

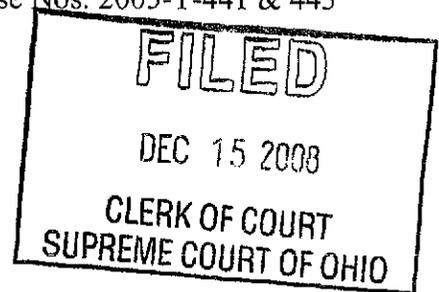
IN THE SUPREME COURT OF OHIO

Meijer Stores Limited Partnership,)
)
 Appellant,)
)
 vs.)
)
 Franklin County Board of Revision,)
 Franklin County Auditor, Licking Heights)
 Local School District, and the Tax)
 Commissioner of the State of Ohio,)
)
 Appellees,)
)
 and)
)
 Marvin J. & Ursula F. Siesel, Shops at)
 Waggoner LLC, and Fifth Third Bank,)
)
 Appellees.)

Case No. 2008-1248

Appeal from the Ohio
Board of Tax Appeals

BTA Case Nos. 2005-T-441 & 443



APPELLANT MEIJER STORES LIMITED PARTNERSHIP MERIT BRIEF

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INTRODUCTION AND DESCRIPTION OF THE PROPERTY

The subject property is designated by the Franklin County Auditor (“Auditor”) as permanent parcel numbers 515-254556-80 and 515-254556-90. (Lorms, p. 3, Appellant’s Supplement, p. 82)¹. The property is located at 8000 East Broad Street in Columbus, Ohio. (Lorms, p. 3). The subject has a total land area of 32.5080 acres and consists of the primary site, a service station and two out-parcels as of the tax lien date. (Lorms, p. 3, Appellant’s Supplement, p. 82). The site was improved in 2001 with a one-story, 192,977 square foot discount retail storeroom and a one-story 2,500 square foot convenience store. (Lorms, p. 1, Appellant’s Supplement, p. 80). Meijer Stores L.P. (“Property Owner”) purchased the subject land in August 2000 and improved the property. (Lorms, p. 3, Appellant’s Supplement, p. 82). As a result, Meijer is the original occupant and there is no lease encumbering the subject property since it is both owned and occupied by Meijer.

For the tax year 2003, the Auditor placed an assessed taxable value on the subject parcel of \$13,290,000. On March 25, 2004, the property owner filed a complaint with the Franklin County Board of Revision (“BOR”) seeking to decrease the assessment of the two parcels to \$9,500,000. On May 10, 2004, the Board of Education of the Licking Heights Local School District (“School Board”) filed a counter complaint seeking to retain the Auditor’s value.

On March 28, 2005, the BOR held a hearing concerning the property owner’s complaint. The property owner presented the appraisal and expert opinion of Robin Lorms, MAI, of Integra Realty Resources – Columbus. The opinion of value presented by Mr. Lorms before the BOR was \$8,800,000. On April 5, 2005 the BOR issued its decisions maintaining the Auditor’s original value. The property owner then appealed to the Ohio Board of Tax Appeals (“BTA” or

¹ The appraisal report prepared by Robin Lorms and admitted into evidence as Appellant’s Exhibit 1 will hereafter be cited as “Lorms, p. ___”.

“Board”) on May 5, 2005. The case was assigned to Attorney Examiner Steven Smiseck. The case proceeded to hearing before the Board on November 7th and 8th of 2006. Once again, the property owner presented the testimony of Mr. Lorms. Mr. Lorms outlined various reasons why the use of leases resulting from build-to-suit arrangements and the reliance upon sales of properties subject to these build-to-suit leases was not reflective of value, and how it primarily reflected the use value of the property instead of its value in exchange. Mr. Lorms further supported his opinion with an independent appraisal of the subject property for \$8,800,000. Upon completion of his testimony, Mr. Lorms’ appraisal was admitted into evidence as Appellant’s Exhibit A.

The School Board relied on an appraisal prepared by Samuel Koon, MAI, of Samuel D. Koon & Associates. Mr. Koon arrived at his opinion of value by, essentially, relying upon build-to-suit leases which do not meet the accepted definition of market rent and sales of properties still occupied by tenants who entered into those build to suit leases. Mr. Koon expressed an opinion of value of \$14,850,000. As will be discussed below, for none of the first generation leases relied upon in his appraisal report was Mr. Koon knowledgeable concerning how the lease rate was determined. Additionally, for a significant number of sales comparables, Mr. Koon did not even know the rates of the underlying leases in order to compare it with his opinion of market rent for the subject property. Mr. Koon’s appraisal report also impermissibly intertwines non-real estate components with the value of the real property and reflects the potential value to one entity, the current owner-occupant, and not a market value. Given this lack of fundamental knowledge concerning the underlying facts of comparables relied upon and the clear conflict with the guidance from this Court, the opinion of value set forth by Mr. Koon is not supportable.

Even though Mr. Koon was unable to support his comparables utilized in his appraisal and it was clearly at odds with this Court's precedent, the BTA in a decision dated May 27, 2008 erroneously accepted the appraised value of Mr. Koon. The Property Owner then appealed that decision to this Court.

LAW AND ARGUMENT

The property owner has established, by clear and convincing evidence submitted in the record, the following:

- I. Mr. Lorms' appraisal of the subject property constitutes competent, probative evidence of its value. It is the only competent, supported opinion of value that is consistent with Ohio law and should be adopted by this Court.
 - II. The School Board's appraisal by Mr. Koon does not constitute competent, probative evidence of the value of the subject property. The value conclusions reached by Mr. Koon cannot be supported by the appraisal report or his testimony before the Board. The BTA's reliance upon this report is clearly erroneous and should be overturned by this Court.
 - III. The adoption of Mr. Koon's appraised value of the subject property would result in a constitutionally prohibited assessment in use.
 - IV. Accepting the approach utilized by Mr. Koon for the valuation of the property without further evaluation of specifics of the transactions relied upon by Mr. Koon is inconsistent with the Ohio Supreme Court's holding in *Higbee Co. v. Cuyahoga Cty. Bd. of Revision* (2006), 107 Ohio St. 3d 325, wherein the Ohio Supreme Court rejected appraisal evidence of value inextricably intertwined with the non-real estate business value of the tenant. The lack of knowledge concerning several of the comparables utilized makes it impossible for the Appellant or any reviewing Board or Court to determine the real property value indicated by those transactions versus the non-real estate value.
- I. Mr. Lorms' appraisal of the subject property constitutes competent, probative evidence of its value. It is the only competent, supported opinion of value that is consistent with Ohio law and should be adopted by this Court.²**

² This argument addresses Assignments of Error 1, 2, 3 and 4.

Mr. Lorms is an appraiser with outstanding credentials. He has been an appraiser for over thirty years and is a member of the Appraisal Institute, the Counselors of Real Estate, and the International Council of Shopping Centers. (Lorms, Addendum A, Appellant's Supplement, p. 187). He has repeatedly been recognized by the Board as an expert, particularly relating to the appraisal of big box retail properties. In *Auction Properties Inc. v. Columbiana County Board of Revision* (Mar. 5 2004), BTA Case No. 2003-G-183, a case involving a Wal-Mart, the Board stated:

We find Mr. Lorms' appraisal most closely reflects the fair market value of the property. **Mr. Lorms exhibited a vast knowledge regarding the appraisal and valuing process of "big box" properties.** (Emphasis added).

The knowledge and credibility exhibited in *Auction Properties*, a case involving a five year old Wal Mart where the Board found the value to be the same as the opinion offered by Mr. Lorms, was evident in this matter as well. Mr. Lorms utilized all three approaches to value; utilized three different methods to extract depreciation; eight comparable sale indications; six rent indications; twelve expense indications; twenty vacancy indications; and, three sources for his capitalization rate.

His testimony and opinions have been cited favorably many times by the Board when valuing these properties including, but not limited to *Lowes Home Centers, Inc. v. Fairfield Cty. Bd. of Revision* (May 27, 2008), BTA Case No. 2006-R-801, *unreported*; *Board of Edn. of the Columbus City Schools v. Franklin Cty. Bd. of Revision* (July 28, 2006), BTA Case No. 2005-V-211, *unreported* (another Target store that was submitted upon the record created before the Board of Revision); *Meijer Stores L. P. v. Montgomery Cty. Bd. of Revision* (October 14, 2005), BTA Case No. 2003-A-2160, *unreported*; *Agree L. P. v. Wood Cty. Bd. of Revision* (September 23, 2005), BTA Case No. 2003-T-1205, *unreported* (a K-Mart store); *Meijer Stores L. P. v.*

Wood Cty Bd. of Revision (July 15, 2005), BTA Case No. 2003-A-1204, *unreported*; *Wal-Mart Real Estate Business Trust v. Fulton Cty. Bd. of Revision* (July 15, 2005), BTA Case No. 2003-T-913, *unreported*; and *Auction Properties Inc. v. Columbiana County Board of Revision* (Mar. 5 2004), BTA Case No. 2003-G-183, *unreported*.

It is this same approach, accepted repeatedly by the Board that was applied in this case. It is designed to determine the most likely price at which the property would sell. As indicated above, the subject property is owner-occupied by Meijer. If the property were to sell it would naturally have to result from the current owner-occupant leaving the property. Mr. Lorms' report is the only report that properly considers the facts of this case. As will be discussed in more detail below, Mr. Koon's reliance upon the idea that the current owner-occupant would become the tenant is illogical, not consistent with the facts in this case and inconsistent with the likely highest and best use analysis of the likely continued use and buyer of the property.

The following analysis of Mr. Lorms' report demonstrates that it is the only analysis in this case that addresses the price at which the subject property, not some fictional other property subject to a lease that doesn't exist in this case, would transfer in an arm's length transaction

Cost Approach:

Turning to Mr. Lorms' cost approach, Mr. Lorms relies on four land sales for the primary site and three land sales, including an actual sale of one of the out-parcels to arrive at a fair market value for the subject's land. (Lorms, pp. 66-69, Appellant's Supplement, pp. 145 - 148). The total land value arrived at by Mr. Lorms is \$5,600,000. (Lorms, p. 69, Appellant's Supplement, p. 148). Mr. Koon arrives at a total land value of \$5,821,850. The two appraisers do not vary greatly on their land values.

Mr. Lorms then developed a replacement cost estimate from Marshall's Valuation Service for both the discount store and the convenience store. (Lorms, p. 72, Appellant's Supplement, p. 151). After adding the value of the land, together with replacement cost of the building and site improvements, then deducting depreciation and obsolescence, Mr. Lorms arrived at a value of \$10,200,000 via the cost approach. (Lorms, p. 78, Appellant's Supplement, p. 157). Mr. Lorms' estimate of obsolescence was confirmed by three separate sources, including extraction from market sales, including supporting land values and depreciation estimates in the addendum; extraction from capitalized rent loss, and extraction from the sale and resale of three K-Marts that sold subject to their original lease and then resold after they were closed. (Lorms, pp. 73-77, Addendum for land sales and depreciation estimates; Appellant's Supplement, pp. 152 – 156 and pp. 219 - 226). Each of these sources is recognized by The Appraisal Institute. (The Appraisal of Real Estate, 13th Edition, pp. 416 – 420, p. 444.)

While the Board has requested additional information from Mr. Lorms in the past for such items as his Comparable Sale Depreciation Extraction found on page 75 of his report (Appellant's Supplement, p. 154), that required information is now included in the addendum to Mr. Lorms report (Appellant's Supplement, pp. 219 – 226). The Board of Tax Appeals in the Lowes, Target, Meijer, K-Mart and Wal-Mart big box examples cited above has thoroughly reviewed and accepted Mr. Lorms calculation of obsolescence in the past. There is nothing in this report that strays from that previously accepted approach. Mr. Koon on the other hand, totally ignores the market evidence that such obsolescence exists. As will be discussed in detail below, the fact that the property is still occupied by the party it was designed for is a reflection of its value in use, not its value in exchange. When, as in the case of big box properties, "retailers rarely, if ever, locate in existing big boxes" (Lorms, p. 29, Appellant's

Supplement, p. 108), extensive market data bears out the fact that second generation users do not value the improvements similar to the initial, build-to-suit tenant. Mr. Koon's choice to ignore these market facts and the previous decisions of the Board is, quite simply, not supportable.

In summary, the land values developed by both appraisers do not vary greatly. The cost approach and calculation of obsolescence performed by Mr. Lorms is consistent with previous presentations to the Board and is supported by three methods of calculating obsolescence. Mr. Koon ignores the market reality. Even he admits the maybe only 2% of retailers would go into existing space (Tr. #2, pp. 57-58, Appellant's Supplement, p. 423). Utilizing the fact that the original occupant still occupies a building to support the argument that no obsolescence exists, without supporting data to show that others place similar value on those improvements, cannot be supported. Mr. Koon is, at best, valuing the use-value of the subject property to its original tenant; not the value at which it would transfer in the open market.

The Board, in reviewing the cost approaches of both appraisers correctly noted that both appraisers agreed that the likely buyer would not rely upon the cost approach to determine a value at which the subject property would transfer. BTA Decision at p. 24. As a result, the BTA correctly did not rely upon the cost approach of either appraiser.

Sales Comparison Approach:

In the sales comparison approach, for purposes of valuing the discount store, Mr. Lorms relied on eight comparable sales ranging from \$34.92 per square foot to \$60.74 per square foot. (Lorms, p. 82, Appellant's Supplement, p. 161). After consideration of various criteria, including location, size, age, and condition, sales 1 and 7 were found to be the most comparable to the subject. Comparable number 1 sold for \$35.95 per square foot and comparable number 7 sold for \$34.92 per square foot. Primary evidence was placed upon these sales to arrive at a per

square foot value for the discount store of \$35 per square foot. (Lorms, p. 84, Appellant's Supplement, p. 163). This amount was added to the values developed under the cost approach for the outparcels and convenience store to arrive at an indicated value of \$8,800,000. (Lorms, p. 84, Appellant's Supplement, p. 163). Complete write-ups were provided in the addendum to support the summary of each transaction provided in the body of the report. (See Appellant's Supplement, pp. 205 – 212).

As will be discussed in detail below, Mr. Koon was unable to provide fundamental information such as lease rates for many of the comparable sales relied upon. It is impossible to determine even internal comparability to the opinion of rent determined by Mr. Koon. Furthermore, since the properties would be subject to some unknown lease rate there would be a capitalization rate at which those properties transferred and it is impossible to even internally compare that in Mr. Koon's report. The failure to know or capture such basic information eliminates the credibility of Mr. Koon's report and opinion of value. Significantly he relies upon build-to-suit properties where the underlying leases were never subject to market conditions and which reflect a use value to the original tenant. Mr. Koon's sales comparison approach is not well supported. Mr. Lorms on the other hand includes only fee simple sales which are fully supported by his appraisal report and his testimony before the Board.

Each of the sales utilized by Mr. Lorms is a fee simple sale. Mr. Lorms further testified that the comparable properties were not failed locations and, through his testimony, supported this position based upon the retail activity in the market where the properties were located. (Tr. #1, pp. 71-72, Appellant's Supplement, p. 20). The argument that these locations are failed fails to distinguish between a failed location and a failed tenant. Ames or Kmart are failed tenants who filed for bankruptcy. They presumably closed some stores in good locations and some

stores in bad locations. No conclusion can be reached about a local, particular store because of the national bankruptcy of the user. For example, a Wal-Mart succeeds where a Kmart failed and a Target succeeds where an Ames failed. Mr. Lorms acknowledges this (Tr. #1, p. 72, Appellant's Supplement, p. 20) as does Mr. Koon (Tr. #2, pp. 41-42, Appellant's Supplement, p. 419).

Some perfect examples of the distinction between a failed tenant and a failed location can be seen in the comparables that Mr. Lorms utilized in his appraisal. Take the two Ames stores that were built for Ames but never occupied because they went bankrupt. The stores were purchased by Target and Home Depot. Those locations have strong demographics and are surrounded by other users at the same location, including Wal-Mart, Kroger's, and Lowe's. Would Target and Home Depot purchase bad locations? Take the former Kmart purchased by Liberty Ford. Would a bad location be purchased by a new car dealership, which is itself across the street from Home Depot and Giant Eagle? How about the Kmart at Mill Run in Hilliard? The surrounding users who are succeeding at the same location where Kmart failed are Lowe's, Target, Home Depot and Staples. The Kmart on Ridge is nearby a Wal-Mart and a Lowe's. The examples are endless of users who failed where others succeed. So the mere fact that a user filed for bankruptcy says nothing about any particular location they may have vacated.

Mr. Lorms approach is consistent with prior appraisals accepted by the Board. It is supported by market data and values the fee simple, value in exchange of the subject property. It is not based significantly upon transfers based upon build-to-suit leases where obsolescence is not captured. Mr. Lorms approach, as discussed further below, is the only approach that is consistent with the specific property and its highest and best use. It is owner occupied; not leased. It will not sell subject to a first generation lease—that is impossible. Mr. Koon's

approach, unlike Mr. Lorms', is inconsistent with the likely highest and best use of the specific property being valued.

Income Approach:

In his income approach, Mr. Lorms relied on six market comparable rents ranging from \$0.00 per square foot after allowance for tenant improvement to \$4.80 per square foot. (Lorms, p. 88, Appellant's Supplement, p. 167). Mr. Lorms concluded to a market rent at the upper end of the range at \$4 per square foot for the subject or a potential gross rent of \$771,908. (Lorms, p. 90, Appellant's Supplement, p. 169). After adding expense reimbursements of \$337,333 and deducting 10% for vacancy and credit loss, Mr. Lorms arrived at an effective gross income of \$998,317. (Lorms, p. 93, Appellant's Supplement, p. 172). From his estimate of the gross income, Mr. Lorms deducted \$415,527 in expenses, including reserves, to arrive at a projected net income of \$582,790. (Lorms, p. 93, Appellant's Supplement, p. 172). Estimating a capitalization rate of 10.0% derived from three separate sources, Mr. Lorms concluded to a value of \$5,827,901 for the discount store. (Lorms, p. 99, Appellant's Supplement, p. 178). To this value, the value determined under the cost approach for the outparcels and convenience store are added to arrive at a total value conclusion under the income approach of \$7,800,000. (Lorms, p. 99, Appellant's Supplement, p. 178).

The most significant consideration in evaluating the income approach applied by the appraisers is that, to value the fee simple interest in the property as required by Ohio law, market rent is the basis for estimating rental income. (Lorms, p. 86, Appellant's Supplement, p. 165). This property was not subject to a recent, arm's length sale. Page 86 of Mr. Lorms report, citing *The Dictionary of Real Estate Appraisal*, sets for the conditions precedent for market rent. Significantly, one of those requirements is that "[a] reasonable time is allowed for exposure to

the open market.” (Lorms, p. 86, Appellant’s Supplement, p. 165). The leases relied upon by Mr. Lorms meet such a requirement. The build-to-suit leases relied upon by Mr. Koon do not. As discussed below, in all cases, Mr. Koon can not even testify as to how the lease rate was determined other than a general belief that it was based upon the build-to-suit costs to construct the property. (Tr. #2, p. 77, Appellant’s Supplement, p. 428).

Mr. Lorms’ income approach is based upon transactions that meet the definition of market rent. It is well supported and consistent with prior approaches reviewed by this Board.

Mr. Lorms’ sale and lease comparables are consistent with the highest and best use of the subject property.

Mr. Lorms fully addresses the highest and best use of the subject property and concludes that the highest and best use, as improved, would be continued use as a discount storeroom and that the most probable buyer would be an owner-user or a local or regional investor such as an individual or partnership (once Meijer would vacate the property). (Integra, p. 52, Appellant’s Supplement, p. 131).

As set forth in the Integra appraisal, the highest and best use must be:

- Legally permissible under the zoning laws and other restrictions that apply to the site.
- Physically possible for the site.
- Financially feasible.
- Capable of producing the highest value from among the permissible, possible, and financially feasible uses. (Integra, p. 51, Appellant’s Supplement, p. 130).

Each of these factors was taken into account by Mr. Lorms in its appraisal report and in selecting the comparables utilized for both the sales comparison and income approach to values. The buyers or lessor are owner-occupiers, local or regional investors and represented continued retail use. The appraisers are valuing an existing improvement to the property by reference to

fee simple, unencumbered sales of property with the same highest and best use and by reference to leases which meet the definition of market rent because they arise from transactions made in the open market.

By comparison, Mr. Koon assumes that an owner-occupied property could miraculously become subject to a first generation lease and sell subject to that lease. The use of first generation lease comparables is not appropriate in this case and inconsistent with the most likely transfer of the subject property where there is no lease on the property and the current occupant would be vacating the property and selling it.

Reconciliation of Value:

Because of the significant amount of depreciation and obsolescence inherent in a big box retail store, Mr. Lorms relied on his cost approach the least. (Lorms, p. 100, Appellant's Supplement, p. 179). Mr. Lorms gave primary consideration to the sales comparison approach which was further supported by the income approach in reconciling to a final value of \$8,800,000. (Lorms, pp. 100-01, Appellant's Supplement, pp. 179 - 180). This value was derived from 21 comparable indications, including seven land sales, eight improved sales, and six market rentals. Accordingly, the property owner would submit that the value of the subject property is well-supported and clearly consistent with the price at which this specific property would most likely sell.

II. The School Board's appraisal by Mr. Koon does not constitute competent, probative evidence of the value of the subject property. The value conclusions reached by Mr. Koon cannot be supported by the appraisal report or his testimony before the Board. The BTA's reliance upon this report is clearly erroneous and should be overturned by this Court.³

³ This argument addresses Assignments of Error 1, 2, 3 and 4.

There are several problems with the appraisal report prepared by Mr. Koon. In addition to the expression of a value in use to Meijer, as discussed below, the appraisal and the testimony of Mr. Koon fail to adequately support the opinions contained in the report and therefore it cannot be relied upon. The reliance by the BTA upon this report is clearly erroneous.

Mr. Koon's Cost Approach:

Mr. Koon's cost approach is discussed in some detail above. In determining a value under the cost approach, Mr. Koon ignores the market evidence that obsolescence exists. Mr. Koon testified that the main reason for this conclusion is that the store continues to be occupied by the user is was designed for. (Tr. #2, p. 38, Appellant's Supplement, p. 418). This fact, on its own, without testimony or market support that others similarly value the improvements to the property fails to establish that no obsolescence exists. To the contrary, Mr. Koon estimated that maybe only 2% of retailers would go into existing space (Tr. #2, pp. 57-58, Appellant's Supplement, p. 423). Accepting for a moment that this percentage is correct, something the Property Owner does not concede, in only 2% of the cases are market participants finding value in the improvements of other retailers. They opt instead to build their own improvements or have others build them to their specification. (Tr. #2, pp. 57-58, Appellant's Supplement, p. 423). This fact is consistent with Mr. Lorms' statement that in the case of big box properties, "retailers rarely, if ever, locate in existing big boxes" (Lorms, p. 29, Appellant's Supplement, p. 108). By Mr. Koon ignoring these market facts and relying simply upon the original tenant's continued occupancy to conclude that no obsolescence exists dooms his entire cost approach.

Mr. Koon's Income Approach:

Mr. Koon's income approach is also not adequately supported by his appraisal report and testimony before the Board. Mr. Koon acknowledges that the rental rate to be used is the "rental

which the subject would command if offered on the open market as of the valuation date.” (Koon, p. V-1, Appellant’s Supplement, p. 324). This belief was confirmed during the hearing before the Board. (Tr. #2, p. 64, Appellant’s Supplement, p. 424). Mr. Koon then provides several rent comparables group by first generation comparables and second generation comparable. (see Koon, pp. V-2 – 17, Appellant’s Supplement, pp. 325 - 340). As discussed above, a condition precedent to a market rent is that it was subject to an open market. For each of Mr. Koon’s first generation comparable properties, the testimony of Mr. Koon was that these properties were built-to-suit the user and he had absolutely no idea in each case how the rental rate was determined. (see Tr. #2, pp. 64-68, Appellant’s Supplement, pp. 424 - 425). Later in his testimony, Mr. Koon opinions that it is reasonable to assume that these lease rates were based upon costs of construction. (Tr. #2, p. 77, Appellant’s Supplement, p. 428). This is simply speculation however as Mr. Koon cannot support the basis for the build-to-suit lease rates. In addition to those arguments raised below concerning the use of build-to-suit lease rates to determine a market rental rate, the first generation lease rates relied upon by Mr. Koon are not well support and should be disregarded.

Mr. Koon also provides second generation lease rates which would, on their face, seem to provide a better indication of market rent. Five second generation rent comparables are presented at rates per square foot of \$4.06, \$9.00, \$4.00, \$3.00, and \$6.14, respectively. (Koon, p. V-21, Appellant’s Supplement, p. 344). The second and last comparables are for grocery stores and the other three are for big box discount retailers. The three big box lease rates, for properties most similar to the subject, of \$4.06, \$4.00 and \$3.00 support the market rental conclusion of \$4.00 per square foot reached by Mr. Lorms in his report. As discussed in the testimony before the Board, significant changes were made to the last comparable to convert it

from a department store to a grocery store. (Tr. #2, p. 72, Appellant's Supplement, p. 426). Mr. Koon was unable to testify as to how the costs were born for such a conversion in use and what impact that might have on the rental rate paid. (Tr. #2, p. 72, Appellant's Supplement, p. 426). For both of the grocery store comparables, Mr. Koon was unable to make an allocation between the real property and the personal property located in the store for such items as the "tremendous amount of plumbing necessary to get coolers and the various other equipment in place that would create the aisles for frozen food and open meat counters." (Tr. #2, p. 72, Appellant's Supplement, p. 426). Even though Mr. Koon fully understands that a personal property component exists, in both cases of the grocery store, no allocation for the rent associated with the personal property is made. (Tr. #2, p. 69, Appellant's Supplement, p. 426).

In order to significantly adjust these second generation comparables upward, in all cases, Mr. Koon made an upward adjustment "based on the consideration that the subject property [the Meijer property] represents a building which was purpose-built for a retailer that continues to experience growth within the regional retail market." (Koon, pp. V-21 – 24, Appellant's Supplement, pp. 344 - 347).

This adjustment is flawed for several reasons. First, as has already been discussed and will be discussed in further detail below, such adjustment relates to the value in use to the original occupant of the improvement—not the value to the market. We are discussing an improvement purpose built for one market participant that other market participants do not hold in the same value.

Second, under cross-examination, Mr. Koon admitted that he had no knowledge of the financial strength of Meijer and their growth, other than they continue to occupy the subject property. (Tr. #2, p. 80, Appellant's Supplement, p. 428). Under further questioning, Mr. Koon

acknowledged that the now bankrupt Ames department stores continued to open stores and enter into leases on properties right up to the time they declared bankruptcy. (Tr. #2, p. 80, Appellant's Supplement, p. 428). The simple fact that Meijer continues to occupy a location proves absolutely nothing.

Additionally, as further reviewed below, such an adjusted is clearly not based upon the real property but rather upon the business success of the property owner. This is clearly at odds with this Court's clear guidance provided in *Higbee Co. v. Cuyahoga Cty. Bd. of Revision* (2006), 107 Ohio St. 3d 325 that the business factors cannot be made the impact the real property value.

Also, Mr. Koon was not consistent and during cross examination changed his position as it relates to second generation properties. On page V-25 of his report (Appellant's Supplement, p. 348), Mr. Koon claims that it "is the singular fact that second-generation rents will never adequately reflect market rent for such a property. . . . Second generation retail properties are available due to circumstances which generally tend to indicate functional or economic deficiencies." On cross examination, however, Mr. Koon concedes that it is not a blanket statement in all cases that second generation properties are available due to functional or economic deficiencies. (Tr. #2, p. 46, Appellant's Supplement, p. 420). Such a conclusion would require further analysis that was not conducted by Mr. Koon.

Finally, in determining a capitalization rate, Mr. Koon replied upon a debt coverage ratio analysis that fails to take into account the proper rate of return for a 20% equity holder who would have a second position as it relates to the property in comparison to a lender. Such equity holder would typically require a higher rate of return and such difference is not reflected in a debt coverage ratio analysis. As to why such a method was selected over a mortgage equity

approach Mr. Koon could not answer. His response was "I'm sorry, you would have to ask Ben Kessler, who co-wrote the report with me. He made the decision *and the rate is where it needs to be*, so I didn't question his use of it." (Tr. #2, p. 95, Appellant's Supplement, p. 432, emphasis added). This leads one to wonder whether it should have been Mr. Kessler testifying before the Board.

As discussed above, *all* of the first generation comparable utilized by Mr. Koon are not supported by his appraisal report nor by his testimony before this Board. *All* the first generation properties are build-to-suit leases negotiated without the benefit of the open market. As such further analysis should have been undertaken to determine that the leases were reasonable reflections of market rent. Mr. Koon was unable to testify as to how the lease rates were even determined making such analysis impossible. As a result, the first generation lease comparables should be disregarded.

Additionally, after discarding those second generation comparables which are not truly comparable to the subject property and disregarding adjustments made by Mr. Koon which cannot be supported under Ohio law, the remaining second generation comparables provided by Mr. Koon support Mr. Lorms' opinion of value. Two of the second generation lease comparables are for grocery dominated stores which contain, Mr. Koon admits, a significant amount of personal property. Such property was not identified nor an allocation made for the same in Mr. Koon's analysis. The other second generation lease comparables sighted by Mr. Koon support the market rent determined by Mr. Lorms when not subject to an adjustment since it was not purpose-built for the user and who may or may not be experiencing growth in the market. Such adjustment is not supportable. As a result, Mr. Koon has failed to establish a market rent and his income approach should be disregarded.

Mr. Koon's Sales Comparison Approach:

Finally, Mr. Koon attempts a sales comparison approach to value but this approach is subject to the same problems discussed above. The sales comparison approach begins with an attempt to value the convenience store. As discussed in more detail below, such sales are, based upon Mr. Koon's own testimony, based upon sales volumes which do not establish value under Ohio law. Furthermore, Mr. Koon made no attempt to analyze the allocations made to the real property as a result of these transactions but blindly accepted the allocations made by the parties. As a result, Mr. Koon's attempt to value the convenience store based upon a sales comparison approach is not supportable.

For the main store, the comparable sales relied upon by Mr. Koon range from a gross amount of \$47.59 to \$81.63 per square foot. (Koon, p. VI-31, Appellant's Supplement, p. 384). There are a total of seven sales provided. Each is discussed below.

The first sale is of the former K-Mart in Mill Run in Hilliard, Ohio. Both appraisers use this property as a comparable sale. It was no longer occupied by its original tenant. Although there was considerable discussion concerning this property, at the time of its sale, both appraisers acknowledge that the area was experiencing growth with the addition of Target and Home Depot to the area. Considerable discussion surrounded the desirability of this location. In evaluating this property, Mr. Koon made downward adjustments due to time, location, and size with an upward adjustment for condition. (Koon, pp. VI-31 -32, Appellant's Supplement, pp. 384 - 385). Similar to the second generation rent comparables however, Mr. Koon again attempts to make a "strong upward adjustment" since the Meijer property improvements are "well suited and ideal for use by a regional user which continues to experience growth within its marketplace." (Koon, p. VI-32, Appellant's Supplement, p. 385). As discussed above, this is (1) a value in use

adjustment since it is specific to the occupant for which the building was designed and for which the market does not place similar value; (2) not supported by any specific knowledge possessed by Mr. Koon since he has no knowledge as to the financial position of the occupant; and, (3) based upon the business success of the tenant and not real estate fundamentals as required by this Court's decision in *Higbee*. As a result, this adjustment is not well taken. Without this adjustment, given the number of downward adjustments noted by Mr. Koon, it is reasonable to believe that a downward adjustment is necessary or that the property is superior to the subject property as determined by Mr. Lorms. (Lorms, p. 83, Appellant's Supplement, p. 162).

Comparable sale number two is a Lowes store located on Brice Road in Columbus, Ohio. This property was also utilized as a rent comparable and Mr. Koon did not know how the rent was determined. The sale in question is of a property subject to that lease. Furthermore, Mr. Koon testified that this property was purchased by a tenant in common to be used to satisfy Internal Revenue Code section 1031 transactions by effectively sub-dividing the property to sell in smaller units. (Tr. #2, pp. 104 – 109, Appellant's Supplement, pp. 434 - 436). It appears based upon the testimony that the property was purchased to subdivide into smaller economic units with greater value. The impact of this as well as the income stream expected to be received by the "promoter" of this transaction were not considered by Mr. Koon. Furthermore, as discussed below, this transfer is representative of the leased fee interest in the subject property and not its fee simple value. Mr. Koon did not even attempt to address this issue. Given the lack of information concerning the basis for the lease encumbering the property and the lack of analysis concerning the impact of the structure of the transaction it is impossible to fully evaluate this comparable and therefore it cannot be relied upon.

Comparable sale number three is the former Office Depot also in the Mill Run area. As indicated in Mr. Koon's appraisal and testimony the fee simple interest in the property, not subject to any lease, transferred in 1997 for \$2,775,000 or \$45 per square foot. (Koon, p. VI-24, Appellant's Supplement, p. 377). Later, in 2001, when it appears that the property was subject to a lease to Office Depot, the property sold for \$4,325,000 or \$70.69 per square foot. (Koon, p. VI-24, Appellant's Supplement, p. 377). In his report and in his testimony, however, Mr. Koon has no idea what the lease rate or terms were for the subject property. (Tr. #2, p. 111, Appellant's Supplement, p. 436). It is obvious from his own report that this lease had a very significant impact on the sale price of the property but Mr. Koon undertook no analysis of nor possessed no information regarding the rate or terms of the lease to determine whether there was anything outside market terms or conditions that would lead to such a significant increase. It is impossible to evaluate the implications of this transfer without this information.

Comparable sale number four is a Value City Department store located in St. Louis, Missouri. Mr. Koon indicated that this comparable was "well located" but was unable to provide information concerning population demographics or name any surrounding retailers. (Tr. #2, p. 112, Appellant's Supplement, p. 436). Given the limited number of sales of this property type, appraisers, including Mr. Lorms, utilize sales from around the State of Ohio in order to find comparable properties. While they may be geographically diverse throughout the State of Ohio they share the commonality of one state, one taxing system, one set of general market conditions that impact the property. Such is not true when comparables are pulled from other states. As Mr. Lorms' report shows, there are comparables within Ohio to value this property—it is not necessary to expand this search to Missouri. This problem is further exacerbated when Mr. Koon's report indicates that this property is located in a "similar area in terms of demographics"

(Koon, p. VI-33, Appellant's Supplement, p. 386) but his testimony is that "the retail market is a step below the subject market." (Tr. #2, p. 112, Appellant's Supplement, p. 436). Without data to support the assertions made, it is impossible to evaluate the reasonableness of those assertions. The use of this comparable is not well supported and it should be disregarded.

Comparable sale number five is a former Incredible Universe Store which is now occupied by Garden Ridge also in the Mill Run area. This sale occurred in May 1998 well in advance of the tax lien date of January 1, 2003. (Koon, p. VI-27, Appellant's Supplement, p. 380). Once again, Mr. Koon's information concerning this property is not clear. In his report, Mr. Koon indicates that the property was purchased for owner-occupancy, but the property also serves as one of the second-generation lease comparables utilized by Mr. Koon. (see Koon, p. VI-28, Appellant's Supplement, p. 381 and Koon, p. V-11, Appellant's Supplement, p. 334). If it is owner-occupied, why is there a lease? Additionally, no lease information is available at the time of the transfer relied upon by Mr. Koon. Under cross examination, it appears that Mr. Koon finally determined that the property was purchased in 1998 with a commitment to lease the property to Garden Ridge for \$7.15 per square foot. (Tr. #2, p. 116, Appellant's Supplement, p. 437). Based upon the testimony of Mr. Koon, solicited by counsel for the Property Owner, it is difficult to tell what the actual facts are surrounding this location. Furthermore, Mr. Koon again makes the "strong upward adjustment" since the Meijer property improvements are "well suited and ideal for use by a regional user which continues to experience growth within its marketplace." (Koon, p. VI-33, Appellant's Supplement, p. 386). As discussed above, this is (1) a value in use adjustment since it is specific to the occupant for which the building was designed and for which the market does not place similar value; (2) not supported by any specific knowledge possessed by Mr. Koon since he has no knowledge as to the financial position of the

occupant; and, (3) based upon the business success of the tenant and not real estate fundamentals as required by this Court's decision in *Higbee*. As a result, this adjustment is not well taken. The use of comparable sale number five is not well supported and it should be disregarded.

Comparable sale number six is a Lowe's store located in Middletown, Ohio. The transfer was part of another Internal Revenue Code section 1031 exchange involving a single investor this time. (Koon, p. VI-29, Appellant's Supplement, p. 382). Mr. Koon indicates that this is a build-to suit property and the lease encumbering the property at the time of its sale is the original build-to-suit lease. (Tr. #2, p. 117, Appellant's Supplement, p. 438). Mr. Koon was unable to confirm how this lease rate was determined. (Tr. #2, p. 118, Appellant's Supplement, p. 438). He also possessed no information concerning the motivation of a buyer who was clearly forced with time constraints as a result of the 1031 transaction. These constraints could have no impact on the transaction or some impact on the transaction—it is impossible to know. The property attracted twelve offers over a wide range of \$7,300,000 to \$9,031,000 with the final sale price equaling \$9,000,000. (Koon, p. VI-29, Appellant's Supplement, p. 382). Mr. Koon is only able to "speculate" as to how the property was marketed and could not comment on how long it was offered for sale. (Tr. #2, p. 119, Appellant's Supplement, p. 438). Based upon Mr. Koon's speculation it is possible that the property may have been subject to a blind auction with a set date for submitting offers. (Tr. #2, p. 119, Appellant's Supplement, p. 438). Unfortunately, this is only speculation as Mr. Koon does not have sufficient knowledge concerning the transfer of this property. Once again, as with the other comparables utilized by Mr. Koon, it is not well supported, it is impossible to evaluate, and throwing a comparable into an appraisal report but not fully evaluating and understanding the transaction cannot be tolerated. The use of comparable sale number six is not well supported and it should be disregarded.

Finally, the last potential comparable sale is comparable sale number seven. This comparable is a Home Depot located on Sawmill Road in Dublin, Ohio. In this case, Home Depot purchased the property it occupied from its lessor, Credit Suisse. (Koon, p. VI-30, Appellant's Supplement, p. 383). The property was built to suit Home Depot. (Tr. #2, p. 120, Appellant's Supplement, p. 438). Mr. Koon did not have the lease rate previously being paid by Home Depot. (Tr. #2, p. 120, Appellant's Supplement, p. 438). It is this lease rate and terms of the lease that are being bought out by Home Depot given that they already possess the property. The tenant, Home Depot, would have been relieved from paying rent as part of this transaction, but Mr. Koon cannot comment on the actual amount of rent at issue or the difference between any rent payment and mortgage payment taken on by Home Depot, if any. (Tr. #2, p. 121, Appellant's Supplement, p. 439). Again, without such basic information it is impossible to review this transaction to determine if its value is establishing the market value of the subject property. The use of comparable sale number seven is not well supported and it should be disregarded.

Mr. Koon failed to adequately support *any* of the comparable sales relied upon in his appraisal and/or the adjustments made to those comparables. As a result, his sales comparison approach is without value and should be disregarded.

In summary, Mr. Koon's appraisal ignores market reality, is not well supported and makes adjustments which are clearly contrary to Ohio law.

- Mr. Koon's cost approach ignores the market reality, admitted by Mr. Koon, that other users do not place the same value in the improvements as those for whom the improvements are purposefully built. Mr. Koon's own testimony as well as that of Mr. Lorms

supports this contention. By failing to do so, Mr. Koon fails to make any adjustment for the obsolescence that the market demands and the BTA has recognized.

- Additionally, all of the first generation comparables relied upon by Mr. Koon in his income approach are build-to-suit leases negotiated without the benefit of the open market. As such, further analysis should have been undertaken to determine that the leases were reasonable reflections of market rent. Mr. Koon was unable to testify as to how the lease rates were even determined making such analysis impossible. As a result, the first generation lease comparables should be disregarded.

- Additionally, two of the second generation lease comparables are for grocery dominated stores for which no personal property allocations were made. The other second generation leases support Mr. Lorms' opinion of value.

- Finally, Mr. Koon failed to adequately support any of the comparable sales relied upon in his appraisal and/or the adjustments made to those comparables.

- The reliance on unsupported, first generation sales to value an owner occupied property also does not stand up to reason. The property is not subject to a lease that will transfer in a transaction even remotely similar to the first generation sales set forth by Mr. Koon. By failing to consider the factors specific to this property, the reliability and creditability of the Koon appraisal is undermined and cannot be relied upon.

As a result of the foregoing, Mr. Koon's appraisal report is of no value in determining the fair market value of the subject property and should be disregarded. The BTA reliance upon a report which lacks competent support is clearly erroneous and must be overturned

III. The adoption of Mr. Koon's appraised value of the subject property would result in a constitutionally prohibited assessment in use.⁴

The report and testimony of Mr. Koon leave little doubt that his appraisal is focused on the value in use of the subject property to Meijer. As has been discussed above, several of the adjustments made to the comparable transactions are because, in Mr. Koon's opinion, the subject property is occupied by the first generation user the property was designed for who, in Mr. Koon's unsupported opinion, is experiencing growth in the market. (see Tr. #2, pp. 38 – 41, Appellant's Supplement, pp. 418 - 419). These adjustments are based upon the fact that the space continues to be occupied by the user it was designed for resulting in upward adjustments to second generation lease rates because those properties have been exposed to the market for all users not just the user it was designed for. This is an adjustment to reflect the value in use to the party the property was designed to accommodate.

Furthermore, Mr. Koon states that

[T]he fact that the subject facility continues to operate under the auspice of its first generation users indicates that it possesses certain attributes which make it inherently more desirable than second generation space. . . . The continued operation of the subject property by its first generation user is material proof that it does not suffer from deficiencies." (Koon, p. V-25, Appellant's Supplement, p. 348).

The only thing that the continued occupancy of the property by the user it was built for demonstrates is that it continues to have utility for the user it was built for. Mr. Koon, provides no market information, and if anything contrary information, to show that any other market participant would place the same value in the property as the one it was originally constructed for. In fact, Mr. Koon, himself, admits that maybe only 2% of retailers would go into existing space (Tr. #2, pp. 57-58, Appellant's Supplement, p. 423).

⁴ This argument addresses Assignments of Error 6 and 7.

The fact that Mr. Koon is opining as to the use value of the subject property is further supported by his testimony. In turning to an evaluation of Mr. Koon's income approach, the following exchange occurred between counsel for the Property Owner and Mr. Koon:

Q. Okay. Turning to your income approach, Section V-1 under the estimate of potential gross income, third line down over to the fourth, you know, the rental the subject space would command if offered for lease on the open market as of the valuation date—

A. Correct.

Q. —in our opinion, who would lease this space?

A. Meijer.

Q. Okay. So the rental rate is the rate you believe Meijer, if they had to pay rent, would pay?

A. Yeah. I think that would be fair.

(Tr. #2, p. 64, Appellant's Supplement, p. 424).

The tenant envisioned by Mr. Koon is the current owner and occupant. No other potential tenant was identified at the rates opined to by Mr. Koon. It is clearly illogical that the likely tenant for a property is the one entity that currently owns and occupies the property. If one were to rent out the home they current own and live in, the likely tenant for that property is certainly not the current owner-occupant.

The testimony of Mr. Koon further indicates that his conclusion as to obsolescence is based upon continued occupancy by Meijer and not based upon market factors. The desirability of the floor plan and amenities are, in Mr. Koon's testimony based upon their desirability to Meijer and not based upon any market considerations identified by Mr. Koon. (Tr. #2, p. 82, Appellant's Supplement, p. 430).

The analysis of transactions involving first generation, built to suit leases and sales of properties still occupied by its first generation user and subject to the initial build to suit lease is necessitated by Mr. Koon's reliance upon such transactions in opining as to the value of the subject property. Such reliance does not result in the value in exchange for the subject property but, rather, a value in use.

The Ohio Supreme Court has consistently ruled that the Ohio Constitution prohibits the adoption of the use value of real estate for assessment purposes. In *State ex rel. Park Inv. Co. v. Board of Tax Appeals* (1972), 32 Ohio St. 2d 28, the Court stated as follows:

* * * We have held that Section 2, Article XII of the Ohio Constitution and the Fourteenth Amendment to the United States Constitution require that the ultimate result of an appraisal must be to determine that amount which the property should bring if sold on the open market. *State ex rel. Park Invest. Co., v. Bd. of Tax Appeals, supra* (175 Ohio St. 410, 412); *State ex rel. Park Invest. Co., v. Bd. of Tax Appeals, supra* (26 Ohio St. 2d 161, 167).

* * *

Since the **current use** method of evaluation excludes, among other factors, location and speculative value which comprise market value, such **current use** method cannot be made the basis for valuation of real property for tax assessment purposes, and that portion of [the statute] making provision for such method of valuation is invalid, as being contrary to Section 2, Article XII of the Ohio Constitution, which enjoins that land and improvements thereon shall be taxed by uniform rule according to value. (Emphasis added.)

Consistent with the above holding of the Supreme Court, the BTA recently held that the sale of a drugstore subject to a build-to-suit lease was, in fact, indicative of its value in use. In *Dayton School Dist. Bd. of Edn. v. Montgomery Cty. Bd. of Revision* (September 2, 2005), BTA No. 2004-V-76, unreported, the Board had the opportunity to address the exact same questions that are at issue in the instant matter and agreed that the sale price of a build-to-suit, single tenant

retail property is a function of the tenant's credit-worthiness and an indication of the use value of the property. The Board rejected an appraiser's reliance on sales of drug stores that were built-to-suit, stating the following:

Nevertheless, [the BOE's appraiser's] opinion of value is borne from his exclusive reliance on the sixteen similar build-to-suit comparables, all of which present the same issues concerning the occupants' creditworthiness and the like. The data gleaned from the comparables appear to be tied (as is in the case of the subject) to the creditworthiness of their tenants. The difficulty in relying upon income derived from a business activity, or **value in use**, is that the value ultimately derived may not be the market value of the subject property. (Emphasis added)

The best way to examine the concept of use value is to consider the often repeated example of the manufacturer with a unique manufacturing process. As discussed in the Appraisal of Real Estate (Appraisal of Real Estate, 13th Ed., pp. 27 - 28), and Mr. Lorms' appraisal, (Lorms, p. 55, Appellant's Supplement, p. 134) the manufacturer's property might have a use value to the manufacturer for which it was designed and built in order to maximize the utility of their business enterprise. If the same building was placed on the open market, however, and other manufacturers that did not utilize the same manufacturing process were to purchase it, it would have a different, lesser value in exchange.⁵

The value in use to the manufacturer that designed the manufacturing property and had it built-to-suit its business enterprise, under the law of Ohio, cannot be the basis of the assessment of the property. That is, however, the basic premise of Mr. Koon's approach to value.

⁵ The value in exchange need not necessarily be less than the value in use. Specifically, in Ohio, agriculture property is valued under the state's Certified Agricultural Use Valuation ("CAUV") program. The program is necessary because property is otherwise valued in exchange in Ohio. In contrast with the manufacturing property example and the subject property before this Board, the value of properties in use for agriculture is usually less than their value in exchange.

To see how this constitutionally prohibited result might result from reliance upon first generation sales to value an existing, owner-occupied property one first needs to consider how the occupancy by the hypothetical manufacturer might be accomplished.

If the manufacturer decides to own its facility, it could buy the land, hire an architect and contractor, and have the facility constructed to its specifications. (Lorms, p. 55, Appellant's Supplement, p. 134). After it is built, the manufacturer can take out a mortgage to amortize the costs of the land and building. Many businesses, however, rather than investing in ownership of their real estate, can earn higher returns on their capital in their core business. (Lorms, p. 55, Appellant's Supplement, p. 134). Therefore, these users prefer to lease their real estate. Again, returning to the hypothetical manufacturer, if it decides to lease its real estate, it can do so either via a sale/leaseback arrangement or by simply entering into a lease with a third party developer who is hired to construct the property for the manufacturer. As Mr. Lorms stated,

[W]hether leased or purchased by the user that dictated the build to suit design, the transaction reflects the value in use of the property to the user that dictated the design. (Lorms, p. 56, Appellant's Supplement, p. 135).

The resulting lease is a function of the costs to develop the property. (Lorms, p. 55, Appellant's Supplement, p. 134). In turn, the costs to develop the property are a function of the specific and unique needs of the manufacturer's business enterprise. (Lorms, p. 55, Appellant's Supplement, p. 134). The obsolescence that may be inherent in the design to other manufacturers is not reflected in the lease. (Tr. #1, p. 36, Appellant's Supplement, p. 11). Therefore, the lease reflects the property value to the user, or value-in-use, not its market value or value in exchange. (Lorms, p. 56, Appellant's Supplement, p. 135). Similarly, any subsequent sale based upon that value in use lease is a reflection of the value of the property in use, not in exchange. (Lorms, p. 56, Appellant's Supplement, p. 135).

Although the foregoing example concerns the development of a manufacturing facility that has different value in use and value in exchange, the same principles apply in markets for other property types as well. Whereas a manufacturer might have a floor-plan unique to its business enterprise, including specific square footage requirements, ceiling heights, loading docks, construction materials, and layout, so too may a retailer. (Lorms, pp. 56-57, Appellant's Supplement, pp. 135 - 136). Many retailers have floor-plans that are equally unique to their business enterprise. (Lorms, p. 56-57, Appellant's Supplement, pp. 135 - 136).

These retailers thrive on efficiency, knowing that their stores are of specific dimensions for purposes of store design, product and display placement and restocking. Costs to retrofit existing big boxes to accommodate the needs of first generation retailers are too high for financial feasibility. Retrofitting an existing big box for a first generation tenant would in most instances include moving an entryway, changing customer service areas, new floor coverings, changes in electrical work and HVAC, moving restrooms, increasing or decreasing the depth and width of the building, etc. A domino effect of changing building components occurs making the purchase of an existing big box undesirable. (Lorms, p. 29, Appellant's Supplement, p. 108).

Indeed, evidence that these specific design requirements differ from user to user can be found in the fact that single-tenant retail properties are almost always built-to-suit for the user. (Lorms, p. 27, Appellant's Supplement, p. 106). If these criteria were readily interchangeable, these stores would be built speculatively and held on the open market for sale or lease to the highest bidding user. This, however, is not the manner in which these stores are developed, as big box retail storerooms are never built on a speculative basis. (Lorms, p. 27, Appellant's Supplement, p. 106). As Lorms states,

The most obvious example of the lack of utility of an existing big box on the open market is provided by two brand new big boxes in the Columbus market area. These two stores were constructed by an area developer for occupancy by Ames. Before Ames took occupancy, they went into bankruptcy and vacated all of their

stores in Ohio. Thus, two brand new, never occupied big boxes were available on the open market. One was located in an in-filled market area with high population density across from a new Lowe's store. The other was located at the corner of an interchange along a dynamic retail corridor that included a recently constructed Kroger anchored shopping center and a proposed Wal-Mart supercenter. The Wal-Mart supercenter was constructed across the street from the [former Ames] property. Thus, the [former Ames] property was given no interest by Wal-Mart. Both [Ames] properties were on the market for approximately three to four years before the developer settled on interested parties, Target and Home Depot. Both retailers purchased the properties and demolished the brand new existing improvements for construction of their own store prototypes, even though they were of similar size. This provides evidence that vacant big boxes hold little or no value for the national retailers. (Lorms, p. 29, Appellant's Supplement, p. 108).

Obviously, if, prior to the bankruptcy of Ames, Ames had entered into leases with the developer designed to amortize the construction costs, and the Ames properties sold subject to the build-to-suit, value-in-use leases, the obsolescence that was subsequently borne out by the market when Target and Home Depot demolished both brand new stores would not have been reflected in the net lease sales of the Ames properties. As Lorms explained:

Where a building is designed and constructed to meet the user's specific needs, regardless of whether the ultimate transaction results in the user leasing the new building, purchasing it from the developer, or building it itself and then selling to an investor (sale/leaseback), the final outcome is identical – a financial transaction to accommodate the value-in-use by the specific user. The value reflected by that transaction is unique to that specific user and not, in and of itself, reflective of the market value or value in exchange of the property.” (Lorms, p. 58, Appellant's Supplement, p. 137).

The unique construction requirements for the big box stores by the occupants of those stores is admitted by Mr. Koon. His admission that maybe only 2% of retailers would go into existing space (Tr. #2, pp. 57-58, Appellant's Supplement, p. 423) but then relying upon those

leases and sales subject to those non-market, value in use leases to value the property cannot be sustained. 2% of retailers paying these lease rates for properties designed to their specific needs is not the market for this property. Once again, Mr. Koon is valuing to the 2% and not to the most likely market for this property.

**PROPERTIES SUBJECT TO A VALUE-IN-USE LEASE ARE SOLD IN THE
NET LEASE MARKET, NOT THE REAL ESTATE MARKET. RELIANCE UPON
THESE SALES RESULTS IN A VALUE IN USE.**

After a user has a building built-to-suit, and executes a value-in-use lease with its developer to amortize the construction costs, the property will typically be sold to a third party in what is commonly referred to as the net lease market as opposed to the traditional real estate market. In the net lease market, single tenant properties with high credit tenants and long term leases are sold to investors. As explained below, a sale of the property in this market is determined based on the value-in-use lease and the credit-worthiness of the lessee without regard to the value in exchange of the real estate, and therefore is not indicative of the market value of the property.

While this Court has recently accepted such sales to value the property, such decisions are based upon the requirements of Ohio Revised Code and are not applicable to situations where no sale is present. There is no sale present here. In those cases, the Court was applying the specific statutory language in Ohio Revised Code (“R.C.”) § 5713.03 which the Court interpreted as requiring the use of a recent, arm’s length sale to value property for tax purposes. That provision is not applicable in this case. As the Court noted in *Berea City School Dist. Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (2005), 106 Ohio St. 3d 269, ¶ 15, “appraisals based upon factors other than sale price are appropriate only when no arm’s length sale has taken place.” Given no sale in this case, appraisals are appropriate and are used to determine the price at

which the property would likely transfer. Only Mr. Lorms' appraisal, taking into consideration the specifics of the subject property, reflects what the subject property would likely transfer for in this case.

Many characteristics of the net lease market distinguish it from the typical real estate market. First, the typical buyer is frequently from out of town, has limited knowledge of local real estate market dynamics, and may not even personally see the property before purchasing it. (Tr. #1, pp. 38-39, Appellant's Supplement, p. 12). Such buyers base their purchase decisions on the value-in-use lease and the credit-worthiness of the tenant, without regard to the value of the real estate itself. (Tr. #1, pp. 39 - 42, Appellant's Supplement, pp. 12 - 13). In contrast, the typical purchaser in the traditional real estate market is much more knowledgeable about the local market and certainly would be unlikely to purchase a property without ever seeing it.

Second, unlike traditional real estate investments such as apartment buildings, office buildings, or shopping centers, which require active professional management for the investment to succeed, the ownership of net lease property is completely passive. (Lorms, p. 62, Appellant's Supplement, p. 141). Net leased property, as an investment, with passive income based upon the credit-worthiness of the tenant, is much more akin to a financial or bond transaction than a real estate transaction. (Lorms, p. 62, Appellant's Supplement, p. 141).

Third, much like a financial market, net leased properties are much more liquid than other types of investments in real estate. (Lorms, p. 61, Appellant's Supplement, p. 140). Whereas the typical real estate transaction is culminated only after extensive time, effort, and due diligence, the net leased properties are bought and sold over the internet, often sight unseen. (Lorms, pp. 61-62, Appellant's Supplement, pp. 140 - 141). If it becomes necessary for the property to again be sold, it can again be listed on the internet and quickly sold unlike a traditional real estate sale.

In summary, the value-in-use lease, which reflects the cost to construct the property to the specific requirements of the user's business enterprise, is then the basis of the value-in-use sale price in the net lease market. The net lease market has many characteristics that distinguish it from traditional real estate markets. As such, the sale price of a net leased property in the net lease market does not reflect the value of the underlying real property in the normal real estate market, i.e. its value-in-exchange. Therefore, an assessment of the property based on the sale price in the net lease market is prohibited by the law in Ohio. *State ex rel. Park Inv. Co., supra.*

**MARKET EVIDENCE ESTABLISHES THE DISTINCTION BETWEEN
VALUE IN USE AND MARKET VALUE**

Based upon the foregoing, one would expect to find evidence of transactions in the market showing a lack of correlation between net lease sale prices and the values of the underlying real estate. Such, evidence is abundant. Consider the net lease sales of various Walgreens drugstores in greater Columbus presented in Lorms' report. The comparison between the Walgreens on Kenny Road and the Walgreens on South High Street is but one of many that illustrates the lack of any relationship to the underlying real estate.

Sale Comparison 1						
Property	Year Built	Sale Date	GLA	Price Per SF	Population HH Income Housing Value	OAR
Walgreens 4540 Kenny Rd. Columbus, Ohio	2005	12/05	14,820	\$367.85	24,961 \$70,218 \$181,130	6.25%
Walgreens 3445 S. High St. Columbus, Ohio	2003	11/04	14,560	\$376.48	13,207 \$49,249 \$90,666	6.25%

(Lorms, p. 64, Appellant's Supplement, p. 143).

Despite the fact that the Kenney Road property is in a far superior location, with an 89% greater population, 43% greater income levels, and over twice the housing values, the South High Street property sold for slightly more. This cannot reasonably be explained on the basis the underlying real estate fundamentals. Rather, it is strong evidence that the sale price in these transactions are determined by factors other than the real estate itself, and therefore the sale price is not probative of the market value of the properties.

Another example showing that value-in-use net lease sales are not correlated to the value of the real estate is the comparison between two big box sales in the greater Columbus area. Below are the characteristics of the Lowe's property on Brice Road, which sold subject to a net lease, and the former Kmart on Mill Run, which sold unencumbered.⁶ Both of these properties are relied upon by Mr. Koon in his report.

SALES COMPARISON 2		
	Lowes's 2888 Brice Road Columbus, Ohio (Net Lease, Value In Use Sale)	Former Kmart 3780 Mill Run Columbus, Ohio (Unencumbered Fee Simple Sale)
Population (3-Mile Radius)	78,231	76,609
HH Income (3-Mile Radius)	\$55,594	\$88,655
Land Size	12.836 Acres	12.240 Acres
Building Size	125,357 SF	121,876 SF
Year Built	1995	1995
Sale Date	April-05	August-05
Sale Price	\$10,636,470	\$5,800,000
Price per SF	\$84.85	\$47.59

(Lorms, p. 62, Appellant's Supplement, p. 141).

⁶ Kmart was the former tenant, not the seller of the property.

Once again, the comparison shows that the value-in use net lease sale price is completely unrelated to the value of the underlying, fee simple real estate. In fact, the former Kmart property is actually located in a superior area by many measures, including area rents, occupancy, development activity, and household income. (Lorms, p. 63, Appellant's Supplement, p. 142). Yet the Lowe's property sold for almost twice as much. This is inexplicable on the basis of the fee simple value of the real estate. The vast divergence can only be explained by either the credit-worthiness of Lowe's or that fact that the Lowe's lease does not reflect any market obsolescence, an issue that does not cloud the sale price of the unencumbered former Kmart in an even better location.

As discussed above, the sale of first generation properties and the lease rates paid for first generation, build to suit, properties is reflective of the value in use of such property to the user for which it was built; it is not reflective of its market in exchange. While the Court, constrained by the Ohio Revised Code, has accepted recent sales to value the property, no sale is present in this case. Turning to appraisal evidence, the use of such sales to value the subject property where it is owner occupied and therefore not subject to lease is inappropriate. The reliance upon such transactions by Mr. Koon is misplaced and does not result in a value reflective of the likely sale price for the subject property. His comparables are not truly comparable to the subject property or are adjusted significantly upwards to reflect the business success of the tenant and not real estate fundamentals.

IV. Accepting the approach utilized by Mr. Koon for the valuation of the property without further evaluation of specifics of the transactions relied upon by Mr. Koon is inconsistent with the Ohio Supreme Court's holding in *Higbee Co. v. Cuyahoga Cty. Bd. of Revision* (2006), 107 Ohio St. 3d 325, wherein the Ohio Supreme Court rejected appraisal evidence of value inextricably intertwined with the non-real estate business value of the tenant. The lack of knowledge concerning several of the comparables utilized makes it impossible for the Appellant or any reviewing Board or Court to determine the real property value indicated by those transactions versus the non-real estate value.⁷

In *Higbee*, the taxpayer proffered an appraisal in which the valuation of a single-tenant retail property was based on its gross sales. The Ohio Supreme Court rejected this approach as an impermissible valuation of the property essentially in use. In rejecting a valuation based on gross sales, the Court held:

If it is the real property being valued, its valuation cannot be made to vary depending on the success or lack thereof of the businesses located on the property. Admittedly, the location of a property may influence the sales made by a merchant at that property. However, the merchant's business practices may also influence sales. The business factors and the real-property factors must be separated when the real property is being valued for tax purposes. Higbee. (emphasis added)

The Court acknowledged that gross sales could vary by location, but the influence of the business practices would remain with the tenant. That is, while gross sales could be attributable to the location of the real estate, they could also be attributable to the success or lack thereof of the tenant as a business, and therefore the Court rejected valuation based on gross sales.

In the instant matter, Mr. Koon attempts to value the subject convenience store based upon comparable sales and to adjust comparables based upon the business success of the current owner-occupant. Both of these items are directly at odds with the *Higbee* decision. As a result, Mr. Koon is not only valuing the real estate but also taking into account the business practices of

⁷ This argument addresses Assignments of Error 5 and 7.

Meijer. The BTA's reliance upon such a report which is clearly at odds with *Higbee* is clearly erroneous.

Looking at the convenience store, Mr. Koon testified that the sales prices of these properties are a reflection of the gallons of gasoline sold and convenience store sales. (Tr. #2, pp. 98-99, Appellant's Supplement, p. 433). It is exactly the reliance upon gross sales that the Ohio Supreme Court rejected in *Higbee*. Mr. Koon presented information concerning an allocation of these purchase prices to the real estate but was unable to testify as to how such an allocation was made. (Tr. #2, pp. 99-100, Appellant's Supplement, p. 433). Furthermore, of the eight comparable sales provided by Mr. Koon, sales one and four are part of one portfolio sale of several properties and sales two and three also appear to be part of another bulk sale. (Koon, pp. VI-2 – 17, Appellant's Supplement, pp. 355 - 370). According to Mr. Koon's testimony, no adjustments were made to the raw results (Tr. #2, p. 103, Appellant's Supplement, p. 434) and no attempts were made to analyze the allocation to real estate made in all of the comparables. (Tr. #2, p. 100, Appellant's Supplement, p. 433).

Mr. Koon's reliance upon sales values admittedly tied to the sales made at a particular location is not supportable based upon the Ohio Supreme Court's reasoning in *Higbee*. Furthermore, faced with such sales, Mr. Koon blindly relies upon allocations made by the parties to the transaction without taking any further steps to determine the reasonableness of such allocation or the resulting value for the underlying real estate. As a result, the value conclusion reached by Mr. Koon as to the value of the convenience store is contrary to Ohio law, not supported, and should be rejected by this Board.

As was discussed in detail above, Mr. Koon also makes several significant upward adjustments to his comparables "based on the consideration that the subject property [the Meijer

property] represents a building which was purpose-built for a retailer that continues to experience growth within the regional retail market.” (Koon, pp. V-21 – 24, Appellant’s Supplement, pp. 344 - 347). Mr. Koon’s adjustment is based upon his uninformed opinion as to the business success of Meijer and not real estate fundamentals. Under cross-examination, Mr. Koon admitted that he had no knowledge of the financial strength of Meijer and their growth, other than they continue to occupy the subject property. (Tr. #2, p. 80, Appellant’s Supplement, p. 428). Even if properly informed such adjustment is clearly based upon the expectations of the business success of the occupant and not real estate fundamentals.

The fact that Mr. Koon values this property based upon the business success of the tenant is obvious throughout Mr. Koon’s report. Mr. Koon also states that

[T]he fact that the subject facility continues to operate under the auspice of its first generation users indicates that it possesses certain attributes which make it inherently more desirable than second generation space. . . . The continued operation of the subject property by its first generation user is material proof that it does not suffer from deficiencies.” (Koon, p. V-25, Appellant’s Supplement, p. 348).

The only thing that the continued occupancy of the property by the user it was built for demonstrates is that its occupant is successful in that location and it continues to have utility for the user it was built for—nothing more. This is further amplified by the comments cited above where Mr. Koon indicates that the expected tenant at his opinion of a lease rate is the current owner-occupant Meijer. It is this retailer the Mr. Koon believes deserves such a large upward adjustment based upon nothing more than his opinion of business success which is the only tenant he would name for the property. Not only is this value in use to the current owner as described above but it is also tied to the business success of the retailer and not real estate fundamentals.

For the reasons reviewed above, Mr. Koon's appraisal evidence of value is inextricably intertwined with the non-real estate business value of the owner occupant. The Ohio Supreme Court in *Higbee* was clear and correct in prohibiting such a combination of values. As a result the BTA's reliance upon such a report is clearly erroneous.

CONCLUSION

The Property Owner in this case, in presenting the appraisal report of Mr. Lorms has met its burden of establishing the value of the subject property. Mr. Lorms' analysis is consistent with that previously accepted by the Board and is designed to determine the fee simple, value in exchange for the subject property. It does not impermissibly intertwine the non-real estate business value of the owner occupant with that of the real estate.

It is clear from the report and the testimony before the Board that Mr. Koon's appraisal report focuses on the value in use of the subject property to the occupant for which it was originally designed and built. This approach is contrary to Ohio law. Furthermore, the analysis set forth by Mr. Koon in his appraisal report and in testimony before the Board is not well supported. He ignores market realities. Market realities previously recognized by the Board and demonstrated by Mr. Lorms in his appraisal. Additionally, he has not provided adequate support for the comparables utilized in his report and routinely replied that he did not know the answer when asked about specifics concerning his report. Finally, his report, clearly ignores the standards set forth by this Court in *Higbee* and intertwines the non-real estate business value of the owner occupant with that of the real estate. As such, his report is not well supported and should be disregarded for this reason as well as its focus on the value in use of the subject property. The BTA's reliance upon Mr. Koon's report is clearly erroneous.

The Property Owner respectfully requests that this Court find that the value of the subject property as of the tax lien date is \$8,800,000.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Nicholas M.J. Ray", written over a horizontal line.

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CERTIFICATE OF SERVICE

This is to certify that on this 15th day of December, 2008, a copy of the Appellant

Meijer Stores Limited Partnership Brief and Appendix was sent via Federal Express to:

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