market, the build-to-suit market, and the build-to-suit re-lease market. The market for existing stores is based on market conditions and supply and demand. It's

> a normal market, where property is offered on the market for a period of time, generally through a broker, and the broker searches and advertises and tries to find a tenant for the property. And eventually there's negotiation between a willing lessor, willing lessee and a determination of rent for—in a lease transaction. (TR, Vol 2, p 6)

On the other hand, the build-to-suit lease is

> not a market in the sense the property is offered on the market for a time to find a tenant; rather, it's a negotiated transaction before a property is built based on the cost to put it in place and a rent that a developer will have to have to support that cost new." (TR, Vol 2, p 6)

Mr. Allen indicated that rents vary between an existing building and a non-existent, build-to-suit property:

> [T]he rents on build-to-suit properties are generally much higher because they represent the rent for a custom-built structure for the specific needs of the user. Whereas when a property is leased in the market, it's generally leased to or it's offered to a variety of users and it's not—no longer a custom-built structure for a specific user. (TR, Vol 2, pp 6-7)

For each of the three tax years at issue in this appeal, Mr. Allen examined thirteen existing retail big box store buildings that were leased or offered for lease

in Michigan, and twelve similar properties situated in the states of Wisconsin and Minnesota. The price per square foot of the Michigan lease comparables ranges from $3.75/SF to $6.00/SF, while the Wisconsin and Minnesota leases range from $2.25/SF to $8.00/SF. Consideration was given to tenant improvement allowances where necessary. Mr. Allen explained:

> Often during a lease the landlord gives the tenant a tenant improvement allowance, either in cash or in terms of improvements that the landlord builds for the tenant's specific needs. . . . [T]he big difference . . . to the landlord is if a tenant takes the space as is or if he has to spend money to customize it for the tenant. And if he does have to spend that money, he, in fact, gets less rent for the property than if he didn't. (TR, Vol 2, pp 10-11)

Additionally, eight original build-to-suit leases with rents ranging from $5.44/SF to $9.50/SF were identified. Mr. Allen compared the difference between the original build-to-suit leases and eleven build-to-suit leases that were vacated and subsequently re-leased in the open market. The analysis indicated a range of 30% to 85% difference in value between the two types of leases, and an average decrease in value of approximately 47.21% for re-leased properties. With consideration to all of the relevant information, Mr. Allen concluded that an adjustment of 35% was appropriately applied to build-to-suit leases in estimating a market rent for the subject property. The analyzed final triple net market rent rates for the subject property were concluded to be $4.25/SF as of December 31, 2008, $4.00/SF as of December 31, 2009, and $3.75/SF as of December 31, 2010.

Mr. Allen calculated gross income for each year from the indicated rental rate per square foot. The next step was to determine appropriate vacancy and credit loss deductions.

> A vacancy and credit loss was accounted for because a property like this is difficult to find a tenant, and there's vacancy during time periods when you have to locate a tenant. And once you find a tenant the tenants aren't always successful, and typically on these stores it's a ten-year lease. And if—if the tenant makes it through the ten-year term, then there's a possibility of vacancy at the end of the term and there's a time—usually an extended time to find a new tenant. (TR, Vol 2, p 13)

There was no national survey for the Breitung Township or Dickinson County retail communities, so Mr. Allen relied on conversations with real estate brokers and competing market data to conclude to a 15% vacancy and credit loss for all three years. (TR, Vol 2, p 13) Operating expenses were then subtracted to equal the net operating income. The reimbursable operating expenses included common area maintenance, property taxes, and insurance expenses. Mr. Allen estimated the expenses utilizing *Dollars and Cents of Shopping Centers* for 2008. (TR, Vol 2, pp 14-15) These expenses are incurred by a landlord when the property is vacant. Mr. Allen explained:

> The importance to a buyer with vacancy on triple net leases is not only does he lose the rent during that vacancy, but he [also] loses expense reimbursements. So he loses tax reimbursement, insurance reimbursement, [and] reimbursements for maintenance costs. (TR, Vol 2, p 14)

In determining the overall capitalization rate for each of the relevant valuation dates, Mr. Allen considered rates from extracted sales of single-tenant retail buildings and centers, band-of-investment techniques, and investor surveys. (TR, Vol 2, pp 15-19) After analysis, he concluded to an overall rate of 10.00% for the 2009 tax year and 10.50% for both the 2010 and 2011 tax years. (TR, Vol 2, pp 19-20) After capitalizing the net operating income, Mr. Allen deducted leasing commissions to arrive at final true cash value indications for the subject property as follows: $2,800,000 as of December 31, 2008, $2,500,000 as of December 31, 2009, and $2,320,000 as of December 31, 2010. (TR, Vol 2, p 21)

COST APPROACH

Mr. Allen considered and analyzed, but did not develop the cost approach in his appraisal of the subject property. He deemed the approach inapplicable to the subject valuation and explained his reasoning as follows:

> The primary reason why a cost approach does not provide a very reliable determination of value is for this type of property during these years there was substantial functional obsolescence and substantial external obsolescence, which is difficult to accurately determine. Second, during this time period there is many big box stores available and a user and a purchaser of this property would not base it on . . . the cost new, would not base the purchase decision on the cost new. (TR, Vol 2, pp 22-23)

Mr. Allen stated further that "[a]s an appraiser it becomes pretty obvious when you look at sales, leases, research the market, find out what's going on, and buyers aren't buying based on replacement cost and aren't paying full replacement

cost for these buildings, which would indicate there's obsolescence." (TR, Vol 2, p 28)

SUMMARY OF RESPONDENT'S CASE

Respondent contends that the subject property is not assessed in excess of 50% of its true cash value. Respondent's contentions of TCV, SEV, and TV are as follows:

Parcel Number: 2202-005-002-10

| Year | TCV | SEV | TV |
|---|---|---|---|
| 2009 | $5,950,000 | $2,975,000 | $2,923,400 |
| 2010 | $5,450,000 | $2,725,000 | $2,725,000 |
| 2011 | $5,650,000 | $2,825,000 | $2,825,000 |

Respondent offered no exhibits in support of its value contentions.

Respondent presented testimony from its appraiser, Bruce Closser, MAI, CRE. Based on his experience and training, which includes expertise in ski resorts, the Tribunal accepted Mr. Closser as an expert in the area of real estate appraisal. Mr. Closser prepared and communicated an appraisal of the subject property. The appraisal, which Mr. Closser indicated is either the first or second appraisal of a big box property prepared by him (TR, Vol 3, p 33) sets forth a sales comparison, income, and cost analysis for each of the tax years at issue. All three approaches are developed on the foundation of a fee simple interest. Although his appraisal does not set forth a definition of the term as used therein, Mr. Closser testified that the fee simple interest is defined as absolute ownership,

unencumbered by any other interest. (TR, Vol 1-A, pp 86-87) A leased fee interest, on the other hand, is a landlord's interest in a property subject to lease. It is different than a fee simple interest and can indicate a significantly different value than a fee simple valuation of the exact same property. (TR, Vol 1-A, pp 100-101)

Mr. Closser concluded that the highest and best use of the property as improved to be continued use as a home improvement store. He explained:

> The site is currently improved with the Home Depot facility, which is a relatively modern store . . . similar to those being constructed today. It's sized appropriately to the community and the store manager reported that the store is doing well and . . . Home Depot has no plans to close it. The improvements closely resemble the ideal improvement, as discussed in the highest and best use as vacant, and therefore continued use of the property as a—of the building as constructed on the site as a big box home improvement store would be the highest and best use. (TR, Vol 2, pp 179-180)

Referencing page 49 of his appraisal report, Mr. Closser indicated that his highest and best use determination was not limited to use only by Home Depot. (TR, Vol 2, p 180) Notwithstanding this assertion, and his acknowledgement that the existing specific user is not relevant to a true cash value determination of the fee simple interest, Mr. Closser testified that his valuation of the subject property was directly affected by the fact that Home Depot was the user of the property. He explained: "Use value is value for a particular use. In this case, the use of the property is occupancy by Home Depot as a big box home improvement store. Continuation of the existing use is also its highest and best use, so in this case use value and market value are the same." (TR, Vol 3, p 149)

COST APPROACH

Mr. Closser testified that he developed the cost approach only “because assessors typically use [it] and I thought that it would be kind of expected to be seen in an appraisal. It’s not a necessary approach. It is . . . applicable and can be helpful but not a terribly strong approach in valuation of properties of this type.” (TR, Vol 2, p 218) In his cost analysis, Mr. Closser considered both replacement costs (i.e., the cost of constructing buildings of equal utility) and reproduction costs (i.e., the cost of constructing an exact replica). To estimate the replacement cost of the subject improvements, he consulted the cost schedules provided by the Marshall Valuation Service. More specifically, Mr. Closser utilized the schedules provided in section 13, page 28, which pertain to discount stores. He costed the property as a class C, average-to-low cost discount store. (TR, Vol 1-A, p 38; TR, Vol 2, p 220) He initially disputed categorizing the subject as a discount store, terming it instead a home improvement store. He subsequently then acknowledged the existence and appropriateness of a Marshall category for warehouse discount stores. (TR, Vol 1-A, pp 37-39) Mr. Closser testified that he believed his categorical selection to be proper:

> [T]he category for discount stores . . . says discount stores are typically large, open shells, with some partitioning for office and storage areas. Often called department stores, the best quality approaches low quality department store in cost. This category will also include the large off price center and furniture and home improvement type shell outlets. So clearly home improvement stores

> are included in the discount store category, and that's why I used that as the . . . source. (TR, Vol 2, p 220)

The noted cost schedules indicate a cost per square foot of $60.51 for the subject building improvements (inclusive of a 10% adjustment for entrepreneurial profit), which results in a building value of $5,747,397 for the 2009 tax year. Reproduction cost, which Mr. Closser acknowledged was erroneously referred to as a replacement cost in his appraisal (see TR, Vol 1-B, p. 43) was estimated utilizing the historical cost index provided by the Marshal Valuation Service. Mr. Closser adjusted the actual cost to construct the subject property (pursuant to an August 14, 2002, building permit) from the original date of construction to the December 31, 2008, valuation date. As with the replacement cost analysis, a 10% adjustment for entrepreneurial profit was added to the base cost, resulting in a total building value of $5,203,243. In support of his entrepreneurial profit considerations, Mr. Closser explained:

> Any . . . real estate enterprise that is constructed needs to have profit incentive, otherwise why would anyone bother? It takes time, effort, coordination to produce a commercial building. And whether it's build-to-suit or built for speculation, entrepreneurial profit needs to be included. And in fact it is referred to specifically on two . . . occasions in the 13th Edition of the Appraisal of Real Estate. . . . (TR, Vol 2, pp 220-221)

After completion of the initial calculations utilizing the replacement and reproduction cost methodologies, the two cost estimates were averaged for a final

concluded value of $5,475,000 for the 2009 tax year. Mr. Closser testified that he believed this technique reliable:

> [C]ertain types of . . . functional obsolescence are eliminated from the property if you use replacement cost. These would be functional obsolescence caused by super adequacy. . . . In the case of the subject property, the building that—as exists is very much like a building that would be built today. It was built with modern materials and techniques. It has no super adequate items of any significance, and, therefore, functionally the replacement costs and reproduction costs are equivalent. And so the average of those two sources, regardless of what they're called, is—is appropriate and basically the replacement cost estimate is measuring the cost of the same kind of building as the reproduction cost was. (TR, Vol 2, p 219 and TR, Vol 1-B, p 46)

Mr. Closser estimated the effective age of the subject building to be six years, the same as its actual age, and a depreciation rate of 20% was deemed appropriate based on the straight-line methodology and projected building life of approximately 30 years. Land value of $1,715,000[1] and a site improvement value of $438,833[2] were added to the depreciated cost of the building improvements. This resulted in an indicated value of $6,525,000 for the subject property for the 2009 tax year. Similar analyses were prepared for the 2010 and 2011 tax years and

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[1] To estimate the value of the subject land, Mr. Closser utilized the sales comparison approach. His analysis examines four sales of vacant land. The comparable sales data indicates differences in various elements of comparison, with the biggest factors being size and topography. After adjustments, Mr. Closser concluded to a market value of $2.20/square foot for the 2009 tax year.

[2] Site improvements include parking lots, drives and associate improvements, exterior lighting, utilities, and the septic system. The replacement cost new for the 2009 tax year was $600,742. Mr. Closser estimated the effective age of the site improvements at six years and calculated depreciation using the straight-line method and projected life of the improvements, which ranged from 20 to 30 years.

resulted in final true cash value indications of $5,600,000 and $5,800,000 for each, respectively.

SALES COMPARARISON APPROACH

Mr. Closser's income and sales comparison analyses utilize the same ten comparable properties, none of which were inspected by him personally. (TR, Vol 3, pp 33-40) Mr. Closser testified that in searching for comparables, he limited his search to occupied properties within the concluded market area. He explained:

> I'm not sure if it ever happens, big box stores being built for speculation, they're usually built for a particular user. And when they're closed it is usually because they . . . no longer suit the intended use for which they were . . . constructed. Consequently, there will be a change in highest and best use, and when that happens costs are incurred, as was pointed out, maybe have to be converted to multi-tenant use. Or sometimes, as Mr. Allen testified, they get torn down because they've reach the end of their economic life and they're sold essentially for land value less the demolition cost. So we . . . have an occupied store for which there appears to be no reasonable expectation that it would be closed, and so we looked for sales of occupied stores, realizing that Home Depot if it wanted to sell the store would not be required to vacate the store in order to sell it. They could sell it and continue their occupancy. . . . It could be sold to an investor, who would lease the store to the . . . owner-occupant. That investor could sell the store to another investor. There is an active market in these properties. TR, Vol 2, pp 182-184.

Mr. Closser testified that he began his search by defining the primary market area, which ultimately included the Upper Peninsula of Michigan, northern lower Michigan, and Wisconsin. (TR, Vol 3, p 127) He indicated that southeast Michigan was specifically excluded:

> We specifically excluded southeast Michigan in our market because of the extreme distress that had been suffered in that market. . . . In addition to that, it was far from the subject property. However, had it been a market that was relatively normal compared to other commercial real estate markets in the United States and had there been sales of occupied big box stores in that market, we . . . might have used them so we would have considered them. (TR, Vol 3, p 128)

Mr. Closser testified that all of his comparables were leased properties "because sales of occupied . . . big box stores for continued occupancy are always leased." (TR, Vol 2, p 186) He acknowledged that most such transactions constitute leased fee sales, but indicated that "as long as the lease terms are representative of the market, a leased fee sale is . . . evidence of the value of the fee simple." (TR, Vol 2, p 186 and TR, Vol 1-A, p 126) When questioned about the reliability of these comparables, Mr. Closser testified that

> the . . . best information we had on these, which admittedly was not as much as I would have liked to have, indicated that these were . . . legitimate sales. And the fact that the sales prices . . . fit in with the rest of the data . . . gave us confidence that these . . . were . . . legitimate sale transactions. (TR, Vol, 2 p 190)

With respect to the reliability of such transactions in general, Mr. Closser indicated that he was advised by several real estate professionals "to use sale leasebacks with caution. [They] said if they're not structured at market rents they can be in trouble with the IRS. . . . However,] if they're a major publicly traded corporation, they're probably alright, but . . . use them with caution." He further states:

> [A]n accountant . . . told me that the problem with sale leasebacks is the IRS could reclassify them based on the facts as a financing

> transaction rather than a real estate transaction. And he said that is not what most of these participants desire. He said if you're structuring these you need to be careful that the buyer and seller are not related, that you're getting at least a market rate of return, that a lease term over thirty years is likely to be treated as an exchange rather than as a lease, that IRS regulations would tend to push these parties toward market terms and that the transaction needs to be arm's length between the parties. It needs to be a normal . . . business motivation that is not a tax motivation for the transaction, and that . . . rents and . . . prices are at market levels. And is the buyer . . . normally in the lending or leasing business? Does this look like a lending transaction? So he said the IRS considers these transactions on their merits and makes a judgment. And so he said because of this terms tend to be driven toward market terms. (TR, Vol 2, pp 192-194)

Write-ups and photographs of each of Respondent's comparables are included in the admitted appraisal report. A summary of the properties is as follows:

| Sale/ Lease | RET 28 | RET 29 | RET 30 | RET 31 | RET 35 | RET 40 | RET 49 | RET 50 | RET 55 | RET 57 |
|---|---|---|---|---|---|---|---|---|---|---|
| Location | Marquette MI | Onalaska WI | Onalaska WI | Ashland WI | Eau Claire WI | Gainesville GA | Neenah WI | Houghton MI | Ft. Wayne In | Hudson WI |
| Date of Sale | May 2006 | Dec 2010 | Oct 2010 | Oct 2008 | Dec 2009 | Sep 2010 | May 2006 | May 2006 | Jan 2006 | Jan 2011 |
| SP/SF | $64.84 | $83.91 | $49.57 | $72.94 | $65.65 | $58.09 | $79.60 | $62.88 | $74.59 | $46.25 |
| Rent/SF (All Years) | N/A | $6.51 | $5.50 | $4.92 | N/A | $5.36 | N/A | N/A | $6.91 | $4.34 |
| Year Built | 1969<br>1972<br>1988 | 1992 | 1993 | 1992 | 1994 | 1994 | 1990<br>2003 | 1994 | 1994 | 1990<br>2003 |
| Building Area (SF) | 124,761 | 86,398 | 134,900 | 72,113 | 76,164 | 123,948 | 94,225 | 73,956 | 109,800 | 86,479 |
| Land Area (Acre) | 10.28 | 6.26 | 11.40 | 16.40 | 6.24 | 12.96 | UNK | UNK | 13.00 | 8.46 |
| Adj SP/SF<br>(2009)<br>(2010)<br>(2011) | <br>$64.84<br>$55.12<br>$60.30 | <br><br><br>$71.33 | <br><br><br>$57.01 | <br>$62.00<br>$52.70<br>$57.66 | <br><br>$55.80<br>$60.26 | <br><br><br>$58.09 | <br>$63.68<br>$54.13<br>$59.22 | <br>$62.88<br>$53.44<br>$58.47 | <br>$59.67<br>$50.72<br>$55.50 | <br><br><br>$57.82 |
| Adj Rent/SF (All Years) | N/A | $5.53 | $5.50 | $4.92 | N/A | $5.36 | N/A | N/A | $5.53 | $5.43 |

Mr. Closser's sales comparison analysis examines five sales of build-to-suit properties for the 2009 tax year, six sales for the 2010 tax year, and ten sales for the 2011 tax year. Mr. Closser acknowledged that two deeds were recorded on the same day for RET-55, which was utilized in his analysis for all three years, one for the amount utilized by him in his report, and one for approximately half that amount. TR, Vol 3, pp 91-92. Admittedly, he could not explain the transactions. TR, Vol 3, p 92. The comparable sales data indicates differences in various elements of comparison for all three years, with the biggest factors being market conditions, condition of sale, and location for each. With respect to the latter, Mr. Closser testified that land value was a primary factor in determining appropriate adjustments. (TR, Vol 1-B, p 21) He indicated that his adjustments were derived from *Dollars and Cents of Shopping Centers* for 2008, and that he used the median rent per square foot GLA by space type and population density US open pair discount department stores. (TR, Vol 1-B, p 22) In further explanation, Mr. Closser stated:

> We looked at whether they were urban or rural, because that seemed to be the differentiating factor in location. . . . I had erroneously calculated the adjustments, assuming that all of the . . . properties . . . were discount stores, whereas . . . they were a mixture of different types of stores. However, I still think the adjustment is appropriate. When you look at the data, there is not a dramatic difference between the few properties—I think there were only two of them here—that were located in urban areas. And I classified an urban area as . . . any community with a population over 40,000. . . . Or if it was a suburb of a major city, I included that as . . . an urban area regardless of its population. . . . So I think the 20% adjustment is . . . appropriate and

> seems to address . . . the differences that we see between the urban and rural properties. . . . (TR, Vol 2, p 200)

Mr. Closser testified that he did not consider visibility, access, traffic counts, or population density in determining his location adjustments, though the latter is inherent in an urban/rural area comparison. (TR, Vol 3, pp 41-42, 153) He did acknowledge that there is not enough population to support more than one home improvement store within fifty miles of the subject property. (TR, Vol 3, p 74)

Mr. Closser indicated that his market conditions adjustments were based on the difference in the market for big box stores. On the other hand, Mr. Allen's adjustments were based on the comparables' locations (primarily southeast Michigan). (TR, Vol 3, pp 130-131). He explained: "The market is a national market. Investors are looking at properties all over the country. These are net leased properties and I made this adjustment based on that market." (TR, Vol 3, p 15) Further in that regard, Mr. Closser stated that an adjustment for a big box store in Fort Wayne Indiana, is going to be the same as the Upper Peninsula because they are in the same market. (TR, Vol 3, p 15) Mr. Closser did not take into account or adjust for the difference between the subject's septic system and the municipal sewer systems of the comparables. (TR, Vol 3, pp 41-42)

More generally, Mr. Closser testified that his method for calculating transaction adjustments achieved the same result as that utilized by Mr. Allen.

(TR, Vol 2, p 195). With respect to property adjustments, however, he indicated as follows:

> I use additive percentage adjustments for property . . . and economic adjustments. This is what . . . the Appraisal Institute text recommends, and I don't believe it's an issue that has to do with residential versus commercial properties. The problem with using factors for . . . non-transactional adjustments is that it makes each adjustment dependent on . . . the other adjustments. It doesn't make any difference what order you do them, but . . . [d]epending on how big the other adjustments are, it would be affected. (TR, Vol 2, p 196)

After analyzing the comparable sales and adjusting for difference in amenities, Mr. Closser concluded to final true cash value indications for the subject property as follows: $5,890,000 as of December 31, 2008, $5,030,000 as of December 31, 2009, and $5,600,000 as of December 31, 2010.

INCOME APPROACH

Mr. Closser's income approach is based on a direct capitalization methodology. On the applicability of this approach, Mr. Closser acknowledged that the subject property has been owner-occupied since its original date of construction. (TR, Vol 1-A, pp 57-58) Nonetheless, Mr. Closser argues:

> [The subject] is a property that is suitable for leasing and could be . . . an income-producing property. It is also actually producing income, although that typically isn't recognized as such. But . . . a commercial property that's housed in real estate, part of the income that's generated by the enterprise going on the property is attributable to the real estate. The real estate has to contribute something to the income, although generally owner-occupants do not recognize this, but it's there nonetheless. (TR, Vol 2, pp 204-205)

A comparable survey of six big box leases[3] were analyzed and adjusted for varying attributes, including location and interior finish. None of the comparable rentals represent existing buildings when leases were signed; rather, all were build-to-suit leases. (TR, Vol 1-B, p 35) The comparables indicate an unadjusted range in lease rates of $4.34/SF to $6.91/SF and an adjusted range of $4.92/SF to $5.53/SF. After adjustments, Mr. Closser concluded to a market rent of $5.45/SF for all three relevant valuation dates, which resulted in a net operating income of $517,663 for the subject property. With respect to the reliability of the selected leases and indicated values, Mr. Closser testified:

> [I]t was pointed out that these are based on . . . older leases. . . . But I think that in spite of that they are still relevant. In . . . Mr. Allen's report . . . he had a table which contained eight relatively current big box build-to-suit leases. If I look at those . . . I find that seven out of the eight properties . . . would fulfill my criteria . . . [and] have an average lease rate of $6.94/SF annually. If we consider that these are urban locations and that I adjusted . . . urban locations downward by 20% . . . we get $5.55/SF. My conclusion is $5.45/SF. It's very close. (TR, Vol 2, p 208; TR, Vol 1-A, p 113, and TR, Vol 3, p 149)

Vacancy and collection loss allowances were estimated at 1% for the 2009 tax year and 2% for the 2010 and 2011 tax years. These estimates were based upon Home Depot remaining as the occupant tenant if the property were sold. (TR, Vol 1-B, p 37). Mr. Closser explained:

> I chose 1% because it needed to be something but it didn't need to be very much. . . . T]he assumption here is that this is a triple net leased property . . . and typically these are to high credit tenants. Home

[3] RET-29, RET-30, RET-31, RET-40, RET-55 and RET-57.

> Depot certainly fulfills these requirements, as most big box store operators do. There's very little likelihood that the store will close, and even if it did, Home Depot would still stand behind the lease and continue to make lease payments. So the amount of risk to the investor in a situation like this of vacancy and collection loss is minimal. (TR, Vol 2, p 211)

The estimate increased by 1% for the latter two tax years "[b]ecause the effects of the recession increased risk slightly." (TR, Vol 2, p 212) These allowances were deducted along with the concluded operating expenses, which included only a 2% management fee for each year. No reserves or common area maintenance expenses were considered.

> [B]ecause these are triple net leases, the maintenance of the building, including replacement of building components, is generally the responsibility of the tenant to do. . . . [I]f Home Depot were to lease this property to . . . an investor, the likelihood is that they would continue on maintaining the property just as they do now. The only difference is they have sold the property and [will] be paying rent instead. . . . [Similarly,] [a] tenant w[ould] be [responsible for] paying [common area maintenance] expenses directly rather than . . . the landlord paying the expenses and receiving reimbursement from the tenant. (TR, Vol 2, pp 212-213)

Mr. Closser considered capitalization rates from national investment surveys as well as the same six sales that were used to develop an opinion of the market rent for the subject property. None of the surveyed cap rates were for single occupant retail stores. (TR, Vol 3, pp 117-118) He concluded to overall capitalization rates of 8.25%, 8.95%, and 8.75% for the three years under appeal, respectively. In further explanation,

> Derivation of the median capitalization rate was not really an error in calculation, it was a typographical error. Because the correct number is in the text. . . . So we actually did use the correct numbers, but that is a misprint on that table and should have been corrected. (TR, Vol 2, p 214)

After capitalization, Mr. Closser concluded to true cash value indications for the subject property as follows: $5,740,000 as of December 31, 2008, $5,525,000 as of December 31, 2009, and $5,575,000 as of December 31, 2010.

RECONCILIATION

In reconciling the value of the subject property, Mr. Closser placed primary reliance on the income approach. He explained:

> It was my opinion that the typical buyer of this property, the most likely buyer with continued occupancy, continued use of the subject property, was an investor who would buy this property with the intention of leasing it to the . . . existing operator. If Home Depot wanted to sell this property, they would have no difficulty doing that. There would be investors available. There's a ready market in these types of properties to be purchased and then leased back to the . . . owner. And that seems to me to be the most likely purchaser of the property that would maintain its highest and best use. (TR, Vol 2, pp 205-206)

The sales comparison and cost approaches were given equal weight, though Mr. Closser testified that if he were to do the appraisal over again, he might give less weight to the cost approach. The weight given to this approach resulted in a higher valuation than if he hadn't relied on it. (TR, Vol 3, pp 84-85)

FINDINGS OF FACT

1. The subject property is located at West 8141 US Highway 2, Breitung Township, Dickinson County, Michigan.

2. Dickinson County is located in the southwesterly portion of Michigan's Upper Peninsula at the Wisconsin border. Highway US-2 merges with US-141 at Iron Mountain from Wisconsin. M-69 connects the middle part of the county to M-95 traveling north/south.

3. The County had a population of 26,168 in 2010, down from 27,472 in 2000. In 2010, the unemployment rate was at 11.7%. Dickinson County's economy is based primarily on the harvesting and processing of forest resources, manufacturing operations, and tourism.

4. The subject property is identified as Parcel No. 2202-005-002-10 and commonly known as The Home Depot.

5. The subject parcel is irregularly shaped and has a total land area of 17.69 acres. It is located on the south side of US-2, and east of downtown Iron Mountain.

6. The subject parcel has only 60 feet of frontage along US-2. A 60' x 250' access drive is part of the site and leads from the highway into the main part of the property at its northeastern corner. This access is shared with neighboring parcels via an easement agreement. Because the property's primary frontage is located behind developed outlot parcels along US-2, the subject site has obstructed visibility from the primary commercial road.

7. The property is improved with a freestanding, commercial building originally constructed in 2003 for The Home Depot.

8. The subject building is a modern, single story, big box retail structure. More specifically, it is a class C warehouse discount store. It is rectangular in shape and has a total gross area of 94,984 square feet.

9. The subject property is owner-occupied. It is not an income-producing property and has no history of an income stream.

10. The subject property is classified as 201-commercial and zoned C-2, commercial/light industrial. The highest and best use of the property as improved is as a commercial warehouse retail store.

11. Both parties develop and communicate valuation disclosures in the form of appraisal reports. Petitioner conveys a summary appraisal report. Respondent conveys a self-contained appraisal report.

12. Both parties' appraisal reports are predicated on the concept of fee simple interest.

13. Petitioner values the subject as vacant and available for use.

14. Petitioner considered the existing use of the subject property through the highest and best use analysis. This consideration is also demonstrated in the comparable listing data, comparable lease data, comparable build-to-suit lease data, and re-lease study data.

15. Respondent values the subject as a single occupant use property. Specifically, Respondent values the subject as a Home Depot Store and the user of the property. (TR, Vol 3, p 114) Respondent's opinions of value equate to the use value for the subject property as a Home Depot Store (TR, Vol 3, p 152)

16. Petitioner's appraiser analyzes sales and rental data of fee simple properties.

17. Respondent's appraiser analyzes sales and rental data of sale-leaseback and leased fee properties. The data search was limited to occupied properties only.

18. Petitioner's sales comparison analysis includes 16 comparable listings. The listings indicate price per square foot ranges as follows: $36.27/SF to $57.65/SF in 2008, $13.20/SF to $49.75/SF in 2009, and $10.92/SF to $49.75/SF in 2010. Additionally, Comparable Listing 4 sold in June 2010 for $2.10/SF, Comparable Listing 5 sold in April 2011 for $14.87/SF, and Comparable Listing 7 sold in March 2012 for $19.42/SF.

19. In developing his sales comparison analyses, Petitioner's appraiser also provided summary information for 9 comparable listings and sales located in Minnesota and Wisconsin. The listing price range is $15.00/SF to $49.07/SF, while the sales provide a range of $8.62/SF to $22.63/SF.

20. Petitioner's summary appraisal report carries more data/analysis than Respondent's self-contained appraisal report.

21. Respondent's expert, Mr. Closser, is not aware of any discount store built and thereafter leased or sold. (TR, Vol 1-A, p 83)

22. Mr. Closser limits his data search solely to occupied properties. (TR, Vol 2, 182)

23. Mr. Closser admits that true cash value determination is based on property unencumbered by a lease; a lease is another interest in a property which is not fee simple. (TR, Vol 1-A, p 100)

24. Mr. Closser admits a specific user is not relevant to the true cash value of a fee simple interest. (TR, Vol 1-A, p 105)

25. Mr. Closser admits the subject property may be the first big box store that he has appraised. He admits that his expertise is in ski resort valuation. (TR, Vol 3, pp 31-32)

## APPLICABLE LAW

Pursuant to Section 3 of Article IX of the State Constitution, the assessment of real property in Michigan must not exceed 50 % of its true cash value. The Michigan Legislature defined "true cash value" as "the usual selling price at the place where the property to which the term is applied is at the time of assessment, being the price which could be obtained for the property at private sale, and not at forced or auction sale." See MCL 211.27(1). The Michigan Supreme Court, in *CAF Investment Co v State Tax Commission*, 392 Mich 442, 450; 221 NW2d 588 (1974), held that "true cash value" is synonymous with "fair market value."

The Tribunal is charged with finding a property's true cash value to determine the property's lawful assessment. *Alhi Development Co v Orion Twp*, 110, Mich App 764, 767; 314 NW2d 479 (1981). The determination of the lawful assessment will, in turn, facilitate the calculation of the property's taxable value as provided by MCL 211.27a. True cash value is properly determined using one of three widely accepted appraisal methods: cost less depreciation, sales comparison, and capitalization of income. See *Meadowlanes Limited Dividend Housing Ass'n v City of Holland*, 437 Mich 473, 484-485; 473 NW2d 636 (1991); *Antisdale v City of Galesburg*, 420 Mich 265, at 276-277; 362 NW2d 632 (1984). Fundamental to the determination of a property's true cash value is the concept of "highest and best use." It recognizes that the use to which a prospective buyer would put the property will influence the price which the buyer would be willing to pay. *Rose Bldg Co v Independence Twp*, 436 Mich 620, 623; 426 NW2d 325 (1990).

A proceeding before the Tax Tribunal is original, independent, and de novo. MCL 205.735(1). The Tribunal's factual findings must be supported by competent, material, and substantial evidence. *Antisdale v City of Galesburg*, 420 Mich 265, 277; 362 NW2d 632 (1984); *Dow Chemical Co v Department of Treasury*, 185 Mich App 458, 462-463; 452 NW2d 765 (1990). Substantial evidence must be more than a scintilla of evidence, although it may be substantially less than a preponderance of the evidence. *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 352-353; 483 NW2d 416 (1992).

MCL 205.737 provides that "[t]he petitioner has the burden of proof in establishing the property's true cash value." The Michigan Court of Appeals has held that "[t]his burden encompasses two separate concepts: (1) the burden of persuasion, which does not shift during the course of the hearing, and (2) the burden of going forward with the evidence, which may shift to the opposing party." *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 355-356; 483 NW2d 416 (1992). Nonetheless, the Tribunal *must* make an independent determination of true cash value. *Id* at 355. The Tribunal is also obligated to select the valuation methodology that is accurate and bears a reasonable relation to the property's true cash value. *Safran Printing Co v Detroit*, 88 Mich App 376; 276 NW2d 602 (1979), *lv den* 411 Mich 880 (1981). The Tribunal is not, however, "bound to accept either of the parties' theories of valuation. It may accept one theory and reject the other, it may reject both theories, or . . . utilize a combination of both in arriving at its determination." *Jones, supra* at 356. Regardless of the valuation approach employed, the final valuation determined must represent the usual price for which the subject property would sell. *Meadowlanes Ltd Dividend Housing Ass'n v City of Holland*, 437 Mich 473; 473 NW2d 636 (1991).

CONCLUSIONS OF LAW

Respondent objected to Mr. Allen being qualified as and testifying as an expert witness in this case and moved for the exclusion of his valuation opinion pursuant to MRE 702.[4] Respondent argued:

> [T]his witness's expected testimony, based on the appraisal submitted as Petitioner's valuation disclosure, is not based on sufficient facts or data and is not the product of reliable principles and methods. He's expected to offer . . . testimony based on a fundamentally flawed methodology that is directly contrary to controlling law which requires that true cash value be based on consideration of the property's existing use and present income of land and structures. (TR, Vol 1-B, p 60)

The Tribunal, noting its prior Order of September 26, 2012, denying both Respondent's Motion to Strike and Motion to Preclude, overruled Respondent's objection and, based on his experience and training, which includes expertise in big box stores, accepted Mr. Allen as an expert in the valuation of real property. (TR, Vol A-2, p 83) Respondent's Motions requested that the Tribunal (i) strike Petitioner's valuation disclosure and (ii) preclude Petitioner from offering "any other unlawful appraisal evidence or methodologies that . . . [Petitioner] may attempt to present at the trial or hearing of this case." Despite the untimeliness[5] of

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[4]MRE 702 provides: "If the court determines that scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise if (1) the testimony is based on sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case."

[5] The motions were filed on September 17, 2012, and as such did not provide sufficient time to permit Peitioner to respond prior to the commencement of the September 28, 2012, hearing.

its Motions, the Tribunal found that Respondent was, in essence, asking the Tribunal to "rubber stamp" the assessments at issue, which is contrary to the Michigan Court of Appeals unpublished decision in *Charter Oak Homes v City of Detroit*, COA Docket No. 297509 (October 6, 2011). Rather, the Tribunal is required to render an independent determination of a property's true cash and taxable values under MCL 205.737. See also *Jones & Laughlin Steel Corporation v City of Warren*, 193 Mich App 348; 483 NW2d 416 (1992). Further,

> The determination of when [expert] testimony is admissible lies within the discretion of the trial court and will vary according to the area at issue and the particular facts of the case. Generally, the testimony must assist the [trier] in understanding the evidence or the factual issues, and the witness must have sufficient qualifications 'as to make it appear that his opinion or inference will probably aid the trier in the search for truth.' *People v Smith*, 425 Mich 98, 106; 387 NW2d 814 (1986), quoting McCormick, Evidence (3d ed), § 13, p 33.

The Court in *Smith* also noted that in accordance with MRE 704 "expert opinion testimony will not be excluded simply because it concerns the ultimate issue: 'Testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact.'" *Id.* Here, there is no question that Petitioner's appraiser is qualified by education, experience, training, skill, and knowledge to perform an appraisal of a commercial property like the subject. (TR, Vol A-2, pp 54-60). The only issue is whether the testimony and supporting documentary evidence provided is the most reliable indicator of the subject property's true cash value for the tax years at issue

in this appeal. More importantly, however, for the reasons set forth below, the Tribunal is satisfied that Mr. Allen's valuation is not only based on sufficient facts and data, but also is the product of reliable principles and methodologies, which were reliably applied to the specific facts of this case in accordance with MRE 702.

Respondent contends that "[a] very long line of decisions by our Supreme Court and the Court of Appeals have consistently rejected [Petitioner's] argument that the existing uses of the land must be ignored (or deeply discounted) in determining the property's true cash value." [6] In support of this contention, Respondent first notes the Court of Appeals decision in *Southfield Western, Inc v Southfield*, 146 Mich App 585; 382 NW2d 187 (1985), wherein the Court recognized that "[i]n assessing the true cash value of a parcel of property, an assessor is to consider the existing use of the land, the income generated by any structures on the land and income generated by any other income-producing use." *Id.* at 589. Neither Petitioner nor the Tribunal disputes that such considerations are proper, however. In that regard, MCL 211.27(1) states, in pertinent part, as follows:

> In determining the true cash value, the assessor shall also consider the advantages and disadvantages of location; quality of soil; zoning; existing use; present economic income of structures, including farm structures; present economic income of land if the land is being farmed or otherwise put to income producing use; quantity and value of standing timber; water power and privileges; and mines, minerals,

[6] Respondent's Motion to Strike, p 5.

> quarries, or other valuable deposits known to be available in the land and their value.

Contrary to Respondent's assertions, Petitioner's appraiser did in fact consider the existing use of the subject property, as evidenced by his highest and best use analysis. Further, consideration of other potential uses is not precluded. See *Kern v Pontiac Twp,* 93 Mich App 621, 287 NW2d 603 (1979), and *Safran Printing Co v Detroit*, 88 Mich App 376; 276 NW2d 602 (1979), *lv den* 411 Mich 880 (1981), wherein the Michigan Court of Appeals held that the Tribunal erred in attributing great weight and substantial value to the property's current, existing use "where such use b[ore] no relationship to what a likely buyer would pay for the property." *Id.* at 382. The Court explained:

> The fair market value of real property, unlike stocks traded on a national exchange, is often difficult to determine. It is for this reason the Legislature set forth a list of factors to be considered, such as location, zoning, existing use, etc. . . . It is these factors that are to be used as guidelines in an attempt to determine the fair market value of a piece of property. . . . Normally, existing use may be indicative of the use to which a potential buyer would put the property and is, therefore, relevant to the fair market value of the property. However, in this case it is undisputed that the property is obsolete, inefficient, and could not be sold as a printing plant. Only the prohibitive cost prevents Safran from relocating. *Id.*

As noted by the Court of Appeals in *Clark Equipment Company v Township of Leoni*, 113 Mich App 778; 318 NW2d 586 (1982), another case relied upon by Respondent to support its position in this case,

> [t]he *Safran* holding is easily summarized as follows: a particular property cannot be valued by reference to its current use where all

> evidence shows that, due to the property's inefficiency and obsolescence, no buyer would consider purchasing the property with the purpose of utilizing it in conformity with its present use. *Id.* at 782.

Unlike *Safran*, however, and unlike the instant appeal, "all the appraisers in [the *Clark* case] agreed that the subject property's current use is also its highest and best use." *Id.* at 782. In light of that fact, the Court held that "to the extent a large industrial facility is suited for its current use and would be considered for purchase by a hypothetical buyer who wanted to own an industrial facility which could operate in accordance with the subject property's capabilities, said facility must be valued as if there were such a potential buyer, even if, in fact, no such buyer (and therefore no such market) actually exists." *Id.* at 785. The Court reasoned:

> To construe MCL 211.27 . . . as requiring the taxing unit to prove an *actual* market for a property's existing use would lead to absurd undervaluations. Large industrial plants are constructed to order, in accordance with the exact specifications of the purchasing user. . . . When a large corporate entity…builds a factory, it is probable that absolutely no market exists for the resale of that factory consistent with its current use. It is ludicrous to conclude, however, that such a brand new, modern, industrial facility is worth significantly less than represented by its replacement cost premised on value in use because, in actuality, such industrial facilities are rarely bought and sold. . . . This is in accordance with *First Federal Savings [& Loan Ass'n v Flint*, 104 Mich App 609; 305 NW2d 553 (1981)]. *Id.*

Petitioner correctly notes that the referenced *First Federal* decision was subsequently reversed by the Michigan Supreme Court in *First Federal Savings & Loan Ass'n v Flint*, 415 Mich 702; 329 NW2d 755 (1982). The High Court

recognized in that case that "[w]hile actual and reproduction cost are some evidence of value, the constitutional and statutory standard is market-based." *Id.* at 705. Accordingly, it determined that the Tribunal erred in concluding that

> the value should include amounts expended for physical improvements that . . . were made to enhance the bank's 'image' or 'business,' without regard to whether the expenditures added to the 'cash' or 'usual selling price' of the property. The law does not tax expenditures that merely enhance the image or business of the owner, only expenditures that add to the cash value or selling price of the property. *Id.*

On a point of clarification, the Court stated:

> We do not hold that the income approach advocated by First Federal's appraiser should govern, nor do we fault the city's appraiser or the Tax Tribunal for *considering* historical cost. Rather, we reject the notion that it is proper to include, in determining value, expenditures made, as the Tax Tribunal found, to enhance plaintiff's image and business without regard to whether they add to the selling price of the building. *Id.* at 706 (Emphasis in original.)

Although the Tribunal finds that the Supreme Court's holding in *First Federal* did not impact the validity of the Court of Appeals *Clark* decision as Petitioner contends, Respondent's reliance on the latter is nonetheless misplaced. More specifically, the industrial facility at issue in *Clark* was concluded to be well suited for its existing use and "would be considered for purchase by a hypothetical buyer who wanted to own an industrial facility *which could operate in accordance with the subject property's capabilities*." *Clark, supra* at 785 (Emphasis added). Here, Petitioner's appraiser successfully established that there is a market for built-to-suit properties like the subject. When such properties are sold to second-

generation purchasers, however, considerable modification (or even demolition) of the existing improvements is generally required. The result is a type of functional obsolescence that must be considered in a determination of true cash value in accordance with the Court of Appeals decision in *Meijer, Inc v City of Midland*, 240 Mich App 1; 610 NW2d 242 (2000). The *Meijer* court defined "functional obsolescence" as follows:

> [A] loss in value brought about by failure or inability of the assessed property to provide full utility. *Teledyne Continental Motors v Muskegon Twp*, 145 Mich App 749, 755; 378 NW2d 590 (1985), citing *The Appraisal of Real Estate* (8th ed), p 449. It includes any loss of value by reason of shortcomings or undesirable features within the property itself. *Id*. "Functional obsolescence can be caused by internal property characteristics, such as poor floor plan, inadequate mechanical output, or functional inadequacy or superadequacy due to size or other characteristics." *Id.*

Noting the Supreme Court's holding in *First Federal Savings & Loan Ass'n v City of Flint,* 415 Mich 702, 705, 329 NW2d 755 (1982), the Court of Appeals reasoned that

> [i]f a buyer could build an equivalent building for an amount equal to the replacement cost, that buyer would not buy a building needing substantial modification unless the selling price were lower than or equal to the replacement cost less the cost to modify the property. . . . Once the Tax Tribunal found that a typical buyer in the market place would incur considerable modification costs, it was not free to wholly reject petitioner's claim for functional obsolescence. *Meijer, supra* at 7-8.

The Tribunal also finds no merit in Respondent's reliance on *Palace Sports & Entertainment v Auburn Hills*, an unpublished opinion per curiam of the Court

of Appeals, issued June 21, 2012 (Docket Nos. 294051 and 294185). In that case, the Court held:

> Additionally, MCL 211.27(1) directs an assessor to 'consider the . . . present economic income of structures . . . [and] present economic income of land if the land is being . . . put to income producing use. . . .' Because the Palace's income as of December 31, 2002, derived in significant measure from the Detroit Piston's lease of the arena, the Tax Tribunal properly took into account the Piston's residency at the Palace for 'present economic income' purposes as well.
>
> MCL 211.27(4) defines "present economic income as follows:
>
> [F]or leased or rented property the ordinary, general, and usual economic return realized from the lease or rental of property negotiated under current, contemporary conditions between parties equally knowledgeable and familiar with real estate values. The actual income generated by the lease or rental of property is not the controlling indicator of its true cash value in all cases.

In the instant appeal, the subject property is not leased or rented, but is in fact owner-occupied. As such, there is no present economic income to be considered.

The remainder of the cases cited by Respondent, including *Meadowlanes Ltd Dividend Housing Assoc v Holland*, 437 Mich 473, 486; 473 NW 2d 636 (1991), do not speak to the substantive issues present in the instant appeal, but rather appear to have been provided in an attempt to diminish the credibility of Petitioner's valuation expert. Mr. Allen's involvement in prior cases, particularly ones involving different types of properties and varying approaches to valuation, are irrelevant to the reliability of his valuation of the subject property.

The parties' experts were charged with developing and communicating valuations of the subject property to assist the Tribunal in a determination of its lawful true cash, assessed, and taxable values for each of the tax years at issue in this appeal. All three approaches to value were considered by each party. Petitioner's appraiser, Mr. Allen, developed only the sales comparison and income approaches. Mr. Allen relies primarily on the sales comparison approach to support Petitioner's specified contentions of value. Respondent's appraiser, Mr. Closser, determined the income capitalization approach to be the most relevant and reliable indicator of value.

Having considered all of the testimonial and documentary evidence provided, the Tribunal concludes that Petitioner was able to explain and provide documentation for the sales comparison approach. Mr. Allen provided extensive listings and sales of big box stores throughout the Midwest (Michigan, Wisconsin, and Minnesota). Respondent contends that Petitioner's use of data in southeast Michigan is inappropriate and overlooks all other comparable data. To the contrary, Petitioner gave extensive consideration to listings and sales in Minnesota and Wisconsin. Petitioner's summary data is more elaborative than Respondent's data in an unrealistic self-contained presentation. The overall data illustrated to the Tribunal the decline in asking prices over a three-year period. The comparable data was analyzed in conjunction with supported market conditions. Mr. Allen's application of available data to the subject property is logical and persuasive.

Therefore, Petitioner's sales comparison approach is meaningful to the final conclusions of value.

Petitioner's comparison analysis and adjustments reflect market actions; however, Petitioner's reconciliation of the adjusted sale prices for the three years under appeal is incomplete. The reconciliation of approaches is similar to the reconciliation of sales data. Reconciliation is an appraiser's opportunity to fill in gaps, and to prove overall logic and reasoning for the value conclusions. In this instance, Petitioner's data, even after adjustments, indicates a given range in adjusted sales prices. "Even when adjustments are supported by comparable data, the adjustment process and the values indicated reflect human judgment." Appraisal Institute, *The Appraisal of Real Estate,* (Chicago: 13th ed, 2008), p 313. The strengths and weaknesses of each comparable sale are examined for reliability and appropriateness. Petitioner's adjustments for all three years are the same, except for the location and market conditions. Petitioner has provided sufficient support for the market conditions adjustment; nonetheless, certain sales are more germane for each year under appeal. The sales comparison approach for each year is reconciled with the similarities and dissimilarities of each comparable sale. The Tribunal accepts Petitioner's sales comparisons, but disagrees with the reasoning for the concluded prices per square foot.

In regards to the 2009 valuation, Petitioner's sale 2 is the oldest sale occurring in 2004; this sale is less reliable. Sale 7 is relatively similar in market

conditions and age/condition. Sale 3 has the largest total adjustments and is given less weight in the final conclusion. Sale 5 has the least amount of adjustments in the overall analysis. Sales 4 and 5 are relatively similar in location to the subject. While Sales 5 and 7 help to bracket the relevant time period, they sold after December 31, 2008, and are slightly less applicable to the 2009 value. Therefore, a reasoned and reconciled price per square foot for the 2009 valuation is $30, calculated as a value of $2,849,520.

In regards to the 2010 valuation, Petitioner's sale 2 is the oldest sale occurring in 2004; this sale is less reliable. Sale 5 is the most similar in market conditions and sale 7 is relatively similar in market conditions. Sale 3 has the largest total adjustments and is given less weight in the final conclusion. Sale 5 has the least amount of adjustments in the overall analysis. Sales 4 and 5 are similar in location to the subject. Sales 5 and 7 are the closest to the relevant tax day and applicable to the 2010 value. Therefore, a reasoned and reconciled price per square foot for the 2010 valuation is $28, calculated as a value of $2,659,552.

In regards to the 2011 valuation, Petitioner's sale 2 is the oldest sale occurring in 2004; this sale is less reliable. Sales 5 and 7 are the most similar in market conditions. Sale 3 has the largest total adjustments and is given less weight in the final conclusion. Sale 5 has the least amount of adjustments in the overall analysis. Sales 4 and 5 are similar in location to the subject. Sales 5 and 7 are the closest to the relevant tax day and applicable to the 2011 value. Therefore, a

reasoned and reconciled price per square foot for the 2011 valuation is $25, calculated as a value of $2,374,600.

Petitioner developed and communicated an income approach to derive an indication of value. Petitioner's appraiser sets forth all of the customary elements of this approach. The Tribunal, however, finds the conclusion of market rents slightly baffling. Mr. Allen's report concludes to two different sets of rents per square foot. Rents of $4.25, $4.00, and $3.75 are shown for each year under appeal. (Petitioner's Exhibit, P-1, p 69) Within the same exhibit on page 71, Mr. Allen denotes rental rates of $4.50, $4.25, and $4.00 for the income analysis. Nonetheless, the Tribunal is not compelled to place any weight on this approach to value. Petitioner's primary indication of value rests on the sales comparison approach.

Respondent's valuation expert develops the sales comparison approach to value. As part of his analysis, Mr. Closser analyzes ten comparable sales in a grid format. All ten sales occurred between January, 2006, and June, 2011. All of the data were leased fee sales except for the three Shopko sale-leaseback transactions. These sale-leaseback transactions involved 178 total properties in 13 states. (TR, Vol 2, p 189, TR, Vol 3, pp 90-91, and TR, Vol 1-A, pp 126-127) Mr. Closser's data analysis did not include knowledge of how the total purchase price was allocated to the various buildings. (TR, Vol 3, pp 90-91)

Although Respondent purports to value the subject property in fee simple, the Tribunal concludes, in light of the above, that it is instead valuing the leased fee interest of the same. (TR, Vol 3, p 152) Respondent's appraiser determined the highest and best use of the property as improved to be its current use as a home improvement store, but testified that his valuation of the subject property was directly affected by the fact that Home Depot was the user of the property. The subject property was built for The Home Depot and continues to be used as such. The Tribunal is not looking for the value of a Home Depot, however, but rather the value of a big-box commercial big box building. Petitioner's selected comparables were vacant and available at the time of sale. The Tribunal finds that these sales best represent the fee simple interest in the subject property. Vacant and available at the time of sale is not an alien term; an appraiser's analysis of exchange value must account for this eventuality. Not all properties transition instantaneously from seller to buyer like a light switch. Moreover, vacant and available for sale does not automatically present a negative connotation. Hence, the consideration of exposure time and market time in an appraisal report. Respondent's expert acknowledged that if a big box store were vacated as opposed to abandoned (TR, Vol 1-A, p 60) and sold to another user, the expected price in the marketplace would be substantially discounted (TR, Vol 1-A, p 59) and the building would have to adapted to that user's needs at a cost. (TR, Vol 1-A, pp 117-118)

Respondent's use of leased fee sales is quite striking based on Mr. Closser's admission that the subject property was valued on the premise of fee simple. Mr. Closser goes even further to admit that none of his data are fee simple properties. (TR, 1-A, p 129) His consideration and conclusion that the subject property is best suited as a leased fee property clashes with other portions of his testimony. For example, he testifies that the specific user of the property is not relevant to the true cash value of the fee simple interest. (TR, 1-A, p 105) Mr. Closser acknowledged that if two identical buildings were located next to each other, one of which is leased and one of which is not, the true cash value would be the same for both in a fee simple interest valuation. (TR, Vol 1-A, p 92)

Again, Respondent's selected comparables were all sales of properties subject to leases in place, otherwise known as sale-leaseback or leased fee transactions. Payments in such transactions are not predicated on market rent, however, but rather upon the amount the business can afford to pay based on its operations. Accordingly, sale-leasebacks are not true sales, but are more in the nature of a financing tool similar to a mortgage.

In further testimony, Mr. Closser admits to valuing the subject use as a Home Depot store. (TR, Vol 3, p 114) The lack of clarity between fee simple and leased fee does not bolster Respondent's opinions, analyses and conclusions. This gives rise to the question of adjustments between fee simple and lease fee

properties; the result is Mr. Closser makes no adjustment for this difference in his sales comparison analysis.

Next, Respondent's comparative analysis focuses on the difference indicated for urban versus rural locations. Respondent's reliance upon an unpublished number creates an incorrect assumption that all of the centers from which the figures were derived were discount stores. (TR, Vol 1-B, pp 22-23, 30)

Mr. Closser does not properly analyze the Indiana or Georgia sales within his report. The lack of comparative analysis relative to the subject market is glaring; he knows very little about the Indiana or Georgia locations to convince the Tribunal that they are part of the subject market. (TR, Vol 3, pp 127-129) He considered access and visibility for these comparables but did not consider traffic counts. (TR, Vol 3, p 153) In testimony, he admits to knowing nothing regarding the demographics of these comparable sales and was not aware of multiple transactions occurring to the sale in Indiana. (TR, Vol 3, p 92) Respondent's contention regarding the relevance of Petitioner's southeast Michigan sales data is implausible in light of its sales used in Indiana and Georgia.

In light of Petitioner's more extensive sales data analysis, Respondent's limited data and analysis is not supportive. Respondent's reasoning is not meaningful and is misleading. Therefore, Respondent's sales comparison approach is given no weight or credibility in the final conclusions of value.

Respondent develops and communicates an income approach to value. The reliance and basis of this approach is not persuasive. Mr. Closser's rental comparables are all build-to-suit properties based on leases occurring between 1990 and 1994. (TR, Vol 1-B, pp 35-36) In compounded fashion, Mr. Closser makes only one lease adjustment out of the six rental comparables. The concluded rent per square foot of $5.45 for all three years counters the general decline in Dickinson County. The application of the leases to the subject is not meaningful and is quite misleading; the older leases dates were not disclosed in Mr. Closser's appraisal report.

Mr. Closser's vacancy and credit loss determination is based on Home Depot remaining as the tenant. (TR, Vol 1-B, p 37) This analysis is devoid of market application. These determinations are quite narrow and exude a level of arbitrary subjectivity. They are based entirely around the subject's owner-occupant. In other words, the vacancy was based on the exclusive actions of Home Depot to the subject property. There is no reference or application of Home Depot's actions being commensurate with the market. Reasonably, the market includes more than the subject property. Moreover, the market encompasses more than sale-leaseback data. Therefore, Respondent's income approach is given no weight or credibility in the final conclusions of value.

Respondent develops and communicates a cost approach to value. The Tribunal is satisfied from written and oral testimony that this approach is not

necessary to provide credible appraisal results. The subject is a relatively newer building; however, potential market investors typically do not base their purchase decisions on this approach. Moreover, Mr. Closser's peculiar analyses with blended replacement and reproduction costs and entrepreneurial profits gives even less credence to his cost approach. Therefore, Respondent's income approach is not given any weight or consideration in the final conclusions of value.

The subject property is an owner-occupied building. The property has no history of an income stream. In other words, the subject is not an income-producing property. This is validated by both parties' analysis of the subject property in a fee simple interest; therefore, the income approach is not the primary indicator of value for the years under appeal. The primary focus is given to the sales comparison approach to value.

The Tribunal finds that Petitioner was able to show that the property was over-assessed for the tax years under appeal. As such, and in light of the above, the Tribunal finds that Petitioner has succeeded in meeting its burden of going forward with competent evidence on the issue of true cash value, assessed value, and taxable value. Petitioner has provided credible documentary evidence and testimony for the 2009, 2010, and 2011 tax years at issue and, as such, the Tribunal finds Petitioner's data within the sales comparison approach is sufficient to arrive at an independent determination of value.

JUDGMENT

IT IS ORDERED that the subject property's true cash, assessed, and taxable values are those shown in the Summary of Judgment section of this Opinion and Judgment.

IT IS FURTHER ORDERED that the officer charged with maintaining the assessment rolls for the tax years at issue shall correct or cause the assessment rolls to be corrected to reflect the property's true cash and taxable values as finally provided in this Final Opinion and Judgment within 20 days of the entry of the Final Opinion and Judgment, subject to the processes of equalization. See MCL 205.755. To the extent that the final level of assessment for a given year has not yet been determined and published, the assessment rolls shall be corrected once the final level is published or becomes known.

IT IS FURTHER ORDERED that the officer charged with collecting or refunding the affected taxes shall collect taxes and any applicable interest or issue a refund as required by the Final Opinion and Judgment within 28 days of the entry of the Final Opinion and Judgment. If a refund is warranted, it shall include a proportionate share of any property tax administration fees paid and of penalty and interest paid on delinquent taxes. The refund shall also separately indicate the amount of the taxes, fees, penalties, and interest being refunded. A sum determined by the Tribunal to have been unlawfully paid shall bear interest from the date of payment to the date of judgment and the judgment shall bear interest to the date of its payment. A sum determined by the Tribunal to have been underpaid shall not bear interest for any time period prior to 28 days after the issuance of this Final Opinion and Judgment. Pursuant to MCL 205.737, interest shall accrue (i) after December 31, 2008, at the rate of 3.31% for calendar year 2009, and (ii) after December 31, 2009, at the rate of 1.23% for calendar year 2010 (iii) after December 31, 2009, at the rate of 1.23% for calendar year 2010, (iv) after December 31, 2010, at the rate of 1.12% for calendar year 2011, (v) after December 31, 2011, and prior to July 1, 2012, at the rate of 1.09% for calendar year 2012 and (vi) after June 30, 2012 and prior to January 1, 2013, at the rate of 4.25%.

This Final Opinion and Judgment resolves all pending claims in this matter and closes this case.

MICHIGAN TAX TRIBUNAL

Entered: December 26, 2012 By: _Marcus L. Abood