STATE OF MINNESOTA

COUNTY OF CLAY

TAX COURT
REGULAR DIVISION
SEVENTH JUDICIAL DISTRICT

Menard, Inc.,

Petitioner,

v.

County of Clay,

Respondent.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER FOR JUDGMENT

File Nos. 14-CV-12-1500
14-CV-13-1454
14-CV-13-1405
14-CV-14-1352

Filed: September 18, 2015

This matter came on for trial before The Honorable Bradford S. Delapena, Judge of the Minnesota Tax Court.

Robert A. Hill, Attorney at Law, represented petitioner Menard, Inc.

Thomas J. Radio, Best & Flanagan LLP, and Jenny M. Samarzja, Assistant Clay County Attorney, represented respondent Clay County.

These property tax cases concern the market value of the Menards home improvement store located in Moorhead, Minnesota as of the January 2, 2011, through January 2, 2014 assessment dates. We find that the assessed value of the subject property overstates its market value as of each of the four assessment dates.

The court, having heard and considered the evidence adduced at the hearings and the arguments of counsel, and upon all of the files, records, and proceedings herein, now makes the following:

FINDINGS OF FACT

1. Petitioner Menard, Inc., has sufficient interest in the property to maintain this petition; all statutory and jurisdictional requirements have been fulfilled; and the court has jurisdiction over the subject matter of the action and the parties thereto.

2. The subject property is the Menards home improvement center in Moorhead, Minnesota, with a street address of 3000 27th Avenue South. The center occupies a parcel of approximately 771,350 square feet.

3. The subject property is improved by two structures. The first is a 202,948 square-foot building composing: (1) a single-story heated retail space of 162,340 square feet, with an additional 11,041 square feet of mezzanine space; and (2) a covered/unheated garden center of 40,608 square feet. This building is Class C tilt-up masonry construction atop a concrete slab with reinforced concert footings and a reinforced concrete floor. It is an average quality big box retail store.

4. The subject property's second building is a 22,440 square-foot open-air detached shed used as a warehouse.

5. Both structures were built in 2007, and were in good condition as of each assessment date.

6. The subject property is located in a developing section of eastern Moorhead, Minnesota.

7. The subject property has good visibility from Interstate 94, and enjoys good access from the interstate, and from both Main Avenue Southeast and 34th Street South.

8. The subject property is zoned RC – Regional Commercial.

9. The Clay County Assessor estimated the market value of the subject property at $11,220,000 for all four assessment dates.

10. Menard's expert appraiser, Mr. Michael S. MaRous, MAI, CRE, valued the property at $4,000,000 for all four assessment dates.

11. The County's expert appraiser, Mr. Timothy L. Vergin, MAI, valued it at $12,000,000 for the 2011 valuation date; at $12,300,000 for the 2012 date; at $12,500,000 for the 2013 date; and at $12,700,000 for the 2014 date.

12. There was at most one vacant big box retail store in the Fargo/Moorhead region as of the four valuation dates.

13. There was no excess supply of vacant big box stores in the Fargo/Moorhead area as of the four valuation dates.

14. The Fargo/Moorhead area was far less affected by the Great Recession than many communities.

15. Home improvement stores are not as vulnerable to online sales as booksellers or consumer electronics stores.

16. Big box retailers are divisible into different market segments depending on factors such as product type (*e.g.*, books versus lumber) and favored store size (smaller versus larger footprints).

17. As a large big box retail store, the subject property occupies the submarket of large stores attractive to the market segment of big box retailers whose business models favor larger stores.

18. The subject property was a viable big box retail location as of all four valuation dates, at least for that market segment of big box retailers whose business models favor larger facilities.

19. The subject property's highest and best use as vacant on all four valuation dates was for commercial use.

20. The subject property's highest and best use as improved on all four dates was for continued use as a big box retail store.

21. The subject property's site value for each valuation date was $2,890,000.

22. The value of the subject property's site improvements was Menard's actual 2007 site improvement cost of $1,820,000, indexed to each valuation date at annual rate of 2.25 percent.

23. The value of the subject property's building improvements was equal to Mr. MaRous' 2014 estimate of $7,961,904, indexed to each valuation date at annual rate of 2.25 percent.

24. The cost of the subject property's improvements include a 10 percent addition for entrepreneurial incentive.

25. The subject property suffered from physical deterioration of $1,649,533 on the 2011 valuation date; $1,701,853 on the 2012 date; $2,196,350 on the 2013 date; and $2,744,620 on the 2014 date.

26. The subject property suffered from functional obsolescence of $2,500,000 on each valuation date.

27. The subject property suffered from no external obsolescence on any of the valuation dates.

28. The subject property's indicated market value under the cost approach was $9,121,382 for the 2011 valuation date; $9,302,631 for the 2012 date; $9,046,960 for the 2013 date; and $8,742,890 for the 2014 date.

29. The subject property's gross building area for purposes of the sales comparison approach was 162,340 square feet.

30. The subject property's indicated market value under the sales comparison approach was $4,898,122 for the 2011 valuation date; $5,010,462 for the 2012 date; $5,390,987 for the 2013 date; and $6,044,243 for the 2014 date.

31. Neither appraiser developed a relevant and reliable income capitalization approach.

32. We give the cost approach a 60 percent weighting and the sales comparison approach a 40 percent weighting for the 2011 and 2012 valuation dates. For the 2013 and 2014 dates, we give each approach a 50 percent weighting.

33. The market value of the subject property for each valuation date is as follows:

	2011	**2012**	**2013**	**2014**
Cost Approach	$ 9,121,382	$ 9,302,631	$ 9,046,960	$ 8,742,890
Sales Approach	$ 4,898,122	$ 5,010,462	$ 5,390,987	$ 6,044,243
Market Value	**$ 7,432,100**	**$ 7,585,800**	**$ 7,219,000**	**$ 7,393,600**

CONCLUSIONS OF LAW

1. Petitioner submitted sufficient credible evidence to rebut the prima facie validity of the assessed value as of each valuation date.

2. The assessor's estimated market value for the subject property as of January 2, 2011, overstates its market value as of that date.

3. The assessor's estimated market value for the subject property as of January 2, 2012, overstates its market value as of that date.

4. The assessor's estimated market value for the subject property as of January 2, 2013, overstates its market value as of that date.

5. The assessor's estimated market value for the subject property as of January 2, 2014, overstates its market value as of that date.

ORDER FOR JUDGMENT

1. The assessed value of the subject property as of January 2, 2011, shall be decreased from $11,220,000 to $7,432,100.

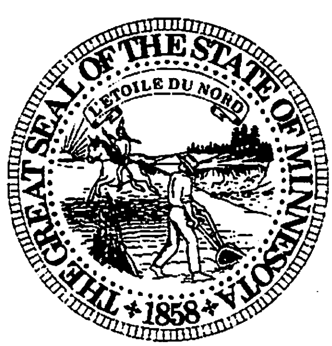
2. The assessed value of the subject property as of January 2, 2012, shall be decreased from $11,220,000 to $7,585,800.

3. The assessed value of the subject property as of January 2, 2013, shall be decreased from $11,220,000 to $7,219,000.

4. The assessed value of the subject property as of January 2, 2014, shall be decreased from $11,220,000 to $7,393,600.

5. Real estate taxes due and payable in 2012, 2013, 2014, and 2015 shall be recomputed accordingly and refunds, if any, paid to petitioner as required by such computations, together with interest from the original date of payment.

IT IS SO ORDERED. THIS IS A FINAL ORDER. ENTRY OF JUDGMENT IS STAYED FOR 15 DAYS. LET JUDGMENT BE ENTERED ACCORDINGLY.



BY THE COURT,

Bradford S. Delapena, Judge
MINNESOTA TAX COURT

Dated: September 18, 2015

MEMORANDUM

I. THE SUBJECT PROPERTY

The subject property is the Menards home improvement center in Moorhead, Minnesota, with a street address of 3000 27th Avenue South. The center occupies a parcel of approximately 771,350 square feet,[1] and is improved by two structures.[2] The first is a 202,948 square-foot building composing: (1) a single-story heated retail space of 162,340 square feet, with an additional 11,041 square feet of mezzanine space; and (2) a covered/unheated garden center of 40,608 square feet.[3] This building is Class C tilt-up masonry construction atop a concrete slab with reinforced concert footings and a reinforced concrete floor.[4] It is an average quality big box retail store.[5] The second building is a 22,440 square-foot open-air detached shed used as a warehouse.[6] Both structures were built in 2007, and were in good condition as of each assessment date.[7]

The subject property is located in a developing section of eastern Moorhead, Minnesota. Beginning in approximately 2000, the City of Moorhead implemented a development plan to create an eastward growth ring. At a cost of over $60 million in public investment, the City furnished utilities to 3,100 acres of land and, through construction of ramps at both Main Avenue Southeast and 34th Street South, increased local access from Interstate 94.[8] The retail store has

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[1] Ex. 1, at 1; Ex. A, at 16, 43.

[2] Ex. 1, at 34; Ex. A, 13-15.

[3] Ex. 1, at 1, 34; Ex. A, at 16, 47-48.

[4] Ex. 1, at 39; Ex. A, at 48.

[5] Ex. A, at 49.

[6] Ex. 1, at 1, 34, 41; Ex. A, at 16, 47.

[7] Ex. 1, at 1, 34, 41; Ex. A, at 16, 26, 47.

[8] Tr. 211-14.

good visibility from Interstate 94,[9] and enjoys good access from the interstate (which runs east/west) and from both Main Avenue Southeast and 34th Street South (which run roughly north/south).[10] Traffic volume on Interstate 94 ranges between 27,000 and 37,500 vehicles per day; volume on Main Avenue Southeast and 34th Street South average approximately 10,000 vehicles per day on each roadway.[11] The subject property is zoned RC – Regional Commercial.[12]

The Clay County Assessor estimated the market value of the subject property at $11,220,000 for all four assessment dates.[13] Menard's expert appraiser, Mr. Michael S. MaRous, MAI, CRE, valued the property at $4,000,000 for all four assessment dates.[14] The County's expert appraiser, Mr. Timothy L. Vergin, MAI, valued it at $12,000,000 for the 2011 valuation date; at $12,300,000 for the 2012 date; at $12,500,000 for the 2013 date; and at $12,700,000 for the 2014 date.[15]

II. BURDEN OF PROOF

An assessor's estimated market value is prima facie valid. *S. Minn. Beet Sugar Coop. v. Cnty. of Renville*, 737 N.W.2d 545, 557 (Minn. 2007) (citing Minn. Stat. §§ 271.06, subd. 6 & 272.06 (2014)). A petitioner may overcome the presumption of validity by introducing evidence that the assessor's estimated market value is excessive. *Id.* at 558. We conclude that Menard presented sufficient evidence through the testimony of its expert appraiser to rebut the

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[9] Tr. 224.

[10] Ex. 1, at 19; Ex. A, at 15 (map), 34-35; Tr. 219, 223, 244.

[11] Ex. A, at 35.

[12] Ex. 1, at 1, 22, 30-33; Ex. A, at 16, 27-29, 52.

[13] Ex. 1, at 49; Ex. A, at 25; Ex. A1, at 25-26.

[14] Ex. 1, at 142-43.

[15] Ex. A, at 135; Ex. A1, at 1, 83-84.

presumption. When the prima facie validity is overcome, we determine market value based upon a preponderance of the evidence. *See Red Owl Stores, Inc. v. Comm'r of Taxation*, 264 Minn. 1, 7-8, 117 N.W.2d 401, 406-07 (1962); *Macy's Retail Holdings, Inc. v. Cnty. of Hennepin*, No. 27-CV-07-07774 et al., 2011 WL 6117899, at *2 (Minn. T.C. Nov. 28, 2011) (citing *Pep Boys v. Cnty. of Anoka*, No. C2-01-2780 et al., 2004 WL 2436350, at *3 (Minn. T.C. Oct. 26, 2004)).

III. Tax Valuation Generally

We consider the three traditional approaches to valuation—cost, income, and sales comparison—in determining market value. *See Equitable Life Assur. Soc'y of the U.S. v. Cnty. of Ramsey*, 530 N.W.2d 544, 552 (Minn. 1995). We are not required, however, to give weight to all three valuation approaches, and we may place greater emphasis on a particular approach or approaches. *Id.* at 554. Because the approaches to value are applied in light of a property's highest and best use, *see, e.g.*, Appraisal Institute, *The Appraisal of Real Estate* 42-43, 331, 362, 373, 379, 565 (14th ed. 2013) (so indicating), we turn to highest and best use.

IV. Highest and Best Use

A property's highest and best use is "[t]he reasonably probable use of property that results in the highest value." *Appraisal of Real Estate* 332. To be reasonably probable, a use must be physically possible, legally permissible, and financially feasible. *Id.* Uses that satisfy these three criteria are then tested under a fourth "for economic *productivity*, and the reasonably probable use with the highest value is the highest and best use." *Id.*

Highest and best use analysis is undertaken "from two perspectives: [1] the use of a property based on the assumption that the parcel of land is vacant or can be made vacant by demolishing any improvements [and 2] the use that should be made of a property as it exists (i.e., considering the current improvements)." *Appraisal of Real Estate* 336. These two perspectives "are connected but [reflect] distinctly different concepts." *Id.* An "as vacant" analysis "focuses [broadly] on alternative uses, with the appraiser testing each reasonably probable use for legal permissibility, physical possibility, financial feasibility, and maximum productivity." *Id.* at 337. An "as improved" analysis, in contrast, applies the four criteria more narrowly to alternative uses *of the existing improvements in particular*, evaluating whether to retain, modify, or demolish them. *Id.*

A. The Parties' Evidence

In his as-vacant analysis, Mr. MaRous, Menard's expert appraiser, noted that "a wide variety of structures" were physically possible on the subject property.[16] Likewise, the property's RC – Regional Commercial zoning permitted a wide range of uses.[17] MaRous did not address which physically possible and legally permissible uses were either financially feasible or maximally productive.[18] MaRous concluded that the subject property's highest and best use as vacant was for "a relatively low-intensity commercial development or for a long-term, buy and hold position." [19]

Mr. Vergin, the County's expert appraiser, agreed that a wide variety of uses were both physically possible and legally permissible.[20] With respect to financial feasibility, Vergin commented that "[t]he subject is located in a growing area that has experienced commercial growth over the years." [21] He concluded that the maximally productive use of the property as vacant was a commercial use. On this basis, Vergin determined that "[t]he highest and best use

[16] Ex. 1, at 43.

[17] Ex. 1, at 43.

[18] Ex. 1, at 43.

[19] Ex. 1, at 43.

[20] Ex. A, at 52.

[21] Ex. A, at 52.

of the subject site as though vacant is a commercial use that conforms to the current zoning ordinance." [22]

For purposes of his as-improved analysis, MaRous considered the subject property to be "in average to good condition," but commented that its "most critical limiting factor is the large building size," which he believed "limits the pool of potential buyers or tenants." [23] Implicitly concluding that this limit was absolute—that there were *no* prospective purchasers of the property for use as a big box retail store—MaRous included in his report both a developer interview summarizing the difficulties of converting a big box store into a multi-tenant retail property and a cost analysis for such a conversion.[24] Based on this analysis, which he characterized as a "test of reasonableness," [25] MaRous concluded that "it is not economically feasible to convert the subject property from a mega/oversize big-box store into four, approximately 20,000-square-foot retail units totaling 80,000 square feet." [26]

MaRous concluded that the subject property's highest and best use as improved was "continued use as a single-tenant retail building with its current owner-occupant, a Menards Home Improvement retail store." [27] Then, again relying on his implicit conclusion that there were no prospective purchasers of the property for use as a big box retail store, MaRous added: "Should this building become vacant, it is highly likely the building would remain vacant." [28] After repeating that conversion to multi-tenant retail was not financially feasible, MaRous

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[22] Ex. A, at 56; Ex. A1, at 17.

[23] Ex. 1, at 43.

[24] Ex. 1, at 44-48.

[25] Ex. 1, at 45.

[26] Ex. 1, at 48.

[27] Ex. 1, at 48.

[28] Ex. 1, at 48.

commented that "[a] more likely scenario is converting the space to some type of light industrial use or securing an alternate user who would raze the improvements in favor of its own design and alternate use." [29]

Mr. Vergin opined that the subject property's existing improvements were physically suited to both its current use and to possible industrial use.[30] He noted that the property's current use was legally conforming, and that the property might also be used as a distribution/warehouse were the property rezoned to CC – Community Commercial.[31] Vergin believed that his income capitalization approach demonstrated the financial feasibility of the property's current use as a big box retail store, and concluded that this was the property's maximally productive use as improved.[32] On this basis, Vergin determined that "[t]he highest and best use as improved is the current use as a big box retail store." [33]

These highest and best use conclusions, although superficially similar, conceal a critical underlying disagreement. Whereas MaRous believed that the subject property was *not* viable as a big box retail store (if sold by Menard), Vergin concluded that it was. For the reasons set forth below, we find that the subject property was viable as a big box retail store on all the valuation dates and, therefore, agree with Vergin's highest and best use conclusions.

B. Analysis

We find Mr. MaRous' highest and best use analysis unpersuasive owing to its general and abstract character. Although consideration of macroeconomic trends and national market

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[29] Ex. 1, at 48.

[30] Ex. A, at 54.

[31] Ex. A, at 54-55.

[32] Ex. A, at 55.

[33] Ex. A, at 56; Ex. A1, at 17.

conditions is surely warranted at the outset, proper analysis eventually must focus on the local economy and on the subject property's place within the relevant local market. *See Appraisal of Real Estate* 331 (indicating that the economic concept of highest and best use is "the logical end of a spectrum of market analysis procedures, running from the macroeconomic overview of a general market study, through more detailed marketability studies ... to the formal analysis of highest and best use"). MaRous never descended to this level of particularity in concluding that the subject property was not a viable big box retail store.

National Supply of Big Box Stores: MaRous indicated that the market value of the subject property—a typical big box store—was significantly impaired as of all four valuation dates by a nationwide oversupply of big box properties due to recent store closings.[34] MaRous commented that, "[p]articularly since the recession, big box retail stores have a certain stigma due to, among many other causes, a historically low demand and an overbuilt large supply of inventory."[35] He concluded that recent sales of big box properties nationwide demonstrated "that the stifling market dynamics for big box retail stores are not limited to a specific demographic or geographic area, but are regional and in fact national in scope."[36]

The County presented evidence, however, that there was at most one vacant big box store in the Fargo/Moorhead region as of the four valuation dates.[37] Thus, although national data might show a glut of vacant big box retail stores considering the nation as a whole, the record indicates that there was no excess supply of vacant big box stores in the Fargo/Moorhead area.

[34] Ex. 1, at 25-26, 28.

[35] Ex. 1, at 25.

[36] Ex. 1, at 77. *See also id.* at 105 (asserting that analysis of nationwide sales "is clear market evidence that the factors influencing big box retail store values, (*i.e.*, imbalance in supply and demand, market trends and influences that retailers are moving to smaller stores, online purchasing, etc.) is a *nationwide* market truth and is not limited to any one geographic area").

[37] Ex. A, at 40-41; Tr. 16, 109, 273-74.

The Great Recession: MaRous indicated that big box retailers were particularly affected by the Great Recession.[38] Again, however, MaRous painted with too broad a brush, for he specifically recognized that

> [t]he magnitude and duration of the downturn depended a great deal on a number of factors including location, both in terms of the regional market and the specific locale within a specific regional market; including location demographics, in terms of stability of employment, degree of affluence, etc.; and including the market desirability of a property, in terms of how a specific property fits within the local market, (*i.e.* is the market over-supplied, in balance, or undersupplied within a given property type).[39]

The County presented evidence that the Fargo/Moorhead area, although not immune from the effects of the Great Recession,[40] was far less affected than many communities. Indeed, MaRous' own report demonstrates: (a) that the area's population grew at an annual rate of 1.7 percent between 2010 and 2013;[41] (b) that the area's unemployment rate never exceeded 4.3 percent between 2009 and 2013;[42] and (c) that during the same period, the area enjoyed an average annual wage growth of between 1.4 and 5.2 percent.[43] The virtual absence of vacant big box stores in the Fargo/Moorhead area suggests that retailers decided not to close big box stores in this particular market, despite the Great Recession. In the smaller and relevant area, the market was not over-supplied for the particular property type of big box stores.

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[38] Ex. 1, at 24-25.

[39] Ex. 1, at 24-25.

[40] Tr. 208-09.

[41] Ex. 1, at 10. Indeed, the Fargo/Moorhead area had the thirteenth fastest population growth by percentage among U.S. metropolitan areas. Ex. L; Tr. 209.

[42] Ex. 1, at 11.

[43] Ex. 1, at 11.

Big Box Retail Trends: MaRous identified a general trend away from big box retail[44] owing, in part, to the proliferation of online retailing.[45] He likewise noted a trend among "junior" big box retailers toward smaller store footprints.[46] These trends, however, do not equally affect all big box retailers. MaRous acknowledged that home improvement stores are not as vulnerable to online sales as, say, booksellers or consumer electronics stores.[47] In addition, although some big box retailers have adjusted their business models in favor of smaller stores, others are moving in the direction of even larger facilities.[48] Thus, although it is certainly possible to speak generally of big box retailers, the very trends MaRous identified indicate that such retailers now differ from one another in pertinent respects.

Proper market analysis involves market segmentation, which "differentiates the most probable users of a property from the general population by their consumer characteristics." *Appraisal of Real Estate* 164. The evidence in this case indicates that big box retailers are now divisible into different market segments depending, for example, on factors such as product type (*e.g.*, books versus lumber) and favored store size (smaller versus larger footprints). Treating all big box retailers as a single market segment thus fails to identify and analyze genuine differences that affect which properties particular retailers might purchase. Whereas MaRous cited general big box trends as an indication that the subject property would attract no prospective purchasers, the trends actually indicate that a certain market segment—big box retailers whose business

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[44] Ex. 1, at 27 & n.10, 74.

[45] Ex. 1, at 27 & n.9, 114

[46] Ex. 1, at 26, 74, 114.

[47] Tr. 54-56, 59, 62.

[48] Tr. 66-67.

models favor larger stores—might be attracted to the subject property specifically because of its large size.[49]

Proper market analysis likewise involves product disaggregation, which "differentiates the subject property and competitive properties from other types of properties on the basis of their attributes or characteristics." *Appraisal of Real Estate* 164. Just as MaRous failed to identify as a market segment big box retailers attracted to large stores, he also failed to identify the subject property as one occupying a particular submarket—large big box stores attractive precisely to that market segment.

Market Area Dichotomy: MaRous considered the general characteristics of the United States Census Bureau's Fargo/Moorhead metropolitan statistical area, which comprises (along with those two cities) both Cass County, North Dakota and Clay County, Minnesota.[50] The area's population was approximately 210,000 in 2010, and 220,000 in 2013.[51] According to MaRous, this made the region a small to mid-sized market area,[52] and a secondary market area in comparison with more populated regions of Minnesota such as the Twin Cities and St. Cloud.[53]

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[49] In one sense, MaRous did segment the market, for he repeatedly emphasized that *most* big box retailers were seeking smaller stores. Ex. 1, at 43, 107. Having thus implicitly recognized a market segment seeking larger stores, he nevertheless assumed that the subject property would attract no buyers. Ex. 1, at 43. MaRous indicated that large-store users prefer to build their own facilities. Ex. 1, at 107. If the suggestion is that large-store users would prefer to build new stores from scratch for $10 million, rather than purchase recently constructed stores for $5 million and spending another $2.5 million to reconfigure them, thereby saving approximately $2.5 million in the process, that suggestion is unpersuasive, and is belied by sales comparables upon which Menard itself relies.

[50] Ex. 1, at 7, 10; Tr. 207.

[51] Ex. 1, at 10.

[52] Ex. 1, at 10.

[53] Ex. 1, at 9.

The area's significant distances from surrounding communities gave it "a rather fixed trade area and consumer base." [54]

Although concluding that "the Fargo-Moorhead market area has a degree of homogeneity," MaRous found "a number of significant variances within this market in terms of population and income demographics and the location of retail commercial districts." [55] MaRous noted, for example, that Cass County's population in 2012 was 155,589, whereas Clay County's was 60,514;[56] and that Cass County's 2012 median household income was $50,069, whereas Clay County's was $47,011.[57] MaRous likewise observed that "[t]he majority of the retail stores are located within the Fargo/West Fargo portion of the metro area and that is where the majority of the retail dollars are being spent." [58] MaRous thus commented: "The overall population and income demographics are superior in the Fargo, North Dakota, side of the market area versus the Moorhead, Minnesota section of the metro area. There are some larger retail properties within the Moorhead/Dilworth portion of this market; however, they are located away from the subject property." [59]

Based primarily upon the foregoing, MaRous commented: "[I]f a general retail user were to move into this market, it would most certainly locate in the more established and successful commercial areas of West Fargo/Fargo or Moorhead/Dilworth and most certainly *not* locate in

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[54] Ex. 1, at 9.

[55] Ex. 1, at 6-7.

[56] Ex. 1, at 16.

[57] Ex. 1, at 18.

[58] Ex. 1, at 23. *See also id.* (noting that "the locations of the majority of the retail properties within [the Fargo/Moorhead] market area are located within a fairly small grouping the Fargo/West Fargo area and along U.S. Route 10 in the Moorhead/Dilworth area" to the north of the subject property).

[59] Ex. 1, at 23.

the subject property's immediate local area." [60] Essentially, then, MaRous posited that retailers would make a simple, disjunctive choice between existing commercial areas. We cannot agree with this reasoning.

First, Moorhead real estate development services manager Peter Doll[61] testified that retail site selectors focus primarily upon "rooftops" and related demographics within 1-, 3-, 5-, and 10-mile concentric rings of candidate locations.[62] According to Doll, Menard's site selector indicated that Menard was content with its radial trade area analysis for the subject property, and considered the site "very adequate" to support a new store.[63] This testimony was un-rebutted by Menard. Moreover, radial trade area analysis is consistent with both appraisal literature and cases determining the value of retail facilities. *See, e.g.*, Appraisal Institute, *Shopping Center Appraisal and Analysis* 47-50 (2d ed. 2009) (indicating that "[t]he analyst's first task is to define the retail trade area that is appropriate to the subject property," noting that trade area "is smaller than the geographic area that represents the market area," and defining "primary trade area" as "the geographic area around a retail facility from which approximately 60% to 70% of the facility's customers are drawn") (quoting Appraisal Institute, *The Dictionary of Real Estate Appraisal* 219 (4th ed. 2002)); *J.C. Penney Properties, Inc. v. Cnty. of Hennepin*, No. 27-CV-10-07609 et al., 2014 WL 4311269, at *2 (Minn. T.C. Aug. 27, 2014) (identifying department store subject property and noting that "[h]ousehold incomes within a five-mile radius ... significantly exceed median household incomes for Minnesota in general"); *Westridge Mall Ltd. P'ship v. Cnty. of Otter Tail*, No. 56-CV-10-1119 et al., 2014 WL 1224971, at *14 (Minn. T.C. Mar. 20,

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[60] Ex. 1, at 24.

[61] Tr. 197.

[62] Tr. 217, 224-25.

[63] Tr. 216-19.

2014) (noting that a regional mall "typically draws from … a 5 to 15–mile radius"); *Kmart Corp. v. Cnty. of Becker*, No. CX-02-410 et al., 2004 WL 3021358, at *3 (Minn. T.C. Dec. 1, 2004) (applying a retail trade area of "approximately a 15 to 30 mile radius" from the subject property), *aff'd*, 709 N.W.2d 238 (Minn. 2006).

MaRous indicated that "any commercial development within this area must carefully analyze the respective potential to capture an economically viable portion of the retail market." [64] His own analysis, however, is bereft of any radial trade-area analysis for either the subject property or for potentially competitive sites.[65] *See, e.g.*, *Eden Prairie Mall, LLC v. Cnty. of Hennepin*, No. 27-CV-06-04210 et al., 2012 WL 360453, at *18 (Minn. T.C. Jan. 25, 2012) (noting that appraiser using anchor department store comparable sales "made locational adjustments based upon the five-mile radius demographic information he analyzed"), *rev'd on other grounds*, 830 N.W.2d 16 (Minn. 2013). We thus have no evidence concerning the respective potential of a retailer considering a new store in the Fargo/Moorhead area "to capture an economically viable portion of the retail market." [66] Moreover, MaRous' implicit assertion that retailers genuinely consider only "established and successful commercial areas" [67] inexplicably suggests that retailers eschew underserved and developing trade areas in favor of areas saturated with retail, where competition can actually impair market capture. *Appraisal of Real Estate* 632 (temporary or permanent external obsolescence may result from the "value loss due to an oversupplied market"); *see also Dolan, Sexton & Heim Realty Co. v. Cnty. of Hennepin*, No. TC-9835, 1992 WL 114634, at *2 (Minn. T.C. Apr. 29, 1992) (finding that "the

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[64] Ex. 1, at 24.

[65] Ex. A, at 40-42.

[66] Ex. 1, at 24.

[67] Ex. 1, at 24.

subject property suffer[ed] from economic obsolescence by reason of the highly competitive office market, the high vacancy rate and the rent concessions required to remain competitive").

MaRous' conclusion that the subject property's location is "certainly" not attractive to retailers is further undermined by Menard's own 2006 decision to purchase and develop the subject site. Mr. Doll testified that Menard had long operated in Fargo when it made this decision.[68] Menard's site selector told Doll that Menard was happy to be in the metro area's eastern growth ring, and that Menard "wanted to service the Fargo-Moorhead location with two locations, one on the west side and one on the east side."[69] According to Doll, Menard's principal concerns were: (1) to secure a location that constituted "the first access point coming into the city" from the east; and (2) to ensure that the City of Moorhead followed through on its plan to construct a double ramp system connecting with Interstate 94 at both 34th Street South and Main Street Southeast.[70] Considering that Menard purchased in 2006 not only the parcel on which the subject property now sits, but also an adjacent parcel (which Menard sold to Sam's Club in May 2013) and eleven separate out-lots,[71] it is plain that at least one retailer considered the subject site a location with significant retail potential.

Finally, Doll testified that, like Menard, other big box retailers operate under business models apparently calling for multiple locations in the larger Fargo/Moorhead market area.[72] Record evidence indicates that Sam's Club had an existing Fargo location before it opened a store on the parcel adjacent to the subject property in 2014; that Wal-Mart operated two stores in

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[68] Tr. 216.

[69] Tr. 218-19.

[70] Tr. 219-20.

[71] Ex. 1, at 30; Tr. 229-30.

[72] Tr. 218-19.

Fargo and one in Dilworth, a short distance north of the subject property; and that Target operated stores in both Fargo and Moorhead.[73] The evidence thus shows that numerous big box retailers have concluded that the Fargo/Moorhead market furnishes viable trade areas for multiple retail locations.

We find that the subject property was a viable big box retail location as of all four valuation dates, at least for that market segment of big box retailers whose business models favor larger facilities. Fargo/Moorhead had an unusually strong and stable economy throughout the relevant period, and the area was experiencing steady population and wage growth. Moorhead's development of an eastward growth ring was proceeding much more quickly than anticipated.[74] There was at most one vacant big box stores in the entire Fargo/Moorhead area, and the subject property was a recently-constructed typical big box store with both good visibility and recently augmented access from Interstate 94. We find that the subject property would therefore have been attractive to big box retailers, including those already operating in Fargo who wished—like Menard—to serve the metro area with more than one location. There is simply no reason to infer, as did MaRous, that other big box retailers would find the subject site unattractive.

We find that the subject property's highest and best use as vacant on all four valuation dates was for commercial use. We find that its highest and best use as improved on all four dates was for continued use as a big box retail store.

V. Cost Approach

The cost approach supposes that "an informed buyer would pay no more for the property than the cost of constructing new property having the same utility." *Equitable Life Assur. Soc'y*, 530 N.W.2d at 552. "Under the cost approach, the appraiser determines the current cost of

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[73] Ex. A, at 40-41; Tr. 219, 224-26.

[74] Tr. 233.

constructing the existing improvements on the property, subtracts depreciation to determine the current value of the improvements, and then adds the value of the land to determine the market value." *Cont'l Retail, LLC v. Cnty. of Hennepin*, 801 N.W.2d 395, 403 (Minn. 2011) (citation omitted); *see also Appraisal of Real Estate* 568-69 (setting forth general procedure for the cost approach). The cost approach "is useful for estimating the market value of new or relatively new construction ... and ... is best applied when land value is well supported and the improvements are new or suffer only minor depreciation." *Guardian Energy, LLC v. Cnty. of Waseca*, No. A14-1883 et al., 2015 WL 4747826, at *6 (Minn. Aug. 12, 2015) (citation and internal quotation marks omitted). It is also used "when market or income data is unavailable." *Cont'l Retail*, 801 N.W.2d at 403 (citation omitted).

A. Site Value

"Sales comparison is usually the preferable methodology for developing an opinion of site value," *Appraisal of Real Estate* 364, and both appraisers used that method here. Mr. MaRous considered two comparable land sales: the first was Menard's May 2013 sale to Sam's Club of the parcel adjacent to the subject property for $3.50 per square foot;[75] the second was a May 2006 sale for $2.24 per square foot.[76] Citing the lack of available comparable sales data, MaRous ultimately relied on the City Assessor's land value estimate of $3.00 per square foot for the subject property and, using the 771,350 square-foot site area, derived a total site value of $2,315,000.[77]

[75] Ex. 1, at 51 (MaRous's Comparable 2 – Sam's Club located in Moorhead, MN).

[76] Ex. 1, at 51 (MaRous's Comparable 1 – located in Moorhead, MN).

[77] Ex. 1, at 51.

Mr. Vergin considered nine comparable sales, one of which was the May 2013 Sam's Club transaction.[78] We find that six of Vergin's comparables are entitled to scant weight: three are 2007 transactions that predate the recession,[79] and three others are transactions from outside the Fargo/Moorhead market area (Baxter, Princeton, and Sartell).[80] In addition, Vergin's two remaining sales[81] (leaving aside the Sam's Club transaction) were both rejected by the Minnesota Department of Revenue for sales ratio purposes.[82] Although such rejection does not automatically preclude use of a transaction as a comparable sale, *see, e.g.*, *Geneva Exch. Fund XVII, LLC v. Cnty. of Dakota*, No. 19-C6-07-8009 et al., 2009 WL 4017075, at *7 (Minn. T.C. Nov. 19, 2009), Vergin failed to explain why either sale could properly be relied upon.[83] Consequently, these two sales are entitled to little if any weight. After adjustment (for factors such as size and location), Vergin's nine comparable land sales ranged from $3.50 per square foot to $5.65 per square foot, with a mean of $4.45 per square foot.[84] Placing primary reliance

[78] Ex. A, at 61-78; Ex. A, at 64 (Vergin's Comparable 1 – Sam's Club located at 2800 27th Ave. S., Moorhead, MN).

[79] Ex. A, at 61; Ex. A, at 70 (Vergin's Comparable 7 – Globe University located at 2777 34th Street S., Moorhead, MN); Ex. A, at 71 (Vergin's Comparable 8 – BioLife Plasma Services located at 2960 12th Street South, Moorehead, MN), Ex. A, at 72 (Vergin's Comparable 9 – the Proposed Multi-Plex Theatre located at 2900 13th Street S., Moorhead, MN).

[80] Ex. A, at 61; Ex. A, at 65 (Vergin's Comparable 2 – Costco located at 13720 Elder Dr., Baxter, MN); Ex. A, at 66 (Vergin's Comparable 3 – Walmart at 300 21st Ave. N., Princeton, MN); Ex. A, at 69 (Vergin's Comparable 6 – Wal-Mart/Sam's Club located at SEC of County Road 1/State Hwy 15, Sartell, MN).

[81] Ex. A, at 61; Ex. A, at 67 (Vergin's Comparable 4 – Holiday located at 3475 28th Ave. S., Moorhead, MN); Ex. A, at 68 (Vergin's Comparable 5 – Sanford Medical Center located at 4000 28th Ave. S., Moorhead, MN).

[82] Tr. 422, 426-27; Exs. 13-14.

[83] Vergin merely asserted that one of the sales had been independently verified and that he had been assured by a third party that the other was a "good sale." Tr. 422, 427.

[84] Ex. A, at 78.

on the May 2013 Sam's Club transaction at $3.50 per square foot, Vergin estimated site value at $3.75 per square foot, and thus derived a total site value of $2,890,000.[85]

We agree with both appraisers that the May 2013 Sam's Club transaction at $3.50 per square foot is entitled to controlling weight in determining site value. We reject MaRous' reliance on the assessed site value because a property's assessed value is irrelevant to that property's market value. *EOP–Nicollet Mall, L.L.C. v. Cnty. of Hennepin,* 723 N.W.2d 270, 283 (Minn. 2006) ("[T]he assessed value of property for tax purposes is not relevant to the question of that same property's market value."). Although Vergin's remaining land sales are less than ideal individually, their collective adjusted mean of $4.45 per square foot indicates that a value slightly higher than $3.50 per square foot is warranted. Consequently, we agree with Vergin and find that the subject property's site value for each valuation date is $3.75 per square foot, yielding a site value of $2,890,000 for each date.[86]

B. Improvements

Mr. MaRous relied on Menard's actual 2007 construction costs for the subject property's building and land improvements ($6,363,984 and $1,820,000, respectively), which he indexed to the four valuation dates at an annual rate of 2.25 percent.[87] MaRous' cost figures for the 2011 date were as follows:

Menards Store	$6,956,365
Land Improvements	$1,989,412
Entrepreneurial Incentive	$0
Total	**$8,945,777**

[85] Ex. A, at 79. Vergin used a site area of 771,341 square feet. Ex. A, at 43.

[86] Ex. A, at 79; Ex. A1, at 44.

[87] Ex. 1, at 57, 59.

MaRous noted that Menard's actual 2007 cost for the buildings, when indexed to a 2014 figure ($7,436,564), was approximately 6.6 percent lower that his own 2014 building cost estimate of $7,961,904 based on the Marshall & Swift Valuation Service (MVS).[88] After commenting on the similarity, MaRous simply relied on the lower actual cost figures.

Mr. Vergin relied on MVS cost estimates for the property's improvements.[89] Vergin's estimate for the 2011 valuation date were as follows:

Building Improvements	$9,566,696
Elevator to mezzanine	$50,000
Site Improvements	$1,091,906
Entrepreneurial Incentive	$1,070,860
Total	**$11,779,462**

Vergin asserted that this figure was within 8 percent of Menard's actual 2007 costs when those costs were: (a) indexed by 5.44 percent to 2011, which he computed as $9,901,862;[90] and then (b) increased by 10 percent for entrepreneurial incentive ($9,901,862 x 1.10 = $10,890,000).[91] Vergin averaged the two figures and reached a final improvement cost estimate of $11,350,000.[92]

We first observe that Vergin's actual cost computation is incorrect because, unlike Mr. MaRous, he failed to deduct from Menard's actual site costs those not attributable to the subject

[88] Ex. 1, at 59.

[89] Ex. A, at 80-81.

[90] In deriving this figure, Vergin relied on Menard's total building and site costs ($6,363,984 + $3,027,008 = $9,390,992), *see* Ex. A, at 82; *id.* at Appendix ("Menard's Provided Cost Statement"), and indexed them by 5.44 percent ($9,390,992 x 1.0544 = $9,901,862). As indicated below, however, not all of Menard's site costs were attributable to the subject property. Ex. 1, at 57.

[91] Ex. A, at 82.

[92] Ex. A, at 82.

property itself.[93] When these additional site costs are deducted, Menard's actual costs indexed to 2011 in accordance with Vergin's calculation (at 5.44 percent) and augmented for a 10 percent entrepreneurial incentive come to $9,492,112,[94] which is 24 percent lower than Vergin's 2011 MVS estimate of $11,779,462.

We also note that the appraisers arrived at starkly different cost estimates using MVS. MaRous' 2014 MVS estimate for the building improvements of $7,961,904—when indexed back to 2011 at his own annual rate of 2.25 percent—comes to $7,447,783. Vergin's 2011 building improvements estimate, in contrast, was $9,616,696 ($9,566,696 + $50,000 = $9,616,696). The appraisers thus differed by $1,654,792 on their 2011 MVS estimates for the cost of the buildings alone.

For site improvements, we adopt Menard's actual 2007 site improvement costs, as adjusted by Mr. MaRous from $3,027,008 to $1,820,000 to exclude site costs not attributable to the subject parcel.[95] MaRous' adjustment was unchallenged by the County, and Vergin's MVS site improvement estimate of $1,091,906 was not sufficiently justified to warrant reliance. We index this $1,820,000 figure to each valuation date using MaRous' annual rate of 2.25 percent.

As to the building improvements, we adopt MaRous' 2014 MVS cost estimate. For the 2011 valuation date, the record contains three separate figures: (a) MaRous' indexed actual cost

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[93] Ex. 1, at 57, 62 (MaRous appraisal explaining that some 2007 site costs were attributable to subdividing the larger parcel from which the subject property taken and to off-site improvements).

[94] The computation is as follows. MaRous' corrected site cost of $1,820,000 replaces the total site cost of $3,027,008 used by Vergin ($6,363,984 + $1,820,000 = $8,183,984). That lower sum is then indexed by 5.44 percent ($8,183,984 x 1.0544 = $8,629,193), and the resulting product is augmented by 10 percent for entrepreneurial profit ($8,629,193 x 1.10 = $9,492,112).

[95] Ex. 1, at 57, 62.

estimate of $6,956,365;[96] (b) MaRous' 2014 MVS estimate of $7,961,904, indexed to a 2011 figure of $7,447,783 (using MaRous' annual rate of 2.25 percent);[97] and (c) Vergin's 2011 MVS estimate of $9,616,969.[98] We agree with MaRous that the indexed actual cost figure ($6,956,365) and his adjusted MVS estimate ($7,447,783) are reasonably close, particularly considering that the actual cost figure does not include soft costs. Vergin's MVS estimate of $9,616,969, in contrast, is substantially above the indexed actual cost. Considering that the building improvements were constructed fairly recently, we prefer MaRous' MVS estimate, as supported by the indexed actual cost.

MaRous did not include in his cost approach any amount for entrepreneurial incentive or profit on the ground that Menard developed the property for occupancy rather than for sale or lease.[99] Vergin, in contrast, added 10 percent to his total improvement cost (site plus buildings),[100] explaining that an addition for entrepreneurial incentive is required by standard appraisal practice.[101] We agree that the cost of improvements should include a 10 percent addition for entrepreneurial incentive. *See Appraisal of Real Estate* 573 ("[A]ny building project will include an economic reward (above and beyond direct and indirect costs) sufficient to convince an entrepreneur to take on the risk associated with the project in that market."); *id.* at 563, 567, 571, 573-76 (all indicating that the cost approach should include an estimate of entrepreneurial incentive or profit). *See also Beneficial Facilities Corp. v. Peapack & Gladstone Borough*, 11 N.J. Tax 359, 381 (1990), *aff'd*, 13 N.J. Tax 112 (Super. Ct. App. Div. 1992)

[96] Ex. 1, at 57.

[97] Ex. 1, at 57-58.

[98] Ex. A, at 81 ($9,566,696 + $50,000 = $9,616,696).

[99] Ex. 1, at 61.

[100] Ex. A, at 80-81.

[101] Tr. 432.

("Entrepreneurial profit is justified, even for an owner-constructed and owner-occupied building because the principle of uniformity requires such property to be treated in the same manner as investment or speculation type property."); *Hoheisel v. Cnty. of Morrison*, No. CX-00-1413, 2001 WL 660867, at *1-2 (Minn. T.C. June 7, 2001) (finding that a 5 percent adjustment for entrepreneurial profit was warranted where "[p]etitioner acted as his own architect and general contractor" because "[i]n a normal market project of this type there are costs for an architect, a general contractor and labor"); *but see Vernon Woods of Edina v. Cnty. of Hennepin*, No. TC-10556, 1991 WL 95741, at *2 (Minn. T.C. May 3, 1991) (stating that entrepreneurial profit is included in soft costs "only when a primary motive for the development was to turn a profit rather than to hold the property long term").

Based on the foregoing, we compute the cost of improvements for the 2011 valuation date as follows:

Site Improvements	$1,989,412
Building Improvements	$7,447,783
Subtotal	**$9,437,195**
Entrepreneurial Incentive	$943,720
Total	**$10,380,915**

Computed in a similar manner, the cost of improvements is $10,614,484 for the 2012 valuation date; $10,853,310 for the 2013 date; and $11,097,510 for the 2014 date.

C. Depreciation

Generally, depreciation represents "losses in the value of improvements due to the effects of age, wear and tear, and other causes." *Appraisal of Real Estate* 576. There are three major causes of depreciation, which can operate separately or in combination. *Id.* Physical deterioration is attributable to "wear and tear from regular use, the impact of the elements, or damage." *Id.* Functional obsolescence arises from "a flaw in the structure, materials, or design that diminishes the function, utility, and value of the improvement." *Id.* These two forms of depreciation can be curable or incurable. *Id.* External obsolescence is "a temporary or permanent impairment of the utility or salability of an improvement or property due to negative influences outside the property." *Id.* This form of depreciation is incurable. *Id.* Methods for estimating depreciation include the market extraction method, the economic age-life method, and the breakdown method. *Id.* at 597.

1. The Parties' Evidence

Mr. MaRous indicated that he had used "a modified economic age-life method in estimating the total depreciation attributable to the subject property," [102] but furnished no explanation of how his method deviated from a standard analysis.

With respect to physical deterioration, MaRous estimated the useful life of the improvements at 50 years.[103] For the 2011 valuation date, he considered the improvements to be 3.5 years old, and consequently computed physical depreciation at 7 percent.[104]

MaRous assigned the building improvements significant functional obsolescence by again assuming that the subject property would *not* be sold for use as a big box retail store:

> As discussed in the highest and best use section of this report, the subject's large building size appeals to a relatively narrow segment of the market. There is a significantly larger pool of potential tenants for small retail buildings and units. Based upon the above attributes, a 75 percent functional depreciation allowance has been included in this analysis.[105]

MaRous indicated that this high degree of functional obsolescence took into account "the imbalance in supply and demand for big box stores, the several market factors that are diminishing the appeal of the big box stores," and market trends indicating that larger big box

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[102] Ex. 1, at 61.

[103] Ex. 1, at 61.

[104] Ex. 1, at 61-62.

[105] Ex. 1, at 62.

stores in particular were becoming obsolete.[106] Employing similar reasoning, MaRous assigned the site improvements significant functional obsolescence on the ground that they "would have very little to no appeal to the market independent of an economically viable big box store on the subject's site." [107]

MaRous estimated external obsolescence at 10 percent.[108] He commented that "[i]n the subject's instance, external obsolescence is attributed to the on-going recession and to its adverse and significant impact on all segments of the real estate market." [109] Although MaRous saw "signs of recovery in the retail market and in the subject's submarket," he believed that "the increased vacancy rates, the decreased lease rates, and the lower market values likely will demonstrate a very slow and moderate recovery to return to prerecession levels." [110] As will be discussed more below, MaRous attempted to support his high total obsolescence estimates of "79.1, 79.5, 80.0, and 80.4 percent for the respective dates of value" [111] by applying the market extraction method to two separate sets of sale comparables.[112]

Mr. Vergin used the breakdown method to generate a separate estimate for each of the five varieties of depreciation (curable physical deterioration, incurable physical deterioration, curable functional obsolescence, incurable functional obsolescence, and external obsolescence).[113] For the 2011 valuation date, Vergin found no curable physical deterioration;

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[106] Ex. 1, at 62.

[107] Ex. 1, at 63.

[108] Ex. 1, at 62.

[109] Ex. 1, at 62.

[110] Ex. 1, at 62.

[111] Ex. 1, at 63.

[112] Ex. 1, at 64-68.

[113] Ex. A, at 83.

curable physical deterioration of $1,649,533 ($1,059,333 for short-lived components and $590,200 for long-lived components); no functional obsolescence (curable or incurable); and (relying upon his income approach) no external obsolescence.[114]

2. Analysis

We adopt Mr. Vergin's method for determining physical deterioration because it distinguishes between curable and incurable deterioration and separately considers short-lived components (with 15-year economic lives) and long-lived components (with 50-year economic lives), computing separate depreciation rates for each type of component. We find that the subject property suffered from physical deterioration of $1,649,533 on the 2011 valuation date; $1,701,853 on the 2012 date; $2,196,350 on the 2013 date; and $2,744,620 on the 2014 date.[115]

We reject both appraisers' functional obsolescence estimates. Mr. MaRous' 75 percent estimate was based on the assumption that the subject property would not be sold for use as a big box retail store,[116] an assumption based directly upon his flawed highest and best use analysis.[117] Because we have found that the subject property was a viable big box store, we reject MaRous' contrary assumption and his resulting estimate of functional obsolescence. Mr. Vergin's estimate of no functional obsolescence was based on his statement that "there does not appear to be any design characteristic or building component which adversely affects the marketability of the subject property." [118] Functional obsolescence, however, relates to "the function, utility, and value of the improvement," *Appraisal of Real Estate* 576, not to its "marketability." We agree

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[114] Ex. A, at 83-85.

[115] Ex. A1, at 47-48.

[116] Ex. 1, at 62.

[117] Ex. 1, 43-48. *See supra* § IV.B.

[118] Ex. A, at 85.

with Vergin that the subject property (with its existing improvements) is marketable as a big box retail store. This does not mean, however, that the improvements would have the same utility for a purchaser as they had for Menard.

The point is perfectly illustrated by a comparable sale each appraiser used in his sales comparison approach. In October 2012, Lowe's sold its Cambridge, Minnesota store to Mills Fleet Farm.[119] "This building was designed and was occupied as a prototypical Lowe's Home Improvement Store." [120] Although the approximately 117,000 square-foot big box store had been constructed in 2009, the reported sale price was only $5,000,000.[121] After the sale, Mills spent approximately $2,800,000 to reconfigure the store in accordance with its preferences.[122] "The buyer reported 'it was a lot of hard work to tweak the existing building to our layout specifications.' " [123] The record contains additional evidence that big box retailers typically have relatively detailed preferences concerning such matters as a store's external appearance and internal layout (*e.g.*, the location of restrooms).[124] The Lowe's/Mills transaction illustrates that even a recently constructed big box store built to one retailer's ideal specifications will not have equal utility in the hands of a different big box retailer. For this reason, we reject Vergin's conclusion that the subject property suffered from no functional obsolescence. Based on the evidence in this case, we find that $2,500,000 is a reasonable estimate of functional obsolescence

[119] Ex. 1, at 75, 78-79; Ex. A, at 88, 92.

[120] Ex. 1, at 79.

[121] Ex. 1, at 79; Ex. A, at 92.

[122] Ex. A, at 92; Ex. 3, at 9; Tr. 319-26, 394

[123] Ex. 1, at 79.

[124] Ex. 1, at A262.

for the subject property, the approximate cost of converting a recently constructed Lowe's home improvement store to a Mill's Fleet Farm home improvement store.[125]

Finally, we find that the subject property suffered from no external obsolescence. MaRous' 10 percent estimate was—like his market analysis—based exclusively on broad generalizations and on national rather than local data. *See supra* § IV.B. For example, MaRous attributed external obsolescence at the subject property "to the on-going recession and to its adverse and significant impact on all segments of the real estate market" [126] and he commented that "the increased vacancy rates, the decreased lease rates, and the lower market values likely will demonstrate a very slow and moderate recovery to return to prerecession levels." [127] MaRous, however, presented no data indicating that the recession had produced lower property values in the Fargo/Moorhead real estate market in particular,[128] and no studies documenting either increased local vacancy rates or decreased local lease rates. Because MaRous failed to demonstrate that factors allegedly causing external obsolescence elsewhere in the United States were operative in the Fargo/Moorhead market area, he perforce failed to demonstrate that the subject property suffered from external obsolescence. *See Am. Crystal Sugar Co. v. Cnty. of*

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[125] Vergin testified that the Lowe's store was improperly insulated, and that a portion of the funds spent by Mills was to remedy this problem. Tr. 319. Vergin had no documentation to support this assertion, and did not provide a cost estimate. We reduce the $2,800,000 actually spent by $300,000 to account for the cost of new insulation, thereby arriving at our figure of $2,500,000.

In a 2014 appraisal of brand new Costco big box store in what Mr. MaRous considered an "outstanding location," MaRous assigned the property "25 percent functional obsolescence." Tr. 150-52. Applying that 25 percent rate to our cost of improvements estimate for the 2011 valuation date yields functional obsolescence of $2,595,079 ($10,380,915 x 0.25 = $2,595,078.75), a figure quite close to our own functional obsolescence estimate in this case.

[126] Ex. 1, at 62.

[127] Ex. 1, at 62.

[128] Mr. Doll testified that, at worst, values leveled off during the recession rather than increasing at their prevous rate. Tr. 208.

Polk, No. C1-05-574 et al., 2009 WL 2431376, at *26 (Minn. T.C. Aug. 5, 2009), *amended by* 2009 WL 5064334 (Minn. T.C. Dec. 21, 2009) (declining to make an adjustment for external obsolescence where taxpayer offered "no credible evidence that [the subject property] suffered from external obsolescence or evidence that quantified such obsolescence"); *Pep Boys*, 2004 WL 2436350, at *7 (declining to "allow a deduction for economic obsolescence" where "there was insufficient proof to demonstrate that the Subject Property suffered from economic obsolescence"); *Minn. Energy Res. Corp. v. Comm'r of Revenue*, No. 8041 et al., 2014 WL 4953754, at *16-18 (Minn. T.C. Sept. 29, 2014), *amended by* 2015 WL 213779 (Minn. T.C. Jan. 9, 2015) (declining to make an obsolescence adjustment where the taxpayer "did not show that the alleged cause of the external obsolescence affected the subject property"), *appeal docketed*, No. A15-0422 (Minn. Mar. 9, 2015); *Guardian Energy, LLC*, 2015 WL 4747826, at *2 ("[A]ssum[ing], without deciding," that "a taxpayer's burden in proving external obsolescence 'requires a showing of the cause of the asserted obsolescence and proof that it affects the value of the subject property' " (quoting *Guardian Energy, LLC v. Cnty. of Waseca*, No. 81-CV-10-365 et al., 2014 WL 4459133, at *40 (Minn. T.C. Sept. 5, 2014), *amended by* 2014 WL 7051221 (Minn. T.C. Dec. 9, 2014))).

3. Menard's Market Extraction is Unreliable

We reject Mr. MaRous' attempt to justify his high total obsolescence estimate by applying the market extraction method to his two sets of sales comparables. That method "relies on the availability of comparable sales from which depreciation can be extracted," and should be used only where "the quality of th[e] data is adequate to permit meaningful analysis." *Appraisal of Real Estate* 605. Comparables should be "similar in terms of age and utility to the subject property." *Id.* at 605. Put another way, they should have "physical, functional, and external characteristics similar to the subject property, and they should have incurred similar amounts and types of depreciation." *Id.* at 610. Although "[l]ocational differences are usually removed with the subtraction of land value," external conditions "may affect building values as well, which is why it is important to select sales that are subject to the same (or similar) market influences." *Id.* If comparable sales "are located in market areas that are not comparable to the subject property's the method may not be appropriate." *Id.*

Our principal concern is with the comparability of MaRous' comparable sales. Menard insists that big box retailers do not build stores to sell or lease them; that their *motivation* is neither to earn profit upon the sale of a store nor to secure from it a stream of *rental* income. To the contrary, Menard continues, big box retailers build stores despite knowing that they are unprofitable as real estate investments, and construct them solely because their business models indicate that big box stores are the most efficient physical retail outlets.[129] Retailers build stores for occupancy only: to generate retail sales. So the argument goes.

This very theory, however, generates our concern with comparability, for it prompts the following question: If a big box retailer has recently sold a store, why did it do so? If the retailer built the store solely for the retail sales revenue it was intended to generate through occupancy, in other words, why did it vacate and sell the store? Menard's occupancy-only theory necessarily suggests that sales of big box retail stores are extraordinary events that must be carefully analyzed for comparability. In this case, Menard fails to demonstrate sufficient comparability to warrant use of market extraction.

Menard's primary set of comparable sales includes seven transactions.[130] One sale involves a store built in 1978;[131] four others involve stores built during the early 1990's.[132]

[129] Tr. 11-13; Pet'r's Post-Trial Br. 11-12.

[130] Ex. 1, at 65-67, 75-92.

[131] Ex. 1, at 75, 89.

Considering that the subject improvements were built in 2007, these five of Menard's seven comparables are not similar in age. *See Appraisal of Real Estate* 605 (noting that comparables should be "similar in terms of age ... to the subject property"). Depreciation at these stores could be attributable largely to age and to functional obsolescence not shared by the subject property.

The only two comparables similar in age were former Lowe's stores built, respectively, in 2006 and 2009.[133] MaRous indicated that each was "designed and was occupied as a prototypical Lowe's Home Improvement store." [134] As to each, MaRous also explained: "Due to the downturn in the economy, Lowe's closed some of its stores due to insufficient sales." [135] Because both of these comparables were new, it is unlikely that they had physical deterioration or functional obsolescence beyond that affecting the subject property. The fact that Lowe's closed the stores for "insufficient sales," however, indicates that depreciation at these stores may well be attributable to external obsolescence not shared by the subject property. *See Appraisal of Real Estate* 610 ("[E]xternal conditions may affect building values ..., which is why it is important to select sales that are subject to the same (or similar) market influences."); *id.* at 577 ("Because of its fixed location, real estate is subject to external influences that usually cannot be controlled by the property owner ...."). Indeed, a developer quoted by MaRous commented: "If

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[132] Ex. 1, at 75, 81, 83, 87, 91.

[133] Ex. 1, at 75, 79, 85.

[134] Ex. 1, at 79, 85

[135] Ex. 1, at 79, 85.

there's a big box sitting empty, it's probably not a prime location."[136] MaRous generally agreed with this comment.[137]

Finally, two of MaRous' seven comparable sales were older stores (a Menards built in 1978 and a Wal-Mart built in 1990) that were sold because they had been replaced by nearby new stores.[138] Replacement indicates that the big box retailers were pleased with location, suggesting that depreciation at these stores was likely attributable primarily to age and functional obsolescence not shared by the subject property.

We find that MaRous' implementation of the market extraction method renders his results unreliable. Most importantly, the seven transactions comprising MaRous' primary set of comparable sales are not sufficiently comparable to the subject property. *See Appraisal of Real Estate* 605, 610 (emphasizing need for truly comparable sales). "The market extraction method is difficult to apply when the type or extent of depreciation varies greatly among the comparable properties due to characteristics other than age." *Appraisal of Real Estate* 610. Because MaRous' market extraction method relies on comparable sales possessing attributes (*e.g.*, advanced age and possibly inferior micro-locations) differing materially from those

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[136] Ex. 1, at 44.

[137] Tr. 64-65. *See also* Ex. 1, at 97-98 (paraphrasing a big box selling agent as reporting that "if a particular home improvement store closed due to lack of business, there was virtually no likelihood a competitor would relocate to that area because they probably would not be successful in that location").

[138] Ex. 1, at 89, 91; Ex. A, at 91.

characterizing that the subject property, it does not reliably indicate the total depreciation of the subject property.[139]

D. Cost Approach Conclusion

Based on the foregoing analysis we find that the indicated market value of the subject property under the cost approach for the 2011 valuation date is $9,121,382. The computation is as follows:

Replacement Cost of Improvements		
Site Improvements	$ 1,989,412	
Building Improvements	$ 7,447,783	
Subtotal	$ 9,437,195	
Entrepreneurial Incentive	$ 943,720	
Total		**$ 10,380,915**
Depreciation		
Physical	($ 1,649,533)	
Functional	($ 2,500,000)	
External		
Total		**($ 4,149,533)**
Site		**$ 2,890,000**
Cost Approach Value		**$ 9,121,382**

Based on similar computations, the market value of the property under the cost approach was $9,302,631 for the 2012 valuation date; $9,046,960 for the 2013 date; and $8,742,890 for the 2014 date.

[139] Because MaRous included so little information about the transactions making up his second set of comparable sales, Ex. 1, at 101-04, we cannot evaluate their true comparability to the subject property and therefore place no reliance on his market extraction using that second set. We note that MaRous' market extraction could not, even in theory, be used to support the existence or magnitude of any particular form of depreciation at the subject property. *See Appraisal of Real Estate* 610 ("Market extraction considers all types of depreciation in a lump sum and does not break down the estimate into the various components of depreciation."); *id.* at 605 ("By considering all elements in one calculation, market extraction can be an oversimplification of the complex interplay of physical, functional, and external causes of depreciation.").

VI. SALES COMPARISON APPROACH

The sales comparison approach assumes, among other things, "that the value of property tends to be set by the cost of acquiring a substitute or alternative property of similar utility and desirability within a reasonable amount of time." *Appraisal of Real Estate* 379; *see also Equitable Life Assur. Soc'y*, 530 N.W.2d at 552 (observing that the sales comparison approach "is based on prices paid in actual market transactions involving comparable properties"). Application of the approach requires analysis of recent sales of other properties to determine the comparability of those properties to the subject property, and the adjustment of their sale prices as necessary for such features as age, size, location, and condition to make those properties comparable to the subject property. *Appraisal of Real Estate* 381-82. The reliability of this approach depends on the availability of sales information for other properties, and on the comparability of those properties to the subject. *Id.* at 380-81.

A. The Parties' Evidence

Mr. MaRous considered seven transactions in his sales comparison approach,[140] and adjusted them for property rights, market conditions, location, size, age, quality, land-to-building ratio, and use restrictions.[141] MaRous adopted for the subject property a gross building area of 162,340 square feet, the area of the main building's enclosed and heated space (without addition

[140] Ex. 1, at 75-92; Ex. 1, at 78 (MaRous's Comparable 1 – Fleet Farm located at 2324 3rd Ave. NE, Cambridge, MN); Ex. 1, at 80 (MaRous's Comparable 2 – Runnings located at 300 W. 7th St., Monticello, MN); Ex. 1, at 82 (MaRous's Comparable 3 – Furniture Outlets located at 19146 Freeport St., Elk River, MN); Ex. 1, at 84 (MaRous's Comparable 4 – HOM Furniture located at 13800 Rogers Dr., Rogers, MN); Ex. 1, at 86 (MaRous's Comparable 5 – Walmart located at 1360 Town Centre Dr., Eagan, MN); Ex. 1, at 88 (MaRous's Comparable 6 – Durham Bus located at 3100 W. Minn. Hwy 13, Burnsville, MN); Ex. 1, at 90 (MaRous's Comparable 7 – Miller Auto Plaza located at 380 33rd Ave. S., St. Cloud, MN).

[141] Ex. 1, at 92-100.

for the building's 11,041 square feet of mezzanine or covered/unheated space).[142] After adjusting his comparables, MaRous derived a range of "$22.75 to $24.64 per square foot of building area including land ... based on middle points of the adjusted sale prices," and a range of "$21.49 to $22.43 per square foot ... based on the average of the adjusted sale prices." [143] MaRous ultimately adopted a range of $22.50 to $25.00 for the subject property as of the 2011 valuation date, indicating "a value range of $3,652,650 to $4,058,500." [144] MaRous opined that the value of the subject property under the sales comparison approach was $4,000,000 for each valuation date.[145]

Mr. Vergin considered eleven transactions in his sales comparison approach,[146] and adjusted them for property rights, financing, conditions of sale, expenditures after sale, market conditions, age, land-to-building ratio, size, mezzanine, unheated storage space, and location.[147] For the subject property, Vergin used a gross building area of 236,429 square feet, which included the main building's 11,041 square feet of mezzanine space, its 40,608 square feet of

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[142] Ex. 1, at 1, 34, 74.

[143] Ex. 1, at 101.

[144] Ex. 1, at 105.

[145] Ex. 1, at 105-06.

[146] Ex. A, at 88-100; Ex. A, at 90 (Vergin's Comparable 1 – Gander Mountain located at 2121 43rd St. S., Fargo, ND); Ex. A, at 91 (Vergin's Comparable 2 – Former Menards located at 3050 & 3100 Hwy 13 W., Burnsville, MN); Ex. A, at 92 (Vergin's Comparable 3 – Former Lowe's located at 2324 3rd Ave. NE, Cambridge, MN); Ex. A, at 93 (Vergin's Comparable 4 – Former Kmart located at 1400 18th Ave. NW, Austin, MN); Ex. A, at 94 (Vergin's Comparable 5 – Former Lowe's located at 13800 Rogers Dr., Rogers, MN); Ex. A, at 95 (Vergin's Comparable 6 – Home Depot located at 2330 Crest View Dr., Hudson, WI); Ex. A, at 96 (Vergin's Comparable 7 – Former Sportsman Warehouse located at 60 Waite Ave. S., St. Cloud, MN); Ex. A, at 97 (Vergin's Comparable 8 – Former Target located at 19146 Freeport St. NW, Elk River, MN); Ex. A, at 98 (Vergin's Comparable 9 – Former Target located at 9450 Dunkirk Ln. N., Maple Grove, MN); Ex. A, at 99 (Vergin's Comparable 10 – HOM Furniture located at 4601 23rd Ave. SW, Fargo, ND); Ex. A, at 100 (Vergin's Comparable 11 – Former Walmart located at 1711 Hwy 10 W., Dilworth, MN).

[147] Ex. A, at 101-08.

covered/unheated space, and the 22,440 square-foot detached open-air shed.[148] After adjusting his comparables, Vergin derived a range of $37.70 to $65.27 per square foot of building area, with a mean of $47.14 per square foot for the 2011 valuation date.[149] Vergin ultimately adopted a unit value of $48.00 per square foot of gross building area and thus derived a market value of $11,348,592 under the sales comparison approach, which he rounded to $11,350,000.[150] Based on additional market condition adjustments, Vergin derived a rounded value of $11,590,000 for the 2012 valuation date; $11,820,000 for the 2013 date; and $12,060,000 for the 2014 date.[151]

B. Analysis

We begin by adopting Mr. MaRous' gross building area of 162,340 square feet for the subject property. Mr. Vergin agreed that market would not attach any value to the main building's 11,041 square feet of mezzanine space.[152] In addition, we agree with MaRous that the main building's 40,608 square feet of covered/unheated space and the property's 22,440 square-foot detached open-air shed would likely have "very little contributory impact on value, particularly when considering the oversized big box retail store of the subject property." [153] We likewise agree with Menard's review appraiser, Mr. Gary Battuello, MAI, AI-GRS, that the "[m]ore appropriate treatment of this space may be achieved by using only the primary building square footage ... and applying an upward adjustment" for the excluded spaces.[154] We next address comparable sales and adjustments.

[148] Ex. A, at 6, 16, 47, 88.

[149] Ex. A, at 108-09.

[150] Ex. A, at 110.

[151] Ex. A1, at 62-67.

[152] Tr. 363-65.

[153] Ex. 1, at 96.

[154] Ex. 3, at 10.

1. Comparable Sales

Four of Vergin's comparable sales were leased-fee transactions.[155] "If the sale of a leased property is to be used as a comparable sale in the valuation of the fee simple estate of another property, the comparable sale can only be used if reasonable and supportable market adjustments for the differences in rights can be made." *Appraisal of Real Estate* 406. Vergin attempted to adjust his leased-fee transactions for use in a fee simple valuation by pairing two leased-fee transactions.[156] We agree with Mr. Battuello that this adjustment is unpersuasive.[157] Accordingly, we disregard Vergin's four leased-fee transactions. *EOP-Nicollet Mall, L.L.C. v. Cnty. of Hennepin*, No. 28793, 2005 WL 443844, at *4 (Minn. T.C. Feb. 11, 2005), *aff'd*, 723 N.W.2d 270 (Minn. 2006).

A significant factor in the selection of sales comparables in this case is the main building's 40,608 square feet of covered/unheated space, and the property's 22,440 square-foot detached open-air shed.[158] The appraisers had four comparable sales in common. Three of those common comparables: (a) had similar covered/unheated space; (b) were relatively close in gross building area (excluding covered/unheated space); and (c) had sale dates close to the center of the four valuation dates (all in late 2012). Because these three comparable sales were used by both appraisers, and because the specified similarities to the subject property reduce the need for adjustment, we rely on these three common comparable sales.

<u>Former Lowe's, Cambridge</u>: The former Lowe's store in Cambridge, Minnesota had a gross building area of 117,397 square feet and an additional 8,899 square feet of

[155] Ex. A, at 90, 93, 95, 99.

[156] Ex. A, at 101.

[157] Ex. 3, at 9; Tr. 491-93, 498-500.

[158] Ex. 1, at 1; Ex. A, at 6.

covered/unheated space.[159] It was built in 2009 and was sold to Mills Fleet Farm in October 2012 for $5,000,000, or $42.59 per square foot of building area.[160] The improvements occupied a parcel of 751,141 square feet.[161]

Former Lowe's, Rogers: The former Lowe's store in Rogers, Minnesota had a gross building area of 130,620 square feet and an additional 8,868 square feet of covered/unheated space.[162] It was built in 2006 and was sold to HOM Furniture in August 2012 for $3,200,000, or $24.50 per square foot of building area.[163] The improvements occupied a parcel of 571,507 square feet.[164] A provision contained in the warranty deed partially limited use of the property.[165]

Former Menards, Burnsville: The former Menards store in Burnsville, Minnesota had a gross building area of 123,262 square feet and an unspecified additional amount of covered/unheated space.[166] It was built in 1978 and was sold to Fairchild Best Investments, Inc.,

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[159] Ex. 1, at 75, 78. We rely on Mr. MaRous' descriptions of the common comparable sales because he was more consistent in distinguishing between heated and unheated space.

[160] Ex. 1, at 79. Mr. Vergin reported the sale price as $7,800,000 because Mills subsequently spent $2,800,000 reconfiguring the property in accordance with its preferences. Ex. A, at 92. We agree with Menard that this post-sale investment is not properly included in sale price. *See Appraisal of Real Estate* 412 (noting that where sale price is increased by expenditures made immediately after purchase, "[t]he relevant figure is not the actual cost that was incurred but the cost that was anticipated by both the buyer and seller"). Vergin furnished no evidence that Mill's post-sale expenditures were anticipated by Lowe's and, indeed, stated that they probably were not. Tr. 319, 418-21, 462-68.

[161] Ex. 1, at 78.

[162] Ex. 1, at 75, 84.

[163] Ex. 1, at 85.

[164] Ex. 1, at 84.

[165] Ex. 12 (Limited Warranty Deed), at 1-2.

[166] Ex. 1, at 75, 89, 96.

in October 2012 for $3,000,000, or $24.34 per square foot of building area.[167] The improvements occupied a parcel of 566,280 square feet.[168]

2. Use Restriction Adjustment[169]

A provision contained in the warranty deed partially limited use of the former Lowe's in Rogers. The deed provided, in pertinent part, as follows:

> This conveyance is further made subject to the following conditions and use restrictions:
>
> (a) neither Buyer nor his successors and assigns shall permit the occupancy or use of any space upon or within Property by or as a retail store or center (or any other business) owned or operated by any of the following parties:
>
> Lowe's, Home Depot, Home Depot Expo, Villagers Hardware, 84 Lumber, Wickes, Hughes Lumber McCoys, Menard's, stores under the Sears name … Great Indoors, Pacific Sales, hhgregg, Conn's, Sutherlands, Scotty's and Orchard Supply.
>
> (b) The above stated use restrictions shall expire seven (7) years after the date of Closing and shall thereafter be of no further force and/or effect.[170]

Treating this provision as a "condition of sale" putting "severe use restrictions in place that significantly limited the demand for" the property,[171] Mr. Vergin made a 75 percent upward adjustment to the sale price of this comparable.[172] Mr. MaRous' firm interviewed the selling agent for the Rogers store, who commented that such use restrictions typically affect neither sale price nor marketability.[173] Although agreeing with this evaluation, MaRous applied "a minor

167 Ex. 1, at 89.

168 Ex. 1, at 88.

169 Neither appraiser adjusted any of the common comparables for property rights, financing, expenditures after sale, or quality (although one or both appraisers considered those adjustments). Ex. 1, at 100; Ex. A, at 108. Consequently, we do not address these adjustments.

170 Ex. 12 (Limited Warranty Deed), at 1-2.

171 Ex. 1, at 102.

172 Ex. A, at 108.

173 Ex. 1, at 97.

positive adjustment range of 0 to 5 percent to [all of] the comparable improved sales for any use restrictions that were in place." [174]

We agree with neither appraiser's treatment of the use restriction. Vergin acknowledged that he did not base his 75 percent upward adjustment solely, or even principally, on the language of the deed.[175] Rather, Vergin relied in substantial part on the buyer's expansive interpretation of the restriction[176] (under which the property could not be used as a grocery store, for example), and on his own belief that potential purchasers might be deterred from buying the property for fear that even uses *not* prohibited by the plain meaning of the deed might involve them in litigation.[177] Because we reject both the buyer's expansive reading of the restriction and Vergin's speculation about *in terrorem* effects, we find that Vergin's 75 percent adjustment is excessive.

By the same token, Mr. MaRous' conclusion that use restrictions generally have no impact—apparently without regard to their express scope or duration—is unpersuasive. We find that the deed's use restriction, although limited in both scope and duration, imposes a genuine constraint upon the Rogers property for seven years. Consequently, we adopt a 15 percent use restriction adjustment for each valuation date.

3. Market Condition (Time) Adjustment

Mr. MaRous did not make any market condition adjustments because all but one of his comparable sales fell within "the period of time represented by the [four] retrospective dates of value," and because "[t]here were no measurable changes in the market conditions during this

[174] Ex. 1, at 98; *id.* at 100 (showing all comparable sales received the same 0 to 5 percent upward adjustment for use restrictions).

[175] Tr. 352, 355.

[176] Tr. 352, 355-56, 358, 360.

[177] Tr. 356-57.

period for big box retail stores."[178] Relying on three paired sales and a capitalization rate study, Mr. Vergin derived a 2.5 percent annual market condition adjustment for sales between 2009 and 2013.[179] Finding Vergin's analysis better supported and more persuasive, we adopt his annual market condition adjustments for each of the common comparables, all of which sold during 2012.

4. Location Adjustment

Mr. MaRous concluded that all seven of his comparable sales were superior to the subject property because they were "located within the suburban (or exurban) communities comprising the Minneapolis/St. Paul and St. Cloud metropolitan areas."[180] Citing population within a 30-mile radius,[181] MaRous commented that "[t]hese locations provide a larger and growing consumer base and, overall, are more readily accessible to a much larger local trading area than the subject property."[182] In addition, all but one of MaRous' comparables were in a primary commercial area, whereas the subject was not.[183] Based on this reasoning, MaRous adjusted all of his comparables downward by ranges of between 7.5 to 12 percent and 15 to 20 percent.[184]

Mr. Vergin asserted that he used his location adjustment "to account for macro and micro location differences between the subject and each comparable," and indicated that "[t]hese differences may include access, identity, daily traffic flow, adjacent development, population,

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[178] Ex. 1, at 92.

[179] Ex. A, at 103-05.

[180] Ex. 1, at 93.

[181] Ex. 1, at 75.

[182] Ex. 1, at 93.

[183] Ex. 1, at 93.

[184] Ex. 1, at 100.

etc."[185] But Vergin neither presented any data concerning these variables nor otherwise explained his specific location adjustments. Vergin's location adjustments ranged 10 percent downward to 50 percent upward.[186]

We find neither appraiser's location adjustments well supported. MaRous implicitly posited a 30-mile trade area without any empirical support for such a figure, particularly for the more densely developed metropolitan areas from which he drew his comparables. For purposes of this adjustment, MaRous improperly equated trade area with market area. *See Shopping Center Appraisal and Analysis* 47 (noting that trade area "is smaller than the geographic area that represents the market area"). Vergin failed to explain in any way his location adjustments.

Because we find that neither appraiser's location adjustments were adequately supported, we decline to make any location adjustments. We note, as an aside, that as to the three common comparables on which we rely, the appraisers' location adjustments tend to offset one another in any event.

5. Age/Condition Adjustment

Mr. MaRous made modest age adjustments to his comparable sales (between 2 and 8 percent) on the ground that even new big box retail stores manifest significant depreciation.[187] Mr. Vergin adjusted his comparables by one percent per year to reflect depreciation. We agree with Vergin that the comparables should be adjusted for age/condition, *see Appraisal of Real Estate* 381, 420 (so indicating), and adopt Vergin's one percent annual rate as reasonable.[188]

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[185] Ex. A, at 107.

[186] Ex. A, at 108.

[187] Ex. 1, at 96, 100.

[188] Considering that both appraisers estimated the economic life of the improvements at 50 years, Ex. 1, at 61, Ex. A, at 84, a two percent rate would also have been reasonable.

6. Size Adjustment

Although the appraisers used different gross building areas for the subject property, their size adjustments for the three common comparables upon which we rely were quite similar.[189] Mr. MaRous indicated that in making his size adjustments, he considered the modest contributory value the market would assign to the main building's covered/unheated space and the detached open-air shed.[190] Consistent with both appraisers, we adjust the price of each of the common comparables downward by 10 percent for size.

7 Land-to-Building Ratio Adjustment

Mr. MaRous indicated that "[a] typical land to building ratio for a big box retail store ranges from 3.75 to 1.0 to 5.25 to 1.0." [191] Using a gross building area of 162,340 square feet and the subject property's land area of 771,357 square feet, MaRous computed a land to building ratio of 4.75 to 1.0,[192] a figure toward the high end of the range. Although we have adopted this gross building area (which excludes mezzanine, covered/unheated, and detached shed space), land-to-building ratio could reasonably be computed by including the uncovered/heated space and the shed, considering (1) that those areas actually occupy land and (2) that we credited MaRous' view that the spaces may have only nominal contributory value. Including these otherwise excluded areas yields a land-to-building ratio of 3.42 to 1.0,[193] a figure just beneath the low end of the typical range. In light of our belief that some potential purchasers of the subject

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[189] *Compare* Ex. 1, at 100, *with* Ex. A, at 108.

[190] Ex. 1, at 95-96.

[191] Ex. 1, at 96.

[192] Ex. 1, at 96.

[193] Total building area including the mezzanine, covered/unheated space and the shed is 236,429 square feet. Ex. A, at 6. Subtracting the 11,041 foot mezzanine leaves 225,388 square feet. This yields the 3.42 land-to-building ratio (771,357 ÷ 225,388 = 3.42).

property might use the covered/unheated space, while others might prefer to demolish some or all of that space, we find that no land-to-building ratio adjustment is warranted.

8. Sales Approach Conclusion

Although we rely on all three common comparables analyzed above, we find that the first two—sales of recently constructed Lowe's stores for big box retail use—furnish a more reliable indication of the price that a prospective purchaser might pay for the subject property, which is also a recently constructed big box store. Accordingly, we assign each Lowe's sale a 40 percent weighting in our sales comparison reconciliation, and assign the Burnsville Menards sale the remaining 20 percent.

Applying the foregoing adjustments to these sales produces a market value indication of $4,870,200 under the sales comparison approach for the 2011 valuation date. The application and computation are as follows:

	Sale Price	Price/Sq. Ft.	Use	Market	Preliminary Adjustment	Age	Size	Net Adjustment
Cambridge	$ 5,000,000	$ 42.59		-4	**$ 40.89**	-1	-10	**$ 36.39**
Rogers	$ 3,200,000	$ 24.50	+15	-4	**$ 27.20**	+2	-10	**$ 25.02**
Burnsville	$ 3,000,000	$ 24.34		-4	**$ 23.37**	+30	-10	**$ 28.04**
Weighted Average								**$ 30.17**

Accordingly, under the sales comparison approach, the market value of the subject property for the 2011 valuation date is $4,898,122 ($30.17 per square foot multiplied by 162,340 square feet). Based on similar computations, the subject property's market value under the sales comparison approach is $5,010,462 for the 2012 valuation date; $5,390,987 for the 2013 date; and $6,044,243 for the 2014 date.

VII. INCOME CAPITALIZATION APPROACH

"The income capitalization approach determines the value of income-producing property by capitalizing the income the property is expected to generate over a specific period of time at a specified capitalization yield rate." *Cont'l Retail*, 801 N.W.2d at 402. Under the income capitalization approach, the anticipated income stream of an income-producing property is reduced to a present value by applying a suitable discount rate. *Equitable Life Assur. Soc'y*, 530 N.W.2d at 549. When valuing a fee simple interest in property, the amount to be capitalized is the "anticipated market level of rent less the market level of expenses." *Macy's Retail Holdings*, 2011 WL 6117909, at *9; *see also Eden Prairie Mall, LLC v. Cnty. of Hennepin*, 797 N.W.2d 186, 195 (Minn. 2011) ("In valuing a fee simple interest in property, the value of rentable space is estimated using market rent levels.").

Mr. MaRous' conclusion that the subject property would not be sold for big box retail use[194] prompted him to develop an income approach under which the property was re-demised into four 20,000 square-foot units.[195] Because MaRous' income approach capitalizes net income from use of the property for multi-tenant retail, his analysis is simply not relevant to the value of the subject property when put to its highest and best use, namely, occupancy as a single-user big box retail store. Consequently, we do not consider MaRous' income approach.[196]

Although Mr. Vergin's income approach analyzes the subject property's highest and best use, we find that it is fatally undermined by an unsupported estimate of market rent. Vergin

[194] Ex. 1, at 43-48.

[195] Ex. 1, at 45, 48, 62; *id.* at 116-17 (discussing build-out costs to re-demise the property).

[196] MaRous expressed reservations about his income approach, and ultimately gave it no weight. Ex. 1, at 5, 107, 141-42.

based his market rent conclusion upon thirteen lease comparables.[197] Although Vergin's appraisal report provides very little information about those comparables, Menard's review appraiser, Mr. Battuello, indicated that all but two of Vergin's lease comparables were either build-to-suit or sale/leaseback transactions that likely did not reflect market rent.[198] Vergin admitted on cross-examination that two of his lease comparables were indeed build-to-suit or sale/leaseback transactions, and the County presented no evidence contradicting Battuello's assertion that eleven of Vergin's thirteen comparables arose from such transactions.

We have previously expressed skepticism about the use of build-to-suit and sale/leaseback transactions to estimate market rent. *See, e.g.*, *Bon Stores Realty Two LLC v. Cnty. of Ramsey*, No. 62-C0-07-4475 et al., 2011 WL 3621612, at *11 (Minn. T.C. Aug. 8, 2011) (observing that specified comparables "were all leases of brand new build to suit properties developed for the tenant" and noting that "[b]oth experts agreed that these may not be indicative

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[197] Ex. A, at 113-20; Ex. A, at 114 (Vergin's Comparable 1 – Gander Mountain located at 212 43rd St. S., Fargo, ND); Ex. A, at 114 (Vergin's Comparable 2 – HOM Furniture located at 4601 23rd Ave. SW, Fargo, ND); Ex. A, at 114 (Vergin's Comparable 3 – Axis Clinicals located at 1711 Hwy 10 W., Dilworth, MN); Ex. A, at 114 (Vergin's Comparable 4 – Kohl's located at 13900 Aldrich Ave., Burnsville, MN); Ex. A, at 114 (Vergin's Comparable 5 – HOM Furniture located at 7600 Hudson Rd., Woodbury, MN); Ex. A, at 114 (Vergin's Comparable 6 – Shopko located at 5630 St. Croix Trail, North Branch, MN); Ex. A, at 115 (Vergin's Comparable 7 – Home Depot located at 2330 Crest View Dr., Hudson, WI); Ex. A, at 115 (Vergin's Comparable 8 – Kohl's located at 2960 Decker Dr., Rice Lake, WI); Ex. A, at 115 (Vergin's Comparable 9 – HOM Furniture located at 4726 Mall Dr., Hermantown, MN); Ex. A, at 115 (Vergin's Comparable 10 – Gander Mountain located at 14640 W. Freeway Dr., Columbus, MN); Ex. A, at 115 (Vergin's Comparable 11 – Kmart located at 1400 18th Ave. NW, Austin, MN); Ex. A, at 115 (Vergin's Comparable 12 – Pamida located at 1500 E. Sheridan St., Ely, Minnesota); Ex. A, at 116 (Vergin's Comparable 13 – Home De..pot located at 1520 New Brighton Ave., Minneapolis, MN).

Although Vergin asserted that a set of industrial rent comparables and a discussion of rent as a percentage of retail sales support his market rent determination, Ex. A, at 120-22, his income approach computations rely exclusively upon the market rent he determined using his thirteen lease comparables. *Compare* Ex. A, at 120, *with id.* at 133 (value computation).

[198] Ex. 3, at 12; Tr. at 498-501.

of market rent as they are intended as a return on the construction costs"); *CPT Corp. v. Cnty. of Hennepin*, No. TC-11107, 1992 WL 109246, at *4 (Minn. T.C. May 8, 1992) ("[W]e are suspect of all sale/leaseback transactions."). Accordingly, we have required some affirmative showing that such transactions actually reflect market rent. *Lone Oak Rogers, L.L.C. v. Cnty. of Hennepin*, No. 27-CV-11-06077 et al., 2015 WL 2329356, at *8 (Minn. T.C. Apr. 9, 2015), *amended by* 2015 WL 2329367 (Minn. T.C. May 13, 2015). In addition, a peer-reviewed article in the record indicates: "Faulty appraisals ... use the build to suits and sale/leasebacks as their comparables. These rental rates, however, were not based on market rent criteria. Instead, they represent amortization of custom built construction costs." [199] Because Vergin presented no persuasive evidence that his build-to-suit or sale/leaseback transaction reflected market rent, we decline to rely on them.

Of Vergin's two remaining comparables, one was a 2013 lease to Axis Clinicals.[200] Because this lease plainly was not for big box retail use, we find that it is not relevant to determining the subject property's likely income when used as a big box retail store. Vergin's sole remaining comparable was a 2008 lease of an 86,350 square-foot store to HOM Furniture in Woodbury, Minnesota.[201] Assuming (without deciding) that this lease is otherwise unobjectionable, we decline to base market rent—and by implication our entire income capitalization approach—upon a single lease comparable, particularly where we have been furnished with so little information about the leased property from which we can determine its true comparability.

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[199] Ex. 1, at A266.

[200] Ex. A, at 113-14.

[201] Ex. A, at 113-14.

VIII. FINAL RECONCILIATION

We have no reliable market value indication under the income capitalization approach. We find that the cost approach is well supported and is appropriately used give the recent vintage of the subject property's improvements. The sales comparison approach likewise produces reliable indications of market value. Because the subject property's improvements were only four years old on the first valuation date, we give the cost approach 60 percent weighting and the sales comparison approach 40 percent weighting for the 2011 and 2012 valuation dates. For the 2013 and 2014 dates, we give each approach a 50 percent weighting. Our final values are thus as follows:

	2011	2012	2013	2014
Cost Approach	$ 9,121,382	$ 9,302,631	$ 9,046,960	$ 8,742,890
Sales Approach	$ 4,898,122	$ 5,010,462	$ 5,390,987	$ 6,044,243
Market Value	**$ 7,432,100**	**$ 7,585,800**	**$ 7,219,000**	**$ 7,393,600**

B.S.D.