

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

L'Anse Warden Electric Co. LLC,
Petitioner,

MTT Docket No. 392335

v

Township of L'Anse,
Respondent.

Tribunal Judge Presiding
Victoria L. Enyart

OPINION AND JUDGMENT

INTRODUCTION

A default hearing was held in the above-captioned case on June 4, 2012, pursuant to TTR 247. In that regard, the Tribunal entered an Order of Default on April 29, 2011, placing Respondent in default for failing to file an answer to the petition as required by TTR 245. The Order required Respondent to cure the default within 21 days of the Order. The Tribunal entered its Order scheduling a Default Hearing on November 30, 2011. On January 19, 2012, Petitioner requested an adjournment, which the Tribunal granted.

Petitioner was represented by Christian E. Meyer, attorney. Michael J. Diedrich, ASA, PE, CDP Principal AUS Consultants, Valuation Services Group, was Petitioner's valuation witness. Zachary J. Hakola, Energy Sales and Financial Manager, Traxys Power Group, was also a witness.

Petitioner filed a Motion to Amend to add the 2012 subsequent years. Respondent was not in default for failure to answer the 2012 Motion to Amend. Petitioner's Motion to Add

2012 Tax Year was therefore granted, severed from the instant matter and assigned a separate docket number, 436306. The hearing continued for tax years 2010 and 2011.

Summary of Judgment

Contentions of value:

Parcel No. 07-044-545-013-10

	Petitioner			Respondent		
Year	TCV	SEV	TV	TCV	SEV	TV
2010	\$6,300,000	\$3,150,000	\$3,150,000	\$17,216,178	\$8,608,089	\$8,027,775
2011	\$10,300,000	\$5,150,000	\$5,150,000	\$18,258,156	\$9,129,078	\$8,164,247

The Tribunal finds the values shall be:

Parcel No. 07-044-545-013-10

Year	TCV	SEV	TV
2010	\$17,216,178	\$8,608,089	\$8,027,775
2011	\$18,258,156	\$9,129,078	\$8,164,247

Background and Introduction

At issue is the true cash value for a Biomass Power Plant located at 157 South Main Street, in L’Anse, Baraga County. The subject property is a nominal 20 Megawatt (“MW”) biomass-fueled power plant. It was constructed in 1950 as a coal burner power plant. It was converted to natural gas in 1993 and placed in long term standby condition at that time. Traxys purchased the subject property in 2007 for \$4 million and converted it to a biomass-fueled power plant.

Petitioner’s Arguments

Petitioner believes that the value should be based on the appraisal that was prepared for the hearing. Exhibits Admitted:

P-1 Appraisal AUS.

P-2 Covenant Deed.

P-3 Real Estate Transfer Tax Valuation Affidavit.

P-4 Fixed Asset Schedule and Original Summary.

P-5 2011 Change of Assessment Notice for IFT Parcel 07-044-999-002-00.

P-6 2011 Change of Assessment Notice for IFT Parcel 07-044-999-001-00.

P-7 IFT Certificate 2007-609 for Real and Personal Property.

P-8 IFT Certificate 2007-608 for Real and Personal Property.

Michael J. Diedrich, ASA, PE, CDP Principal AUS Consultants, Valuation Services Group, was qualified as an expert witness. Diedrich's specialty is depreciation. He has appraised over 50 power plants.

Biomass was described in the appraisal (P-1, p 2) as carbon, hydrogen and oxygen-based biological material from living or recently living organisms. In the subject property wood chips are the biomass is used to heat the steam that drives the turbines which turns the generator that converts the power into electricity. Steam is a byproduct of the power plant and is sold to Certain Teed; the majority of the electricity generated is credited to DTE. In addition tires make up approximately 7% of the BTU. Tires are not considered "green" energy for DTE's renewable energy credits.

Diedrich testified that the industry is driven by incentives for renewable power. Because the biomass power plants are not as efficient as other power plants they are subsidized. The Production Tax Credit ("PTC") is a direct federal subsidy, which is currently 2.2 cents per kilowatt hour (kwh) for renewable power. PTC is for the electricity generated that is sold wholesale. The owners of the renewable power plant subtract the value of the credit from their business income taxes. It is transferable but it is not renewed after the initial ten years.

In addition to the PTC, a cash grant was available through the American Recovery and Reinvestment Act of 2009. This program was part of a stimulus package wherein the Convertible Investment Tax Credit ("CITI") is a cash grant from the government for 30% of eligible investments.

Diedrich described the subject property as:

The subject property consists of buildings housing a boiler and turbo generator. Fuel in the form of woodchips, bark, paper mill residue, railroad ties and tire chips is fed into the boiler where it is burned. Tubes along the walls of the boiler carry water into the boiler. The heat from the combustion of the fuel turns the water into steam. That steam is fed into the turbo generator where it contacts vanes which start the turbine spinning. The spinning turbine is coupled to an electric generator. The spinning motion is converted into electric power in the generator. That electric power is then sold to the two customers while some of the steam is bled off and sold to CertainTeed. The fact that this plant supplies electricity and steam makes it a cogeneration plant. P-1 pp 6,7.

Diedrich testified that he considered all three approaches to value. He calculated a cost approach. The income analysis, which considered income for the sale of steam and electricity at market prices as of the tax dates at issue, was used to determine external obsolescence. The enterprise value was identified and deducted. Sales of power plants were considered; however, due to lack of comparable properties and inability to make adjustments, the sales comparison approach was not used.

The highest and best use conclusion was the subject property's continued use as it is currently operated.

Diedrich explained the two techniques to calculate the Reproduction Cost New (“RCN”) of the subject property. One technique is to develop a cost estimate with either the comparative-unit method, unit-in-place method, or the quantity survey method. While very specific, data intensive, they are time consuming. He used the trended original cost method to derive the RCN. The technique applies appropriate cost indexes to the vintage-dated surviving original cost of property. This method is described as:

Cost indexes convert a known cost as of a past date into a current cost estimate. Sometimes cost index tables can be used to adjust costs for different geographic areas. Cost index trending is also useful for estimating the current cost of one-of-a-kind items when standard costs are not available. However, there are practical limitations in applying this procedure because, as the time span increases, the reliability of the current cost indication tends to decrease. The Appraisal Institute, *The Appraisal of Real Estate* (Chicago, Illinois: 12th ed, 2008), p 369.

The Handy-Whitman Index of Public Utility Construction Costs is the indices referenced by Petitioner. The index numbers are based on the year 1973=100. The subject property is located in the North Central Region, with labor costs drawn from this specific region. Indirect costs such as administrative overheads, contractor’s profit, and contingency fees are added as percentage overrides to the basic costs. The indirect costs are capitalized and required to be by the Federal Energy Regulatory Commission (“FERC”) Uniform System of Accounts.

The RCN for the subject property using the trended original cost is \$69,800,000 as of December 31, 2009, and \$72,700,000 as of December 31, 2010.

The physical, functional, and external obsolescence is then deducted. The physical depreciation was measured based on service lives for steam-powered generating facilities. Diedrich has experience developing capital recovery studies. Physical deterioration for most generation assets was developed. Based on experience and analysis, the service lives by FERC plant account was Exhibit 5 of the appraisal. Based on experience, he determined that the Iowa curve that would best match the survivor characteristics for a fleet of steam-powered generating station was the R5.0 curve. The R-shape of the curve indicated to Diedrich that the peak of retirements occur just after the average service life. The age was divided by the Useful Life; the average service life is between 35 to 50 years. This results in physical deterioration of \$36,900,000 as of December 31, 2009, and \$39,400,000 as of December 31, 2010.

Functional obsolescence “is caused by a flaw in the structure, materials, or design of the improvement when compared with the highest and best use and most cost-effective functional design requirements at the time of appraisal.” *The Appraisal of Real Estate*, 13th ed., p 434.

Diedrich considered the difference between the reproduction cost new and the cost of replacement looking at two models. The first model uses the combined-cycle gas turbine technology as replacing the subject property at 30% of its reproduction cost new. The technology, however, is not renewable energy.

Dietrich's second model was a Biomass Bubbling Fluidized Bed. Nonetheless, the cost of replacement was the same as the reproduction cost new of the subject property; therefore, he determined that no functional obsolescence existed due to superadequacies in the subject property.

The loss in value within the property as a result of improved technology was found in the subject property in the form of excess operating costs. The heat rate (measured in British Thermal Units ("BTU")) measures how much fuel is required to create a kilowatt-hour ("KWH") of electric power. The subject property has a heat rate of 17,200 BTU/KWH. The modern replacement has a heat rate of 13,500 BTU/KWH. The replacement requires 22% less fuel to operate. The 22% difference equates to a \$7,000,000 loss to be deducted from the reproduction cost new.

Diedrich also considered that at the end of the subject's useful life a cost of demolition should be deducted. He states that approximately 5% of the original cost is adequate and applied a tax shelter discount rate to result in a present worth of the demolition costs of \$300,000.

Diedrich found the uncertainty of politics and the availability of cash grants from the federal government was a form of external obsolescence. He stated that a purchaser would need to earn approximately \$5.7 million per year before income and property taxes to justify the purchase of the subject property at the depreciated reproduction cost new. Diedrich includes all of the tangible and intangible property in the business to

determine income. The revenue is forecasted for electric and steam. Expenses were deducted for hourly operating labor, supplies, maintenance labor, supplies, salary labor, biomass fuel, and utilities. The total operation and maintenance costs are deducted, then general and administrative costs are deducted. The result is the net operating income capital expenditures are deducted the year in which they are spent.

Pretax cash flow is the result of the net income less the capital expenditures. The cash flows are forecast for twenty years and discounted to present value.

The development of costs of capital and the weighing into a weighted average cost of capital. Is the method used by Petitioner to determine external obsolescence. Diedrich used a capital asset pricing model to develop the equity return requirement. He started with US Bonds adjusted to reflect the risk of the small company. The next estimate adds a premium for size with an equity return of 16.00%. Floatation costs, which are incurred in the issuance of new securities, were then added for a final cost of equity at 16.75%. Diedrich estimated the cost of long term debt using 25 basis points more than utility debt (6.78%) and added floatation costs for a total of 6.85%.

The 12.79% is the weighted average cost of capital which Diedrich determined was appropriate to apply to the after tax cash flows. The taxes calculated considered the tax shelter effect of the debt payments. A 38.90% state and federal income tax rate was applied to a taxable value not adjusted for tax sheltering. The pre-income tax and pre-property tax rate is 21.90% for December 31, 2009, and 16.90% as of December 31, 2011.

Diedrich assumed that all cash flow is evenly spread throughout the year. The result is the business enterprise value of \$8,041,624. Working capital was estimated at 15% of the first year's revenues. The value of the workforce and other various intangible assets and personal property was estimated by Diedrich at \$500,000 for a net result of \$5,815,970 for December 31, 2009. This is an indication that 75% external obsolescence exists in the subject property. After the deduction from the Reproduction Cost New of the physical, functional, demolition costs and external obsolescence, the tangible assets of the subject property as of December 31, 2010, is \$6,400,000 and \$10,200,000 as of December 31, 2010.

Reproduction	
Cost New	\$69,800,000
Physical Deterioration	-\$36,900,000
Demolition	-\$300,000
Functional Obsolescence	-\$7,000,000
Subtotal	\$25,600,000
External Obsolescence	-\$19,200,000
Conclusion	\$6,400,000

Zachary J. Hakola, Energy Sales and Financial Manager, Traxys Power Group was the next witness. He was familiar with the July 5, 2007, purchase of the subject property.

He prepared the internal fixed asset schedule (Petitioner's Exhibits 4 and 5) to track the fixed assets, depreciation schedules, and original approved grant assets. It shows the additions made in 2010 and the cost.

Hakola explained Line items: 311 Buildings indicates that \$59,960.94 (Petitioner’s P-1, Exhibit 2, page 1) was added in 2010 for a new building. To understand the specifics Petitioner’s Exhibit-4 item 000270 states “Electricians Shop Addition” was \$59,960.94.

The assets were separated by land, land improvements, equipment, furniture and fixtures, vehicles, computers, electronics and software. The column headings include a number assigned to the asset, a brief description, installation date, depreciation months, and 30% deduction.

The Deferred Tax Impact contained the same columns as the gross investments. The totals for the columns are not separated by install date and include July 18, 2009, to January 31, 2012. Land improvements for 2009, only, is \$5,705,449, Buildings total \$2,793,728. The Equipment section includes items from a belt scale antenna kit for \$62.83, to testing expenses & start-up expenses for \$8,525,815.79.

The real and personal property are not separated. The asset listing does indicate that Petitioner has invested \$48,192,376.17 for various expenditures at the facility since the purchase. The 2009 acquisitions are broken down as follows:

Assets	
Land Imp	\$5,705,449
Buildings	\$2,793,728
Equipment	\$34,866,507
Furniture Fixtures	\$2,318
Computer	\$76,064
Software	\$61,125
2009 Total	\$43,505,191

Hakola explained that the IFT's were granted for significant clean up and new buildings.

Respondent's Arguments

Respondent was placed in Default by the April 29, 2011, Order Placing Respondent in Default for failure to answer the petition. The Order provided 21 days in which Respondent was to file a motion to cure the default and file an answer. Respondent failed to do so.

Tribunal's Findings of Fact

1. Subject property is located at 157 S. Main Street, L'Anse, in Baraga County.
2. Subject property was purchased by Petitioner in 2007 for \$4,000,000.
3. Subject property was constructed in 1959 as a coal burner power plant.
4. Subject property was converted to a natural gas plant in 1993 and put into long term storage.
5. Subject property was converted to a biomass-fueled power plant.
6. Subject property has a 20 megawatt name plate.
7. Petitioner used the cost new less depreciation approach to determine true cash value of the subject property.
8. Petitioner used the Handy-Whitman Index to trend the original cost new to the tax date.
9. Subject property has some physical obsolescence.
10. Subject property has some functional obsolescence.
11. The Tribunal finds that 75% external obsolescence as opined by Petitioner is not accepted as appropriate.
12. The weighted average cost of capital technique was applied to the subject property's business value to determine external obsolescence.
13. Land was not described in the body of the appraisal.
14. No value was assigned to the land.
15. Petitioner failed to describe the specific property that was appraised, other than an address.
16. The cost less depreciation is an appropriate methodology for a special use property.

Traxys purchased the plant in 2007 from the Upper Peninsula Power Company for \$4 million and converted it to a biomass-fueled power plant. It supplies renewable electricity to Certain Teed Gypsum and Ceiling Manufacturing plant and DTE. In

addition, it supplies steam to a Certain Teed Gypsum and Ceiling Manufacturing, thus it is a cogeneration power plant. Petitioner has invested approximately \$16,000,000 to \$23,000,000¹ in real and personal property for the subject property. The specifics of the inclusion of property were not known at the hearing.

Subject property includes buildings that house a boiler and a turbo-generator. Fuel is woodchips, bark, paper mill residue, railroad ties, and tire chips. Tubes along the walls of the boiler carry water into the boiler. The heat turns the water into steam which is fed into the turbo-generator where it contacts vanes which start the turbine spinning. The spinning turbine is coupled to an electric generator. The electricity is sold to two main customers.

DTE is required to have 10% of their electricity supply come from a renewable source. They sign contracts (power purchase agreements “PPA”) to purchase a specific MW of electricity long term. DTE receives renewable energy credits for purchasing the renewable electricity. In this specific instance, they pay \$102 per megawatt hour for the term of the 20 year contract.

The cost approach is accepted as better evidence of the value of the subject property. L’Anse Warden Electric Company is considered a special-purpose property that would not be frequently exchanged in the market; therefore, a cost approach is appropriate.

¹ The Tribunal notes that the real and personal property IFT exemptions indicate abatements of \$1,768,000 for real property and \$14,656,000 for personal property for a total of \$16,424,000. Petitioner has assigned a true cash value of \$23,847,634 to the IFT’s.

Conclusions of Law

Pursuant to Const 1963, art 9, §3, the assessment of real property in Michigan must not exceed 50% of its true cash value. 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 the assessment, being the price which could be obtained for the property at private sale, and not 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), has also held that true cash value is synonymous with fair market value.

In that regard, the Tribunal is charged in such cases 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 (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. A petitioner does, however, have the burden of establishing the property's true cash value. See MCL 205.737(3) and *Kern v Pontiac Twp*, 93 Mich App 612 (1974).

The legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law...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%....; and for a system of equalization of assessments. For taxes levied in 1995 and each year thereafter, the legislature shall provide that the taxable value of each parcel of property adjusted for additions and losses, shall not increase each year by more than the increase in the immediately preceding year in the general price level, as defined in section 33 of this article, or 5 percent, whichever is less until ownership of the parcel of property is transferred. When ownership of the parcel of property is transferred as defined by law, the parcel shall be assessed at the applicable proportion of current true cash value. Const 1963, art 9, §3.

As used in the General Property Tax Act, “true cash value” means 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. MCL 211.27(1).

“True cash value” is synonymous with “fair market value.” *CAF Investment Co, supra*. The Michigan Supreme Court, in *Meadowlanes Limited Dividend Housing Ass’n v City of Holland*, 437 Mich 473; 473 NW2d 363 (1991), acknowledged that the goal of the assessment process is to determine “the usual selling price for a given piece of property.” In determining a property’s true cash value or fair market value, Michigan courts and the Tribunal recognize the three traditional valuation approaches as reliable evidence of value. See *Antisdale v Galesburg*, 420 Mich 265, 277; 362 NW2d (1984).

“The petitioner has the burden of establishing the true cash value of the property....” MCL 205.737(3); MCL 211.27(1); *Meadowlanes, supra*. “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.” *Jones & Laughlin Steel v City of Warren*, 193 Mich App 348, 483 NW2d, 416 (1992), at 354-355, citing: *Kar v Hogan*, 399 Mich 529, 539-540; 251 NW2d 77(1976); *Holy Spirit Ass’n for the Unification of World Christianity v Dept of Treasury*, 131 Mich App 743, 752; 347 NW2d 707(1984).

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. *Meadowlanes*, at 484-485; *Pantlind Hotel Co v State Tax Comm*, 3 Mich App 170; 141 NW2d 699 (1966), aff'd 380 Mich 390 (1968); *Antisdale*, at 276. 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. *Antisdale*, at 277.

The Tribunal may not automatically accept a respondent's assessment but must make its own finding of fact and arrive at a legally supportable true cash value. *Pinelake Housing Cooperative v Ann Arbor*, 159 Mich App 208, 220; 406 NW2d 832 (1987); *Consolidated Aluminum Corp v Richmond Twp*, 88 Mich App 229, 232-233; 276 NW2d 566 (1979). The Tribunal is not bound to accept either of the parties' theories of valuation. *Teledyne Continental Motors v Muskegon Twp*, 145 Mich App 749, 754; 377 NW2d 908 (1985). 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. *Meadowlanes*, at 485-486; *Wolverine Tower Associates v City of Ann Arbor*, 96 Mich App 780; 293 NW2d 669 (1980); *Tatham v City of Birmingham*, 119 Mich App 583, 597; 326 NW2d 568 (1982).

Summary of Judgment

Although the above-captioned case is a Default Hearing, Petitioner still has the burden of proof. The burden of proof may be lower without opposition, but it remains a hurdle that Petitioner has to overcome. Petitioner has to produce evidence that persuades the

Tribunal that the subject property is over assessed. As indicated below, Petitioner has failed to meet this burden.

True cash value is synonymous with fair market value which can be determined by three different approaches: (1) cost new less depreciation, (2) sales comparison, and (3) income capitalization. The three approaches to value are:

In the cost approach, the value of a property is derived by adding the estimated value of the site 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. Appraisal Institute, *The Appraisal of Real Estate* (Chicago: 13th ed, 2008), p 142.

In the sales comparison approach, an opinion of market value is developed by comparing properties similar to the subject property that have recently sold, are listed for sale, or are under contract (i.e., for which purchase offers and a deposit have been recently submitted). A major premise of the sales comparison approach is that an opinion of the market value of a property can be supported by studying the market's reaction to comparable and competitive properties. Appraisal Institute, *The Appraisal of Real Estate* (Chicago: 13th ed, 2008), p 297.

In the income capitalization approach, an appraiser analyzes a property's capacity to generate future benefits and capitalizes the income into an indication of present value. The principal of anticipation is fundamental to the approach. Techniques and procedures from this approach are used to analyze comparable sales data and to measure obsolescence in the cost approach. Appraisal Institute, *The Appraisal of Real Estate* (Chicago: 13th ed, 2008), p 445.

The cost approach was considered and developed for the subject, but did not include a valuation for the land. The income approach was also developed and included the value of intangible assets of the business enterprise and was adjusted to determine external obsolescence. Petitioner appraised the market value of the subject property using sales of power plants, but found none remotely comparable to the subject.

Although 4,600 projects of renewable power were added in 2009, due to the cash grant through the American Recovery and Reinvestment Act of 2009, Petitioner found no comparable sales.

Petitioner's appraisal utilized the income approach to determine the external (economic) obsolescence of the subject property. The subject property itself is not an income-producing property akin to an apartment complex. It is in the business of producing energy; therefore, an income approach would not be appropriate to determine true cash value.

Petitioner's discounted cash flow was used to determine the amount supportable by the business (derived from income) which is determined for all the assets of the business. The amount supportable is compared to the market value-in-place to ascertain if any additional economic obsolescence is present. Petitioner's discounted cash flow analysis does not make an adjustment for the fact that during the first year of the appeal the subject property was not up and running for the full year. This skews the income approach beginning with year one. The extraction of capital expenditures was not spread out as in a reserve account but was taken out in their entirety. Petitioner's discounted cash flow to determine economic obsolescence began with the first tax year at issue in which the subject property was not operating at full capacity. The operating expenses for year one at \$9,244,388 was \$277,333 less than the subsequent years. The administration was fairly stable including the first year. The result is a net operating income (NOI) of \$534,318 for tax year 2010. The subsequent years' NOIs are

approximately \$2 million. The use of the discounted cash flow to determine the weighted average cost of capital and determining the amount of cash flow necessary to be generated is flawed in this instance. The use of the partial year decreases is to Petitioner's advantage for the 2010 true cash value. The income approach as projected by Petitioner indicates that the subject property only earns approximately 25% of the income necessary to justify the purchase of the subject property at the reproduction cost new less physical deterioration and functional obsolescence. Petitioner has skewed the results while acknowledging that the subject property was in a start-up mode for the first couple of years.

The Tribunal finds that the value of the business is within the boundary and confines of the subject property itself. External obsolescence² should measure outside influences that affect the true cash value of the subject property. The business valuation of the going concern is not distinguished from the real estate value of the subject property.

Petitioner's testimony on external obsolescence is:

There's a third form of obsolescence called external obsolescence. External obsolescence basically says can I make money on that? If you can't make money on the reproduction cost it's less functional then there must be something else that needs to be deducted, that brings the cost approach into reality because now you've built this thing up there theoretically and now you have to make – make it live in reality.

Back when I started at American Appraisal as a new employee there we all had to take what they called appraisal 101 and I got my best example of external obsolescence in that class. There was a gentleman there who appraised buildings and he said I just built a brand-new plant, it's the most state-of-the art, the most efficient plant, I spend \$10 million on it, it's brand new. What's its value? He says you don't know until I tell you what the plant makes. If it makes something that the market wants its value is

² Diedrich defines the result of the discounted cash flow as economic obsolescence and uses external and economic obsolescence throughout the testimony and report.

probably \$10 million, a brand new, state-of-the-art plant. If that plant makes buggy whips it's probably zero because there isn't a market out there for buggy whips. We don't ride around in horses and carriages anymore so if that plant is a state-of-the-art, brand-new power plant that makes buggy whips there isn't a market, therefore that plant is probably worth nothing, so external obsolescence brings reality into the whole equation and all of the appraisal texts explain how external obsolescence needs to be addressed before you can conclude your cost approach to value. Tr. Pp 36, 37.

Diedrich, therefore, ties external obsolescence to the amount of income the business produces to result in 75% external obsolescence for tax year 2010. This is confused with the income producing capability of the subject property. Subject property is not an income-producing property; however, the business of producing steam and electrical power is income producing. The object of the appraisal is to value the real property including land and land improvements of the subject property, not the value of the business enterprise and whether it's profitable.

External obsolescence is defined as:

External obsolescence is a loss in value caused by factors outside a property. It is often incurable. External obsolescence can be either temporary (e.g., an oversupplied market) or permanent (e.g., proximity to an environmental disaster) Appraisal Institute, *The Appraisal of Real Estate* (Chicago: 13th ed, 2008), p 442.

External obsolescence can be measured by allocation of market-extracted depreciation, analysis of market data, or capitalization of an income loss. The income-producing property begins with the market to quantify the loss, which is then capitalized to obtain the value loss affecting the property as a whole. In this instance, the method used to determine external obsolescence is akin to a business valuation which is used when a

business is considering an investment. The cause is not due to external factors outside the property. The loss as calculated by Petitioner was partially start-up costs specific to the subject property, as well as the costs to run a power plant which included the cost of producing electricity, personal property, work force, etc. All of the data presented was property specific; there was no outside negative influence to the subject property.

Therefore, the economic obsolescence as put forth by Petitioner is not accepted as reflective of the subject property and its specific location or the negative influence of the political environment.

Petitioner provided the expenses of operating the business of producing electricity and not the expenses of operating the property. The value of the going concern of a newly established business will be influenced by the initial start-up years where the subject is being tested to determine how to produce electricity and steam as efficiently as possible.

The cost less depreciation approach would be the most reliable method of determining true cash value as this approach does not include the influence of the ability of the subject property's business (of producing electricity and steam) to produce an income. The subject property is a special use, is not obsolete, and was recently renovated for the use for which it was designed. Under the cost approach, the land, alone, is valued as if unimproved, then the value of any improvements is established separately by calculating what the improvements would cost to newly construct and deducting an appropriate amount for depreciation.

Petitioner's cost approach began with the original reproduction cost new adjusted with a multiplier from Handy-Whitman for each individual component of the subject property. The result is a \$69,765,979 cost new. The IFT exemption was estimated at 34% or \$23,847,634. Within the appendix of the appraisal, but without testimony, the tax bills indicate that the subject property has one ad valorem real parcel, two parcels with an IFT, one ad valorem personal property, and two personal property parcels with IFT exemptions. The true cash that was invested in the four IFT properties is \$16,424,000. Petitioner has, therefore, overestimated the two year old improvements and deducted from the ad valorem cost \$23,847,634.

The testimony from Hakola explained some of the history and where new additions are booked on the internal fixed asset schedule. It serves to indicate to the Tribunal that Petitioner invested \$43,500,000 in the subject property for real and personal property. Cost does not always equal value; however, in this instance it is unclear how the cost relates to market value of the subject's real property.

The actual working of the plant is described and the transitioning of the plant from the original construction. The valuation contains references to how to appraise personal property, as well as real property and business valuation. The Handy-Whitman Index was applied to the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts. Petitioner's exhibit 1 contains the FERC accounts; however, it contains categories that appear to be personal property. This is noticeable when, for example, equipment is part of the description of the property. Petitioner assigned a vintage,

original cost, Handy Whitman Index, Spot Index, and a Trend Factor to equal the Reproduction Cost New. It is not clear what, if any, actual personal property is included in the Reproduction Cost New. The IFT exemptions are included in appendix 4, pages 4-7. They are marked IFT Exempt and equal 34% of Petitioner's cost new.

The Reproduction Cost New figure of \$69,800,000 that is used for 2009 contains real and what may be personal property. Without detailed descriptions the Tribunal cannot separate the real and personal property, or the property that has a tax abatement assigned to it. To further complicate the analysis of the subject property, \$300,000 is deducted as the present value of demolition costs. The Tribunal finds it is premature to consider demolition costs for a newly renovated facility; this is disallowed as a deduction from the cost approach.

Functional obsolescence using the difference between the subject property's heat rate and a new facility heat rate of 22% is appropriate. The calculation for external obsolescence using the weighted average cost of capital is a business valuation technique that does not assist the Tribunal in determining whether external obsolescence exists or some influence outside of the facility causes it to be worth less.

The Tribunal has invested considerable time after the hearing, considering all of the information (13 appendices with several hundred pages) and finds that the "cost" approach was missing some of the basic elements of a cost analysis. First, a description of exactly what is appraised in the form of a legal description with the size

and contribution of land was missing. Petitioner's appendix 1, page 4, indicates that it will not address the value of any land and states that an independent contractor should be hired if it was required. Therefore, land was not separately calculated and added to the real estate. This is a critical part of the cost approach that is completely omitted from the report.

In this specific instance the "description" for the property that Petitioner appraised is located on page 5 of Petitioner's appraisal. It is two sentences: "The subject property is located at 157 South Main Street, in L'Anse, Michigan. The subject property is located in Baraga County in the Upper Peninsula of Michigan." An excerpt from Google Maps is included. The Tribunal is unsure what Diedrich appraised. The appraisal itself was confusing, unclear, and was not easily understood. The Tribunal does not have any source that identifies the actual acreage, building size, and the contribution of any land or land improvements. It is incumbent on the appraiser to also be familiar with what is exempted from ad valorem taxation. The subject property has real and personal property interspersed throughout the appraisal; however, the actual elements of the real property are not described anywhere in the confines of the appraisal. The sketch of the subject property is found in Appendix 17, TIF Agreement with the Village of L'Anse for Brownfield Redevelopment. The land and surrounding area and market is not described.

The complexities of any particular appraisal assignment do not negate (or alleviate) the appraiser's obligation to satisfy fundamental elements of a credible appraisal (i.e., site

description, site analysis, site value). The necessity of these perceived basic elements is the very foundation of a summary report and the culmination of credible results. The Tribunal finds that while Diedrich may appraise power plants, in this instance the appraisal is misleading, does not appraise the subject property in its entirety, and appears to give more weight to the business portion of the subject property, with skewed results.

The Tribunal concludes that external obsolescence was not proven by Petitioner. In addition, the \$300,000 future cost of demolition is not accepted as part of the consideration of a cost approach. Therefore, the Tribunal finds the following cost new without the IFT's, disallowance for the demolition, and external obsolescence:

New W/O IFT	\$45,833,318
Physical	-\$24,209,159
Demolition	NA
Functional	-\$10,083,330
Subtotal	\$11,540,829
External	NA
Conclusion	\$11,500,000

The conclusion of \$11,500,000 is without an estimate for the value of land, because no description stating how much land contributed to the value of the subject property and land value was included in the \$40,000³ appraisal. The caveat was that the value of any land be independently contracted with a local appraiser if needed. The Tribunal

³ Appendix 1, page 4, "Our fee is based on the time expended and the billing rates of the individuals involved. Our bid to complete the above-described work is \$40,000 plus expenses."

finds that the cost new less depreciation requires the addition of land value separately or within the appraisal. This was not done.

Petitioner provided no evidence of the value of any land upon which the subject property sits, or the contributory value of the land. The only evidence is the metes and bounds description found in appendix 17. It does not include acreage. The Tribunal would be remiss in adopting the cost approach without the appropriate consideration of the land value. The lack of the acreage and the value that the land contributes to the overall market value of the subject property is a fatal flaw in Petitioner's cost approach. Therefore, Petitioner's value is incomplete and not accepted as market value for the subject property for the tax years at issue.

The Tribunal is unable to accept Petitioner's deficient true cash value because of the lack of a value and legal description for the land value in its valuation report. The Tribunal has no evidence that indicates the actual land legal description that would allow the Tribunal to clearly know what was actually appraised. Petitioner's valuation disclosure did not include a value for land. The complete lack of concern for the legal description and any resulting land value was a shock to this Tribunal. Without Petitioner providing the information it would require the Tribunal to go outside of the parameter of the evidence presented. It is incumbent on Petitioner to provide land value. Land value requires the valuation expert to justify the omission or exclusion of that component, not merely pass it off to the local appraiser. This appears to be in complete defiance of Petitioner's appraiser's invoked Standards and Ethics.

The Tribunal finds that the subject property is not worth less than \$11,500,000, to which value for land should be included. The value placed on the roll by Respondent was \$17,216,178 as of December 31, 2009. This could be proper if the land is valued at \$5,716,178. The Tribunal has no property record card from Respondent that establishes the acreage or size of the land for the subject property. Petitioner provided no evidence of land value (or for that matter a legal description or acreage) and, accordingly, the appraisal is given little weight and credibility as it was incomplete and contained misleading external obsolescence. The Tribunal finds that, based upon the evidence, testimony, and law, the subject property is not assessed in excess of 50% of market value.

JUDGMENT

IT IS ORDERED that the property's assessed and taxable values for the tax years at issue shall be as set forth in the *Summary of Judgment* section of this Final Opinion and Judgment.

IT IS FURTHER ORDERED that the officer charged with maintaining the assessment rolls for the tax year 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 90 days of the entry of the Final Opinion and Judgment, the 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 this Order within 28 days of the entry of this Order. 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 the Tribunal's order. As provided in 1995 PA 232, being MCL 205.737, as amended, interest shall accrue for periods after January 1, 1996 at an interest rate set each year by the Department of Treasury. Pursuant to 1995 PA 232, 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, and (iii) after December 31, 2011, at the rate of 1.09% for calendar year 2012.

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

MICHIGAN TAX TRIBUNAL

Entered: August 3, 2012

By: Victoria L. Enyart