

STATE OF MINNESOTA

TAX COURT

COUNTY OF DAKOTA

REGULAR DIVISION

KCP Hastings, LLC,

Petitioner,

**AMENDED FINDINGS OF FACT
AND CONCLUSIONS OF LAW
ON REMAND AND ORDER FOR
JUDGMENT**

vs.

File Nos: 19HA-CV-11-2713
19HA-CV-12-2223
19HA-CV-13-1742

County of Dakota,

Respondent.

Filed: January 11, 2018

This matter came before The Honorable Joanne H. Turner, Judge of the Minnesota Tax Court, on remand from the Minnesota Supreme Court.

Dan Biersdorf and Ryan Simatic, Biersdorf & Associates, P.A., represented petitioner KCP Hastings, LLC.

Suzanne W. Schrader, Assistant Dakota County Attorney, represented respondent Dakota County.

These property tax cases concern the market value of a multi-tenant retail shopping center in Hastings, Minnesota, as of January 2, 2010, January 2, 2011, and January 2, 2012. On November 12, 2014, we filed findings of fact, conclusions of law, and order for judgment finding that the assessed value of the subject property understated its market value as of all three valuation dates. *KCP Hastings, LLC v. Cty. of Dakota*, No. 19HA-CV-11-2713 et al., 2014 WL 6345861 (Minn. T.C. Nov. 12, 2014). In doing so, we rejected the cost method because of the age of the subject property. *Id.* at *3. We further rejected the properties offered by KCP's expert appraiser as comparable. *Id.* at *4. Finally, we rejected both experts' analyses under the income approach: the County's because it applied direct capitalization to a property we considered unlikely to have

the stable income necessary for that approach; KCP's because we could not replicate its expert's calculations. *Id.* at *9, *11. There were no post-trial motions.

Petitioner KCP Hastings appealed our decision to the Minnesota Supreme Court. The supreme court affirmed our findings concerning gross building area and our rejection of KCP's expert's sales comparison approach. *KCP Hastings, LLC v. Cty. of Dakota*, 868 N.W.2d 268, 273-74 (Minn. 2015). The court concluded, however, that we erred in rejecting KCP's expert's discounted-cash-flow (DCF) approach and, consequently, in failing to consider the income approach to value. *Id.* at 275-76. The court therefore remanded the matter to our court. *Id.* at 276.

After consulting with the parties, we invited the parties to supplement their appraisals on remand, "limited to opinions of value under the discounted-cash-flow approach and final reconciliations of value under the discounted-cash-flow approach and the sales-comparison approach as previously admitted." Order ¶ 1 (filed Nov. 18, 2015). KCP filed a supplemental appraisal that included its expert's underlying DCF calculations; the County filed a supplemental appraisal using the DCF approach.

In April 2016, KCP moved to exclude the County's supplemental appraisal because it was prepared in part by Mr. Toelke (another Dakota County assessor), rather than solely by Mr. Ducklow (who prepared the original appraisal and testified at trial), and because the County had "argued that the 'Discounted Cash Flow method is not a reliable indicator of value in this case.' " ¹ KCP argued that the County should be barred from "introduc[ing] evidence that it previously

¹ Mem. Law Supp. Pet'r's Mot. Limine 2, 6; *see also* Aff. of Brian Ducklow Opp. Pet'r's Mot. Limine ¶¶ 1-3 (filed May 11, 2016).

argued was speculative, unreliable, and incapable of assisting the Court with the paramount inquiry of this case: the fee simple value of the Subject Property on the dates of valuation.”² We denied KCP’s motion. Order Denying Mot. Limine (filed June 7, 2016).

Although the matter was essentially trial-ready upon the filing of the parties’ supplemental appraisals in February, because of Mr. Bakken’s schedule the evidentiary hearing could not be convened until August 11, 2016. On July 7, 2016, KCP filed a “Rebuttal Appraisal Review” signed by David S. Reach, MAI, Mr. Bakken’s partner. Mr. Reach’s review appraisal indicated that it was restricted to the appraisal report prepared for the County by Messrs. Ducklow and Toelke, and recited that Reach was asked “to evaluate and comment on the technical procedures employed in the County’s discounted cash flow analysis.”³ The County moved to exclude Mr. Reach’s review appraisal, and to prevent Mr. Reach from testifying, on the grounds that such testimony was not contemplated by our November 2015 scheduling order and that KCP should not unjustly benefit from the long delay in conducting the evidentiary hearing occasioned by the unavailability of its own expert.⁴ Because the County indicated it could, if it chose, prepare its own review appraisal of Mr. Bakken’s work without delaying the August 11 hearing, we denied the County’s motion without prejudice. Order Resp’t’s Mot. Limine (filed July 27, 2016).⁵

² Mem. Law Supp. Pet’r’s Mot. Limine 2.

³ Appraisal Review 1, Ex. 2.

⁴ Mem. Resp’t Supp. Mot. Limine 1-2.

⁵ In the end, the County chose not to commission a review appraisal or to otherwise object to Mr. Reach’s report.

The evidentiary hearing convened on August 11, 2016. We heard testimony from and received the supplemental appraisal of Mr. Bakken.⁶ Likewise, we heard testimony from Messrs. Toelke and Ducklow and received the County's supplemental appraisal.⁷ Finally, we received the review appraisal of Mr. Reach.⁸ In December 2016, we issued findings of fact and conclusions of law on remand and an order for judgment. *KCP Hastings, LLC v. Cty. of Dakota*, No. 19HA-CV-11-2713 et al., 2016 WL 7638310 (Minn. T.C. Dec. 29, 2016).

Both parties moved for amended findings of fact and conclusions of law.⁹ In April 2017, we denied KCP's motion to amend our findings with respect to the outlot and with respect to the square footage of the property, but corrected a clerical mistake with respect to capitalization rates, as permitted by Minn. R. Civ. P. 60.01. *KCP Hastings, LLC v. Cty. of Dakota*, No. 19HA-CV-11-2713 et al., 2017 WL 1750381, at *5 (Minn. T.C. Apr. 27, 2017). The County's motion asked that we amend our findings of fact "by showing the various calculations performed" in our discounted-cash-flow (DCF) approach. *Id.* at *6 (citing Resp't's Mem. Supp. Mot Amended Findings & Conclusions Law). During the hearing on the parties' motions, we proposed instead providing the parties with specific parameters from which the parties could make their own DCF calculations, agree on the result if possible and, if not, submit their separate calculations to the court for resolution. *Id.* (citing Tr. 42-44). The parties agreed. *Id.* Our April 27, 2017 order on

⁶ Ex. 1A.

⁷ Ex. R1A.

⁸ Ex. R2.

⁹ Pet'r's Mot. Amended Findings 11 (filed Jan. 13, 2017); Resp't's Not. Mot. & Mot. Amended Findings & Conclusions Law (filed Jan. 17, 2017).

the parties' motions for amended findings of fact and conclusions of law therefore specified the parameters to be used under the discounted-cash-flow approach. *Id.* at *6-7.

Initially, KCP asked its expert to prepare a discounted-cash-flow approach using the court's parameters.¹⁰ After several months, however, it became apparent that KCP's expert's software program could not accommodate the court's parameters.¹¹ Thereafter, the Dakota County Assessor's staff completed a discounted-cash-flow approach using an Excel spreadsheet, which was filed with the court on October 31, 2017. Without waiving its objections to our findings of fact and conclusions of law on remand, KCP agreed that the values reached under the County's approach accurately reflect the court's findings of fact.¹² The court held a final conference call with the parties on November 7, 2017, after which the matter was again deemed submitted.

After careful and detailed consideration of all of the evidence, we find that the assessed value of the subject property understates its market value as of each valuation date.

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

FINDINGS OF FACT

1. KCP Hastings, 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.

¹⁰ Letter from Ryan Simatic to Judge Joanne Turner (May 27, 2017) (on file with the Minnesota Tax Court).

¹¹ Letter from Ryan Simatic to Judge Joanne Turner (Sept. 11, 2017) (on file with the Minnesota Tax Court).

¹² Letter from Ryan R. Simatic to Judge Joanne Turner (Oct. 27, 2017) (on file with the Minnesota Tax Court) ("Petitioner is not objecting to the County's mathematics Petitioner maintains all rights of appeal and continues to object to the Court's specific findings and the Court's determination of market value.").

2. The subject property consists of approximately 11 acres of land with a street address of 1355 South Frontage Road, Hastings, Minnesota. The subject property was improved in 1976 with a 153,749 square foot multi-tenant retail shopping center (129,475 square feet of net rentable area). The property is zoned C-4.

3. The highest and best use of the subject property is as it is currently improved, namely, as a multi-tenant retail shopping center.

4. The Dakota County Assessor valued the property at \$4,791,600 as of January 2, 2010; \$4,821,700 as of January 2, 2011; and \$4,821,700 as of January 2, 2012.

5. Petitioner's appraiser, Paul G. Bakken, opined on remand that the fee-simple market value of the subject property was \$3,250,000 as of January 2, 2010; \$2,850,000 as of January 2, 2011; and \$2,800,000 as of January 2, 2012.

6. The County's appraiser, Brian M. Ducklow, opined on remand that the fee-simple market value of the subject property was \$6,167,500 as of January 2, 2010; \$5,514,100 as of January 2, 2012; and \$5,033,600 as of January 2, 2012.

7. The fee-simple market value of the subject property as of January 2, 2010, was \$5,307,100.

8. The fee-simple market value of the subject property as of January 2, 2011, was \$4,856,000.

9. The fee-simple market value of the subject property as of January 2, 2012, was \$5,221,800.

CONCLUSIONS OF LAW

1. Petitioner KCP Hastings submitted sufficient credible evidence to rebut the presumptive validity of the assessed value as of each valuation date at issue.

2. The Dakota County Assessor's estimated market value for the subject property as of January 2, 2010, understates its market value as of that date.

3. The Dakota County Assessor's estimated market value for the subject property as of January 2, 2011, understates its market value as of that date.

4. The Dakota County Assessor's estimated market value for the subject property as of January 2, 2012, understates its market value as of that date.

ORDER FOR JUDGMENT

1. The County's assessed value of the subject property as of January 2, 2010, shall be increased from \$4,791,600 to \$5,307,100.

2. The County's assessed value of the subject property as of January 2, 2011, shall be increased from \$4,821,700 to \$4,856,000.

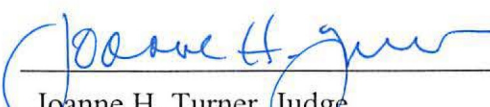
3. The County's assessed value of the subject property as of January 2, 2012, shall be increased from \$4,821,700 to \$5,221,800.

4. Real estate taxes 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. A STAY OF 15 DAYS IS HEREBY ORDERED. LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT:




Joanne H. Turner, Judge
MINNESOTA TAX COURT

DATED: January 11, 2018

MEMORANDUM

These property tax cases concern the market value as of January 2, 2010, January 2, 2011, and January 2, 2012, of a multi-tenant retail shopping center in Hastings, Minnesota.

A. DESCRIPTION OF THE SUBJECT PROPERTY

The subject property consists of three tax parcels totaling approximately 11.18 acres of land at the southeast corner of Pleasant and 145th Street East (the south frontage road of Highway 55) on the west side of Hastings, Minnesota. The subject property is south and east of the Dakota County Government Center. Several fast-food restaurants, two banks, and a gas station occupy the block north of the subject property, between 145th Street and Highway 55 itself. A portion of the property (about 1.18 acres in the northwest corner of the site) has been separately offered for sale for a number of years, apparently without success.

On appeal, the Minnesota Supreme Court concluded that we “clearly erred by rejecting KCP’s [discounted-cash-flow] analysis” and abused our discretion in failing to consider the income approach in valuing the subject property. *KCP Hastings, LLC v. Cty. of Dakota*, 868 N.W.2d 268, 276 (Minn. 2015). The matter was remanded to us for a conclusion of value under the income approach. *Id.* Nevertheless, petitioner KCP contends we must on remand amend a factual finding—as to the physical characteristics of the subject property—that was specifically affirmed by the Minnesota Supreme Court.¹³ We disagree.

The subject property is improved with an L-shaped, partially enclosed, retail shopping center constructed in 1976. Although the parties purported to stipulate that the building

¹³ See Pet’r’s Remanded Post-Trial Br. 30-31 (filed Sept. 26, 2016).

comprised 140,852 square feet of gross building area,¹⁴ our November 2014 decision found the building to contain 153,749 square feet of gross building area (129,475 square feet of net rentable area). *KCP Hastings v. Cty. of Dakota*, No. 19HA-CV-11-2713 et al., 2014 WL 6345861, at *1 (Minn. T.C. Nov. 12, 2014). On remand, KCP insists that we cannot use anything but a gross building area of 140,852 square feet “because such a finding would directly contradict an undisputed record.”¹⁵ Indeed, KCP maintains that if the court were to apply a different gross building area, it “would consciously be making a finding that it knew was false.”¹⁶ We reject the contention and offer two responses.

First, the square footage of the subject property was *not* “undisputed” during the first trial. As our November 2014 decision made explicit, the County’s appraiser used the parties’ stipulated size of 140,852 square feet of gross building area but *KCP’s own expert* assumed a completely different figure of 153,749 square feet. *KCP Hastings*, 2014 WL 6345861, at *1 n.1 (referencing Ex. 1, at 27). “[W]here the parties stipulate as to what the facts are, all parties to the stipulation, as well as the courts, are bound by the stipulation until it is abandoned.” *Gethsemane Lutheran*

¹⁴ Stipulation Facts ¶ 1.c (filed Feb. 12, 2014).

¹⁵ Pet’r’s Proposed Findings Fact, Conclusions Law Order Judgment ¶ 7 (filed Sept. 26, 2016); *see also* Pet’r’s Remanded Post-Trial Br. 30 (filed Sept. 26, 2016) (asserting “[t]here is no basis in the record for the Court to apply a unit value to anything other than” the stipulated figures of 140,852 square feet of gross building area and 129,475 square feet of net rentable area).

¹⁶ Pet’r’s Remanded Post-Trial Br. 30 (“The Court should not be trapped into thinking that, because it previously used an incorrect [gross building area], it must use an incorrect [gross building area] again. There is no law to support this proposition. This is most probably because such a proposition is anathema to the paramount function of any court. The purpose of any proceeding before a court is to get to the truth of the matter. If the Court applied a different [gross building area] or [net rentable area], the Court would consciously be making a finding that it knew was false.”).

Church v. Zacho, 253 Minn. 469, 479-80, 92 N.W.2d 905, 913 (1958). “[W]here the parties at the trial abandon such stipulation and proceed to try the issue,” however, “they are bound by the results of that trial.” *Id.* at 480, 92 N.W.2d at 913. In this case, although counsel may have stipulated to a gross building area of the shopping center, KCP’s counsel apparently did not so inform KCP’s expert, who used a different gross building area *and* supported that figure with detailed floor plans of the building.¹⁷ Put simply, *KCP itself* abandoned the stipulation and placed the square footage of the building at issue. KCP having done so, we were obligated to resolve the factual dispute. We did so using the floor plans provided by KCP’s expert, Mr. Bakken, which showed a gross building area of 153,749 square feet. *KCP Hastings*, 2014 WL 6345861, at *1 n.1 (referencing Ex. 1, at 27); *see KCP Hastings*, 868 N.W.2d at 270 n.1 (the supreme court noting that we “independently verified through floor plans that the correct measurement is 153,749 square feet”).

Second, the supreme court *affirmed* our findings as to the size of the building. *KCP Hastings*, 868 N.W.2d at 270 & 270 n.1 (describing the property as having “a gross building area of 153,749 square feet and a gross leasable area of 129,475 square feet”).¹⁸ And, the supreme court held that we did not err by using that gross building area in our calculations of market value under the sales comparison approach. *Id.* at 272-73. We therefore have no occasion to revisit the issue on remand. Indeed, we are barred from doing so. *See, e.g., United States v. Mansion House*

¹⁷ See Ex. 1 at 6 (stating a gross building area of 153,749 square feet), 26 (same), 27 (floor plans). KCP has never explained how counsel apparently mutually arrived at a gross building area of 140,852 square feet or how such a figure can be derived from the undisputed floor plans included in KCP’s own expert’s report.

¹⁸ KCP argued to the supreme court that we “applied the wrong building area to [our] sales comparison approach” and thereby “clearly overvalued the subject property under that approach.” Appellant’s Appellate Br. 37. But KCP apparently did not actually assert that our determination of gross building area was clear error. *See KCP Hastings*, 868 N.W.2d at 270 n.1.

Ctr. Redev. Co., 118 F.R.D. 487, 490 (E.D. Mo. 1987), *aff'd*, 855 F.2d 524, 527 (8th Cir.) (noting that after an appeal, the trial court has the power under Fed. R. Civ. P. 60(a) to correct its judgment, but only “so long as the Court’s corrections do not alter or amend anything expressly or implicitly ruled on by the [appellate court].”). KCP’s demand that we alter our finding as to gross building area after it has been affirmed by the supreme court borders on the frivolous. *See* Minn. R. Prof. Conduct 3.1, 3.3(a).

B. HIGHEST AND BEST USE

In valuing real property, we consider both “the use that should be made of an improved property in light of the existing improvements” and “the ideal improvement” if the property were already vacant. Appraisal Institute, *The Appraisal of Real Estate* 345 (14th ed. 2013) (sometimes “Fourteenth Edition”); *see id.* at 42 (noting that the purpose of analyzing the property’s highest and best use is to “identif[y] the use or uses on which the final opinion of value is based”). Here, the experts agreed that the highest and best use of the subject property is as it is currently improved, namely, as a multi-tenant strip shopping center.¹⁹ We agreed. *KCP Hastings*, 2014 WL 6345861, at *1. Our decision on this point was not appealed, *KCP Hastings*, 868 N.W.2d at 269.

C. VALUATION

We consider the three traditional approaches to valuation—cost, income, and sales comparison—in determining market value. *See Equitable Life Assur. Soc’y of U.S. v. Cty. 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 one or more particular approaches. *Id.* at 554.

¹⁹ Ex. 1, at 58; Ex. R1, at 32.

1. COST APPROACH

Our November 2014 decision made no determination of market value using the cost approach because the improvements to the subject property were constructed in 1976, making cost estimates inherently less than reliable. *KCP Hastings*, 2014 WL 6345861, at *3. Neither party challenged this on appeal, and it is law of the case.

2. SALES COMPARISON APPROACH

Calling the County's expert's analysis "not credible," KCP urges us to revisit our determination of value under the sales comparison approach and to put "little weight" on the County's analysis under that approach.²⁰ Again, we must address the scope of remand. "[W]hen a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case." *Arizona v. California*, 460 U.S. 605, 618 (1983); *In re Welfare of M.D.O.*, 462 N.W.2d 370, 375 (Minn. 1990) ("The 'law of the case' doctrine commonly applies to issues decided in earlier stages of the same case."). In this case, we previously adjudicated the disputed issue of the subject property's value under the sales comparison approach. *KCP Hastings*, 2014 WL 6345861, at *4-7. KCP appealed our decision to the supreme court, arguing that we "clearly overvalued the subject property under that approach."²¹ The supreme court disagreed and affirmed our decision on this point. *KCP Hastings*, 868 N.W.2d at 273-74 (holding that we "did not clearly err by rejecting KCP's valuation using the sales-comparison

²⁰ Pet'r's Proposed Findings ¶ 44; *see also* Pet'r's Remanded Post-Trial Br. 30 (arguing that because the supreme court vacated our prior judgment, "the Court will have to issue *new* findings and a *new* judgment based on those findings.").

²¹ Appellant's Appellate Br. 37.

approach.”). We therefore decline to revisit our determination of value under the sales comparison approach.

3. INCOME APPROACH

As we have indicated, our focus on remand is the income approach to value. *See KCP Hastings*, 868 N.W.2d at 276. The income approach to value is based on the present value of future rights to income generated by a property, determined by capitalizing anticipated rents generated by the property at market rates, less expenses of the property at market rates. *Macy’s Retail Holdings, Inc. v. Cty. of Hennepin*, 2011 WL 6117899, at *9 (Minn. T.C. Nov. 28, 2011) (citing *Space Ctr. Enters., Inc. v. Cty. of Ramsey*, No. C4-97-3360 et al., 1999 WL 1018098 (Minn. T.C. Nov. 4, 1999)).

a. The parties’ approaches during trial; ruling on appeal

Our decision on remand will be easier to understand with the following background. The parties’ experts initially approached the valuation problem from different perspectives. KCP’s expert, Mr. Bakken, estimated value under the income approach using a discounted-cash-flow technique.²² Discounted-cash-flow analysis “explicitly calculates the year-by-year effects of potentially changing income patterns, changes in the original investment’s value, and other considerations.” *Appraisal of Real Estate* 492. The discounted-cash-flow approach is therefore specifically designed to capture the effects on market value of expected changes in such things as market rents and market vacancy levels. In this case, Mr. Bakken employed the discounted-cash-

²² Ex. 1, at 60.

flow technique because he concluded, given forecast occupancy levels, that “the subject property has not achieved stabilized operations.”²³

To employ the discounted-cash-flow technique, Mr. Bakken estimated market rents for each category of space at the subject property.²⁴ He then estimated losses due to vacancy and turnover, relying on expiration dates of leases actually in place at the subject property.²⁵ He also estimated expenditures for tenant improvements and leasing commissions, again relying on the expiration of leases actually in place at the subject property.²⁶ After subtracting operating expenses and reserves for structural expenses, Mr. Bakken arrived at annual cash flows before debt service and taxes, to which he applied a discount factor and added a lump sum reflecting the sale of the property at the end of ten years to arrive at his final estimate of market value.²⁷

The County’s expert, Mr. Ducklow, initially estimated value under the income approach using a direct-capitalization technique.²⁸ “Direct capitalization is a method used in the income capitalization approach to convert a single year’s income expectancy into a value indication.” *Appraisal of Real Estate* 491. The approach “is widely used when properties are already operating on a stabilized basis.” *Id.* “The direct capitalization methodology may be less useful for properties going through an initial lease-up period and for properties with income or expenses that are

²³ Ex. 1, at 60.

²⁴ Ex. 1, at 85, 87.

²⁵ Ex. 1, at 83-84.

²⁶ Ex. 1, at 83-84.

²⁷ Ex. 1, at 84-88.

²⁸ Ex. R1, at 96.

expected to change in an irregular pattern over time.” *Id.* Indeed, direct capitalization “does not directly consider individual cash flows beyond one year.” *Id.* at 492.

In this case, Mr. Ducklow applied the direct-capitalization approach as of each valuation date, thereby converting “a single year’s income expectancy into a value indication,” but using different market rents and vacancy rates as of each valuation date.²⁹ The direct-capitalization approach initially used by Mr. Ducklow necessarily assumed that a potential buyer of the subject property would have forecasted on each valuation date that market rents, vacancy rates, and operating expenses for the subject property were stable.³⁰ In other words, Mr. Ducklow’s calculations necessarily assumed, for example, that as of January 2, 2010, a prospective buyer of the subject property would have expected the property to generate \$787,689 in total rental revenues, not just in 2010 but every year for the foreseeable future.³¹ Similarly, Mr. Ducklow’s calculations necessarily assumed that as of January 2, 2010, a potential buyer of the subject property would have expected to lose 10% of that potential revenue to vacancies and collection losses,³² not just in 2010 but every year for the foreseeable future.

The evidence in the record before us—indeed, the evidence in Mr. Ducklow’s own report—did not support such assumptions. To the contrary, the record indicated not only that market rents for the subject property were declining during the years at issue, but that on each valuation date, market rents were expected to decline further for at least some period of time. Similarly, the record indicated not only that market vacancy rates for community and neighborhood centers like the

²⁹ Ex. R1, at 94-96.

³⁰ Or are forecast to change consistently over time at rates that can be captured in the applicable discount rate.

³¹ See Ex. R1, at 95.

³² See Ex. R1, at 96.

subject property were increasing during the years at issue, but that on each valuation date, vacancy rates were expected to increase further for at least some period of time.

As part of his analysis, Mr. Ducklow cited a January 2010 analysis by NorthMarq indicating there were nearly 2.3 million square feet of vacant retail space in community shopping centers in the Twin Cities.³³ At the same time, according to NorthMarq, “many retailers’ sales are down, and they do not have the capital to support a relocation.”³⁴ “Because of the abundance of space and lack of active retailers,” NorthMarq wrote, “landlords are faced with rate reductions virtually across the board,” with overall net effective rates down 20-30% from their peak.³⁵ Furthermore, NorthMarq found “[t]here is no competition” for space in community centers.³⁶ “No community centers are under construction,” NorthMarq noted, and “[p]lans for more than 25 centers, totaling 9.7 million square feet, have been downgraded from ‘planned’ status to ‘preliminary’ until the market begins to rebound.”³⁷

The January 2011 NorthMarq report indicated only a slight reduction in the vacancy rate at community shopping centers, with most of that improvement coming at community centers that (unlike the subject property) were “anchored by big-box, category-dominant retailers.”³⁸ Indeed,

³³ Ex. R1, at 24.

³⁴ Ex. R1, at 24.

³⁵ Ex. R1, at 25.

³⁶ Ex. R1, at 24.

³⁷ Ex. R1, at 25.

³⁸ Ex. R1, at 26.

NorthMarq concluded, “[t]he best centers are seeing a majority of the activity, so *the strong centers are becoming stronger and the weak are becoming weaker.*”³⁹

The January 2012 NorthMarq report concluded that vacancy rates increased during 2011.⁴⁰ According to NorthMarq, having “selected the [vacant big] boxes they wanted in prime trade areas at favorable rates,” retailers “may take a step back and look at their sales before opening more stores,”⁴¹ indicating that vacancy rates (even at centers with big-box retail space to lease) were likely to remain high. With respect to market rents, NorthMarq indicated: “Many landlords do not have pricing power yet. Landlords may be getting tenants to pay market rates, but they are investing significantly more up front in tenant improvements and build-outs than they were pre-recession.”⁴² In addition, some 923,000 square feet of additional space in community retail centers was under construction, NorthMarq noted, “driven by a handful of big-box users.”⁴³

Based on this record, we concluded that a direct-capitalization approach was not appropriate here. *KCP Hastings*, 2014 WL 6345861, at *9. A prospective buyer of the subject property could not reasonably have concluded on any of the valuation dates that market rents or vacancy rates were stable, we reasoned. *Id.* We therefore placed little weight on the market values determined by Mr. Ducklow using the direct-capitalization approach. *Id.*

³⁹ Ex. R1, at 28 (emphasis added).

⁴⁰ Ex. R1, at 29.

⁴¹ Ex. R1, at 31.

⁴² Ex. R1, at 31.

⁴³ Ex. R1, at 30.

In *Equitable Life Assurance Society of the United States v. County of Ramsey*, we arrived at market value by applying a discounted-cash-flow analysis on the assumption that a prospective purchaser of the subject property would do the same: “A prospective purchaser would be a sophisticated investor who would project the cash flow and the capital requirements of the Property during the ownership period.” No. C8-91-6247 et al., 1993 WL 377210, at * 3 (Minn. T.C. Sept. 24, 1993). The Minnesota Supreme Court affirmed. *Equitable Life Assur. Soc.*, 530 N.W.2d at 547. The supreme court rejected Ramsey County’s argument that our discounted-cash-flow analysis “improperly determined the investment value of the subject property as opposed to its market value.” *Id.* at 555. Rather, the court noted, “value, to a large extent, is created in the minds of individuals who constitute a market.” *Id.* at 555-56. The record established that “the likely universe of prospective purchasers of the subject property” was “institutional investors or large development companies,” and the petitioner’s expert’s discounted cash flow analysis (on which we had relied, to some extent) had been prepared “with that likely market in mind, incorporating the investment criteria held by such entities.” *Id.* at 550-51.

Similarly, we concluded in this case that a discounted-cash-flow analysis represented one approach by which prospective buyers and sellers of the subject property would evaluate the subject property as an investment. The record in this case indicated that the most likely buyer for the subject property on the valuation dates at issue was an individual investor, rather than a pension fund or real estate investment trust. *KCP Hastings*, 2014 WL 6345861, at *10 (citing Tr. 16-17, 18-20). The record further indicated that a prospective individual buyer of the subject property would have been required to present a rent roll and historical financial information to lenders to obtain financing. *Id.* (citing Tr. 35). Finally, the record indicated that in arriving at a listing price, a broker would have prepared a discounted-cash-flow analysis, taking into

consideration the probability that current tenants would renew existing leases and, to the extent they did not, forecasting expenditures for tenant improvements and leasing commissions needed to re-lease the space. *Id.* (citing Tr. 27-29).

Although we concluded that a discounted-cash-flow approach was appropriate, we determined that we could not rely on the discounted-cash-flow analysis performed by Mr. Bakken. *Id.* at *11. We were unable to replicate Mr. Bakken’s calculations of base rental revenue, losses due to absorption and turnover vacancy, CAM charges, losses due to “general vacancy,” expenditures for tenant improvements, or expenditures for leasing commissions.⁴⁴ Indeed, at trial Mr. Bakken conceded that verification of his calculations required “a schedule that [the court doesn’t] have” and which apparently was not produced to the County either.⁴⁵ Mr. Bakken testified that his discounted-cash-flow spreadsheet was not produced to the County because it was not “asked for.”⁴⁶ The scheduling order issued in this case, however, explicitly required “disclosure of the facts or data underlying the appraiser’s opinion either as part of the written appraisal or as a separate document or collection of documents.” Amended Scheduling Order ¶ 5 (filed Sept. 9, 2013); *see* Minn. R. Evid. 705. KCP offered to introduce Mr. Bakken’s worksheets during rebuttal; the offer coming only on rebuttal, we sustained the County’s objection to the exhibits on

⁴⁴ For example, Mr. Bakken testified at trial that he assumed annual increases of 3% in “both income and expenses.” Tr. 169. But Mr. Bakken’s discounted cash flow statements did not appear to incorporate 3% increases, at least in rent revenues. *See KCP Hastings*, 2014 WL 6345861, at *11 n.16.

⁴⁵ Tr. 168-69.

⁴⁶ Tr. 167.

the basis of unfair surprise.⁴⁷ Because we could not replicate Mr. Bakken’s discounted-cash-flow analysis, we gave it no weight. *KCP Hastings*, 2014 WL 6345861, at *11.

On appeal to the supreme court, KCP argued that we had erred in rejecting Mr. Bakken’s discounted-cash-flow (DCF) analysis.⁴⁸ The supreme court agreed. *KCP Hastings*, 868 N.W.2d at 275. The court further concluded that we had abused our discretion by relying solely on the sales-comparison approach to value. *Id.* at 276. The court therefore vacated our overall determinations of value and remanded the matter for further proceedings. *Id.*

b. Proceedings on remand

On remand, we invited both parties to supplement their appraisals. KCP supplemented Mr. Bakken’s appraisal by providing his calculations under the DCF approach.⁴⁹ The County supplemented its appraiser’s opinion with a DCF calculation of its own.⁵⁰ We begin with a discussion of the appraisers’ detailed DCF calculations.

(1) Market rents

(a) Petitioner’s approach

KCP’s expert, Mr. Bakken, began by dividing the space at the subject property into five types—gas station; over 20,000 square feet; in-line; small interior; and large interior⁵¹—and

⁴⁷ Tr. 313-16.

⁴⁸ Appellant’s Appellate Br. 16-17.

⁴⁹ Ex. 1A.

⁵⁰ Ex. R1A.

⁵¹ “Interior” spaces are those in the enclosed section of the shopping center. These suites lack direct access to the parking lot. *See* Ex. 1A, at 27 (floor plan).

estimating a market rent for each type.⁵² To arrive at market rent for each type of tenant space, Mr. Bakken considered “the actual leasing performance at the subject” property.⁵³ He noted that “there were no deals completed in either 2009 or early 2010 at the subject.”⁵⁴ In other words, the most recent leases signed at the subject were in 2008: Goodwill leased at \$8.83 per square foot gross (\$5.20 per square foot net); Nu-Wave Tanning leased at \$9.50 per square foot net; and Nu-Wave Hair Salon leased at \$7.83 per square foot net.⁵⁵ There were, as Mr. Bakken noted, two letters of intent provided to prospective tenants: one for 4,650 square feet of restaurant space at a starting rent of \$6.60 per square foot per year; and another to an appliance dealer for 10,000 square feet at \$7.00 per square foot per year net.⁵⁶ Mr. Bakken further noted that during 2010, the vacancy rate at the subject property increased as several existing tenants vacated the premises.⁵⁷

Mr. Bakken also considered rental rates at properties he considered comparable to the subject, including Hastings Marketplace (a newer strip shopping center west of the subject); County Crossroads (a strip shopping center in southeast Hastings); Hastings Midtown I (a smaller strip shopping center in central Hastings), Hastings Midtown II (a strip shopping center near

⁵² Ex. 1A, at 86.

⁵³ Ex. 1A, at 62.

⁵⁴ Ex. 1A, at 62.

⁵⁵ Ex. 1A, at 62. In a gross lease, the landlord pays all expenses of the property, such as property taxes and maintenance. *Gross Lease, The Dictionary of Real Estate Appraisal* (5th ed. 2010). In a so-called triple net lease, the tenant pays all expenses of the property except structural maintenance, building reserves, and management fees. *Net Net Net Lease, The Dictionary of Real Estate Appraisal*.

⁵⁶ Ex. 1A, at 62; *see id.* at 178-79 (copies of letters of intent).

⁵⁷ Ex. 1A, at 62.

Hastings Midtown I); and Dakota Summit Center (a newer strip shopping center adjacent to Wal-Mart west of the subject and north of Highway 55).⁵⁸ Rental rates at these properties ranged from a low of \$7.00 per square foot (Hastings Midtown Center) to a high of \$22.48 per square foot (Hastings Marketplace), according to Mr. Bakken's report.⁵⁹

On remand, Mr. Bakken claimed to have considered "the income in place, the leasing work, . . . and a survey of the rental comparables," and to have had "conversations with the leasing broker" to determine market rent, although he offered no details as to any of these.⁶⁰ Mr. Bakken opined that market rents at the subject property as of January 2, 2010 (our first valuation date) were as follows:⁶¹

TYPE OF SPACE	SQUARE FOOTAGE	MARKET RENT
Gas station	1,085	\$10.00
Over 20,000 sq. ft.	62,931	\$5.00
In-line	40,577	\$6.50
Small interior	10,459	\$6.00
Large interior	14,423	\$5.00
TOTAL RENTABLE AREA	129,475	

Mr. Bakken assumed that market rents for all types of spaces would increase by 3% per year, but not until 2014.⁶²

⁵⁸ Ex. 1A, at 69.

⁵⁹ Ex. 1A, at 70-75. Mr. Bakken's report identified only a range of rents at each property without indicating, for example, the size or other type of space at any particular price point.

⁶⁰ Ex. 1A, at 97.

⁶¹ Ex. 1A, at 84-85.

⁶² Ex. 1A, at 135.

Mr. Bakken opined that market rents at the subject property as of both January 2, 2011 (our second valuation date) and January 2, 2012 (our third valuation date) would be as follows:⁶³

TYPE OF SPACE	SQUARE FOOTAGE	MARKET RENT
Gas station	1,085	\$10.00
Over 20,000 sq. ft.	62,931	\$5.00
In-line	40,577	\$6.00
Small interior	10,459	\$5.50
Large interior	14,423	\$4.50
TOTAL RENTABLE AREA	129,475	

In other words, Mr. Bakken assumed no change in market rents for the gas station or space over 20,000 square feet at the subject property. He further assumed that market rents for in-line and interior spaces would each decrease by \$0.50 per square feet between 2010 and 2011, but not between 2011 and 2012. Again, Mr. Bakken assumed market rents would increase by 3% per year, starting in 2015 (one year later than the assumption as of January 2010).⁶⁴

(b) The County's approach

Like Mr. Bakken, the County's appraisers considered the rental history at the subject property, noting that the advertised asking rent at the subject between May 2011 and December 2013 was \$10.00 per square foot net, regardless of size.⁶⁵ The County's appraisers also considered leases commencing between October 2009 and October 2011 at other properties south

⁶³ Ex. 1A, at 97-98, 149-50, 139-41.

⁶⁴ Ex. 1A, at 139.

⁶⁵ Ex. R1, at 90A. There are two pages marked "90" in Exhibit R1; we refer to them as pages 90A and 90B.

of the river considered similar to the subject. Base rents under these leases ranged from a low of \$2.31 per square foot to a high of \$19.85 per square foot.⁶⁶

The County's appraisers also considered three properties in Hastings (Midtown I and II, and Hastings Marketplace), at which rents ranged from \$7.00 per square foot to \$22.48 per square foot net.⁶⁷ The County's appraisers considered the subject property comparable to Midtown I and II in age but older than Hastings Marketplace.⁶⁸ All properties offered comparable amenities, such as paved parking lots, loading docks, and quality of interior finishes.⁶⁹ Considering this evidence, the County's appraisers arrived at the following market rents per square foot as of January 2, 2010:⁷⁰

TYPE OF SPACE	MARKET RENT
Anchor	\$3.00
In-line	\$9.00

The County assumed market rents would decrease in 2011 and 2012 for both categories of space. For January 2011, the County assumed market rent of \$2.75 per square foot for anchor space

⁶⁶ Ex. R1, at 90B.

⁶⁷ Ex. R1, at 91-92.

⁶⁸ Ex. R1, at 94.

⁶⁹ Ex. R1, at 94.

⁷⁰ Ex. R1, at 94. KCP criticizes the County's opinions of market rents, claiming that Mr. Ducklow "himself noted, being off the highway" (as this property is, a block south of Highway 55) "can reduce rents in excess of 20%." Pet'r's Remanded Post-Trial Br. 15 (citing Ex. R1, at 94). KCP mischaracterizes Mr. Ducklow's opinion. According to Mr. Ducklow's report, "[p]roperties located along and on major highways can increase rents by as much as 20%." Ex. R1, at 94. An increase in rents of 20% is not the same as a decrease in rents of 20%. Suppose that rent off the highway is \$80. A 20% increase in rents amounts to \$16, or \$96. Now suppose that rent *on* the highway is \$96. A decrease in rent by 20% yields a rent of \$76.80—not the same as \$80.

(compared to \$3.00 per square foot as of January 2, 2010) and \$8.50 per square foot for in-line space (compared to \$9.00 per square foot as of January 2, 2010).⁷¹ For January 2012, the County assumed market rent of \$2.75 per square foot for anchor space (unchanged from January 2, 2011) but \$8.00 per square foot for in-line space (compared to \$8.50 per square foot as of January 2, 2011).⁷²

(c) Analysis

(i) The nature of Mr. Bakken's DCF analysis

Before proceeding with our analysis of value under the income approach, we address a dispute concerning the nature of Mr. Bakken's DCF analysis. The County contends that Mr. Bakken's report arrives at a leased-fee, rather than a fee-simple, value for the subject property.⁷³ KCP variously ridicules the County's contention as "utter nonsense," "pure fantasy," and "utter fiction."⁷⁴ We agree with the County: Mr. Bakken's report arrives at a leased-fee, rather than a fee-simple, value for the subject property.

By way of background, an appraisal values a particular set of interests in a particular piece of real property, rather than the real estate itself. *Appraisal of Real Estate* 4 (explaining that real estate has no value without some right to it or interest in it). "The most complete form of ownership is the fee simple interest—i.e., absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat." *Id.* at 5. Fee-simple ownership carries with it various rights, such as

⁷¹ Ex. R1, at 94-95.

⁷² Ex. R1, at 94-95.

⁷³ Resp't's Post-Trial Br. Remand 3.

⁷⁴ Pet'r's Remanded Post-Trial Br. 2, 4.

the right to use and occupy the property, the right to sell an interest in the property, and the right to lease an interest in the property. *Id.* Each of these rights may have value. *Id.* For example, a tenant pays for the right to use and occupy the property. *Id.* at 69.

Conveyance of one or more of these rights leaves the owner with an interest in the property that is less than fee-simple ownership. *Id.* at 5; *see Cont'l Retail*, 801 N.W.2d at 401 (“Because the leased fee interest is limited to the current landlord’s interest in the property, the leased fee interest is not the entire, unencumbered interest in the real property.”). Consequently, valuing the fee-simple interest in the property requires valuing *all* of the interests in the property, *including* those no longer held by the property owner itself:

In determining the market value of a particular piece of property for real estate tax purposes, the assessor must value the entire bundle of rights that make up that piece of real property. The fact that the Petitioners do not possess the entire bundle of rights does not affect the market value for real estate tax purposes. The correct assessor’s estimated market value is the value of all interests in the property.

Jermyn v. Cty. of Stearns, No. 44347, 1984 WL 2093, at *4 (Minn. T.C. Dec. 12, 1984).

The value of a leasehold interest—that is, the tenant’s right to use and occupy the property—depends on the relationship between contract rent and market rent. If contract rent is less than market rent, the tenant’s leasehold interest has a positive value. *Appraisal of Real Estate* 72. Conversely, if contract rent is more than market rent, the tenant’s leasehold interest has a negative value. *Id.* As we have explained:

Ordinarily, a leasee’s “leasehold interest” has minimal value if the rents paid are market rents. If they are below market rents the leasee would have a leasee’s interest to assign which might have a market value. If the rents are above the current market the “leasehold interest” might have a negative value and the leasee might even be willing to pay something to be relieved of its obligation under the lease.

N. Cent. Airlines, Inc. v. Cty. of Hennepin, Nos. 0125, 0441, 1981 WL 1219, at *9 (Minn. T.C. May 19, 1981). The value of the leasehold interest in turn affects the value of the leased-fee

interest: the value of a leased-fee interest encumbered by a lease at below-market rents is less than the value of an unencumbered fee-simple interest or of a leased-fee interest leased at market rents.

Appraisal of Real Estate 72.

In fee-simple valuations, therefore, “all rentable space is estimated at market rent levels. Any rent attributed to specific leases is disregarded in the income analysis.” *Id.* at 447. In contrast, in a leased-fee analysis, “current contract rents defined by any existing leases are used for leased space, and income for vacant space is estimated at market rent.” *Id.* We value the fee-simple estate, not some lesser estate. Minn. Stat. § 273.11, subd. 1 (2016) (“All property, or the use thereof, . . . shall be valued at the market value of such property and not at the value of a leasehold estate in such property, or at some lesser value than its market value.”). As we have observed, section 273.11

contemplates valuation of the entire, unencumbered interest in the real property, and not a lesser estate. The fee simple interest of the property is the “absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat.” It is the “bundle of rights” that constitutes the entire interest in the real property. A leased fee interest, however, does not contain the entire, unencumbered interest in the real property. . . . Because the leased fee interest is limited to the current landlord’s interest in the property, the leased fee interest is not the entire, unencumbered interest in the real property

Cont’l Retail, 801 N.W.2d at 401 (citations omitted).

With the difference between a fee-simple and a leased-fee interest in mind, we examine Mr. Bakken’s approach in more detail. Mr. Bakken used his assumed market rents to estimate cash flow in the first year of each analysis.⁷⁵ If a tenant space was already leased as of the valuation date, Mr. Bakken employed a market rent for that space for the valuation date regardless of the

⁷⁵ Ex. 1A, at 84.

actual rent.⁷⁶ As of January 2010, for example, tenant space 100 was leased to Goodwill at \$6.83 per square foot.⁷⁷ For his analysis, Mr. Bakken lowered the 2010 rent to his assumed market rent for that space of \$5.00.⁷⁸ Similarly, as of January 2010 tenant space 480/500 was leased to Clancy's at \$2.75 per square foot.⁷⁹ For his analysis, Mr. Bakken increased the 2010 rent to his assumed market rent for that space of \$5.00.⁸⁰

If a tenant space was vacant as of the valuation date, Mr. Bakken assumed that when the space was eventually rented, it would be at market rent. For example, tenant space 106 was vacant as of January 2, 2010, but Mr. Bakken assumed it would be leased starting December 1, 2010, at \$6.50 per square foot (Mr. Bakken's assumed market rent for 2010 for in-line tenant space).⁸¹ Similarly, tenant space 240 was vacant as of January 2, 2010; Mr. Bakken assumed that when it was eventually leased—effective September 1, 2010—the rent would be \$6.00 per square foot (Mr. Bakken's assumed 2010 market rent for small interior spaces).⁸² Because it utilizes market rents, this much of Mr. Bakken's analysis is consistent with a fee-simple valuation as the Fourteenth Edition defines it.

⁷⁶ Compare, e.g., Ex. 1A, at 62-63, with Ex. 1A, at 84-85.

⁷⁷ Ex. 1A, at 62.

⁷⁸ See Ex. 1A, at 84.

⁷⁹ Ex. 1A, at 63.

⁸⁰ Ex. 1A, at 85.

⁸¹ Ex. 1A, at 83-84.

⁸² Ex. 1A, at 83-84.

Mr. Bakken assumed, however, that rent paid with respect to any particular tenant space would not increase during the life of the lease.⁸³ If a tenant space was already leased as of the valuation date, Mr. Bakken employed a market rent for that space as of the valuation date, but the same rent through the end of the term of the existing lease, *even if market rent for the space was otherwise assumed to have increased*. For example, tenant space 460 was leased as of January 2010 and through April 30, 2015, to Sherwin Williams.⁸⁴ Mr. Bakken's discounted-cash-flow analysis assumed market rent of \$6.50 per square foot, not just for 2010 but through April 30, 2015,⁸⁵ *even though he also assumed that market rent for that space would increase by 3% starting in 2014*.⁸⁶ More specifically, under Mr. Bakken's analysis, Sherwin Williams is assumed to pay only \$6.50 per square foot through April 30, 2015, even though Mr. Bakken projected a market rent of \$6.70 per square foot in 2014 and \$6.90 per square foot in 2015. Put another way, under Mr. Bakken's analysis Sherwin Williams' rent is \$982.40 less than market rent in 2014 and \$654.92 less than market rent for the first four months of 2015.

Similarly, tenant space 440 was leased as of January 2010 and through January 31, 2016, to Sun Moon Buffet.⁸⁷ Mr. Bakken's discounted-cash-flow analysis assumes market rent of \$6.50 per square foot, not just for 2010 but through January 31, 2016,⁸⁸ *even though he also projected*

⁸³ Ex. 1A, at 87.

⁸⁴ Ex. 1A, at 63.

⁸⁵ See Ex. 1A, at 87.

⁸⁶ Ex. 1A, at 135.

⁸⁷ Ex. 1A, at 63.

⁸⁸ Ex. 1A, at 85, 87.

*that market rent for that space would increase by 3% each year starting in 2014.*⁸⁹ More specifically, under Mr. Bakken's analysis, Sun Moon Buffet is assumed to pay only \$6.50 per square foot through January 31, 2016, even though Mr. Bakken projected market rent would be \$6.70 per square foot in 2014, \$6.90 per square foot in 2015, and \$7.11 per square foot in 2016. Under Mr. Bakken's analysis, Sun Moon Buffet therefore pays \$938.70 less than market rent in 2014 and \$1,876.90 less than market rent in 2015.

Similarly, if a tenant space was re-leased after the valuation date, Mr. Bakken assumed that rent would start at market rates but, again, would not increase over the life of the new lease (assumed to be five years).⁹⁰ For example, Mr. Bakken assumed that tenant space 101 (leased to Lifeworks as of the January 2, 2010 valuation date and through October 31, 2011) would be re-leased in 2011 (either to Lifeworks or to a new tenant) at market rent of \$6.50, *but* that the rent would remain at \$6.50 for the next five years⁹¹—even though, again, he also assumed that market rent for in-line space like suite 101 would increase by 3% annually starting in 2014.⁹² That means that Mr. Bakken assumed that by 2018 the tenant in space 101 would pay \$6.50 for space for which the market rent would actually be \$7.54 per square foot—a discount of more than \$1.00 per square foot.

⁸⁹ Ex. 1A, at 135.

⁹⁰ Ex. 1A, at 87.

⁹¹ Ex. 1A, at 62, 84, 87.

⁹² Ex. 1A, at 63, 135.

To pick the most extreme example, with respect to tenant spaces 480 and 500—leased to Clancy’s drug store chain through January 31, 2019⁹³—Mr. Bakken’s approach used his assumed market rent of \$5.00 per square foot, not just for 2010 but for every year through January 2019.⁹⁴ As a result, Mr. Bakken’s cash flows with respect to leased space 480/500 reflected his assumed market rents only through 2013 and only because he assumed market rents do not change in those years. By 2018, Mr. Bakken’s assumed rent of \$5.00 per square foot is some 16%—\$.80 per square foot or nearly \$27,000 per year—less than his assumed market rent for that category of space.⁹⁵

Because it relies on contract rents, rather than market rents, this aspect of Mr. Bakken’s approach is consistent with a leased-fee valuation but inconsistent with a fee-simple valuation. *See Appraisal of Real Estate* 447.

KCP strenuously disagrees:⁹⁶

While leases sometimes have rent escalations built into them, tenants do not usually get to renegotiate rents during the lease term. Neither do landlords. Sometimes this may result in a tenant paying below market rents for a short period of the lease, and sometimes it may result in the tenant paying above market rent. Recognizing that fact is not a leased fee analysis; it is simply a recognition of market realities.

⁹³ Ex. 1A, at 63.

⁹⁴ Ex. 1A, at 85, 87.

⁹⁵ \$5.00 per square foot increased by 3% for each year from 2014 through 2018, or $\$5.00 \times (1 \times 1.03)^5$.

⁹⁶ Pet’r’s Remanded Post-Trial Resp. Br. 6 (footnote omitted).

According to KCP, we *must* adopt Mr. Bakken's approach because that is what buyers and sellers in "the real world" do:⁹⁷

Honoring lease terms while also increasing market rents on rollovers presents an NOI^[98] that, on the *aggregate*, is both reflective of market rents and reflective of market expectations. It reflects an NOI that has some tenants at market, some below market, and some above market. This is the type of NOI that will exist on a multi-tenant property in perpetuity. This is the type of NOI that any seller would sell and any buyer would buy. So on the aggregate, NOIs created using the Bakken method of holding rents flat during the lease terms reflects what realistic income is now, and what are realistic incomes in the future. Bakken's recognition of this fact does not equate to a leased fee. Instead, it reflects a market reality for this property type, a market reality that any buyer or seller would appreciate.

Indeed, KCP characterizes the arguments about the difference between a leased-fee and a fee-simple interest as nothing more than "[u]nsupported, inconsequential, and frankly silly semantic arguments."⁹⁹ We disagree.

As we have explained, we are obligated by statute to value the fee-simple interest in the property. Minn. Stat. § 273.11, subd. 1. We can do that in one of two ways. If, as Mr. Bakken assumes, market rents are increasing but contract rents are flat, then leasehold estates have value. For example, as we have just explained, Mr. Bakken assumes that the rent on tenant space 480/500 remains at \$5.00 throughout the term of the lease, even as market rents increase. For 2014, that is a savings of \$.15 per square foot, or \$5,046 per year over the market; by 2018, the savings are \$.80 per square foot, or \$26,910 per year over the market. At a discount rate of, say, 12.5%, that

⁹⁷ Pet'r's Remanded Post-Trial Resp. Br. 4; *see also id.* at 6-7 (characterizing the failure to model the terms of actual leases at the subject property "nothing more than ignoring market evidence, unsupported semantics, and an attempt to game the system.").

⁹⁸ Net operating income, or "[t]he actual or anticipated net income that remains after all operating expenses are deducted from effective gross income but before mortgage debt service and book depreciation are deducted." *Appraisal of Real Estate* 452.

⁹⁹ Pet'r's Remanded Post-Trial Br. 9.

amounts to a present value of some \$51,575 over the life of the lease—even more at a lower discount rate. If we use contract rents, we will arrive at the value of only the leased-fee estate. To arrive at the value of the fee-simple estate, we must then add the values of the various leasehold estates to the value of the leased-fee estate determined using contract rents. *See Hillcrest Dev. v. Cty. of Hennepin*, No. 2208, 1984 WL 2059, at *2 (Minn. T.C. Sept. 5, 1984) (holding that an unfavorable long-term lease will not affect the determination of market value because both owner and lessee have valuable interests in the property and the market value is the sum of the value of all interests in the property).

Alternately, we can assume that all rentable space is leased at market level rents *each year*, meaning that (other things being equal) there is no value in any leasehold estate and the value of the leased-fee each year is the same as a fee-simple value. *See Appraisal of Real Estate* 447. We choose this approach.

KCP further contends that Mr. Bakken’s approach only mirrors the approach taken by market participants.¹⁰⁰

All of Bakken’s hypothetical leasing activity is based on market rent, at market 5-year terms. There is no evidence that these standard commercial terms would not be prudent when negotiated. Terms of 5-years have been the gold standard of retail leasing for decades. If the projected leases were market-oriented when initiated, then they are the correct frame of reference for assessing market

¹⁰⁰ Pet’r’s Remanded Post-Trial Resp. Br. 10; *see also, e.g.*, Pet’r’s Remanded Post-Trial Br. 2 (arguing that this court must consider “[a]ny factor that would influence a prospective, willing and informed purchaser or seller of the subject property”), 3 (asserting that “[i]n setting market value the assessor (and thus the Court) is obligated to consider *every element and factor* affecting such valuation” (citation omitted)), 4 (claiming that this court should be “attempting to mimic the behaviors of market participants”).

There is no evidence in our record that market lease terms did not include periodic rent adjustments during the term of the lease (commonly called “escalator” clauses). To the contrary, for example, virtually all of the existing leases at the subject property included periodic rent increases during the term of the lease. *See Ex. 1A*, at 62-67.

value. Recognizing their flat rents is thus a recognition of the market, not a rejection of it.

We do not dismiss the importance of market behavior but, again, we are statutorily charged with determining the market value of *the fee-simple interest* in the subject property. Minn. Stat. § 273.11, subd. 1; *see Cont'l Retail*, 801 N.W.2d at 401. To do so, we must value the property as though all tenant spaces are leased at market rates every year; otherwise, the value of the leased fee diverges from the fee-simple value. Put another way, the income approach requires us to determine what a buyer would pay (and what a seller would demand) for the property *if it were leased at market rents*, not just on the valuation date but *for the foreseeable future*. Whether this is the way that market participants *actually* value income-producing property is irrelevant to the statutory requirement. And we categorically reject KCP's argument that compliance with Minnesota law on this point is either "inconsequential" or "frankly silly."¹⁰¹

KCP contends that Minnesota courts "have never explicitly addressed the issue of considering the impact of leases and their effect on the market value of multi-tenant commercial property."¹⁰² To the contrary, Minnesota courts have addressed the issue numerous times, each time valuing multi-tenant commercial properties using market, rather than actual, rents. *See, e.g., Cont'l Retail, LLC v. Cty. of Hennepin*, No. 27-CV-07-06549 et al., 2010 WL 11475227, at *7-8 (Minn. T.C. Dec. 21, 2010) (concluding that taxpayer's expert's use of actual, rather than market, rents to value the property under the income approach resulting in valuation of a leased-fee interest, rather than a fee-simple interest), *aff'd*, 801 N.W.2d 395, 401 (Minn. 2011); *Geneva Exch. Fund XVII, LLC v. Cty. of Dakota*, Nos. 19-C6-07-8009, 19HA-CV-08-931, 2009 WL 4017075, at *11, *14 (Minn. T.C. Nov. 19, 2009) ("Under the income approach, the value of the property is

¹⁰¹ Pet'r's Remanded Post-Trial Br. 9.

¹⁰² Pet'r's Remanded Post-Trial Br. 2.

determined by looking at the present worth of the future rights to income by capitalizing *the anticipated market level of rent* less the market level of expenses” (emphasis added)); *EOP-Nicollet Mall, L.L.C. v. Cty. of Hennepin*, Nos. 28793, 29743, 2005 WL 443844, at *9 (Minn. T.C. Feb. 11, 2005) (noting that the parties’ experts “extrapolated office rents from information from the market place because the Subject Property was not fully leased on both assessment dates”); *Chamber Assocs. v. Cty. of Hennepin*, No. TC-6241, 1988 WL 114637, at *3 (Minn. T.C. Oct. 7, 1988) (imputing market-level rents to a multi-tenant commercial building in downtown Minneapolis, the second floor of which was vacant on the valuation date because of construction); *see also TMG Life Ins. Co. v. Cty. of Goodhue*, 540 N.W.2d 848, 853 (Minn. 1995) (rejecting the taxpayer’s assertion “that only the actual rent paid under a below-market lease is to be used to calculate the fair market value of income-producing property”); *Crossroads Ctr. (Rochester), Inc. v. Comm’r of Taxation*, 286 Minn. 440, 446-47, 176 N.W.2d 530, 535 (1970) (rejecting the taxpayer’s argument that because the subject property “is burdened with an unprofitable lease the property value is considerably lower than it would otherwise be” and valuing the property using its fair rental value).

In *Continental Retail*, we concluded that the taxpayer’s appraiser had improperly valued the leased-fee interest, rather than the fee-simple interest, because he used actual, rather than market, rents to value the property. 2010 WL 11475227, at *8. We noted that we are “charged with determining market value for the subject property on a fee simple basis.” *Id.* “Thus,” we reasoned, “an expert must look at the actual rent, expenses and vacancy rates and make a determination as to whether these are at ‘market’ for the subject property.” *Id.* “If they are below or above ‘market,’ they cannot be used to value the subject property.” *Id.* We concluded that

because the taxpayer's appraiser had not relied on market rents, he had not "provided any evidence of the fee simple interest value of the Subject Property." *Id.*

The Minnesota Supreme Court affirmed. *Cont'l Retail*, 801 N.W.2d at 401. The supreme court noted that under Minn. Stat. § 273.11, subd. 1, property is specifically not to be valued as a leasehold estate, because the leasehold estate "is limited to the current landlord's interest in the property." *Id.* The court agreed that because the taxpayer's expert used "actual, 'as is' rents to value the property," his calculations "result[ed] in a valuation of the leased fee interest rather than the fee simple interest." *Id.* Nor was there any evidence that the resulting leased-fee interest was equivalent to a fee-simple interest. *Id.*

KCP acknowledges the Minnesota Supreme Court's decision in *Continental Retail* but contends that it "does not apply to the facts at bar" for two reasons: (1) Mr. Bakken used market rents rather than the "actual, 'as is' rents" used by Continental Retail's expert; and (2) Continental Retail's expert *admitted* that he had valued a leased fee interest and Mr. Bakken *denied* doing so.¹⁰³ These are distinctions without a difference. First, as we have explained, Mr. Bakken may have used market rents for some years of the valuation, but he assumed no changes in rents for the duration of each lease even though he projected market rent increases.¹⁰⁴ That the rents Mr. Bakken assumed were not "actual, 'as is' rents" is beside the point: whatever they were, they were not *market* rents. Second, as we have explained, because Mr. Bakken used something other than market rents, Mr. Bakken did not value a fee-simple interest in the subject property. Even if we

¹⁰³ Pet'r's Remanded Post-Trial Resp. Br. 2.

¹⁰⁴ See Ex. 1A, at 87, 96, 135.

assume that an expert's characterization of his own opinion is a subject for expert testimony—a dubious proposition at best—we find Mr. Bakken's testimony on this point not credible.

KCP also acknowledges our decision in *Northwestern National Life Insurance Co. v. County of Hennepin*, No. TC-18794, 1995 WL 377079 (Minn. T.C. June 21, 1995).¹⁰⁵ In *Northwestern National Life*, the taxpayer's expert did exactly as Mr. Bakken does here: he “kept net effective rent flat for four years because his research showed that the length of 1992 leases was three to five years.” *Id.* at *2-3. Taxpayer's expert increased rent “to account for lease-renewal market increases” only in year five of the analysis and then kept the new rent figure flat through the ninth year of the lease. *Id.* at *3. We rejected the taxpayer's approach as valuing only the landlord's leased-fee interest:

A fee simple market valuation for real estate tax purposes requires the valuation of all interests in a property. If we assume that market rent increased in 1993, the value of the leased fee under a flat four-year lease decreased between 1992 and 1993 and the value of the tenant interest increased. [The taxpayer's expert's] flat income reflects only the landlord's interest in the Property.

Id. (citation omitted).

KCP derides our opinion in *Northwestern National Life* as “nothing more than a dated, ill-informed decision” that “was wrong when it was decided.”¹⁰⁶ KCP contends that the logic of *Northwestern National Life* does not apply to multi-tenant commercial property, as to which “there are *always* leases rolling over, being set at market, and then held flat during the lease term.”¹⁰⁷

¹⁰⁵ Pet'r's Remanded Post-Trial Resp. Br. 6-7.

¹⁰⁶ Pet'r's Remanded Post-Trial Resp. Br. 6. Under Minn. Stat. § 271.01, subd. 5 (2016), this court is “the sole, exclusive, and final authority for the hearing and determination of all questions of law and fact arising under the tax laws of the state . . . in those cases that have been appealed to the Tax Court and in any case that has been transferred by the district court to the Tax Court.”

¹⁰⁷ Pet'r's Remanded Post-Trial Resp. Br. 7.

“[T]o the extent the tenant has a temporary benefit of a below market lease, that is a short-term contractual benefit,” KCP argues, “not an attribute of the real estate.”¹⁰⁸ We disagree. As we have explained, Minnesota law requires us to value the fee-simple interest in the property, which includes the right to use and occupy the property. A lease, whether below-market or not, represents that right and the value of that lease is part of the value of the fee-simple interest in the property.¹⁰⁹

Because Mr. Bakken’s income approach values a leased-fee, rather than a fee-simple interest in the subject property, it significantly undervalues the subject property. We give his conclusions of value under that approach no weight.¹¹⁰

(ii) Market rents

Although we conclude that Mr. Bakken’s income approach improperly values a leased-fee rather than a fee-simple estate, we nevertheless consider the individual components of his

¹⁰⁸ Pet’r’s Remanded Post-Trial Resp. Br. 8.

¹⁰⁹ KCP further contends that the effect of “[h]onoring lease terms while also increasing market rents on rollovers” results in a net operating income “that has some tenants at market, some below market, and some above market.” Pet’r’s Remanded Post-Trial Br. 8. But, as Mr. Bakken’s discounted-cash-flow approach demonstrates, when market rents are increasing, the effect of “honoring lease terms” results in cash flows that are at market levels only by coincidence.

Concluding (albeit erroneously) that the issue is undecided in this state, KCP therefore directs our attention to cases decided in other states that have applied actual rather than market rents. Pet’r’s Remanded Post-Trial Resp. Br. 4 (citing *C.A.F. Inv. Co. v. Michigan State Tax Comm’n*, 392 Mich. 442, 450, 221 N.W.2d 588, 592 (1974)), 9 (citing *Mo. Baptist Children’s Home v. State Tax Comm’n*, 867 S.W.2d 510, 512 (Mo. 1993)), 10 (citing *Townsend v. Town of Middlebury*, 134 Vt. 438, 440, 365 A.2d 515, 517 (1976)), 10-11 (citing *City & Cty. of Denver v. Bd. of Assessment Appeals of State of Colo.*, 848 P.2d 355, 361 (Colo. 1993)). Given that Minn. Stat. § 273.11, subd. 1, bars us from valuing a leasehold interest in the subject property, given the Minnesota Supreme Court’s binding precedent, and given our own caselaw, we need not discuss, much less distinguish, such cases.

¹¹⁰ That Mr. Bakken valued a leased-fee, rather than a fee-simple, value also helps to explain why we were originally unable to replicate his analysis.

approach, starting with his opinions of market rents. As we have explained, Mr. Bakken estimated five different market rents, depending on the size and location of the tenant space.¹¹¹ In contrast, the County's appraisers estimated only two levels of market rent: one for anchor spaces (\$3.00 per square foot in 2010) and another for in-line spaces (\$9.00 per square foot in 2010).¹¹²

At \$9.00 per square foot, the County's opinion of rent for in-line spaces is too high. We note that KCP has advertised vacant space at the subject property at \$10.00 per square foot, regardless of size, at least as far back as June 2011,¹¹³ but there is no evidence that price found market acceptance. Although the County provides details of nearly 30 leases executed at other properties in Dakota County during the years at issue at base rents as high as \$19.85 per square foot, none of those properties are located in Hastings.¹¹⁴ At the same time, we conclude that at only \$3.00 per square foot, the County's opinion of rent for anchor spaces is too low. In this case, as we have explained, we cannot conclude on this record that either Clancy's Drug Store or Goodwill Industries constitutes a true anchor tenant that would justify a lower rent in return for the possibility of higher rents from other tenants. *KCP Hastings*, 2014 WL 6345861, at *5. Nor

¹¹¹ Ex. 1A, at 84-85.

¹¹² Ex. R1A, at 4. KCP claims that rents at the subject property were "in the range of \$5-6," meaning that under the County's proposed rents "tenants would be looking at an immediate 80% increase in rents." Pet'r's Remanded Post-Trial Br. 14. The record in no way supports KCP's assertion. According to Mr. Bakken's report, actual rents at the subject property as of January 2, 2010, ranged from a low of \$2.75 per square foot to a high of \$14.00 per square foot, with at least five non-anchor tenants already paying more than \$9.00 per square foot. Ex. 1A, at 62-63.

¹¹³ Ex. R1A, at 90A.

¹¹⁴ Ex. R1, at 90B.

is there evidence, given the size of those tenant spaces, that they could be leased to some other tenant that would constitute a true anchor.

After careful review of the record, we adopt Mr. Bakken's rent schedules with two exceptions, namely, spaces 100 (leased as of January 2, 2010, to Goodwill) and 480/500 (leased as of January 2, 2010, to Clancy's). As to those spaces, we conclude—given their sizes (29,293 and 33,638 square feet respectively)¹¹⁵—that market rent was \$6.00 per square foot as of January 2, 2010 (\$5.50 per square foot as of January 2011 and January 2012). At Mr. Bakken's figure of only \$5.00 per square foot, market rent for these two spaces would be comparable to a "large" space in the "elbow" of the building, lacking direct access to the parking lot. At \$6.00 per square foot, market rent for these two spaces is \$.50 less per square foot than in-line space at the subject property with the same direct outside access, the lower rent reflecting their larger footprints.

(2) Probability of renewal

Mr. Bakken assumed, without explanation, a renewal probability of 60% as of all three valuation dates.¹¹⁶ The County assumed a 70% renewal probability as of all three valuation dates.¹¹⁷ In reaching this conclusion, the County considered surveys of tenant retention conducted by PriceWaterhouseCoopers.¹¹⁸ For the three valuation dates, opinions of the likelihood of retention of existing tenants ranged from 50% to 80% for all retail categories, the likelihood of

¹¹⁵ Ex. 1A, at 84-85.

¹¹⁶ Ex. 1A, at 86, 99.

¹¹⁷ Ex. R1A, at 6.

¹¹⁸ Ex. R1A, at 6.

renewal increasing somewhat over the years at issue here.¹¹⁹ The County also took into account “the subject’s history of tenants with longer-term occupation,” noting that as of January 2010 there were many tenants who had leased space in the subject property for ten years or more.¹²⁰ The County further cited the subject’s “good local retail locational characteristics and the somewhat limited overall retail competition in Hastings compared to other metro market areas.”¹²¹

We adopt a renewal probability of 70% as of each valuation date. Like the County, we are persuaded by the number of long-term tenants at the property. We are also persuaded by the proximity of the subject property to the Dakota County Government Center, and by its affordability for local small businesses.

Mr. Bakken testified that uncertainty over the possibility of the departure of Goodwill Industries from the center contributed to a lower probability of renewal by other tenants.¹²² We discount the effect of this possible departure on other tenants. First, as we explained in our November 2014 decision, KCP failed to establish Goodwill as a true anchor tenant, that is, a tenant who by virtue of its advertising and product mix draws traffic to the center for the benefit of other tenants. *KCP Hastings*, 2014 WL 6345861, at *5 (“We could not say on this record that either [Goodwill or Clancy’s Drug Store] does substantial advertising to generate customer traffic, or in fact generates a high amount of retail customer traffic from which other tenants of the subject property benefit.”). Second, a number of the center’s tenants (as of each valuation date) served

¹¹⁹ Ex. R1A, at 6.

¹²⁰ Ex. R1A, at 6; *see* Ex. 1A, at 62-65 (January and November 2010 rent rolls showing starting and ending dates of current leases on the property).

¹²¹ Ex. R1A, at 6.

¹²² *See* Tr. 73-74 (Aug. 11, 2016).

customers by appointment only or were otherwise unaffected by levels of foot traffic. For example, Power Within Chiropractic and Westview Dental are presumably medical offices whose patients likely make appointments in advance. Similarly, fitness centers like Uptown Fitness typically operate on a membership, rather than walk-in, basis. Ebenezer Daybreak is an adult daycare center that, again, presumably operates on something other than a walk-in basis. Other tenants (like the Hastings School District) would also seem to rely little on foot traffic, although their employees may have been customers of other businesses in the center.

(3) Vacancy rates and credit losses

(a) KCP's approach

To estimate revenues lost due to vacancy, Mr. Bakken assumed a 15% “general” vacancy rate for each year at issue, including an “absorption and turnover” vacancy tied to the expiration of existing leases, the probability of renewal, and the estimated time to replace a vacating tenant.¹²³ For all types of tenant spaces, Mr. Bakken assumed the probability of renewal was 60% and, in the event of nonrenewal, that the property would be vacant for six months.¹²⁴ Mr. Bakken therefore assumed that each tenant space would effectively be vacant for about two months (six months times a 40% chance of nonrenewal) upon the expiration of the lease.¹²⁵

Mr. Bakken scheduled revenue losses due to vacancy according to the expiration of the existing leases on the subject property and assuming five-year terms for all new leases. For

¹²³ Ex. 1A at 90-91; *see* Ex. 1A at 135, 139.

¹²⁴ Ex. 1A, at 86.

¹²⁵ Ex. 1A, at 86, 88.

example, the existing lease for the gas station at the subject property ran through May 31, 2010.¹²⁶ Mr. Bakken assumed that during 2010 the gas station would be vacant for two months (resulting in lost rent of \$1,808), then would be leased for five years at a market rent of \$1,152 per month.¹²⁷ At the end of that five-year term, Mr. Bakken assumed the property would again be vacant for two months, resulting in lost rent of \$2,304.¹²⁸ Mr. Bakken did similar calculations for each rental space.¹²⁹ Those calculations generated rent losses attributable to “absorption and turnover vacancy.”¹³⁰ For 2010, for example, rents lost to absorption and turnover vacancy totaled \$95,435.¹³¹

Mr. Bakken further assumed a “general” or overall vacancy rate of 15% in each year.¹³² To calculate this “general” vacancy, Mr. Bakken multiplied 15% by his calculation of potential gross revenues at 100% occupancy and then subtracted the amounts already attributed to absorption and turnover vacancy.¹³³ For example, for year 1 (2010) of his DCF as of January 2, 2010, Mr. Bakken calculated rent losses attributable to absorption and turnover vacancy

¹²⁶ Ex. 1A, at 62.

¹²⁷ Ex. 1A, at 87-88. Because Mr. Bakken assumed no change in market rents during the first few years of each DCF calculation, he assumed the gas station lease renewed in 2010 at the prior market rent of \$10,850 per year (\$904 per month).

¹²⁸ Ex. 1A, at 87-88.

¹²⁹ See Ex. 1A, at 90.

¹³⁰ Ex. 1A, at 90-91; *see also* Tr. 60-62 (Aug. 11, 2016).

¹³¹ Ex. 1A, at 88, 90.

¹³² Ex. 1A, at 91.

¹³³ Ex. 1A, at 91.

of \$95,435.¹³⁴ Mr. Bakken further calculated total potential gross revenue for 2010 of \$1,100,504.¹³⁵ Multiplying \$1,100,504 by 15% resulted in overall vacancy losses of \$165,075, of which \$95,435 was attributed to absorption and the remainder (\$69,641) to “general” vacancy.¹³⁶ The effect of this was to assume a constant overall vacancy rate of 15% across the eleven years of each analysis.

Mr. Bakken also assumed a separate allowance for credit and collection losses equal to 1% of potential gross revenues.¹³⁷

(b) The County’s approach

The County assumed an overall vacancy rate of 10% for each year of the analysis as of January 2, 2010; 15% for each year of the analysis as of January 2, 2011; and 20% for each year of the analysis as of January 2, 2012, with no separate allowance for credit or collection losses.¹³⁸

¹³⁴ Ex. 1A, at 91.

¹³⁵ Ex. 1A, at 91.

¹³⁶ Ex. 1A, at 91.

¹³⁷ Ex. 1A, at 91, 96, 98.

We note that KCP ridicules the County’s approach as “preposterous” because it uses “the same vacancy, the same collection loss rate, and the same capital costs for tenant improvements (TIs) and leasing commissions throughout the entire 11-year period” of each analysis. Pet’r’s Remanded Post-Trial Br. 12. Yet KCP’s expert, Mr. Bakken, assumed “the same vacancy” and “the same collection loss rate” throughout each of his analyses. Indeed, Mr. Bakken assumed the same 15% vacancy rate and the same 1% loss for collections each year.

¹³⁸ Ex. R1A, at 5, 11-15. The County’s initial income approach relied on direct capitalization and therefore required a single vacancy rate that was assumed to apply in perpetuity. *See* Ex. R1, at 96, 99-101. On remand, the County projected the general vacancy rate over the entire 10-year holding period. Ex. R1A, at 5.

(c) Analysis

As our November 2014 decision explained, the record before us indicated “that market vacancy rates for community and neighborhood centers like the subject property were increasing during the years at issue.” *KCP*, 2014 WL 6345861, at *9. For that reason, we reject Mr. Bakken’s approach to vacancy, which assumes a constant 15% vacancy rate across the entire analysis period.¹³⁹

Our November 2014 decision further indicated that, on the basis of the record before us, “vacancy rates were expected to increase further” on each valuation date. *KCP Hastings*, 2014 WL 6345861, at *9. In other words, the record before us indicates that on January 2, 2010, a buyer of the subject property would not have expected the 2010 vacancy rate to persist in future years. Rather, a buyer would have expected vacancy rates to increase in at least some future years. Although the County’s approach assumes vacancy rates increasing from 2010 to 2011 and from 2011 to 2012, it does not assume that vacancy rates would change during each period of analysis. In other words, the County’s approach assumes that a buyer of the subject property on January 2, 2010, would assume a vacancy rate of 10%, not just in 2010 but for the ensuing ten years without change. Similarly, the County’s approach assumes that, by January 2011, a buyer

¹³⁹ KCP contends that Mr. Bakken assumed vacancy rates of 13.2% for 2010, 19.3% in 2011, and 25% in 2012. Pet’r’s Remanded Post-Trial Resp. Br. 19. Curiously, though, KCP attributes this testimony to *Mr. Pounds*, not to Mr. Bakken himself or even to Mr. Bakken’s expert report. *Id.*; see Tr. 46-47 (June 3, 2014).

We credit Mr. Bakken’s expert report, which discloses the inputs Mr. Bakken programmed into the Argus software to generate his discounted-cash-flow approach. According to Mr. Bakken’s report, the Argus software was programmed for a 15% general vacancy rate across all three valuation dates. See Ex. 1A, at 135, 139 (indicating a 15% “primary rate” of general vacancy, with the “General Vacancy Result” to be reduced by “Absorption & Turnover Vacancy”), 91 (demonstrating the calculation of losses due to vacancy for 2010).

of the subject property would assume a 15% vacancy rate in 2011 and in the ensuing ten years without change. For that reason, we reject the County's approach as well.

Consistent with the record before us, we conclude that as of January 2, 2010, the appropriate vacancy rate for 2010 is 13% (which coincides with the property's actual vacancy rate); increasing to 20% in 2011; then decreasing to 15% for 2012, 2013, and 2014; decreasing further to 12% for 2015 and 2016; and decreasing further to 10% for 2017, 2018, and 2019. As of January 2, 2011, the appropriate vacancy rate for 2011 remains 20% but, in light of a slower-than-expected recovery, the expected vacancy rate remained 20% for 2012 before decreasing as indicated above and eventually decreasing to 8% in 2020. Finally, as of January 2, 2012, the appropriate vacancy rate for 2012 is 20%; for 2013 and 2014 it is 15%; for 2015 and 2016 it is 12%; for 2017, 2018, and 2019 it is 10%; and for 2020 and 2021 it is 8%. We assume a collection loss of 1% (that is, a loss due to the inability to collect rent and expense reimbursements from existing tenants) for each year of the analysis.

(4) Common area maintenance (CAM), property taxes, and expense reimbursements

(a) Common area maintenance

Mr. Bakken assumed initial expenditures for common area maintenance (CAM) of \$2.50 per square foot of net rentable area, increasing them by 3% each year thereafter.¹⁴⁰ The County assumed initial CAM charges of \$2.40 per square foot of net rentable area for each analysis, increasing by 3% each year thereafter.¹⁴¹

¹⁴⁰ See Ex. 1A, at 96-98, 135, 139. As the term implies, common area maintenance is maintenance of the common areas of the property (such as parking lots, sidewalks, and corridors). *Common Area Maintenance (CAM)*, *The Dictionary of Real Estate Appraisal*.

¹⁴¹ Ex. R1A, at 11-15.

KCP criticizes the County's CAM charges on remand, noting that Mr. Ducklow's original report assumed initial CAM charges of only \$2.34 per square foot of net rentable area in 2011 and 2012.¹⁴² We think the criticism misplaced. Mr. Bakken's report includes cash-basis income statements for the subject property for the years ended December 2009 and 2010, including a detailed breakdown of operating expenses.¹⁴³ Mindful that the County assumed increasing vacancy rates across the three years at issue, we are able to identify from Mr. Bakken's report some expenditures—primarily utilities—that might be reduced as vacancy increased. At six cents per square foot of net rentable area (\$7,768.50 overall), however, the County's reduction in CAM charges likely overstated the amount by which expenses could be reduced to compensate for increased vacancy rates. Even vacant space must be heated enough to prevent pipes from freezing, for example, and some lighting in vacant space reduces the chance of burglary and vandalism. Although we also apply increasing vacancy rates, we assume no corresponding decrease in expenditures for common area maintenance.

¹⁴² Ex. R2, at 11. KCP's review appraiser criticizes the County for using the same \$2.40 per square foot estimate of CAM charges as a starting point for all three DCF calculations, rather than applying "slight inflationary differences in the beginning expense levels for these items over the three appraisal pro formas." Ex. 2, at 11. But KCP's appraiser, Mr. Bakken, also used the same initial amount of CAM charges (\$323,688) as the starting point for all three of his DCF calculations. *Compare* Ex. 1A, at 96 (DCF calculation as of January 2, 2010), *with* Ex. 1A, at 98 (DCF calculation as of January 2, 2011, and January 2, 2012).

¹⁴³ Ex. 1A, at 174-75.

(b) Property taxes

Mr. Bakken included property taxes in his calculation of cash expenses, starting with actual amounts in 2010 and increasing those figures by 3% each year.¹⁴⁴ For example, for 2010 Mr. Bakken assumed a cash outlay for property taxes of \$109,469; for 2011, Mr. Bakken assumed a cash outlay of \$112,753 (an increase of 3%); and so on.¹⁴⁵ In contrast, the County's appraisers increased the reversionary capitalization rate by the effective tax rate (multiplied by the market vacancy rate).¹⁴⁶ More specifically, the County's appraisers arrived at a reversionary capitalization rate of 10.25% for 2010, which they increased by 0.36% (an effective tax rate of 3.6% multiplied by the assumed 10% market vacancy rate).¹⁴⁷

KCP contends that the County erred in failing to account for real estate taxes during the property holding period.¹⁴⁸ We agree. During the August 2016 hearing, the County's appraiser (Mr. Ducklow) testified that, outside of the reversion, property taxes are reflected in a higher discount rate.¹⁴⁹

[O]ur attempt is, because we didn't know—that's the whole point of why we are here today, we didn't know exactly what the taxes are for these years, and the idea that if the property taxes are not included there, there is a certain amount of—there is quite a degree of uncertainty as to what number that would be. So, I think if you look at both our discount rate and our cap rate, you will find that we bumped that

¹⁴⁴ Ex. 1A, at 96-97 ("The taxes in year one were estimated based on the current tax rate times the overall market value of the property in iterative fashion."). After year one, Bakken assumed property taxes would increase 3% each year.

¹⁴⁵ Ex. 1A, at 96.

¹⁴⁶ Ex. R1A, at 5.

¹⁴⁷ Ex. R1A, at 11.

¹⁴⁸ Pet'r's Remanded Post-Trial Br. 21.

¹⁴⁹ Tr. 139-40 (Aug. 11, 2016).

cap rate and discount rate up over and above what our midpoint analysis is based on our research.

Indeed, for 2010 the County's survey of discount rates indicated a range from 9.25% to 11.80% with a "central tendency" of 10.10%; the County elected to use a discount rate of 10.75% for 2010 and 2011 (10.5% for 2012).¹⁵⁰ But the County explains its discount rate as a function of "economic conditions, the quality of the property, and the impact of overall risk to an investor associated with relatively low rental rates and minimal projected [tenant improvements]," with no mention of property taxes.¹⁵¹ Nor does a difference of 0.65% translate to an effective tax rate here. We credit the County's written report.

We assume property taxes payable as of the first year of each analysis equal to the actual property taxes payable in that year and, like Mr. Bakken, increase them by 3% each year. For example, our calculation of market value as of January 2, 2010, uses property taxes actually payable in 2010, increased by 3% each year thereafter; our calculation of market value as of January 2, 2011, uses property taxes actually payable in 2011 increased by 3% each year thereafter.

(c) Expense reimbursements

Both experts assumed the subject property would be leased under so-called "triple net" leases. Under a triple-net lease, the tenant reimburses the landlord for property taxes and for the cost (utilities, taxes, insurance, and maintenance) of maintaining the property's common spaces (such as sidewalks and parking lots). *Appraisal of Real Estate* 445. A discounted-cash-flow approach must therefore account for both the landlord's payment of these expenses and the monies received from tenants as reimbursements.

¹⁵⁰ Ex. R1A, at 9.

¹⁵¹ Ex. R1A, at 9.

The County's experts calculated net operating income for each year by including expected tenant reimbursements for common-area maintenance in revenues, and then subtracting payments for common-area maintenance.¹⁵² For example, for 2010 the County began by assuming that all tenant spaces were fully leased, meaning that expenses of common-area maintenance were fully reimbursed by tenants.¹⁵³ On that basis, the County calculated potential gross revenues as the sum of rental income (\$787,698) and reimbursements for common-area maintenance (\$310,740), for a total of \$1,098,429.¹⁵⁴ The County then subtracted 10% for losses due to vacancy and credit losses (10% of \$1,098,429 or \$109,843).¹⁵⁵

KCP's expert, Mr. Bakken, took a somewhat different approach. Mr. Bakken included amounts for total property taxes and total CAM charges in his calculation of operating expenses, increasing those figures by 3% each year.¹⁵⁶ For example, Mr. Bakken's calculation of operating expenses for 2010 included total property taxes of \$109,469 and total CAM charges of \$323,688, for a total of \$433,157.¹⁵⁷ Mr. Bakken's calculation of potential gross revenues from tenants included amounts for property taxes and CAM charges effectively paid by tenants, equal to total property taxes and CAM charges less those presumed uncollected due to absorption and turnover

¹⁵² See, e.g., Ex. R1A, at 11. As we have explained, the County's appraisers did not include property taxes as an ongoing cash expense.

¹⁵³ Ex. R1A, at 11.

¹⁵⁴ Ex. R1A, at 11.

¹⁵⁵ Ex. R1A, at 11.

¹⁵⁶ Ex. 1A, at 96.

¹⁵⁷ Ex. 1A, at 96.

vacancy.¹⁵⁸ For example, for 2010 Mr. Bakken calculated that the landlord would collect only \$376,381 from tenants to cover property taxes and common-area maintenance charges, leaving \$56,776 unpaid by tenants due to absorption and turnover vacancy (and therefore to be paid by the landlord).¹⁵⁹

But Mr. Bakken assumed vacancies due not just to absorption and turnover, but also due to “general” causes.¹⁶⁰ For example, as of January 2010 Mr. Bakken assumed vacancies due to absorption and turnover of 13.2%, plus another 1.8% due to “general” or market vacancy, for a total vacancy rate of 15%.¹⁶¹ Mr. Bakken does not appear to have reduced property tax reimbursements for this “general” vacancy. In other words, Mr. Bakken effectively assumed that a buyer of the subject property could expect to collect property tax and common-area maintenance charges—but not rent—on space vacant due to “general” causes.

We disagree with this approach. We therefore treat expense reimbursements as the County does. We reduce effective gross revenue by the amount of expenses to be borne by the landlord as a result of vacancies.

(5) Reserves for replacement

Mr. Bakken estimated reserves for replacement of \$0.15 per square foot of net rentable area, increasing by 3% each year.¹⁶² The County estimated reserves for replacement of \$0.25 per

¹⁵⁸ Ex. 1A, at 90-91.

¹⁵⁹ Ex. 1A, at 91, 96.

¹⁶⁰ Ex. 1A, at 91.

¹⁶¹ Ex. 1A, at 90-91.

¹⁶² Ex. 1A, at 96, 135.

square foot of gross building area for each year of the analysis.¹⁶³ We adopt Mr. Bakken’s figure; because structural repairs must be made to the entire building, not just to the leased spaces, we apply that figure to the gross building area, not just the net rentable area.

(6) Tenant improvements

Mr. Bakken assumed, without explanation, a variety of tenant improvements tied to the type of tenant space and the timing of lease renewals and new leases.¹⁶⁴ For the gas station at the subject property, Mr. Bakken assumed tenant improvements of \$15.00 per square foot for a new tenant; for all other tenant spaces, Mr. Bakken assumed tenant improvements of \$7.50 per square foot for new leases.¹⁶⁵ For lease renewals, Mr. Bakken assumed tenant improvements of \$2.00 per square foot across all types of tenant spaces.¹⁶⁶

The County reasoned “that cost-conscious owners of lower net-rent retail centers . . . would not view renewal tenant improvements as financially feasible.”¹⁶⁷ In fact, the current ownership of the subject property offered no tenant improvements to prospective tenants in 2010 or 2011.¹⁶⁸ The County nevertheless assumed tenant improvements of \$1.00 per square foot of net rentable area for lease renewals, reasoning that “a landlord looking to mitigate the risk of turnover may provide renewing tenants limited [tenant improvements], such as allowance for new paint, carpet

¹⁶³ Ex. R1A, at 5.

¹⁶⁴ See Ex. 1A, at 94, 86, 136-37.

¹⁶⁵ Ex. 1A, at 86, 99.

¹⁶⁶ Ex. 1A, at 86, 99.

¹⁶⁷ Ex. R1A, at 6.

¹⁶⁸ See Ex. 1A, at 178-81.

cleaning, and/or minor touch-ups.”¹⁶⁹ On the same basis, the County assumed tenant improvements of \$5.00 per square foot for new leases.¹⁷⁰

We adopt the County’s figures. Although KCP does not explain why the cost of tenant improvements of the gas station space would be twice the cost of tenant improvements for any other type of space at the subject property, we nevertheless acknowledge that the cost of renovating a gas station may indeed be higher—perhaps significantly higher—than the cost of renovating other types of spaces if the renovation includes, for example, replacement of underground fuel tanks. But there is no evidence that tank replacement would be required as a condition of renting to a different tenant (as opposed to a mere renewal) or that paying for tank replacement would be KCP’s responsibility in any event. As for other tenant spaces, we find the County’s allowances of \$5.00 per square foot for new leases and \$1.00 per square foot for lease renewals sufficient—and Mr. Bakken’s allowances somewhat excessive—to cover the indicated work.

(7) Leasing commissions

Mr. Bakken assumed, without explanation, leasing commissions of \$6.00 per square foot for new leases and \$2.00 per square foot for lease renewals.¹⁷¹ The County assumed leasing commissions of \$5.00 per square foot for new leases and \$2.00 per square foot for lease renewals, characterizing them as “relatively standard allowances in the real estate industry.”¹⁷² We adopt the County’s figures.

¹⁶⁹ Ex. R1A, at 6.

¹⁷⁰ Ex. R1A, at 7.

¹⁷¹ Ex. 1A, at 86, 97.

¹⁷² Ex. R1A, at 7.

(8) Capitalization rates

(a) Petitioner's approach

Mr. Bakken employed a discount rate of 12.5% and a terminal capitalization rate of 11.5%.¹⁷³ In arriving at these estimates, Mr. Bakken cited the Korpacz Real Estate Investor Survey of cap rate opinions, which showed cap rates for strip shopping centers increasing from about 7.25% (first quarter 2008) to 8.5% (first quarter 2010), and his private survey of cap rates derived from an unknown number of unidentified “local-larger retail” centers in the Twin Cities.¹⁷⁴ Mr. Bakken also provided cap rates derived from sales of various shopping centers in the greater Twin Cities.¹⁷⁵ Over time, these derived cap rates generally increased, from 5.5% or 6.5% in the spring and summer of 2007, peaking in May 2009 at 10.6%, then decreasing slightly to 9.9% in September 2009 and January 2010.¹⁷⁶ Finally, Mr. Bakken derived cap rates from the sales of six enclosed malls in greater Minnesota and North Dakota between June 2008 and December 2012.¹⁷⁷

Mr. Bakken gave the most weight to the 9.9% cap rate derived from the September 2009 sale of Hastings Marketplace.¹⁷⁸ Mr. Bakken reasoned that Hastings Marketplace is “almost

¹⁷³ Ex. 1A, at 97; *see id.* at 82 (“A going in cap rate of 11.0% will be used and a terminal cap rate of 11.5% will be used at the end of the resale period. . . . The discount rate will be priced out at 100 basis points higher than the terminal rate.”).

¹⁷⁴ Ex. 1A, at 77.

¹⁷⁵ Ex. 1A, at 78-81.

¹⁷⁶ *See* Ex. 1A, at 78-81.

¹⁷⁷ Ex. 1A, at 82. Overall cap rates derived from these sales ranged from 9.5% to 12.5%, and averaged 11.0%. *Id.*

¹⁷⁸ Ex. 1A, at 78, 82.

adjacent” to the subject property, although “substantially better than the subject in terms of age, income producing ability, tenancy, credit, remaining lease lengths and other factors.” ¹⁷⁹

(b) The County’s approach

“Considering economic conditions, the quality of the property, and the impact of overall risk to an investor associated with relatively low rental rates and minimal projected [tenant improvements],” the County used a discount rate of 10.75% for the January 2010 and 2011 calculations and 10.50% for the January 2012 calculations.¹⁸⁰ In arriving at these rates, the County relied exclusively on surveys of cap rates, specifically, IRR-Viewpoint, RERC, PwC, and RealtyRates.com.¹⁸¹ As of year-end 2009, for example, these surveys indicated discount rates between 9.25% (community shopping centers in Minneapolis) and 11.8% (third-tier retail neighborhood or community centers), averaging about 10.10%.¹⁸² The County’s chosen 10.75% rate is about 75 basis points above the average of these surveys. Similarly, the surveys indicated a range of cap rates between 9.00% and 11.6% for 2011, averaging about 10.3%; the County’s chosen 10.75% is about 50 basis points above the average. The indicated surveys generally (but not uniformly) showed cap rates increasing between 2010 and 2011 and decreasing between 2011 and 2012, and the County’s chosen cap rates follow this pattern.¹⁸³

¹⁷⁹ Ex. 1A, at 82.

¹⁸⁰ Ex. R1A, at 9.

¹⁸¹ Ex. R1A, at 8.

¹⁸² Ex. R1A, at 8.

¹⁸³ Ex. R1A, at 8-9.

For reversionary cap rates, the County used 10.25% for 2010; 10.00% for 2011; and 9.75% for 2012.¹⁸⁴ The County indicated that reversionary rates “are typically 25 to 100 basis points greater than going-in rates.”¹⁸⁵

(c) Analysis

As we have indicated, in estimating the discount rate to apply here, Mr. Bakken relied in part on overall cap rates derived from the sales of five fully-enclosed malls in out-state Minnesota and one in North Dakota.¹⁸⁶ The Fourteenth Edition describes the derivation of cap rates from comparable sales as “the preferred technique when sufficient information about sales of *similar, competitive* properties is available.” *Appraisal of Real Estate* 493 (emphasis added). But we rejected five of these malls as properties comparable to the subject property for purposes of the sales comparison approach because they are fully enclosed, whereas less than 20% of the net rentable area of the subject property is enclosed. *KCP Hastings*, 2014 WL 6345861, at *4. Mr. Bakken himself rejected the sixth because, among other things, it sold after the valuation dates at issue here and sold as part of a portfolio of properties.¹⁸⁷ The supreme court affirmed our rejection of KCP’s sales comparison approach. *KCP Hastings*, 868 N.W.2d at 273-74. On remand, we therefore place no weight on the cap rates derived by Mr. Bakken from these sales.

¹⁸⁴ Ex. R1A, at 9.

¹⁸⁵ Ex. R1A, at 9.

¹⁸⁶ Ex. 1A, at 82; *see* Tr. 108-18, 87 (Aug. 11, 2016) (Mr. Bakken describing the subject property as “more in align[ment] with the out-state comparables” than properties in the metro area).

¹⁸⁷ Ex. 1A, at 121.

Mr. Bakken further relied on cap rates derived from sales of 12 comparable shopping centers in the metro area between March 2007 and January 2010.¹⁸⁸ Cap rates derived from these sales ranged from 5.5% to 10.6%.¹⁸⁹ Broadly speaking, cap rates derived from these sales increased after October 2007, peaking in May 2009 and then decreasing somewhat.¹⁹⁰ As indicated, Mr. Bakken considered the Hastings Marketplace, which sold in September 2009 at a cap rate of 9.9%, to be the most comparable to the subject, but reasoned that the cap rate applicable to the subject property should be higher than 9.9% to reflect its additional risk.¹⁹¹ We agree.

Both experts relied on surveys of investor opinions as to cap rates. Mr. Bakken relied on a survey of national cap rates and on his own private research into local retail cap rates, details of which were not disclosed at trial.¹⁹² The County's experts relied on several surveys specific to neighborhood and community shopping centers in the metro area, including one specific to "older" neighborhood and community retail centers "with functional inadequacies and/or marginal locations."¹⁹³ Because they were specific to the metro area, we place greater weight on the surveys

¹⁸⁸ Ex. 1A, at 70-79.

¹⁸⁹ Ex. 1A, at 78-81.

¹⁹⁰ Ex. 1A, at 78-81.

¹⁹¹ Ex. 1A, at 78, 82.

¹⁹² Ex. 1A, at 77.

¹⁹³ Ex. R1A, at 8. A shopping center of 30,000 to 100,000 square feet is considered a "neighborhood" center, with a supermarket as a typical "leading tenant." The Appraisal Institute, *Shopping Center Appraisal and Analysis* 4 (2d ed. 2009). A shopping center of between 100,000 and 400,000 square feet is considered a "community" center, with a supermarket, drugstore, or discount department store as a typical "leading tenant." *Id.* Based on these categories, and given its size and tenant mix, we consider the subject property a community center.

KCP asserts that the surveys on which the County's appraisers relied reflect "investment grade properties," Pet'r's Remanded Post-Trial Br. 20, but cites no authority for the assertion. To

relied upon by the County's experts. Considering all the evidence, we use a discount rate of 10.75% for 2010; 10.75% for 2011; and 10.50% for 2012.

The experts agree that the cap rate to be applied to the proceeds of the sale of the property during year 11 (the so-called terminal cap rate) should be less than the discount rate, but they disagree by how much less. Mr. Bakken used a terminal cap rate 100 basis points (1 percentage point) less than the associated discount rate;¹⁹⁴ the County's experts used a terminal cap rate only 50 basis points (one-half percentage point) less than the discount rate.¹⁹⁵

We rely (primarily but not exclusively) on the investor surveys cited by the County.¹⁹⁶ Those surveys show the terminal cap rate for community centers and neighborhood centers in the metro area was on average about 50 basis points less than the discount rate as of year-end 2009 (the survey point closest to our January 2010 valuation date). We therefore use a terminal cap rate of 10.25% for 2010 (50 basis points lower than our chosen discount rate). Those same surveys

the contrary, according to the County's appraisers, at least the RERC survey of third-tier retail neighborhood and community centers relies on "older properties with functional inadequacies and/or marginal locations." Ex. R1A, at 8.

KCP further criticizes the County's appraisers for relying on cap rates derived from sales in other communities that, according to KCP, are in no way comparable to Hastings. Pet'r's Remanded Post-Trial Br. 19 (noting that "the 'local' surveys the County used are aggregated such that they treat Eden Prairie, Edina, Minnetonka, and Hastings all as equivalent markets"), *id.* (arguing that because "survey data is only a reflection of what buyers or sellers would hypothetically accept for a hypothetical property," it is "not reflective of the subject property, the subject market, or of any property transactions at all"). KCP's expert appraiser, Mr. Bakken, also relied on surveys of cap rates, both national and "local," with presumably the same faults, Ex. 1A, at 77, but without the same criticism.

¹⁹⁴ Ex. 1A, at 97.

¹⁹⁵ Ex. R1A, at 9.

¹⁹⁶ Ex. R1A at 8.

show the terminal cap rate for community centers and neighborhood centers in the metro area was between 1.00% and 1.50% below the discount rate for year-end 2010 (the survey point closest to our January 2011 valuation date). We use a terminal cap rate of 10.0% for 2011 (75 basis points below our chosen discount rate). Finally, the surveys show the terminal cap rate for community centers and neighborhood centers in the metro area was between .50% and .75% below the discount rate for year-end 2011 (the survey point closest to our January 2012 valuation date). We use a terminal cap rate of 10.0% for 2012 (50 basis points below our chosen discount rate).

To summarize our chosen rates:

	2010	2011	2012
Discount rate	10.75%	10.75%	10.5%
Terminal cap rate	10.25%	10.00%	10.0%

(9) Costs of sale

The County deducted 3% from its reversion value for costs associated with the sale.¹⁹⁷ Mr. Bakken assumed a 4% commission to the selling broker.¹⁹⁸ We adopt the County's position.

(10) Final values

Applying the determinations made thus far, we arrive at the following market values for the subject property under the income approach:

January 2, 2010	\$4,548,532
January 2, 2011	\$4,022,709
January 2, 2012	\$4,658,080

¹⁹⁷ Ex. R1A, at 10.

¹⁹⁸ Ex. 1A, at 97.

4. Outlot¹⁹⁹

The subject property includes a 1.18-acre vacant outlot in the northwest corner that has been listed for sale, unsuccessfully, for several years. The parties disagree as to whether the outlot has any value at all, much less what that value was as of any of the dates at issue here.

The County values the outlot as excess land, its appraisers assigning a value of \$462,600 as of each valuation date.²⁰⁰ KCP assigns no separate value to the outlot.²⁰¹ Its expert, Mr. Bakken, reasoned that the subject property's land-to-building ratio of 3.14:1 suggested "there is no excess land at the subject" because "the existing shopping center may require that for parking depending on the occupancy and tenancy of the mall."²⁰²

As a threshold matter, the parties dispute the burden of proof with respect to the outlot. KCP asserts, without citation to any authority, that "[a]s the proponent of the idea that the Subject

¹⁹⁹ Because our initial decision did not reach a conclusion as to value under the income approach, we need not have determined, and did not, determine the separate value of the outlot. Because we reach a determination of value under the income approach on remand, we now value the outlot. Because the outlot is not income-producing (that is, not generating rental income), we make a separate determination of value and add it to the value of the shopping center itself.

²⁰⁰ Ex. R1A, at 3, 11, 13, 15.

In the terminology of the Fourteenth Edition, "excess" land is "not needed to serve or support the existing use" and need not have the same highest and best use as the rest of the parcel." *Appraisal of Real Estate* 200. Because excess land can be sold separately from the rest of the parcel, it must be valued separately. *Id.* Excess land is distinguishable from "surplus" land, which "is not currently needed to support the existing use but cannot be separated from the property and sold off for another use." *Id.* "Surplus land does not have an independent highest and best use and may or may not contribute value to the improved parcel." *Id.*

²⁰¹ Ex. 1A, at 12; *but see* Tr. 88-89 (June 3, 2014) (Mr. Bakken testifying that he is "not saying that [the outlot] has no value" but rather "that if it has value, it doesn't have much, and I honestly don't know what to put on it.").

²⁰² Ex. 1A, at 12.

Property has excess land, the County has the burden to demonstrate that it is actually possible to sell off part of the property.”²⁰³ We disagree. The burden is on the petitioner to show that the assessment is excessive. *S. Minn. Beet Sugar Coop v. Cty. of Renville*, 737 N.W.2d 545, 558 (Minn. 2007). It is therefore KCP’s burden to prove that the outlot is not excess land or otherwise has no value.

KCP contends the outlot cannot be developed because it is needed to satisfy parking requirements for the rest of the subject property. In particular, KCP’s remanded post-trial brief posits that the City of Hastings’s zoning code requires one parking space per 200 square feet of retail space, or 647 parking spots for the 129,475 square feet of net rentable area at the subject.²⁰⁴ KCP further contends that there are only 700 parking spaces at the subject property, including the outlot.²⁰⁵ Developing the outlot would, according to KCP, “remove a vast swath of parking” and bring “its own parking requirement.”²⁰⁶ According to KCP, “any appraiser hypothesizing that there is excess land should have analyzed the parking.”²⁰⁷

KCP fails to show that the outlot is surplus, not excess, land. KCP did not argue the point during trial, raising the Hastings zoning code only on remand and only in post-hearing briefing. Moreover, even if the Hastings zoning code provides as KCP asserts,²⁰⁸ there remains the

²⁰³ Pet’r’s Remanded Post-Trial Br. 29.

²⁰⁴ Pet’r’s Remanded Post-Trial Br. 29 (citing City of Hastings, Title XV, App. B).

²⁰⁵ Pet’r’s Remanded Post-Trial Br. 29.

²⁰⁶ Pet’r’s Remanded Post-Trial Br. 29.

²⁰⁷ Pet’r’s Remanded Post-Trial Br. 29.

²⁰⁸ Minnesota Rule of Evidence 201 allows a court to take judicial notice of a “fact” that is “not subject to reasonable dispute in that it is either (1) generally known within the territorial

possibility that a buyer of the outlot could seek a variance that would allow its development. *See, e.g., Hedberg & Sons Co. v. Cty. of Hennepin*, 305 Minn. 80, 92, 232 N.W.2d 743, 751 (1975) (observing that the probability of rezoning may be considered in determining the market value of property); *State v. Pahl*, 254 Minn. 349, 356, 95 N.W.2d 85, 90 (1959) (“Evidence of value for uses prohibited by an ordinance may be introduced and considered only where there is evidence showing a reasonable probability that the ordinance will be changed in the near future.”).

Alternately, a buyer of the outlot could enter into a reciprocal easement with KCP Hastings—common to shopping centers—that would allow customers of a business constructed on the outlot to share parking with customers of the main shopping center, and vice versa. *See, e.g., J.C. Penney Props. v. Cty. of Hennepin*, No. 27-CV-09-14547 et al., 2013 WL 5346374, at *1-2 (Minn. T.C. Sept. 19, 2013) (describing a cross-easement among retailers at Southdale Center that allows parking on the entire parcel for the benefit of customers of individual tenants). Finally, the fact that KCP has listed the outlot for sale belies its contention here that the outlot has no value because it cannot be legally developed.

We therefore adopt the County’s value of \$462,600 for the outlot for each valuation date.

D. FINAL VALUES

To recap, we have concluded to the following values under the sales comparison and income approaches:

APPROACH	Jan. 2, 2010	Jan. 2, 2011	Jan. 2, 2012
Sales comparison	\$5,535,000	\$5,258,200	\$4,995,300

jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.” Minn. R. Evid. 201(b). The court can take judicial notice if requested by a party, but must be supplied with the necessary information. Minn. R. Evid. 201(d). In this case, the court has not been supplied with copies of the Hastings zoning code.

Income	\$4,548,532	\$4,022,709	\$4,658,080
Outlot	\$462,600	\$462,600	\$462,600

The weight to be given to each approach to value depends on “the quantity and quality of available data.” *KCP Hastings*, 868 N.W.2d at 275 (quoting *Nw. Racquet Swim & Health Clubs, Inc. v. Cty. of Dakota*, 557 N.W.2d 582, 587 (Minn. 1997)). We give the income approach a weight of approximately 70% and the sales comparison approach a weight of approximately 30% and add to the weighted total the value of the outlot.

Based on the foregoing, we conclude that the market value of the subject property (rounded to the nearest hundred dollars) is as follows:

January 2, 2010	\$5,307,100
January 2, 2011	\$4,856,000
January 2, 2012	\$5,221,800

J.H.T.