

Inc. Madison County Assessor of Property Francis Hunley appeared on her own behalf. She was assisted by Deputy Assessor Kevin Mills

Findings of Fact and Conclusions of Law

The subject property in this appeal consists of a manufacturing and distribution center owned and wholly occupied by Delta Faucet. The total area of the improvement is approximately 600,000 square feet.

The taxpayer contended that the overall value of the subject property should be \$9,500,000. In support of this position, the appellant introduced an appraisal by Mr. Jesse Clanton using the market, income and cost approach methods. The appraisal maintained that the supported values were \$9,800,000, \$8,600,000 and \$14,425,000 respectively. From these, Mr. Clanton concluded that the property should be valued at \$9,500,000.

The Assessor also valued the property utilizing all three approaches to value. The Assessor contended that respective values of \$15,347,400, \$16,688,300 and 20,514,000 were supported. This led Mr. Mills to testify that he believed the local board's determination of a total value of \$15,159,800 should be affirmed.

The basis of valuation set out in Tenn. Code Ann. §67-5-601(a) is that [t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values. . .”

As the party seeking to change the current assessment of the subject property, the appellant has the burden of proof in this administrative proceeding. State Board Rule 0600-1-.11(1).

General appraisal principles require that the sales comparison, cost and income approaches to value be used whenever possible. Appraisal Institute, *The Appraisal of Real Estate* at 130 and 140-141. (13th ed. 2008). However, certain approaches to value may be more meaningful than others with respect to a specific type of property and such is noted in the correlation of value indicators to determine the final value estimate. The value indicators must be judged in three categories: (1) the amount and reliability of the data collected in each approach; (2) the inherent strengths and weaknesses of each approach; and (3) the relevance of each approach to the subject of the appraisal. *Id.* at 559-565.

The value to be determined in the present case is market value. A generally accepted definition of market value for ad valorem tax purposes is that it is the most probable price expressed in terms of money that a property would bring if exposed for sale in the open market in an arm's length transaction between a willing seller and a willing buyer, both of whom are knowledgeable concerning all the uses to which it is adapted and for which it is capable of being used. *Id.* at 23.

In view of the definition of market value, the income producing nature of the subject property and the age of subject property, generally accepted appraisal principles would indicate that the sales comparison and income approaches have greater relevance and should normally be given greater weight than the cost approach in the correlation of value indicators.

The parties quickly agreed that in this instance, the cost approach simply did not provide an effective measure of the market value of the property.

In both his income and sales analyses, Mr. Clanton sought to distinguish the supported values of the property between leased fee and fee simple. In order to properly arrive at the fee simple value of the property, he felt that the property had to be valued as if it were vacant.

Otherwise, he argued, any value estimate would be a leased fee value. Thus, he accordingly made adjustments to his comparable sales to reflect his contention. Likewise, his income analysis is predicated on the need for any potential purchaser to “lease up” the property.

However, as Mr. Mills pointed out, the State Board has historically not taken this approach. Indeed, in Lowes Home Centers, Inc. (Coffee County, Initial Decision and Order, November 21, 2014)¹, Administrative Judge Mark Minsky addressed an almost identical argument:

The central issue before the administrative judge concerns the taxpayer’s assertion that since Tennessee law requires property to be valued in fee simple for *ad valorem* tax purposes, it must be assumed that the property under appeal is vacant and available for sale or lease. Put somewhat differently, the taxpayer maintained that it is irrelevant whether the subject property is presently occupied.

(Page 3).

After a detailed review of several decisions of the State Board, Administrative Judge Minsky concluded that Tennessee law did not provide for valuing property such as this as vacant:

The administrative judge might very well have adopted Mr. Holliday’s analysis, in whole or in part, if Tennessee law required the assumption that the property under appeal is vacant and available for sale or lease. Given the Court’s ruling in *National Life*, the administrative judge finds it inappropriate to value the subject property as if vacant and available for sale or lease.

(Page 6).

Conversely, the proof submitted by Mr. Mills conforms to the rulings of the State Board. Both parties agreed that the best comparable sale was the Perseus National Distribution Center.²

¹ A copy of this Order is attached.

² Although this sale occurred after the relevant assessment date, the parties agreed that the sale price reflected the market value as of the assessment date.

However, it appears the adjustments made by Mr. Mills were appropriate and supported the value assigned to the subject property by the local board.

Respectfully, the proof offered by the Assessor is compelling, while the theory advanced by the taxpayer, namely that the property be valued as if it were vacant, simply has not been accepted by the State Board.

Order

It is, therefore, ORDERED that the following equalized values be adopted for tax year 2014:

Parcel 042-064.00

<u>Land Value</u>	<u>Improvement Value</u>	<u>Total Value</u>	<u>Assessment</u>
\$481,500	\$9,107,900	\$9,589,400	\$3,835,760

Parcel 042-064.00 001

<u>Land Value</u>	<u>Improvement Value</u>	<u>Total Value</u>	<u>Assessment</u>
\$0	\$5,570,400	\$5,570,400	2,228,160

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

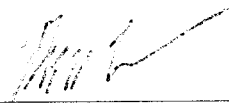
1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal “**must be filed within thirty (30) days from the date the initial decision is sent.**” Rule 0600-1-.12 of

the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal “**identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order**”; or

2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review.

The result of this appeal is final only after the time expires for further administrative review, usually seventy-five (75) days after entry of the Initial Decision and Order if no party has appealed.

Entered this 21st day of January ²⁰¹⁶~~2015~~.



Brook Thompson, Administrative Judge
Tennessee Department of State
Administrative Procedures Division
William R. Snodgrass, TN Tower
312 Rosa L. Parks Avenue, 8th Floor
Nashville, Tennessee 37243

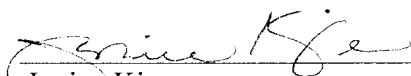
CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and exact copy of the foregoing Order has been mailed or otherwise transmitted to:

Mark T. McMerrell, CPA
Ryan
Suite 2800, Key Tower
127 Public Square
Cleveland, Ohio 44114

Frances Hunley
Madison Co. Assessor of Property
100 East Main Street, Suite 304
Jackson, Tennessee 38301

This the 21st day of January 2015.



Janice Kizer
Department of State
Administrative Procedures Division

maintained support value indications of \$5,150,000, \$4,500,000, and \$5,150,000 respectively. He placed primary emphasis on the income and sales comparison approaches and reconciled the various indications of value at \$4,850,000.

As will be discussed below, Mr. Holliday maintained that in order to value subject property in fee simple it must be assumed that the property is vacant and available for sale or lease. Accordingly, he asserted that it is inappropriate to consider sales of leased properties because such sales constitute leased fee sales rather than fee simple sales.

The assessor contended that subject property should be valued at \$8,745,500. In support of this position, the testimony and "Consultant Report" of Robert L. Spencer, III was offered into evidence. Essentially, Mr. Spencer processed cost and sales comparison approaches which he claimed support value indications of \$9,513,800 and \$10,358,800 respectively. Mr. Spencer also noted that the CAAS value resulting from the 2014 mass reappraisal program was \$8,745,500. Rather than conclude a certain value, Mr. Spencer simply noted the range of values supported by the cost, sales comparison and CAAS approaches to value.

Unlike Mr. Holliday, Mr. Spencer considered sales of occupied Lowe's Home Centers as well as a Walmart Supercenter in his sales comparison approach. He argued, in substance, that those sales constituted fee simple sales and that sales of other Lowe's Home Centers represent the best indicators of the market value of subject property.

The basis of valuation as stated in Tennessee Code Annotated § 67-5-601(a) is that "[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values. . . ."

Since the taxpayer is appealing from the determination of the Coffee County Board of Equalization, the burden of proof is on the taxpayer. See State Board of Equalization Rule 0600-

1-11(1) and *Big Fork Mining Company v. Tennessee Water Quality Control Board*, 620 S.W.2d 515 (Tenn. App. 1981).

For the reasons discussed below, the administrative judge finds that the current appraisal of subject property must be affirmed, with one relatively minor adjustment, based upon the presumption of correctness attaching to the ruling of the Coffee County Board of Equalization.

The central issue before the administrative judge concerns the taxpayer's assertion that since Tennessee law requires property to be valued in fee simple for *ad valorem* tax purposes, it must be assumed that the property under appeal is vacant and available for sale or lease. Put somewhat differently, the taxpayer maintained that it is irrelevant whether the subject property is presently occupied.

The administrative judge recognizes that in an unpublished ruling dated April 22, 2014, the Michigan Court of Appeals adopted the taxpayer's position in *Lowe's Home Centers, Inc., et al. v. Township of Marquette, et al.* (Case Nos. 314111 & 31430). However, Michigan law and Tennessee law are fundamentally different.

The administrative judge finds that in many cases Tennessee law and generally accepted appraisal practices are one in the same. In certain instances, however, Tennessee law and generally accepted appraisal practices are not synonymous. For example, the discounted cash flow analysis ["DCF"] probably constitutes the most commonly encountered situation wherein Tennessee law and generally accepted appraisal practices differ. In many instances wherein a fee appraiser might utilize a DCF the State Board of Equalization, reasoning that such an analysis is unduly speculative in contravention of Tenn. Code Ann. 67-5-601(a), does not. *See, e.g.*, the oft-cited ruling of the Assessment Appeals Commission in *MetroCenter Holdings, Inc.* (Davidson County, Tax Years 1993-1995). Similarly, the *State of Tennessee Assessment Manual* approved by the State Board in 1972 provides in relevant part at page AP – 8 as follows:

The one point common to all definitions of market value is the presumption of a sale or exchange of the property. If the property is of the type commonly bought and sold in the market, then the subjective concept of value prevails and weight is given to value indicators derived from the market. Thus, value in exchange is the basis of estimating market value.

If a property is of a highly special design or use, and is of the type not commonly bought or sold in the market, then the objective concept of value prevails and other methods of estimating value must be formulated. Under a situation of this nature, the property is useful to the present owner and is of a functional design for its particular use. However, it may have little, if any utility to buyers ordinarily forming the real estate market. Consequently, the property is said to have a value in use as opposed to value in exchange. The value of such special purpose property is generally estimated on the basis of depreciated replacement cost.

See also UCAR Carbon Co., Inc. (Montgomery County, Tax Year 1994) wherein the administrative judge concluded that limited market properties are also properly valued in use rather than in exchange.²

For purposes of this appeal, the administrative judge finds dispositive the ruling of the Tennessee Court of Appeals in *National Life & Accident Insurance Co. v. Keaton*, No. 85-326-II, 1986 WL 4846 (Tenn. Ct. App. April 23, 1986) (no Tenn. R. App. P. 11 application filed) [*“National Life”*]. In that case, the Court dealt with the value of a computer for personal property tax purposes. Although it was uncontroverted that the “going market value” of a computer of like make and model was \$82,000, the Court upheld the decision of the Assessment Appeals Commission and Chancellor to set the value at \$875,103 (rather than at \$82,000 as determined by the ALJ) based upon the fact the computer was leased for \$31,000 per month. The Court reasoned in pertinent part as follows:

... any person interested in purchasing the subject property would be willing to pay more for it because of the expectation of substantial rents. Correspondingly, the owner would require a purchase price commensurate with the anticipated income from the property. Thus, is established the ‘willing seller, willing buyer’ value of property subject to a lease.

² The term “limited market property” is commonly defined as “[a] property or property right that has relatively few potential buyers.” Appraisal Institute, *The Dictionary of Real Estate Appraisal* (5th ed. 2010) at 114.

* * *

Appellant insists that the Commission ignored the 'market value' of the subject property. Such is not the case. The Commission was not bound by the market value of other identical property which was not similarly based. The Commission did consider and fix the market value of the particular property in the light of the profitable lease which was inherent or 'intrinsic' in the particular property.

Appellant next complains that the Commission failed to consider that the lease was executed in 1977 when the value of the property was \$2,917,000 and the rent was set as \$49,010.44 per month to afford a reasonable return upon an investment of \$2,917,000. The rent was subsequently reduced by agreement to \$31,000 per month, and the assessment of the Commission was based upon this rental. This is not to say, however, that, had the rent not been reduced by agreement, the continuing obligation of the lessee to pay and of the owner to receive the full originally agreed rental for the taxable year would not have been a valid consideration in the determination of taxable value.

An assured substantial income from a property is a major element of its value.

* * *

Finally, appellant insists that the assessment is 'discriminatory', because, an identical computer might have been purchased on [the assessment date] for \$82,000. Such a computer would not have been identical unless it were the subject of a lease providing an identical rental.

Id. at *7-*8. Based upon the Court's rationale, any value attributable to the existing lease at the time of sale constitutes part of the "intrinsic" value of the property within the meaning of Tenn. Code Ann. § 67-5-601(a).³

The administrative judge recognizes that the appraisal community would consider the Court's conclusion in *National Life* as indicative of the value of the leased fee estate. However,

³ The administrative judge finds that such a result would not follow in the situation wherein contract rent is less than market rent. In that scenario, the leasehold estate has a positive value. Theoretically, the value of the leased fee estate would have to be added to the value of the leasehold estate to arrive at the value of the fee simple estate. See *First American National Bank Building Partnership* (Assessment Appeals Commission, Davidson County, Tax Years 1984-1987) wherein the Commission ruled that "is the entire fee simple unencumbered value and not any lesser of partial interests" which is normally subject to taxation. See also *Hoover v. State Board of Equalization*, 579 S.W.2d 192, (Tenn. Ct. App. 1978) wherein the Court ruled that "for property tax purposes, value attaches to the property itself, not to the interest of the current party in possession." *Id.* at 195.

for purposes of Tennessee law a lease at or above market rent must be considered part of the “intrinsic” value of the real property within the meaning of Tenn. Code Ann. § 67-5-601(a).⁴

This appeal was actually the first in a series of hearings involving Lowe’s Home Centers located in different counties. In each case, the taxpayer relied on an appraisal prepared by Mr. Holliday. In the subsequent hearing in Warren County, the administrative judge asked Mr. Holliday if his conclusion of value would have been different if it was assumed that a leased fee valuation (as that term is understood in the appraisal community) was appropriate under Tennessee law. Not surprisingly, Mr. Holliday testified that his conclusion of value would have been different.

The administrative judge might very well have adopted Mr. Holliday’s analysis, in whole or in part, if Tennessee law required the assumption that the property under appeal is vacant and available for sale or lease. Given the Court’s ruling in *National Life*, the administrative judge finds it inappropriate to value the subject property as if vacant and available for sale or lease. The administrative judge adopts the assessor’s contention that sales of other Lowe’s Home Centers normally constitute the best indicators of value for purposes of the sales comparison approach. Similarly, the administrative judge finds Mr. Spencer properly considered both the sale and lease terms in the Walmart Supercenter sale.

The administrative judge finds that Mr. Holliday’s cost approach cannot be adopted as the basis of valuation for three primary reasons. First, the administrative judge finds both parties understandably gave little weight to the cost approach. Second, Mr. Holliday’s \$1,847,290

⁴ The administrative judge finds that prior decisions involving excess rent such as *Seventeenth & Church Developers* (Davidson County, Tax Years 1993 & 1994) can no longer be considered good law. Historically, *National Life* was simply not raised by the assessing authorities or State Board in the context of real property appeals. It could plausibly be argued that *National Life* should be limited to the valuation of personal property. However, in *Spring Hill, L.P. v. Tenn. State Board of Equalization*, 2003 WL 23099679 (December 31, 2003) [“*Spring Hill*”] the Court of Appeals relied, in part, on *National Life* in deciding how to appraise LIHTC Properties for *ad valorem* tax purposes. Given that *Spring Hill* involved real property, it can no longer be argued that the Court’s rationale in *National Life* should be limited to the valuation of personal property.

deduction for external obsolescence is based upon the net operating income and cap rate assumed in his income approach. For the reasons previously stated, the administrative judge finds that Mr. Holliday's income approach does not comport with Tennessee law. Third, the cross-examination of Mr. Holliday established that his cost approach should be modified to include the canopies and the fact subject building has package unit air rather than forced air. Absent additional evidence, one cannot determine what value would result from such modifications to Mr. Holliday's cost approach.

Although the administrative judge finds that Mr. Holliday's cost approach cannot provide a basis of valuation standing by itself, it does support one modification to the current appraisal of subject property. In particular, the administrative judge finds that Mr. Holliday supported his estimated land value of \$1,900,000 with a traditional analysis of comparable land sales. Mr. Spencer, in contrast, simply utilized the land value estimate from the 2014 reappraisal program.⁵ There is nothing in the record explaining the basis for the current land value of \$2,084,000. Accordingly, the administrative judge adopts Mr. Holliday's valuation of subject land.

The administrative judge wants to stress that he has affirmed the current appraisal of the improvements based upon the presumption of correctness attaching to the ruling of the Coffee County Board of Equalization. Respectfully, the administrative judge finds that Mr. Spencer's actual value conclusions lack probative value for the same reasons his report was rejected in *Batesville Manufacturing* (Coffee County, Tax Year 2014).

⁵ The appraisal affirmed by the Coffee County Board of Equalization is the functional equivalent of a cost approach wherein the land and improvements have been separately valued. This is not a situation where the land value represents an allocation derived from the sales comparison or income approaches.

ORDER

It is therefore ORDERED that the following value and assessment be adopted for tax year 2014:


<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$1,900,000	\$6,661,500	\$8,561,500	\$3,424,600

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **“must be filed within thirty (30) days from the date the initial decision is sent.”** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review.

The result of this appeal is final only after the time expires for further administrative review, usually seventy-five (75) days after entry of the Initial Decision and Order if no party has appealed.

ENTERED this 21st day of Nov. ~~October~~ 2014.



MARK J. MINSKY, Administrative Judge
Tennessee Department of State
Administrative Procedures Division
William R. Snodgrass, TN Tower
312 Rosa L. Parks Avenue, 8th Floor
Nashville, Tennessee 37243

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and exact copy of the foregoing Order has been mailed or otherwise transmitted to:

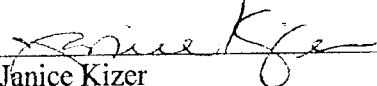
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This the 21st day of Nov. ~~October~~ 2014.



Janice Kizer
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