STATE OF MINNESOTA **TAX COURT**

COUNTY OF CLAY **SEVENTH JUDICIAL DISTRICT**

Menard, Inc.,

Petitioner, **Court File No.: 14-CV-12-1500**

v. **PETITIONER'S POST-TRIAL BRIEF**

County of Clay,

Respondent.

INTRODUCTION

This case requires the Minnesota Tax Court to determine the market value of a mega "big box store"[1] owned and operated by Menard, Inc. ("Petitioner" or "Menards") in Moorhead, Minnesota. The issue presented is whether to value Menards' big box store in accordance with the 27 fee simple sales of big box stores analyzed by Menards' expert, Michael Marous ("Marous") or, alternatively, to value the property based on the leased fee, investment value, and value in use methodologies Respondent Clay County ("Respondent") suggests as a ready substitute?

There is nothing in the record to support the current assessments for January 2, 2011 through January 2, 2014 (the "years-in- issue"). In fact, Respondent stipulated that "for the limited purposes of the Court's consideration of whether the petitioner has rebutted the prima facie case of validity of the assessor's valuation, the

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[1] The Dictionary of Real Estate Appraisal (5^{th} ed. 2010), defines a "big-box store" as a "single-use store, typically between 10,000 and 100,000 square feet or more, such as a large bookstore, office-supply store, pet store, electronics store, or toy store. (ICSC) 2. A general merchandiser or category killer. General merchandisers … offer a wide variety of merchandise at deeply-discounted prices. The product mix of these stores includes nearly everything shoppers need for their home, work, garden, garage, or car, as well as recreational items and apparel." *Id.* at 19; *see also* 229 (defining "Big box" as a "large single-user retail building between 15,000 and 100,000 square feet, e.g., Circuit City; Best Buy; Bed, Bath, and Beyond; Home Depot; Sportmart; Target.").

County and the City are taking the position and assuming the valuation figure calculated by Mr. Vergin in his stated appraisal reports (the "DRES reports") as their own and would have been adopted during the years in question."[2]

Accordingly, the Court must weigh the evidence in the record to determine whether Menards' $4,000,000 market values for the years-in-issue,[3] are more persuasive than Respondent's proposed values of $12,000,000, $12,300,000, $12,500,000, and $12,700,000.[4] This brief demonstrates the reasons why the market analysis presented in Marous' appraisal is the only credible evidence of market value presented in this case.

EXECUTIVE SUMMARY OF THE CASE

Menards' market value opinion is supported by more than 50 sales of big box stores. The Marous appraisal is credible because he confined his analysis to fee simple principles, as opposed to the investment value and value-in-use concepts that became the touchstone of Respondent's case.[5]

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[2] Trial Transcript (hereinafter "Tr. Hearing Day _, p. _, l. _") at Tr. Hearing Day 1, p. 190, l. 1 through l. 8. Despite his reliance upon DRES's value conclusions for the 2011-2014 assessment years, Peter Doll, the Moorhead City Assessor and Real Estate Redevelopment Services Manager, testified that "I have changed this year's valuation [i.e., the 2015 assessment] to 14.2 million," or $1,500,000 beyond DRES's 2014 value conclusion. Tr. Hearing Day 2, p. 239, ll. 4-5.

[3] Trial Exhibit 1 at 141-142.

[4] Trial Exhibit A at 135, A-1 at 83-84. Significantly, Respondent's investment value conclusions appear to violate the principle of substitution. This is because any buyer willing to purchase the property for $12,000,000 to $12,700,000 would face an additional $3,000,000 to $4,000,000 expenditure to convert Menards' trade dress to a competing trade dress. Hence, it would be more cost effective to build a new big box store in the same locale for $45.81 per square foot plus the cost of the land (s*ee, e.g.*, Tr. Exhibit 1 at 57), than it would be to invest $96.71 per square foot to acquire and retrofit an existing Menards store.

[5] A telling example of the investment value/value-in-use nature of Respondent's case, occurred during Mr. Doll's direct testimony. When asked by Clay County's counsel how he "calculated your assessed value for this property", Mr. Doll responded: "You do not value a big box store on the size of the city. You value it on the piece of the pie that they serve, the 1, the 3, the 5, the 10 mile rings, <u>because that's how they decide to make investments in the store</u>. That's when they build. It's not based on the population of any larger than whatever area." Tr. Hearing Day 2, p. 237, l. 19 through p. 238, l. 6 (emphasis added).

The confusion between market value and investment value/value in use happens when an appraiser looks at the building, but sees *only* the occupant. The appraiser then makes a leap of faith to assume the occupant's current use is the highest and best use for the property as improved.[6] This leads to investment value/value in use determinations rather than market value of the fee simple estate. The reason for this is that it allows the appraiser to sidestep the penultimate valuation question, "What would the hypothetical new buyer desire that may be different from the use the property is being devoted to by the current user/seller?"[7]

A good example of this is DRES's refusal to consider *any* functional or economic "obsolescence for an extremely large store in a limited market situation."[8] Despite the fact each of DRES's comparable sales sold for far less than their original cost to build, DRES refused to analyze the sources of the accrued obsolescence associated with their sale prices. Instead, DRES concluded that in "the case of the subject property, there does not appear to be any design characteristic or building component which adversely affects the marketability of the subject property."[9] DRES similarly concluded that "the subject property generates sufficient rent to support the construction costs."[10] Neither of these conclusions is supported by market evidence. Nonetheless, simply by converting the analysis from fee simple market value principles to investment value ideas, DRES was able to sidestep a fee simple market valuation altogether.

[6] Tr. Exhibit A at 56.

[7] *See, e.g.,* Petitioner's Addendum, Part 2, at A-261 through A-268, Valuation of Big-Box Retail for Assessment Purposes: Right Answer to the Wrong Question, for an authoritative, peer reviewed analysis of the market realities affecting sales of big-box retail stores; *see also*, Tr. Exhibit 1 at 2 (summarizing the market factors which are combining "to depress the big box retail markets").

[8] Tr. Exhibit 3 at 7 (noting that even though a "highly comparable [DRES] sale demonstrates 78.7% depreciation from all sources," DRES "ignores" the inherent functional and economic obsolescence big box retail stores suffer from in its cost approach for the subject).

[9] Tr. Exhibit A-1 at 48.

[10] Tr. Exhibit A-1 at 49.

A second example of the same phenomenon is DRES's reliance on the 2006 sale of a former Walmart two miles north of the subject.[11] In this instance, DRES reported the sale price at $35.49 per square foot. According to DRES, the store was converted from its original big box retail use to an alternative commercial use. The property eventually was leased to a commercial tenant.[12] During the intervening years, the market demonstrated no one was willing to pay rent for any type of retail occupancy. Yet, simply by confusing value in use/investment value with fee simple market value, DRES is able to ignore the functional and economic obsolescence associated with the comparable sale's change in highest and best use. This allowed DRES to adjust the sale price upward by 31% to an "adjusted sale price" of $45.56 for the subject, despite the fact the Menards store is 43,780 square feet larger than the converted Walmart and is situated in a third tier location within a third tier market.[13]

A third example of this same phenomenon is shown by the 50% locational adjustment DRES made between the former Walmart and the subject property. The properties are two miles apart. The comparable sits directly across from a new Walmart. Yet DRES concludes its location is 50% inferior to the subject, without explanation. This contrasts with DRES's view that "market participants have indicated the Fargo/Moorhead area has continued to grow … [which] has resulted in increasing real estate values and high demand for retail space in the market."[14] And it again suggests that DRES is valuing the "investments in the store," not the fee simple market value the store would sell for on the open market should Menards decide to leave this remote location.

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[11] Tr. Exhibit A-1 at 54.
[12] Tr. Hearing Day 2, p. 269. l. 10 through p. 270, l. 20.
[13] Tr. Exhibit A-1 at 62; Tr. Exhibit 1 at 2, 6-24.
[14] Tr. Exhibit A-1 at 34.

In Minnesota, however, market value means the value of the fee simple interest of a property *for* its highest and best use, not *of* its current use. Market value determinations are rarely based on leased fee & sale-leaseback sale prices, or the contract rents generated from them, precisely because these transactions typically fail to reflect the value of the real property standing alone.[15] Instead, they normally include the value of economic interests and contract rights which are <u>never</u> supposed to be included in a fee simple analysis of "the price which could be obtained at a private sale … [which] represents an arm's-length transaction." Minn. Stat. § 272.03, subd. 8 (2015).

In this case, Marous confined his analysis to fee simple transactions. He did not violate USPAP Advisory Opinion 23 by relying on leased fee sales or sale-leaseback financing transactions. He considered and developed all three approaches to market value. And he used the compelling market data demonstrated by 50+ recent sales of big box stores to explain how the subject would be perceived by potential buyers.

In his cost approach, Marous demonstrated 86% depreciation for the seven primary comparable sales to the subject.[16] He also demonstrated 90% depreciation for the 20 sales comprising the secondary set of comparable sales.[17] By extracting total depreciation directly from market transactions, Marous objectively measured the 79.1% depreciation the subject would experience if placed on the open market.[18] Finally, in his income approach, Marous demonstrated why the estimated income and

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[15] The Dictionary of Real Estate Appraisal (5th ed. 2010), defines a "sale-leaseback" as a "financing arrangement in which the real estate is sold by its owner-user, who simultaneously leases the property from the buyer for continued use. Under this arrangement, the seller receives cash from the transaction and the buyer is assured a tenant." *Id.* at 175. For an excellent discussion of why the contract rent paid in such transactions is not a good indicator of the fee simple market value of real property rights, *see Walgreen Co. v. City of Madison*, 752 N.W.2d 687 (Wis. 2008).
[16] Trial Exhibit 1 at 65.
[17] Trial Exhibit 1 at 67-68.
[18] Trial Exhibit 1 at 67.

expenses associated with converting an owner-occupied mega/oversize big box retail store into an investment property "has no to very little market appeal."[19]

In contrast to the Marous appraisal, the DRES reports contain numerous errors including: (a) 100% net-leased properties and sale-leaseback financing transactions "that provide indications of leased fee value when the assignment is a fee simple valuation:"[20] (b) net leases that "are mostly non-arm's length build-to-suit or sale-leaseback type of agreements;"[21] (c) estimates of market rent "using primarily non-arms-length rental agreements from build-to-suit or sale-leaseback rental agreements;"[22] (d) inappropriate entrepreneurial profit in its "costs new" estimate for a building built by Menards for use by Menards;[23] (e) depreciation "estimated without any market support;"[24] and (f) no consideration of functional and economic obsolescence despite compelling market data demonstrating "that obsolescence is present in the sale of a highly similar property."[25]

The DRES reports were reviewed by Gary Battuello, MAI, AI-GRS, who has conducted between 100-150 review appraisals. Mr. Battuello achieved certification by the Appraisal Institute as a specialist in critiquing appraisals for USPAP compliance.[26] Battuello found the DRES reports contained various areas of inconsistency, numerous errors under USPAP,[27] and a general lack of adherence to Minnesota's fee simple market value principles. Battuello concluded none "of the valuation methods are completed properly for a fee simple appraisal assignment. The appraisal procedure

[19] Trial Exhibit 1 at 121-122.
[20] Tr. Exhibit 3 at 15.
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Id.*
[26] Tr. Hearing Day 2, p. 469, l. 22 through p. 472, l. 20.
[27] *See* Tr. Exhibit 10 (USPAP Advisory Opinion 23); Tr. Hearing Day 2, at p. 290. l. 12 through p. 292, l. 4.

and value estimate [are] not considered to be reasonable or reliable and [lack] support for a fee simple valuation assignment."[28]

Battuello's review of the DRES appraisal went unchallenged during cross-examination, particularly with respect to the fact that a "highly comparable sale demonstrates 78.7 percent depreciation from all sources … which cannot be ignored in the Cost Approach," yet the DRES report "does not recognize any obsolescence for [the subject property], an extremely large store in a limited market situation."[29]

Similarly, Battuello's observation that DRES's use of four leased fee sales which "do not directly compete with fee simple properties and do not meet the principle of substitution inherent in the Sales Comparison Approach,"[30] also went unrebutted. So too did his pointed criticism that DRES had improperly included "adjustments to the [sales] price [of four comparable sales] for expenditures made after purchase."[31] Finally, Battuello's observation that DRES's income approach is based primarily on leases that "appear to be build-to-suit or sale-leaseback agreements that lack the exposure to the market and competition between landlords and tenants that represents true market rental deals," also was left unrebutted.[32]

The DRES reports contain several additional mistakes which were identified during cross-examination. For example, DRES appraiser Timothy Vergin admitted that he mistakenly excluded mezzanine square footage from at least one comparable sale (*i.e.*, DRES Sales comparable #7), while continuing to include it in the total square footage he ascribes to the subject.[33] Mr. Vergin attempted to justify this subtle error

[28] Tr. Exhibit 3 at 15.
[29] Tr. Exhibit 3 at 7.
[30] Tr. Exhibit 3 at 9.
[31] Tr. Exhibit 3 at 9.
[32] Tr. Exhibit 3 at 12.
[33] Tr. Hearing Day 2, p. 364, l.5 through p. 365, l.20.

by testifying "it's kind of a zero sum gain" because "the mezzanine, that's the only worthless space."[34]

If this were true, DRES would not have continued to value Menards' 11,041 square feet of mezzanine space at the same $50.76 to $53.71 per square foot value DRES imputes to the rest of Menards' ground floor space (and its unheated garden center/overhang and warehouse lumber shed). Respondent also would not be asking this Court to add $560,441.16 to $593,077.41 in market value to account for what it admits is "worthless space." Yet the DRES reports do precisely that.

A second example of the nature of the DRES reports are their insistence that the $24.50 per square foot sale of a Lowes big box retail store in Rogers, Minnesota, had extensive use restrictions in place at the time of sale. In DRES's view, these alleged use restrictions justified a 75% "conditions of sale" adjustment to make it comparable to the subject.[35] Mr. Vergin testified that "I spoke to the buyer at length, and he told me that that property could not be used for anything but a furniture store. Wouldn't allow for grocery. There was a use restriction. Wouldn't allow for other similar Lowe's, Menards's type, Fleet Farm type uses."[36] When questioned further about the extent of the use restrictions in place at the time of sale, Mr. Vergin reiterated that the use restrictions prohibited anyone but a furniture store retailer from buying the property.[37]

However, when confronted with the limited warranty deed[38] demonstrating that numerous retailers could have purchased the store, and that <u>no</u> use restriction prohibiting sales of groceries actually existed with respect to any of these potential

[34] Tr. Hearing Day 2, p 365, ll. 9 & 19.
[35] Tr. Exhibit A-1 at 62.
[36] Tr. Hearing Day 2, p. 329, ll. 1-6.
[37] Tr. Hearing Day 2, p. 329, ll. 7-19.
[38] Tr. Exhibit 12.

buyers, Mr. Vergin admitted his characterization was not true.[39] Nevertheless, he refused to reconsider his "opinion as to the expansive nature of the use restrictions,"[40] much less his 75% conditions of sale adjustment. When combined with the 30% location adjustment DRES made in favor of the subject, DRES was able to convert a bellwether comparable sale into a sale price which bears no relation to the actual transaction.

A third example of the nature of the DRES reports came from Mr. Vergin's admission that even though every one of the four comparable sales the parties have in common[41] was assessed at the sale prices reported by Marous,[42] DRES still added the buyers' alleged "renovation costs" to two of these sales. By doing so, DRES increased their alleged sale prices by $2,369,902 (Burnsville Menards/Petitioner's Sale #6) and $2,800,000 (Cambridge Lowe's/Petitioner's sale # 1).[43] DRES did this, despite Mr. Vergin's acknowledgement he was unaware of any discussion between the sellers and buyers that may have justified such expenditures being added to the actual purchase prices,[44] and despite his recognition that his increases in sale prices went well beyond the sale prices reported by the parties to the Minnesota Department of Revenue or the county assessors.

A fourth example of this same phenomenon occurred with respect to DRES's reporting of the square footages of its comparable sales. For example, in the case of the Rogers Lowe's sale (Respondent's Comparable Sale #5), Mr. Vergin testified he

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[39] Tr. Hearing Day 2, p. 352, l. 19 through p. 354, l. 25.
[40] Tr. Hearing Day 2, p. 355, ll. 15-23; *See also*, Tr. Hearing Day 2, p. 356, l. 4 through p. 360, l. 18.
[41] Tr. Exhibit 1 at 75 (Sale #1, Sale # 3, Sale # 4, and Sale # 6); Tr. Exhibit A-1 at 54 (Sale #2, Sale #3, Sale #5, and Sale #8).
[42] *See* Tr. Exhibit 1 at 98; *see generally*, Tr. Exhibit 1 Addendum at A-119, A-130, A-152, A-172, and A-195.
[43] Tr. Hearing Day 2, p. 418, l. 8 through p. 421, l. 7.
[44] Tr. Hearing Day 2, p. 463, ll. 9-24.

received the ACER report from the Hennepin County Assessor's Office confirming the store was comprised of 130,620 square feet of enclosed ground floor space and an additional 8,968 square feet of unheated garden center space.[45] He also admitted he did not "know for sure" the actual square footage of the store. Yet he "used the 120,000 square feet" figure in his report anyway, because "if it were larger it would even show a more depressed price per square foot."[46]

A fifth example of this same phenomenon lies with DRES's use of at least two "invalid" land sales in the vicinity of the subject.[47] In this instance, DRES used these invalid sales to justify a land value for the subject well in excess of its assessed value (*i.e.*, $3.00 per square foot), as well as the sale price Menards received from a recent sale of adjoining land to Sams Club (*i.e.*, $3.50 per square foot).[48] When asked why he did not report the actual sale price for one of the land parcels sold, Mr. Vergin testified "the sale was adjusted up, because it was an atypical sale."[49] With respect to the other invalid sale, Mr. Vergin testified that "we verified the sale independently and decided that we could use it based on our discussions with either the buyer, seller or market participant."[50]

This type of appraisal practice is not credible, because it fails to provide any objectively verifiable method for determining unit pricing of big box stores in the 2011-2014 market. On the other hand, Petitioner's appraisal (and its review appraisal) do conform to Minnesota's definition of market value. Each adheres to generally accepted

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[45] Tr. Exhibit 1 at 75, Tr. Exhibit 1 Addendum at A-160.
[46] Tr. Hearing Day 2, p. 360, l. 19 through p. 361, l. 11.
[47] *See* Tr. Exhibits 13 & 14.
[48] Tr. Exhibit 1 at 51.
[49] Tr. Hearing Day 2, at p. 424, l. 9.
[50] Tr. Hearing Day 2, p. 426, l. 22 through p. 428, l. 17.

appraisal principles. Petitioner thus has presented a persuasive evidentiary record as to what the assessed values for the subject should be for the years-in-issue.

FACTS

By agreement between the parties at the close of trial, Petitioner has attached its Proposed Findings of Fact, Conclusions of Law, and Order for Judgment to this Post-Trial Brief at Exhibit A, and incorporates its Proposed Findings by reference as if fully set forth in the applicable sections of this brief.[51]

ARGUMENT

1. The Peer-Reviewed Empirical Data Underlying Petitioner's Value Conclusions.

As Menards' pointed out in its pre-trial submission, big-box stores have proven to be a very difficult valuation problem for many assessors over the past five years, as the temptation to assess them at estimated market values in line with smaller income-producing stores (or multi-tenant shopping centers), is often too great to pass up.[52] The problem with this approach is that, unlike other types of retail properties, big box stores are not built to be income-producing real estate, and each suffers from various forms of functional and economic obsolescence from the moment the lights turn on and the store opens.[53]

As consumer trends continue to evolve away from "one-stop shopping," so too has the demand for big box stores.[54] Consequently, these stores have been closing at

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[51] Tr. Hearing Day 2, p. 511, ll. 1-15.
[52] *See, e.g.*, Tr. Hearing Day 2, p. 239, ll. 4-5 (Moorhead City Assessor testifies that he has raised Menards' 2015 assessment to $14,200,000, or $87.47 per square foot).
[53] *See, e.g.*, Tr. Exhibit 1 Addendum, Part 2, at A-261 through A-268.
[54] *Id.*

a rapid rate, and their "functional inutility"[55] in the retail marketplace has led to diminished pricing for the resale of the real estate itself.

Moreover, reconfiguring these buildings for multi-tenant use is very costly, due to the need to redistribute central electrical and heating controls, restrooms, entryways, security systems, etc.[56] High costs of retrofit have left these properties with very few options in a resale scenario. They are not built to sell for continued use as retail centers, since they have very little potential in most cases to become income-producing retail properties, and often are not in legally permissible locations for an alternative highest & best use, such as an industrial warehouse use.

Rather, they were built to generate an income stream by an AAA credit tenant. Hence, when they do sell, the sale prices invariably reflect a tremendous discount off of actual construction costs. This has been demonstrated multiple times in recent years through the fee simple sales of more than 50 Target, Lowe's, Wal-Mart, Costco, Home Depot, and Menards stores in locations nation-wide. These sales are partially depicted in the following summaries:[57]

[55] The Dictionary of Real Estate Appraisal (5th Ed.2010), defines "functional inutility" as the "Impairment of the functional utility of a property or building according to market tastes and standards; equivalent to functional obsolescence because ongoing change makes the plan, form, style, design, layouts, or features obsolete." *Id.* at 85.
[56] Tr. Exhibit 1 at 2.
[57] See Tr. Exhibit 1, Addendum, Part 2, at A-269 through A-275.

Summary of Target Corporation Sales

Location	State	Year Built	Sale Date	Land Sq Ft	Building Sq Ft	Sale Price	Per Sq Ft
Brownsville	TX	1995	10/10/2011	320,128	97,607	$1,900,000	$19.47
Ridgmar	TX	1979	1/5/2012	536,224	102,997	$2,140,000	$20.78
NewPark Mall	CA	1997	5/1/2012	492,855	135,792	$5,300,000	$39.03
Port Richey	FL	1990	5/16/2012	369,389	105,247	$2,072,000	$19.69
South Denver	CO	1971	6/19/2012	567,500	110,535	$2,150,000	$19.45
Capital Boulevard	NC	1994	6/19/2012	463,552	116,244	$3,850,000	$33.12
Hampton	VA	1996	8/14/2012	422,340	117,803	$3,700,000	$33.12
Kenosha	WI	1994	11/14/2012	421,182	96,149	$2,385,000	$24.81
Gastonia	NC	1989	11/16/2012	332,981	99,799	$1,900,000	$19.04
Warren	MI	1990	12/13/2012	387,279	105,738	$2,250,000	$21.28
New Braunfels	TX	1994	12/21/2012	302,960	90,241	$2,000,000	$22.16
West Colonial	FL	2001	1/29/2013	777,546	177,081	$5,400,000	$30.49
Ocotillo	AZ	2000	2/27/2013	473,410	122,622	$4,050,000	$33.03
San Antonio	TX	1997	4/25/2013	845,156	118,911	$3,650,000	$30.70
Almeda	TX	1970	4/24/2013	1,466,230	122,952	$2,600,000	$21.15
Antioch	TN	1981	7/25/2013	678,230	116,949	$2,700,000	$23.09
Colorado Springs	CO	1969	7/30/2013	672,916	151,030	$3,500,000	$23.17
Broomfield	CO	1995	7/30/2013	494,088	116,244	$3,500,000	$30.11
Manassas	VA	1997	7/30/2013	165,903	103,243	$4,700,000	$45.52
Kissimmee	FL	1992	9/17/2013	575,471	114,386	$2,650,000	$23.17
TOTALS				10,765,340	2,321,570	$62,397,000	$26.88

Summary of Lowe's Sales

Location	State	Year Built	Sale Date	Land Sq Ft	Building Sq Ft	Sale Price	Per Sq Ft
Biddeford	ME	2006	12/31/2012	824,723	138,135	$4,005,642	$29.00
Ellsworth	ME	2007	10/31/2012	771,448	138,684	$3,200,000	$23.07
Ionia	MI	2005	5/8/2013	636,847	111,316	$2,700,000	$24.26
Rogers	MN	2006	11/19/2011	571,507	139,588	$3,200,000	$22.92
Brown Deer	WI	2006	12/1/2013	478,289	139,571	$2,700,000	$19.34
N Apple Valley	CA	2007	8/8/2012	546,242	135,197	$3,035,000	$22.45
Princeton	WV	1998	3/23/2010	839,227	135,197	$2,500,000	$18.49
Ionia	MI	2006	4/1/2013	741,827	111,119	$2,700,000	$24.30
Kenai	AK	2008	11/20/2012	643,817	109,872	$3,000,000	$27.30
Cambridge	MN	2009	10/15/2012	481,774	127,083	$5,000,000	$39.34
Aurora	IL	2005	1/27/2012	598,079	139,494	$4,000,000	$28.68
Milwaukee	WI	2004	Approved	556,348	134,314	$2,500,000	$18.61
TOTALS				7,690,128	1,559,570	$38,540,642	$24.71

Summary of Walmart Properties for Sale				
Location	State	Building Sq Ft	Asking Price	Per Sq Ft
Amarillo	TX	110,803	$2,800,000	$25.27
Camilla	GA	34,875	$950,000	$27.24
Devil's Lake	ND	72,105	$1,600,000	$22.19
Eastlake	OH	142,108	$3,250,000	$22.87
Elgin	IL	118,827	$3,850,000	$32.40
Hammond	IN	145,542	$3,950,000	$27.14
Houston	TX	132,493	$7,625,000	$57.55
Jackson	MS	128,540	$2,950,000	$22.95
Joliet	IL	116,123	$2,600,000	$22.39
McHenry	IL	115,590	$3,900,000	$33.74
Morganton	NC	88,174	$2,125,000	$24.10
Naperville	IL	115,179	$5,600,000	$48.62
Niagara Falls	NY	138,658	$2,500,000	$18.03
North Lauderdale	FL	126,947	$7,500,000	$59.08
Port Angeles	WA	129,842	$2,950,000	$22.72
Rexburg	ID	94,370	$2,950,000	$31.26
Richardson	TX	41,685	$2,875,000	$68.97
St. Petersburg	FL	121,595	$7,500,000	$61.68
Stamford	TX	41,306	$1,050,000	$25.42
Victorville	CA	126,022	$3,700,000	$29.36
Woonsocket	RI	121,162	$3,275,000	$27.03
TOTALS		2,261,945	$75,500,000	$33.38

As these summaries demonstrate, Target Corporation sold 20 of its big box stores, totaling 2,321,570 square feet, between October of 2011 and September of 2013, for an average sales price of $26.88 per square foot. Similarly, Walmart has listed 21 of its big box stores for sale (including a 72,105 square foot store listed for sale at $22.19/sf. located in Devil's Lake, North Dakota approximately 166 miles northwest of the subject property), with an average listing price of $33.38 per square foot. And, perhaps most significantly, between March of 2010 and December of 2013, Lowe's sold 12 of its stores, totaling 1,559,570 square feet, for an average sales price of $24.71 per square foot.

The vast majority of Lowe's properties sold are considered to be highly comparable to the subject in terms of age, size, and overall design/layout. This was demonstrated at trial by the fact that both appraisers used two of these sales in their respective sales comparison approaches to value the subject property. Menards' primary contention at trial was that its assessed value(s) for the years-in-issue should reflect the market realities that are affecting the market value of big box retail stores nation-wide.

In light of the significance of recent market trends, Menards also asked this Court to examine the case law from states such as Michigan and Indiana, where the issues associated with big box store functional and economic obsolescence already have been litigated to reflect actual unit pricing for this property type.[58] The Marous appraisal follows each of the appraisal principles credited in these persuasive decisions, which is why Menards believes it should be considered persuasive by this Court as well**.**

2. The Marous Appraisal Is Based on the Compelling Market Data Reflected in 50+ Sales of Big Box Stores Which Have Occurred During The Past Four Years.

As noted earlier, at trial Menards presented a comprehensive fee simple appraisal authored by Michael S. Marous, MAI, CRE. Mr. Marous is a nationally-recognized appraiser who, for the past 35 years, has evaluated the market value(s) of big box retail stores on behalf of both taxing authorities and taxpayers in more than 25 states.[59] Mr. Marous analyzed the fee simple sales of twenty-seven (27) comparable properties to demonstrate that the concluded unit value range for the subject property as of January 2, 2011 is $22.50 to $25.00 per square foot of building area, including

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[58] See Exhibit 1, Petitioner's Addendum, Part 2, at A-241 through A-260, A-282 through A-300, and A-301 through A-359.
[59] See Tr. Exhibit 1 at 149-154, depicting Michael S. Marous' Statement of Qualifications.

land. Mr. Marous also relied on these sales to conclude that because market "fundamentals have remained relatively flat over the time period represented by [Menards] retrospective dates of value, particularly in regard to a big box retail store property type under consideration the retrospective fee simple market value of the subject property" remained at an estimated value of $4,000,000 for each of the years-in-issue.[60]

Mr. Marous' appraisal describes the regional overview, market analysis, and neighborhood analysis for the subject property. [Tr. Exhibit 1 at 6-24]. Mr. Marous testified as to "the superior population and income market demographics for Fargo, North Dakota, when compared to those of Moorhead, Minnesota."[61] In addition, he testified that "the subject property is located in a tertiary commercial area of the mostly isolated and secondary Fargo-Moorhead commercial market area. The majority of the retail stores are located within the Fargo/West Fargo portion of the metro area and that is where the majority of the retail dollars are being spent. Further, if a general retail user were to move into this market, it would most certainly locate in the more established and successful commercial areas of West Fargo/Fargo or Moorhead/Dilworth and most certainly <u>not</u> locate in the subject property's immediate local area."[62]

Marous substantiated his conclusion by pointing out that Menards "purchased a larger 64.70-acre parcel for the development of the subject property ... in May 2006," subdivided the overall parcel "into 13 outlots[63] and a larger tract of land containing 18.56 acres," but for nine years has been unable "to sell <u>any</u> of

[60] Tr. Exhibit 1 at 74-106.
[61] Tr. Exhibit 1 at 22.
[62] Tr. Exhibit 1 at 23-24 (emphasis in original).
[63] The Dictionary of Real Estate Appraisal (5th Ed.2010), defines "outlot" as a "building site or Pad that benefits from being part of a larger development." *Id.* at 140.

the outlots in the open market."[64] Marous also testified that the "Gross Sales Comparison" between the Moorhead store and a nearly identical Menards store located in West Fargo further demonstrated why the subject's location is very problematic for any type of retail re-use.[65]

From this information, Marous was able to confirm that in 2011, the Moorhead store operated at only 64.4% of the gross sales enjoyed by the West Fargo location, that the subject's gross sales dropped to 63.6% of West Fargo's sales in 2012, 62.4% in 2013, and rose slightly to 65.4% of the "same store sales" as compared to West Fargo in 2014. From an appraisal standpoint, this comparison buttressed Marous' conclusion that the subject's tertiary location would not be an attractive location for any general retail user seeking to locate in the Fargo-Moorhead area.[66]

Marous' appraisal contains further analysis regarding market inventory (*i.e.*, number of buildings), total available square footage, absorption, vacancy rates, lack of new construction, big box store closures nation-wide, etc., to demonstrate there "has been a severe imbalance in terms of supply and demand for big box stores and this imbalance is expected to continue and, in fact, worsen in the future."[67] Marous then testified that as "I determine the various retrospective value opinions, I am considering these market data, trends, market indicators, etc. that were available at the respective retrospective dates of value."[68] The primary conclusion Marous reached is that little demand exists for big box retail space once the built-to-suit, owner-occupant vacates the building. Further, the demand factors for big box stores are similar throughout Minnesota and, indeed,

[64] Tr. Exhibit 1 at 50, 24 (emphasis in original).
[65] *See* Tr. Exhibit 1, Addendum, Part 2, at A-383.
[66] Tr. Exhibit 1 at 24.
[67] Tr. Exhibit 1 at 26.
[68] Tr. Exhibit 1 at 28.

nationwide. [Tr. Exhibit 1 at 24-28; Addendum at A-65-114; A-209-229; Addendum, Part 2, at A-261-268; A-384].

Mr. Marous also testified regarding the difference between a fee simple market value interest and a leased fee interest. The real property is being appraised, not the occupancy of the property. [Tr. Exhibit 1 at 3-5]. The property rights appraised in Marous' appraisal are the fee simple market value interest. The property was appraised as if unleased, vacant, and available for sale. "Should this building become vacant, it is highly likely the building would remain vacant. The building would require an extensive amount of capital improvements to [re-demise] the space into smaller retail units and this expense is not economically feasible. A more likely scenario is converting the space to some type of light industrial use or securing an alternate user who would raze the improvements in favor of its own design and alternate use." [Tr. Exhibit 1 at 48].

Marous described the highest and best use of the subject property relative to the fee simple, owner-occupied elements. He identified the three approaches to value as the cost approach, sales comparison approach, and income capitalization approach. Further, he identified the LoopNet, MLS, assessors, brokers, bankers, and third-party appraisers as data sources for this appraisal assignment.

Mr. Marous considered various site improvements surrounding the store. He noted the main site improvement is the lumber shed. Other areas that were not included in the overall gross building area were the mezzanine, loading dock, special order area (supply garage), garden center, overhang canopy (shipping), and guard station. In Marous' opinion, "these areas are not considered by market participants, either a potential buyer or user, as traditional building area." [Tr. Exhibit 1 at 38].

Perhaps more importantly, "the subject's site improvements … would have very little to no appeal to the market independent of an economically viable big box store on the site." [Tr. Exhibit 1 at 63]. That said, Mr. Marous did consider them when determining a unit price for the subject, and gave some contributory value to these site improvements in reaching his overall market value conclusions.[69]

Mr. Marous researched and analyzed seven "primary set" comparable sales in Minnesota for the sales comparison approach to value. [Tr. Exhibit 1 at 74-101]. In addition, Marous researched and analyzed 20 additional fee simple sales of big box stores located in Wisconsin, Michigan, Indiana, Illinois, Alaska, California, Maine, and West Virginia, to demonstrate "that regardless of location or age, a rather narrow range of value is indicated. This phenomenon is clear market evidence that the factors influencing big box retail store values, (*i.e.*, imbalance in supply and demand, market trends and influences that retailers are moving to smaller stores, online purchasing, etc.) is a <u>nationwide</u> market truth and is not limited to any one geographic area."[70] [Tr. Exhibit 1 at 105 (emphasis in original); *see generally,* Tr. Exhibit 1 at 101-106].

Marous pointed out that deed restrictions were investigated in each of the comparable sales. "The overwhelming market response to inquiries regarding the potential or actual impact, either positive or negative, on a property resulting from this type of use restriction by the market, is that they do not have any measurable impact on the property, either in terms of marketability, market perception, and, ultimately,

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[69] Tr. Exhibit 1 at 38.

[70] Marous relied on the Minnesota Supreme Court's recognition in *McNeilus Truck Manufacturing v. County of Dodge*, 705 N.W.2d 410 (Minn. 2005), that "what commentators have termed 'economic proximity,' not mere physical proximity, makes two pieces of real estate comparable. J.D. Eaton, Real Estate Valuation in Litigation 209 (2d ed. 1995). The market real buyers examine is not always limited by distance or location, nor by state lines. Indeed, state lines might be practically invisible to certain purchasers of land. Such an arbitrary and artificial limit may not reflect market principles and creates grave risk of distorting property valuation." *Id.* at 413-414; Addendum at A-234.

market value." [Tr. Exhibit 1 at 97]. Specifically, Marous' appraisal documents the fact that "if a particular home improvement store closed for lack of business, there was virtually no likelihood a competitor would relocate to that area because they probably would not be successful in that location." [Tr. Exhibit 1 at 97-98].

The reason for this, according to several market participants Marous interviewed for this assignment (*e.g.*, Mr. Robert J. Meiers, Property Tax Manager at Lowe's), is "that big box retail stores are not built for resale or for entrepreneurial profit … [and in any event] there is a nation-wide oversupply of big box stores and, regardless of location, they all suffer from 'severe obsolescence.'" [Tr. Exhibit 1 at 98]. "Therefore, adjustments are not supported by the market nor are they appropriate for the comparable improved sales' use restrictions." [Id]. Perhaps the best evidence that the use restrictions did not influence the arms-length character of the transactions, much less their sale prices, is the fact that "the [comparable sales] were assessed at or near the purchase prices in the assessment year(s) closest to their respective dates of sale."[71] Nonetheless, Mr. Marous applied "a minor positive adjustment range from 0 to 5 percent to the comparable improved sales for any use restrictions that were in place" at the time of sale.[72]

Mr. Marous' appraisal explains all other transactional and physical characteristic adjustments made to his comparable sales. [Tr. Exhibit 1 at 98-101]. After "all quantified adjustments are made, a range of $22.75 to $24.64 per square foot of building area including land was developed based on the middle points of the adjusted sales prices. Also, a range of $21.49 to $22.43 per square foot of building

[71] Tr. Exhibit 1 at 98; *see generally*, Tr. Exhibit 1, Addendum at A-119, A-130, A-152, A-172, and A-195.
[72] Tr. Exhibit 1 at 98.

area including land was developed based on the average of the adjusted sales prices." [Tr. Exhibit 1 at 101].

To cross-check his value conclusions, Marous included a secondary set of 20 additional improved sales in his appraisal report. [Tr. Exhibit 1 at 101-105]. He pointed out that while these "sales are not located in Minnesota [they each] have a high degree of similarity to the subject property in terms of 'economic proximity'." [Tr. Exhibit 1 at 102]. Following the same analysis/market adjustments he applied to his primary set of comparable sales, Marous concluded the "secondary set develops an overall average price per square foot of $24.56 of building area, including land." [Tr. Exhibit 1 at 105]. And, based upon 27 different fee simple sales of big box retail stores similar to the subject, Marous concluded that the retrospective fee simple market value of the subject property by the sales comparison approach, as of each of years-in-issue, was $4,000,000, rounded. [Tr. Exhibit 1 at 105-106]. This was based on the Menard's store gross building area of 162,340 square feet of heated and enclosed space, with the unheated space and lumber sheds considered in the overall unit pricing Marous determined to be the most likely sale price for the subject. [Id].

Mr. Marous also developed a comprehensive cost approach for this appraisal assignment. He contended that the cost approach is not relevant or necessary because potential buyers do not place any reliance on this approach. [Tr. Exhibit 1 at 63]. Nonetheless, Marous felt the approach was useful to empirically derive "the total and average annual depreciation accrued to the comparable improved sales within the primary set of improved [comparable sales] included in the sales comparison approach to value." [Tr. Exhibit 1 at 64].

Marous determined the Estimated Total Depreciation for the seven improved sales included in his primary set of comparable sales to be 86.00%, on average, with "the newest buildings with ages of 3 years and 6 years [having] overall depreciation ranges from 69.34 percent to 89.31 percent, respectively. My estimate of the approximately 4-year old subject property's depreciation as of January 1, 2011, is 79.1 percent and this amount is very well supported by the market data. Further, when analyzing the improved sales with ages of 3 years and 6 years, their annual depreciation rate ranges from 23.11 percent to 14.89 percent, respectively. My estimate of the subject's annual depreciation rate of 19.8 percent … is very well supported by the market data." [Tr. Exhibit 1 at 65-67].

"In addition to comparing the subject's total estimated depreciation to the total estimated depreciation of the primary set of comparable sales," Marous also "compared the subject property to the secondary set of improved comparable sales in terms of total estimated depreciation." [Tr. Exhibit 1 at 67]. In this instance, the "overall average total depreciation for this data set is 90.00 percent and is quite similar to the overall average total depreciation of 85.71 percent for the primary data set. Of the 20 properties that are included in the secondary set of improved comparable sales, 15 sales have estimated depreciations that are greater than 90 percent, 11 sales have estimated depreciations that are 100 percent, and only 3 sales have total depreciation estimates that are significantly less than 80 percent." [Tr. Exhibit 1 at 67-68].

Based upon his comprehensive, market-extracted depreciation of 27 sales of big box retail stores similar to the subject, Mr. Marous concluded a "retrospective market value for the subject property as of January 2, 2011, by the cost approach of $4,470,000." [Tr. Exhibit 1 at 68]. Similarly, Marous concluded retrospective estimated values of $4,440,000 for 2012, $4,420,000 for 2013, and, finally, $4,390,000 for January 2, 2014, based upon the same market-extracted depreciation from 27 sales of comparable stores. [Tr. Exhibit 1 at 69-73]. Mr. Marous felt his cost approach was supportive of the value conclusions reached under the sales comparison approach, but he relied primarily upon the sales comparison approach in reaching his fee simple market value conclusions for the subject. [Tr. Exhibit 1 at 141-42].

Despite the seminal fact that the "limited number of retailers requiring a store anywhere near the size of the subject property would prefer to construct on a build-to-suit basis to meet their corporate identification needs and would no doubt locate in a commercial district with more identification and synergy, such as the Fargo/West Fargo commercial district," Marous developed and communicated an income approach to value. [Tr. Exhibit 1 at 107]. He testified that this approach was used as a "test of reasonableness" for the sales comparison approach, particularly since, even when basing his value conclusions "on very optimistic market terms it is most likely the subject property would not perform to the level of the stabilized estimates required to make this a feasible economic alternative for any investor." [Id.]. This fact is convincingly demonstrated by Marous' determination that the income capitalization approach to value, at best, yields retrospective estimated values for the subject property of $1,950,000 for 2011, 2012, 2013 and 2014. [Tr. Exhibit 1 at 107-140].

Finally, as noted, based upon the fact "the sales comparison approach is considered the most reliable indicator of value for these types of properties," Marous' "retrospective, market value of the fee simple interest in the appraised property" as of January 2, 2011-2014 is $4,000,000. [Tr. Exhibit 1 at 142]. "However, again I must emphasize that demand by an owner user is extremely low for the entire period under consideration due largely to the property's gross building size and to its specialized, 'built-to-suit' architecture and construction." [Tr. Exhibit 1 at 142].

3. Respondent Failed to Rebut Petitioner's Prima Facie Case.

Once Petitioner established its prima facie case, the burden shifted to Respondent to provide sufficient evidence to establish why the 27 sales Menards' expert relied on, somehow still were inconclusive as to the market value for the subject. *Southern Minnesota Beet Sugar Cooperative v. County of Renville*, 737 N.W.2d 545 (Minn. 2007). Respondent failed to do so, either through its cursory cross-examination of Mr. Marous at trial, or through the value in use/investment value reports Respondent suggests as an alternative method to assess the subject; albeit at unit prices far in excess of the prices paid for any big box store in Minnesota (or elsewhere) in the past 5 years. [Tr. Exhibit 1, Addendum Part 2, at A-269 through A-277].

Respondent's principal means of rebutting Petitioner's case were the DRES reports. As reflected in the record, the DRES reports were not probative of market value when weighed against the Marous appraisal, and in light of the Battuello

Appraisal Review Report [*See* Tr. Exhibit 3]. Moreover, the DRES reports were based upon erroneous interpretations of Minnesota's fee simple market value-in-exchange standards. These standards do not allow <u>unverified</u> leased fee and sale leaseback transactions to become the basis from which to justify fee simple market value conclusions, particularly for an owner-occupied property that bears none of the same economic characteristics in the first place. [Id].

Moreover, the Battuello Appraisal Review Report identified numerous major areas where the DRES Reports fell short of the standards required under USPAP. First, Respondent sets forth sales data for the proposition of a sales comparison approach. The missing link between DRES's data and a comparative sales methodology is that DRES's approach: (a) uses leased fee sales for a fee simple assignment; (b) adjusts purchase prices for expenditures after the sale that are not appropriate; (c) fails to mention that the expenditures either changed the use of the building from single-tenant to multi-tenant, or were for buyer's modifications not needed to restore utility to the buildings; (d) bases certain adjustments on leased fee data which is inconsistent with a fee simple assignment; and (e) multiplies unit prices by the gross square footage of the building, including the primary heated structure, mezzanine, attached unheated warehouse and detached unheated shed, when market participants are not likely to treat all areas as usable or of value and where many of the comparable sales do not include such site improvements. [Tr. Exhibit 3 at 1-15].

Second, in contrast to the Marous appraisal, the DRES reports: (a) estimate market rent "using primarily non-arms-length rental agreements from build-to-suit or sale-leaseback rental agreements;"[73] (b) utilize inappropriate entrepreneurial profit in

[73] *Id.*

its "costs new" estimate for a building built by Menards for use by Menards;[74] (c) estimate depreciation "without any market support;"[75] and (d) give no consideration to the subject's inherent functional and economic obsolescence, despite compelling market data demonstrating "that obsolescence is present in the sale of a highly similar property."[76]

For all these reasons, the results reported are not credible, and should not be given any weight in determining the fee simple estimate of market value for the subject property.

CONCLUSION

At the end of the day, when the Court sets the Marous Appraisal side-by-side with the DRES Reports, there are significant distinctions. The subject property is a mega/big box store located in a third tier location, in a third tier market which has proven to be very problematic for any retail use. This was graphically demonstrated at trial by the fact that all but one of the 13 outlots Menards purchased in 2006 remain for sale to this day.

If Menards were to abandon the location, a scenario similar to the situation that unfolded with respect to the converted Walmart store two miles north of the subject is the most likely market alternative. This stubborn fact should not be discounted simply because local officials (and their experts) remain "optimistic about the future of the Fargo/Moorhead area."[77]

Unlike the Marous appraisal, the DRES reports contain a sales comparison approach which arbitrarily and capriciously blends leased fee sales and sale-leaseback finance transactions of 100% net leased stores with fee simple sales that have been

[74] *Id.*
[75] *Id.*
[76] *Id.*
[77] Tr. Exhibit A-1 at 33.

doctored to include after-the-fact "renovation costs." The reports also misreport square footages to engineer value conclusions that are unsupported by the actual sales prices that have been paid for the properties. This too ignores Minnesota's requirement that the fee simple interest be valued for property tax purposes based upon the actual sales prices of similar properties.

Furthermore, with respect to the cost approach, the Marous appraisal follows generally-accepted appraisal principles by appropriately extracting total depreciation empirically from the market data itself. The sales each appraiser relied on demonstrate a remarkable degree of total depreciation. This depreciation is clearly present in every one of the 27 sales analyzed by Marous. It is further substantiated by the peer-reviewed literature analyzing how (and how not) to assess this property type in light of the functional inutility sales of big box stores have demonstrated during the years-in-issue.

Despite acknowledging his awareness of the opinions of his peers -- as well as the actual sale prices of the big box stores he includes in his sales comparison approach -- Mr. Vergin still found no functional or economic obsolescence existed for the subject property for any of the years-in-issue. His view is unsubstantiated, and is not credible in light of the empirical data to the contrary contained in his own reports as well as the evidentiary record in this case.

Finally, with respect to the income approach to value, DRES made no attempt to demonstrate why a prudent investor would ever be willing to assume the inherent risk associated with converting 162,340 square feet of retail space into an investment grade property. When one considers the subject exists in a third tier market and is situated in a remote, third tier retail location relative to the vast majority of retail owner/users in the Fargo/Moorhead area, the conclusion that it could easily become an income-producing, investment-grade property is at best speculative, at worst "an absurdity too gross to be insisted on." *Programmed Land v. O'Connor*, 633 N.W.2d 517, 532 (Stringer, J. dissenting) (Minn. 2001) (*quoting Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 177, 2 L.Ed. 60 (1803).

In sum, Petitioner made out a prima facie case of overvaluation through the Marous appraisal. Petitioner also established fee simple market value conclusions for the subject property for the respective years-in-issue of $4,000,000. Respondent failed to rebut this value with the DRES Reports, because these reports were based upon erroneous and flawed interpretations of Minnesota law, and were further rebutted by the Battuello Appraisal Review Report and his unrebutted trial testimony demonstrating several USPAP concerns. For all these reasons, Menards respectfully requests that this Court issue Findings of Fact and Conclusions of Law[78] determining that the assessed value of the Property for the respective years-in-issue is $4,000,000, and ordering the Clay County Assessor to reduce Petitioner's assessments accordingly.

Finally, the nine month 2011 Assessment Sales Ratio study performed by the Minnesota Department of Revenue, demonstrates a Median Ratio of 88.4% based upon twelve sales of commercial/industrial properties located within the City of Moorhead. Therefore, as a matter of law, Petitioner is entitled to an additional 6.6% reduction off of the final 2011 assessment as determined by this Court, as relief in response to Petitioner's unequal assessment claim for the 2011 pay 2012 property tax year. [Tr. Exhibit 1, Addendum, Part 2, at A-382; Tr. Hearing Day 2 at p. 239, l. 18 through p. 241, l. 6].

[78] Petitioner has attached its Proposed Findings of Fact, Conclusions of Law, and Order for Judgment to this Post-Trial Brief at Exhibit A, and incorporates them herein by reference as if fully set forth.

Respectfully submitted,

Dated: May 8, 2015

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ATTORNEYS FOR PETITIONER

EXHIBIT A

STATE OF MINNESOTA **TAX COURT**

COUNTY OF CLAY **SEVENTH JUDICIAL DISTRICT**

Menard, Inc.,

Petitioner,

Court File No.: 14-CV-12-1500

v.

PETITIONER'S PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER FOR JUDGMENT

County of Clay,

Respondent.

Petitioner, Menard, Inc. ("Menards"), appeals the 2011, 2012, 2013, and 2014 property tax assessment(s) levied by Respondent, County of Clay ("Clay County"), against the real property owned by Menards in Moorhead, Minnesota. A hearing was held on March 23-24, 2015, to resolve this real property tax dispute. Robert Hill, an attorney at Robert Hill Law, Ltd, appeared on behalf of Menards. Thomas Radio, an attorney at Best & Flanagan, LLP, appeared on behalf of Clay County.

GENERAL PROPERTY DESCRIPTION

The subject property is known as a Menards Home Improvement store, and is located at 3000 27th Avenue South, Moorhead, Minnesota. The property consists of a 162,340 square feet owner-occupied building, located on 771,357 square feet of land. The subject building also contains 11,041 square feet of mezzanine space. It is considered a mega "big box store,"[1] with construction

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[1] The Dictionary of Real Estate Appraisal (5th Ed. 2010), defines a big box store as "a single-use store, typically between 10,000 and 100,000 square feet or more, such as a large bookstore, office-supply store, pet store, electronics store, or toy store. (ICSC) 2. A general

built-to-suit Menard's business model. In addition to the building, the subject property includes 40,608 square feet of covered garden center space and covered overhang space, and a 22,440 square foot warehouse/lumber shed, all of which is unheated space with little to no protection from the elements.

EXECUTIVE SUMMARY OF PETITIONER'S CASE

Big-box stores have proven to be a very difficult valuation problem for many assessors over the past five years, as the temptation to assess them at estimated market values in line with smaller income-producing stores (or multi-tenant shopping centers), is often too great to pass up. The problem with this approach is that, unlike other types of retail properties, big box stores are not built to be income-producing real estate, and suffer from various forms of functional and economic obsolescence, practically from the moment the lights are turned on and the store opened.[2]

Some general merchandisers, such as Menards and Mills Fleet Farm, have been in the big box retail market for a long time, and have experienced this market-based truth each time they decide to close a store and put it up for sale. Others, such as Target, Home Depot, Lowe's, Wal-Mart, Costco, Office Depot, and Best Buy, are just beginning to experience this market-driven reality as they begin to close big box stores in favor of moving to smaller, more intimate spaces to attract customers,

merchandiser or category killer. General merchandisers … offer a wide variety of merchandise at deeply-discounted prices. The product mix of these stores includes nearly everything shoppers need for their home, work, garden, garage, or car, as well as recreational items and apparel." *Id.* at 19; *see also* 229 (defining Big box as a "large single-user retail building between 15,000 and 100,000 square feet, e.g., Circuit City; Best Buy; Bed, Bath, and Beyond; Home Depot; Sportmart; Target.").

[2] *See, e.g.,* Tr. Exhibit 1, Petitioner's Addendum, Part 2, at A-261 through A-268, <u>Valuation of Big-Box Retail for Assessment Purposes: Right Answer to the Wrong Question,</u> for an authoritative analysis of the market realities affecting sales of big-box retail stores.

whose tastes and standards are changing very rapidly in the Age of the Internet.

All of these national retailers have long understood that, at least originally, customers liked the idea of purchasing their building supplies, dry goods, home furnishings, and, in some cases, groceries, under one roof. Some, such as Best Buy, decided to offer a deep selection in a single category of merchandise. Either way, the convenience, accompanied by the lower retail prices the bulk warehouse-style sales concept afforded, caused consumers to abandon local retailers in favor of big box stores.

This trend dominated the retail landscape nation-wide for the better part of two decades. Then came the Great Recession, and perhaps more importantly, the convenience and affordability of switching to "on-line" shopping. As consumer trends continued to evolve away from "one-stop shopping," so too did the demand for big box stores. Consequently, these stores began closing at a rapid rate, and their "functional inutility"[3] in the retail marketplace led to diminished pricing for the resale of the real estate: a seminal fact some assessors have been slow to acknowledge.

Moreover, reconfiguring these buildings for multi-tenant use is very costly, due to the need to redistribute central electrical and heating controls, restrooms, entryways, security systems, etc. This high cost of retrofit has left these properties with very few options in a resale scenario. They are not built to sell for continued use as retail centers, since they have no potential to become income-producing properties, and often are not in prime locations for an alternative highest & best use,

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[3] The Dictionary of Real Estate Appraisal (5th Ed.2010), defines functional inutility as the "Impairment of the functional utility of a property or building according to market tastes and standards; equivalent to functional obsolescence because ongoing change makes the plan, form, style, design, layouts, or features obsolete." *Id.* at 85.

such as distribution warehouse space.

Rather, they were built to generate an income stream by an AAA credit tenant. Hence, when they do sell, the sales prices invariably reflect a tremendous discount off of actual construction costs, which has been demonstrated multiple times in recent years through the fee simple sales of more than 50 Target, Lowe's, Wal-Mart, Costco, Home Depot, and Menards stores, in locations nation-wide, as is partially depicted in the following summaries:[4]

			Summary of Target Corporation Sales				
Location	State	Year Built	Sale Date	Land Sq Ft	Building Sq Ft	Sale Price	Per Sq Ft
Brownsville	TX	1995	10/10/2011	320,128	97,607	$1,900,000	$19.47
Ridgmar	TX	1979	1/5/2012	536,224	102,997	$2,140,000	$20.78
NewPark Mall	CA	1997	5/1/2012	492,855	135,792	$5,300,000	$39.03
Port Richey	FL	1990	5/16/2012	369,389	105,247	$2,072,000	$19.69
South Denver	CO	1971	6/19/2012	567,500	110,535	$2,150,000	$19.45
Capital Boulevard	NC	1994	6/19/2012	463,552	116,244	$3,850,000	$33.12
Hampton	VA	1996	8/14/2012	422,340	117,803	$3,700,000	$33.12
Kenosha	WI	1994	11/14/2012	421,182	96,149	$2,385,000	$24.81
Gastonia	NC	1989	11/16/2012	332,981	99,799	$1,900,000	$19.04
Warren	MI	1990	12/13/2012	387,279	105,738	$2,250,000	$21.28
New Braunfels	TX	1994	12/21/2012	302,960	90,241	$2,000,000	$22.16
West Colonial	FL	2001	1/29/2013	777,546	177,081	$5,400,000	$30.49
Ocotillo	AZ	2000	2/27/2013	473,410	122,622	$4,050,000	$33.03
San Antonio	TX	1997	4/25/2013	845,156	118,911	$3,650,000	$30.70
Almeda	TX	1970	4/24/2013	1,466,230	122,952	$2,600,000	$21.15
Antioch	TN	1981	7/25/2013	678,230	116,949	$2,700,000	$23.09
Colorado Springs	CO	1969	7/30/2013	672,916	151,030	$3,500,000	$23.17
Broomfield	CO	1995	7/30/2013	494,088	116,244	$3,500,000	$30.11
Manassas	VA	1997	7/30/2013	165,903	103,243	$4,700,000	$45.52
Kissimmee	FL	1992	9/17/2013	575,471	114,386	$2,650,000	$23.17
TOTALS				10,765,340	2,321,570	$62,397,000	$26.88

[4] See Tr. Exhibit 1 Addendum, Part 2, at A-269 through A-275.

			Summary of Lowe's Sales				
Location	State	Year Built	Sale Date	Land Sq Ft	Building Sq Ft	Sale Price	Per Sq Ft
Biddeford	ME	2006	12/31/2012	824,723	138,135	$4,005,642	$29.00
Ellsworth	ME	2007	10/31/2012	771,448	138,684	$3,200,000	$23.07
Ionia	MI	2005	5/8/2013	636,847	111,316	$2,700,000	$24.26
Rogers	MN	2006	11/19/2011	571,507	139,588	$3,200,000	$22.92
Brown Deer	WI	2006	12/1/2013	478,289	139,571	$2,700,000	$19.34
N Apple Valley	CA	2007	8/8/2012	546,242	135,197	$3,035,000	$22.45
Princeton	WV	1998	3/23/2010	839,227	135,197	$2,500,000	$18.49
Ionia	MI	2006	4/1/2013	741,827	111,119	$2,700,000	$24.30
Kenai	AK	2008	11/20/2012	643,817	109,872	$3,000,000	$27.30
Cambridge	MN	2009	10/15/2012	481,774	127,083	$5,000,000	$39.34
Aurora	IL	2005	1/27/2012	598,079	139,494	$4,000,000	$28.68
Milwaukee	WI	2004	Approved	556,348	134,314	$2,500,000	$18.61
TOTALS				7,690,128	1,559,570	$38,540,642	$24.71

Summary of Walmart Properties for Sale				
Location	State	Building Sq Ft	Asking Price	Per Sq Ft
Amarillo	TX	110,803	$2,800,000	$25.27
Camilla	GA	34,875	$950,000	$27.24
Devil's Lake	ND	72,105	$1,600,000	$22.19
Eastlake	OH	142,108	$3,250,000	$22.87
Elgin	IL	118,827	$3,850,000	$32.40
Hammond	IN	145,542	$3,950,000	$27.14
Houston	TX	132,493	$7,625,000	$57.55
Jackson	MS	128,540	$2,950,000	$22.95
Joliet	IL	116,123	$2,600,000	$22.39
McHenry	IL	115,590	$3,900,000	$33.74
Morganton	NC	88,174	$2,125,000	$24.10
Naperville	IL	115,179	$5,600,000	$48.62
Niagara Falls	NY	138,658	$2,500,000	$18.03
North Lauderdale	FL	126,947	$7,500,000	$59.08
Port Angeles	WA	129,842	$2,950,000	$22.72
Rexburg	ID	94,370	$2,950,000	$31.26
Richardson	TX	41,685	$2,875,000	$68.97
St. Petersburg	FL	121,595	$7,500,000	$61.68
Stamford	TX	41,306	$1,050,000	$25.42
Victorville	CA	126,022	$3,700,000	$29.36
Woonsocket	RI	121,162	$3,275,000	$27.03
TOTALS		2,261,945	$75,500,000	$33.38

As these summaries demonstrate, Target Corporation sold 20 of its big box stores, totaling 2,321,570 square feet, between October of 2011 and September of 2013, for an average sales price of $26.88 per square foot. Similarly, Walmart has listed 21 of its big box stores for sale, including a 72,105 square foot store listed for sale at $22.19/sf. located in Devil's Lake, North Dakota, approximately 166 miles northwest of the subject property, with an average listing price of $33.38 per square foot. And perhaps most significantly, between March of 2010 and December of 2013, Lowe's sold 12 of its stores, totaling 1,559,570 square feet, for an average sales price of $24.71 per square foot.

Given that the vast majority of Lowe's properties sold are considered to be highly comparable to the subject in terms of age, size, and overall design/layout (as is best demonstrated by the fact that both appraisers have used two of these sales in their respective sales comparison approaches to value the subject property), Menards' primary contention at trial was that its assessed value(s) for the years at-issue must reflect the market realities which are affecting the market value of its stores nation-wide.

In light of recent market trends, Menards also asked this Court to examine the case law from states such as Michigan and Indiana, where the issues associated with big box store functional and economic obsolescence already have been litigated to reflect actual unit pricing for this property type.[5]

Finally, at trial, Menards presented a comprehensive fee simple appraisal done by Michael S. Marous, MAI, CRE ("Marous"), a nationally-recognized appraiser who for the past 35 years, has evaluated the market value(s) of big box retail stores on behalf of both taxing authorities and taxpayers in more than 25 states.[6] At trial, Mr. Marous presented the fee simple sales of twenty-seven (27) comparable properties, to demonstrate that the concluded unit value range for the subject property as of January 2, 2011 is $22.50 to $25.00 per square foot of building area, including land, and that because market "fundamentals have remained relatively flat over the time period represented by [Menards] retrospective dates of value, particularly in regard to a big box retail store property type under consideration …

[5] See Tr. Exhibit 1, Petitioner's Addendum, Part 2, at A-241 through A-260, A-282 throughA-300, and A-301 through A-359.
[6] See Tr. Exhibit 1 at 149-154, depicting Michael S. Marous' Statement of Qualifications.

the retrospective fee simple market value of the subject property" remained at an estimated value of $4,000,000 for the January 2, 2012-2014 assessment dates.[7]

Mr. Marous' appraisal describes the regional overview, market analysis, and neighborhood analysis for the subject property. [Tr. Exhibit 1 at 6-24]. Mr. Marous testified that "the superior population and income market demographics for Fargo, North Dakota, when compared to those of Moorhead, Minnesota."[8] In addition, he testified that "the subject property is located in a tertiary commercial area of the mostly isolated and secondary Fargo-Moorhead commercial market area. The majority of the retail stores are located within the Fargo/West Fargo portion of the metro area and that is where the majority of the retail dollars are being spent. ... Further, if a general retail user were to move into this market, it would most certainly locate in the more established and successful commercial areas of West Fargo/Fargo or Moorhead/Dilworth and most certainly <u>not</u> locate in the subject property's immediate local area."[9]

Marous substantiated his conclusion by pointing out that Menards "purchased a larger 64.70-acre parcel ... for the development of the subject property ... in May 2006," subdivided the overall parcel "into 13 outlots[10] and a larger tract of land containing 18.56 acres," but for nine years has been unable "to sell <u>any</u> of the outlots in the open market."[11] Marous also testified that the "Gross Sales Comparison" between the Moorhead store and a nearly identical Menards store located in West Fargo, further demonstrates why the subject's

[7] Tr. Exhibit 1 at 74-106.
[8] Tr. Exhibit 1 at 22.
[9] Tr. Exhibit 1 at 23-24 (emphasis in original).
[10] The Dictionary of Real Estate Appraisal (5th Ed.2010), defines outlot as a "building site or pad that benefits from being part of a larger development." *Id.* at 140.
[11] Tr. Exhibit 1at 50, 24 (emphasis in original).

location is very problematic for any type of retail re-use. This comparison of gross sales[12] is depicted as follows:

Menard, Inc. - Gross Sales Comparison

Moorhead
3000 27th Ave South, Moorhead MN

	2011	2012	2013	2014
Gross Sales	32,181,612	35,988,785	38,476,064	41,532,757
% + / -		11.8%	6.9%	7.9%

Fargo
1300 13th Avenue East, West Fargo ND

	2011	2012	2013	2014
Gross Sales	49,934,061	56,585,803	61,676,690	63,494,238
% + / -		13.3%	9.0%	2.9%

From this information, Marous was able to confirm that in 2011, the Moorhead store operated at only 64.4% of the gross sales enjoyed by the West Fargo location, that the subject's gross sales dropped to 63.6% of West Fargo's sales in 2012, 62.4% in 2013, and rose slightly to 65.4% of "same store sales" compared to West Fargo in 2014. From an appraisal standpoint, this comparison buttressed Marous' conclusion that the subject's tertiary location would not be an attractive location for any general retail user seeking to locate in the Fargo-Moorhead area.[13]

Marous' appraisal contains further analysis regarding market inventory (i.e., number of buildings), total available square footage, absorption, vacancy rates, lack of new construction, big box store closures nation-wide, etc., to demonstrate there "has been a severe imbalance in terms of supply and demand for big box stores and this imbalance is expected to continue and, in

[12] Tr. Exhibit 1, Addendum, Part 2, at A-383.
[13] Tr. Exhibit 1at 24.

fact, worsen in the future."[14]

Marous then points out that as "I determine the various retrospective value opinions, I am considering these market data, trends, market indicators, etc. that were available at the respective retrospective dates of value";[15] the primary conclusion being there is little demand for big box retail space once the build-to-suit, owner-occupant vacates the building. Further, the demand factors for big box stores are similar throughout Minnesota and, indeed, nationwide. [Tr. Exhibit 1 at 24-28; Addendum at A-65-114; A-209-229; Addendum, Part 2, at A-261-268; A-384].

Mr. Marous testified regarding the difference between a fee simple interest and a leased fee interest. The real property is being appraised, not the occupancy of the property. [Tr. Exhibit 1 at 3-5]. The property rights appraised in Marous' appraisal are the fee simple interest; the property was appraised as if unleased, vacant, and available for sale. "Should this building become vacant, it is highly likely the building would remain vacant. The building would require an extensive amount of capital improvements to [re-demise] the space into smaller retail units and this expense is not economically feasible. A more likely scenario is converting the space to some type of light industrial use or securing an alternate user who would raze the improvements in favor of its own design and alternate use." [Tr. Exhibit 1 at 48].

Marous describes the highest and best use of the subject property relative to the fee simple, owner-occupied elements. He identified the three approaches to

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[14] Tr. Exhibit 1 at 26.
[15] Tr. Exhibit 1 at 28.

value as the cost approach, sales comparison approach, and income capitalization approach. Further, he identified the LoopNet, MLS, assessors, brokers, bankers, and third-party appraisers as data sources for this appraisal assignment.

Mr. Marous considered various areas and spaces surrounding the primary subject building. He noted the main structure is the Menard's warehouse. Other areas that were not included in the overall gross building area were the mezzanine, loading dock, special order area (supply garage), garden center, overhang canopy (shipping), and guard station. In Marous' opinion, "these areas are not considered by market participants, either a potential buyer or user, as traditional building area." [Tr. Exhibit 1 at 38]. Perhaps more importantly, "the subject's site improvements … would have very little to no appeal to the market independent of an economically viable big box store on the site." [Tr. Exhibit 1 at 63].

Mr. Marous researched and analyzed seven "primary set" comparable sales in Minnesota for the sales comparison approach to value. [Tr. Exhibit 1 at 74-101]. In addition, Marous researched and analyzed 20 additional fee simple sales of big box stores located in Wisconsin, Michigan, Indiana, Illinois, Alaska, California, Maine, and West Virginia, to demonstrate "that regardless of location or age, a rather narrow range of value is indicated. This phenomenon is clear market evidence that the factors influencing big box retail store values, (*i.e.*, imbalance in supply and demand, market trends and influences that retailers are moving to smaller stores, online purchasing, etc.) is a <u>nationwide</u> market truth and is not limited to any one geographic area."[16] [Tr. Exhibit 1 at 105 (emphasis in original); *see generally,* Tr.

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[16] Marous relied on the Minnesota Supreme Court's recognition in *McNeilus Truck Manufacturing v. County of Dodge*, 705 N.W.2d 410 (Minn. 2005), that "what commentators

Exhibit 1 at 101-106].

Marous points out that deed restrictions were investigated in each of the comparable sales. "The overwhelming market response to inquiries regarding the potential or actual impact, either positive or negative, on a property resulting from this type of use restriction by the market, is that they do not have any measurable impact on the property, either in terms of marketability, market perception, and, ultimately, market value." [Tr. Exhibit 1 at 97]. More specifically, Marous' appraisal documents the fact that "if a particular home improvement store closed for lack of business, there was virtually no likelihood a competitor would relocate to that area because they probably would not be successful in that location." [Tr. Exhibit 1 at 97-98].

The reason for this, according to several market participants Marous interviewed for this assignment (*e.g.*, Mr. Robert J. Meiers, Property Tax Manager at Lowe's), is "that big box retail stores are not built for resale or for entrepreneurial profit … [and in any event] there is a nation-wide oversupply of big box stores and, regardless of location, they all suffer from 'severe obsolescence.'" [Tr. Exhibit 1 98]. "Therefore, adjustments are not supported by the market nor are they appropriate for the comparable improved sales' use restrictions." [Id.].

Perhaps the best evidence that the use restrictions did not influence the arms-length character of the transactions, much less their sale prices, is the fact

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have termed 'economic proximity,' not mere physical proximity, makes two pieces of real estate comparable. J.D. Eaton, Real Estate Valuation in Litigation 209 (2d ed. 1995). The market real buyers examine is not always limited by distance or location, nor by state lines. Indeed, state lines might be practically invisible to certain purchasers of land. Such an arbitrary and artificial limit may not reflect market principles and creates grave risk of distorting property valuation." *Id.* at 413-414; Tr. Exhibit 1, Addendum at A-234.

that the [comparable sales] were assessed at or near the purchase prices in the assessment year(s) closest to their respective dates of sale." [Tr. Exhibit 1 at 98; *see generally*, Addendum at A-119, A-130, A-152, A-172, and A-195]. Nonetheless, Mr. Marous conservatively applied "a minor positive adjustment range from 0 to 5 percent to the comparable improved sales for any use restrictions that were in place" at the time of sale. [Tr. Exhibit 1 at 98].

Mr. Marous' appraisal explains all other transactional and physical characteristic adjustments made to his comparable sales. [Tr. Exhibit 1 at 98-101]. After "all quantified adjustments are made, a range of $22.75 to $24.64 per square foot of building area including land is developed based on the middle points of the adjusted sales prices. Also, a range of $21.49 to $22.43 per square foot of building area including land is developed based on the average of the adjusted sales prices." [Tr. Exhibit 1 at 101].

To cross-check his value conclusions, Marous included a secondary set of 20 additional improved sales in his appraisal report. [Marous Appraisal at 101-105]. He points out that while these "sales are not located in Minnesota [they each] have a high degree of similarity to the subject property in terms of 'economic proximity'." [Tr. Exhibit 1 at 102].

Following the same analysis/market adjustments he applied to his primary set of comparable sales, Marous concludes the "secondary set develops an overall average price per square foot of $24.56 of building area, including land." [Tr. Exhibit 1 at 105]. And, based upon 27 different fee simple sales of big box retail stores similar to the subject, Marous concludes that the retrospective fee simple market value of the subject property, by the sales comparison approach, as of each of the four retrospective dates of evaluation, is $4,000,000, rounded. [Tr. Exhibit 1 at 105-106]. This was based on the gross building area of 162,340 square feet for the subject. [Id.].

Mr. Marous also developed a comprehensive cost approach for this appraisal assignment. He contends that the cost approach is not relevant or necessary because potential buyers do not place any reliance on this approach. [Tr. Exhibit 1 at 63]. Nonetheless, Marous felt the approach was useful to empirically derive “the total and average annual depreciation accrued to the comparable improved sales within the primary set of improved [comparable sales] included in the sales comparison approach to value.” [Tr. Exhibit 1 at 64].

Marous determined the Estimated Total Depreciation for the seven improved sales included in his primary set of comparable sales to be 86.00%, on average, with “the newest buildings with ages of 3 years and 6 years [having] overall depreciation ranges from 69.34 percent to 89.31 percent, respectively. My estimate of the approximately 4-year old subject property’s depreciation as of January 1, 2011, is 79.1 percent and this amount is very well supported by the market data. Further, when analyzing the improved sales with ages of 3 years and 6 years, their annual depreciation rate ranges from 23.11 percent to 14.89 percent, respectively. My estimate of the subject’s annual depreciation rate of 19.8 percent … is very well supported by the market data.” [Tr. Exhibit 1 at 65-67].

"In addition to comparing the subject's total estimated depreciation to the total estimated depreciation of the primary set of comparable sales," Marous also "compared the subject property to the secondary set of improved comparable sales in terms of total estimated depreciation." [Tr. Exhibit 1 at 67]. In this instance, the "overall average total depreciation for this data set is 90.00 percent and is quite similar to the overall average total depreciation of 85.71 percent for the primary data set. Of the 20 properties that are included in the secondary set of improved comparable sales, 15 sales have estimated depreciations that are greater than 90 percent, 11 sales have estimated depreciations that are 100 percent, and only 3 sales have total depreciation estimates that are significantly less than 80 percent." [Tr. Exhibit 1 at 67-68].

Based upon his comprehensive, market-extracted depreciation of 27 sales of big box retail stores similar to the subject, Mr. Marous concluded a "retrospective market value for the subject property as of January 2, 2011, by the cost approach of $4,470,000." [Tr. Exhibit 1 at 68]. Similarly, Marous concluded retrospective estimated values of $4,440,000 for 2012, $4,420,000 for 2013, and, finally, $4,390,000 for January 2, 2014, based upon the same market-extracted depreciation from 27 sales of comparable stores. [Tr. Exhibit 1 at 69-73].

Finally, despite the seminal fact that the "limited number of retailers requiring a store anywhere near the size of the subject property would prefer to construct on a build-to-suit basis to meet their corporate identification needs and would no doubt locate in a commercial district with more identification and synergy, such as the Fargo/West Fargo commercial district," Marous developed and communicated an income approach to value. [Tr. Exhibit 1 at 107].

He submits that this approach was used as a "test of reasonableness" for the sales comparison approach, particularly since, even when basing his value conclusions "on very optimistic market terms it is most likely the subject property would not perform to the level of the stabilized estimates required to make this a feasible economic alternative for any investor." [Id.]. This fact is convincingly demonstrated by Marous' determination that the income capitalization approach to value, at best, yields retrospective estimated values for the subject property of $1,950,000 for 2011, 2012, 2013 and 2014. [Tr. Exhibit 1 at 107-140].

Finally, based upon the fact "the sales comparison approach is considered the most reliable indicator of value for these types of properties," Marous' "retrospective, market value of the fee simple interest in the appraised property" as of January 2, 2011-2014 is $4,000,000. [Tr. Exhibit 1 at 142]. "However, again I must emphasize that demand by an owner user is extremely low for the entire period under consideration due largely to the property's gross building size and to its specialized, 'built-to-suit' architecture and construction." [Tr. Exhibit 1 at 142].

PROPOSED FINDINGS OF FACT

1. The subject property is located at 3000 27th Avenue South, Moorhead, Minnesota.

2. The subject parcel identification number is 58.470.0030 and is zoned RC, Regional Commercial District.

3. The subject building contains 162,340 square feet of space on the main floor of the store, 11,041 square feet of mezzanine, 22,440 square feet of unheated warehouse/lumber shed space, and 40,608 square feet of unheated covered garden center/overhang space.

4. The subject property has a total land area of 17.08 acres.

5. The current occupant of the subject property should not influence the market value of the fee simple interest in the property, as it is the building which is being assessed/appraised: Not the investment value[17] to the current owner.

6. The subject property is not an income-producing property, thus the income approach is not given weight in the final conclusion of value.

7. The subject property is located in the southeast quadrant of the City of Moorhead.

8. The total population estimate for the City of Moorhead as of 2010 was approximately 39,020, which represents approximately 64 percent of the entire 2012 Clay County, Minnesota population of 60,514, each as reported by

[17] The Dictionary of Real Estate Appraisal (5th Ed.2010), defines "investment value" as the "value of a property interest to a particular investor or class of investors based on the investor's specific requirements. Investment value may be different from market value because it depends on a set of investment criteria that are not necessarily typical of the market." *Id.* at 105.

Site to Do Business (STDB) (2012).

9. The total population estimate for the City of Fargo as of 2010 was 110,142, which represents approximately 71 percent of the entire 2012 Cass County population of 155,589, each as reported by STDB (2012).

10. The subject property is located at the northwest quadrant of the interchange between Interstate 94 and 34th Street South in Moorhead.

11. The subject property is located in a largely undeveloped area that is best described as a tertiary section of Fargo-Moorhead, isolated from the other general retail districts within the overall Fargo-Moorhead community.

12. The income and single-family house value demographics of the populace residing in Cass County, North Dakota, are superior to those of Clay County, and the superiority of income demographics in Cass County have a direct effect on the supply and demand factors as they impact the subject property's market appeal and value estimate(s).

13. The subject property's inferior location in Moorhead, Minnesota is exacerbated by the fact that the subject property's specific location within Moorhead is within a very small and tertiary area of a secondary commercial market of this community which is isolated from the other retail areas within Moorhead.

14. The Petitioner appraised the subject property as a fee simple interest.

15. The Petitioner valued the subject property as a single-tenant retail space.

16. The subject property was constructed in 2007 as a built-to-suit, owner-occupied, big boxstore.

17. Petitioner's valuation disclosure was submitted in the form of a narrative appraisal report prepared by Michael S. Marous, MAI, CRE, General Real Estate

Appraiser in the State of Minnesota.

18. Petitioner's appraiser inspected the subject property on September 10, 2014. [Tr. Exhibit 1 at 4].

19. Petitioner's appraiser relies on the definition of a big box store from the Appraisal Institute, *Dictionary of Real Estate Appraisal* (5th ed., 2010), at 19 & 229.

20. Petitioner's market analysis includes retail spaces in both Clay County, Minnesota and Cass County, North Dakota. [Tr. Exhibit 1at 14-24].

21. Petitioner's market analysis includes a stabilized occupancy for Clay County and the City of Moorhead. [Tr. Exhibit 1 at 23-24].

22. Petitioner's market analysis includes 27 fee simple transactions of build-to-suit, first generation retail space sold on the open market to second generation users, for the most part as owner-occupied real property. [Tr. Exhibit 1 at 75-104].

23. Petitioner's appraiser considered the contributory value to the property as a whole from a market perspective, of the covered garden center, the covered overhang, the warehouse/lumber shed, and the main building's mezzanine space, concluding "they are not viewed by the broader market as having significant contributory value, particularly when considering the large size of the subject's main building." [Tr. Exhibit 1 at 34-38].

24. Petitioner's appraiser considered, analyzed, and applied various adjustments to his comparable sales. Mr. Marous also considered deed restrictions and corresponding adjustments to the 27 comparable sales utilized to derive a fee simple market value conclusion for the subject, applying a minor positive adjustment of 0 to 5% to the comparable improved sales for any use

restrictions that were in place at the time of sale. [Tr. Exhibit 1 at 97-98].

25. In addition to the sales comparison approach to value, Petitioner's appraisal report included the cost and income capitalization approaches tovalue for the years under appeal.

26. Petitioner's appraiser did not rely upon the market value conclusion(s) reached under the income capitalization approach to value, in large part because the subject property---like most owner-occupied, single tenant big box retail properties---“would not perform to the level of the stabilized estimates required to make this a feasible economic alternative for any investor.” [Tr. Exhibit 1 at 107].

27. Petitioner’s appraiser reached this determination by performing a “Test of Reasonableness,” which involved determining the total cost to convert the subject property from a mega/oversize big box store into four, approximately 20,000 square foot retail units.

28. Based upon the extensive amount of capital improvements it would require to convert the space into a multi-tenant, investor grade property, it is not economically feasible to re-demise the space into smaller retail units and this expense is not economically feasible.

29. This is particularly true given the tertiary location and lack of demand for such a highest and best use in the subject property’s immediate area, as is best demonstrated by the fact that the “same store sales” of the subject are only 64.4% of the gross sales enjoyed by the West Fargo Menard’s location in 2011, that the subject’s gross sales dropped to 63.6% of West Fargo’s sales in 2012, 62.4% in 2013, and rose slightly to 65.4% of “same store sales” compared to West Fargo in 2014. [Tr. Exhibit 1, Addendum, Part 2, at A-383].

30. From an appraisal standpoint, this comparison buttressed Marous' conclusion that the subject's tertiary location would not be an attractive location for any general retail user seeking to locate in the Fargo-Moorhead area. [Tr. Exhibit 1 at 45-48].

31. Petitioner's appraiser utilized the cost approach to allow him to make a number of critical conclusions regarding the accrued depreciation which occurs when a big box retail property is sold. First, there is an extremely high level of depreciation which accrues even among buildings 3 to 6 years old at the time of sale (69.34 to 89.31 percent). [Tr. Exhibit 1 at 65-66].

32. Second, there is an extremely high annual depreciation of 23.11 percent, which is demonstrated by the sale of the newest of the comparable buildings. [Tr. Exhibit at 65-66].

33. Third, there is an extremely high overall average of total depreciation of 85.71 percent across all seven comparable sales included in Petitioner's appraiser's Depreciation Summary. [Tr. Exhibit 1 at 65-66].

34. Moreover, Petitioner's appraiser was able to estimate the accrued depreciation associated with the 20 sales he included in his secondary set of comparable sales. The overall average total depreciation for this data set is 90.00 percent, quite similar to the overall average total depreciation of 85.71 percent for the primary data set. [Tr. Exhibit 1 at 67-68].

35. From this market-extraction method of cost analysis, Petitioner's appraiser concluded that the subject property's 79.1 percent total depreciation as of January 2, 2011, "is very well supported by the market data." [Tr. Exhibit 1 at 68].

36. Petitioner's sales comparison approach includes seven sales for a direct

comparative analysis in Minnesota, with an additional twenty sales located throughout the U.S. added to provide additional support for the conclusions reported from the primary set of comparable improved sales. [Tr. Exhibit at 74-106].

37. The Minnesota sales are located in Cambridge, Monticello, Elk River, Rogers, Eagan, Burnsville, and St. Cloud. [Tr. Exhibit 1 at 75].

38. The sales comparable properties in other states include big box retail stores located in Illinois, Indiana, Wisconsin, Michigan, Alaska, California, Maine, and West Virginia. [Tr. Exhibit at 103-104].

39. Based on the 162,340 total square footage of the subject property, Petitioner's appraiser concluded that the estimated market value of the fee simple interest was $4,000,000 for each year under appeal.

40. Additionally, the nine month 2011 Assessment Sales Ratio study, performed by the Minnesota Department of Revenue, demonstrates a Median Ratio of 88.4% based upon twelve sales of commercial/industrial properties located within the City of Moorhead.

41. Therefore, as a matter of law, Petitioner is entitled to an additional 6.6% reduction off of the final 2011 assessment as determined by this Court, as relief in response to Petitioner's unequal assessment claim for the 2011 pay 2012 property tax year. [Tr. Exhibit 1, Addendum, Part 2, at A-382].

42. Respondent submitted two reports prepared by Diversified Real Estate Services (DRES), and co-authored by Timothy L. Vergin, MAI, and Timothy L. Klein, Appraiser. The DRES reports present a Market Overview section on pages 38 to 42 of the initial report. [Tr. Exhibit A, at 38-42].

43. This discussion is a Fargo-Moorhead metro area overview and does not provide an indication that Moorhead and the subject location are different than

the rest of the Fargo metropolitan area.

44. However, Moorhead has always been recognized as the economically weaker part of the metro area. General locational disadvantages for the Minnesota side include income tax rates, corporate tax rates, property tax rates, and slightly higher sales tax rates. Therefore, while Moorhead has participated in the metro area expansion, it does not lead that expansion, and is not viewed as an economic equal to the North Dakota side of the river. [Tr. Exhibit 3 at 4].

45. This fact is best demonstrated by comparing the same store sales between two almost identical Menards' locations in West Fargo and Moorhead; a comparison DRES did not make in either of its reports, despite having requested and received this confidential, proprietary information from Petitioner well prior to submitting its updated second report to the Court on February 23, 2015.

46. Another item in the DRES Market Overview is a long list of occupied big-box stores. Such properties are built for the occupant, and it is true that they remain fully occupied for lengthy timeframes. However, when they do change hands, a period of vacancy can occur.

47. The DRES list of stores on page 40 includes Number 6, a former Wal-Mart now leased to Axis Clinicals. This property was vacated in 2007, and was reportedly largely vacant until ultimately being occupied by Axis in 2013. So vacancy does occur in this market for this real estate product; build-to-suit and owner-occupancy just tends to push down an overall vacancy level. [Tr. Exhibit 3 at 4].

48. The DRES report concludes a highest and best use as vacant to be commercial use that conforms to the current zoning ordinance. They go on to

conclude highest and best use as improved is the current use as a big box retail store [Tr. Exhibit A at 56].

49. In the zoning section and in the highest and best use analysis, DRES reports that the Moorhead City Planner and Zoning Administrator was contacted and she indicated that rezoning to a classification allowing warehouse uses was a possibility, if a pure retail re-use did not occur at the property. This suggests that enough weakness in the market for such stores exists that rezoning was researched by the appraisers. [Tr. Exhibit 3 at 5].

50. Respondent's reports rely upon the cost approach to value for the years under appeal. Land value is estimated by direct comparison to nine land sales, six of which are from Moorhead. "Three of the land sales, numbers 7, 8, and 9, took place in 2007, before the real estate market collapse." [Tr. Exhibit 3 at 6].

51. A final land value estimate of $3.75 per square foot is estimated for January 2011 and this same value is employed for 2012, 2013, and 2014. Sale 1 is a similar size parcel adjacent to the subject and represents a key comparable. It sold in May 2013 for $3.50 per square foot, and included a 1.33-acre outlot parcel across the frontage road from the primary parcel. [Trial Exhibit 3 at 6].

52. This larger sale parcel of 17.23 acres is virtually a twin to the subject site. Outlots reportedly have asking prices of $10 per square foot. Removing the outlot from the sale at the $10 per square foot rate advertised by Menards for the outlots it is attempting to sell, reduces the price per square foot for the primary, and most comparable, parcel to less than $3.50 per square foot; not the $3.75 per square foot reported in the DRES documents. [Tr. Exhibit 3 at 6].

53. Several additional problems result from DRES' Cost Approach

calculations. First, entrepreneurial profit is only appropriate in those situations where speculative development could provide a profit to the real estate developer. Mega-big-box stores are not built on speculation and do not create profits in a fee simple resale. The developed costs new, before Entrepreneurial Profit, totaled $10,708,000 and the indexed actual costs were $10,890,000. This suggests that costs new before Entrepreneurial Profit are more accurate. [Tr. Exhibit 3 at 7].

54. Second, Respondent's cost approach does not include any obsolescence for the subject property. [Tr. Exhibit 3 at 6-7]. Yet, the accrued depreciation exhibited by DRES Improved Comparable 3---a 3 year old store sold in 2012---was 78.7%. Subtracting the 14.5 percent physical depreciation contained within the DRES reports, leaves a 64.2% factor of obsolescence which DRES ignored in its Cost Approach, in error "when general market knowledge and the best comparable data demonstrate large factors for obsolescence in fee simple sales of this property type." [Tr. Exhibit 3 at 7-8].

55. Respondent's sales comparison approach includes four leased fee sales that "should only be used for fee simple assignments when a market-based adjustment can be demonstrated," which in this case was not done. [Tr. Exhibit 3 at 9].

56. DRES also develops a Property Rights adjustment by comparison of two leased fee sales to one another. "Leased fee sales typically trade hands in a national net leased market with a different set of buyers (passive investors) as compared to fee simple sales (owner user/active investor). Therefore, leased fee sales do not directly compete with fee simple properties and do not meet the principle of substitution inherent in the Sales Comparison Approach." [Tr. Exhibit 3 at 9].

57. DRES sales 2, 3, 4, and 9 include adjustments to the price for expenditures made after purchase. "This type of an adjustment is intended to consider costs for items of repair or replacement that buyers and sellers recognized and considered in the purchase negotiation process. Sales 2 and 9 were purchased for conversion to multi-tenant use and those expenditures were for a change of use that should not be added to the purchase price." [Tr. Exhibit 3 at 9].

58. DRES sale 3 "had a $2,800,000 adjustment for expenditures that is not considered reasonable. The sale is a three-year-old store that would not have such a high level of work needed to restore utility for marketing and that amount of money would not be recognized by the seller and buyer of the property. The buyer did significantly change the store to rebrand the interior and exterior of the property and add ±17,500 square feet of space in a brand new, detached building built after the sale was consummated. [Tr. Exhibit 3 at 9-10].

59. Sale 3 is also reported by DRES to have 12.25 acres of land, while Isanti County reports and confirms site size to be 17.25 acres. [Tr. Exhibit 3 at 9-10].

60. Sale 7 is a 48,865-square-foot store with an additional 12,991-square-foot mezzanine in a fully developed commercial district of St. Cloud. It is quite small to be a good comparable for the subject property even though a -30 percent size adjustment is applied. Square footage is 20.7 percent of the subject area for valuation purposes, suggesting the two properties would not compete against one another in the marketplace and therefore should not be used in a sales comparison approach to value. [Tr. Exhibit 3 at 10].

61. Several other observations can be made regarding the adjustment procedures. A Market Conditions adjustment is based on sales/re-sales of net-

leased properties and on capitalization rates over time for national net-leased properties. Use of this data is not consistent with a fee simple assignment and, again, suggests that while the Property Rights Appraised are identified as fee simple, the actual appraisal procedures may not be fee simple and appear to be designed to substitute a leased fee analysis for the fee simple interest in the subject property. [Tr. Exhibit 3 at 10].

62. The DRES Report also uses a -5 percent adjustment for mezzanine space, and a -10 percent adjustment for unheated areas. Mezzanine space often has nominal contributory value. Unheated storage was adjusted based on calculations using base cost factors. [Tr. Exhibit 3 at 10].

63. Unheated spaces, particularly the detached warehouse/sheds, may not be recognized by a buyer and also have no or nominal contributory value. More appropriate treatment of this space may be achieved by using only the primary building square footage of the property, 162,340 square feet, and applying an upward adjustment for the attached unheated space, and little or no adjustments for the mezzanine and detached unheated space. [Tr. Exhibit 3 at 10].

64. Using the larger square foot area and attempting to adjust downwards may not fairly treat the space in the market. All buyers would consider the primary building area in a purchase discussion. Few, if any, buyers would impute value to all the space. [Tr. Exhibit 3 at 10].

65. In sum, because the DRES approach: (a) uses leased fee sales for a fee simple assignment; (b) adjusts purchase prices for expenditures after the sale that are not appropriate; (c) fails to mention that the expenditures either changed the use of the building from single-tenant to multi-tenant, or were for buyer's modifications not needed to restore utility of the building; (d) bases certain adjustments on leased fee

data which is inconsistent with a fee simple assignment; and (e) multiplies unit prices by the gross square footage of the building, including the primary heated structure, mezzanine, attached unheated warehouse and detached unheated shed, when market participants are not likely to treat all areas as usable or of value, the results reported are not credible and should be given no weight in determining the fee simple estimate of market value for the subject property. [Tr. Exhibit 3 at 15].

66. The DRES report also develops an income approach using a market rent estimated by comparison to 13 rental agreements.

67. Rentals 1, 2, 4, 6, 7, 8, 9, 10, 12 and 13 all appear to be build-to-suit or sale-leaseback agreements that lack the exposure to the market and competition between landlords and tenants that represents true market rental deals. [Tr. Exhibit 3 at 12].

68. Rentals 3 and 11 are adjusted upward for location by a factor of 50 percent. Rental 3 is located less than two miles north of the subject on four-lane U.S. Highway 10. Wal-Mart moved out of this store after building a new property adjacent. So the 50 percent location adjustment does not seem appropriate since the comparable is a viable, proven location. DRES does not develop an adjustment for the build-to-suit or sale-leaseback conditions for the majority of the rental data. Therefore, the estimate of market rent for the subject property is not supported. [Tr. Exhibit 3 at 12].

69. Vacancy is estimated at a modest level of 5.5 percent based upon surveyed rates, big-box occupancy and calculated vacancy for one year of vacancy to achieve a 15 to 20 year lease. All of this data may not be applicable to mega-big-box vacancy in today's marketplace of consolidation and change in retailing. [Tr. Exhibit 3 at 12].

70. A basic capitalization rate of 9 percent was forecast based upon various methods, including national net-leased data not applicable to the fee simple assignment. [Tr. Exhibit 3 at 12].

71. The income approach factors are summarized on page 133. Estimated market rent of $5.24 per square foot is multiplied by the entire area of 236,429 square feet for the primary building, mezzanine, and unheated warehouse space. In the market rent estimate, an adjustment of -10 percent is made for non-primary space. Mezzanine and unheated space of 74,089 square feet represents 31.3 percent of the 236,429 square foot total; or 45.6 percent of the primary building at 162,340 square feet. [Tr. Exhibit 3 at 12].

72. Just as in the discussion of this factor in the Sales Comparison Approach, it may not be market accepted or appropriate to use all of the primary and secondary square footage to calculate rental income. [Tr. Exhibit 3 at 12]. This is particularly true in this case, because the income approach conclusions were modified for later years by adopting all of the income approach inputs and changing <u>only</u> the capitalization rates. Information regarding market rental and vacancy was not updated from the original document. [Tr. Exhibit 3 at 13].

73. In sum, because DRES' income approach is based upon: (a) market rent that is mainly supported by non-arm's-length rental agreements, such as build-to-suit and sale-leaseback deals; (b) adjustments to the fee simple data that do not appear accurate for location; (c) vacancy that is not a market-tested factor; and (d) income calculations using gross square footage, including secondary space, that may not be recognized in the marketplace, the conclusions reached in both reports are not credible and should be given no weight in determining the fee simple estimate of market value for the subject property. [Tr. Exhibit 3 at 15].

74. The DRES report developed cost, income, and sales comparison approaches to value in the original and supplemental reports. Each approach was considered a "reliable indicator" of value and each was given "appropriate consideration" in the final value estimate. A final value estimate calculation gave equal weight to the three approaches each year. This is an unusual reconciliation in that all these approaches do not typically provide uniform support due to available market data, applicability of an approach to the subject property, or preference of approaches for the intended use of the report. [Tr. Exhibit 3 at 14].

75. In addition to his review appraisal, Petitioner's review appraiser, Gary Battuello, MAI, AI-GRS, explained in detail during his rebuttal testimony that DRES's: (a) cost approach inappropriately includes entrepreneurial profit in its presentation of replacement costs new for the subject property; (b) estimates depreciation without any market support and considers no obsolescence; (c) contradicts its zero percent obsolescence conclusion by relying upon market sales that clearly demonstrate obsolescence is present in the sale of a highly-similar property used by both appraisers; (d) relies upon sales of 100 percent net-leased properties that provide indications of leased fee value when the assignment is a fee simple valuation; and (e) relies upon net leases of non-arm's-length build-to-suit or sale-leaseback type of agreements. [Tr. Exhibit 3 at 15; Tr. Hearing Day 2, p. 469, l. 9 through p. 507, l. 13].

76. For all of these reasons, none of the valuation methods are completed properly for a fee simple appraisal assignment. The appraisal procedure and value estimate is not considered to be reasonable or reliable and lacks support for a fee simple valuation assignment. [Tr. Exhibit 3 at 15; Tr. Hearing Day 2, p. 469, l. 9 through p. 507, l. 13].

APPLICABLE LAW

Burden of Proof

Pursuant to Minn. Stat. §§ 271.01, subd. 5, and 278, the Minnesota Tax Court exercises its independent judgment to determine the fair market value of the subject property as of the assessment dates. The assessor's estimated market value is presumed to be valid.[18] The presumption disappears, however, when the petitioner introduces some credible evidence that the assessment is excessive.[19] When the petitioner introduces some credible evidence that the assessment is excessive, then determination of the subject property's market value is decided by a preponderance of the evidence.[20]

This means that the evidence offered to prove a given fact must fairly outweigh the evidence offered in opposition to it and be of greater convincing force and effect. It is not necessarily to be determined by the number of witnesses who testified with reference to that fact or the volume of testimony which has been received with reference to it. On the whole it maybe said that if all the evidence coming into the case from whatever source fairly convinces you of the existence of a given fact, then the party who has the burden of proving that fact by a fair preponderance of the evidence has met that burden.[21]

Highest and Best Use

The highest and best use of a property as improved is the use that should be made of an improved property in light of the existing improvements. "Whenever

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[18] Minn. Stat. § 271.06(6); *see also, Schlieff v. County of Freeborn*, 43 N.W.2d 265, 269 (Minn. 1950).
[19] *Southern Minnesota Beet Sugar Coop. v. County of Renville*, 737 N.W.2d 545, 557-58 (Minn. 2007); *Meritex Ent. v. County of Ramsey*, File No. CX-06-4506 (Minn. Tax Ct. July 24, 2009).
[20] *Id.*
[21] *Canada v. McCarthy*, 567 N.W.2d 496, 507 (Minn. 1997), *citing Carpenter v. Nelson*, 101 N.W. 2d 918, 921 (Minn. 1960).

possible, the property being appraised should be compared with similar properties that have been sold recently in the same market."[22] "Each improved property should have the same or a similar highest and best use as the improved subject property, both as though vacant and as improved."[23] "The highest and best use conclusion should specify the optimal use (or uses), when the property will be put to this use or achieve stabilized occupancy, and who would be the most likely purchaser or user of the property (*e.g.*, an owner-operator of the property or an equity or debt investor)."[24]

Here, Petitioner's expert concluded that the highest and best use for the subject property, as vacant, is for "a relatively low intensity commercial development or for a long-term, buy and hold position." [Tr. Exhibit 1 at 43]. Petitioner's expert also concluded that, as improved, "the highest and best use of the subject property is continued use as a single-tenant retail building with its current owner-occupant, a Menards Home Improvement retail store. Should this building become vacant, it is highly likely the building would remain vacant. The building would require an extensive amount of capital improvements to [re-demise] the space into smaller units and this expense is not economically feasible. A more likely scenario is converting the space to some type of light industrial use or securing an alternate user who would raze the improvements in favor of its own design and alternate use." [Tr. Exhibit 1 at 48].

The DRES report concludes a highest and best use as vacant to be commercial use that conforms to the current zoning ordinance. Respondent's

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[22] The Appraisal of Real Estate, at 43 (14th ed. 2013).
[23] *Id.*
[24] *Id.*

experts then conclude the highest and best use as improved is the current use as a big box retail store. [Tr. Exhibit A at 56].

Given the: (a) tertiary nature of the subject property's location in relation to all other retail uses in the Fargo-Moorhead area; (b) lack of interest in purchasing any of the outlots Menards has advertised for sale immediately adjacent to its building since 2006; and (c) the seminal fact that gross sales at the Moorhead Menards from 2011 through 2014 have significantly lagged behind the gross sales achieved by an almost identical Menards store located in West Fargo, the suggestion contained in the DRES report that rezoning to a classification allowing warehouse uses is a possibility, if a pure retail re-use did not occur at the property, is a distinct possibility the Court must keep in mind in evaluating the valuation evidence from both sides. At a minimum, this "suggests that enough weakness in the market for such stores exists that rezoning was researched by [DRES'] appraisers." [Tr. Exhibit 3 at 5].

Valuation

The Court considers the three traditional approaches (cost, income, and sales) to determine market value.[25] Although it is preferable to give weight to more than one approach to value, under appropriate circumstances, a single approach may be used to determine the value of the subject property.[26]

Here, the overwhelming number of sales of big box stores which have occurred in Minnesota (and nation-wide) during the relevant dates under consideration suggests the sales comparison approach should be given the most---if not all of the---weight by the Court in reaching a final determination of estimated

[25] *Equitable Life Assurance Soc'y v. Ramsey County*, 510 N.W.2d544, 552 (Minn. 1995).
[26] *Id.*

market value for the subject property.

This is particularly true given that it is possible to measure the accrued depreciation for all of the sales that have occurred under the cost approach empirically to cross-check the generally held opinion that big box retail stores are suffering from “severe obsolescence.” [Tr. Exhibit 1 at 98]. This generally-accepted view is reflected in the unit pricing of over 50 sales of Target, Walmart, Lowe’s, Home Depot, and Menards (to name a few) stores which have occurred since the Great Recession began in 2009.

CONCLUSIONS OF LAW

Petitioner developed and analyzed the sales comparison, cost, and income capitalization approaches to value, but in the end relied primarily upon the sales comparison approach, given the overwhelming number of fee simple sales reported. Respondent developed all three approaches to value as well, but conveys an indication of value that curiously places equal weight on all three, despite the fact the cost approach is rarely even relevant in the minds of market participants, and despite there being no demonstrable leasing market for owner-occupied, mega big box retail stores in the Fargo-Moorhead area.

As reflected in the findings of fact, as well as in the relevant---highly persuasive---case law from Michigan and Indiana addressing identical valuation issues with respect to Menards, Lowe’s, Home Depot, and Kohl’s big box store(s) [Tr. Exhibit 1, Addendum, Part 2, at A241-260; A282-300; A301-358], the income approach to value is not relevant to this tax appeal.

Petitioner's appraiser was charged with determining the market value of the subject property for the 2011, 2012, 2013, and 2014 assessment years under appeal. Respondent was charged with defending the assessments for the subject property for those years under appeal. As noted in the extensive findings of fact, Respondent's documentary and testimonial evidence has inconsistencies, contradictions, and misrepresentations.

Regarding a cost approach analysis, the subject's improvements are less than ten years old and would indicate minimal physical depreciation. However, Respondent's appraisers did not account for functional or external obsolescence within their cost approach to value. Petitioner's assertion to the limitations of the cost approach is noteworthy in this instance.

Built-to-suit construction, 2nd generation users, and renovation costs demonstrate functional obsolescence which is enormous and occurs at the very inception of the useful life of the big box store. Petitioner has convincingly articulated that 1st generation users develop big box retail space to enhance retail sales and not to optimize market value to the property. For these reasons, Respondent's cost approach is given no weight or credibility in the determination of market value for the subject property.

Respondent sets forth sales data for the proposition of a sales comparison approach. The missing link between DRES's data and a comparative methodology is that the DRES's approach: (a) uses leased fee sales for a fee simple assignment; (b) adjusts purchase prices for expenditures after the sale that are not appropriate; (c) fails to mention that the expenditures either changed the use of the building from single-tenant to multi-tenant, or were for buyer's modifications not needed to restore utility of the building; (d) bases certain adjustments on leased fee data which is inconsistent with a fee simple assignment; and (e) multiplies unit prices by the gross square footage of the building, including the primary heated structure, mezzanine, attached unheated warehouse and detached unheated shed, when market participants are not likely to treat all areas as usable or of value. [Tr. Exhibit 3 at 15]. For all these reasons, the results reported are not credible and therefore are given no weight in determining the fee simple estimate of market value for the subject property.

Petitioner was able to explain and provide documentation for the 27 fee simple sales of big box retail stores comprising its sales comparison approach. Mr. Marous provided extensive sales of big box stores throughout the state. The data included comparable sales in other states as well to demonstrate the national scope of the "depreciated cost" unit pricing for this property type as retailers move away from the big box business model altogether. This comparative data is further supported by sales data within the market analysis of his appraisal report.

Marous analyzed the sales for each year under appeal that "were acquired in respect to the various retrospective dates of value and, therefore, which were relied upon the most." [Tr. Exhibit 1 at 99]. By relying most heavily on "sales that closed shortly after a retrospective date of value," Marous felt he had successfully organized the sales data in the most "germane" way. [Id.]. The overall data illustrated to the Court the impact of sales of retail big box stores for the four-year period in a convincing fashion given both the number of sales and the tight range of sale prices reported during the entire time period under consideration.

The comparable data was analyzed in conjunction with supported market conditions. Moreover, Mr. Marous' testimony regarding the consideration of deed restrictions is meaningful to his overall analysis. The application of available data to the subject property is persuasive. Therefore, Petitioner's sales comparison approach is meaningful to the determination of market value for the subject property this Court is charged with making for all four years at-issue.

Petitioner's comparison analysis and adjustments reflect market actions. Similarly, Petitioner's reconciliation of the adjusted sale prices for the three years under appeal is complete. Petitioner concludes to the values by quantifying the adjustments made to the comparable sales that were closest in time to the retrospective dates of valuation, not simply by averaging the adjusted sales prices for all sales regardless of how remote in time they became from the valuation date under consideration. [Tr. Exhibit 1 at 98-106].

The reconciliation of approaches is similar to the reconciliation of sales data. Reconciliation is an appraiser's opportunity to fill in gaps, and to prove overall logic and reasoning for the value conclusions. Averaging adjusted sales prices infers equal weight and consideration to the data. In this instance, Petitioner's data, even after adjustments, indicates a given range in adjusted sales prices. Even when adjustments are supported by comparable data and the adjustment process, the values indicated still reflect human judgment. This unalterable fact is somewhat ameliorated in this case due to the overwhelming number of big box store sales included in the tables Petitioner presented for this Court’s review.

“The sales comparison approach is not formulaic. It does not lend itself to detailed mathematical precision. Rather, it is based on judgment and experience as much as quantitative analysis." [Appraisal Institute, *The Appraisal of Real Estate* (14th ed. 2013) at 394]. The strengths and weaknesses of each comparable sale are examined for reliability and appropriateness. Petitioner's appraiser provided consistent testimony and explanatory narration for his comparison analysis and adjustments.

Nonetheless, certain sales are more germane for each year under appeal. The sales comparison approach for each year is reconciled with the similarities and dissimilarities of each comparable sale. Petitioner's elaborate comparison analysis gives rise to more than averaged value conclusions. We agree with Petitioner's sales comparisons, as well as its reasoned decision to highlight which sales "were relied on the most" for the individual assessment years under appeal. [Tr. Exhibit 1 at 99].

Again, the subject property is an owner-occupied building. The property has no history of an income stream. In other words, the subject is not an income-producing property. This is validated by Mr. Marous' "test of reasonableness" to demonstrate empirically why the income approach is not applicable in the analysis of the subject property in a fee simple interest. The primary focus therefore must be given to the sales comparison approach to value. And based upon the comprehensive set of fee simple sales of similar big box retail stores Petitioner has presented, the Court finds that Petitioner was able to show that the property was over-assessed for the tax years under appeal.

The extensive findings of fact not only focus on Petitioner's significant evidence, but also on Respondent's insignificant evidence. As such, and in light of the above, the Court finds that Petitioner has succeeded in meeting its burden of going forward with competent evidence regarding estimated market value. Petitioner has provided credible documentary evidence and testimony for the 2011, 2012, 2013, and 2014 tax assessment year(s) at-issue and, as such, the Court finds Petitioner's data within the sales comparison approach is sufficient to arrive at an independent determination of value.

ORDER FOR JUDGMENT

1. The Clay County assessor's estimated market value for the Subject Property as of January 2, 2011, shall be decreased on the books and records of Clay County from $11,200,000 to $4,000,000.
2. Additionally, based upon the 88.4% Median Ratio established in the 2011 Assessment Sales Ration Study derived from 12 sales of commercial/industrial property in the City of Moorhead, the $4,000,000 2011 assessment shall be decreased on the books and records of Clay County from $4,000,000 to $3,736,000.
3. The Clay County assessor's estimated market value for the Subject Property as of January 2, 2012, shall be decreased on the books and records of Clay County from $11,200,000 to $4,000,000.
4. The Clay County assessor's estimated market value for the Subject Property as of January 2, 2013, shall be decreased on the books and records of Clay County from $11,200,000 to $4,000,000.
5. The Clay County assessor's estimated market value for the Subject Property as of January 2, 2014, shall be decreased on the books and records of Clay County from $11,200,000 to $4,000,000.
6. Real Estate taxes due and payable in 2012, 2013, 2014, and 2015 shall be recomputed accordingly and refunds, if any, paid to Petitioner as required by such computations, together with interest from the original date of payment.

LET JUDGMENT BE ENTERED ACCORDINGLY. A STAY OF FIFTEEN DAYS IS HEREBY ORDERED. THIS IS A FINAL ORDER.

BY THE COURT:

Dated:

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Bradford S. Delapena, Judge
MINNESOTA TAX COURT