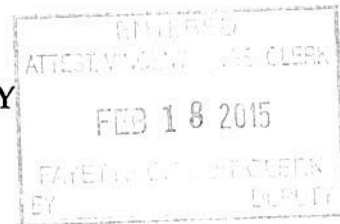


COMMONWEALTH OF KENTUCKY  
FAYETTE CIRCUIT COURT  
EIGHTH DIVISION  
CIVIL BRANCH  
NO. 14-CI-1566



WILGREENS, LLC AND WALGREEN CO.

PETITIONERS

v.

OPINION and ORDER

DAVID O'NEILL  
FAYETTE COUNTY PVA

RESPONDENT

\*\*\*\*\*

This matter has come before the Court upon the Petitioners petition for judicial review of the Kentucky Board of Tax Appeals' ("KBTA") final order. The Court having taken it under advisement and having duly considered the motions and responses, the arguments of counsel, and the applicable law:

It is hereby **ORDERED** that the KBTA's Order is **SUSTAINED**.

FACTS

The Petitioners selected a highly desirable location in Lexington, Kentucky for a retail store. (Hrg. Transcr. 283:23-284:3). At this site, the traffic flow is in excess of 40,000 vehicles per day surrounding a residential community, high-end retail, and located near University of Kentucky Medical Center, Central Baptist Hospital, and Saint Joseph Health Complex. (*Id.* at 284:4-286:9). The exact location is 2290 Nicholasville Road, where Petitioners entered into an agreement with the owner of the property, the Ruttenburg family, to construct a building according to Petitioner's specifications. In

2005, the Ruttenburg family entered into a triple net lease with Petitioners, wherein Petitioners agreed to pay all real estate taxes, insurance, maintenance costs, and monthly rent. Later, the Ruttenburgs placed the property for sale. In 2007, the land and building subject to the lease were bought for \$6,275,000.

In the past, the income based approach has been used to assess the property for tax purposes. However, Petitioners contested this in the tax years of 2012-2013 and filed a declared value with the KBTA.

### **I. Walgreens' Business Model**

Walgreens leases, rather than owns, most of its stores. (CD Vol. 1 at 9:20:46). Normally, Walgreens will work with a local developer to choose potential sites for new locations in high-traffic areas, generally on corner lots. Walgreens has specific requirements regarding the building that is then constructed. These specifications are unique and distinct, which greatly differs from other retail stores.

During the development process, the developer enters into a long-term lease with Walgreens, typically for seventy-five (75) years. Yet, Walgreens has the right to cancel after twenty-five (25) years. After development, the developer often puts the land, the building, and the lease on the market for sale. Subsequently, Walgreens then pays rent to the investor/owner. The archetype Walgreens buildings are never built and then put on the open market for possible lease to other tenants; they are always fully leased by Walgreens even before the properties are ready and available for occupancy. Under the Walgreens leases, the lease payment subsumes the total acquisition cost of the property, the building costs, financing and other soft costs, and a developer's profit.

## **II. Hearing before the KBTA**

The KBTA held an evidentiary hearing on August 27 and 28, 2013. Petitioners presented testimony from: Anna Pelts, Walgreens' supervisor of tax appeals; David Lenhoff, expert on appraisal theory and technique; and Glenn Katz, certified Kentucky appraiser. Mr. Katz valued the property at \$2,600,000 by comparing two (2) properties outside of Fayette County and five (5) within Fayette County. Those in Fayette County were in a small strip shopping center, not free-standing, or on Nicholasville Road. In opposition, Respondents presented testimony of three witnesses: Justin Stevens, the property assessor for the PVA; David Donan, an MAI appraiser; and James Schrader, a Fayette County real estate broker.

On March 26, 2014, the KBTA held that "the existence of a long-term, build-to-suit lease on a commercial property adds measurable value to that property which must be taken into consideration by the property valuation administrator when assessing the property." (KBTA Order, p. 7). Further, they asserted that Petitioner's witnesses either provided no valuation evidence or failed to provide an analysis quantifying the difference in value between the PVA assessment and the Walgreens' proposed value. Consequently, on April 24, 2014, Petitioners filed a petition for judicial review of the KBTA's final order to the Fayette Circuit Court.

## **DISCUSSION**

### **I. Standard of Review**

In an appeal from an administrative agency decision, the circuit court is acting as an appellate court. The reviewing court will not disturb the factual findings of the

administrative tribunal, unless the tribunal's decision is found to be arbitrary and capricious. McManus v. Kentucky Retirement Systems, 124 S.W.3d 454, 458 (Ky. App. 2003). Yet, an agency's conclusions of law are reviewed *de novo*. Kentucky Retirement Systems v. Bowens, 281 S.W.3d 776, 780 (Ky. 2009).

When there are questions of both fact and law, the appellate court reviews the trial court's decision pursuant to the clearly erroneous standard. Cardiovascular Specialists v. Xenopoulos, 328 S.W.3d 215, 218 (Ky. App. 2010). However, the Court has "greater latitude to determine whether the findings below were sustained by evidence of probative value." Uninsured Employers' Fund v. Garland, 805 S.W.2d 116, 117 (Ky. 1991).

## **II. Kentucky Law on Property Valuation for Tax Assessment Purposes Requires Property Be Assessed at its Fair Cash Value**

Section 172 of the Kentucky Constitution states "all property, not exempted from taxation by this Constitution, shall be assessed for taxation at its fair cash value, estimated at the price it would bring at a fair voluntary sale . . . ." Ky. Const. § 172. Fair cash value is what the property is worth in money, which is what it would bring in a voluntary cash sale. Floyd Cnty. v. Kentucky-W. Virginia Gas Co., 407 S.W.2d 721 (Ky. 1966). Though it may seem elementary to say it, the value of property is not established by a tax assessment. Conversely, the Constitution dictates that the value shall determine the assessment. Id.

To elaborate, the General Assembly recognized that Section 172 of the Constitution of Kentucky requires all non-exempted property, to be assessed at one

hundred percent (100%) of the fair cash value, estimated at the price the property would bring at a fair voluntary sale. Ky. Rev. Stat. Ann. § 132.191 (West). Russman v. Luckett reiterates this by stating, section 172 of the Kentucky Constitution and the statutory law implementing that section require all property in Kentucky (not exempted by the Constitution) to be assessed for tax purposes at its fair cash value. Russman v. Luckett, 391 S.W.2d 694, 697 (Ky. 1965). It requires is that it be assessed for the amount of money it would bring at a fair voluntary sale. See Parrent v. Fannin, 616 S.W.2d 501 (Ky. 1981).

Here, 2290 Nicholasville Road was purchased for \$6,200,000 in 2007, which includes the land, building, and long-term Walgreens' lease. Later, in 2013, the land, building, and lease were listed for sale at \$6,900,000. Additionally, these triple net leases properties were available for sale on the internet under TripleNetLease.com. (Hrg. Transcr. 5:7-14.) Given this, there has not been sufficient evidence presented that would lead the Court to believe the sale in 2007 was not a fair, voluntary sale; nor has there has not been a substantial change in the value of the property since the 2007 sale. (Hrg. Transcr. 278:2-20). If anything, the value may have increased in recent years. When applying the Kentucky Constitution, it is accurate to regard the purchase price as an approximation of the fair cash value. This figure, as the fair cash value, determines the value for tax assessment purposes.

Conversely, the Petitioners argue that the contract rights associated with the Walgreens' leases are intangible property. They contend that the General Assembly has the power under Section 170 of the Constitution and has chosen to exempt intangible

property from taxation. (2005 Acts Ch. 168, §§ 53-65) Thus, in order to assess the “real property” the PVA must assess the fee simple interest, not the leased fee. Further, the rental rates contained in the Walgreens lease, and the sales of the leased Walgreens properties, do not reflect the value of the real property, but instead, reflect the “investment value” of both the real property and the Walgreens lease.

Yet, the Court believes Kentucky law states differently. KRS 132.191(2) (d) addresses the valuation of the raw land anticipated for future development and demonstrates that the only time it is fitting to estimate value is when dealing with undeveloped land. It states that the “when all direct and indirect costs and entrepreneurial incentives are deducted from the estimated anticipated gross sales price of the finished lots, and the resultant net sales proceeds are then discounted to present value at a market-derived rate over the development and absorption period.” Ky. Rev. Stat. Ann. § 132.191 (West). Based upon this, legislative intent does not seem to support the use of a generalized market rate for properties currently producing income. This is because the Legislature addressed when to deviate from actual costs and values within the same statute. Moreover, “the true income approach to fix fair cash value is a valid one and income from or rental value of real property is a proper factor to be considered in fixing its valuation for tax purposes.” Helman v. Kentucky Bd. of Tax Appeals, 554 S.W.2d 889, 891 (Ky. Ct. App. 1977)

Additionally, the location chosen by Petitioners is in one of the prime retail corridors not only in Lexington, but perhaps in the state of Kentucky. The traffic flow is in excess of 40,000 vehicles per day with a high density of high-end retail, surrounding

a residential community, and located in close proximity to three hospitals. (Hrg. Transcr. 284:4-286:9). Considering this, the value proposed by Petitioners is seemingly too low to be logical.

Not to mention, Petitioner's expert Glen Katz valued the location at \$2,600,000 by comparing two (2) properties outside of Fayette County and five (5) in Fayette County. Those in Fayette County were not comparable to this particular location. They were in small strip shopping centers, not the same size, not free standing, and not located on Nicholasville Road.

This case is similar to Russman v. Luckett, 391 S.W.2d 694, 697 (Ky. 1965). Russman was a suit by taxpayers, parents of school children, and students against taxation authorities for injunctive relief. Id. The issue was that certain real estate and tangible personal property was assessed at 100% of its fair cash value, while some was assessed a percentages ranging from 33 to 12.5% of its fair cash value. Id. Defendants claimed the Court had, in effect, nullified section 172 and the implementing statutes by substituting the test of 'uniformity' in place of 'fair cash value.' Id. However, the court held that fundamental law is not outdated, or obsolete, or contrary to any known policy. *See Id.* at 697. Consequently, Section 172 of the Kentucky Constitution and the statutory law implementing that section require all property in Kentucky (not exempted by the Constitution) to be assessed for tax purposes at its fair cash value. Id. at 697.

Likewise, Parrent v. Fannin, 616 S.W.2d 501 (Ky. 1981) reasoned, it is beyond cavil that not all parcels of real estate are worth the same amount of money and Section 172 does not require that they be assessed for the same amount of money. Id. at 502.



What it does require is that each be assessed for the amount of money it would bring at a fair voluntary sale. Id. The uniformity insured is not uniformity of value but is uniformity of standard of assessment. Further, Section 171 means, no more and no less than, that the rate of taxation must be the same for property of the same class. Id.

Here, the KBTA decision was not clearly erroneous and in line with the uniformity mandates of Section 171. They held that the PVA's sales comparison approach is the most reliable because it used properties that were similar to the subject property in every respect (location, size, age, etc.) and then applied the same tax rate as applies to all income producing property.

### **III. Under Kentucky Law, the Lease Must Be Considered.**

Helman v. Kentucky Board of Tax Appeals recognizes the importance of considering a lease when using an income approach to property valuation. "The true income approach to fix fair cash value is a valid one and income from or rental value of real property is a proper factor to be considered in fixing its valuation for tax purposes."

Helman v. Kentucky Bd. of Tax Appeals, 554 S.W.2d 889, 891 (Ky. Ct. App. 1977).

Additionally, "the leasehold is taxable as real estate at its fair cash value." Kentucky Dep't of Revenue v. Hobart Mfg. Co., 549 S.W.2d 297, 299 (Ky. 1977)

Petitioners rely on Commonwealth, Department of Highways v. Sherrod to prove only the fee simple should be used. However, unlike this case, Sherrod was an eminent domain case involving the taking of a strip for highway purposes, from a portion which was under lease for commercial use. Commonwealth, Department of Highways v. Sherrod, 367 S.W.2d 844 (Ky. 1963). The Court of Appeals ultimately held:



an error in instructions was prejudicial where they did not state that total damages could not exceed difference in value of the entire tract before and after the taking. Id. Clearly, Sherrod and this case are of a different subject matter. It would be a stretch to heavily rely and apply Sherrod to these specific facts.

Additionally, Petitioners point to a Wisconsin State Supreme Court case which held the tax assessor was required to determine value of leased properties under the income approach using market rather than contract rates. Walgreen Co. v. City of Madison, 2008 WI 80, 311 Wis. 2d 158, 752 N.W.2d 687. However, this case also held that the power to determine the appropriate methodology for valuing property for taxation purposes lies with the legislature. Considering this, Kentucky and Wisconsin statutory law are very different. Wisconsin Statute § 70.32(1) states, “real property shall be valued by the assessor in the manner specified in the Wisconsin property assessment manual.” Wis. Stat. Ann. § 70.32 (West). The Manual, in turn, provides that the goal of the assessor is to estimate the market value of a full interest in the property, subject only to governmental restrictions. All the rights, privileges, and benefits of the real estate are included in this value. This is also called the market value of a fee simple interest in the property.” (Property Assessment Manual 7-4).

On the contrary, the Kentucky Constitution states “all property, not exempted from taxation by this Constitution, shall be assessed for taxation at its fair cash value, estimated at the price it would bring at a fair voluntary sale . . . .” Ky. Const. § 172. Kentucky case law interprets this to be an arm’s length transaction between a willing seller and a willing buyer. See Floyd Cnty. v. Kentucky-W. Virginia Gas Co., 407 S.W.2d 721 (Ky. 1966). Further, “the leasehold is

taxable as real estate at its fair cash value." Kentucky Dep't of Revenue v. Hobart Mfg. Co., 549 S.W.2d 297, 299 (Ky. 1977)

### CONCLUSION

For the foregoing reasons, it is clear that Kentucky law requires property be assessed at its fair cash value, which is the estimated price it would bring at a fair voluntary sale. Additionally, based upon legislative intent and case law, a lease should be considered when using an income approach to valuation. The decision of the KBTA was not arbitrary or capricious, nor was it clearly erroneous. Given the information presented, the Court has determined the findings were sustained by evidence of probative value. Thus, it is hereby **ORDERED** that the KBTA's Order is **SUSTAINED**.

Entered this 13 day of February 2015.

/S/ THOMAS L. CLARK  
A TRUE COPY  
ATTEST, VINCENT RIGGS, CLERK  
FAYETTE CIRCUIT COURT

BY  D.C.

Honorable Thomas Clark  
Fayette Circuit Court, 8<sup>th</sup> Division

## CERTIFICATE OF SERVICE

This is to certify a copy of the foregoing has been mailed on

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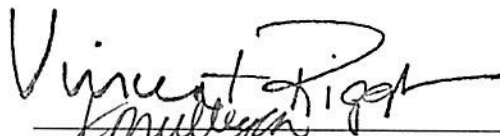
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