

STATE OF MINNESOTA
COUNTY OF HENNEPIN

TAX COURT
REGULAR DIVISION
FOURTH JUDICIAL DISTRICT

Lone Oak Rogers, L.L.C.

Petitioner,

vs.

County of Hennepin,

Respondent.

FINDINGS OF FACT,
CONCLUSIONS OF LAW, AND
ORDER FOR JUDGMENT

Case Nos.: 27-CV-11-06077
27-CV-12-05686
27-CV-13-07180

Filed: April 9, 2015

This matter came on for trial before the Honorable Thomas G. Haluska, Judge of the Minnesota Tax Court, on October 29, 2014 and on November 3, 2014.

Jrunes R. Dorsey and Marc D. Simpson, Attorneys at Law, represented petitioner Lone Oak Rogers, L.L.C.

Jane N.B. Holzer and Thomas F. Pursell, Assistant Hennepin County Attorneys, represented respondent County of Hennepin.

The court, having considered the evidence produced at trial and arguments of counsel, and based upon all of the files, records and proceedings herein, now makes the following:

FINDINGS OF FACT

1. Lone Oak Rogers 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 hereto.

2. The subject property consists of two separate parcels. The first is a single-tenant cold-storage warehouse in Rogers, Minnesota, identified as Parcel 14-120-23-44-0016 ("warehouse parcel"). The second is an unimproved parcel, identified as Parcel 13-120-23-33-0002 ("vacant land parcel").

3. At issue are the real estate taxes due on the subject properties, payable in the years 2011 (January 2, 2010 assessment), 2012 (January 2, 2011 assessment), and 2013 (January 2, 2012 assessment).

4. The warehouse was built in 1998 and was expanded in 2003 and 2007; it has an average year-built of 2000.¹

5. The highest and best use of the warehouse parcel is a single-tenant warehouse.

6. The Hennepin County Assessor estimated the market value of the warehouse parcel as \$9,986,000 as of January 2, 2010; \$9,986,000 as of January 2, 2011; and \$11,500,000 as of January 2, 2012.

7. The Hennepin County Assessor estimated the market value of the unimproved parcel as \$1,900,000 as of January 2, 2010; \$1,735,000 as of January 2, 2011; and \$2,200,000 as of January 2, 2012.

8. Petitioner's expert appraisers, Paul G. Bakken, MS, MAI, CCIM, and Matthew R. Schroeder, MAI, opined that the value of the warehouse parcel was \$8,000,000 as of January 2, 2010; \$7,900,000 as of January 2, 2011; and \$8,300,000 as of January 2, 2012.

9. Petitioner's expert appraisers opined that the value of the unimproved parcel was \$1,750,000 as of January 2, 2010; \$1,750,000 as of January 2, 2011; and \$2,100,000 as of January 2, 2012.

10. Respondent's expert appraiser, Justin J. Massmann, SAMA, opined that the value of the warehouse parcel was \$11,060,000 as of January 2, 2010; \$10,740,000 as of January 2, 2011; and \$12,900,000 as of January 2, 2012.

Ex. 1, at 28.

11. Respondent's expert appraiser opined that the value of the unimproved parcel was \$2,460,000 as of January 2, 2010; \$2,370,000 as of January 2, 2011; and \$2,370,000 as of January 2, 2012.

CONCLUSIONS OF LAW

1. Petitioner has overcome the prima facie validity of the assessor's estimated market value of the subject properties.

2. The market value of the warehouse parcel (14-120-23-44-0016) is \$8,475,000 as of January 2, 2010; \$8,461,000 as of January 2, 2011; and \$8,461,000 as of January 2, 2012.

3. The market value of the unimproved parcel (13-120-23-33-0002) is \$2,460,000 as of January 2, 2010; \$2,370,000 as of January 2, 2011; and \$2,370,000 as of January 2, 2012.

ORDER FOR JUDGMENT

1. The Hennepin County Assessor's estimated market value for the warehouse parcel (14-120-23-44-0016) shall be decreased on the books and records of Hennepin County from \$9,986,000 to \$8,475,000 as of January 2, 2010; from \$9,986,000 to \$8,461,000 as of January 2, 2011; and from \$11,500,000 to \$8,461,000 as of January 2, 2012.

2. The Hennepin County Assessor's estimated market value for the unimproved parcel (13-120-23-33-0002) shall be increased on the books and records of Hennepin County from \$1,900,000 to \$2,400,000 as of January 2, 2010; from \$1,735,000 to \$2,370,000 as of January 2, 2011; and from \$2,200,000 to \$2,370,000 as of January 2, 2012.

3. Real estate truces due and payable in 2011, 2012, and 2013 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:


Thomas G. Haluska, Judge

MINNESOTA TAX COURT

DATED: April 9, 2015

MEMORANDUM

Introduction

The sole issue before the court is the value of the two subject parcels, a bulk warehouse facility² and an adjoining unimproved parcel³ located at 13400 Commerce Boulevard in Rogers, Minnesota, as of January 2, 2010, January 2, 2011, and January 2, 2012. Petitioner Lone Oak-Rogers, L.L.C., is the fee owner of the subject property and therefore has sufficient interest in the property to maintain these petitions.⁴ The subject properties are located at the edge of the seven-county metropolitan area, within the City of Rogers, and are zoned LI, Limited Industrial District.⁵ The abutting streets are Commerce Boulevard, to which the properties have direct access, and Diamond Lake Road South, to which there is no direct access.⁶

² Property Identification Number 14-120-23-44-0016. Ex. 1, at 6; Ex. A1, at 8.

³ Property Identification Number 13-120-23-33-0002. Ex. 1, at 6; Ex. A1, at 12.

⁴ See Minn. Stat. § 278.01, subd. 1(a) (2014); Ex. 1, at 52.

⁵ Ex. 1, at 16, 50.

⁶ Ex. 1, at 20-22.

The Hennepin County Assessor's Office valued the subject properties for assessment purposes as follows:

	12/10	12/11	12/12
Warehouse	\$9,886,000	\$9,886,000	\$11,500,000
Vacant Land	\$1,900,000	\$1,735,000	\$2,200,000

We address the value of each parcel separately.

Burden of Proof

The assessor's estimated market value is prima facie valid.⁷ A petitioner may overcome prima facie validity by introducing substantial evidence that the subject property's market value differs from the assessment. If the prima facie validity has been overcome, it is the court's duty to "use its independent judgment in evaluating all testimony and evidence before the court."⁸ In the instant case, petitioner's appraisal expert provided substantial credible evidence that the assessor's market value of each parcel was excessive. Thus, based on the evidence presented, we find that petitioner has met its burden.

Warehouse Parcel

The warehouse was originally constructed in 1998, with additions in 2003 and 2007, giving it an average year-built of 2000.⁹ The structure includes significant cooler and freezer space and a truck maintenance and washing facility. It is constructed of tilt-up, pre-cast concrete panels and metal insulated panels, with approximately 238,381 square feet of floor area

⁷ Minn. Stat. § 271.06, subd. 6 (2014) (stating that "the order of the commissioner or the appropriate unit of government in every case shall be prima facie valid."); Minn. Stat. § 272.06 (2014) (providing that the assessment is "presumed to be legal until the contrary is affirmatively shown").

⁸ *McNeilus Truck & Mfg., Inc. v. Cnty. of Dodge*, 705 N.W.2d 410, 413 (Minn. 2005); *S. Minnesota Beet Sugar Coop v. Cnty. of Renville*, 737 N.W.2d 545, 556 (Minn. 2007).

⁹ Ex. 1, at 6.

including 16,530 square feet of office space,¹⁰ excluding the mezzanine.¹¹ The building has ceilings of slightly varying clear heights, averaging approximately 32 feet.¹² It also has 45 loading docks and two drive-in docks.

The truck maintenance facility contains approximately 7,440 square feet of floor space, including 960 square feet of office space, excluding the mezzanine. It has three drive-through bays (two for service and one for wash).¹³

As of all three assessment dates, the parties agree that the warehouse parcel's parking lot suffered from deferred maintenance in the amount of approximately \$220,000.¹⁴

Deferred Maintenance

Based on the evidence presented, we agree with the parties that the subject property suffers from deferred maintenance of approximately \$220,000 for each of the years at issue.

Highest and Best Use

Highest and best use is defined as "[t]he reasonably probable use of property that results in the highest value."¹⁵ To be reasonably probable, the use must be physically possible, legally permissible, and financially feasible.¹⁶ Based on the evidence presented, we agree with the

¹⁰ Ex. 1, at 28.

¹¹ Ex. 1, at 6.

¹² *Id.*

¹³ Ex. 1, at 28, 32, 33.

¹⁴ Ex. 1, at 29; Ex. A1, at 61.

¹⁵ The Appraisal Institute, *The Appraisal of Real Estate* 332 (14th ed. 2013).

¹⁶ *Id.*

parties that the highest and best use of the warehouse parcel, as of each of the valuation dates, is as a single-tenant warehouse.¹⁷

Valuation Analysis

Minnesota law requires that all real property be assessed at its market value.¹⁸ Market value has been defined as "the price for which property would sell upon the market at private sale."¹⁹ In determining market value, this court recognizes the three basic approaches: (1) the market approach, which is based on prices paid in actual market transactions involving comparable properties; (2) the cost approach, which is founded on the proposition that an informed buyer would pay no more for the property than the cost of constructing new property having the same utility as the subject property; and (3) the income approach, which is predicated on the capitalization of the income the property is expected to generate.²⁰ The three valuation approaches "are suggested but are neither exclusive nor mandatory upon either the assessor or the factfinding court."²¹ Additionally,

[w]henver possible, appraisers should apply at least two approaches to market value because the alternative value indications derived can serve as useful checks on each other. In a given valuation assignment, more than one approach to value is usually appropriate and necessary. A final determination of value, however, may require that one approach be given greater emphasis in making a final value estimate. The appraiser's judgment and experience, and the quantity

¹⁷ Ex. 1, at 69; Ex. A1, at 76.

¹⁸ Minn. Stat. § 273.11, subd. 1 (2014).

¹⁹ *Equitable Life Assur. Soc. of U.S. v. Cnty. of Ramsey*, 530 N.W.2d 544, 555 (Minn. 1995) (citations omitted).

²⁰ *Equitable Life Assur. Soc. y*, 530 N.W.2d at 552; *Lewis & Harris v. Cnty. of Hennepin*, 516 N.W.2d 177, 178 (Minn. 1994); *Montgomery Ward & Co., Inc. v. Cnty. of Hennepin*, 450 N.W.2d 299, 302 (Minn. 1990); *Fed Reserve Bank of Minneapolis v. Cnty. of Hennepin*, 372 N.W.2d 699, 700 (Minn. 1985).

²¹ *Equitable Life Assur. Soc y*, 530 N.W.2d at 554.

and quality of data available, may determine which approach or approaches are used and what weight each deserves.²²

In considering the three valuation approaches, the priority and weight of reliance on the various approaches depends on the facts of each case.²³ Thus, Minnesota law requires every assessor to "consider and give due weight to every element and factor affecting the market value" of real property for the purpose of taxation;²⁴ however, the term "due weight" implies that every element and factor deserves only so much weight as is appropriate to the valuation problem at issue.

Both appraisers used the market and income approaches to determine value. Neither appraiser used the cost approach. Based on the evidence presented at trial concerning the age of the structure, we agree that an analysis of the value of the property based on the cost approach would not be helpful.²⁵

Market Approach

Under the market approach, the appraiser evaluates sales of similar properties and makes adjustments for factors such as a property's physical characteristics, location, time of sale, terms of sale, market conditions, and rights conveyed.²⁶ Here, in addition to these factors, both appraisers adjusted their comparable sales for clear height.

Petitioner's expert appraiser, Paul G. Bakken, utilized eight sales in his analysis. Five of the sales were leased-fee sales; three were fee simple sales. Respondent asserts that Bakken

²² *Id.* at 553 (internal citations omitted).

²³ *Lewis & Harris*, 516 N.W.2d at 180.

²⁴ Minn. Stat. § 273.12 (2014).

²⁵ *See Sears, Roebuck & Co. v. Cnty. of Dakota*, No. C4-04-7619, et al., 2007 WL 2481290, at *4 (Minn. T.C. Aug. 30, 2007).

²⁶ *The Appraisal of Real Estate* 45-46.

provided no support for the property rights adjustment that he made to the leased fee sales. We agree.²⁷ Bakken provided no reasoning for any of his property rights adjustments. Thus, after due consideration of the evidence presented, we place no weight on Bakken's leased fee sales.²⁸

Bakken made substantial adjustments to each of his remaining sales comparables. Bakken's sale comparable three required a gross adjustment of over 73%,²⁹ and comparables two and seven required gross adjustments of over 100%.³⁰ We have consistently held that comparables requiring excessive adjustments are less persuasive or not persuasive at all,³¹ and we therefore place no weight on these comparables. Thus, after considering the lack of support for his leased fee comparables and the significant differences between his fee simple comparables and the warehouse parcel, we give no weight to Bakken's market approach.

²⁷ Bakken's leased fee comparables included his sales one, four, five six and eight. *See* Ex. 1, at 74, 80, 82, 84, 88.

²⁸ Minn. R. Evid. 702, which governs the admissibility of expert evidence, requires foundational reliability before the evidence can be considered. *Cf. Kohl's Dep 't Stores, Inc. v. Cnty. of Washington*, No. CQ-06-8287, 2008 WL 80841, at *3--4 (Minn. T.C. Jan. 3, 2008) (rejecting external obsolescence adjustments where the appraiser provided no market data supporting them); *Kmart Corp. v. Cnty. of Crow Wing*, No. CX-00-768, 2001 WL 1007798, at *1 (Minn. T.C. Aug. 28, 2001) ("Assuming a zero [market] adjustment without market support data, as Mr. Leimess did however, is . . . no more justifiable than making any other adjustment without market support data.").

²⁹ Bakken's comparable three was the former Guyer's Building in Plymouth. Ex. 1 at 78.

³⁰ Bakken's gross adjustment for market comparable two, the former 99 Cent Warehouse in Eagan, was 101.6%. Bakken's gross adjustment for market comparable seven, the Citi Cargo & Storage facility in Eagan, was 100.9%. Ex. 1, at 93.

³¹ *Smalkoski and Fox v. Cnty of Hennepin*, File No. 27-CV-09-02798, 2010 WL 4868006, at *6 (Minn. Tax Ct. Nov. 17, 2010); *McCarthy v. Cnty of Hennepin*, File No. 27-CV-09-09144, 2010 WL 3719925, at *3 (Minn. Tax Ct. Sept. 16, 2010) ("we give this comparable [68%] less weight because the magnitude of adjustments make it not comparable to the subject property"); *Shoppes of Woodbury Village v. Cnty of Washington*, Nos. CX-07-2880, et al., 2009 WL 3837267, at *4 (Minn. Tax Ct. Nov. 12, 2009) (no weight to the comparable as the gross adjustment was over 65%).

We also have serious reservations concerning the market approach prepared by respondent's appraiser, Justin Massmann, Hennepin County Senior Appraiser. First and foremost, we disagree with the methodology Massmann employed in attempting to convert his leased fee comparables³² to fee simple sales. Massmann inappropriately relied on asking rents rather than actual rents to form his opinion of market rents³³ and fails to consider concessions granted to tenants.³⁴ He also inappropriately relied on market reports that apply to properties much larger than the warehouse parcel³⁵ and applied improper estimates of market vacancy.³⁶ Finally, to adjust the leased fee comparables to fee simple sales, Massmann relied on capitalization rates extracted from the market, which he then improperly adjusted based on his assumption that a knowledgeable buyer would pay the same price for a property, whether (a) it was fully leased with long-term tenants and required minimal cash outlay or (b) it was subject to market vacancies and had lower potential net operating income.³⁷ Given these faulty adjustments and unsupported assumptions, we find that the property rights adjustment for each of

³² Massmann considered leased fee sales only in his market approach. Ex. A1, at 82-86.

³³ Tr. 88-90. Massmann provided no support for his opinion that asking rents reliably indicated market rents.

³⁴ Indeed, Massmann acknowledged that if concessions are part of a transaction, "you have to make appropriate adjustments to the sale." Tr. 55. Additionally, in making his property rights adjustment, the reports on which he based his market rents failed to account for such concessions. Tr. 64-65. *See also* Tr. 111.

³⁵ Tr. 62-63, 87-88.

³⁶ *See* vacancy explanation *infra* p. 19.

³⁷ Massmann used the same capitalization rate analysis for his sales comparison and income approach analyses.

Massmann's leased fee sales lacks foundational reliability and credibility. Accordingly, we give his market approach analysis no weight.³⁸

Thus, after due consideration of the testimony presented and the argument of counsel, we decline to consider the market approach of either appraiser.

Income Approach

The income capitalization approach determines the value of income-producing property by capitalizing the income that the property is expected to generate over a specific period of time at a specified capitalization rate.³⁹ As noted, both appraisers used the income approach to determine the market value of the warehouse parcel. Their resulting values, however, differ significantly.

Bakken used 17 leases derived from 14 separate leased properties.⁴⁰ He used six separate criteria to select leased comparables. Specifically, Bakken considered: leases totaling over 100,000 sq. ft. (the subject property is 238,381 sq. ft.), warehouse use, leases occurring during what he considered a relevant timeframe, percentage of office space (6.9% of the subject

³⁸ Minn. R. Evid. 702. Massmann's analysis was flawed in other respects as well, particularly as to his comparable sales. Specifically, Massmann's comparables two, four, and five are entitled to no weight. Massmann's comparable sale two was between related parties and was therefore not an arm's length transaction. Massmann's comparable sale four was part of a package sale. Its sale price was not based on an independent appraisal, but rather on a pro forma, which was not disclosed to Massmann. Tr. 103. Consequently, there is no reliable evidence available to determine the appropriateness of the allocated sale price. Finally, Massmann's comparable five is also an atypical market transaction. The buyer owned nearby property and assumed a \$370,000 broker fee. Tr. 104.

³⁹ *Cont'l Retail, LLC v. Cnty. of Hennepin*, 801 N.W.2d 395, 402 (Minn. 2011) (citing *Eden Prairie Mall v. Cnty of Hennepin*, 797 N.W.2d 186, 193 (Minn. 2011)).

⁴⁰ Although Bakken's adjustment grid, Ex. 1, at 130-31, includes 18 separate leases, the AM Retail lease described on page 130 is not otherwise described in Bakken's appraisal, nor is it discussed in petitioner's briefs. We therefore do not consider this lease in our analysis.

warehouse is office space), actual rents, and original leases.⁴¹ Generally, we agree with Bakken's market rent search criteria for his income approach analysis. Based on the record, however, greater clear height also has a significant impact on lease rates, and we therefore deem clear height an appropriate additional factor to consider in selecting comparables for the income analysis. We agree with Bakken that the facility's 32-foot clear height⁴² places the subject warehouse in the "excellent" category on the scale utilized by Bakken.⁴³ We use the above criteria to weigh the leased comparables selected by the parties' experts.

We place less weight on Bakken's lease comparable one, the Citi-Cargo Building located in Eagan, Minnesota.⁴⁴ The leased area is substantially larger than the subject (312,254 sq. ft. to the subject's 238,381 sq. ft.). Bakken's lease comparable one has two different clear heights (28 ft./22 ft.) compared to the subject's 32-ft. clear height. This places comparable one in a poor to average category for clear height compared to the subject's excellent category. We are also concerned with Bakken's failure to appropriately discuss the locational differences, if any, between the subject and comparable one's location in Eagan. Finally we are concerned that the lease began in January 2006, substantially before the first assessment date at issue.

We place greater weight on Bakken's lease comparable two, the Walgreens facility in Rogers, Minnesota.⁴⁵ Although we are concerned about the size of the leased area compared to

⁴¹ Ex. 1, at 98.

⁴² The parties dispute the clear height of the building. Based on the building owner's plans, which were verified by Bakken, Bakken testified that the clear height of the building averages approximately 32 feet. Based on his personal measurements of the building, Massmann testified that the clear height was 30 feet. Tr. 59. We accept Bakken's determination of clear height.

⁴³ Ex. 1, at 92.

⁴⁴ Ex. 1, at 101-02.

⁴⁵ Ex. 1, at 102-03.

the subject (334,400 sq. ft. versus 238,381 sq. ft.), comparable two is otherwise very similar to the subject warehouse in other pertinent respects. The lease commenced only one and one-half years before the assessment date, the structure has the same clear height as the subject property, and it is located very close to the subject. We also agree with Bakken's lease rate adjustment because Walgreens received six months rent-free and some interior racking from the landlord at slgmng.

We place less weight on Bakken's lease comparable three, the MPC building located in Mendota Heights, Minnesota.⁴⁶ The leased area is substantially smaller than the subject's (124,783 sq. ft. versus 238,381 sq. ft.), it has a clear height of 24 ft. compared to the subject's clear height of 32 ft., and it has a substantially greater percentage of office space (16.2% versus 6.9%). Finally, we are also concerned with Bakken's failure to appropriately discuss the locational differences, if any, between the subject and comparable three's location in Mendota Heights.

We place little weight on Bakken's lease comparable four, the Continental Distribution facility located in Shakopee, Minnesota.⁴⁷ The leased area is substantially smaller than the subject's (106,371 sq. ft. to the subject's 238,381 sq. ft.), it has a substantially shorter lease than the other comparables (a 2.1-year term compared to a generally five to ten year term), and it has an unspecified amount of free rent that Bakken attempted to consider in his adjustments.

Based on the atypical nature of the transactions and the lack of adequate support for the adjustments he made, we decline to consider Bakken's comparable leases five, six, and seven.⁴⁸

⁴⁶ Ex. 1, at 104-05.

⁴⁷ Ex. 1, at 106-07.

⁴⁸ Ex. 1, at 108-09, 110-11, 112-13.

Bakken's lease comparable five, the Caterpillar facility in Maple Grove, Minnesota, is effectively a lease renewal.⁴⁹ Caterpillar is an existing tenant who elected to take additional space rather than move its operations. A tenant in this situation would essentially be faced with dividing its operations or breaking its existing lease to move.⁵⁰ Bakken's lease comparable six, the Centerpoint Marketing facility in Woodbury, Minnesota, involves a convoluted analysis of a build-to-suit lease with two separate amendments and a broker's asking rent. Lease comparable seven, the Anchor Glass facility in Shakopee, Minnesota, also deals with an atypical situation involving the analysis of a confidential lease of a build-to-suit property being held for future expansion.⁵¹

We place little weight on Bakken's lease comparable eight, the Diversified Distribution Systems facility in Brooklyn Park, Minnesota.⁵² The leased area is substantially smaller than the subject's (123,796 sq. ft. to the subject's 238,381 sq. ft.), it has a clear height of 24 ft. compared to the subject's clear height of 32 ft., and it has a substantially greater percentage of office space (17.6% compared to the subject's 6.9%).⁵³

⁴⁹ Given the availability of other leases that furnish a more reliable indication of market rent, we give these lease comparables no weight. *See Silgan Containers Mfg Corp. v. Cnty. of Scott*, No. 70-CV-07-9396, et al., 2014 WL 470820, at *17-18 (Minn. T.C. Jan. 30, 2014) (noting that lease renewals must be used with caution).

⁵⁰ Additionally, the leased area is substantially smaller than the subject and the clear height of the comparable is 20 ft. compared to the subject's 32 ft. clear height.

⁵¹ Ex. 1, at 112.

⁵² Ex. 1, at 114-15.

⁵³ Although we are concerned with Bakken's failure to appropriately discuss the locational differences, if any, between the subject and the comparable's location in Brooklyn Park, we note that the respondent also utilized lease comparables from Brooklyn Park and Brooklyn Center, thus at least impliedly agreeing that they are in markets similar to the subject.

We place greater weight on Bakken's lease comparable nine, the LDI Building in Brooklyn Park, Minnesota.⁵⁴ Bakken analyzed two separate leases related to different portions of the lease comparable. The first lease was 140,000 sq. ft. to Dedicated Logistics, beginning in February 2011. The second lease was 129,000 sq. ft. to Northern Corporation, beginning July 2011. Although we are concerned about the size of comparable nine's leased area compared to the subject (140,000 sq. ft. and 129,000 sq. ft. compared to the subject's 238,381 sq. ft.), these comparables otherwise closely match the subject in other pertinent respects. The leases commenced close to assessment dates, the structures have the same clear height as the subject, and they are located in a similar market.

We decline to consider Bakken's lease comparable ten, the Pilot Knob Distribution facility located in Mendota Heights, Minnesota.⁵⁵ The leased area is substantially smaller than the subject's (101,251 sq. ft. to the subject's 238,381 sq. ft.), it has a clear height of 24 ft. compared to the subject's clear height of 32 ft., it has a substantially shorter lease than the other comparables (a 3.125 year term compared with a generally five to ten year term), and we are concerned with Bakken's failure to appropriately discuss the locational differences, if any, between the subject and comparable nine's location in Mendota Heights. Finally, and most importantly, Bakken does not explain how he derives the effective warehouse rent for this lease comparable.

We place greater weight on Bakken's lease comparable 11, the Minnesota Valley D.C. II facility located in Shakopee, Minnesota.⁵⁶ Although we are concerned about the size of the

⁵⁴ Ex. 1, at 116-17.

⁵⁵ Ex. 1, at 118-19.

⁵⁶ Ex. 1, at 120-21.

leased area compared to the subject (125,000 sq. ft. compared to the subject's 238,381 sq. ft.) and with Bakken's failure to appropriately discuss the locational differences, if any, between the subject and the comparable eleven's location in Shakopee, the lease is within the range of the assessment dates, the building has the same clear height as the subject, and the percentage of office space matches very well with the subject.

We decline to consider Bakken's lease comparable 12, the Super Valu facility located in Hopkins, Minnesota.⁵⁷ Bakken failed to provide any testimony on clear height or the age of the structure. Without that basic information, we are unable to determine comparability to the subject.⁵⁸

We place lesser weight on Bakken's lease comparable 13, the Interstate 35 Distribution Center, located in Burnsville, Minnesota.⁵⁹ Bakken analyzed two separate leases related to different portions of the lease comparable. The first was 240,000 sq. ft. to Shop.Jimmy.Com., beginning January 2013. The second was 124,109 sq. ft. to NC Minerals, beginning January 2014. Although the leases are within the range of the assessment dates, the structure is substantially older than the subject (comparable 13 was built in 1970 while the subject's effective build date is 2000), it has a clear height of 21 ft. compared to the subject's clear height of 32 ft., and the size of the leased area is substantially smaller than that of the subject (124,109 sq. ft. compared to the subject's 238,381 sq. ft.). Finally, Bakken failed to discuss the locational differences, if any, between the subject and comparable 13's location in Burnsville.

⁵⁷ Ex. 1, at 122-23.

⁵⁸ We are also unable to determine how Bakken derived his estimate of warehouse net rent based on the evidence provided. Although Bakken explains that he used operating expenses to arrive at net rent, he fails to explain what the operating expenses were or how he derived them.

⁵⁹ Ex. 1, at 124-25.

We place no weight on Bakken's lease comparable 14, the Prime Source facility in Rogers, Minnesota.⁶⁰ Bakken analyzed two separate leases related to different portions of the lease comparable. The first was 71,147 sq. ft. to Prime Source Building Products, beginning January 2013. The second was 71,148 sq. ft. to the Profile Company, signed sometime in 2008. Although this building is located in close proximity to the subject, both have 32 ft. clear height, and both were built around the same time, the size of the leases (71,148 sq. ft. compared to the subject's 238,381 sq. ft.) makes their use inappropriate given the availability of better comparables.⁶¹

Massmann utilized eight lease comparables in his income approach. Three of the eight were lease renewals,⁶² which based on the evidence presented, we decline to consider.⁶³ We also decline to consider Massmann's comparable four, the lease of a build-to-suit property developed for the tenant.⁶⁴ Because such leases are typically based on an intended return on construction costs, they may or may not be indicative of a market rent.⁶⁵ Although Massmann testified that the lease was based on market rates, he provided no credible support for how the lease rate was derived.⁶⁶

⁶⁰ Ex. 1, at 126-27.

⁶¹ Ex. 1, at 126.

⁶² Massmann's lease comparables five through seven.

⁶³ See discussion *supra* note 66.

⁶⁴ Ex. A1, at 126-27.

⁶⁵ See *Bon Stores Realty Two LLC v. Cnty. of Ramsey*, No. 62-CV-08-3291, et al., 2011 WL 3621612, at *11 (Minn. T.C. Aug. 8, 2011).

⁶⁶ Ex. A1, at 127; Tr. 160-61.

We also disagree with Massmann's selection of his lease comparable one,⁶⁷ which, at 100,000 square feet, is less than one-half the size of the subject property. After due consideration of the testimony provided,⁶⁸ we place no weight on comparable one.

We accept Massmann's remaining comparables⁶⁹ and the adjustments he made to each. However, we disagree with Massmann's failure to take into account lease concessions.⁷⁰ Taking those concessions into account, we determine an indicated market rent of \$3.52 for Massmann's lease comparable two,⁷¹ and an indicated market rent of \$3.09 for Massmann's lease comparable three.⁷²

Based on the above analysis and after due consideration of the evidence presented by both parties, we conclude that the subject warehouse had a market rent of \$3.28 per sq. ft. for each of the assessment dates at issue.⁷³ We further adopt both appraisers' conclusion that the office rent is effectively twice that of the warehouse rate.⁷⁴

⁶⁷ Ex. A1, at 120-21.

⁶⁸ Ex. 1, at 98.

⁶⁹ Massmann's lease comparables two, three, and eight. Ex. A1, at 122-23, 124-25, 134-35.

⁷⁰ "Concessions are provided by landlords when demand is weak and there is increased competition among landlords to attract new tenants. It is not unusual for free rent concessions to be given outside of the lease term so that the concessions do not appear on the written lease contract. In these situations appraisers must still consider the lease concessions when calculating the effective rent being paid. Concessions together with tenant installation allowances influence market rent estimates." *The Appraisal of Real Estate* 471.

⁷¹ Ex. A1, at 122-23.

⁷² Ex. A1, at 124-25.

⁷³ After careful consideration of the testimony and appraisal evidence presented, we adopt Bakken's conclusion that the conditions for leases were considered flat through the assessment years at issue. Ex. 1, at 131.

⁷⁴ Ex. 1, at 100; Ex. A1, at 171, 172, 173.

Vacancy Rate and Credit Loss

The experts disagree on the appropriate vacancy and credit loss rate. Bakken used rates of 12.5% and 15%; Massmann used rates of 10%, 9.5%, and 8%. Both used similar methodology and relied on surveys prepared by outside sources to arrive at their separate conclusions.⁷⁵

Massmann relied on "direct vacancy rates" from market reports and his own market survey, the "Rogers Market Bulk Distribution Warehouse-100,000 SF or Greater,"⁷⁶ concluding that the appropriate market vacancy rates and collection loss are 10%, 9.5%, and 8% for the three respective assessment dates. "Direct vacancy" is narrowly defined as "space that is unoccupied and not under lease."⁷⁷ Thus Massmann did not include all available market vacancy in his analysis, such as space that was currently leased but vacant and available for sublease.⁷⁸

In contrast, Bakken considered all available space to determine his vacancy rate, including space under construction but available for lease in the marketplace. Bakken testified that in his experience, this is the relevant market vacancy for purposes for valuing competing properties in the large industrial properties market.⁷⁹ We agree with Bakken. The Dictionary of Real Estate Appraisal defines vacancy as "unrented space."⁸⁰ It further defines vacancy as "[t]he measurement of the amount of unoccupied or unused space of land in a defined

⁷⁵ Ex. 1, at 132-33; Ex. A, at 89.

⁷⁶ Ex A1, at 153-54.

⁷⁷ Ex. A1, at 148.

⁷⁸ See Tr. 28-31 (discussion of subleases and shadow space as other potential market vacancy considerations).

⁷⁹ Tr. 32.

⁸⁰ Appraisal Institute, *Dictionary of Real Estate Appraisal* 205 (5th ed.).

market" ⁸¹ Thus, it is our opinion that vacancy includes all constructed, unoccupied or unused space that is on the market for lease or rent.

Massmann determined that the northwest quarter of the metropolitan area was the appropriate region in which to locate properties comparable to the subject warehouse; ⁸² Bakken selected sales and lease comparables from the entire metropolitan area.⁸³ However, Bakken apparently considered vacancy only in the Rogers market area for his vacancy analysis.⁸⁴ After due consideration of the conflicting evidence presented, we find that the appropriate stabilized vacancy and credit loss rate is 10.5%.

Operating Expenses

The parties also disagree on the appropriate operating expense calculations to be used. Bakken, based on a generalized statement, opined operating expenses at \$1.00 per square foot.⁸⁵ Massmann, based on study of comparable buildings' operating expense statements within close proximity to the subject warehouse, opined operating expenses at \$0.75 per square foot.⁸⁶ After due consideration of the evidence presented by both parties, we find that the operating expense determination reached by Massmann is better supported by the record as a whole. Massmann did

⁸¹ *Id*

⁸² See Ex. A1, at 82-86 (Massmann's sales comparables); Ex. A1, at 120-35 (Massmann's lease comparables).

⁸³ See Ex. 1, at 72-89 (Bakken's sales comparables); Ex. 1, at 99-127 (Bakken's lease comparables).

⁸⁴ We also take issue with the fact that Bakken did not provide any analysis regarding the lease length of his comparables, despite noting that a single-tenant building under a long-term lease generally has lower vacancy rates. Ex. 1, at 132.

⁸⁵ Ex. 1 at 134.

⁸⁶ Ex. A1 at 155-156.

a thorough review of the market to determine expenses, something apparently not done by Bakken.⁸⁷ Thus, we adopt Massmann's operating expense determination.⁸⁸

Capitalization Rate

The appraisers also disagreed on the appropriate capitalization rate for each of the assessment dates at issue. Massmann arrived at a capitalization rate of 7.75% as of January 2, 2010 and January 2, 2011; and a capitalization rate of 6.50% as of January 2, 2012.⁸⁹ In contrast, Bakken arrived at a capitalization rate of 8.35% as of January 2, 2010; 8.15% as of January 2, 2011; and 7.95% as of January 2, 2012.⁹⁰

In deriving his capitalizations rates, Massmann first reviewed three separate market surveys, the "Korpacz/PwC - National Warehouse Market,"⁹¹ the "RERC-Minneapolis Warehouse Market,"⁹² and the "CBRE-Warehouse Market,"⁹³ which together indicated an overall average capitalization rate of 8.84% as of January 2, 2010; 8.17% as of January 2, 2011; and 7.42% as of January 2, 2012. Massmann effectively disregarded these published studies, however. Massmann then attempted to calculate his capitalization rate using market extractions.

Minnesota Rule of Evidence 702 governs the admissibility of all expert testimony and provides:

⁸⁷ See Ex. 1, at 134; Ex A1, at 155-56.

⁸⁸ As Bakken did not consider a reserve for replacements necessary, and we find Massmann's determination reliable, we accept Massmann's determination on that issue.

⁸⁹ Ex. A1, at 170.

⁹⁰ Ex. 1, at 145.

⁹¹ Ex. A1, at 157.

⁹² *Id* at 158.

⁹³ *Id* at 159.

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise. The opinion must have foundational reliability. In addition, if the opinion or evidence involves novel scientific theory, the proponent must establish that the underlying scientific evidence is generally accepted in the relevant scientific community.

Massmann's capitalization rate analysis is based on his assumption that a knowledgeable buyer would pay the same price for a property, (a) whether it was fully leased with long-term tenants and required minimal cash outlay or (b) it was subject to market vacancies and had lower potential net operating income. This unsupported assumption improperly skews Massmann's determination of net operating income and capitalization rate, which in turn skews his results. As Massmann testified, using his methodology, higher vacancy results in a lower computed capitalization rate⁹⁴ and a lower estimated market rent would result in a lower computed capitalization rate.⁹⁵ In other words, using Massmann's method to derive a capitalization rate, all other factors being equal, a riskier investment produces greater value than a secure one. We cannot accept this reasoning and find Massmann's testimony on this issue not credible and lacking in foundational reliability.⁹⁶

Bakken derived his capitalization rates from the market, relying primarily on five comparable properties located in the Rogers. Bakken then verified his rate by comparing it to

⁹⁴ Tr. 202.

⁹⁵ Tr. 202 -03.

⁹⁶ Minn. R. Evid. 702. Massmann's methodology is one he apparently created based on his understanding of a paragraph from *The Appraisal of Real Estate* 493-94. Tr. 204-05.

various market surveys. We agree with Bakken's comparables and methodology and adopt his results.⁹⁷

Based on the above considerations, we arrive at an indicated market value of the subject warehouse parcel using the income approach (including a deduction of \$220,000 for deferred maintenance for each assessment year) as follows:

Assessment 2010	\$8,475,000
Assessment 2011	\$8,461,000
Assessment 2012	\$8,461,000

Summary and Conclusion of Final Value of the Subject Warehouse Property

Neither expert relied on the cost approach to value. Although both experts relied on the market approach, we give it no weight. Both appraisers testified that income approach produced reliable indication of value. We agree. After making appropriate adjustments for the reasons stated above, we find that the subject warehouse property has an indicated market value of \$8,475,000 as of January 2, 2010; \$8,461,000 as of January 2, 2011; and \$8,461,000 as of January 2, 2012.

Vacant Land Parcel

The tax petition also includes an unimproved land parcel of approximately 18.72 acres, with a usable net area of 660,000 sq. ft.⁹⁸ Although both appraisers address the parcel in their

⁹⁷ The parties did agree on the appropriate effective tax rate for each year in question. 3.61% for January 2, 2010; 3.83% for January 2, 2011; and 4.03% for January 2, 2012. Ex. 1, at 146-148 and Ex. A1, at 170.

⁹⁸ The parties have a very slight disagreement over both the gross land area and the net usable area involved. As neither appraiser explained how he determined the net usable area, we have averaged their conclusions of net usable area to arrive at our determination of 660,000 sq. ft.

appraisal reports, neither party cross-examined the other's appraiser concerning his conclusion for value of the vacant land parcel.

Because the parcel is unimproved land, both appraisers valued it using only a market approach. Bakken analyzed 11 sales, making adjustment for market conditions, site work, location, size, access, visibility, highest and best use, and for what he termed "other/misc." ⁹⁹ Bakken then arrived at an indicated value of \$1,750,000 as of January 2, 2010; \$1,750,000 as of January 2, 2011; and \$2,100,000 as of January 2, 2012. Massmann considered similar adjustments to analyze four comparable sales, arriving at an indicated value of \$2,460,000 as of January 2, 2010; \$2,370,000 as of January 2, 2011; and \$2,370,000 as of January 2, 2012. The difference in the appraisers' analyses is that Massmann credibly explained the adjustments he made, whereas Bakken did not. We adopt Massmann's value conclusions for the vacant parcel for each assessment date.

T.G.H.