IN THE CIRCUIT COURT OF THE THIRTEENTH JUDICIAL CIRCUIT, IN AND FOR HILLSBOROUGH COUNTY, FLORIDA
CIVIL DIVISION

CVS CORPORATION; CVS PHARMACY, INC.; CVS NEW YORK, INC.; CVS IN DISTRIBUTION INC.; HOLIDAY CVS, L.L.C., and its Affiliates,

Plaintiffs,

v.

ROB TURNER, as Property Appraiser for Hillsborough County, Florida; DOUG BELDEN, as Tax Collector for Hillsborough County, Florida; and FLORIDA DEPARTMENT OF REVENUE,

Defendants.
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CONSOLIDATED
CASE NOS.: 07-008515
08-010799
09-020997
10-009490

DIVISION: H

FINAL JUDGMENT

THIS CAUSE came before the Court for trial on April 16-19, 2012. The trial covered four consolidated cases related to Plaintiffs' challenge of the ad valorem tax assessments on approximately forty CVS stores in Hillsborough County for tax years 2006 through 2009. Post-trial, the Court requested, and the parties submitted, proposed findings and judgments. The parties returned before the Court on October 8, 2012, to argue in support of their proposed judgment and in opposition to the judgment submitted by the other side. On October 8, 2012, the parties advised the Court that informal negotiations and attempts at settlement were anticipated in the future. Accordingly, the parties requested that the Court delay entry of a final judgment pending the results of the settlement attempts. Having now been notified by the parties that post-trial settlement was unsuccessful, and having considered the testimony and evidence as well as the arguments of counsel for both sides, the Court file, and applicable law, the Court makes the following **FINDINGS OF FACT** and **CONCLUSIONS OF LAW**:

History of the Case

This case is a challenge by CVS Corporation, CVS Pharmacy, Inc., CVS New York, Inc., CVS IN Distribution Inc., and Holiday CVS, LLC (collectively "CVS") under section 194.301, Florida Statutes, to the ad valorem property tax assessments placed on its properties by the Hillsborough County Property Appraiser ("Property Appraiser"). The tax years involved are 2006 through 2009. There are approximately 40 separate CVS locations involved for each tax year.[1] *See* attached **Exhibit A**. The properties fall into two categories: (1) currently operating CVS freestanding drug store properties; and (2) former freestanding drug store properties, not currently operating as drug stores. (T. 273). The second category, sometimes referred to throughout the proceedings as "second-generation" stores, consists primarily of former Eckerd drug store locations acquired by CVS.

CVS contends that the Property Appraiser over-assessed the subject properties in each of the four years. As to the properties currently operating as drug stores, CVS contends that the over-assessments result primarily from too narrow of a classification of the properties as drug stores. CVS asserts that this classification improperly values the tenant and use of the properties as opposed to properly taxable physical characteristics of the properties themselves. CVS asserts that both the currently operating drug stores and the second-generation stores should be classified as general commercial properties and assessed accordingly. CVS further contends that the over-assessments on all the properties resulted from the Property Appraiser using improper valuation methodology and failing to comply with Florida law governing ad valorem tax assessments.

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[1] CVS' proposed final judgment provides an excellent synopsis of the precise procedural history of this consolidated litigation which began as four separate suits challenging the assessments on various locations during four separate tax years. Except as it relates to the statutory changes for tax year 2009, addressed further in this Judgment, the Court chose not replicate the history for brevity purposes, but appreciates the detail that went into both parties' proposed findings and judgments.

The Property Appraiser responds that the classification of the highest and best use of the currently operating drug store properties as drug stores and of the second-generation stores under categories such as bank branch or auto parts store, is not too narrow. The Property Appraiser further responds that the assessments were properly reached according to governing law and the valuation approach resulted in a proper value for each of these properties.

Findings of Fact and Conclusions of Law

I. Witnesses

CVS presented the testimony of four witnesses: Lee Lapierre, Lee Pallardy, MAI, Barry Diskin, Ph.D., MAI, and David Lennhoff, MAI. Lee Lapierre is the in-house property tax manager for CVS. Lee Pallardy, MAI, appraised all but one of the properties for each tax year at issue.[2] Barry Diskin, Ph.D., MAI, and David Lennhoff, MAI, each testified as to methodology issues. The Hillsborough County Property Appraiser presented the testimony of three witnesses: Tim Wilmath, MAI, Peter Korpacz, MAI, and Lawrence Jay, MAI. Tim Wilmath, MAI, testified as both a fact and expert witness, first as to how the assessments were determined, and secondly as to appropriate methodologies for valuing drug stores. Peter Korpacz, MAI, testified as to appropriate methodologies for valuing drug stores. Lawrence Jay, MAI, appraised most of the properties for each tax year at issue.[3]

II. Property Tax Law

All property in Florida is to be assessed at "just value." Art. VII, § 4, Fla. Const. Just value is synonymous with "fair market value." *Walter v. Schuler*, 176 So. 2d 81, 85-86 (Fla. 1965). Just value/fair market value is defined as,

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[2] Lee Pallardy did not appraise the property located at 15499 N. Dale Mabry Highway for tax year 2006, nor did he appraise the property located at 4820 S. Himes Ave. for tax year 2009.

[3] Lawrence Jay did not appraise the property located at 6701 N. Dale Mabry Highway for tax years 2006 through 2009, nor did he appraise the property located at 704 W. MLK Blvd. for tax year 2009.

> The price at which a property, if offered for sale in the open market, with a reasonable time for the seller to find a purchaser, would transfer for cash or its equivalent, under prevailing market conditions between parties who have knowledge of the uses to which the property may be put, both seeking to maximize their gains and neither being in a position to take advantage of the exigencies of the other.

Fla. Admin. Code R. 12d-1.002(5). The Property Appraiser must assess property at 100% of fair market value, not some lesser percentage. *Walter*, 176 So. 2d at 85. Further, only the unencumbered fee simple value is to be used in preparing property tax assessments. *See, e.g.*, *Department of Revenue v. Morganwoods Greentree, Inc.*, 341 So.2d 756, 758 (Fla. 1976). In *Morganwoods*, the Florida Supreme Court stated:

> We reaffirm the general rule that in the levy of property tax the assessed value of the land must represent all the interests in the land. This means that despite the mortgage, lease, or sublease of the property, the landowner will still be taxed as though he possessed the property in fee simple.

Id. (citations omitted). All property must be assessed according to its value as of January 1 of the tax year at issue. *See* § 192.042(1), Fla. Stat.

The core issue to be decided in these consolidated cases is whether these properties were assessed at values in excess of their just or fair market value as defined by Florida law. Art. VII, § 4, Fla. Const. In making that determination, the Court must determine initially whether the assessments were prepared by the Property Appraiser in accordance with the requirements of section 193.011, Florida Statutes and other applicable Florida law.

In arriving at just valuation, the Property Appraiser is required to consider each of the following factors under section 193.011, Florida Statutes:

(1) The present cash value of the property, which is the amount a willing purchaser would pay a willing seller, exclusive of reasonable fees and costs of purchase, in cash or the immediate equivalent thereof in a transaction at arm's length;

(2) The highest and best use to which the property can be expected to be put in the immediate future and the present use of the property, taking into

consideration the legally permissible use of the property, including any applicable judicial limitation, local or state land use regulation, or historic preservation ordinance, and any zoning changes, concurrency requirements, and permits necessary to achieve the highest and best use, and considering any moratorium imposed by executive order, law, ordinance, regulation, resolution, or proclamation adopted by any governmental body or agency or the Governor when the moratorium or judicial limitation prohibits or restricts the development or improvement of property as otherwise authorized by applicable law. The applicable governmental body or agency or the Governor shall notify the property appraiser in writing of any executive order, ordinance, regulation, resolution, or proclamation it adopts imposing any such limitation, regulation, or moratorium;

(3) The location of said property;

(4) The quantity or size of said property;

(5) The cost of said property and the present replacement value of any improvements thereon;

(6) The condition of said property;

(7) The income from said property; and

(8) The net proceeds of the sale of the property, as received by the seller, after deduction of all of the usual and reasonable fees and costs of the sale, including the costs and expenses of financing, and allowance for unconventional or atypical terms of financing arrangements. When the net proceeds of the sale of any property are utilized, directly or indirectly, in the determination of just valuation of realty of the sold parcel or any other parcel under the provisions of this section, the property appraiser, for the purposes of such determination, shall exclude any portion of such net proceeds attributable to payments for household furnishings or other items of personal property.

Section 193.011, Florida Statutes, does not require the Property Appraiser to *use* all eight criteria in reaching its assessment, but rather, only requires the Property Appraiser to *consider* each factor. *See, e.g., Wal-Mart Stores, Inc. v. Todora*, 791 So. 2d 29, 30 (Fla. 2d DCA 2001).

When a taxpayer brings a circuit court proceeding challenging a tax assessment, the matter is to be heard de novo by the circuit court, and the initial burden of proof is on the party initiating the action, in this case, CVS. § 194.036(3), Fla. Stat. (1995). Section 194.301, Florida

Statutes, governs the trial of an ad valorem tax challenge and lays out what the party challenging the assessment, as well as what the party defending the assessment, must prove.

There was an "old" version of section 194.301 in effect for tax years 2006, 2007, and 2008. The current version of section 194.301 became effective for tax year 2009.[4] In the 2006 through 2008 version of section 194.301, the Property Appraiser's assessment comes to the action cloaked with a presumption of correctness, although this presumption is a rebuttable presumption. *See* § 194.301, Fla. Stat. (2006). In the 2009 version of section 194.301, the Property Appraiser must make an initial showing in order to obtain the presumption.

For tax years 2006-2008, the "presumption of correctness is lost if the taxpayer shows by a preponderance of the evidence that either the property appraiser has failed to consider properly the criteria in s. 193.011, or if the property appraiser's assessment is arbitrarily based on appraisal practices which are different from the appraisal practices generally applied by the property appraiser to comparable property within the same class and within the same county." § 194.301, Fla. Stat. (2006) (emphasis added). If "the presumption of correctness is lost, the taxpayer shall have the burden of proving by a preponderance of the evidence that the appraiser's assessment is in excess of just value." Even if the presumption of correctness is retained, the taxpayer can still show by "clear and convincing evidence that the appraiser's assessment is in excess of just value." § 194.301, Fla. Stat. (2006).

For tax year 2009, "the property appraiser's assessment is presumed correct if the appraiser proves by a preponderance of the evidence that the assessment was arrived at by complying with s. 193.011, any other applicable statutory requirements relating to classified values or assessment caps, and professionally accepted appraisal practices, including mass

[4] The Court notes, and the parties agree, that nothing in this case turns on the distinction between the two versions of section 194.301.

appraisal standards, if appropriate." § 194.301, Fla. Stat. (2009) (emphasis added). The presumption of correctness is overcome if the taxpayer proves by a preponderance of the evidence that the assessed value: "[d]oes not represent just value;" "[d]oes not represent the classified use value or fractional value of the property if the property is required to be assessed based on its character or use;" or is "arbitrarily based on appraisal practices that are different from the appraisal practices generally applied by the property appraiser to comparable property within the same county." § 194.301(a), Fla. Stat. (2009). For tax year 2009, if the taxpayer satisfies this burden of proof, not only is the presumption of correctness, if established, overcome, but also the taxpayer is then entitled to have the value adjustment board or court establish the assessment if there is competent, substantial evidence of value in the record.

In no event does the taxpayer have "the burden of proving that the property appraiser's assessment is not supported by any reasonable hypothesis of a legal assessment." § 194.301, Fla. Stat. (2006); § 194.3015, Fla. Stat. (2009). Furthermore, "[a]ll cases establishing the every-reasonable hypothesis standard were expressly rejected by the Legislature." § 194.3015, Fla. Stat. (2009).

In both versions of section 194.301, if the Property Appraiser is shown to have an erroneous valuation, the court or value adjustment board shall establish the assessment if there exists "competent, substantial evidence" in the record "which cumulatively meets the [criteria] of s. 193.011," §§ 194.301, Fla. Stat. (2006) and (2009), and additionally for tax year 2009, "professionally accepted appraisal practices." § 194.301, Fla. Stat. (2009). If the record lacks such evidence, the matter shall be remanded to the property appraiser with appropriate directions from the court or value adjustment board. *See id.*

As to methods of valuation, there are three traditional approaches to value: the cost, income, and market approaches. *See Havill v. Lake Port Properties, Inc.*, 729 So. 2d 467, 470

(Fla. 5th DCA 1999). The cost approach considers the cost that a prudent purchaser would pay to acquire an equally desirable substitute on the open market. *See Havill v. Scripps Howard Cable Co.*, 742 So. 2d 210, 213 (Fla. 1998). The cost approach values the original, reproduction or replacement cost of the property, less an allowance for depreciation. *Id.* The income approach requires the property appraiser to estimate the future income that a prospective purchaser could expect to receive from the property. *Id.* After estimating the future income, the property appraiser discounts the amount to present value by applying a capitalization rate. *Id.* The market approach analyzes the recent sales of similar property to arrive at the market value of the property being appraised. *Id.* at 212-13.

Assuming the statutory requirements are met, any one approach, or any combination thereof, will support an assessment of value for tax purposes. *See id.* A property appraiser is not required to use all three recognized approaches to valuing property; rather the appraiser is only required to consider them. *See Mastroianni v. Barnett Banks, Inc.*, 664 So. 2d 284, 288 (Fla. 1st DCA 1995). The particular method of valuation and the weight to be given to the factors set forth in section 193.011, are left to the discretion of the appraiser. *See Florida Dept. of Revenue v. Howard*, 916 So. 2d 640, 643 (Fla. 2005).

III. The crux of the dispute between the parties: Highest and Best Use

Each party acknowledged that a determination of the highest and best use of the properties under section 193.011(2), is a critical issue in any appraisal and of foremost importance in this case.

As stated in *The Appraisal of Real Estate*, 13th Edition,

> Highest and best use may be defined as: The reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, and financially feasible and that results in the highest value.

Id. at 278-279.[5] The highest and best use requires the appraiser to determine the most likely and most profitable use of the property. That in turn allows the appraiser to determine what what price the property would most likely sell for in a hypothetical sale, assuming a buyer would want to maximize the use of the property. Section 193.011(2) specifically requires the Property Appraiser to consider the present use of the property as part of the highest and best use analysis. Florida case law has discussed the importance of considering the present use because it keeps the highest and best use determination grounded in reality, as opposed to conjecture of potential future uses. *See, e.g., Lanier v. Overstreet*, 175 So. 2d 521, 542 (Fla. 1965).

In this case, CVS argues that the highest and best use of the functioning drug store properties is for general commercial purposes. (T. 288). As a result, CVS argues that sales and income information from properties sold or leased and operating as bank branches, auto parts stores, and office buildings, among other uses, should be used to value functioning drug stores. The Property Appraiser argues that the highest and best use of the functioning drug store properties is as drug stores, and therefore, uses sales and income data from properties used as drug stores to value the properties.

As to the former drug store properties, CVS also asserts that the highest and best use of those properties is for general commercial purposes. The Property Appraiser agrees that because of the legal restrictions and market demands, among other factors, on those former stores, that the highest and best use of those properties is for general commercial use or whatever subsequent use the properties are put to: *i.e.*, the highest and best use of a bank branch is as a bank branch, the highest and best use of an auto parts store is as an auto parts store.

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[5] *The Appraisal of Real Estate*, 13th Edition was recognized by all the experts as an authoritative text and previous editions are cited in several property tax cases. *See Calder Race Course, Inc. v. Overstreet*, 363 So. 2d 631 (Fla. 3d DCA 1978); *Robbins v. Adlee Developers*, 556 So. 2d 503 (Fla. 3d DCA 1990); *Fla. East Coast Ry. v. Florida Dept. of Rev.*, 620 So. 2d 1051 (Fla. 1st DCA 1993).

IV. Testimony Regarding Burden of Proof: Presumption of Correctness

As noted above, for tax years 2006 through 2008, the presumption of correctness of the assessments is retained unless CVS demonstrates by a preponderance of the evidence either that: (1) The Property Appraiser failed to properly consider the section 193.011 criteria; or (2) The assessments are arbitrarily based on appraisal practices different from practices applied to comparable properties within the same class and county. *See* § 194.301, Fla. Stat. (2006). For tax year 2009, the presumption of correctness is obtained if the Property Appraiser proves by a preponderance of the evidence that the assessment was arrived at by complying with section 193.011, and professionally accepted appraisal practices, including mass appraisal standards, if appropriate. *See* § 194.301(1), Fla. Stat. (2009).

Relevant to this issue was the testimony of Tim Wilmath, MAI, the Director of Valuation for the Hillsborough County Property Appraiser. Mr. Wilmath holds the MAI appraiser designation from the Appraisal Institute and has been appraising real estate for 27 years. (T. 486). It was his responsibility to determine the appropriate methodology to value drug stores and to ultimately oversee the assessment of those stores. (T. 491). Mr. Wilmath testified as to how the original assessment was derived and how that assessment comported with section 193.011, Florida Statutes.

Mr. Wilmath testified that two events caused the Property Appraiser's Office to scrutinize how they valued drug stores. The first event was the migration of drug stores in the late 1990's from an in-line location in strip malls to freestanding traffic-lighted corner locations. (T. 492, 494). The second event was litigation brought by CVS' competitor, Walgreens, challenging their 2001 property tax assessments. (T. 495).

Those events prompted Mr. Wilmath to reach out to other real estate appraisers to determine their methodologies for appraising freestanding drug stores. (T. 497-509, Def. Ex. 65-

77). The appraisals reviewed by Mr. Wilmath and admitted into evidence show that real estate appraisers estimating the fair market value of the fee simple interest of freestanding drug stores determine the highest and best use of the stores to be as drug stores. (T. 591, Def. Ex. 65-77). The appraisals also use the cost, income, and market approaches to value the stores. In the cost approach, no deductions for functional or external obsolescence are made. In the income approach, rent and expenses, as well as capitalization rates, from drug stores are used. In the sales comparison approach, sales of other freestanding drug stores are used as comparables.

Mr. Wilmath testified that as to the CVS stores functioning as drug stores, he determined the highest and best use to be as drug stores. (T. 512-513). As to former drug store properties, he determined the highest and best use to be whatever subsequent use the market puts those properties to. (T. 515).

Mr. Wilmath considered the cost approach to valuing the stores and noted that his office excluded land sales where drug store chains paid an amount that was excessively higher than land sales on the other traffic-lighted corners. (T. 517). Accordingly, the Property Appraiser used other land sales from traffic-lighted corners. (T. 519). The land sales information was summarized in a chart showing CVS land purchase prices per square foot and the actual assessments per square foot. (T. 517-518, Def. Ex. 58). The average land value per square foot used by the Property Appraiser in 2007 was approximately half of the average per square foot land purchase price paid by CVS. (T. 518, Def. Ex. 58). The chart also shows that the overall assessments (land and buildings) were in most instances less than the price CVS paid for the land alone. (T. 518, Def. Ex. 58). Regarding the estimate of the improvement value within the cost approach, Mr. Wilmath testified that his office accumulated cost data from the Marshall Valuation Service and cost data received from Walgreens during the earlier litigation. (T. 519-520).

As to physical depreciation, Mr. Wilmath's office used the Marshall Valuation depreciation tables. (T. 520-521). Mr. Wilmath noted that drug store properties are well maintained by the drug store chains and that his office physically inspects each property. (T. 520-521). Mr. Wilmath concluded that the operating drug stores did not suffer from functional obsolescence – the stores are well-designed and well-suited for their purpose as drug stores. (T. 522). As to the former drug stores, Mr. Wilmath recognized that functional obsolescence existed, as subsequent uses of these stores typically do not maximize the use of the properties and therefore downward adjustments were made to those properties. (T. 523-524). With regard to external obsolescence, Mr. Wilmath saw no evidence of external obsolescence in the operating drug stores. (T. 525). As to the former drug stores, external obsolescence existed because of a lack of market demand for those properties as drug stores, the use for which the improvements were originally designed; therefore downward adjustments were made. (T. 524-525).

Mr. Wilmath concluded that the cost approach was a good methodology for valuing drug stores because of the lack of depreciation and obsolescence and because the cost approach eliminates any issues with regard to the "leased fee/fee simple" issue. (T. 526). Mr. Wilmath presented a chart that showed that the assessments derived from the cost approach were, on average, 60% of CVS' actual total (land and improvement) costs. (T. 527-529, Def. Ex. 59).

The Property Appraiser also considered the sales comparison approach. (T. 530). As to the type of sales comparables considered, the office looked at sales of functioning drug stores and sales of former drug stores. (T. 531). Mr. Wilmath noted that the advantage to sales of drug stores was the physical similarity to the drug stores appraised, while the disadvantage was that the sale price was possibly affected by the lease in place at the time of the sale (the "leased fee" issue). (T. 531-532). As to CVS' claim that the sales are not truly sales, but actually sales/leaseback financing arrangements, Mr. Wilmath noted that the leases specifically state that

they are not financing arrangements. (T. 531-534, Def. Ex. 44-46.). Mr. Wilmath also testified that the office sends out sales verification questionnaires to drug store buyers verifying the facts of the sales, in order to determine whether the sales can appropriately be used in the sales comparison approach. (T. 534-537 Def. Ex. 39). All of the respondents to those questionnaires, except one, Lee Lapierre, confirmed that the sales price represented the market value of the real estate only. (T. 536-538. Def. Ex. 39).

Mr. Wilmath researched sales of former drug stores as well. He noted that whenever CVS or Walgreens no longer desires a location as a drug store, they place a restrictive covenant on the property, prohibiting its future use as a drug store along with certian other uses. (T. 540-543, Def. Ex. 42, 43). Thus, those properties are legally precluded from being used as drug stores. This legal restriction must be considered under section 193.011(2). Other concerns Mr. Wilmath had regarding the use of former drug stores to value functioning drug stores was the under-utilization of the properties by subsequent users. (T. 544-552). Mr. Wilmath inspected former drug stores and found that many subsequent users did not fully utilize the full square footage of the buildings. Other users did not use the drive-through feature of the buildings. Multiple photographs of this under-utilization were submitted as evidence. (Def. Ex. 49-52). Mr. Wilmath noted that a buyer will not pay for space the buyer is not going to use. (T. 547). Finally, Mr. Wilmath noted that some purchasers took the buildings down to the bare walls and that those types of sales virtually constituted a land sale, as most of the building features were not desired by the subsequent user. (T. 550-552, Def. Ex. 52). As a result, Mr. Wilmath did not believe that those sales were good comparables for functioning drug store properties. (T. 552).

Mr. Wilmath provided a chart showing the 2009 assessments as compared to sales of functioning drug stores. (T. 538-539, Def. Ex. 61). The chart showed that on average, the assessments of the subject properties are approximately 60% of the actual drug store sales prices.

Mr. Wilmath felt that any possibility of leased fee influence in the assessment was eliminated given the substantially lower assessments. (T. 539). However, ultimately, the office chose not to rely on the sales comparison approach to value the subject properties. (T. 539).

Mr. Wilmath also considered the income approach. Mr. Wilmath testified that the office does significant research every year into income and expense information, reviews national publications, and sends out income and expense questionnaires to property owners, all of which culminates in an annual report for each property type. (T. 556-559). As to the functioning drug stores, the Property Appraiser based rent figures on the income and expense surveys, approximately twenty CVS drug store leases, and numerous Walgreens leases. (T. 560-561). Those contract rents were used to extrapolate market rents for the subject properties. (T. 562-563). Mr. Wilmath noted that as CVS entered into new leases over the years, the rents continued to increase. (T. 563). Mr. Wilmath presented a chart showing that the Hillsborough County Property Appraiser's estimate of market rent for 2009 was approximately 50% of CVS' actual contract rent on the subject properties. (T. 562-563, Def. Ex. 60).

Ultimately, to arrive at the value of the currently operating drug stores, the Property Appraiser used a blend of the cost approach and the income approach, giving the cost approach 65% weight and the income approach 35% weight. (T. 530, 564-566).

As to the former drug stores, the valuation was similar, except the highest and best use was based upon the properties' current usages: bank branch, auto parts store, etc. (T. 570) That different highest and best use conclusion resulted in lower values for those former drug store properties. (T. 554). Mr. Wilmath presented evidence that the assessments of those properties were again lower than sales of those former drug store properties. (T. 575, 578-579).

Finally, Mr. Wilmath testified that based on his extensive research performed on the valuation of drug stores, he wrote an article entitled "A Prescription For Assessing Drugstores,"

which was published in the Journal of Property Tax Assessment and Administration in the summer of 2010. (T. 570-571; Def. Ex. 53).

Mr. Wilmath concluded by demonstrating how the appraisal process described above considered the requisite factors under section 193.011, Florida Statutes, and how the process comported with professionally accepted appraisal practices and with other appraisers' approaches to valuing drug stores. (T. 586-592). He also stated that he is familiar with mass appraisal standards set forth by the Florida Department of Revenue and by the International Association of Assessing Officers, and that the Property Appraiser's office met those standards in assessing the properties. (T. 592).

The Court found Mr. Wilmath's testimony highly credible and believable, and concludes that Mr. Wilmath and the Property Appraiser's office thoroughly considered all the necessary factors and statutory criteria under section 193.011, Florida Statutes. In addition, the Court finds that the Property Appraiser's approach to these properties complied with professionally accepted appraisal practices, including mass appraisal standards. Therefore, the Property Appraiser's assessments maintain a presumption of correctness for all tax years in question. *See* §§ 194.301, Fla. Stat. (2006) and (2009).

V. Testimony of CVS' witnesses

As noted above, CVS had the initial burden of proof in this case to show that the assessments were in excess of just value (for tax years 2006-2009), or that the assessments were based on arbitrary appraisal practices (for tax year 2009). *See* §§ 194.036(3), 194.301 (2006), and 194.301 (2009). CVS began by putting on the testimony of Mr. Lee Lapierre, the tax manager for CVS. Mr. Lapierre explained the manner in which CVS acquires drug store properties. One avenue is by acquiring other drug store chains' properties. In Florida, CVS acquired 600 Eckerd's locations, continuing drug store use in 546 locations. (T. 96). Mr.

Lapierre acknowledged that the Eckerd stores worked well for CVS and there were only nominal, mostly interior changes to the properties. (T. 97-98). The abandoned or "dark" stores are locations where CVS either already had a nearby store or the store was older and the design was out of date or the demographics of the neighborhood had changed. (T. 97-98). When a store goes "dark" and CVS sells or leases the property, it places a thirty-year restrictive covenant on the property, precluding its use as a drug store, among other prohibited uses. (T. 99).

Another option CVS uses is the construction of its own store - acquiring the land and paying a developer to construct the building. Once the store is completed, CVS sells the property (often in bulk with other stores) to an investor and simultaneously enters into a long-term lease on the property. (T. 67-72). Rent is based upon the land acquisition and building construction costs. (T. 71). In that manner, CVS recoups its land and construction costs and uses that money to construct more stores.[6] This transaction is commonly called a sale/leaseback transaction. From there, investors regularly sell and buy the stores, each still subject to CVS' lease on the property.

CVS additionally presented the testimony of Lee Pallardy, MAI, whose appraisal firm appraised all of the properties at issue for purposes of this litigation. Mr. Pallardy's appraisal firm analyzed the cost, income, and market approaches to each property. (T. 222). Mr. Pallardy acknowledged, as did multiple witnesses on each side, that in order to arrive at an estimate of the fair market value of the fee simple interest of a property, the appraiser assumes a hypothetical sale of the property, between a hypothetical seller and a hypothetical buyer, each party typically knowledgeable about the property. (T. 274-275 – Mr. Pallardy; 110 – Mr. Lapierre; 510 – Mr. Wilmath; 459-460- Mr. Diskin). Mr. Pallardy further acknowledged that the appraisal of fee

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[6] CVS construction costs include a vast array of hard and soft costs; most, if not all, are costs that appear to be properly included in building cost estimates for appraisal purposes. (T. 104-106, 124-125; *Appraisal of Real Estate*, 13th Edition, page 387).

simple market value assumes a prudent buyer and prudent seller, and does not assume that CVS is occupying the property. (T. 189). Mr. Pallardy explained that in estimating a fee simple value, the lease is ignored, because the goal is the fee simple interest of the property, not the leased fee. (T. 276). However, the appraiser assumes all the facts about the store remain the same; *i.e.*, the location, size, design and most importantly, the market demand. (T. 275-277).

In the cost approach, Mr. Pallardy based his land value on comparable land sales. (T. 222-223). For improvement costs, he relied on three sources: (1) CVS actual costs on seven stores; (2) interviews with CVS developers; and (3) the Marshall Valuation Survey. (T. 223-224). To determine physical depreciation, he used the age-life method, assuming a forty-year life on the buildings. (T. 225). Mr. Pallardy did not estimate any functional or economic depreciation on the improvements, preferring to let the results of the income and sales comparison approaches suggest obsolescence. (T. 225)

For the sales comparison approach, Mr. Pallardy used sales of closed Eckerd and CVS stores in Hillsborough and Pinellas counties, the sale of an existing Walgreens store in Tampa and a former Rooms-To-Go store in Pinellas. (T. 228). Mr. Pallardy acknowledged that the former drug store properties used as comparables all had the legal restriction on them precluding their use as a drug store at the time of the sale. (T. 298).

Mr. Pallardy's explanation for rejecting the sales between investors of operating drug stores was that: (1) They were subject to a lease and therefore represented a leased fee sale (the sales price was affected by the existing lease); and (2) The sales price was affected by the CVS guarantee of the lease terms, thereby giving the buyer a greater than typical confidence in receiving the rent attached to the properties. (T. 187-188).

Within the income approach, Mr. Pallardy noted that the appraiser is seeking what the market would rent the property for as of the date of valuation, not necessarily what the rent is per

the existing lease (the contract rent). (T. 196). In the income approach, Mr. Pallardy relied on rents from former drug stores, now used as bank branches, auto parts stores, etc., along with some properties that were never drug stores (T. 231).

Mr. Pallardy ultimately rejected the cost approach, citing the difficulty in estimating functional and economic obsolescence. (T. 233). However, Mr. Pallardy's explanation of rejecting the cost approach was not supported by and was contrary to the evidence because he acknowledged that the currently operating drug stores do not suffer from any unusual wear and tear, are well-maintained and do not suffer from functional or external obsolescence. (T. 363 - 367). In arriving at his final values, Mr. Pallardy gave primary weight to the sales comparison approach and secondary weight was given to the income approach. (T. 233)

Mr. Pallardy's sales comparison approach and income approach values were considerably lower than his cost approach values, however, he admitted that if a chain drug store was the buyer of these properties, his values would go up. (T. 283-284). In addition to estimating the fair market values of the properties, Mr. Pallardy also arrived at "assessed values" of the properties, further reducing his fair market values by 8%, based upon direction from CVS' attorneys and his understanding of Florida Statute 193.011.[7] (T. 233-234, 272).

Finally, CVS presented the testimony of Barry Diskin, Ph.D. MAI and David Lennhoff, MAI, both of whom testified as to their opinions of the appropriate methodology for valuing drug stores. Dr. Diskin could not recall the last time he valued the fee simple interest of a drug store and Mr. Lennhoff admitted to not doing a lot of drug store appraisals. (T. 465-466, 1013) Dr. Diskin also provided a critique of the appraisal of Lawrence Jay, who performed an appraisal of the properties on behalf of the Hillsborough County Property Appraiser.

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[7] Mr. Pallardy acknowledged that he does not make a similar deduction when arriving at fair market value in other appraisal assignments. (T. 271-273).

Dr. Diskin admitted that under a hypothetical sale, the appraiser does not assume CVS is the seller of the property. (T. 460). He also agreed that the only reason a successful currently operating CVS drug store would sell would be if the operator was leaving the market. (T. 463, 464-465, 962-963). Dr. Diskin acknowledged that if CVS were to leave, it is possible, absent a legal restriction imposed by CVS, that another drug store chain would acquire the stores. (T. 966-968).

VI. Testimony of Hillsborough County Property Appraiser witnesses.

The Property Appraiser first put on the testimony of Tim Wilmath, MAI. That testimony is detailed in section IV above relating to the Property Appraiser's methodology and the retention of the presumption of correctness. Next, appraiser Peter Korpacz, MAI testified as to his research into appraisal issues involving drug stores. To determine market behaviors, Mr. Korpacz interviewed market participants who bought and sold drug store properties (T. 742). His research indicated that market participants do not believe that chain drug stores overpay for land and that building costs incurred to build drug stores are, as a percentage of business costs, in line with construction costs for other retail properties. (T. 758-760). In addition, market participants stated that rents paid for drug stores are in accordance with other types of retail properties. (T. 760). Mr. Korpacz also stated that in appraising drug stores, the appropriate highest and best use conclusion was for a drug store rather than a more generalized use. (T. 764-766).

Finally, Lawrence Jay, MAI, testified as to his estimate of the value of the properties. Mr. Jay performed an appraisal of a single CVS store, applying all three approaches to value. His highest and best use conclusion was for "continued use of the drug store facility." (T. 857, Def. Ex. 92).

Mr. Jay considered the cost approach using actual CVS and Walgreens construction costs, along with cost information from the Marshall Valuation Service. He found nominal

physical depreciation in the properties and no functional or external obsolescence. (T. 861-863). He considered the sales comparison approach using investor-to-investor sales and adjusting them to remove any influence of non-market lease rates on the sales price. (T. 865). Mr. Jay additionally considered the income approach, using 10% of acquisition and construction costs as his market rent estimate, the same method used by CVS to determine rents. (T. 867). He also adjusted the cap rate to eliminate the possible influence of CVS' credit-worthiness. (T. 868).

After applying all three approaches, Mr. Jay concluded that the cost approach was the most appropriate approach for these properties. He then performed a separate appraisal, applying the cost approach to all but two of the properties at issue. As demonstrated on the attached **Exhibit A**, Mr. Jay's cost approach values were similar to both Mr. Pallardy's cost approach values and the actual assessment values on the properties for tax years 2006 – 2009.

VII. Conclusions

A. Highest and best use.

As noted earlier, the highest and best use of the operating drug stores and the proper appraisal approach to apply to these properties is the crux of the dispute between the parties. CVS' conclusion as to the highest and best of the operating drug stores properties was for "continued commercial use of the existing improvements, which is not solely specific to a retail drug store." (T. 288). Those uses would include restaurants, furniture stores, office buildings, used car lots, and bank branches, in addition to retail stores. (T. 289, 290). Therefore, CVS concludes that a buyer would pay the same for freestanding drug stores as they would for those types of properties. (T. 290). Subsequently, those types of properties are used by CVS in the sales comparison and income approaches.

The evidence shows, however, that when a drug store property is converted to some of the secondary commercial uses described above, not only does the property have a legal

restriction prohibiting use as a drug store, but the buyers also either renovated the properties or did not use all the square footage. Those secondary general commercial uses are not the highest or the best use of the currently operating drug store properties. CVS' appraiser also acknowledged that it would be reasonable to conclude that the maximally productive use of these properties would be for drug store use.[8] (T. 301).

It is significant to the Court that CVS' experts testified that it is within the appraisers' discretion as to how broadly or narrowly they define highest and best use. (T. 291-292). In fact, they admitted to arriving at very narrow highest and best use conclusions in other appraisal assignments. (T. 292-293- Mr. Pallardy; 457 – Mr. Diskin).

The Property Appraiser admitted into evidence numerous appraisals of the fair market value of the fee simple interest of drug stores, including some CVS stores, unrelated to this action. (Def. Ex. 65-77). Mr. Pallardy admitted that in eminent domain assignments, the appraisal is typically of the fee simple interest of the property, just as it is for property tax valuation. (T. 183-184, 192). These unrelated appraisals were prepared for both eminent domain and finance purposes. (T. 591, Def. Ex. 65-77). Some of the appraisals were prepared on behalf of CVS, Walgreens, and Rite-Aid. (Def. Ex. 65-77). Others were prepared on behalf of banks and local governments. (Def. Ex. 65-77). All found the highest and best use of an operating drug store to be a drug store. (T. 591, Def. Ex. 65-77). The unrelated appraisals used currently operating drug store properties as comparables in the sales comparison and income approaches. (T. 591).

The Court finds that the unrelated appraisals show that the Property Appraiser's classification of the highest and best use of the functioning drug stores as drug stores, as opposed

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[8] The "maximally productive" use is the fourth test of the highest and best use analysis. *The Appraisal of Real Estate*, 13th Edition page 279.

to general commercial, and using drug store data to reach the assessments, is not arbitrary and is in accordance with professionally accepted appraisal practices. Further, CVS advocates a highest and best use classification of drug store when it is financially advantageous to CVS, but opposes such classification when it is financially disadvantageous. This selective advocacy undermines CVS' argument that such classification by the Property Appraiser in the instant case is arbitrary and erroneous.

The Court notes that the highest and best use dispute is not uncommon in cases similar to the one at bar. In *Brae Associates C/O Hertz Realty v. Park Ridge Borough*, 17 N.J. Tax 187 (N.J. Tax 1998), the subject property was a corporate headquarters. There, the court rejected the taxpayer's estimate of value based upon a broader highest and best use:

> Accordingly, this court finds on the first step in the valuation of the subject property, that the highest and best use of the subject is that of a corporate headquarters.
>
> In addition to determining that the subject's highest and best use is as a corporate headquarters, this court finds the cost approach is the most reliable method for determining the value of the subject improvements.
>
> ...With respect to the market sales approach, taxpayer's analysis begins with purported comparables that are general purpose office buildings, not corporate headquarters. Similarly, with respect to taxpayer's income capitalization analysis, the beginning point, comparable rentals, also involved general purpose office buildings. Such comparables cannot be equated with the subject simply because the subject is not a general purpose office building, but rather a corporate headquarters.

Id. at 196-197.

Similarly, the Wisconsin Supreme Court in *Nestle U.S.A., Inc. v. Wisconsin Dept. of Revenue*, 776 N.W.2d 589 (Wis. 2009), addressed how specific a classification for purposes of valuation can be. There, the property was a "...facility devoted to the production of whole protein powdered infant formula." *Id.* at 166. The Department of Revenue considered the highest and best use of the property as a powdered infant formula plant, as the property still fully

served that purpose. The taxpayer argued that the highest and best use should be for general manufacturing processes. The following excerpts lay out the issues before the court and its decision:

> Nestle's appraiser's analysis under the comparable sales approach began with his determination that, if the Gateway Plant were sold, it would be unlikely to see continued use as a powdered infant formula facility, given the limited number of powdered infant formula manufacturers. The appraiser thus concluded that the plant's highest and best use needed to be expanded to include other functional uses, including other food or light manufacturing processes.
>
> ...Nestle's appraiser determined that all of the special features of the plant unique to its use as a powdered infant formula plant were functionally obsolete, and reduced the assessment accordingly.
>
> ...Given that the property's highest and best use is its current use as a powdered infant formula plant, we agree with the Commission that the general food processing plants cited by Nestle's appraiser as comparable sales were not 'reasonably comparable' to the property under assessment.

Id. at 595-600. Ultimately, the Wisconsin Supreme Court found that Nestle's sales comparables were not actually comparable and that the best valuation method was the cost approach.

The case of *Riegel Products Corp. v. Milford Borough*, 13 N.J. Tax 546 (N.J. Tax 1994) also illustrates and clarifies the issue of how specific a use classification can be. The subject property in *Riegel Products* was described by the court as, "...a manufacturing complex producing specialty papers... ." *Id.* at 548. The court summarized the issue between the property owner and the property appraiser as follows:

> Taxpayer's expert testified that the highest and best use for the subject is general manufacturing, industrial and warehousing use. Taxpayer's expert testified that he did not value the property as a paper manufacturing plant but as a general manufacturing and warehouse facility. He testified that he did not include the value of specific features of the property such as rail sidings, high ceilings, water supply and water treatment facility. Taxpayer's expert states that there is no certainty that a buyer, who requires such features, would be found and therefore, such features should not be included in the value determination.

Id. at 551. Thus, the taxpayer's appraiser used sales of general warehouse facilities to value the manufacturing plant. The taxing district however, recognized the highest and best use of the property to be a paper manufacturing plant and valued it as such.

Ultimately, the court rejected the taxpayer's appraisal evidence and found for the taxing district, stating,

> I find that the highest and best use of the subject property is for heavy manufacturing, paper manufacturing which requires large space, heavy floor loads, high ceilings, railroad service onto the floor of the plant, water treatment facilities and a substantial supply of water and power. The five improved sales utilized by taxpayer's expert in his sales comparison approach are not comparable because of the substantial difference from the subject in size and utility and because the properties were sold vacant and purchased either for warehouse or multi-tenant use, not heavy manufacturing. As such, these sales do not provide evidence of value for many of the characteristics of the subject property such as the water supply, waste-water treatment facility, heavy floor loads and high ceilings. No sales of paper manufacturing plants were included in taxpayer's expert's report or testimony.

Id. at 559-562.

Another factually similar case is *Meijer Stores Limited Partnership v. Franklin County Bd. of Revision*, 122 Ohio 3d 447 (Ohio 2009). In *Meijer* the subject property was a "big box" retail store, still functioning perfectly as a Meijer food store. The Ohio Supreme Court described the controversy as follows:

> The most significant point of contention between the litigants lies in valuing the big-box Meijer store on the main parcel, a building that encompasses approximately 193,000 square feet and that Meijer built to its specifications.

Id. at 448. There the court rejected the taxpayer's expert appraisal report which used as comparable properties,

> ...four Kmarts that had been abandoned by that entity during its bankruptcy, two Ames stores that had also been abandoned during bankruptcy, a WalMart abandoned by the retailer when it moved into a new supercenter, and a Sam's Club that 'went dark' in 1995 and took five years to sell.

Id. at 449. Ultimately, in ruling in favor of the taxing district, the court, stated,

> ...the present use of a property may be considered when 'a building in good condition [is] being used currently and for the foreseeable future for the unique purpose for which it was built,' otherwise, 'the owner of a distinctive, but yet highly useful, building [would be able] to escape full property tax liability.

Id. at 453.

Just as the courts in the foregoing cases found highly specific classifications of property to constitute the highest and best use of the property, this Court concludes that the highest and best use of the currently functioning drug stores is as drug stores. As to the former drug stores, the highest and best use properly changes and either becomes one of a more general retail nature, or one more specifically related to the secondary use; *i.e.*, bank branch, auto parts store, etc.

B. Appropriate appraisal methodology.

As noted above, the Property Appraiser's original assessments were derived from a blend of the cost approach (65%) and the income approach (35%). In his independent appraisal of the properties, Lawrence Jay, MAI ultimately relied on the cost approach.

CVS on the other hand, relied on the income and sales comparison approaches. The income and sales comparison approaches were affected, however, by the overly broad conclusion as to highest and best use, which resulted in sales comparables and rent comparables from properties dissimilar in use and in market demand. Some of the results of that decision are as follows:

- **4401 W. Gandy Blvd.** CVS' estimate of the 2009 market value of the property was $2,630,000, of which the land value was $1,430,000, leaving a building value of $1,100,000. However, the store was built just a few months prior at a cost (according to CVS) of $2,202,725. Thus, within a couple of months, the building allegedly lost over $1,100,000 of value. (Def.'s Exhibit 1, pages 85-94).

- **6202 U.S. Hwy 41 and Apollo Beach Blvd.** CVS' January 2006 market value estimate was $2,100,000. The property sold in April of 2006 for $4,575,000.[9] (Def.'s Exhibit 1, pages 205-218).
- **6701 N. Dale Mabry.** CVS' January 2006 market value estimate was $2,600,00 of which $1,365,000 was land value, leaving a building value of $1,235,000. The store was completed in late 2005 at a building cost (CVS's estimate) of $2,236,000. Thus, according to CVS, the store instantaneously lost $1,000,000 of value. The same property sold in November of 2005 for $3,650,000. (Def.'s Exhibit 1, pages 423-436).
- **8801 W. Linebaugh Avenue.** CVS's January 2009 market value on the *land and building was $1,975,000*, whereas appraiser Chad Durrance, retained by CVS' attorney for an eminent domain matter appraised the fee simple market value of *the land only at $2,474,200* as of August 2008. (Def.'s Exhibit 1, pages 523-537 and Def.'s Exhibit 77, Page 14).

The Court finds that the cost approach is a logical appraisal method to apply to the currently operating stores. As noted, the properties suffer little in the way of physical depreciation, functional obsolescence or external obsolescence. That, according to *The Appraisal of Real Estate*, 13th Edition, makes them a prime candidate for the cost approach:

> The approach is especially persuasive when land value is well supported and the improvements are new or suffer only minor depreciation and, therefore, approximate the ideal improvement that is the highest and best use of the land as though vacant.

Id. at 382. CVS' appraisal itself notes, "This approach is most valid when analyzing new improvements which have not experienced any loss in value through normal wear and tear or other forms of depreciation." (T. 362; Def. Ex. 1, page 12). Mr. Pallardy testified that the

[9] CVS attempted to explain these discrepancies by alleging that the sales prices reflected were so much higher than the true value of the property because the buyers were willing to pay more in order to have a tenant that was creditworthy.

currently operating stores do not suffer from any unusual wear and tear, are well-maintained and do not suffer from functional or external obsolesence. (T. 363 - 367).

It is logical that, should a drug store chain decide what to pay for one of these properties, the drug store would look to the costs involved in building a new store on a competing corner. As noted by Lee Lapierre, CVS itself weighs the costs and benefits of building their own stores when it comes to the decision to acquire an existing store or chain of stores.[10] (T. 65). In addition, CVS expert Lee Pallardy also testified that cost would be a factor CVS would consider in determining what to pay for a store. (T. 280-281). Finally, the cost approach completely avoids one of CVS' primary concerns, the influence of the existing lease upon any sale of the property.

The Court concludes that Mr. Wilmath and the Property Appraiser's office thoroughly considered all the necessary factors and statutory criteria in order to maintain the presumption of correctness in each tax year in question. In reaching the assessments at issue through a blend of the cost and income approaches, the Property Appraiser used appropriate appraisal methodology that complied with the criteria of section 193.011 and professionally accepted appraisal practices. *See* § 194.301(1), Fla. Stat. (2009); and 194.301, Fla. Stat. (2006).

The attached **Exhibit A** charts the Hillsborough County Property Appraiser's 2006-2009 assessments at issue along with the cost approach values by CVS expert Lee Pallardy and the Property Appraiser's expert Lawrence Jay. Mr. Pallardy and Mr. Jay arrived at similar values in the cost approach, and for the most part, those values are in excess of the original assessments. As can be seen, the assessments are either in line with, or in many cases substantially below, the cost approach estimates of Mr. Pallardy or Mr. Jay.

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[10] Mr. Korpacz also testified that the cost approach is used by the chain drug stores to analyze their acquisitions of drug stores. (T. 794).

In sum, the Court finds that CVS failed to meet its burden of proof in this case for each of the tax years in question. For tax years 2006 through 2008, the Property Appraiser's assessments retained a presumption of correctness because CVS failed to show, by a preponderance of the evidence, that the Property Appraiser failed to properly consider the section 193.011 criteria or that the assessments were arbitrarily based on appraisal practices different from the appraisal practices generally applied by the Property Appraiser to comparable property within the same class and county. *See* § 194.301, Fla. Stat. (2006). Because the assessments maintained a presumption of correctness, in order to have the assessments set aside, CVS needed to prove, by clear and convincing evidence, that the assessments were in excess of just value. *See id.* For tax years 2006 through 2008, CVS did not prove, by clear and convincing evidence, or even by a preponderance of the evidence, that the assessments were in excess of just value. *See id.*

For tax year 2009, the Property Appraiser's assessments were presumed correct because the Property Appraiser proved, by a preponderance of the evidence, that the assessments were arrived at by complying with section 193.011, and professionally accepted appraisal practices, including mass appraisal standards. *See* § 194.301(1), Fla. Stat. (2009). In order to overcome that presumption and set aside the assessments, CVS needed to prove, by a preponderance of the evidence, that the assessed values did not represent the just values of the properties, or that they were arbitrarily based on appraisal practices different from appraisal practices generally applied by the Property Appraiser to comparable property within the same county. *See* § 194.301(2)(a) and (b), Fla. Stat. (2009). For tax year 2009, CVS did not prove, by a preponderance of the evidence, that the assessed values did not represent the properties' just values, or that they were arbitrarily based on appraisal practices different from appraisal practices generally applied by the Property Appraiser to comparable property within the same county. *See id.*

WHEREFORE, it is **ORDERED** and **ADJUDGED** that:

1. Judgment is entered in favor of Defendants, Rob Turner, as Property Appraiser for Hillsborough County, Doug Belden, as Tax Collector for Hillsborough County, and James Zingale, as Executive Director of the Florida Department of Revenue, and against Plaintiffs, CVS Corporation, CVS Pharmacy, Inc., CVS New York, Inc., CVS In Distribution, Inc., and Holiday CVS, L.L.C., and its Affiliates.

2. The assessments for the years 2006 through 2009 for the CVS properties involved in this suit and set forth in **Exhibit A** to this Judgment, are ratified and confirmed in all respects.

3. The Court retains jurisdiction in this matter to enter any and all such further orders as may be appropriate in accordance with the law, including, but not limited to an assessment of costs pursuant to section 194.192, Florida Statutes.

DONE and **ORDERED** in Tampa, Hillsborough County, Florida, on this the 31st day of July, 2013.

Bernard C. Silver

Bernard C. Silver
Circuit Judge

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