

ORIGINAL

IN THE SUPREME COURT
STATE OF OHIO
APPEAL FROM THE BOARD OF TAX APPEALS

LOWE'S HOME CENTERS, INC.,)
)
Appellant,)
)
v.)
)
WASHINGTON COUNTY BOARD)
OF REVISION, et al.,)
)
Appellees.)
)

CASE NO. 2014-0843

MERIT BRIEF OF APPELLANT LOWE'S HOME CENTERS, INC.

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STATEMENT OF FACTS

The subject property is a 142,446 square foot box retail store located at 842 Pike Street, Marietta, Ohio and is further identified as Washington County Auditor as parcel numbers 23-0084565.001, 24-0084563.001, 24-0084566.001, 24-0084563.004, 24-0084570.002. For tax year 2010, the Washington County Auditor set the combined market value of the parcels at issue at \$9,091,000. Lowe's Home Centers, Inc. owns the subject property and operates it as a home improvement retail store. There is no lease encumbering the subject property.

The Appellant originally filed a complaint against the valuation of real property with the Washington County Board of Revision ("BOR"). After a hearing held on May 24, 2011, the BOR issued a "no change in value" decision on June 22, 2011. The Appellant appealed the BOR's decision to the Ohio Board of Tax Appeals ("BTA") on July 11, 2011.

The BTA hearing was held on April 2, 2013. Attorney Ryan J. Gibbs represented the Appellant. Kelley Gorry of Rich & Gillis Law Group entered an appearance on behalf of the Washington County Board of Revision and Washington County Auditor. As its evidence, the Appellant presented an appraisal report of the subject property by Robert J. Weiler, MAI and Patricia Costello, who opined to a value of \$5,700,000 as of January 1, 2010. The Appellee submitted an appraisal by Karen L. Blosser, MAI, who opined to a value of \$7,200,000 as of January 1, 2010. Both Ms. Costello and Ms. Blosser appeared at the hearing and testified. Both appraisals claimed to value the fee simple interest in the subject property as required by R.C. §5713.03.

Ms. Costello testified that widely-accepted appraisal principles dictate that valuing the fee simple interest in real property requires an examination of the subject as unencumbered by any lease or mortgage. She explained that this means that her lease rates would be based on

market rates as of the appraisal date, and comparable sales would be vacant when transferred (BTA Tr., 14).

The report by Ms. Costello and Mr. Weiler used the income capitalization approach and sales comparison approach to value the subject property. For the income capitalization approach, they used five recently negotiated leases for similar properties in similar markets. All the leases used were of buildings that were previously occupied by a different retail business, were vacated, and subsequently leased to a new tenant (Weiler/Costello Report, 21-29). The leases ranged from \$2.50-\$3.90 per square foot and, after adjustments, the appraisers selected a market rent of \$4.00 per square foot (Weiler/Costello Report, 31). This led to a market value conclusion based on the income capitalization approach of \$5,295,000 (Weiler/Costello Report, 36).

Except for comparable sale no. 4, all of the sales used by Weiler and Costello in the sales comparison approach to value were vacant at the time of sale. Sale no. 4 was a leased fee sale of a Garden Ridge retail store in Hilliard, OH, which was adjusted downward for property rights appraised. (Weiler/Costello Report, 38). Costello testified that this sale was used for comparison purposes to differentiate between a fee simple and leased fee transaction (BTA Tr., 37). The comparable sales in this approach ranged in sale price from \$15-\$50 per square foot and, after adjustments for building age and location, Weiler and Costello concluded that a value of \$5,700,000, or \$40 per square foot (Weiler/Costello Report, 39). Because potential purchasers will look to what similar buildings have sold for and often occupy the buildings themselves after purchase, the appraisers gave greater weight to the sales comparison approach and came to a final value conclusion of \$5,700,000 (Weiler/Costello Report, 49).

In Ms. Blosser's income capitalization approach, she used rents of all first-generation lessees where the property was built to suit the tenant. They include a Wal-Mart, Lowe's, Home Depot, and Giant Eagle. Each of the properties relating to the four lease comparables were also in superior markets than the subject (Blosser report, III-8). In addition, Blosser admitted that she did not know if some of the lease rates she cited included consideration for non-real estate items such as fixtures for newly constructed properties (BTA Tr., 105). She indicated that she may have made different adjustments if she knew these details (Id.). With these rent comparables, Blosser came to a conclusion of \$5.75 for a market rent, which resulted in a value conclusion of \$7,200,000 for her income capitalization approach (Blosser report, V-5).

Blosser's sale comparison approach utilized six sales involving a variety of legal interests conveyed, with no adjustments for the difference in rights before applying them to the subject. Comparable sales one through four involved properties which were encumbered with long term leases at the time they were sold and, consequently, were sales of the leased fee interest rather than the fee simple interest. These leased fee sales constituted the high end of her range. Blosser's sale comparable no. 1 is the transfer of a Home Depot in October of 2008, with the price having been determined in 1998, twelve years before the January 1, 2010 assessment date at issue in this case, as part of the lease agreement negotiated in 1998 (Blosser report, VI-4). Blosser admitted at trial that she did not know if Home Depot was required to purchase the property as part of the lease agreement signed in 1998 (BTA Tr., 119). Blosser treated the sale as arms-length, although the Board of Tax Appeals did not consider the sale a good indication of value (BTA Tr., 120). Comparables 2-4 all were similarly encumbered with long term leases at the time of sale, unlike the owner-occupied subject property (Blosser report VI-4 – VI-7). Comparable sales 5 and 6 were the only two fee simple sales of box stores provided by Blosser,

and the sale prices were \$17.43 and \$28.22 per square foot, respectively (Blosser report, VI-8 – VI-9). Blosser made no adjustments to the leased fee sales which constituted her sales one through four before applying them to the owner-occupied subject property (Blosser report, VI-18). Blosser then concluded to a “fee simple” value for the subject of \$50 per square foot via her sales comparison approach. This is nearly three times the value per square foot of her own fee simple comparable provided as sale number 5. (Blosser report, VI-19). Blosser reconciled her approaches to come to a final value of \$7,200,000 (Blosser report, VI-20).

At the BTA trial, Blosser testified regarding how she acquired information regarding the leases she used as comparable rental rates. The appraisal report was signed at the bottom by both Blosser and Melissa J. Hamilton (Blosser report VIII-1). Blosser testified that although Hamilton was not licensed as an appraiser in the State of Ohio, Hamilton gathered some of the information used to select comparable leases (BTA Tr., 84). Under the “Marietta Retail Market Overview” section of her report, Blosser reported interviewing Mary Bresnahan, Tony Michalak, and Debi Becksted, among others, as sources for her lease rates (Blosser report, III-2). At trial, Blosser admitted that she did not know that Bresnahan and Becksted were not licensed as brokers or realtors with the State of Ohio, and that she did not know Michalak had his Ohio Real Estate Salesperson License *revoked* in 2005 (BTA Tr., 108-112).

In a decision dated April 22, 2014, the BTA set the true market value of the subject property as of January 1, 2010, at \$7,200,000 (BTA decision, 3). The BTA’s justification for its decision was short, and it ultimately concluded that Blosser’s opinion of value was more persuasive (Id.). The BTA noted that the Costello purposefully excluded the use of first-generation, built-to-suit properties, and these intentional omissions skewed her analysis (BTA decision, 2).

ARGUMENT

Proposition of Law No. I:

The Board of Tax Appeals decision to adopt Blosser's appraisal report, which appraised the subject property in leased fee without adjustments for property rights appraised, as probative and credible evidence of value was an unreasonable and unlawful abuse of discretion contrary to the plain language of §5713.03 of the Ohio Revised Code

The Ohio Supreme Court will reverse a decision by the BTA when it is based on an incorrect legal conclusion. *Satullo v. Wilkins* (2006), 111 Ohio St.3d 399, 2006-Ohio-5856, 856 N.E.2d 954, quoting *Gahanna-Jefferson Local School Dist. Bd. of Edn. v. Zaino* (2001), 93 Ohio St.3d 231, 232, 754 N.E.2d 789. The Court should overturn a BTA decision regarding evidence and testimony when it amounts to an abuse of discretion. *Strongsville Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (2007), 112 Ohio St.3d 309, 2007-Ohio-6, 859 N.E. 2d 540, quoting *Natl. Church Residence v. Licking Cty. Bd. of Revision* (1995), 73 Ohio St.3d 397, 398, 653 N.E.2d 240.

The concept of fee simple interest in real property has remained unchanged from the beginnings of English common law. It represents the highest form of absolute ownership in property. Ohio courts have adopted the common law rule that “fee simple comprises all the qualities and attributes of ownership.” *The Widows Home v. Lippardt*, (1904) 70 Ohio St. 261, 274, 71 N.E. 770. Ohio Revised Code §5713.03 requires that all real property shall be valued based on its market value in fee simple for taxation purposes.

The appraisal profession has adopted the common law definition of fee simple. The Appraisal Institute, whose “Appraisal of Real Estate” treatise the BTA frequently cites as authority for its decisions, defines “fee simple estate” as “[a]bsolute ownership unencumbered by any other interest or estate, subject of to the limitations imposed by the governmental powers of

taxation, eminent domain, police power, and escheat." *The Dictionary of Real Estate Appraisal* (Appraisal Institute, 3rd Ed., 1993), 140. The Ohio Supreme Court has affirmed that, for real estate tax purposes, a property should be valued based on its fee simple market value as if unencumbered. *Wynwood Apartments, Inc. v. Bd. of Revision* (1979), 59 Ohio St.2d 34, 35, 391 N.E.2d 346. The 129th Ohio General Assembly further clarified the intent of the R.C. §5713.03 when it passed H.B. 510, amending the language to add "as if unencumbered" after the words "fee simple estate." This clarification did not change the unambiguous and plain language of the statute requiring appraisal of the fee simple estate.

The "bundle of rights" concept is often used to illustrate the rights attendant to fee simple ownership. These are the right to occupy, to sell, to lease, to gift away, or the right to do none of these things. *Dictionary of Real Estate Appraisal*, 43. When property is leased, and subsequently sold, the leased fee interest, rather than the fee simple interest, is transferred. The new owner acquires the property without all of the rights inherent in a fee simple estate.

The Appraisal Institute and others have provided further context for the difference in rights received in a fee simple vs. a leased fee transaction. When appraising a fee simple interest in a retail property, an appraiser must assume that the property is vacant and available for lease. An appraiser must therefore use market rents when appraising a fee simple value. *The Appraisal of Real Estate* (Appraisal Institute, 12th Ed., 2001), 83. Any appraiser examining leased fee sales in a fee simple valuation must recognize the difference in market value that a leased fee transaction presents. Lenhoff, David C., MAI, "You Can't Get the Value Right If You Get the Rights Wrong," *The Appraisal Journal* (Winter, 2009), 60.

The Ohio Supreme Court has previously addressed the use of leased fee sales as comparables in a fee simple appraisal. *Meier Stores Ltd. Partnership v. Franklin Cty. Bd. of*

Revision (2009), 122 Ohio St.3d 447, 2009-Ohio 3479, 912 N.E.2d. While the *Meijer* Court opined that the use of leased fee comparables in a fee simple appraisal assignment, *alone*, does not render a report unreliable, *Meijer* did *not* state a preference for the use of leased fee sales *over* fee simple sales to determine the value of the subject in fee simple, as required by O.R.C. §5713.03. *Meijer* does *not* stand for the proposition that applying the sale prices of leased fee properties, *without adjusting for property rights conveyed*, is an appropriate manner of calculating the fee simple value of the subject.

Although both Blosser and Costello acknowledge in their appraisals their duty to value the fee simple interest of the subject as required by Ohio law, Blosser's value clearly reflects that of the leased fee. Blosser's labeling of her appraisal as "fee simple" does not make it so. As stated above, the first four comparables provided by Blosser were sales of the leased fee interest. Blosser's comparable sales five and six were sales the of the fee simple interest, at \$17.43 and \$28.22 per square foot, respectively. Blosser's conclusion of value for the subject was \$50.00 per square foot. Sales one through four were utilized in Ms. Blosser's report because they were high. In addition, although Blosser concluded to market rent of \$5.75 in her income capitalization approach, all of her leased fee sales in the sales comparison approach were above this rate. Yet no adjustments were made for these leased fee sales that were receiving rents substantially above Blosser's own stated market rent. When properly adjusted for property rights conveyed, such leased fee sales would support a value below that set forth by even Appellant's appraisers, Weiler and Costello, at \$40.00 per square foot. This is why Weiler and Costello used only sales where the fee simple rights were conveyed.

Given the plain language of R.C. §5713.03 requiring that every property be valued in its fee simple value, as if unencumbered, for tax purposes, the BTA's decision relying on the

appraisal of Blosser as probative and credible evidence of value was an unreasonable and unlawful abuse of discretion. This Court should overturn the BTA's unlawful decision and remand the appeal so that the BTA may enter an order accepting the fee simple appraisal of Weiler and Costello as probative and credible evidence of value.

Proposition of Law No. II:

By applying §5713.03 of the Ohio Revised Code in an inconsistent and discriminatory manner, the Board of Tax Appeals violated Appellant's Equal Protection rights under Article I of the Constitution of the State of Ohio and the Fourteenth Amendment of the United States Constitution

The Fourteenth Amendment to the United States Constitution states “[n]o state shall...deny to any person within its jurisdiction the equal protection of the laws.” Article I, section 2 of the Ohio Constitution has a similar provision, stating “[a]ll political power is inherent in the people. Government is instituted for their equal protection and benefit.” When a state or local taxing agency discriminates among taxpayers with respect to a specific property, it violates the Equal Protection Clauses of the U.S. and Ohio Constitutions. *State ex rel. Struble v. Davis* (1937) 132 Ohio St. 555, 563, 9 N.E.2d 684.

The approach taken by Weiler and Costello in their appraisal of the subject property is supported by the BTA's recent decision in *Rite Aid v. Washington County Board of Revision, et al.*, BTA Case No. 2011-1760, 2014 Ohio Tax LEXIS 2541, at *4. In *Rite Aid*, the BTA accepted an appraisal using only fee simple sales as probative and credible evidence of value. Similar to this case, *Rite Aid* involved a box retail store in Marietta, OH that was owner-occupied and not encumbered by a lease. *Id* at *2. In this case, Karen Blosser also provided the appraisal report for the Appellees Washington County Auditor and Washington County Board of Revision. In *Rite Aid*, Blosser used leased fee sales of properties located throughout Ohio as she did in the present case. The BTA noted that while *Meijer* allows the use of leased fee sales, an appraiser is

not required to use them. *Id.* at *4. Geoffrey A. Hatcher, MAI, the appraiser for the Appellant, testified that he used only vacant box store sales because they were more appropriate for a fee simple analysis. *Id.* The BTA found Hatcher's appraisal more probative and credible than Blosser's. *Id.* at *3.

The Equal Protection clause stands for the proposition that state actors may not act in a discriminatory fashion outside the bounds of the law. The *State ex rel Struble* case tells us that an agency such as the Board of Tax Appeals may not discriminate among taxpayers with respect to its decisions and application of the law. In *Rite Aid*, the BTA heard a case involving a box retail store in the same city and county as the subject in the present case, and with the same appraiser testifying for the Appellees. Just as Costello and Weiler did here, Appellant's appraiser in *Rite Aid* used only fee simple sales as comparables because he believed they were more appropriate to the fee simple analysis. The BTA transcript in this case shows that Costello's testimony was nearly identical to that of Hatcher.

In *Rite Aid*, the BTA correctly applied R.C. §5713.03 by accepting the appraisal of Hatcher as more probative and credible evidence of value over Blosser's leased fee appraisal. In this case, with very similar facts and evidence, the BTA ruled in favor of Blosser's leased fee appraisal over an appraisal that valued the subject in fee simple. By accepting Blosser's leased fee valuation as probative and credible evidence of value, and rejecting Costello's fee simple value, the Board of Tax Appeals violated Appellant's rights under Equal Protection clauses of the Ohio and U.S. Constitutions, applying the plain language of R.C. §5713.03 in an inconsistent and discriminatory fashion. This Court should remand the case and require the BTA to decide it by accepting the fee simple analysis conducted by Weiler/Costello as it did in *Rite*

Aid, and consistent with the definition of “fee simple” under R.C. §5713.03, and the common law in Ohio.

Proposition of Law No. III:

The Board of Tax Appeals abused its discretion by accepting the report and testimony of Blosser as probative and credible evidence of value.

The BTA is required to make actual findings, supported by the record, of the appropriate market rents and expenses to be used in the income approach to value. *Olmsted Falls Village Assn. v. Cuyahoga Cty. Bd. of Revision* (1996), 75 Ohio St.3d 552, 555, 1996-Ohio-456, 664 N.E.2d 922. The BTA may adopt their findings based on expert evidence and testimony of appraisers.

The Uniform Standards of Appraisal Practice (USPAP) are the standards established by the appraisal industry which governs the quality and credibility of appraisal reports. USPAP Rule 1-1 states that “[i]n developing a real property appraisal, an appraiser must: (c) not render appraisal services in a careless or negligent manner, such as by making a series of errors that, although individually might not significantly affect the results of an appraisal, in the aggregate affects the credibility of those results.”

In this case, Blosser failed to adhere to USPAP by using an unlicensed appraiser to gather information and report market rents, as well as by relying on interviews regarding Marietta rental rates with persons who were not licensed as brokers or real estate salespeople. Blosser admitted at trial that she relied on the work of Melissa J. Hamilton to gather and report the information needed to develop her comparable rents. The report also listed that Blosser and Hamilton interviewed two people who did not possess broker or salesperson licenses, and another who had his license revoked. It is unclear the extent to which the data received from these persons affected Blosser’s conclusion under the income approach. However, these errors are of the type

that affect the report's credibility, and put her final valuation into question. Developing a supportable market rental rate is the key to developing an opinion of value based on income capitalization.

By accepting the report and testimony of Blosser as probative and credible evidence of value, the BTA abused its discretion. This Court should reverse and remand the BTA's decision for being unreasonable and unlawful.

Proposition of Law No. IV:

The report and testimony of Blosser did not constitute probative and credible evidence of value. On remand, the Board of Tax Appeals must either accept the value conclusion of Costello or perform an independent determination of value as required by §5713.03 of the Ohio Revised Code.

In *Dublin City Schools Board of Education v. Franklin County Board of Revision, et al.* 2014-Ohio-1940, the Ohio Supreme Court held that where there is no evidence on the record to support the Auditor's valuation, the BTA must come to an independent opinion of value based on the evidence in the record. In *Dublin*, the BTA rejected the appraisal evidence presented by the taxpayer and issued a decision reverting the Auditor's original valuation. *Id.* at ¶3. The Supreme Court, noting that the record contained no evidence supporting the Auditor's valuation, remanded the case to the BTA so that it could come to an independent determination of value. *Id.*

In this case, the BTA is tasked with determining the fee simple value of the subject property pursuant to R.C. §5713.03 based on the evidence in the record. The record contains five fee simple comparable sales, three from the Costello/Weiler appraisal and two from Blosser's appraisal. Additionally, the BTA may take the leased fee sales that are in the record and apply adjustments for property rights conveyed in accordance with R.C. §5713.03. With the use of the fee simple sales and the opportunity to adjust the leased fee sales, the BTA has sufficient

evidence to make an independent determination of value. There is no evidence in the record that supports the Auditor's original valuation of \$9,091,000.

For the reasons set forth in the first three propositions of law in this brief, this Court should find that Blosser's leased fee report was not probative and credible evidence of value and that the BTA's decision was unreasonable and unlawful. On remand, the BTA must either accept Costello's fee simple report as the subject property's true value, or in the alternative it must come to its own conclusion of value based on the evidence in the record. Under no circumstances may the BTA revert to the Auditor's original valuation.

CONCLUSION

The plain and unambiguous language of R.C. §5713.03 requires all real property be valued in its fee simple interest for tax purposes. By accepting an appraisal that relies predominantly on leased-fee sales, unadjusted for property rights conveyed, the BTA issued an unreasonable and unlawful decision and abused its discretion. The decision also violates Appellant's Equal Protection rights because it applies R.C. §5713.03 in a discriminatory and inconsistent manner. The Appellant respectfully urges that this Court remand the case to the BTA for a decision consistent with the law.

Respectfully submitted,



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APPENDIX

IN THE SUPREME COURT

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APPEAL FROM THE BOARD OF TAX APPEALS

LOWE'S HOME CENTERS, INC.,)
Appellant,)

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OF REVISION, WASHINGTON)
COUNTY AUDITOR, AND TAX)
COMMISSIONER OF THE STATE OF)
OHIO,)
Appellees.)

SUPREME COURT CASE)
NUMBER: ~~14-0843~~)

BOARD OF TAX APPEALS CASE)
NUMBER 2011-1664)

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COMMISSIONER OF THE STATE OF)
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Appellees.)

SUPREME COURT CASE
NUMBER: _____

BOARD OF TAX APPEALS CASE
NUMBER 2011-1664

The Appellant, Lowe's Home Centers, Inc., by and through counsel, hereby gives notice of its appeal to the Supreme Court of The State of Ohio, from a Decision and Order of the Ohio Board of Tax Appeals, rendered on the 22nd of April, 2014, a copy of which is attached as "Exhibit A" and which is incorporated herein as though fully rewritten in this Notice of Appeal. The Errors complained of are attached hereto as "Exhibit B", which is incorporated herein by reference.

Respectfully submitted,



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LOWE'S HOME CENTERS, INC.

EXHIBIT "A"

OHIO BOARD OF TAX APPEALS DECISION AND ORDER
CASE NO. 2011-1664

OHIO BOARD OF TAX APPEALS

Lowe's Home Centers, Inc.,

Appellant(s),

vs.

Washington County Board of Revision, et al.,

Appellees.

CASE NO(S). 2011-1664

(REAL PROPERTY TAX)

DECISION AND ORDER

APPEARANCES:

For the Appellant

- The Gibbs Firm, LPA
Ryan J. Gibbs
2355 Auburn Avenue
Cincinnati, Ohio 45219

For the County
Appellees

- James E. Schneider
Washington County Prosecuting Attorney
Kelley A. Gorry
Special Prosecuting Attorney
Rich & Gillis Law Group, LLC
6400 Riverside Drive, Suite D
Dublin, Ohio 43017

Entered APR 22 2014

Mr. Williamson, Mr. Johrendt, and Mr. Harbarger concur.

Appellant(s) appeals a decision of the board of revision ("BOR") which determined the value of the subject real property, parcel number(s) 23-00-84565.001, 24-00-84563.001, 24-00-84566.001, 24-00-84566.004, 24-00-84566.720, and 24-00-84570.002 for tax year 2010. This matter is now considered upon the notice of appeal, the transcript certified by the BOR pursuant to R.C. 5717.01, the record of this board's hearing, and the written legal argument of the parties. The subject's total true value was initially assessed at \$9,091,000. A decrease complaint was filed with the BOR seeking a reduction in value to \$3,600,000.

At the hearing before the BOR, the appellant, through its counsel, presented an owner's opinion of value which opined a total true value of the subject of \$3,600,000 as of tax lien date. The BOR issued a decision maintaining the initially assessed valuation, which led to the filing of the present appeal.

At the hearing before this board, the appellant presented the testimony and report of state certified appraiser Patricia Costello. Costello described the subject as a Lowe's store situated in Marietta, Ohio. Costello described the data used in her income approach to value in which she ultimately arrived a total true value for the subject at \$5,295,000. Costello then went on to explain the criteria used to obtain the comparable properties in her sales comparison approach and any adjustments she made to each. Through that approach, she arrived at a total true value of \$5,700,000 for the subject. While she also performed an income approach to value, reflecting an opinion of \$5,295,000, Costello testified that because she believed that if sold, the building would be purchased by an owner user, she relied primarily on the sales comparison approach and

concluded to a final value of \$7,200,000 for the subject as of tax lien date. Counsel for the county appellees had the opportunity to cross-examine Costello. Through this line of questioning, Costello admitted that she deliberately excluded first-generation users from her analysis and that she valued the property as if Lowe's vacated the subject as of the tax lien date. The county appellees then presented the testimony and report of Karen L. Blosser, MAI. Blosser first described the subject's location. Blosser testified that although the subject is in a small town, the subject property is directly off the interstate and in a regional shopping area for a much wider region.¹ Blosser explained that when selecting comparable properties for her report, she considered traffic count, population, and median disposable income and then made adjustments based upon location and age as compared to the subject. Blosser concluded to a total true value for the subject at \$7,200,000 via the income approach and \$7,100,000 via the sales comparison approach. Giving primary weight to the income approach, Blosser concluded to a final value of \$7,200,000 for the subject as of January 1, 2010. Counsel for the appellant cross-examined Blosser, focusing on who assisted her in preparing the report and the accuracy of the data she utilized in arriving at her final value conclusion.

When cases are appealed from a board of revision to this board, an appellant must prove the adjustment in value requested. See, e.g., *Shinkle v. Ashtabula Cty. Bd. of Revision*, 135 Ohio St.3d 227, 2013-Ohio-397. As the Supreme Court of Ohio has consistently held, "[t]he best method of determining value, when such information is available, is an actual sale of such property between one who is willing to sell but not compelled to do so and one who is willing to buy but not compelled to do so. *** However, such information is not usually available, and thus an appraisal becomes necessary." *State ex rel. Park Invest. Co. v. Bd. of Tax Appeals* (1964), 175 Ohio St. 410. Such is the case in this matter, as the record does not indicate that the subject property "recently" transferred through a qualifying sale.

The record before this board contains two appraisal reports, each of which provides an opinion of value as of tax lien date, prepared for tax valuation purposes, and attested to by qualified experts. Counsel for the appellant argued at this board's hearing, as well as in his written argument, that Costello's appraisal is more probative because she gave careful consideration to the fact that the subject is located in a small town in a rural county. The county appellees, on the other hand, argue that Blosser's appraisal is more probative of the subject's value because Blosser, unlike Costello, did not exclude first-generation user-occupied comparable properties nor did she exclude long-term leased built-to-suit properties. See *Meijer Stores Ltd. Partnership v. Franklin Cty. Bd. of Revision*, 122 Ohio St.3d 447, 2009-Ohio-3479; *Target Corp. v. Lake Cty. Bd. of Revision* (Dec. 20, 2011), BTA No. 2008-M-1088, unreported. We believe that by intentionally excluding first-generation users and long-term leased build-to-suit properties within her two approaches, Costello has not properly analyzed the market, potentially skewing her analysis. We find that Blosser's comparables were more appropriate given that Lowe's occupied the property as of the tax lien date, as well as

¹ Blosser testified that she spoke with many real estate professionals in the area to confirm the market.

Blosser's testimony that the subject is located in a high-trafficked area which draws from a regional market. We ultimately find Blosser's testimony and report more persuasive, and while we have considered the appellant's arguments, we do not find that any of the arguments warrant a rejection of Blosser's final opinion of value.

It is therefore the order of this board that the total true and taxable values of the subject property as of January 1, 2010 were \$7,200,000 and allocated as follows:²

PARCEL NUMBER	TRUE VALUE	TAXABLE VALUE
23-00-84565.001	\$ 26,970	\$ 9,440
24-00-84563.001	\$ 134,050	\$ 46,920
24-00-84566.001	\$2,743,340	\$ 960,170
24-00-84566.004	\$ 3,170	\$ 1,110
24-00-84566.720 ³	\$4,265,500	\$1,492,920
24-00-84570.002	\$ 26,970	\$ 9,440

It is the order of the Board of Tax Appeals that the subject property be assessed in conformity with this decision and order.

I hereby certify the foregoing to be a true and complete copy of the action taken by the Board of Tax Appeals of the State of Ohio and entered upon its journal this day, with respect to the captioned matter.



A.J. Groeber, Board Secretary

² We have allocated Blosser's final opinion of value to each parcel based upon the auditor's original assessments for tax year 2010. See *FirstCal Industrial 2 Acquisition LLC v. Franklin Cty. Bd of Revision*, 125 Ohio St.3d 485, 2010-Ohio-1921.

³ The record indicates that this parcel is subject to Tax Increment Financing ("TIF").

EXHIBIT "B"

ASSIGNMENT OF ERRORS

ASSIGNMENT OF ERROR NO. 1

The Board of Tax Appeals decision violates the Due Process clauses under Article I, Section 16 of the Ohio State Constitution and the Fourteenth Amendment of the United States Constitution by applying the definition of fee simple and interpreting §5713.03 of the Ohio Revised Code in an inconsistent and discriminatory manner among taxpayers. *Rite Aid of Ohio, Inc. vs. Washington County Board of Revision, et al.* (2014) BTA No. 2011-1760.

ASSIGNMENT OF ERROR NO. 2

The Board of Tax Appeals decision violates the Equal Protection clauses under Article I, Section 2 of the Ohio State Constitution and the Fourteenth Amendment of the United States Constitution by applying the definition of fee simple, and interpreting §5713.03 of the Ohio Revised Code, in a manner that discriminates against certain taxpayers. *Rite Aid of Ohio, Inc. vs. Washington County Board of Revision, et al.* (2014) BTA No. 2011-1760.

ASSIGNMENT OF ERROR NO. 3

The report and testimony of Blosser did not constitute probative and credible evidence of value, and therefore the Board of Tax Appeals should have performed an independent determination of value. *Dublin City Schools Board of Education v. Franklin County Board of Revision, et al.* (2014) Ohio Supreme Ct. Slip Opinion No. 2014-Ohio-1940.

ASSIGNMENT OF ERROR NO. 4

In accepting the value conclusion from the Blosser appraisal, the Board of Tax Appeals violated its duty to independently determine the fee simple value of the subject real property as required by §5713.03 of the Ohio Revised Code and the prior decisions of this Court.

ASSIGNMENT OF ERROR NO. 5

The Board of Tax Appeals decision is arbitrary and capricious.

ASSIGNMENT OF ERROR NO. 6

The Board of Tax Appeals decision is against the manifest weight of the evidence.

ASSIGNMENT OF ERROR NO. 7

The Board of Tax Appeals abused its discretion by accepting the report and testimony of Blosser as probative and credible evidence of value.

CERTIFICATE OF SERVICE

A copy of the foregoing *Notice of Appeal* was served this 21 day of May, 2014, by personal service upon:

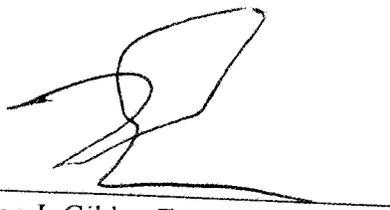
The Ohio Board of Tax Appeals
Rhodes Tower
30 East Broad Street, 24th Floor
Columbus, Ohio 43215

A copy of foregoing *Notice of Appeal* was served this 22 day of May, 2014, by certified mail upon:

Mike Dewine, Esq.
Ohio Attorney General
State Office Tower, 17th Floor
30 East Broad Street
Columbus, OH 43215-3428

James E. Schneider, Esq.
Washington County Prosecutor's Office
223 Putnam St.
Marietta, OH 45750

Kelley A. Gorry, Esq.
Rich & Gillis Law Group, LLC
6400 Riverside Drive, Suite D
Dublin, OH 43017



Ryan J. Gibbs, Esq.

OHIO BOARD OF TAX APPEALS

Lowe's Home Centers, Inc.,)	CASE NO(S). 2011-1664
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Appellant(s),)	(REAL PROPERTY TAX)
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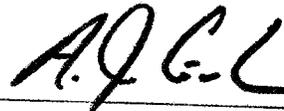
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³ The record indicates that this parcel is subject to Tax Increment Financing ("TIF").

BOARD OF REVISION
WASHINGTON COUNTY, OHIO
c/o WASHINGTON COUNTY AUDITOR
205 Putnam Street
Marietta, Ohio 45750
740-373-6623 ext. 339

Certified Notice To:

6-22-11

Lowe's Home Centers
PO Box 1111 Hwy 268
Wilkesboro, NC 28658

RE: Board of Revision complaint # 201 1-176
Hearing date: May 24, 2011

In accordance with the Ohio Revised Code, the Washington County Board of Revision hereby certifies its action in the matter of the above complaint, relating to property on the tax lists of Washington County in the name of: Lowes Home Centers Inc

Said case having been presented by complainant and after due consideration and review of evidence presented, the board has arrived at the following decision,

<u>PARCEL#</u>	<u>TOTAL MARKET VALUATION BEFORE</u>	<u>TOTAL MARKET VALUATION AFTER</u>	<u>CHANGE-/+</u>
23-00-84565.001	No change in value		
24-00-84563.001	No change in value		
24-00-84566.001	No change in value		
24-00-84566.004	No change in value		
24-00-84566.720	No change in value		
24-00-84570.002	No change in value		

The results here reported are the final action of this board. Further appeal as to this decision may be made to the Board of Tax Appeals or Common Pleas Court as specified in the Ohio Revised Code. Appeal forms will be furnished to you upon request. The appeal must be filed within 30 days after this notification is mailed.

Washington County Board of Revision

William D. McFarland
Washington County Auditor
Secretary

5713.03 County auditor to determine taxable value of real property.

The county auditor, from the best sources of information available, shall determine, as nearly as practicable, the true value of the fee simple estate, as if unencumbered but subject to any effects from the exercise of police powers or from other governmental actions, of each separate tract, lot, or parcel of real property and of buildings, structures, and improvements located thereon and the current agricultural use value of land valued for tax purposes in accordance with section 5713.31 of the Revised Code, in every district, according to the rules prescribed by this chapter and section 5715.01 of the Revised Code, and in accordance with the uniform rules and methods of valuing and assessing real property as adopted, prescribed, and promulgated by the tax commissioner. The auditor shall determine the taxable value of all real property by reducing its true or current agricultural use value by the percentage ordered by the commissioner. In determining the true value of any tract, lot, or parcel of real estate under this section, if such tract, lot, or parcel has been the subject of an arm's length sale between a willing seller and a willing buyer within a reasonable length of time, either before or after the tax lien date, the auditor may consider the sale price of such tract, lot, or parcel to be the true value for taxation purposes. However, the sale price in an arm's length transaction between a willing seller and a willing buyer shall not be considered the true value of the property sold if subsequent to the sale:

- (A) The tract, lot, or parcel of real estate loses value due to some casualty;
- (B) An improvement is added to the property. Nothing in this section or section 5713.01 of the Revised Code and no rule adopted under section 5715.01 of the Revised Code shall require the county auditor to change the true value in money of any property in any year except a year in which the tax commissioner is required to determine under section 5715.24 of the Revised Code whether the property has been assessed as required by law.

The county auditor shall adopt and use a real property record approved by the commissioner for each tract, lot, or parcel of real property, setting forth the true and taxable value of land and, in the case of land valued in accordance with section 5713.31 of the Revised Code, its current agricultural use value, the number of acres of arable land, permanent pasture land, woodland, and wasteland in each tract, lot, or parcel. The auditor shall record pertinent information and the true and taxable value of each building, structure, or improvement to land, which value shall be included as a separate part of the total value of each tract, lot, or parcel of real property.

Cite as R.C. § 5713.03

History. Amended by 129th General Assembly File No. 186, HB 510, §1, eff. 3/27/2013.

Amended by 129th General Assembly File No. 127, HB 487, §101.01, eff. 9/10/2012.

Effective Date: 09-27-1983

Related Legislative Provision: See 129th General Assembly File No. 186, HB 510, §3

See 129th General Assembly File No. 127, HB 487, §757.51.

15

Amendment XIV. Rights Guaranteed: Privileges and Immunities of Citizenship, Due Process, and Equal Protection.

CONSTITUTION OF UNITED STATES

AMENDMENTS

Current through 2012

Amendment XIV. Rights Guaranteed: Privileges and Immunities of Citizenship, Due Process, and Equal Protection

SECTION. 1. All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

SECTION. 2. Representatives shall be apportioned among the several States according to their respective numbers, counting the whole number of persons in each State, excluding Indians not taxed. But when the right to vote at any election for the choice of electors for President and Vice President of the United States, Representatives in Congress, the Executive and Judicial officers of a State, or the members of the Legislature thereof, is denied to any of the male inhabitants of such State, being twenty-one years of age, and citizens of the United States, or in any way abridged, except for participation in rebellion, or other crime, the basis of representation therein shall be reduced in the proportion which the number of such male citizens shall bear to the whole number of male citizens twenty-one years of age in such State.

SECTION. 3. No person shall be a Senator or Representative in Congress, or elector of President and Vice President, or hold any office, civil or military, under the United States, or under any State, who, having previously taken an oath, as a member of Congress, or as an officer of the United States, or as a member of any State legislature, or as an executive or judicial officer of any State, to support the Constitution of the United States, shall have engaged in insurrection or rebellion against the same, or given aid or comfort to the enemies thereof. But Congress may by a vote of two-thirds of each House, remove such disability.

SECTION. 4. The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be

held illegal and void.

SECTION. 5. The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.

§ 2. Right to alter, reform, or abolish government, and repeal special privileges.

Ohio Constitution

Article I. Bill of Rights

Current through the November, 2011 General Election

§ 2. Right to alter, reform, or abolish government, and repeal special privileges

All political power is inherent in the people. Government is instituted for their equal protection and benefit, and they have the right to alter, reform, or abolish the same, whenever they may deem it necessary; and no special privileges or immunities shall ever be granted, that may not be altered, revoked, or repealed by the general assembly.

You Can't Get the Value Right If You Get the Rights Wrong

by David C. Lennhoff, MAI, SRA

Market value opinions of the fee interest in custom-built commercial properties present challenging problems. In these assignments, appraisers must understand the nuances between value in use and market value, and fee simple estates and leased fees. These built-to-suit properties have rents, sale prices, and overall capitalization rates that are not representative of the market for second-generation users. The cost to build and worth to the initial owner or tenant well exceeds what the property would be able to command on the market for either lease or sale. This article reviews the three traditional valuation approaches and discusses the misconceptions that lead to the wrong value for the property fee interest.

Single-tenant, built-to-suit commercial real estate presents difficult valuation problems. One of the most challenging of these valuation problems arises when the assignment involves developing an opinion of the market value of the fee interest in the real property. This assignment condition requires the appraiser to value the property as if it sold, *available to be leased at market*. However, these custom-built properties are always occupied by the owner or tenant for whom the improvements were built, with any lease structured to recoup the original cost of the custom construction. If the properties were sold, they would sell as leased fees with rents well above the market rent. So, an estimate of the market value of what would actually sell would be the market value of the leased fee, which is inconsistent with the value premise. Because the value premise is inconsistent with what would sell if the property were offered for sale, appraisers frequently end up answering the wrong question: rather than the market value of the fee, they provide an opinion of the value in use of the leased fee estate based on the original lease. To properly approach such assignments, appraisers must suspend reality—as these properties never sell as if vacant and available to be leased at market—and value the properties under the assumption they are vacant and available.

These are fundamental issues in appraisal of custom-built commercial properties, and it is important to explore the root causes for the problems that appraisers may have with them. This article reviews how to approach such an assignment, considering all three traditional appraisal methods, and exposes related misconceptions that should be avoided.

Custom-Built Commercial Properties

Properties such as bank branches, fast food restaurants, freestanding pharmacies, and fitness clubs are frequently built by the owners to their specifications or built-to-suit for them. In either situation, the building is designed to conform to

a particular business-model prototype. For example, Life Time Fitness health clubs are typically located in 110,000-square-foot buildings on about twelve acres, with a distinctive Federal-style architectural design. The buildings usually have two stories, three swimming pools, an expensive interior finish, and every imaginable type of fitness equipment. Walgreens' pharmacies are typically in single-story, freestanding 15,000-square-foot buildings on about two acres. These buildings also have a distinctive architectural design that features a glass entrance atrium.

For many reasons, it is often advantageous to lease the property rather than own it. This is accomplished with a build-to-suit sale/leaseback. Under these arrangements, the rental amount is based on the cost of construction. These properties are never built speculatively and then put on the market for rent or sale. Once the property is rented, the real property is often sold from investor to investor. The attractiveness of the purchase to investors, however, is more a function of the lease-rent amount, terms, and tenant—than the real estate. This is obvious from the fact that some buyers do not even bother to inspect the property before purchase.

The Appraisal Problem

Although appraisals of commercial properties are sometimes obtained for purchase price purposes, more often they are for other uses such as condemnation and tax assessment. The question the appraiser is asked to answer when the use is related to a purchase is quite different from the question to be answered when the appraisal is for one of the other possible intended uses. The purchase-related appraisal involves an opinion of how much an informed purchaser would pay for the property *as encumbered* by the lease. The appraisal for condemnation or tax purposes, however, usually calls for an opinion of the market value of the *fee* interest. The specific question then is, if this property, which was custom built for this particular occupant's needs, were on the market for the typical exposure time and available to be leased or occupied, how much would an informed purchaser be willing to pay for it?

Market Value vs. Value in Use

The primary difference between *market value* and *value in use* is that market value is couched in terms

of the property's highest and best use, and is a value in exchange concept. Market value considers how much a knowledgeable buyer would pay for the defined interest as of a specified date if the property had been exposed on the market for a typical period of time. It requires the assumption of a transaction and a willing seller, regardless of whether the occupant has any intention of selling.

Value in use, on the other hand, is a function of the current use, regardless of the property's highest and best use; in its purest form it is not a value in exchange concept.¹ A property that has been custom built for the current occupant—be that an owner-occupant or tenant—will usually have a value in use that is higher than the property's market value. This is not surprising, as the improvements have been tailored to the wants and needs of the occupant, and those requirements are unlikely to be exactly the same as those of the market in general. A McDonald's restaurant, for example, is a perfect design for the McDonald's business plan, but largely undesirable for the market in general, even for another fast-food outlet.

Fee Simple vs. Leased Fee

The fee simple is perhaps one of the most misunderstood of fundamental appraisal principles. Simply put, the owner of the fee interest owns the entire bundle of rights that comes with property ownership, subject only to the four governmental powers of escheat, eminent domain, police power, and taxation. The bundle of rights includes the right to sell an interest, the right to lease an interest, the right to occupy the property, the right to mortgage an interest, and the right to give an interest away. Once the property has been leased—regardless of the terms of that lease—the owner no longer has the right of occupancy, the right to lease, or the right to give an interest away. Even if the lease is at market rent, the fee does not necessarily equal the leased fee.

The Three Approaches to Value and Market Value of the Fee Interest

All three of the traditional valuation approaches are potentially applicable in the market value estimate of the fee interest in custom-built commercial properties. Whether or not an approach can be used is a function of the availability of data and support for the elements of its application.

1. Some jurisdictions have assessment criteria that mandate a market value in use estimate, which usually means the exchange value of the property assuming the current use is the highest and best use.

Sales Comparison Approach

As noted, custom-built commercial properties frequently sell. Invariably, they are sold subject to the lease to the original occupant that outlined the construction specifications and is paying a rent structured on the cost to build the improvements. Therefore, the sales are most appropriately categorized as sales of the leased fee interest.

The rent for a custom-built commercial property is routinely higher than the rent for space that is not specifically designed for a tenant. Anyone who has purchased a custom home can appreciate this fact. A custom builder will build whatever you want and charge cost plus profit for it. When you sell the property, however, the market will only pay for the features it wants, not for the special features you wanted built in. This is the foundation of the concept of functional obsolescence and superadequacy.

The transactions or sales of the leased fee interests for the custom properties are at prices that reflect the very high lease rate; typically the leases are net lease deals. The purchases are tantamount to a bond purchase, as the quantity, quality, and durability of the income streams being purchased are consistent with bonds. These are not arm's-length leases. The transactions are not representative of the amount for which the real property would sell if it were vacant and available to be leased (a fee interest) or leased in an arm's-length, open market transaction.

Sometimes, the only available comparable sales are net lease deals. In such circumstances, the appraiser has two choices: (1) find the evidence to support an adjustment for both rights appraised (the fee and the leased fee) and for an adjustment for the contribution of the above-market lease amount and terms; or (2) not apply the sales comparison approach. The only alternative would be to find sales of second-generation uses of these properties; for example, a reuse of a Walgreens as a local restaurant or a Kmart as a call center. If these sales are not distress sales and share the same highest and best use as the subject if vacant and available to be leased, then they will provide credible evidence of the subject's market value. More times than not, however, ample transactions of this kind are not available and the appraiser is not able to use the sales comparison technique.

Income Capitalization Approach

Direct capitalization seems to be the preferred model to develop an opinion of value for custom commercial

properties via the income capitalization approach. To apply this approach properly, support is needed for its three major ingredients: potential gross income, operating expenses, and overall capitalization rate. The same issues arise with its application as with the sales comparison approach when the appraisal problem involves estimating the market value of the fee simple interest of the custom-built property.

The first step in applying the income capitalization approach is to determine the market rent. In order to properly develop the market rent, sufficient market evidence must be found of the amount that a willing lessee would pay a willing lessor to occupy the space. A search of sources usually available to appraisers (such as CoStar, NNEx.com, or similar services) will quickly reveal many leases. When these leases are scrutinized, however, it will be apparent that almost every one is a lease to the original tenant based on a rate that was driven by that tenant's custom-construction specifications. As such these lease rents have little in common with the rent a second-generation tenant would be willing to pay for the space. Evidence of this is both obvious and available.

For example, when the fast-food franchise Roy Rogers Restaurants closed, many of its stores went to other fast-food franchises or to local restaurants. However, the buyers stripped the restaurants to their shells, removing all evidence of the prior user, and then rebuilt the restaurants to their own prototypical specifications. The buyers clearly did not want—nor were they willing to pay for—the sometimes expensive custom features of the original construction. So, it quickly becomes apparent that what may look like a substantial pool of potential leases that might be used as comparables in an estimate of market rent for the subject is really of no use whatsoever in determining how much a second-generation tenant would be willing to pay in rent for these custom-built properties.

Alternatively, an appraiser might develop a market rental rate using percentage rent, a typical retail lease mechanism. Percentage rent is expressed as a certain percentage of the typical sales for the type of tenant best suited to the particular real estate. An indication of market rent can be developed if the appropriate percentage can be found, from a review of actual leases or from a secondary source such as *Dollars and Cents of Shopping Centers*, and the typical sales can be similarly established.

Support for the operating expenses is usually not a problem, so the next step is development of



an overall capitalization rate. *The Appraisal of Real Estate*, 13th edition, describes the methods for developing a capitalization rate, and it states that the preferred method is derivation from comparable sales.² However, the problem with derivation from comparables sales related to custom commercial buildings is the same as the problem encountered when trying to use the sales comparison approach: transaction prices for this type of property are based on the in-place lease to the original tenant and the rent being paid by that tenant, which is a function of the build-to-suit cost of construction. As a result, any capitalization rate extracted from these sales will be much lower than appropriate for an opinion of the market value of the fee interest.

Although substantial obstacles need to be overcome, application of the income capitalization approach is important to the solution of this type of appraisal problem. Careful analysis of second-generation lease transactions and overall capitalization rates extracted from these sales offers the best application. In the absence of sufficient data from second-generation deals, an option would be to estimate market rent using a percentage rent model and to develop an overall capitalization rate by an alternative method, such as a carefully vetted survey. Particular care would be needed, however, with the development of both the market rent and the overall capitalization rate.

The Cost Approach

Initially, the cost approach seems to carry a lot of promise as a method for valuing custom-built commercial properties. The value of the fee simple interest is estimated by adding the value of the land to the cost of the improvements, minus depreciation. The three components of the cost approach—cost new, depreciation, and site value—are all capable of being supported by solid market evidence. There may be problems, however, with the way the depreciation component is developed.

The amount of depreciation is estimated using one or more of three fundamental methods: the economic age-life method, the market extraction method, and the breakdown method. The market extraction method has little application to custom-built commercial properties for the same reasons the sales comparison approach is not useable, i.e., the

lack of similar sales. The breakdown method also is not particularly practical. The method used most often is the economic age-life method. The problem with the economic age-life method is that appraisers frequently select an effective age equal to or close to actual age, based solely on physical condition, and take the total economic life from a published source. For custom-built properties, this inevitably results in an understatement of the depreciation, as these properties almost by definition have features that the general market is not willing to pay for.

Feasibility Rent Analysis

The key to the cost approach is the accurate measurement of functional and external obsolescence elements of depreciation. Often, even very new properties suffer substantial functional and external obsolescence.

Feasibility rent analysis is one of the very best tools available to show the magnitude of depreciation. It helps explain why cost new, even with a relatively new property, does not approximate market value. If the feasibility rent is above the market rent, then the property has obsolescence and cost new will exceed the market value.

The feasibility rent concept is taught in the Appraisal Institute's highest and best use courses, although there it is used to estimate the timing of a use rather than to quantify existing depreciation. Although some appraisers may be put off by the circularity that exists between feasibility rent analysis and direct capitalization, it is a methodology taught in the *Advanced Cost and Sales Comparison* course, which is currently a requirement for the MAI designation.

Feasibility rent analysis is, in effect, direct capitalization in reverse. Direct capitalization begins with an estimate of market rent from which appropriate vacancy and collection loss and operating expenses are deducted. The resulting net operating income is then converted to an indication of value by dividing it by an overall capitalization rate (R_o).

Feasibility rent, on the other hand, begins with the assumption that the cost new plus the site value equals value. Rearranging the relationship, value equals income divided by rate, allows the appraiser to calculate feasibility rent, or the net operating income necessary to support this assertion (net operating income equals cost new plus site value times the overall capitalization rate). The difference

2. Appraisal Institute, *The Appraisal of Real Estate*, 13th ed. (Chicago: Appraisal Institute, 2008), 501.

between this amount and the estimated net operating income developed in the income capitalization approach represents the net income shortfall, which when capitalized with the overall capitalization rate results in the total depreciation from all sources. Dividing the net income shortfall by the previously calculated feasibility rent results in the total percentage of depreciation in the improvements.

An example using a custom-built property helps illustrate why feasibility rent is a valuable tool in explaining why the cost new does not approximate market value for this type of property.

Feasibility Rent Case Study

Assume that the subject is a two-year-old health club with 110,000 square feet of improvements on twelve acres. The site value, determined by the sales comparison approach, is \$3,500,000, and the all-inclusive cost new for the real property (personalty excluded) is \$177.00 per square foot. This includes entrepreneurial incentive, which is a necessary cost in all market value estimates. (Unachieved profit would be reflected in the depreciation estimate.) The physical depreciation for the facility is \$500,000. Although only two years old, this facility has been operated on a 24-hour-a-day basis and shows minor physical depreciation as a result.

Also assume that the estimated market rent by percent typical for similar retail is 8%; the typical sales level is \$120 per square foot; and the market rent is \$9.60 per square foot. The overall capitalization rate is 9%, based on analysis of the subject relative to alternative retail investment opportunities such as strip centers, power centers, and hotels.

We can now calculate the feasibility rent, which is the rent necessary for the property to be worth what it cost to construct at the effective date of value.

Cost new of improvements	\$19,470,000
Site value	+ 3,500,000
Total cost new	\$22,970,000
Capitalization rate	× 9%
Feasibility rent	\$2,067,500

We can now compare the market rent estimate to the feasibility rent (both on a net basis). The difference between the two serves as a market-extracted measure of total depreciation in the subject

real property. The depreciation calculation using feasibility rent analysis is as follows:

Total development cost new	\$22,970,000
Capitalization rate	× 9%
Feasibility rent	\$2,067,500
Less net market rent (\$9.60 × 110,000 sq. ft.)	- 1,056,000
Income loss due to depreciation, all sources	\$1,011,500
Value of loss, capitalized at 9% (\$1,011,500/.09)	\$11,256,666

Of the total loss in value, \$500,000 is physical depreciation, so the property suffers the balance \$10,756,666 in functional or external obsolescence. It is not particularly important in this situation to identify how much of this amount is functional obsolescence and how much is external obsolescence. A reconstructed cost approach would look as follows:

Cost new	\$19,470,000
Less depreciation	
Physical deterioration	\$500,000
Functional/external obsolescence	\$10,756,666
Total depreciation	- 11,256,666
Depreciated value of improvements	\$8,233,334
Site value	+ 3,500,000
Total market value of fee by cost approach	\$11,733,334

It is important to emphasize that the cost approach did *not* produce an independent indication of value. However, it did provide a very useful way of demonstrating that, although only two years old, this property suffers substantial functional or external obsolescence and its market value is significantly less than its value in use would be.

Summary and Conclusions

Estimating the market value of the fee interest in the real property component of a single-tenant, built-to-suit or custom-built commercial property is a difficult assignment. The reason it is so difficult is that no one builds these properties on a speculative basis and then offers them for sale or rent on the open market. Instead, they are built-to-suit, and if they

sell, they trade on a sale/leaseback arrangement. The rent, sale price, and overall capitalization rate are not arm's-length and not equivalent to market rent, value, or capitalization rates. As a result, it is very difficult to find support for market rent, market sales comparables, and market overall capitalization rates. However, the value in use to a specific tenant or owner does not become market value just because support for the latter is hard to find. The best support for the components of both the sales comparison approach (the comparables) and the components of the income capitalization approach (rental and capitalization rate comparables) is second-generation space that has leased or sold and that enjoys the same highest and best use as the subject would if it were available for lease or sale on the open market. The key to the cost approach is the accurate quantification of the functional and external obsolescence. Feasibility rent analysis is an excellent tool for such quantification in these situations.

Appraisers often respond to these types of appraisal assignments by asking, why would an intelligent and sophisticated national corporation pay an amount well above the market value or market rent for these custom-built properties? The answer is simply this. The cost of the real estate might not

make sense on a stand-alone basis, but makes complete sense as a part of the overall business operation of the owner or tenant. When a nationally known fast-food establishment was asked why it had paid what was seemingly well above the market value for land for one of its restaurants, the response was, "We're not in the real estate business, we're in the hamburger business. The land price is completely acceptable as a part of the overall business plan, and that is all we care about." However, no one else would be willing to pay either rent or a sale price for custom-built improvements that fit perfectly into someone else's business plan, but not their own. The price a buyer is willing to pay would be well below the cost-based amounts, and this represents the very crux of this valuation issue.

David C. Lennhoff, MAI, SRA, is president of PGH Consulting, LLC, which is officed in Rockville, Maryland. His practice centers on litigation valuation and expert testimony relating to appraisal methodology, USPAP and allocating assets of a going concern. He has taught nationally and internationally for the Appraisal Institute and is a frequent contributor to *The Appraisal Journal*. Contact: dlennhoff@aol.com



1 of 2 DOCUMENTS

Rite Aid of Ohio Inc., Appellant, vs. Washington County Board of Revision and
Washington County Auditor, Appellees.

CASE NO. 2011-1760 (REAL PROPERTY TAX)

STATE OF OHIO -- BOARD OF TAX APPEALS

2014 Ohio Tax LEXIS 2541

April 22, 2014, Entered

COUNSEL:

[*1] APPEARANCES:

For the Appellant - Stephen Swaim, Attorney at Law

For the County Appellees - James E. Schneider, Washington County Prosecuting Attorney, Kelley A. Gorry,
Rich & Gillis Law Group, LLC

OPINION:

DECISION AND ORDER

Mr. Williamson, Mr. Johrendt, and Mr. Harbarger concur.

Appellant appeals a decision of the board of revision ("BOR") which determined the value of the subject parcels n1 for tax year 2010. This matter is now considered upon the notice of appeal, the transcript certified by the BOR pursuant to R.C. 5717.01, the record of the hearing before this board, and the parties' briefs.

n1 Appellant has appealed decisions pertaining to the following parcel numbers: 24-00-07944.000, 24-00-04592.000, 24-00-04656.000, 24-00-04668.000, 24-00-07956.000, 24-00-07964.000, 24-00-04652.000, 24-00-00152.000, 24-00-04596.000, 24-00-07952.000, 24-00-07948.000, 24-00-07960.000, and 24-00-25492.000.

The subject property, located in Marietta, is improved with a retail drugstore owned and operated by Rite Aid. The subject parcels' total true value was initially assessed at \$ 3,319,600. A decrease complaint was filed by the appellee owner seeking a reduction in total value to \$ 1,396,920. The BOR ultimately issued a decision making no changes in the values of the parcels, and the present appeal ensued.

When cases are appealed from a board of revision to this board, an appellant must prove the adjustment in value requested. See, e.g., *Shinkle v. Ashtabula Cty. Bd. of Revision*, 135 Ohio St.3d 227, 2013-Ohio-397. It has long been held by the Supreme Court that "the best evidence of 'true value in money' of real property is

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an actual, recent sale of the property in an arm's-length transaction." *Conalco v. Bd. of Revision* (1977), 50 Ohio St.2d 129. Then, typically, "the only rebuttal lies in challenging whether the elements of recency and arm's-length character between a willing seller and a willing buyer are genuinely present for that particular sale." *Cummins Property Servs., L.L.C. v. Franklin Cty. Bd. of Revision*, 117 Ohio St.3d 516, 2008-Ohio-1473, at P13.

Here, none of the subject parcels have recently sold in an arm's-length transaction. [*3] We therefore turn to the parties' appraisal evidence. See *Pingue v. Franklin Cty. Bd. of Revision* (1999), 87 Ohio St.3d 62. At this board's hearing, the owner presented the appraisal report and testimony of Geoffrey A. Hatcher, MAI, who opined a value of \$ 1,150,000 as of January 1, 2010. The county appellees presented the appraisal report and testimony of Karen L. Blosser, MAI, who opined a value of \$ 2,400,000 as of January 1, 2010. Both appraisers used the sales comparison and income capitalization approaches to value; however, they differed in their selection of comparable sales and leases. Mr. Hatcher looked primarily to other retail properties and leases in the surrounding area, n2 while Ms. Blosser looked to sales and leases of other major drugstores, i.e., CVS, Walgreens, and Rite Aid, throughout the state. n3 Upon review of the evidence presented, we find Mr. Hatcher's sale and lease comparable more comparable to the subject property, and therefore, find his value conclusion more persuasive. n4 It is therefore the order of this board that the subject parcels' true and taxable values, as of January 1, 2010, were as follows n5:

Parcel no.	True Value	Taxable Value
24-00-07944.000	\$ 1,029,350	\$ 360,270
24-00-04592.000	\$ 3,600	\$ 1,260
24-00-04656.000	\$ 7,920	\$ 2,770
24-00-04668.000	\$ 27,640	\$ 9,670
24-00-07956.000	\$ 5,020	\$ 1,760
24-00-07964.000	\$ 6,830	\$ 2,390
24-00-04652.000	\$ 2,910	\$ 1,020
24-00-04596.000	\$ 13,620	\$ 4,770
24-00-07952.000	\$ 10,810	\$ 3,780
24-00-07948.000	\$ 2,950	\$ 1,030
24-00-07960.000	\$ 9,270	\$ 3,250
24-00-25492.000	\$ 13,510	\$ 4,730
	\$ 16,570	\$ 5,800

[*4]

n2 Mr. Hatcher's six sale comparable were from areas surrounding Marietta, including Zanesville, Nelsonville, Parkersburg, and Vienna, West Virginia. His lease comparable were of other retail properties in Marietta in the surrounding area; he also included data regarding leases of other Rite Aid stores in the area.

n3 Ms. Blosser's five sale comparable (chosen with age similarity a primary factor) were in Canton, Medina, Columbus, Englewood, and Dayton. Her lease comparable came from throughout Ohio, including major cities such as Cleveland, Columbus, and Cincinnati. Noticeably absent from her lease comparable are the leases of the CVS and Walgreens located in close proximity to the subject property.

n4 Mr. Hatcher testified that he did not use any leased fee sales as comparable, as he felt they were not appropriate in a fee simple appraisal analysis. While we acknowledge decisions of the Supreme Court and this board holding that leased fee sales are appropriate to use in such an analysis, see, e.g., *Meijer Stores Ltd. Partnership v. Franklin Cty. Bd. of Revision*, 122 Ohio St.3d 477, 2009-Ohio-3479, an appraiser is not required to rely only upon leased fee sales.

[*5]

n5 The beginning point of the board's value findings is the auditor's original assessments for tax year 2010. We have utilized the percentages reflected therein to allocate value among the parcels. See *FirstCal Industrial 2 Acquisition LLC v. Franklin Cty. Bd. of Revision, 125 Ohio St.3d 485, 2010-Ohio-1921*.

It is the order of the Board of Tax Appeals that the Washington County Auditor list and assess the subject parcels in conformity with this decision and order.

Legal Topics:

For related research and practice materials, see the following legal topics:

Tax LawState & Local TaxesAdministration & ProceedingsAudits & InvestigationsTax LawState & Local TaxesAdministration & ProceedingsJudicial Review