**IN THE IOWA DISTRICT COURT FOR STORY COUNTY**

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| CITY OF AMES BOARD OF REVIEW,<br><br>Petitioner,<br><br>v.<br><br>IOWA PROPERTY ASSESSMENT APPEAL BOARD,<br><br>Respondent,<br><br>SEARS HOLDING CORP. d/b/a KMART,<br><br>Intervenor. | ) | Case No. CVCV046092<br><br>**RULING ON JUDICIAL REVIEW** |

## STATEMENT OF THE CASE

The City of Ames Board of Review seeks judicial review of the decision of the Property Assessment Appeal Board. The Property Assessment Appeal Board (hereinafter "PAAB") modified the 2009 value set by the Ames Board of Review for the subject property at 1405 Buckeye Avenue in Ames, Story County, Iowa, parcel number 09-11-375-150. Specifically, in its May 17, 2010, decision, the PAAB changed the assessed value from $7,939,000, as set by the Board of Review, to $5,500,000, with $2,959,000 in improvement value and $2,541,000 in land value. The Board of Review now appeals the PAAB's value determination.

## STATEMENTS OF FACTS

The PAAB included its Findings of Fact in its Order dated May 17, 2010. (R. at 546-52). Sears Holding Corporation, doing business as Kmart (hereinafter "Kmart"), protested the Ames Board of Review's assessment of the subject property. (R. at 546). The Board of Review assessed the property at a value of $8,235,000, with $3,448,800 in land value and $4,786,200 in

improvement value. (R. at 546). On April 28, 2009, Kmart petitioned to the Board of Review, requesting the 2009 assessment value be reduced to $5,600,000, because a downward change in value occurred since the last assessment. (R. at 6). The Board of Review granted partial relief and reduced the total assessment value to $7,939,000. (R. at 3). On June 15, 2009, Kmart filed a Notice of Appeal again requesting a revised value of $5,600,000 on the same grounds. (R. at 1).

The PAAB held a hearing on April 7, 2010. (R. at 425). At the hearing, Kmart presented two witnesses: Mr. Richard Hermes, a Senior Property Tax Manager for Sears Holding, and Mr. Dane Anderson, a commercial appraiser with Iowa Appraisal and Research in Des Moines. (R. at 547, 548). The Board of Review had two witnesses; Mr. Kyran "Casey" Cook, a commercial appraiser with Cook Appraisal in Iowa City (R. at 549), and Patrick Schulte, a commercial appraiser with Commercial Appraisers of Iowa, Inc., in West Des Moines (R. at 551). Finally, the Board of Review presented a written summary appraisal report from Greg Lynch, the Ames City Assessor. (R. at 552).

The witnesses varied in their assessments of a 1.8-acre parcel of the property. Specifically, Anderson considered the parcel to be "surplus" land, while Hermes and Cook deemed it "excess" land. (R. at 549). In its Order, the PAAB explained that "[b]asic valuation terminology identifies **excess land** as land that can be parceled off and improved for a separate use, while defining **surplus land** as land that does not have, or could not have a separate use, but rather serves the larger site." (R. at 549) (emphasis added). Notably, the original January 1, 2009, assessment did not have a separate value for this additional site area. (R. at 550).

Hermes testified regarding a decrease in retail sales at the subject property, providing evidence of a 38% decline in sales from 2002 to 2008. (R. at 547). According to his testimony, such a decline supports a downward change in the property's value. (R. at 547). Hermes also

developed an income approach in his analysis, concluding a final value opinion of approximately $5,600,000. (R. at 548). Hermes determined a market value of roughly $4,800,000 from the income approach, and then added an additional $780,000 for "excess land," resulting in his sum value of $5,600,000. (R. at 548). Hermes testified that he did not believe the inclusion of the "excess land" was correct methodology, but included its value to be consistent, as the assessor had done so. (R. at 548).

Kmart retained Anderson to determine the fair market value of the subject property as of January 1, 2009. (R. at 548). Anderson's testimony relied on the sales comparison and income approaches to value. (R. at 248; Pet'r's Br. 2). Anderson did not develop a "cost approach," because the reliability of such an analysis would be limited by depreciation due to the age of the subject property's improvements. (R. at 548). Moreover, Anderson opines that the "cost approach" would not be considered by a typical market participant when estimating value. (R. at 548).

Under the "sales comparison" approach, Anderson valued the subject property at $5,160,000. (R. at 548). To reach this figure, Anderson supplied evidence of six properties comparable to the subject property, four of which with building areas over 100,000 square feet, and five of which that sold in the last half of 2007 or in 2008. (R. at 548). The PAAB noted in its Order that "[t]hese are among the most recent sales present and among the most similar in size than any of the other evidence presented before this Board." (R. at 548).

Under the "income approach", Anderson considered five comparable lease listings, with market rents averaging $4.35 per square foot of gross building area. (R. at 548). Anderson deemed appropriate a 10% vacancy and collection rate for a big-box property such as the subject

property. Using the market rents, vacancy rate, and a 9.32% capitalization rate, Anderson reached a value of $5,570,000 under the "income approach." (R. at 549).

Ultimately, Anderson reconciled the outcomes from the "sales comparison" and "income approaches," reaching a final value opinion of $5,500,000. (R. at 549). Anderson did not make any adjustments for excess land value, as he considered the 1.8 parcel to be surplus land. (R. at 549). Again, the Board noted in its Order that "[w]e find Anderson to be knowledgeable and his testimony credible." (R. at 549).

Cook testified on behalf of the Ames Board of Review, providing his opinion as to the market value of the property as of January 1, 2009. (R. at 549). Cook developed all three appraisal approaches, resulting in the following value figures: $7,850,000 under the "cost approach"; $7,550,000 under the "sales comparison" approach; and $7,550,000 under the "income approach." (R. at 549). Cook concluded that the subject property had excess land (as opposed to surplus), which he valued independently at $700,000, and included such as a separate factor within each of the three approaches.[1] (R. at 549).

Cook gave most consideration to the sales comparison approach, under which he rendered a final value opinion of $7,600,000, as of January 1, 2009. (R. at 549). Cook presented five properties which he considered comparable, including a recent sale that was larger than the subject's improvements, and three properties with improvements less than 85,000 square feet (compared to the subject property's 120,000 square-foot improvement). (R. at 550). Of the five comparable properties, two sales occurred in 2008, while two sold in the first half of 2007 and one sold in 2004. (R. at 550).

[1] In its Order, the PAAB commented on Cook's methodology as follows: "[w]e note it is atypical methodology to add what Cook believes is excess land as a separate factor to the income approach. This land is not separately parceled and would have been included within the income generated for the whole property. The addition of this factor, essentially considers a portion of the site twice." (R. at 549).

In addition to Cook's testimony, the Board of Review presented a second appraisal, performed by Schulte. (R. at 551). Schulte developed all three approaches to value and concluded a final opinion of value of $9,400,000. (R. at 551). The PAAB stated that "[o]f the three appraisal reports presented in regards to the subject property, Schulte's is least credible and given limited consideration by this Board."[2] (R. at 551).

Finally, the Board of Review offered a summary appraisal report from Lynch, the Ames City Assessor. (R. at 552). The report was prepared for and a part of the Board of Review's consideration when preparing the 2009 assessment. (R. at 552). The PAAB gave limited consideration to this report, because it "only offered one method of valuation, and the properties used for comparison were among the oldest sales available." (R. at 552).

Both Anderson and Cook offered zoning requirements in their reports. (R. at 550). Anderson reported that the current zoning requirements mandate a 15% minimum landscaped area. (R. at 550). An estimated 78,000 square feet of the subject property was "unimproved," roughly equating the 15% minimum landscape zoning requirement. (R. at 550). Meanwhile, Cook opined that the unimproved area could be sold and the property would remain in compliance with the zoning requirements through "grandfathering." (R. at 550).

Ultimately, the PAAB determined that "even if zoning would allow for subdivision of the subject site, with each resulting site conforming to zoning requirements, the issue of doing so is not debatable, as it is not the current use of the subject parcel." (R. at 551). Because Cook's appraisal valued the parcel as two independent sites, the PAAB found Cook's opinion to be less

[2] Schulte acknowledged a mathematical error that significantly lowered his range of price per square foot under the sales comparison approach. (R. at 551). Schulte testified that even after correcting the error, his opinion would not change his conclusion regarding the subject property's value per square foot. (R. at 551). Moreover, under the income approach, Schulte examined fifteen properties to compile comparable lease data. (R. at 551). While the subject property's building area is approximately 120,000 square feet, Schulte examined leased properties ranging from 32,000 square feet to 85,000 square feet. (R. at 551).

credible, as the subject is a single platted site and could only be valued in its current use for ad valorem purposes. (R. at 551).

Conversely, the PAAB found Anderson's opinions to be knowledgeable, most comparable to the subject property, and therefore, most credible. (R. at 548-49). Specifically, the PAAB stated that it found Anderson's appraisal to be most reliable as it "values the subject property as one property which is its current classification and use." (R. at 552).

Therefore, the PAAB determined that based on a preponderance of the credible and reliable evidence, the evidence supported the claim that the property was assessed for more than the value authorized by Iowa Code section 441.21. (R. at 553). Thus, the PAAB modified the January 1, 2009, assessment of the subject property to a total value of $5,500,000, with $2,541,000 in land value and $2,959,000 in improvements. (R. at 554).

The City of Ames Board of Review now appeals the PAAB's modification.

## STANDARD OF REVIEW

The Iowa Administrative Procedure Act, codified as Chapter 17A of the Iowa Code, provides administrative procedures for state agencies. Specifically, section 17A.19 governs judicial review of agency decisions:

> The court may affirm the agency action or remand to the agency for further proceedings. The court shall reverse, modify or grant other appropriate relief from agency action, equitable or legal and including declaratory relief, if it determines the substantial rights of the person seeking judicial relief have been prejudiced because the agency is any of the following:
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> . . .
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> *c.* Based upon an erroneous interpretation of a provision of law whose interpretation has not clearly been vested by a provision of law in the discretion of the agency.
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> . . .
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> *f.* Based up on a determination of fact clearly vested by a provision of law in the discretion of the agency that is not supported by substantial evidence in the record before the court when that record is viewed as a whole.
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> . . .
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> *i.* The product of reasoning that is so illogical as to render it wholly irrational.
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> . . .
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> *n.* Otherwise unreasonable, arbitrary, capricious, or an abuse of discretion.

Iowa Code § 17A.19(10) (irrelevant subsections omitted).

On judicial review, courts are bound by the agency's findings of fact if supported by substantial evidence in the record as a whole. *Hy-Vee, Inc. v. Employment Appeal Bd.*, 710 N.W.2d 1, 3 (Iowa 2005). Stated differently, the question on appeal is not whether the evidence supports a different finding, but whether the evidence supports the findings actually made. *St. Luke's Hosp. v. Gray*, 605 N.W.2d 646, 649 (Iowa 2000).

The application of law to the facts assumes a different approach: when an agency exercises its discretion based on an erroneous interpretation of the law, reviewing courts are not bound by those legal conclusions but may correct misapplications of the law. *Meyer v. IBP, Inc.*, 710 N.W.2d 213, 219 (Iowa 2006) (*quoting Stroup v. Reno*, 530 N.W.2d 441, 443 (Iowa 1995)).

As the Iowa Supreme Court has explained, it is important to distinguish between questions of fact and law when claiming error on appeal:

> These different approaches to our review of mixed questions of law and fact make it essential for counsel to search for and pinpoint the precise claim of error on appeal. If the claim of error lies with the agency's findings of *fact,* the proper question on review is whether substantial evidence supports those findings of fact. If the findings of fact are not challenged, but the claim of error lies with the agency's interpretation of the *law,* the question on review is whether the agency's interpretation was erroneous, and we may substitute our interpretation for the agency's.

*Meyer*, 710 N.W.2d at 219.

The Board of Review originally asserted the four grounds for appeal listed above. However, it explains in its brief that all grounds are "based on and follow from the Appeal Board's erroneous application of a rescinded administrative rule determined by court ruling to be contrary to statute." Thus, the Court interprets the appellant's claim of error to be with the agency's interpretation of the law. Iowa Code § 17A.19(10)(c).

## CONCLUSIONS OF LAW

Under Iowa law, all property subject to taxation must be valued at its actual value. Iowa Code § 441.21(1)(a). Actual value is defined as the fair and reasonable market value of the property. Iowa Code § 441.21(1)(b). Market value is defined as "the fair and reasonable exchange in the year in which the property is listed and valued between a willing buyer and a willing seller [in an arm's-length transaction]. Iowa Code § 441.21(1)(b). Sale prices of comparable property in normal transactions reflecting market value must be taken into consideration in arrive at market value. Iowa Code § 441.21(1)(b).

When assessing the value of property, an assessor must determine the appropriate classification of the property. The Iowa Administrative Code requires that "[a]ll real estate subject to assessment by city and county assessors shall be classified as provided in this rule. . . . The assessor shall classify property according to its present use and not according to its highest and best use." Iowa Admin. Code r. 701-71.1(1) (2011) (emphasis added).

The phrase "highest and best use" does not appear in any other code provisions, but is implicit in the concept of market value. *See* 84 C.J.S. *Taxation* § 582 ("a fair market value of property for tax purposes should take into account the highest and best value of the land"). The prior version of Rule 701-71.1(1) instructed the assessor to "classify and value property according to its present use and not according to its highest and best use." The amended, current version of the rule omits the "and value" language. Therefore, under the current rule, property must be classified according to present use, and valued according to market value, with market value implicitly including a "highest and best use" analysis. Iowa Admin. Code r. 701-71.1(1); Iowa Code § 441.21(1).

## ANALYSIS

As grounds for its appeal, the City of Ames Board of Review asserts that the PAAB cited to and relied upon the rescinded portion of Rule 701-71.1(1) when it determined that the subject property was over-valued. The PAAB asserts that it did not rely on or base its decision on the rescinded language. Rather, the PAAB made a credibility assessment based on the assessors' testimony and ultimately concluded the property should be valued in alignment with Anderson's valuation, which valued the property according to its highest and best use.

All appraisers applied a highest and best use analysis when determining the property's value. (R. 232-34, 390-04, 383-83). Both Anderson and Cook's appraisals indicated the highest and best use of the property is for continued retail use. Whether the PAAB adopted Anderson or Cook's valuation, it would be valuing the subject property at its highest and best use.

It is true that the PAAB cited to the old version of Rule 701-71.1(1), which required property be valued at its current use. The PAAB stated "Ad [v]alorem valuation requires the property to first be classified, then valued in its current use . . . . The subject is a single platted site and can only be valued in its current use for ad valorem purposes." (R. at 551) (emphasis added). However, the PAAB ultimately adopted Anderson's appraisal which valued the property at its highest and best use, and not its current use. Therefore, although the PAAB cited to the old version of rule 701-7.1(1), it did not apply that version with respect to value.

In its order, the PAAB valued the property as a single parcel, under the theory that the 1.8 acres parcel was "surplus land," not "excess land," and therefore could not be severed from the site. The 1.8 acres served as the required landscaping under the city's zoning requirements. Under Anderson's appraisal, this was the parcel's highest and best use, given the restrictions from the zoning requirements. While Cook's appraisal included a hypothetical situation in

which the 1.8 acres could be sold and the property remain in compliance with the zoning requirements by "grandfathering," he did not verify this assumption with any zoning authority or provide evidence of a reasonable probability that the property would indeed remain in compliance. Rather, he stated his experience supported that assumption. (R. at 496, 505, 516).

Moreover, the January 1, 2009, assessment did not have a separate value for this additional site area. The appraisers were asked to appraise the subject property for the purposes of an appeal, to determine whether the property was over-valued in the January 1, 2009, assessment. Therefore, the PAAB found Anderson's appraisal the most reliable, as it valued the subject property as one property which is its current classification and use.

The PAAB's credibility assessment was not limited to the difference in opinion regarding parcels and zoning requirements. The PAAB was also careful to note the reliability of data on which the assessors' relied to calculate their respective values. Anderson's sales comparison data contained the most recent sales and were the most similar size to the subject property, than any of the other evidence before the Board. (R. at 548).

Based on the foregoing, the Court determines that the PAAB's findings of fact are supported by substantial evidence in the record as a whole, and therefore, this Court is bound by those findings. Although the Court determines the PAAB applied the correct law, it still erroneously cited to the former version of Rule 701-71.1(1). Therefore, this matter must be remanded to the PAAB, for the limited purpose of correcting its conclusions of law.

IT IS, THEREFORE, THE ORDER OF THE COURT that the decision of the Property Assessment Appeal board dated May 17, 2010, is REMANDED, for the limited purpose of correcting the improperly stated conclusions of law.

IT IS THE FURTHER ORDER OF THE COURT that the costs of this action shall be assessed against the Petitioner and shall be paid 45 days after the Respondent complies with this limited remand and files the same with the Clerk of the District Court.

Copies provided to:

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State of Iowa Courts

**Case Title:** CITY OF AMES BD OF REVIEW V IA PROPERTY ASSESSMENT APPEAL BD

**Case Number:** CVCV046092

**Type:** OTHER ORDER

So Ordered