STATE OF MINNESOTA | TAX COURT
FOURTH JUDICIAL DISTRICT
COUNTY OF HENNEPIN | REGULAR DIVISION

Eden Prairie Mall LLC,

Petitioner,

vs.

County of Hennepin,

Respondent.

FINDINGS OF FACT
CONCLUSIONS OF LAW and
ORDER FOR JUDGMENT

File Nos. 27-CV-06-04210
27-CV-06-04212
27-CV-07-08003
27-CV-07-08004

Dated: October 13, 2009

The Honorable Sheryl A. Ramstad, Judge of the Minnesota Tax Court, heard this matter on February 26, 2009, through March 11, 2009, at the Hennepin County District Court facilities, Minneapolis, Minnesota.

Thomas R. Wilhelmey and Judy S. Engel, Attorneys at Law, represented the Petitioner.

Robert Rudy and Lisa Hahn-Cordes, Assistant Hennepin County Attorneys, represented the Respondent.

The issues in this case are the separate fair market values for the assessment dates of January 2, 2005, and January 2, 2006, for both the Eden Prairie Mall and the Von Maur Department Store.

Both parties filed post-trial briefs. The matter was submitted to the Court for decision on August 25, 2009.

The Court, having heard and considered the evidence adduced at the hearing, and upon all of the files, records and proceedings herein, now makes the following:

FINDINGS OF FACT

1. Eden Prairie Mall, L.L.C. ("Petitioner") has sufficient interest in the property to maintain this petition; all statutory and jurisdictional requirements have been complied with, and the Court has jurisdiction over the subject property and the parties.

2. Petitioner owns real property located at 8251 Flying Cloud Drive[1] and 400 Prairie Center Drive[2] in Eden Prairie, Minnesota, commonly referred to as the Eden Prairie Center Mall ("the Mall") and the attached Von Maur Department Store ("Von Maur").

3. The assessment dates at issue are January 2, 2005, and January 2, 2006 ("Assessment Dates").

4. The Mall was originally developed and constructed in 1975 by Homart, the development arm of Sears, Roebuck and Company, with steel and concrete framing and masonry exterior walls. It was constructed with two levels and included two anchor stores, Sears and Powers. In 1984, a third anchor, Target, was added, and there was minor remodeling to connect Target to the Mall via a pedestrian skyway. In 1989, the food court and mall entry areas were remodeled, and interior walking ramps between the first and second levels were replaced by

[1] PID 14-116-22-42-0011.
[2] PID 14-116-22-41-0088.

escalators and elevators. In 1994, a fourth anchor store, Kohls, was added along with a minor addition allowing for connecting Kohls with the Mall.

5. The Mall has a site size of approximately 35.38 acres. It is a super-regional shopping center. It has two primary floors with a lower (basement) level and enclosed common areas. The Mall has numerous retail spaces, a food court, an entertainment center including restaurants, a multi-screen movie theater, and a 375-stall parking ramp adjacent to Von Maur.

6. The Mall includes in-line space totaling 394,912 square feet net rentable area ("NRA"), including 250,899 square feet NRA of traditional in-line stores and a food court, 8,379 square feet NRA of basement space and 135,634 square feet NRA consisting of an AMC theater and several restaurants (the "Entertainment Wing").

7. The Von Maur space is a two-level anchor department store attached to the Mall consisting of approximately 165,000 square feet of gross building area and approximately 150,000 square feet NRA plus approximately one-third of the parking-deck adjacent to the store. The remaining two-thirds of the parking-deck are located on the Mall parcel.

8. Von Maur is an owner-occupied department store building subject to a ground lease between Petitioner and Von Maur dated May 20, 1999. The terms of the ground lease provide for a percentage rent payment of 2% of net sales in excess of $20,000,000, as well as a contribution of $.25 per square foot for 150,000 square feet/gross leasable area for maintenance and operation of exterior common areas and the Mall to Petitioner absent a Mall operating failure.

In the event of a Mall operating failure continuing for 24 months, Von Maur would be relieved of its obligation to pay exterior common area and Mall maintenance, rent, and taxes.

9. General Growth Properties (“GGP”) acquired the Mall in 1999. Between 2000 and 2002, GGP gutted the Mall and all public common spaces, and rebuilt tenant spaces. Added to the Mall was the 160,000 square foot two-level Entertainment Wing, which included an 18-screen multi-plex AMC Movie Theater, Barnes & Noble Bookstore, and several full service restaurants. The 165,051 square foot Von Maur Department Store was also added on a 6.07-acre site as a fifth anchor, and a two-level parking ramp was constructed adjacent to Von Maur. The Grand Re-opening of the renovated Mall took place on October 4, 2001.

10. The Hennepin County Assessor’s estimated market value (“EMV”) as of January 2, 2005, for the Mall was $90,000,000, with a land value set at $16,927,000 and improvements valued at $73,073,000. The EMV as of January 2, 2005, for Von Maur was $8,913,000, with a land value set at $2,645,000 and improvements valued at $6,269,000.

11. The Hennepin County Assessor’s EMV as of January 2, 2006, for the Mall was $100,000,000, with the land value set at $18,466,000, and improvements valued at $81,534,000. The EMV as of January 2, 2006, for Von Maur was $9,408,000, with a land value set at $2,909,000 and improvements valued at $6,499,000.

12. Petitioner's appraiser, David Lennhoff, MAI, found the value for the Mall as of January 2, 2005, to be $68,750,000, and found the value of Von Maur as of that same date to be $3,950,000.

13. Petitioner's appraiser found the value for the Mall as of January 2, 2006, to be $60,550,000, and found the value of Von Maur as of that same date to be $4,750,000.

14. Respondent's appraiser, Jason Messner, MAI, determined the value for the Mall as of January 2, 2005, to be $110,000,000, and the value of Von Maur as of that same date to be $10,000,000.

15. Respondent's appraiser found the value for the Mall as of January 2, 2006 to be $118,510,000 and the value of Von Maur as of that same date to be $10,500,000.

CONCLUSIONS OF LAW

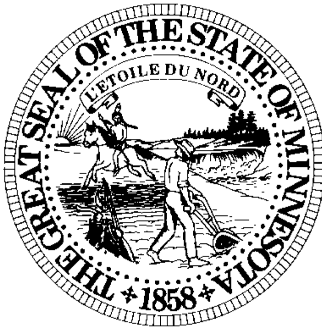
1. The assessor's estimated market value for the Eden Prairie Center subject property as of January 2, 2005, shall be increased on the books and records of Hennepin County from $90,000,000 to $122,876,000.

2. The assessor's estimated market value for the Von Maur Department Store subject property as of January 2, 2005, shall be increased on the books and records of Hennepin County from $8,913,000 to $9,850,000.

3. The assessor's estimated market value for the Eden Prairie Center subject property as of January 2, 2006, shall be increased on the books and records of Hennepin County from $100,000,000 to $120,142,000.

4. The assessor's estimated market value for the Von Maur Department Store subject property as of January 2, 2006, shall be increased on the books and records of Hennepin County from $9,408,000 to $10,490,000.

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



BY THE COURT,

Sheryl A. Ramstad, Judge
MINNESOTA TAX COURT

DATED: October 13, 2009

Memorandum

Background

At issue in these property tax appeals is the market value of Eden Prairie Center ("Mall") and Von Maur Department Store ("Von Maur") located in Eden Prairie, Minnesota and owned by Eden Prairie Mall LLC ("Petitioner") for the assessment dates January 2, 2005, and January 2, 2006 ("Assessment Dates"). The Hennepin County ("Respondent") Assessor placed a January 2, 2005 estimated market value on the Mall of $90,000,000 and on Von Maur of $8,913,000, and, a January 2, 2006 estimated market value on the Mall of $100,000,000, and on Von Maur of $9,850,000. For the reasons below, we find the value of the Mall as of January 2, 2005, is $122,876,000 and Von Maur is

$9,850,000. The value of the Mall as of January 2, 2006, is $120,142,000 and Von Maur is $10,490,000.

Facts

The Subject Properties are a super-regional shopping center located at 8251 Flying Cloud Drive, Eden Prairie, Minnesota ("Mall") and the attached department store located at 400 Prairie Center Drive, Eden Prairie, Minnesota ("Von Maur"). They are situated in the southeast quadrant of Interstate 494 and U.S. Highway 212 in an area mostly comprised of retail, restaurant, and office-type uses. The area has convenient access to Interstate 494 and State Highway 5, as well as fair proximity to U.S. Highways 169 and 212, and is the hub of commercial activity within the Eden Prairie and southwest metro area. Around the south and east sides of the Subject Property there are some residential property, a mixture of housing types, and a recently developed transit station.

The Mall is a two-level enclosed mall with a restaurant wing with separate entrances. It has approximately 90 retail spaces, a food court, and a 160,000 square foot entertainment center, which also includes a 77,500 square foot eight-screen movie theater and a Barnes and Noble Bookstore. The overall center, including all 5 anchors, is approximately 87 acres in land area, with the Mall comprising an approximately 35.38 acre irregularly shaped site. Von Maur is located on a 6.07-acre site.

The Mall was developed and constructed in 1975 by Homart, the development arm of Sears, Roebuck and Co., with steel and concrete framing and masonry exterior walls. It was originally constructed with two levels and two

anchor stores, Sears and Powers. In 1984, a third anchor, Target, was added along with minor remodeling to connect Target to the Mall via a pedestrian skyway. In 1989, the food court and Mall entry areas were remodeled and interior walking ramps between the first and second levels were replaced by escalators and elevators. In 1994, a fourth anchor, Kohl's Department Store, was added along with a minor addition to allow for connection to Kohls. In 1995, General Growth Properties, Inc. acquired Homart, and in 1997, Petitioner bought the Mall.

When General Growth Properties acquired Homart, the Mall was struggling. Between 2000 and 2002, Petitioner gutted the Mall, and all public common spaces and tenant spaces were rebuilt, along with the addition of an approximately 160,000-square foot two-level entertainment wing consisting of an 18-screen multi-plex AMC Movie Theater, Barnes & Noble Bookstore, and several full service restaurants. Additionally, Von Maur was added as the fifth anchor, along with a two-level, 375-stall parking ramp immediately adjacent to it. Petitioner's cost summary for the 2000 – 2002 renovation was approximately $95,500,000, with $18,600,000 in direct construction costs for the Mall, $5,200,000 for the food court, and $16,900,000 for the AMC Theater. Tenant construction allowances of approximately $19,580,000 were also reported.

After the 2000 – 2002 Mall renovations and Von Maur addition, retail sales at the Mall and Von Maur increased through the Assessment Dates even though Mervyn's closed in 2004 and remained vacant through the Assessment Dates. In December 2004, Petitioner purchased the former Mervyn's parcel from May Co. for $5,500,000, the same price May Co. paid to acquire the property in

August of 2004 from Target Corporation.

Von Maur is an owner-occupied department store building subject to a ground lease between Petitioner and Von Maur dated May 20, 1999. Petitioner constructed the building pad, parking lot, and parking deck and gave Von Maur a capital contribution of $11,000,000 to be used for actual costs of labor, materials, and permits in connection with the construction of the Von Maur store building. The terms of the ground lease provide for a percentage rent payment of 2% of net sales in excess of $20,000,000, as well as a contribution of $.25 per square foot for 150,000 square feet of gross leasable area for maintenance and operation of exterior common areas and the Mall, to Petitioner absent a "Mall Operating Failure." In the event a Mall Operating Failure continued for 24 months, Von Maur is relieved of the obligation to pay exterior common area and Mall maintenance, rent and taxes.

Burden of Proof

The assessor's estimated market value is *prima facie* valid. Once the petitioner presents evidence that shows that the assessor's market value is incorrect, the Court makes a determination of the market value of the property.[3] Petitioner may overcome this presumption by introducing credible evidence that the assessor's market value is incorrect. After considering all the evidence, the Court makes a determination based upon the preponderance of the evidence.[4] In this case, Petitioner presented sufficient evidence, through the testimony of its

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[3]Southern Minnesota Beet Sugar Coop. v. County of Renville, 737 N.W.2d 545, 558-60 (Minn. 2007).
[4]The Pep Boys v. County of Anoka, File Nos. C2-01-2780 et al. (Minn. Tax Ct. Oct. 26, 2004); Gregorich v. County of Anoka, File No. C6-02-4557 (Minn. Tax Ct. Oct. 8, 2003).

appraisal expert, to rebut the presumption.

Highest and Best Use

The highest and best use of a property as improved is the use that should be made of an improved property in light of the existing improvements.[5]

There is no issue concerning the highest and best use of the Mall and Von Maur. Petitioner's expert, David Lennhoff, MAI ("Mr. Lennhoff"), found the highest and best use of the property as vacant to be the development of a super-regional mall. Respondent's expert, Jason Messner ("Mr. Messner"), analyzed the Mall and Von Maur separately, and found that the highest and best use as vacant for the Mall site was for large-scale retail commercial development and for the Von Maur parcel was retail, mixed-use commercial development. We agree with Messrs Lennhoff and Messner that the subject parcels' current use is their highest and best use as if vacant. Both experts concluded that the existing improvements contribute substantially to the value and that it would not be maximally productive to raze the existing improvements for redevelopment, particularly in light of the recent construction of Von Maur and the over $100 million in capital improvements made to the Mall. The parties, therefore, agree, and we concur, that the highest and best use of the Mall and Von Maur as improved is to leave existing improvements as they currently exist and to continue operating as a super-regional retail mall and a department store anchor.

Valuation Methods

The assessor's estimated market value is *prima facie* valid.[6] Petitioner has the burden of proving that the market value of the subject property is excessive.[7]

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[5] The Appraisal of Real Estate, 287 (13th ed. 2008).

Petitioner may overcome this presumption by introducing credible evidence as to the subject property's market value. After considering all the evidence, the Court makes a determination based on the preponderance of the evidence.[8] This Court considers the three traditional approaches (cost, income, and sales) to determine market value as outlined in Equitable Life Assurance Society v. County of Ramsey.[9] The Court, however, is free to place greater or lesser emphasis on a particular method or methods of valuation.[10] The Minnesota Supreme Court has recognized that under certain circumstances, a single approach may be used to determine market value.[11] Although we have relied upon only one valuation method where the other two methods are unreliable according to the expert appraisers, we are cautious in using a single approach as a basis for valuation.[12]

Here, Mr. Messner and Mr. Lennhoff considered the three approaches to value. Mr. Messner used all three approaches to value the Mall and Von Maur properties, while Mr. Lennhoff used only the income approach. The experts differed significantly in their approaches to valuing the properties. Mr. Lennhoff valued the Mall and Von Maur together and then carved out the Von Maur value after concluding to a combined value. Mr. Messner valued the two parcels, the Mall and Von Maur, independently in separate reports. Ultimately, the original

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[6] Minn. Stat. § 271.06, subd. 6.
[7] Schleiff v. Country of Freeborn, 231 Minn. 389, 395-96, 43 N.W.2d 265, 269 (1960); Minnesota Entm't Enter. Inc. v. State, 306 Minn. 184, 186, 235 N.W.2d 390, 392 (1975).
[8] The Pep Boys; Gregorich.
[9] 530 N.W.2d 544, 552 (Minn. 1995).
[10] Carson Pirie Scott Co. (Ridgedale) v. County of Hennepin, 576 N.W.2d 445, 447 (Minn. 1998).
[11] See In Re McCannel, 301 N.W.2d 910 (Minn. 1980); Federal Reserve Bank of Minneapolis v. State, 313 N.W.2d 619 (Minn. 1981).
[12] See, e.g., Equitable Life Assurance Society v. County of Hennepin, File Nos. TC-13351 *et al.* (Minn. Tax Ct. Nov. 27, 1995).

assessed values in issue, along with the final opinions of value by the valuation experts, as testified to at trial, are as follows:

Mall	Assessor's EMV	Lennhoff	Messner
January 2, 2005	$ 90,000,000	$ 68,750,000	$110,000,000
January 2, 2006	$100,000,000	$ 60,550,000	$115,000,000

Von Maur	Assessor's EMV	Lennhoff	Messner
January 2, 2005	$ 8,913,000	$ 3,950,000	$10,000,000
January 2, 2006	$ 9,408,000	$ 4,750,000	$10,500,000

We turn now to each approach, first considering the appraisers' use of the sales comparison and cost approaches to valuing both the Mall. Because we find these approaches to be unreliable and do not rely upon them in reaching our conclusions of value, we consider them in the context of both properties. However, since we do rely upon the income approach in valuing the Mall and Von Maur, our discussion will separately consider application of this approach to each of the properties.

Sales Comparison Approach

Under the sales comparison approach, the appraiser evaluates sales of similar properties and adjusts for such factors as size, age, location, time of sale, terms of sale, land to building ratio, and quality of construction.[13]

[13] The Appraisal of Real Estate, 309-310 (13th ed. 2008).

On behalf of Respondent, Mr. Messner conducted a traditional sales approach analysis. He considered a cross-section of 17 sales made on a regional and national basis between January 2005 and early 2007. He made no adjustments to those sales, stating he lacked information needed to appropriately adjust those sales. Because the transactions he considered were complex, involving numerous tenants, differences in business climate dynamics and tax structures from state to state, and lack of detailed financial information, Mr. Messner acknowledged the shortcomings and reduced reliability of the sales comparison approach. Thus, Mr. Messner used his sales comparison analysis only as a cross-check of the other two approaches.

Petitioner's expert, Mr. Lennhoff, found the sales comparison approach inapplicable to the Subject Properties due to the lack of real property comparables. He opined that those transactions that do exist are of limited comparability due to the fact that the sales often involved bulk sales with the value allocated on an ad hoc basis, and there is also a lack of data necessary to extract the impact of the existing agreements, tenant concessions, and business components from the sales of going concerns. He indicated that super-regional mall transactions often involve special circumstances which render the sales non-arm's length transactions and thus, inappropriate for consideration in a sales comparison approach. Petitioner argues that the sales comparison approach is therefore unreliable due to the lack of information concerning appropriate comparable sales. We agree, as does Mr. Messner who indicated that he lacked information necessary to appropriately adjust the sales comparables he used.

Based upon the record, we agree with both Messrs Lennhoff and Messner that the sales comparison approach has too many shortcomings to be a reliable method in valuing the Mall. Even though Mr. Messner considered it in this case, we decline to do so with respect to the Mall but do use it as a cross-check in valuing Von Maur.

Cost Approach

The cost approach is based upon the proposition that an informed purchaser would pay no more than the cost of producing a substitute property with the same utility as the subject property. It is useful when the property being appraised involves relatively new improvements representing the highest and best use of the land, or when relatively unique or specialized improvements are located on the site for which there exist no comparable properties on the market. This approach is particularly applicable when land value constitutes a relatively high proportion of the overall property value.[14]

In the cost approach, market value is obtained by adding the estimated land value to the estimated replacement cost of the improvements, less any depreciation accruing to the improvements. Market value estimates for land are developed by comparing sales of vacant sites that are similar to the subject property and then adjusting the sales prices for time, location, physical characteristics and other relevant variations.[15]

Mr. Lennhoff considered but did not perform a cost approach analysis. In his view, the cost approach would be unreliable because the Mall is older

[14] The Appraisal of Real Estate,142 (13th ed. 2008).
[15] Supra.

construction with a high degree of obsolescence whereas the cost approach is most suitable to new or nearly new construction since depreciation and obsolescence deductions are highly subjective. He also rejected the cost approach due to the lack of land sale comparables.

Mr. Messner considered and performed a cost approach analysis, believing it to be a useful and reliable approach to valuing the Mall due to the extensive renovations that had been done three years prior to the first assessment date. He gave the cost approach secondary weight behind the income approach in valuing the Mall. Mr. Messner also considered the cost approach to be reliable for valuing Von Maur due to its relatively new construction, but he gave it minor weight due to the substantial level of external obsolescence.

Land Value

Because Mr. Messner deemed only one sale in Eden Prairie to be similar to the Subject Property in terms of location, zoning, and use, he expanded his consideration of land comparables to include smaller retail/commercial sites located in Eden Prairie and large commercial sites located throughout the Twin Cities metropolitan area. He valued the 1,541,153 square feet on which the Mall is situated, as well as the Von Maur site comprised of 264,409 square feet, by analyzing 16 land comparables, which included 6 small commercial retail sites in Eden Prairie and 10 large commercial retail sites. Mr. Messner then adjusted the land comparables for market conditions, location and physical characteristics,

arriving at an estimated value of $11.50 per square foot as of January 2, 2005, and $12.00 per square foot as of January 2, 2006, for both properties.

We agree with Petitioner that Mr. Messner's failure to include a land sales adjustment grid in his appraisal reports renders his land value analysis unreliable because we are unable to evaluate the adjustments he made to his comparable land sales to arrive at land values of $11.50 to $12.00 per square foot for both parcels.

Mall Improvements

Next, Mr. Messner used the Marshall Valuation Service to estimate the replacement cost new ("RCN') of the Mall improvements, selecting the Class A Regional Shopping Center category to establish the base cost. He chose the Good to Excellent quality categories based upon the substantial capital improvements recently made, giving more weight to the Excellent category. He also used the Class A Theaters: Cinema costs to refine the base cost attributable to the multi-screen movie theater. Based upon a weighted base cost of $139.23 as of January 2, 2005, from the Marshall Valuation calculator method and adjustments made for the HVAC costs and sprinklers, Mr. Messner arrived at an RCN of $86,072,998. Taking into account site improvement costs approximated at $3,835,000 for the parking lots, concrete areas and $1,723,333 for one third of the parking deck, Mr. Messner calculated the total RCN of the Mall less the indirect costs to be $91,631,331. He then added indirect costs of $1,225,000, as well as a 15% entrepreneurial profit to the total cost estimate to determine a final estimate of RCN before depreciation of $106,819,281 as of January 2, 2005.

Mall's Effective Age and Physical Depreciation

Mr. Messner opined that the Mall's 2001 renovation resulted in the Mall having an overall effective age of 10 years as of the January 2, 2005 assessment date. He estimated the useful life expectancy of the Mall's structural and mechanical components, which were not replaced during the 2001 renovation, to be 70 years. He estimated a weighted useful life of all the improvements at 50 years.

Petitioner argues that Mr. Messner's conclusion that the Mall had a 10-year effective age failed to take into account the actual physical age of the major structural components of the Mall, including the roof structure, foundation and sub-floors, plumbing, electrical systems, chillers, boilers, and the HVAC system, which were all 30 years old as of the Assessment Dates. Petitioner contends that Mr. Messner assumed the major structural components of the Mall have a useful life of 70 years without any supporting data and that this is inconsistent with Marshall Swift, which indicates the life expectancy of the long-lived components of a shopping center, is approximately 50 years. We agree that Mr. Messner's report and testimony lacked detail regarding the actual condition of the Mall's structural components to support his conclusion they could last another 30 to 40 years. His determination of effective age excludes analysis of a number of factors including the actual physical useful life, the rate at which the physical components of the improvements have worn out, the rate at which construction techniques have changed, and external considerations. Without a detailed analysis, we are unable to determine the Mall's effective age.

Functional Obsolescence

Mr. Messner concluded that the Mall had minimal functional obsolescence. Petitioner argues that the Mall has numerous outdated and limiting structural aspects, including an extensive basement with limited use, loading docks unable to accommodate today's larger trucks, and limited accessibility and visibility for the Kohls wing which has no external access. Because Mr. Messner failed to adequately consider or evaluate these characteristics, we cannot accept his conclusion that the Mall has minimal functional obsolescence.

Mr. Messner's Valuation Using Cost Approach

After taking into account curable and incurable physical deterioration and functional obsolescence, Mr. Messner determined the depreciated value of the improvements to be $84,127,600. He added the Mall land value of $17,720,000 to this figure to arrive at an indicated value for the Mall under the cost approach of $100,840,000 as of January 2, 2005. Mr. Messner then estimated the January 2, 2006, Mall market value under the cost approach by increasing the 2005 RCN by 3.78% and the effective age of the 2005 improvements by one year to arrive at an incurable physical deterioration rate of 22%. Because he opined that the market conditions for investment grade retail properties remained very strong as of January 2, 2006, he found no external obsolescence. He then added the January 2, 2006 land value of $18,490,000 to the depreciated value of the improvements, which was $84,127,600 to arrive at an indicated value for the Mall using the cost approach of $102,620,000 as of January 2, 2006.

As previously noted, there are several problems with Mr. Messner's cost approach analysis. These include: his 1) failure to adequately support the adjustments he made to his comparable land sales, 2) failure to analyze the Mall's structural components in arriving at its effective age, and 3) lack of consideration of the Mall's limiting structural aspects in reaching his conclusion that the Mall has minimal functional obsolescence. We, therefore, find that Mr. Messner's cost approach is flawed and give little weight to his conclusions in determining market value.[16]

Income Approach

The income approach to value attempts to find the market value by capitalizing the anticipated market level of rent less the market level of expenses. This provides the basis for capitalizing to market value.[17] It is based upon the principle that value is increased by the expectation of future benefits, or that value is the present worth of future benefits. This approach is particularly appropriate for valuing income-producing properties since the future benefits take the form of net income and possible capital gain at the end of the investment holding period. Both net annual income and anticipated future price may be discounted to a present worth figure by the capitalization and/or discounting process. In applying the income approach, an appraiser first estimates the net operating income from the property by deducting vacancy and collection loss, as well as operating expenses from potential gross income. Next, the appraiser

[16] Moreover, the Court is mindful that during Mr. Messner's testimony he acknowledged that he gave greater than 99% weight to the income approach and virtually no weight to the cost approach in his valuation of the Mall. See Tr. at 1211, lines 11-16.

[17] Space Center Ent., Inc. v. County of Ramsey, File Nos. C4-97-336, C4-98-3241 (Minn. Tax Ct. Nov. 4, 1999).

selects an appropriate cap rate based upon a market analysis and applies that rate to the anticipated net annual income.[18]

Both appraisers considered the income approach. They agreed that a buyer interested in the Mall would be purchasing the property for the income stream it produces. Accordingly, they relied primarily (and in Mr. Lennhoff's case, entirely) upon the income approach. The two experts, however, differed significantly in their methods of utilizing the income approach, making a direct comparison of their analyses challenging. Mr. Lennhoff valued the Mall and Von Maur together and carved out the Von Maur value after concluding to a combined value. Mr. Messner valued the two parcels independently in separate reports. While we agree with some of the adjustments Mr. Lennhoff made in his income approach, we adopt an approach more like that used by Mr. Messner in valuing the Subject Properties. Based upon our analysis and the adjustments we made, we conclude that the fair market value of the Mall is higher than either expert's appraised value.

Petitioner's Valuation of the Mall

Mr. Lennhoff utilized an income capitalization model of income approach analysis. He began his appraisal by looking at the entire going concern or total assets of the business. From there, he identified and valued the tangible and intangible assets of the property. He then made a number of adjustments to his calculation of net operating income deriving from the total assets of the business in order to arrive at the net operating income from the real estate alone.

[18] The Appraisal of Real Estate, 142-43 (13th ed. 2008).

First, Mr. Lennhoff determined the January 2, 2005 effective gross income to the total assets of the business (TAB) by considering the market rent at 100% occupancy and deducting 6% for vacancy and collection loss. He then added specialty leasing income attributable to the kiosks and retail merchandising units at the Mall and other income the Mall received when building out new tenant space, arriving at a total gross income to the TAB of approximately $15.8 million. Next Mr. Lennhoff accounted for the total expenses of the TAB, which included utilities and HVAC, common area maintenance, 3% management fee, general and administrative and some miscellaneous expense in order to arrive at the net operating income before adjustments of approximately $10.9 million. Once he got the net income to the total assets, he made deductions for tangible and intangible personal property to get the net income to the real property. He deducted for tenant improvements that he opined would not survive the tenants and miscellaneous revenues from strollers and lockers which had little real estate value to them in order to get to the effective gross income to the real property from which he deducted expenses to arrive at the net income to the real estate. Then Mr. Lennhoff deducted 7.55% for a return on and of furniture, fixtures and equipment (FF&E) for the food court, play area and carts, 8.55% for a return on and of start-up costs, and 8.55% for a return on and of favorable contracts to arrive at net income to the real property in the amount of approximately $7 million. In order to arrive at his final value for the Mall and Von Maur under the income approach, Mr. Lennhoff divided the net income to the real property by a capitalization rate which he determined based upon the fourth quarter of 2004

Korpacz Real Estate Investors Survey and the Real Estate Research Survey to be 8.5%. Finally, Mr. Lennhoff added 1.25% for the tax load to conclude to an 8.75% cap rate, resulting in a combined valuation for the Mall and Von Maur of $72,700,000 as of January 2, 2005, and of $65,300,000 as of January 2, 2006. To determine his valuation of the Mall, Mr. Lennhoff then carved out the value he attributed to Von Maur in2005 ($3,950,000) and 2006 ($4,750,000), resulting in his final valuations for the Mall as of January 2, 2005, at $68,750,000 and January 2, 2006, at $60,550,000.

Respondent's Valuation of the Mall

Mr. Messner used the direct capitalization method to the income approach. He opined that it was more appropriate than the discounted cash flow analysis in this case because the Mall was substantially renovated and expanded from 2000 to 2002 and most of the leases in place were signed during that time period. Because there was stabilized occupancy by the end of 2004, Mr. Messner concluded it was unnecessary to go through the discounted cash flow analysis.

After looking at the Mall's historical income and expenses, Mr. Messner evaluated the existing contract rents to see if there were in line with market rents. He determined that since the time when most of the Mall's leases were signed, rents and Mall sales had generally increased so that the actual rental income generated by the Mall was lagging market rents. Nevertheless, Mr. Messner ultimately utilized the existing income stream being generated by the Mall as the best estimate of its earning potential. For the 2005 valuation, Mr. Messner

focused on General Growth's forecast of just over $10 million for 2005 and continual increases through 2007 to just under $10.7 million. He concluded to a projected net operating income (NOI) for the Mall of $10 million as of January 2, 2005, from which he deducted a 2% management fee, a return to personal property of $300,000 and real estate taxes payable for 2005 for the Mall of $2,855,029. Mr. Messner loaded his 2005 cap rate of 7.5% with the entire tax rate for the Mall of 3.45%, thereby expensing the taxes paid by Petitioner to arrive at a total indicated value for the Mall as of January 2, 2005, of $111,405,374.Recognizing that there were about $800,000 in future costs projected to occur in 2008 for the replacement and upgrade of escalators, he deducted that amount to arrive at a market value for the Mall as of January 2, 2005, of $110,600,000. For the January 2, 2006 valuation, Mr. Messner started with the projected NOI of $10,300,000, from which he deducted a 2% management fee, a return to the personal property of $300,000 and 2006 real estate taxes paid for the Mall of $3,038,238. Mr. Messner loaded his 2006 cap rate of 7.25% with the entire tax rate for the Mall of 3.38% which took into consideration all real estate taxes paid by Petitioner. As with the 2005 valuation, Mr. Messner deducted $800,000 in deferred maintenance for escalator upgrades scheduled to occur in 2008, arriving at an indicated market value for the Mall as of January 2, 2006, of $118,510,000. He finally concluded to a value as of January 2, 2005, under the income approach of $110 million and as of January 2, 2006, he valued the Mall at $115 million.

Evaluating the Appraisers' Income Approach Methodologies

As previously noted, the different income approach methodologies used by Messrs Messner and Lennhoff make a direct comparison of their appraisals difficult. The following chart and discussion highlight some of their key differences:

Concept	**Lennhoff**	**Messner**
Landlord provided tenant allowances	Deduct as personal property	Do not deduct – part of real estate
Specialty Leasing Income	Deduct 50% as non-real estate related income	Include actual net specialty income
Cost of Occupancy	14% adjustment to revenue received	12% cost of occupancy reported by Petitioner
Start-Up Costs	Intangible asset amortized	Recover investment upon sale: Do not deduct from DCF
Capitalization Rate	8.75% for 2005 and 8.5% for 2006	7.5% for 2005 and 7.25% for 2006
Management Fee	Deduct 3% prior to capitalization	Deduct 2% prior to capitalization
Furniture, Fixtures and Equipment	Actual historical costs used	Market value of FF&E used

Tenant Improvements

Tenant allowances refers to an amount that some, but not all, tenants at received from the landlord to help pay for interior finishing.[19] Mr. Lennhoff

[19] Approximately 55 of the 80 permanent tenants received a tenant improvement allowance.

amortized the tenant improvement allowances, whereas Mr. Messner and Mark T. Kinney ("Mr. Kinney"), MAI, an expert in the case who conducted an appraisal review of Mr. Lennhoff's work, testified that amortizing the tenant improvement allowances understated the Mall's revenue. We agree with Respondent that Mr. Lennhoff's methodology artificially reduces the actual rental income by deducting the amortized tenant improvements. An adjustment for tenant improvements is inappropriate because the allowances had already been spent prior to the dates of the valuations. As a result, Mr. Lennhoff arrived at the amount of $8,076,217 in Mall revenue for 2005, compared to what the owner actually received in cash revenue of $9,385,935. Again in 2006, the Mall generated $9,284,278 in actual rents received while Mr. Lennhoff calculated it at $8,002,000.92. Consequently, Mr. Lennhoff's figures for each of the Assessment Dates were approximately $1.3 million less than the actual rents received, resulting in a lower market value for the Mall.

Specialty Leasing

Mr. Lennhoff made an adjustment for the income derived from specialty leasing, which is the income derived from leasing the Mall's kiosks, retail marketing units, carts, and temporary in-line stores ("TILS"). He reduced the income derived from specialty leasing by 50% because of an analysis he had previously done of two malls, not including the subject property. However, Mr. Lennhoff provided no underlying data or explanation as to the prior malls he had evaluated, and he did no analysis of the Mall's specialty leasing which would justify a 50% adjustment to income. Based upon the lack of underlying data

supporting the 50% reduction, we cannot accept this as an appropriate adjustment in Mr. Lennhoff's income approach. We agree with Respondent that specialty leasing should be handled by including actual specialty leasing income for the Mall and then deducting business-related expenses to get the actual net specialty leasing income.

Cost of Occupancy

Mr. Lennhoff adjusted the specialty leasing revenue for intangibles Based upon a 14% cost of occupancy. He also adjusted revenue from stroller rental, telephone, vending, sprinkler and locker income based upon a cost of occupancy of 14%. However, the costs of occupancy in Property Sales and Occupancy Cost reports show Petitioner's cost of occupancy to be at or under 12% in 2005 and 2006. We question Mr. Lennhoff's higher costs of occupancy figures based upon the cost of occupancy percentages Petitioner reported.

Start-up Costs for 2001 Mall Re-opening

Mr. Lennhoff amortized the 2001 Mall re-opening costs of $623,326 over 12 years. Respondent argues that start-up costs are a one-time expense and therefore would not be a factor considered by a reasonably prudent buyer. We agree. Inasmuch as there had been only one, the 2001 event, Mr. Lennhoff's expectation of the recurrence of a grand-opening was not supported by the Mall's history, and the Mall reopening costs should, therefore, not have been amortized over a 12-year period.

Capitalization Rate

Mr. Messner determined that the Mall was a high Class B+/low Class A mall, while Mr. Lennhoff found it to be a Class B property. As a result, Mr. Messner concluded to a 7.5% capitalization rate for the Mall whereas Mr. Lennhoff used an 8.72% capitalization rate. They both used the Price Waterhouse Cooper Korpacz Real Estate Investor Survey publication ("Korpacz") as a basis for arriving at their capitalization rates. The difference between their cap rates, however, is that Mr. Messner did not add the AMC theater sales figures to the in-line retail shop sales figures and Mr. Lennhoff did. Respondent contends that adding the AMC theater sales to the in-line retail sales caused the retail sales figures to be understated because theaters generate lower sales per square foot than the in-line stores. By including the theater sales, Mr. Lennhoff therefore found the Mall to be a lower class property, resulting in a higher capitalization rate.

We agree with Messrs Messner and Kenney that Mr. Lennhoff's addition of the AMC theater sales was inappropriate. Mr. Kenney testified that it is customary in the industry to omit sales associated with a theater. Had Mr. Lennhoff done so, he would have found the Mall's 2005 sales calculation to be $335 per square foot rather than $285 per square foot. This figure is corroborated by the average retail sales figures for the in-line shops which the Mall itself reported, which were to $311 per square foot in 2004, $337 per square foot in 2005, $346 per square foot in 2006 and $350 per square foot in 2007. Thus, the Mall's retail sales figures support Mr. Messner's analysis and

classification of the Mall as a B+ mall. We, therefore, find that Mr. Messner appropriately relied upon Petitioner's reported year-end total in-line sales, using only in-line retail sales (Mall shops) without adding the AMC theater sales in determining the cap rates to be 7.5% for 2005 and 7.25% for 2006.

Management Fee

Both experts agreed that generally accepted appraisal practice requires the deduction of a management fee under the income approach. They disagree, however, as to quantification of the market-based amount. Mr. Lennhoff used 3% of the revenue derived from the real estate based upon input from Petitioner's representatives who indicated they typically charge 3 to 4% management fee in their private contracts where they manage but do not own a mall. He also considered Korpacz, which suggested management fees in the 2-1/2 to 4-1/2 % range in deciding to use a management fee of 3%. Mr. Messner, on the other hand, used a figure equal to 2% of revenue based upon a review of the publication Dollars & Cents of Shopping Malls. We accept Mr. Lennhoff's 3% management fee as appropriate for the Mall.

Furniture, Fixtures and Equipment

Mr. Lennhoff used historical cost instead of the market value of the furniture, fixtures and equipment in his income approach to value. We agree with Respondent that the furniture, fixtures and equipment have depreciated since 2001 so that Mr. Lennhoff's approach resulted in overstating the assets and deduction. Thus, we find that it would be appropriate to use the market value rather than the historical cost.

Valuation Using Income Approach

For the reasons stated above, we do not accept Mr. Lennhoff's adjustments to NOI for the tenant improvement allowance of $1,512,603 and 50% of the specialty leasing. Moreover, we find that the Mall should be categorized as a class B+ mall, thereby resulting in a cap rate of 7.5% for 2005 and 7.25% for 2006. After making our adjustments, we find Mr. Lennhoff's values under the direct capitalization approach to be significantly higher than Mr. Lennhoff's 2005 market value of $68,750,000 and 2006 market value of $60,550,000 for the Mall. Recalculating Mr. Lennhoff's 2005 valuation with these adjustments results in a market value for the Mall of $122,876,142 for 2005 and $120,142,000 for 2006.

January 2, 2005

Income			
Minimum Rent-in-Line+AMC		$	9,588,820
Less Vacancy & Credit Loss @	6%	$	575,329
Effective Gross *Minimum-Rent-Inlines*		$	8,945,000
Overage Rent		$	
Specialty Leasing		$	1,925,000
Other Income			$ 96,000
Total Base Rent		$	10,966,000
Expense Recoveries			
CAM		$	2,375,000
Real Estate Taxes			
Utilities, HVAC, etc.		$	1,850,000
Other-Food Court		$	87,000
Miscellaneous Revenue		$	75,000
Total Revenue		$	15,353,000
Expenses			
Reimbursable			
CAM		$	2,650,000
Other-Food Court		$	258,000

Real Estate Taxes			
Personal Property Tax			
Utilities & HVAC	$	1,350,000	
Owner's (Non-reimbursable)			
Management Fee (Including Shared Leasing Fees)	$	460,590	3%
General & Administrative	$	145,000	
Bad Debt			
Total Expenses	$	4,863,590	
Net Operating Income	$	10,489,410	

Income to Real Property

Cap Rate to Real Property			
Real Property Rate			7.50000%
Tax Load	30.0%	3.455239%	1.03657%
			8.53657%

Value as of January 2, 2005 **$122,876,142.**[20]

January 2, 2006

Income			
Minimum Rent-in-Line+AMC		$	9,515,505
Less Vacancy & Credit Loss @	6%	$	570,930
Effective Gross *Minimum-Rent-Inlines*		$	8,945,000
Overage Rent		$	
Specialty Leasing		$	2,070,000
Other Income		$	96,000
Total Base Rent		$	11,111,000
Expense Recoveries			
CAM		$	2,400,000
Real Estate Taxes			
Utilities, HVAC, etc.		$	1,500,000
Other-Food Court		$	100,000
Miscellaneous Revenue		$	100,000
Total Revenue		$	15,211,000
Expenses			
Reimbursable			
CAM		$	2,658,000
Other-Food Court		$	265,000

[20] Respondent's Post Trial Brief, p. 42.

Real Estate Taxes			
Personal Property Tax			
Utilities & HVAC		$ 1,700,000	
Owner's (Non-reimbursable)			
Management Fee (Including Shared Leasing Fees)		$ 456,330	3%
General & Administrative		$ 205,000	
Bad Debt			
Total Expenses		$ 5,284,330	
Net Operating Income		$ 9,926,670	
Income to Real Property			
Cap Rate to Real Property			
Real Property Rate			7.25000%
Tax Load	30.0%	3.374732%	1.01242%
			8.26242%
Value as of January 2, 2006		**$120,142,410.**[21]	

Von Maur Valuation

By allocating the total values for the combined Mall and Von Maur, Mr. Lennhoff determined Von Maur's value as of January 2, 2005, to be $3,950,000 and as of January 2, 2006, to be $4,750,000. He considered only the income approach in reaching his valuation. Using all three approaches to valuation, Mr. Messner found the value of Von Maur as of January 2, 2005, to be $10,000,000 and as of January 2, 2006, to be $10,500,000.For the reasons previously noted when considering the Mall, we place no reliance upon Mr. Messner's cost approach in valuing Von Maur, but we do consider the sales comparison approach as a cross-check to the values we arrive at under the income approach.

[21] Respondent's Post Trial Brief, p. 43.

With respect to their income approach analyses, the experts differed most significantly on three points: market rent, gross leasable area, and the cap rate. We will address each of these areas next.

Market Rent

The Von Maur department store is owned by the tenant subject to a ground lease with rent set at 2% of net sales in excess of $20,000,000 plus CAM based upon 150,000 square feet and real estate taxes. The actual lease does not provide an indication of the market rent for the Von Maur building because it is a ground lease. Therefore, rent comparables and other market indicators were analyzed by the experts.

Mr. Lennhoff relied upon six leased anchor stores located in Virginia, which he identified as sales contemporaneous with the Assessments Dates, to support his conclusion of market rent for Von Maur at $3.00 per square foot for 150,000 square feet or $450,000 for 2005. He also considered Dollars & Cents of Shopping Centers, 2004, rental rates for the United States as a whole, which averaged 1.9% of sales, and in the Midwest where they averaged 1.7% of sales. He calculated $3.00 per square foot based upon 2% of the $22,500,000 in 2005 sales he projected for Von Maur and then increased his estimated market rent to $3.53 per square foot for January 2, 2006, using 2% of a projected sales amount of $26,500,000.

Respondent argues that Mr. Lennhoff's $22,500,000 in projected sales for 2005 and $26,500,000 in 2006 were significantly below the actual sales of $24,221,348 in 2005 and $27,812,754 in 2006. Further, Respondent points out

that Mr. Lennhoff's unadjusted comparable market rent data from the six comparables he used averaged $4.24 per square foot, which was substantially more than the $3.00 per square foot he used to determine the January 2, 2005 market rent for Von Maur. Finally, Respondent argues that because Mr. Lennhoff was unable to identify the tenants in stores, the malls where the stores were located, whether there was overage rent paid, whether the leases were renewals, when the leases were signed, or the type of merchandise sold in the stores, the comparables should be rejected.

Mr. Messner looked at five market rent comparables with leases signed between 2004 and 2006 in his analysis of Von Maur's market rent. The comparables were the former Mervyn's at the same Mall, two other former Mervyn's connected to other malls in the Twin Cities (Burnsville and Blaine) and two Kohl's stores (one free-standing and the other connected to a mall). Overall, the comparable leases ranged from $3.83 per square foot to $7.73 per square foot, with an average of $5.07 per square foot. He adjusted his rent comparables for market conditions, size, location and age/condition to arrive at a January 2, 2005 adjusted rent of $5.25 per square foot. Mr. Messner also looked at data from Dollars & Cents of Shopping Centers to conclude to an estimated market rent based on 3% of weighted Von Muar actual sales of $26,301,103 in 2005 and $29,414,200 in 2006 or $4.78 per square foot and $5.35 per square foot, respectively. He finally reconciled the two sets of data to arrive at an estimated rent of $5.25 per square foot for January 2, 2005, and $5.40 per square foot for January 2, 2006.

We agree with Mr. Messner's analysis and choice of comparables in determining the appropriate level of market rent for Von Maur. While Mr. Lennhoff identified several rent comparables in his appraisal report, he could not provide any data regarding them from which we could evaluate them. We find it disingenuous that after being unable to respond to questioning on these comparables, he ultimately stated that he did not rely upon them. Moreover, his formula for determining market rent by taking 2% of the Von Maur sales he projected resulted in lower figures than had he used Von Maur's actual weighted sales for 2005 and 2006. We further find that Mr. Messner's market rent comparables were appropriate and his adjustments supported by the evidence. Thus, we use the estimated market rents of $5.25 per square foot for January 2, 2005, and $5.40 per square foot for January 2, 2006, when determining Von Maur's value.

Gross Leasable Area

The second major difference between the experts' valuations of Von Maur relates to the store's gross leasable area. Both Messr Lennhoff and Messner used a gross *building* area of approximately 165,000 square feet for Von Maur. Mr. Lennhoff used a gross *leasable* area of 150,000 square feet based upon the ground lease which states that the building will contain "approximately 150,000 square feet of Gross Leasable Area." Mr. Messner used a gross *leasable* area of 161,203 square feet, which was based upon the gross leasable area minus rotunda space of 3,848 square feet. We agree with Respondent that the definition of "gross leasable area" should exclude the area of the rotunda where

there is no second floor and, therefore, find that Von Maur has a gross leasable area of 161,203 square feet.

Capitalization Rate

Finally, the experts differed in the cap rates they used under the income approach to valuing Von Maur. Mr. Lennhoff concluded to a 10.5% cap rate, whereas Mr. Messner used cap rates of 7.75% for the January 2, 2005 valuation and 7.5% for the January 2, 2006 valuation.

Mr. Lennhoff's choice of a cap rate for Von Maur started with his base rate for the Mall of 8.5% to which he added 200 basis points for additional risk, resulting in a 10.5% cap rate for the January 2, 2005 valuation. He based his risk conclusion on the vacancy of one of five Mall anchors (Mervyn's) and because he viewed a single tenant anchor department store to be riskier than a stabilized multi-tenant mall. As discussed previously, we do not accept Mr. Lennhoff's cap rate for the Mall. Moreover, his rationale for concluding Von Maur is riskier ignores the fact that sales at Von Maur and the Mall increased annually even though the Mervyn's space was vacant. Thus, the record does not support a 200 basis point risk increase in the cap rate for Von Maur.

Mr. Messner's cap rate for Von Maur was derived from market sales of single tenant retail properties, shopping center sales and Korpacz survey reports. He pointed out that because all the department store comparables were vacant at the time they were sold, it was not possible to derive a capitalization rate out of the market for those sales. Thus, he averaged a number of single tenant retail property sales with cap rates ranging from 6.8% for Kohl's in Waite Park to

8.16% for Cub Foods in St. Anthony, arriving at a cap rate of 7.44%. Recognizing that these sales were not department stores, Mr. Messner next looked at eight shopping center sales during the assessment period, finding a range of cap rates from 5.21% for the Maplewood Town Center to 9.1% for Fisher Marketplace in Apple Valley, for an average of those being 7.51%. Based upon the information he had gathered, and considering the average Korpacz cap rates for regional malls (7.48%) and power centers (7.97%), as well as the RERC reported range of 6.8 to 8%, Mr. Messner concluded to a cap rate of 7.75% for January 2, 2005 and 7.5% for January 2, 2006.

Petitioner challenges Mr. Messner's analysis, contending that he relied upon several single tenant retail stores unlike Von Maur because they were not anchor stores attached to super regional malls. Petitioner also argues that Mr. Messner's analysis is flawed by his failure to identify or quantify the differences in risk associated with free-standing single tenant retail stores. We find, however, that Mr. Messner's conclusions regarding the appropriate capitalization rates to apply to Von Maur were not only based upon single tenant retail stores but also took into account shopping center sales, as well as recognized Korpacz and RERC data. Considering the various sources upon which he relied and looking at the comparables he chose, we find that an appropriate capitalization rate for Von Maur as of January 2, 2005, is 7.75% and for January 2, 2006, is 7.5%.

Based upon the preceding analysis, the indicated market value for Von Maur under the income approach is calculated as follows:

January 2, 2005

Potential Net Income:		
Gross Leasable Area 161,203 SF x $5.25/SF =		$846,316
Less Vacancy & Credit Loss at 4%		(33,853)
Effective Net Income:		$812,463
Less: Operating Expenses		
Vacancy Expenses		
161,203 SF x 4% x $.35/SF	$ 2,257	
Reserves for Replacement	$16,120	
$161,203 SF x $.10/SF		
Management Expense		
$812,463 x 2%	$16,249	
Net Operating Income		$777,837
Capitalization Rate		7.75%
Effective Tax Rate 3.44%		
Adjusted for Vacancy x 4%		
Adjustment to the cap rate for real estate taxes		0.14%
Real estate adjusted Capitalization Rate		7.89%
Indicated Market Value		
$777,837 / 7.89%		= $9,859,517

January 2, 2006

Gla 161,203 sf X $5.40/sf =		$870,496
Less Vacancy & Credit Loss @ 4% =		(34,820)
Effective Net Income		$835,676
Less Operating Expenses		
Vacancy Expenses (excluding RE tax)		
161,203 SF x 4% x $.39/SF =	$2515	
Reserves for Replacement		
161,203/SF x $.10/SF	= 16,120	
Management Expense		
$835,676 x 2%	= 16,714	(35,349)
Net Operating Income		$800,327
Capitalization Rate		7.50%
Effective Tax Rate	3.36%	
Adjusted for Vacancy	x 4%	
Adjustment to cap rate for RE Taxes		0.13%
Real estate tax adjusted Cap Rate		7.63%
Indicated Market Value	$800,327/ 7.63% =	$10,489,214

Mr. Messner's Sales Comparison Approach to Valuing Von Maur

Mr. Messner used the sales comparison approach to value Von Maur, identifying other sales of large department or anchor stores that had sold within the Twin Cities area close to the Assessment Dates. Relying upon six

comparables which were all former Mervyn's stores, he adjusted these sales upward 5% for condition of sale in recognition that at the time these properties sold, there was an atypical amount of available space on the open market. He made a 5% annual adjustment for time to account for changes in market conditions, but this was minimal since the sales were all relatively close to the Assessment Dates. Mr. Messner also adjusted for age and condition because he considered Von Maur to be superior to all of the comparables. As for size, he adjusted Comparables Nos. 5 and 6 because they were substantially smaller than Von Maur. He made locational adjustments based upon the five-mile radius demographic information he analyzed. Most notably, he did not make adjustments to the former Mervyn's at the Mall since it is located next to Von Maur or to the Roseville Mervyn's which he considered similar to Von Maur in location. He made a downward adjustment to Southdale, upward adjustment to Burnsville, a more significant upward adjustment to Maplewood and a slight downward adjustment to the Woodbury location. With respect to the land area, he adjusted the comparables to account for Von Maur's lower land-to-building ratio but made a somewhat offsetting adjustment to account for Von Maur's parking ramp. Finally, Mr. Messner made an adjustment downward 5 percent to the Southdale Mervyn's because of the value contributed by its basement space. After making these adjustments, Mr. Messner concluded to a $60 per square foot market value or a fair market value of $9,900,000 for January 2, 2005, and $62 per square foot for a fair market value of $10,230,000 as of January 2, 2006, under the sales comparison approach.

Mr. Lennhoff did not use the sales comparison approach to value Von Maur. Petitioner argues that Mr. Messner's approach is flawed because all but two of the comparables were purchased by mall owners based upon a right of first refusal so they arguably reflect prices paid by captured buyers who benefited from the acquisition. Further, Petitioner contends that since two of the other sales relied upon by Mr. Messner were a package sale, and buyers often pay a premium for package sales, they are of doubtful reliability as well. Moreover, Petitioner challenges Comparable No. 5, the former Mervyn's in Tamarack Village, because it is not attached to a super-regional mall as the Von Maur store is. These considerations arguably affect the weight to be given Mr. Messner's sales comparison approach.

While we do not rely upon the sales comparison approach in valuing Von Maur, we do consider it as a cross-check of the income approach to valuation.

Summary and Conclusion of Final Value

The experts' final valuations are dramatically different. Both parties question the reliability and accuracy of the other's expert. We note that both appraisals had problems that were corrected or addressed at trial. As we have stated previously, "the quality of the work, the adherence to relevant meaningful industry standards, the witness's comportment and persuasiveness on the stand, their candor and ability to explain their analyses are among the significant factors in determining credibility." [22] We find it more helpful when the parties focus on

[22] Space Center Enterprises, Inc. v. County of Ramsey, File Nos. 97-3360, C4-98-3241 (Minn. Tax Ct. Nov. 4, 1999); Paddock Properties v. County of Hennepin, File Nos. 279771 and 28803 (Minn. Tax Ct. Sept. 19, 2002) and Johnson Mathey Advanced Circuits, Inc. et al v. County of Wright, File Nos. C7-00-869, C9-01-981, C5-01-2954 (Minn. Tax Ct. May 22, 2003).

those facts or theories relevant to the case rather than upon the experts themselves.

We also caution the parties in the future to heed Minnesota Tax Court Rule of Procedure 8610.0070, subd. 7, as applied, which provides that: ″No memorandum of law…may exceed 35 pages…except with permission of the tax court…If a reply memorandum of law is filed, the cumulative total of the original memorandum and the reply memorandum must not exceed 35 pages, except with permission of the tax court.” While we acknowledge that the rule on its face specifies its application in dispositive or nondispositive motion practice, we typically prefer counsel limit their post-trial memoranda to 35 pages as well. In this case, the parties filed a total of 133 pages of post-trial memoranda, with each party separately submitting over 60 pages.

Both experts put weight on the income approach, which was the only valuation method they had in common. The differences between Mr. Messner's and Mr. Lennhoff's final opinion of value under the income approach are significant. The disparity in opinion of value derives largely from the adjustments made in the analyses prepared by each, as well as differences in their approaches to valuation. We do not accept the final opinions of value presented by either appraiser, but rather, rely upon the testimony and appraisals of the experts to assist us in our determination of value. The issue is: What would a willing, knowledgeable purchaser pay a willing seller for the property on the assessment dates? Our task is to determine, from the evidence, the market value of the Mall and Von Maur on January 2, 2005, and January 2, 2006.

While we consider all three approaches, we give the income approach the most weight. We find Mr. Messner's cost approach to be flawed. We further find the sales comparison approach is of little help except as a cross-check for the Von Maur valuation. While we prefer to use more than one approach in valuing a property, when one approach is more reliable than the others, we may rely upon that approach.[23] Here, we rely upon the income approach in arriving at our final valuations, given the problems with the cost and sales comparison approaches, but, we consider the sales comparison approach as a cross-check for the Von Maur valuation.

After making appropriate adjustments for the reasons stated above, we find the market value for the Mall to be higher than that determined by either of the appraisers. We find the Mall's value as of January 2, 2005, to be $122,876,000 and $120,142,000 as of January 2, 2006. Finally, we find the value for Von Maur to be $9,850,000 as of January 2, 2005, and the value for Von Maur to be $10,490,000 as of January 2, 2006.

S. A. R.

[23] Carson Pirie Scott Co. (Ridgedale) v. County of Hennepin, 576 N.W.2d 445, 447.