

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

General Dynamics,
Petitioner,

v

MTT Docket No. 14-001967

City of Sterling Heights,
Respondent.

Tribunal Judge Presiding
Victoria L. Enyart

FINAL OPINION AND JUDGMENT

INTRODUCTION

Petitioner, General Dynamics, appeals ad valorem property tax assessments levied by Respondent, City of Sterling Heights, against Parcel Nos. 10-21-100-042-000, 10-21-100-042-616, 10-21-100-042-608 and 10-21-100-043-000 for the 2014 and 2015 tax years. Carl Rashid, Jr., Attorney, represented Petitioner, and Linda McGrail Belau, Attorney, represented Respondent.

A hearing on this matter was held on January 5, 2016. Petitioner's sole witness was Kevin Kernen, MAI. Respondent's sole witness was Dwayne McLachlan, MMAO(4).

The subject properties, referred to by the parties as the "Mound Road building" are zoned M1 and M2 (light industrial and heavy industrial), with a combined total acreage of 846.77 acres, improved by a flex building (office, industrial and engineering uses), and located at 38500 Mound Road, Sterling Heights.

The parties' contentions are as follows¹:

Parcel No. 10-21-100-042-000

	Petitioner			Respondent		
Year	TCV	SEV	TV	TCV	SEV	TV
2014	\$14,829,998	\$7,414,999	\$7,414,999	\$23,764,000	\$11,882,000	\$11,882,000
2015	\$15,185,206	\$7,592,603	\$7,592,603	\$26,144,000	\$13,072,000	\$13,072,000

¹ TCV true cash value, SEV state equalized value, TV taxable value based on Board of Review final values. The parties stipulated prior to the hearing for Parcel 10-21-100-037-000.

Parcel No. 10-21-100-042-616

	Petitioner			Respondent		
Year	TCV	SEV	TV	TCV	SEV	TV
2014	\$414,062	\$207,031	\$207,031	\$1,783,800	\$891,900	\$891,900
2015	\$423,980	\$211,990	\$211,990	\$1,791,400	\$895,700	\$895,700

Parcel No. 10-21-100-042-608

	Petitioner			Respondent		
Year	TCV	SEV	TV	TCV	SEV	TV
2014	\$377,466	\$188,733	\$188,733	\$549,200	\$274,600	\$274,600
2015	\$386,508	\$193,254	\$193,254	\$808,000	\$404,000	\$278,993

Parcel No. 10-21-100-043-000

	Petitioner			Respondent		
Year	TCV	SEV	TV	TCV	SEV	TV
2014	\$1,078,476	\$539,238	\$539,238	\$3,830,600	\$1,915,300	\$1,915,300
2015	\$1,104,306	\$552,153	\$552,153	\$4,014,600	\$2,007,300	\$1,945,944

Based on the evidence, testimony, and case file, the Tribunal finds that the true cash values (“TCV”), state equalized values (“SEV”), and taxable values (“TV”) of the subject properties for the 2014 and 2015 tax years are as follows:

Parcel No. 10-21-100-042-000

Year	TCV	SEV	TV
2014	\$14,829,998	\$7,414,999	\$7,414,999
2015	\$15,185,206	\$7,592,603	\$7,533,638

Parcel No. 10-21-100-042-616

Year	TCV	SEV	TV
2014	\$414,062	\$207,031	\$207,031
2015	\$423,980	\$211,990	\$210,343

Parcel No. 10-21-100-042-608

Year	TCV	SEV	TV
2014	\$377,466	\$188,733	\$188,733
2015	\$386,508	\$193,254	\$191,752

Parcel No. 10-21-100-043-000

Year	TCV	SEV	TV
2014	\$1,078,476	\$539,238	\$539,238
2015	\$1,104,306	\$552,153	\$547,865

PETITIONER'S CONTENTIONS

Petitioner contends that the subject parcels are over-assessed and Respondent's valuation is not in sync with the market. Petitioner believes the value of the subject parcels is best reflected by placing primary reliance on the sales comparison approach contained in the appraisal prepared by Kevin Kernen.

PETITIONER'S ADMITTED EXHIBITS

P-1: Appraisal prepared by Kevin Kernen, MAI.

PETITIONER'S WITNESS

Kevin Kernen

Kevin Kernen, MAI, was stipulated as an expert witness, and testified as to the appraisal he prepared for the 2014 and 2015 tax years. Kernen prepared an appraisal that determined the market value of the fee-simple interest of the subject property. The appraisal considered the sales comparison and cost approaches to value.

Kernen described the subject as a large flex building, which is a combination of office, industrial, engineering shop space, with a total of 464,544 square feet originally constructed in 1986, located on 84.77 acres. The office is three-stories divided by an atrium with 71.6% of the building. The rear portion of the building is the shop and engineering area, large cafeteria. It is a research, design and minor assembly for light armored vehicles.

He explained the discrepancy in square footage between the parties. Respondent's square footage includes the four mechanical penthouses on the roof, and a stand-alone storage outbuilding approximately 13,408 square feet. Kernen excluded them from the gross building area because the penthouses are air handlers and the storage building provides minimal utility.

The highest and best use of the subject property as vacant is to hold for future development. It is not financially feasible for any development at this time. The continued use as the existing improvement (flex property) is the highest and best use.

Kernen considered the three approaches to value but did not apply the income approach. The subject property's 464,544 square feet is not a typical investment property. Income that

could be gleaned from the market may be unreliable. The cost approach was utilized but not as reliable an estimate as the sales comparison approach. The sales comparison approach was given the most weight.

The initial step in the cost approach is determining the value of the vacant land utilizing land sales.

Kernen testified that the same land sales were used for both tax year 2014 and 2015, the only difference was appreciation. The following sales were considered:

		1	2	3	4	5	6	7
	Subject	Warren	Macomb	Van Buren	Pontiac	Milford	Auburn Hills	Romulus
Sale Price		\$3,200,000	\$3,600,000	\$3,701,594	\$3,717,000	\$750,000	\$1,435,500	\$999,000
Sale Date		Listing	Listing	Dec-14	May-14	Apr-14	Jul-13	Jun-11
Square Feet	3,692,581	1,344,697	1,549,124	3,117,154	1,732,381	456,509	818,928	925,214
SP/Sq. Ft.		\$2.38	\$2.32	\$1.19	\$2.15	\$1.64	\$1.75	\$1.08
Acreage	84.77	30.87	35.56	71.56	39.77	10.48	18.80	21.24
SP/Acre		\$103,661	\$101,229	\$51,727	\$93,462	\$71,565	\$76,356	\$47,034

Kernen explained the location and use of the sales individually. Sales 1 and 2 were listings and would indicate the higher end of the market. Sale 1 is located approximately 3 miles from the subject and was used as an outdoor RV storage. Sale 2 is north of the subject property with mixed use surrounding it. Sale 3 is a Costco Distribution Warehouse. Sale 4 is part of Centerpoint Development for the construction of a large industrial building. Sale 5 is close to the Wixom market near Pontiac Trail for the construction of an industrial building. Sale 6 is north of Chrysler Headquarters in Auburn Hills with significant industrial development in the area. Sale 7 is south of Detroit Metropolitan Airport zoned light industrial.

Kernen made adjustments (minus 20%) to Sale 1 and 2 as they were listings. Sales 1 and 3 had 9,000 square foot buildings that will require demolition after the sale, the adjustment was \$.01 per square foot deducted. Sales 1 and 3 are in inferior market locations, positive 10% adjustment was made. Sale 5 was considered in a superior submarket, a negative 5% adjustment was applied. Sale 3 is the only property that is similar in size to the subject, the remaining sales were adjusted negatively from 5% to 15%. Sale 2 is partially zoned for agricultural, which was considered inferior, the positive adjustment was 5%. Sale 4 is zoned commercial which is superior, a negative 5% adjustment was applied. The last adjustment is a minus 5% for highest

and best use, Sales 3, 4, 5, and 6 were purchased for immediate industrial development. The subject's highest and best use is to hold for future development.

After adjustments, Kernan found that the true cash value of the land is \$1.50 per square foot or \$5,500,000.

The next step in the cost approach is to calculate the replacement cost new of the improvements. Kernan used the Calculator Section of Marshall Valuation Cost Manual ("MVS"). MVS provides revisions as needed. Regional and local adjustment factors are provided. The published costs include all direct costs for the building and indirect costs.²

The subject property was broken into office, warehouse, engineering and storage (outbuilding) for purposes of determining the replacement cost. The craneway, mezzanine, mechanical penthouses were also added to the adjusted base costs after the application of the appropriate multipliers for the adjusted base cost.

Depreciation physical, functional, and economic from all causes is calculated next. Physical depreciation was measured using the age-life method. The effective age of the subject is divided by its economic life. The subject has been adequately maintained and Kernan estimated the weighted actual age and effective age to be 25 years. MVS suggests that the economic life is 46 years. The remaining economic life is 21 years for a total physical depreciation of 54.3%.

The inspection revealed no functional obsolescence. External obsolescence was measured by deducting land value from the sale to equal the present value of the improvements; calculating the replacement cost new for the comparable sales; deducting the present value of the improvements from the replacement cost new to equal the accrued depreciation. The total depreciation is divided by the replacement cost new for the percentage. The depreciation percentage is divided by the age for annual depreciation and indicated economic life. The results were placed on a trend line indicating that newer buildings depreciate at a faster rate. The annual depreciation for the subject is 3.40% resulting in aggregate depreciation of 85%. Kernan deducted the total physical deterioration (54.3%) from the total depreciation (85%) to result in economic obsolescence of 30.7% as extracted from the sales.

² P-1 at 47.

Land value is added to the depreciated replacement cost including site improvements. The total cost as of December 31, 2013, is \$16,700,000 and \$16,900,000 as of December 31, 2014.

Kernen utilized the following six sales for both tax years:

		Sale 1	Sale 2	Sale 3	Sale 4	Sale 5	Sale 6
Name	Subject	Lockheed Martin	Dell Computers	Mayco Int.	Tech Ridge	TE Connectivity	HQ Bldg Vacant
State	MI	PA	TN	MI	TX	MN	MA
Sale Price		\$12,500,000	\$12,700,000	\$11,400,000	\$15,875,000	\$15,500,000	\$8,000,000
Sale Date		15-Jun	14-Jul	14-Jun	13-Oct	13-Aug	12-Jul
Square Footage	464,545	460,514	289,810	520,494	301,644	370,000	301,647
SP/SF		\$27.14	\$43.82	\$21.90	\$52.63	\$41.89	\$26.52
% Office	71.6%	50.6%	29.2%	10.3%	30.4%	35.1%	48.2%
Clear Height	21-39	24-58	30	22-26	26-30	26	30
Dock Doors	6	5	97	22	110	0	10
Yr Blt/Renovated	86/11	70/97/10	2000	79/89	1999	98/10	64/84/96
Land SF	3,692,581	2,276,010	1,365,526	964,854	1,244,335	966,596	3,145,032

The comparable sales did not sell on tax day; Kernen adjusted the sales 3% annually for market conditions that considered the trend in sales of industrial properties in the area, rents, vacancy rates and market reports. All of the sales were adjusted for market conditions. Location adjustment considered access to highway interchange, rental rates and vacancy in the submarket; Comparables 2, 4, 5, and 6 are located in superior submarkets and were adjusted -5% to -10%. Comparable 1 is an inferior submarket and was adjusted upward 10%. The smaller buildings generally sell for a higher amount per square foot; Comparables 2, 4, 5, and 6 are smaller and adjusted -5%. Condition is dependent upon age with the older properties having a shorter remaining life and less potential rent; Comparables 3 and 6 are inferior and adjusted 5% and 10% respectively; Comparables 2, 4, and 5 are superior and adjusted -5%. Industrial properties with higher clear ceiling heights cost more to construct and are in demand due to the flexibility; Comparable 1 is adjusted -10%; Comparables 3 and 5 are lower clear heights and adjusted 5% upward.

The largest adjustment is office percentage as they sell for a higher price, the subject's 71.6% office is substantially more square feet than the comparables, and all were adjusted upward from 5% to 20%. Land to building ratio for the subject allows sufficient area for parking

and setbacks, however; Comparables 1, 2, 3, 4, and 5 have lower ratios for adjustments of 5% to 10% upward. Comparables 2 and 4 have significantly more dock doors than the subject and were adjusted -5%.

After adjustments the range of sale price per square foot (in order by comparable number), \$28.51, \$38.31, \$30.26, \$45.05, \$42.39, and \$27.69. Kernan concluded to \$36.00 per square foot for a true cash value of \$16,700,000 as of December 31, 2013. The same six sales were utilized for the 2015 tax year with the only adjustment difference for market condition. The resulting true cash value is \$17,200,000 as of December 31, 2014.

Kernan placed the most weight on the sales comparison approach. The true cash value was allocated as follows:

Allocation 2014: \$16,700,000 2015: \$17,100,000

Parcel No. 10-21-100-042-000 46.73 Acres 88.8%

Petitioner			
Year	TCV	SEV	TV
2014	\$14,829,998	\$7,414,999	\$7,414,999
2015	\$15,185,206	\$7,592,603	\$7,592,603

Parcel No. 10-21-100-043-000 38.04 Acres 6.5%

Petitioner			
Year	TCV	SEV	TV
2014	\$1,078,476	\$539,238	\$539,238
2015	\$1,104,306	\$552,153	\$552,153

Parcel No. 10-21-100-042-608 2008 IFT Ind. Eng. 2.3%

Petitioner			
Year	TCV	SEV	TV
2014	\$377,466	\$188,733	\$188,733
2015	\$386,508	\$193,254	\$193,254

Parcel No. 10-21-100-042-616 2011 IFT Eng. Bld. 2.5%

Petitioner			
Year	TCV	SEV	TV
2014	\$414,062	\$207,031	\$207,031
2015	\$423,980	\$211,990	\$211,990

RESPONDENT'S CONTENTIONS

Respondent contends the subject parcels are fairly assessed. Respondent argues that Petitioner's appraisal relies on industrial sales that are located outside of Michigan, which is not appropriate. The subject is 70% office with local comparables available (but are not located in an industrial zone).

RESPONDENT'S ADMITTED EXHIBITS

- R-2: Valuation Disclosure prepared by Dwayne McLachlan, MMAO(4).
R-3: Petitioner's Response to Respondent's Post Valuation Disclosure Discovery Request (SRR Work File).

RESPONDENT'S WITNESS

Dwayne McLachlan

Dwayne McLachlan, MMAO(4) and assessor for the City of Sterling Heights, was stipulated as an expert and testified as to the valuation disclosure he prepared for the 2014 and 2015 tax years. McLachlan considered the sales, cost, and income approaches to value.

McLachlan explained that the cost approach is supported by the income and sales comparison approaches. He testified:

These are the appraisal record cards that support the conclusions and they were developed in a mass-appraisal perspective where all of the components, physical components, of the property are valued, depreciated and then trended to the marketplace by application of an economic condition factor. In this case it is interesting to observe that the Petitioner and Respondent agree on land value, we both used \$1.50 a square foot.³

He further explained that the spaces are quantified for their use i.e. office buildings, finishes, floor areas calculated. He explained the cost for the office details, and indicated that the remainder of the property was costed in the same manner. The office summary portion is found on Exhibit R-2 page 7, for the 305,184 square feet office and gross building area of 412,527, for the three-story, class C, Good Quality building with an effective age of 28 years, constructed in 1986, and depreciated 1.75% per year. The summary sheets show the longer calculations as summarized with the economic condition factor which modifies the depreciated cost to blend it with the market tendencies which were .80 for 2014 and reduced to .62 in 2015. The only obsolescence considered was physical no external obsolescence was utilized. When questioned

³ TR. at 109,110.

McLachlan stated, “The equipment (sic economic) factor that’s employed in mass appraisal encompasses all that and trends the depreciated cost-to-market benchmarks so that’s the purpose of that factor that was .62 so it was considerable less than 1.00”⁴

Respondent’s property records identified the individual square footages as follows:

Parcel 042	Year Built	Square Footage
Office	1986	305,184
Connector	1986	12,442
Cafeteria	1986	7,854
Hallway	1986	2,400
Lt. Industrial Class S	1986	77,600
Office addition	2010	7,047
Total		412,527
Parcel 043		
Lt Industrial Class S	1986	28,000
Lt Manufacturing Class C	1995	2,000
Storage Warehouse	2006	13,408
Total		43,408
Parcel 042-616	2011 IFT	
Engineering Class C	2011	10,100
Engineering Class C	2011	1,508
Total		11,608
Parcel 042-608	2008 IFT	
Engineering Class C	2008	6,230
Lt. Manufacturing Class C	2008	4,270
Total		10,500
Aggregate Total		478,043 ⁵

The comparable sales were testified to by McLachlan as developed for benchmarks for the conclusions under the “modified cost approach” with the economic condition factor applied

⁴ Tr. at 122, 123.

⁵ Extracted from the Valuation Reports from each parcel in R-1.

or the mass appraisal method prescribed by the Assessor's Manual in the State of Michigan. The following sales were considered:⁶

		R-1	R-2	R-3	R-4
Name	Subject	11968 Investment	19176 Hall	7408 Metro	42600 Merrill
City	Sterling Ht.	Shelby Twp.	Clinton Twp.	Sterling Ht.	Sterling Hts.
Sale Price		\$5,900,000	\$7,350,000	\$14,900,000	\$5,000,000
Sale Date		13-Dec	13-Dec	14-Sep	12-Nov
Square Footage	489,471	110,900	108,760	200,000	108,000
SP/SF		\$53.20	\$67.58	\$74.50	\$46.30
Use	Office/Lab	Manufacturing	Office	Warehouse	Manufacturing
Acreage	46.73	6.72	6.68	28.15	10.45
Land/Bldg Ratio	4.16	2.64	2.68	6.13	4.2
Age/Condition	1986	2001	2000/2006	2006	1989
Adjusted SP		\$58.52	\$54.06	\$55.88	\$55.56

McLachlan testified to the following adjustments: Sales 1 and 2 were adjusted -20%, and Sale 3 was adjusted -25% for age and condition; all of the sales were adjusted a negative 5% for size; Sales 1, 3 and 4 were adjusted positively 10% to 25% for use; Sales 1, 2, and 3 were adjusted for land to building ratios 5% to 10%. The total gross adjustments are 60%, 40%, 45% and 30% respectively. The conclusion was \$56.00 per square foot or \$27,410,376 for the sales comparison approach.

Upon cross examination McLachlan was questioned if the sales were fee-simple, he answered, "Absolutely, yeah, fee simple trumps any other kind of estate. Okay. One of the elements in the bundle of rights is the ability to lease property so if you can lease property that's certainly your --."⁷ However, all four sales were leased-fee transactions. The sales selected ranged in square footage from 108,000 to 200,000 square feet, with 5% adjustment for size. One comparable that was not utilized for the subject but McLachlan selected it for the smaller parcel for Seventeen Mile Road settled prior to the trial. This is located at 42400 Merrill Street, with 523,869 square feet. Petitioner questioned why it was not utilized for the larger subject parcel. "Because it's a manufacturing facility with only 10% office."⁸

⁶ R-2 at 89 smaller parcels were not considered due to stipulation of parcel 10-21-100-037-000.

⁷ Tr. at 129.

⁸ Tr. at 131.

The income approach was estimated to check the validity of the conclusions. McLachlan estimated that the subject would command \$8.50 per square foot rent, which is half of what office buildings receive. The vacancy and credit loss was 3.6%, as vacancy has not been prevalent in the area. The 3.6% is deducted from the gross income to result in the effective gross income for \$4,010,504. Expenses for management, repair and maintenance, insurance, miscellaneous costs and reserves for replacement, for total expenses of \$1,186,104. Expenses are deducted from the effective gross income to result in a net operating income of \$2,824,399 (\$5.77 per square foot). The overall capitalization rate with the effective tax rate is 11.583. The net operating income is divided by the overall capitalization rate to result in \$31,118,011. McLachlan rounds it to \$31,300 or \$63.95 per square foot for December 31, 2013. The income approach for 2014 is the same methodology with \$8.00 per square foot rent estimated, with a conclusion of \$29,000,000 or \$59.25 per square foot as of December 31, 2014.

Petitioner questioned McLachlan on his basis for the rent used in the income approach. “It was an estimate based on other office rentals, recognizing the size of the subject so it was discounted quite heavily. I mean, normal office rents in my marketplace would be \$15, \$16 a square gross.”⁹ He was then questioned why the net leasable area was 489,471 square feet, which includes the penthouse mechanical and storage building. McLachlan responded “Well, again, that rate blends everything so the total property, we were consistent in utilizing that square footage, the tenants, you can argue about that.”¹⁰ The expenses were explained, but the difference between gross leases, modified gross leases and triple net leases were questioned by Petitioner for McLachlan to explain. The subject is a modified gross, the tenants pay utilities, maintain the property and landlord is responsible for outer walls and site maintenance.

The out-of-state comparable sales used by Petitioner were opined by McLachlan to not be a good practice. He stated: “I don’t believe that’s a good – good practice to rely on national data when we’re dealing with a local – very localized appraisal though that property may have appealed to a broader range of potential users, to ignore Michigan data completely I think is a fatal flaw in that analysis.”¹¹

⁹ Tr. at 132.

¹⁰ Tr. at 132.

¹¹ Tr. at 122.

McLachlan did not tour the facility. He did rely upon the prior assessor's information for the assessment which is updated every year with the application of the economic condition factor.

STIPULATED FACTS¹²

1. The subject property consists of land and buildings located at 38500 Mound Road, Sterling Heights, Michigan (referred to as the "Mound Road building").
2. The Mound Road building is identified on the assessment rolls as Parcel Nos. 10-21-100-042-000, 10-21-100-042-616, 10-21-100-042-608 and 10-21-100-043-000.
3. The subject property is owner occupied.
4. The Mound Road building is zoned M1 (light industrial) and M2 (heavy industrial).
5. The land area of the Mound Road building is 846.77 acres, or 3,692,581 square feet.
6. Both parties filed valuation disclosures.
7. Petitioner's valuation disclosure is in the form of an appraisal prepared by Kevin Kernen, MAI, stipulated as an expert witness.
8. Respondent's valuation disclosure was prepared by Dwayne McLachlan, MMAO(4), assessor for the City of Sterling Heights, and stipulated as an expert.
9. The valuation disclosures submitted by both parties include values for the 2014 and 2015 tax years.
10. Petitioner's appraiser developed the sales comparison approach and cost approach for the valuation of the Mound Road building and conveys an opinion of value based on reconciliation of those approaches.
11. Respondent's assessor developed sales comparison, cost, and income approaches and conveys an opinion of value based on a reconciliation of those approaches.
12. Both experts have appraised the subject as a fee-simple interest.

ADDITIONAL FINDINGS OF FACT¹³

13. The parties disagree as to the correct gross building area of the subject building. Petitioner's appraiser utilized 464,545 square feet while Respondent utilized 489,471 square feet.
14. The Tribunal finds that based on the individual components extracted from Exhibit R-1 the aggregate square footage is 478,043. This includes the 13,408 square foot storage building that both parties utilized in the cost approach.
15. Petitioner testified that the difference in square footage was a storage building that provides minimal utility, and the four mechanical penthouses on the roof which are air-handlers for the HVAC.
16. Petitioner's appraiser determined that the highest and best use of the subject, if vacant, would be to hold for future development, and as improved, for continued existing use as a flex property.
17. Petitioner's appraiser prepared a cost approach based on the use of the current Marshall & Swift Cost Manual and location-based adjustments. The 2014 depreciated value for the buildings under the cost approach was \$9,564,673 and the 2015 value was \$9,986,022.

¹² The parties stipulated to the facts listed under this section.

¹³ In addition to the parties' Stipulated Facts, the Tribunal makes these additional Findings of Fact.

18. The additional depreciated value under the appraiser's cost approach for site improvements was \$1,640,914 for 2014 and 1,460,656 for 2015.
19. Petitioner's appraiser included a land valuation analysis with land sales in Michigan.
20. Petitioner's appraiser concluded to a land value using the land sale comparables of \$1.50 per square foot, or \$5.5 million for the 2014 and 2015 tax years.
21. Petitioner's appraiser included a sales comparison approach that utilized improved sales in Michigan and other states to value the Mound Road building.
22. Petitioner's appraiser concluded to a value for the Mound Road building under the sales comparison approach of \$36.00 per square foot, or \$16.7 million for the 2014 tax year and \$37.00 per square foot, or \$17.2 million for the 2015 tax year.
23. Petitioner's appraiser did not utilize an income approach, based on his determination that the subject was not the type of property that would be looked at by investors for its income-producing potential and there is not enough market data for similar properties to calculate an income approach.
24. In applying the sales comparison approach, Respondent's assessor utilized four sales comparables, concluding to a value of \$27,410,376 for both the 2014 and 2015 tax years.
25. Respondent's assessor also included the property record cards with the values as established on the tax roll under the mass appraisal cost approach. The combined value under the cost approach for all four parcels is \$29,927,600 for the 2014 tax year and \$32,758,000 for the 2015 tax year.
26. In addition, Respondent's assessor prepared an income approach, concluding to a value of \$29 million for the 2014 tax year and \$31.3 million for the 2015 tax year.

CASE LAW

The assessment of real and personal property in Michigan is governed by the constitutional standard that such property shall not be assessed in excess of 50% of its true cash value.¹⁴

The legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law except for taxes levied for school operating purposes. The legislature shall provide for the determination of true cash value of such property; the proportion of true cash value at which such property shall be uniformly assessed, which shall not . . . exceed 50 percent. . . .¹⁵

The Michigan Legislature has defined "true cash value" to mean:

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 that could be obtained for the property at private sale, and not at auction sale except as otherwise provided in this section, or at forced sale.¹⁶

¹⁴ See MCL 211.27a.

¹⁵ Const 1963, art 9, sec 3.

¹⁶ MCL 211.27(1).

The Michigan Supreme Court has determined that “[t]he concepts of ‘true cash value’ and ‘fair market value’ . . . are synonymous.”¹⁷

“By provisions of [MCL] 205.737(1) . . . , the Legislature requires the Tax Tribunal to make a finding of true cash value in arriving at its determination of a lawful property assessment.”¹⁸ The Tribunal is not bound to accept either of the parties' theories of valuation.¹⁹ “It is the Tax Tribunal's duty to determine which approaches are useful in providing the most accurate valuation under the individual circumstances of each case.”²⁰ In that regard, the Tribunal “may accept one theory and reject the other, it may reject both theories, or it may utilize a combination of both in arriving at its determination.”²¹

A proceeding before the Tax Tribunal is original, independent, and *de novo*.²² The Tribunal's factual findings must be supported “by competent, material, and substantial evidence.”²³ “Substantial evidence must be more than a scintilla of evidence, although it may be substantially less than a preponderance of the evidence.”²⁴

“The petitioner has the burden of proof in establishing the true cash value of the property.”²⁵ “This 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.”²⁶ However, “[t]he assessing agency has the burden of proof in establishing the ratio of the average level of assessments in relation to true cash values in the assessment district and the equalization factor that was uniformly applied in the assessment district for the year in question.”²⁷

The three most common approaches to valuation are the capitalization of income approach, the sales comparison, or market, approach, and the cost-less-depreciation approach.²⁸ “The market approach is the only valuation method that directly reflects the balance of supply

¹⁷ *CAF Investment Co v Michigan State Tax Comm*, 392 Mich 442, 450; 221 NW2d 588 (1974).

¹⁸ *Alhi Dev Co v Orion Twp*, 110 Mich App 764, 767; 314 NW2d 479 (1981).

¹⁹ *Teledyne Continental Motors v Muskegon Twp*, 145 Mich App 749, 754; 378 NW2d 590 (1985).

²⁰ *Meadowlanes Ltd Dividend Housing Ass'n v Holland*, 437 Mich 473, 485; 473 NW2d 636 (1991).

²¹ *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 356; 483 NW2d 416 (1992).

²² MCL 205.735a(2).

²³ *Dow Chemical Co v Dep't of Treasury*, 185 Mich App 458, 462-463; 462 NW2d 765 (1990).

²⁴ *Jones & Laughlin Steel Corp*, *supra* at 352-353.

²⁵ MCL 205.737(3).

²⁶ *Jones & Laughlin Steel Corp*, *supra* at 354-355.

²⁷ MCL 205.737(3).

²⁸ *Meadowlanes*, *supra* at 484-485; *Pantlind Hotel Co v State Tax Comm*, 3 Mich App 170, 176; 141 NW2d 699 (1966), *aff'd* 380 Mich 390 (1968).

and demand for property in marketplace trading.”²⁹ The Tribunal is under a duty to apply its own expertise to the facts of the case to determine the appropriate method of arriving at the true cash value of the property, utilizing an approach that provides the most accurate valuation under the circumstances.³⁰

Regardless of the valuation approach employed, the final valuation determined must represent the usual price for which the subject would sell.³¹

CONCLUSIONS OF LAW

Both parties relied upon a cost new less depreciation approach to determine the true cash value of the subject property. Petitioner’s cost approach included vacant land sales that indicated \$1.50 per square foot. Respondent’s property record agrees. However, that is where the similarity ends.

In the cost approach, the value of a property is derived by adding the estimated value of the land to the current cost of constructing a reproduction or replacement for the improvements and then subtracting the amount of depreciation (i.e., deterioration and obsolescence) in the structure from all causes. Entrepreneurial incentive (the amount the developer expects to receive) or entrepreneurial proofing (the amount actually received) may be included in the value indication. This approach is particularly useful in valuing new or nearly new improvements and properties that are not frequently exchanged in the market. Cost approach techniques can also be employed to derive information needed in the sale comparison and income capitalization approaches to value, such as the cost to cure items of deferred maintenance.³²

Petitioner’s Marshall Valuation Service originally was the vendor for the State Tax Commission Assessor’s Manual from 2004. The results between the individual cost based on a manual that is updated regularly, with cost modifier and the Assessor’s Manual that relies upon County Multipliers and Economic Condition Factors to update is the difference between McDonalds and Mitchell’s Fish Market, one is fast food for mass consumption fulfilling a need for quick sustenance like the Assessor’s Manual, the other is fine dining where you slowly select food which is made to order on an individual basis akin to an individual appraisal.

²⁹ *Jones & Laughlin Steel Corp*, *supra* at 353 (citing *Antisdale v City of Galesburg*, 420 Mich 265; 362 NW2d 632 (1984) at 276 n 1).

³⁰ *Antisdale*, *supra* at 277.

³¹ See *Meadowlanes Ltd Dividend Housing Ass’n v Holland*, 437 Mich 473, 485; 473 NW2d 636 (1991).

³² Appraisal Institute, *The Appraisal of Real Estate* (Chicago: 14th ed, 2013) at 47.

The Assessor's Manual is twelve years old and in dire need of updating. The County Multipliers adjust the costs annually for the difference in construction costs and labor. The economic condition factor is utilized by assessors to adjust a specific group of properties based upon what a property was assessed at on its sale date. The economic condition factor adjusts the cost approach for an increase or decrease in the prior year's assessment. It does not, on an individual basis, adjust a property "to the market," it uses sales in the market on a mass basis to adjust the Assessment for an entire class or neighborhood based on the level of assessment at the time of a sale. It is entirely dependent upon the ratio of assessment to the sale price. It is not an indication of inflation or deflation, but the level of assessment. This is dependent upon how often property records are updated with a physical inspection, with updated land values. The industrial property market has not been active in the last few years due to multiple reasons including a severe reduction in demand which as a result aided in the creation and growth of a credit crisis and the downward spiral of the property market.

It is simply not physically possible for assessor's to do a reappraisal of every property within the jurisdiction on December 31st tax day. Therefore, the cost approach is the basis for assessments and adjusted on a broad basis for the neighborhood or class of property. It is not a guarantee that each individual property costed on a mass assessment system will be at 50% of market value. It is a technique that allows the properties to be assessed in the same manner and easily adjusted with the economic condition factor.

The Marshall Swift Manual also determines the replacement cost of a property based upon its class, quality, and amenities. However, it is adjusted for location with the application of multipliers. The costs are updated monthly or as needed. Thus the indication that basing a cost approach for an individual property from the Marshall Swift Manual will be current, requiring less subjective adjustments.

The largest difference between the two parties is the determination of depreciation from all causes. Respondent relied upon the prior assessor's calculations as adjusted with an economic condition factor as the basis for its cost approach. No external obsolescence was applied because "The economic condition factor that's employed in mass appraisal encompasses all that and trends the depreciated cost-to-market benchmarks so that's the purpose of that factor

that was .62 so it was considerable less than 1.00.”³³ Petitioner properly extracts depreciation from properties that have sold. Respondent simply states no economic or functional obsolescence however, testified that while an opportunity was extended, never physically inspected the subject property.³⁴ Respondent did not indicate why the economic condition factor declined 22% from 2014 to 2015 when the economy was in a recovery mode. Respondent relied upon the predecessor’s calculations and any building permits in the cost approach.

The parties had a difference in calculating the total square footage of the subject property. The gross building area may be appropriate for a cost approach, which would include the replacement cost of the storage building, however, the Tribunal agrees with Petitioner’s appraiser, the air handling units are more of a personal nature and should not be part of the net square footage for an income or sales comparison approach.

The Tribunal finds that Petitioner’s cost approach is reliable, current, and based upon proper appraisal techniques making it credible. Petitioner’s appraiser inspected the subject property, made appraisal judgments based upon the physical inspection, and properly extracted depreciation from sales.

Respondent fails to inspect the subject property, and relies upon a predecessor’s calculations without any independent research. Respondent believes that the economic condition factor is all encompassing. It is not, the only discipline that utilized the economic condition factor are assessors. It assists them in increasing or decreasing assessments based upon the level of assessment and sales. It does not indicate that an individual property is assessed at 50% of market value. It does indicate that an entire class of property or a neighborhood is assessed at 50% of market value. Indicating that some properties will be assessed above and some will be below 50%. This Tribunal finds no excuse for any appraiser, including an assessor, when given the opportunity to do a physical inspection of a subject property to not “find the time” especially for an appeal. Respondent’s mass assessment calculated cost approach is given no weight or credibility in this instance, it was not updated or prepared by Respondent.

The sales comparison approach is defined as:

The process of deriving a value indication for the subject property by comparing similar properties that have recently been sold with the property being appraised, identifying appropriate units of comparison, and making adjustments to the sale

³³ Tr. at 122, 123.

³⁴ Tr. at 125.

prices (or unit prices, as appropriate) of the comparable properties based on relevant, market-derived elements of comparison. The sales comparison approach may be used to value improved properties, vacant land, or land being considered as though vacant when an adequate supply of comparable sales is available.³⁵

Both parties prepared a sales comparison approach. Petitioner's sales included one sale in Sterling Heights, the remaining five were out of state. The parameters for selecting the sales were clearly outlined in the appraisal. The sales were selected based on date of transfer, size, location, and income characteristics. The size of the subject and few similar transactions required Petitioner's appraiser to extend the search outside of Michigan. The selected sales range in gross building area from 289,810 to 520,494; percentage of office ranged from 10.3% (the Michigan property) to 50.6%. Petitioner's adjustments were explained, the net adjustments were 0% to 40%, and gross adjustments were 30% to 45%.

Respondent's sales comparison approach relied upon sales of office, manufacturing and warehouses. The sales were adjusted but no narrative on where the adjustments came from or Respondent's parameters for selection of the sales was included in the appraisal. The Tribunal notes that three out of four of the sales were approximately 110,000 square feet, with the fourth sale 200,000 square feet, or less than 50% of the subject's 478,043 square feet. The second notable issue on the grid is lack of support for the use of the sales or the adjustments.

Respondent was questioned on cross why the sale at 42400 Merrill with 532,869 square feet was not used as a comparable sale utilized for the subject's 478,043 square feet, but utilized it as comparable for a different property at 6000 17 Mile Road with 156,736 square foot.³⁶ If Respondent would have considered the sale at 42400 Merrill, Sterling Heights as comparable to the subject it may have resulted in a closer unit price.

When questioned, "Are you telling this tribunal that leased fee and fee simple are the same because of the bundle of rights?" McLaughlin's testimony was, "My testimony is fee simple trumps all other ownership."³⁷ Respondent's testimony confused fee simple and leased fee. All four of Respondent's sales were leased at the time of the sale without any indication whether the leases were market based or influenced the sale prices as "fee simple trumps all other forms of ownership, it's the complete bundle of rights, you have the right to lease, you

³⁵ Appraisal Institute, *The Appraisal of Real Estate* (Chicago: Appraisal Institute, 14th ed, 2013) at 377.

³⁶ 6000 17 Mile Road, was withdrawn at the beginning of the trial.

³⁷ Tr. at 142.

have the right to use, you have the right to give away. A leased fee sale is generally something that's subject to a lease, it doesn't necessarily mean that it's bad or different, it just means it's subject to a lease."³⁸

Respondent's selection of sales, substantially smaller than the subject and ignoring the one larger property with a smaller office percentage, makes this Tribunal ponder if the sales comparison approach needs to be restructured in the State Tax Commission's *Guide to Basic Assessing*³⁹. The Tribunal finds that without basic appraisal theory it is no surprise that market support for Respondent's income and sales approaches could not be found.⁴⁰

Petitioner's use of out-of-state sales was appropriate in an unusual property that would sell on the open market. Petitioner's sales comparison approach is considered more reliable than Respondent's sales comparison approach with no documentation as to the adjustments, and selection of sales.

The income approach is defined as:

The present value of the future benefits of property ownership is measured. A property's income and resale value upon reversion may be capitalized into a current, lump-sum value.⁴¹

Respondent's income approach is quite vague as to the source for the income and expenses. Without testimony, Respondent's income approach could not be more incomplete. Respondent confused fee simple and leased fee. The source for the data in Respondent's report is unknown. Respondent's testimony was somewhat ambiguous when questioned on the source of income/expenses. Some of the data may have come from real property statements, personal property statements, or surveys by the city, in addition to CoStar subscription. The information was contained in a work file but not brought to the hearing. Respondent's inclusion of 20.71% of the expenses for property taxes is inappropriate for an income approach in a property tax appeal, when the value upon which the taxes are paid is appealed. The more appropriate method is to use a tax neutral capitalization rate in which the effective tax rate is included.

³⁸ Tr. at 144.

³⁹ November 2013.

⁴⁰ When a property is appealed at the Tribunal, the subject property is appealed on an individual basis and taken out of the mass assessment paradigm. The true cash value of an individual property as of tax day(s) at issue is the appropriate standard to be considered for the Tribunal. Although, mass assessment is recognized under USPAP Standard 6, it is applicable in mass assessments, not for an individual property.

⁴¹ Appraisal Institute, *The Appraisal of Real Estate* (Chicago: 14th ed, 2013) at 46.

To develop an opinion of market value with the income capitalization approach, the appraiser *must be certain that all the data and forecasts used are market-oriented and reflect the motivations of a typical investor* who would be willing to purchase the property as of the effective date of the appraisal. A particular investor may be willing to pay a price different from market value, if necessary, to acquire a property that satisfies other investment objectives unique to that investor.⁴²

The Tribunal finds that the income approach is an acceptable method, when income and expenses were tested in the market. The income and expenses must be tied into the market *when looking at fee simple interest*. Using data without market rent support is a significant flaw.

Market rent is defined as:

The most probable rent that a property should bring in a competitive and open market reflecting all conditions and restrictions of the lease agreement, including permitted uses, use restrictions, expense obligations, term, concessions, renewal and purchase options, and tenant improvements.⁴³

The Tribunal finds that Petitioner's appraiser utilizing an up to date cost manual, extracting depreciation from all causes from the market, and land sales resulted in a more accurate cost approach than the assessor's mass assessment technique. Respondent failed to inspect the subject property, utilized stale information from the previous assessor (from three years ago), and did not have any up dated information or first-hand knowledge of the subject property. The testimony was elusive. It was clear that the difference between Marshall Valuation Services, up dated on a regular basis and the Assessor's Cost Manual, which has not been updated since it first went into service 12 years ago, is that the updated Marshall Valuation Service is more appropriate for an individual cost approach.

The sales utilized by both parties were contrasting; Petitioner's sales were out of state, larger flex buildings. Respondent's sales were a variety of uses and were 1/3 to 1/2 of the size of the subject property. Petitioner explained the adjustments in the appraisal, Respondent explained in testimony that although the four sales utilized were leased it simply did not matter, they were

⁴² Appraisal Institute, *The Appraisal of Real Estate* (Chicago: 14th ed, 2013) at 444.

⁴³ Appraisal Institute, *The Dictionary of Real Estate Appraisal* (Chicago: 6th ed, 2015) at 140.

considered fee-simple. Respondent was not clear when questioned if the income stream influenced the sale price of the leased properties.

The Tribunal in determining the true cash value of the subject property finds that the fee simple interest is the appropriate interest to be appraised. The value-in-exchange (does not consider the purchaser) of the subject property, is the appropriate method based upon the higher courts guidance, while the value-in-use is akin to the owner's interest.

Respondent's four sales all were leased fee interest when sold. Respondent did not consider nor explain how the leases influenced the sale prices. The difference in fee simple estate and leasehold interest are:

Fee simple estate is:

Absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power and escheat.⁴⁴

Leased fee interest is:

A freehold (ownership interest) where the possessory interest has been granted to another party by creation of a contractual land-lord-tenant relationship (i.e., a lease).

Leasehold interest is:

The tenant's possessory interest created by a lease.⁴⁵

Respondent also used interchangeably gross lease, modified gross lease and triple net lease. The terms reflect the expenses that are included in each type of rent, and their meanings in general the following distinctions can be make:

Gross lease – tenant pays rent and landlord pays expenses.

Modified gross lease – tenant and landlord share expenses.

Net lease – landlord passes on all expenses to tenant.⁴⁶

The square footage for Respondent's income approach included the roof top air handlers and the storage building. When questioned if he knew of any tenants that would pay \$8.50 for a penthouse mechanical and storage building, the response was that rate blends everything that reflects the total use of the property.⁴⁷ The actual expenses were also estimated without indicated

⁴⁴ Appraisal Institute, *The Dictionary of Real Estate Appraisal* (Chicago: 5th ed, 2010) at 78.

⁴⁵ IBID at 111.

⁴⁶ Appraisal Institute, *The Appraisal of Real Estate* (Chicago: 14th ed, 2013) at 445.

⁴⁷ Tr. at 132.

sources contained in the report. However, testimony indicated that rental surveys, real property statements, and CoStar subscription were considered.⁴⁸

The Tribunal finds that Respondent's income approach for a large industrial flex building without market support is not appropriate. The income and expenses that Respondent opined on, appear to be just that, an estimation without any substance to back up the opinion. The low capitalization rate inflates value. Respondent has no foundation for the estimated rent or capitalization rate which results in a value not supported by market data. The Tribunal notes that Respondent's four sales were leased. These sales may have provided a foundation for estimated rent and overall rate (appropriately loaded with an effective tax rate).

Respondent lacked the documentation and explanation for the adjustments found in its sales comparison approach. The addition of the CoStar sales sheet are insufficient to determine the basis for the adjustments in the sales comparison approach. No weight is afforded Respondent's sales comparison approach.

The Tribunal finds that Petitioner's sales comparison approach for the somewhat unique subject property, with one comparable in the area and four out-of-state sales, in this instance is acceptable. The area has large industrial properties, but only one has sold (42400 Merrill) and was considered in Petitioner's appraisal.

The Tribunal finds, based upon the Findings of Fact and the Conclusions of Law set forth herein, that Petitioner met the burden of proving that the assessment exceeds 50% of true cash value. The subject property's TCV, SEV, and TV for the tax years at issue are as stated in the Introduction section above.

JUDGMENT

IT IS ORDERED that the property's state equalized and taxable values for the tax years at issue are MODIFIED as set forth in the Introduction section of this Final 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 shown 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

⁴⁸ Tr. at 140.

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 within 28 days of entry of this Final Opinion and Judgment. If a refund is warranted, it shall include a proportionate share of any property tax administration fees paid and 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, 2009, at the rate of 1.23% for calendar year 2010, (ii) after December 31, 2010, at the rate of 1.12% for calendar year 2011, (iii) after December 31, 2011, through June 30, 2012, at the rate of 1.09%, and (iv) after June 30, 2012, through June 30, 2016, at the rate of 4.25%.

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

APPEAL RIGHTS

If you disagree with the final decision in this case, you may file a motion for reconsideration with the Tribunal or a claim of appeal with the Michigan Court of Appeals.

A Motion for reconsideration must be filed with the required filing fee within 21 days from the date of entry of the final decision.⁴⁹ Because the final decision closes the case, the motion cannot be filed through the Tribunal's web-based e-filing system; it must be filed by mail or personal service. The fee for the filing of such motions is \$50.00 in the Entire Tribunal and \$25.00 in the Small Claims Division, unless the Small Claims decision relates to the valuation of property and the property had a principal residence exemption of at least 50% at the time the petition was filed or the decision relates to the grant or denial of a poverty exemption and, if so, there is no filing fee.⁵⁰ A copy of the motion must be served on the opposing party by mail or personal service or by email if the opposing party agrees to electronic service, and proof

⁴⁹ See TTR 261 and 257.

⁵⁰ See TTR 217 and 267.

demonstrating that service must be submitted with the motion.⁵¹ Responses to motions for reconsideration are prohibited and there are no oral arguments unless otherwise ordered by the Tribunal.⁵²

A claim of appeal must be filed with the appropriate filing fee. If the claim is filed within 21 days of the entry of the final decision, it is an “appeal by right.” If the claim is filed more than 21 days after the entry of the final decisions, it is an “appeal by leave.”⁵³ A copy of the claim must be filed with the Tribunal with the filing fee required for certification of the record on appeal.⁵⁴ The fee for certification is \$100.00 in both the Entire Tribunal and the Small Claims Division, unless no Small Claims fee is required.⁵⁵

Entered: April 8, 2016

By: Victoria L. Enyart

⁵¹ See TTR 261 and 225.

⁵² See TTR 261 and 257.

⁵³ See MCL 205.753 and MCR 7.204.

⁵⁴ See TTR 213.

⁵⁵ See TTR 217 and 267.