

**PROPERTY ASSESSMENT APPEAL BOARD**  
**FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER**

PAAB Docket No. 13-101-0699

Parcel No. 13251-01028-00000

Edgewood-Johnson CR, LLC (Walgreens Co. Lessee),

Appellant,

v.

City of Cedar Rapids Board of Review,

Appellee.

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**Introduction**

This appeal came on for hearing before the Property Assessment Appeal Board (PAAB) on April 9 and 10, 2015. Attorney Deborah M. Tharnish of Davis Brown Law Firm, Des Moines, represented Edgewood-Johnson CR. Assistant City of Cedar Rapids Attorney Mo Sheronick represented the Board of Review.

Edgewood-Johnson CR LLC is the owner of a commercially classified property located at 3400 Johnson Avenue NW, (also known as 324 Edgewood Road NW) Cedar Rapids, Iowa. The property is leased to and operated by Walgreens. It was built in 2010 with 14,739 square feet of gross building area and 32,800 square feet of parking area. The site is 1.87 acres.

The property's January 1, 2013, assessment was \$2,212,656, allocated as \$935,000 in land value and \$1,277,656 in improvement value. Edgewood-Johnson protested to the Board of Review claiming the property was assessed for more than authorized by law under Iowa Code section 441.37(1)(a)(2). The Board of Review denied the petition.

Edgewood-Johnson then appealed to this Board reasserting its claim.

## Findings of Fact

Edgewood-Johnson contends the subject property is over assessed and that the two appraisals it submitted show the correct market fair market value of the subject property. By contrast, it asserts the Board of Review's appraisal concludes a value that is more akin to a leased-fee value.

To support its claim, Edgewood-Johnson first called Chris Marabella, a mortgage banker with Marabella Commercial Finance. Marabella arranges financing exclusively for net lease properties, and has arranged financing for companies including Walgreens, O'Reilly, Jack-in-the-Boxes, and Safeway stores. His company represents the investors who are seeking to purchase property.

Marabella explained that companies like Walgreens typically enter into built-to-suit, lease-back arrangements because the company does not want to keep money tied up in real estate. He noted the majority of the developers working with Walgreens do so on a built-to-suit basis. When the stores are completed, the rents are typically based on a percentage of the total cost (land, building, and entrepreneurial profit), which he claims has no basis in the actual market. Walgreens then will owner-occupy the property until it finds an investor to buy the real estate.

Marabella described Walgreens as Triple-B rated, which is investment-grade credit with a low probability of default. Marabella asserts the lease value is what drives the investors, not the value of the real estate. He explained that the typical lease for a Walgreens is 75 years, with an escape clause at about 20-25 years; further, he notes this is longer than typical leases. The length of the lease assists him in arranging financing.

Marabella testified that he did not inspect the subject property or review its lease; moreover, he was not involved in the financing of the subject property. Marabella did not conclude a market value of the subject property.

## ***Appraisals***

Edgewood-Johnson submitted two independent appraisals of the property completed by Dane Anderson of Real Estate Research Corporation, West Des Moines, and Jason Krentler of Stout-Risius-Ross, Inc., Michigan. (Exs. 4 & 5). Both Anderson and Krentler testified at hearing.

The Board of Review submitted an appraisal completed by Kyran (Casey) J. Cook of Cook Appraisal, Iowa City. (Ex. G).

The following chart summarizes the appraisers' approaches to value and their respective conclusions.

<b>Appraiser</b>	<b>Sales Approach</b>	<b>Income Approach</b>	<b>Cost Approach</b>	<b>Final Opinion of Value</b>
Anderson	\$1,390,000	\$1,370,000	\$1,370,000	\$1,380,000
Krentler	\$1,100,000	\$1,200,000	N/A	\$1,100,000
Cook	\$3,390,000	\$2,680,000	\$2,570,000	\$2,890,000

### ***The Anderson Appraisal***

Anderson completed all three approaches to value. His conclusions were as follows:

<b>Sales Approach</b>	<b>Income Approach</b>	<b>Cost Approach</b>	<b>Final Opinion of Value</b>
\$1,390,000	\$1,370,000	\$1,370,000	\$1,380,000

Anderson's appraisal concludes there is minimal market vacancy, the overall Cedar Rapids market is "healthy" and that demand for the subject improvements will continue to be favorable. (Ex. 4, pp. 42). Anderson determined the property's highest and best use was for continued retail use. Anderson did not distinguish between different types of retail use and explained that he does not identify a particular user or a sub-property-type use. He noted the subject property is in average condition for its age and is located on a well-traveled corridor with good access. (Ex. 4, p. 44).

Anderson first developed the cost approach to value. His appraisal states there was limited data of small retail development in Cedar Rapids due to the recent

recession. (Ex. 4, p. 46). Of the five land sales he located, he determined a site value of \$1,020,000 for the subject property. Anderson then arrived at a total replacement cost new of the improvements of \$1,960,000. He included 10% of the replacement cost for entrepreneurial incentive and 5% for indirect (soft) costs to arrive a total replacement cost new of \$2,254,000. Anderson considered 7.5% physical depreciation based on the age/life method and then applied an additional 76.98% depreciation for external obsolescence. We find this external obsolescence adjustment appears unreasonable given the property is being used for the purpose for which it was built, it is a relatively new building, and there is no concrete evidence that it could not be used similarly in the future. He gave the cost approach conclusion (\$1,370,000) minimal consideration in his final opinion.

Anderson next completed the sales comparison approach. Anderson stated he primarily focused on fee-simple sales when selecting comparable properties. He further testified he tries to avoid using leased-fee sales when determining a property's fee-simple value. In his opinion, these sales require a significant amount of research to properly adjust for this condition. He identified six sales all located in Iowa, but the majority were outside of the Cedar Rapids market. One of the comparable properties, Sale 6, is a sale of another Walgreens. In addition to it and the other sale in Cedar Rapids, his comparables were located in Sioux City, Mason City, Dubuque, and Davenport. The following chart is a summary of his sales.

	Date of Sale	Sale Price	Gross Building Area (GBA)	Year Built	SP/SF	Adjusted SP/SF
Subject	N/A	N/A	14,736	2010	N/A	N/A
1 - Sioux City	Jul-10	\$900,000	11,946	2001	\$75.34	\$94.32
2 - Mason City	Nov-10	\$750,000	12,068	1995	\$62.15	\$89.59
3 - Dubuque	Jan-12	\$650,000	11,830	1995	\$54.95	\$88.85
4 - Cedar Rapids	May-11	\$862,500	10,197	1985	\$84.58	\$100.36
5 - Davenport	Aug-12	\$900,000	11,832	1998	\$76.06	\$87.58
6 - Cedar Rapids	Dec-11	\$4,191,045	13,850	1999	\$302.60	\$105.97

Anderson testified the comparable properties all had retail use prior to and after their sale and all were fee-simple sales with the exception of Sale 6, which was a

leased-fee property. Anderson testified that he considered Sales 1-5 in his conclusions; and Sale 6 was included for demonstration purposes only because it was the purchase of a Walgreens property with an existing lease in place.

Anderson identifies all of the sales as being of good quality/design and average condition similar to the subject property and makes no adjustments for these factors. However, looking at the photos of the properties in the addendum of his report (Ex. 4), Sales 1-5 appear to have inferior quality/design. Further, they do not have as good of an exterior elevation as compared to the subject property and it does not appear that any of the properties have a canopied drive-through feature or adequate ingress/egress to accommodate a drive-through.

Although Anderson identifies all of his comparable properties as being in average condition similar to the subject, he adjusted all of them upward between 14% and 23% for this age.

He also adjusted the properties for differences in market conditions (time), location, age/condition, economic/tenancy, and land-to-building ratio.

Sales 1, 2, and 3 were all former Rex Appliances stores. Sales 1 and 2 were on the market for two-and-a-half years prior to selling; Sale 3 was on the market for approximately four years. Even Sale 5 was on the market for one-and-one half years. Only Sale 6, the transfer of another Walgreens, had a shorter marketing time at just less than four months. While properties may be vacant when they sell, long marketing times may affect the eventual sale price. Moreover, Anderson's appraisal estimates the exposure time for the subject property at nine months. (Ex. 4, pp. 10-12). The marketing period for these properties also draws their comparability to the subject property into question.

Anderson testified that after its purchase, Sale 1 was converted to a Napa Auto Parts store. He did not identify the use of Sale 2 after its purchase. Sale 3 was converted to multi-tenant use. (Ex. 4, Addendum).

Anderson reports that Sale 4, which sold for \$562,500, had an effective sale price of \$862,500 because the purchaser had expenditures immediately after the sale of \$300,000. (Ex. 4, Addendum). The buyer converted the property into multiple suites

and a portion of the building is owner occupied. This property was vacant when it sold and the marketing time is unknown.

Anderson reported that the seller of Sale 5 had some financial difficulty; however, he believes there was no indication the price was discounted as a result. Despite his opinion, the record indicates that the buyer felt like “he got a good deal.” (Ex. 4, Addendum). This property was a flooring retail store prior to and after the sale.

Anderson included the sale of a Walgreens property (Sale 6); however, he testified he gave it minimal consideration. The subject property sold with the long-term lease in place, which has a rental rate of \$29,250 per month. He notes in his addendum the sale represents a 1031 exchange and therefore he adjusted it downward 70%. (Ex. 4, p. 64). Anderson testified that the adjustment was necessary because of the long-term lease that is beyond a typical lease term and it involves a credit-worthy tenant with above market rates.

Anderson explained that he gave most weight to Sales 1, 4, and 5 because they required the least amount of adjustment. He gave secondary weight to Sales 2 and 3; and minimal consideration to Sale 6. (Ex. 4, p. 65).

Anderson also included six active listings, which he asserts lend support and a test of reasonableness to his sales comparison analysis. (Ex. 4, p. 65). The listings have been on the market an average of nearly five years. He asserts the long listing histories could be due to over-listing of the properties, or because the market is still coming out of a recession. We note, however, that Anderson previously identified the subject property’s market as “healthy.” Moreover, the marketing times for these properties again contradict Anderson’s estimated exposure period for the subject property at nine months. (Ex. 4, p. 12). Thus, we find these active listings do little to support Anderson’s sales comparison approach and actually would appear to weaken the credibility of his conclusions.

Anderson concludes \$94 per-square-foot (\$1,390,000) for the subject property, based on the sales comparison approach.

In his income approach, Anderson stated the subject’s rent, at \$28.34 per-square-foot per year, is above market and is based on the cost to construct a custom facility and thus required a return for the investor. (Ex. 4 p. 66). Anderson used the rent

from six properties to determine the market rents for the subject. The following chart summarizes these rentals.

	Net Rentable Area	Year Built	Base Rental Rate	Est. Annual Expenses	Lease Start Date
Subject	14,736	2010	N/A	N/A	N/A
Rental 1	9800	1988	\$5.21	\$4.42	Feb-09
Rental 2	11,200	1988	\$8.04	\$4.42	Jan-12
Rental 3	18,000	2011	\$9.70	\$3.00	Jan-10
Rental 4	13,500	2011	\$11.50	\$3.00	Jan-10
Rental 5	7843	2002	\$5.98	N/A	Apr-12
Rental 6	7847	2003	\$7.62	N/A	Mar-12

Anderson qualitatively identifies the rentals as similar, inferior, or superior compared to the subject property. He notes that market conditions have increased since the time of the leases, requiring an upward adjustment for all of the rentals. (Ex. 4, p. 72). Ultimately, through his qualitative analysis, he determines a rental rate of \$9.25 per-square-foot (\$136,308).

Looking at the photos of Anderson's lease properties (Ex. 4 pp. 69-70), we question their comparability to the subject property; specifically Rentals 1, 2, 5, and 6. The improvements of the comparable rentals appear to be lower quality, lack the more aesthetically appealing elevations and features (drive-through) of the subject property, and/or are in locations with less desirable traffic counts or household demographics. Despite Anderson's indication that he considered upward and downward adjustments for these conditions, he did not provide an adjustment chart. Anderson's market rent conclusion of \$9.25 is below both the rental rates of Rentals 3 and 4, which we find are of more similar age, condition, and quality to the subject.

Anderson developed an income and expense schedule, and determined a net operating income (NOI) of \$126,425. He determined an overall capitalization rate loaded for taxes of 9.23% and concluded an opinion of \$1,370,000 by the income approach.

Ultimately, the sales comparison approach was given primary consideration and Anderson concluded an opinion of \$1,380,000 for the subject property.

### ***The Krentler Appraisal***

Krentler completed the sales comparison and income approaches to value. His conclusions were as follows:

<b>Sales Approach</b>	<b>Income Approach</b>	<b>Cost Approach</b>	<b>Final Opinion of Value</b>
\$1,100,000	\$1,200,000	Not Developed	\$1,100,000

Krentler testified that he did not develop the cost approach because he believes market participants do not consider it when determining a purchase price.

Turning to the sales comparison approach, Krentler stated that when selecting comparable properties he considered the highest and best use, size, year built, and geography. He did not consider leased-fee sales because it would require additional adjustments; and in his opinion, there were ample fee simple sales available for analysis. He also did not consider sale-leasebacks or built-to-suit properties. Krentler believes that sales-leasebacks or built-to-suit properties are tied to the construction costs, are not exposed to the market, and not reflective of a market rental rate. Krentler submitted six sales summarized in the following chart.

	Date of Sale	Sale Price	Gross Building Area (GBA)	Year Built	SP/SF	Adjusted SP/SF
Subject	N/A	N/A	14,739	2010	N/A	N/A
1 - Cedar Rapids	Feb-12	\$1,050,000	21,528	1972	\$48.77	\$67.62
2 - Dubuque	Jan-12	\$650,000	11,830	1995	\$54.95	\$73.43
3 - Mason City	Dec-11	\$600,000	8000	2006	\$75.00	\$73.39
4 - Cedar Rapids	May-11	\$562,500	10,197	1985	\$55.16	\$66.55
5 - Mason City	Nov-10	\$750,000	12,068	1995	\$62.15	\$82.66
6 - Sioux City	Jul-10	\$900,000	11,946	2001	\$75.34	\$76.80

Krentler adjusted these sales for location, building size, condition, and land-to-building ratio. First, we note like Anderson, Krentler's estimated exposure time for the subject property is significantly lower than the average marketing time for his comparable sales. His estimated marketing time for the subject property is a mere twelve to eighteen months, whereas the average marketing time for his comparable

sales is nearly fifty-one months, or over four years. (Ex. 5, p. 6). This marketing time and extended vacancy may likely influence the sales price of these properties.

Sale 1 was an Advanced Auto Parts prior to its sale. The buyer intended to use it as an auto dealership. (Ex. 5, p. 68-69). This sale is the oldest property Krentler used and he therefore adjusted it 25% for condition.

Sales 2, 5, and 6, were all former Rex Appliance stores. Anderson also considered these sales. Similar to Anderson, Krentler explains that Sale 2 was vacant for three years prior to its sale and was converted to multi-tenant use. Krentler also identifies the location of this property as inferior with site limitations affecting the amount of parking available; additionally, it does not have direct access to the main highway along the front of the property. Given these conditions, we question its comparability to the subject property, which we believe has appeal to its current use, in part, because of its high visibility, access, and ease of parking for customers. Sale 5 was converted to a paint and flooring retailer. According to Krentler, Sale 6 was purchased with the intent of opening a used car dealership. (Ex. 5, p. 79).

Krentler reports Sale 3 as a foreclosure sale; he did not adjust for this factor. (Ex. 5, p. 73). Prior to the sale, it was a two-tenant retail building and then converted to an O'Reilly Automotive after the sale.

Krentler's Sale 4 was also used by Anderson and was vacant at time of sale. Unlike Anderson, however, Krentler did not consider the buyer's impending expenditures (approximately \$300,000 as noted by Anderson) in his analysis. Krentler reported this was a single-tenant property prior to the sale and converted to a two-tenant, owner-occupied property after the sale.

Krentler also included seven sales as "additional support" for his conclusions. (Ex. 5, p. 38). These sales included fee simple, leased fee, multi-tenant, and properties developed for specific users. He notes it was necessary to expand his search to include these sales "since there were very few owner-user transactions of free-standing retail properties throughout the subject's marketing area." (Ex. 5, p. 38). The average unadjusted sales price per-square-foot of these properties was \$135.01. Sale 2, a CVS; and Sale 6, a Walgreens had sale prices of \$359.46 and \$302.60, respectively.

Krentler concluded a final opinion of \$75 per-square-foot (\$1,100,000) by the sales comparison approach.

Looking at the photos of Krentler’s sales, we question the comparability of the improvements to the subject property; specifically, Sales 3 and 4. (Ex. 5, pp. 72-75). While Sales 3 and 4 appear to be the most dissimilar, all of the improvements of the comparable sales appear to be lower quality compared to the subject and lack the more aesthetically appealing elevations like the subject property.

Further, we note that Sale 3, received no condition or quality adjustments. Based on the photos it does not appear to be a reasonable substitute for the subject property. When questioned about this property specifically, Krentler admitted, “It probably should have had an adjustment.”

When questioned if the current user, Walgreens, or other like users such as another national or regional drug store chain would occupy any of the comparable properties, Krentler, like Anderson, explained that Walgreens does not buy existing freestanding stores, but rather always builds their own.

In his income approach, Krentler submitted eight comparable properties to determine the market rent for the subject property. The following chart summarizes these rentals.

	Net Rentable Area	Year Built	Base Rental Rate	Lease Start Date	Adjusted Rental Rate
Subject	14,739	2010	N/A	N/A	N/A
Rental 1	7,620	1994	\$8.95	Jan-13	\$8.93
Rental 2	9,500	2013	\$12.00	Jan-13	\$8.82
Rental 3	17,836	1983	\$9.50	Nov-13	\$9.03
Rental 4	11,904	1993	\$10.50	Nov-13	\$9.45
Rental 5	168,563	1984	\$9.00	Oct-12	\$8.49
Rental 6	24,000	2002	\$8.75	Sep-12	\$8.66
Rental 7	6,200	1975	\$9.67	Feb-12	\$9.40
Rental 8	9,100	2011	\$8.37	Sep-11	\$8.44

Krentler adjusted the lease rates for conditions of lease, market conditions, location, tenant size, and condition.

Rentals 1 and 2 were listings as of the date of value. Rental 1 was a former Blockbuster Video and Rental 2 is a newly constructed strip center located in front of a Walmart. (Ex. 5, pp. 80-83). We note that Krentler also completed an appraisal on another Walgreens in Cedar Rapids on a joint docket (13-101-0697). Krentler relied on the sale data sets in both appraisals, however he reports Rental 1 as having a base rental rate of \$10.95 per-square-foot, compared to the \$8.95 per-square-foot he reports in this appraisal.

According to Krentler, Rentals 3 and 4 had rents that were “typical for the market.” Rental 3 was a Petco and Rental 4 was a Party City. (Ex. 5, pp. 84-87).

Rental 5 was a furniture retail store located in a strip shopping center. Krentler identifies the net rentable area (168,563 square feet) on page 41 of his report; however, that is the total strip center building size. The actual suite size that he uses for comparison is 10,843 square feet. (Ex. 5, p 45; 88-89).

Rental 6 was the renewal of a Dollar Tree lease in a newer building located in Davenport next to a Wal-Mart. Krentler identifies the net rentable area (24,000 square feet) on page 41 of his report; however, that is the total building size. The actual suite size that he uses for comparison is 10,300 square feet. (Ex. 5, p 45)

Rental 7 is located in Cedar Rapids and a freestanding retail space. This building is significantly older than the subject property and Krentler explains that as a result it has a significant condition adjustment.

Rental 8 was a new Dollar General lease, located in Postville, Iowa. Although Krentler made a 15% upward adjustment to this lease for location, we question its comparability to the subject’s Cedar Rapids market.

Krentler explained that he did not use any Walgreens or other regional or national drug store chains because in his opinion the rents of those type of properties would be build-to-suit and not reflective of market rent.

Krentler adjusted Rentals 1 and 2 for being active listings and adjusted all of the rentals for differences in location, size, condition, and quality of construction. He determined a range of \$8.49 to \$9.45. From this range, he determined a rent of \$9.00, or \$132,651 potential rental income, for the subject property.

Similar to his comparable sales, the comparability of these lease properties is questionable based on the photos Krentler provided in his report. (Ex. 5, pp. 80-95). Specifically, the quality of Rent Comparables 1, 5, 7, and 8, which all appear to be lower quality exterior finish and wall height and lack a drive-through; for these reasons, they do not appear to be reasonable comparables for the subject property. Rent Comparables 2, 3, 4, and 6 appear superior to the other Rentals Krentler selected, but still appear to have a lower quality exterior facades as compared to the subject property.

Next, Krentler estimated the vacancy and credit loss for the subject property. He determined a 93% occupancy rate then deducted a 1% credit loss, which was an allowance to reflect potential bad debt on the cash flow. (Ex. 5, pp. 46-47).

Krentler arrived at a capitalized rate by considering three different approaches; market transactions (sales), investor surveys, and a band of investment. (Ex. 5, p. 48-49). He gave limited consideration to the investor surveys and band of investment because in his opinion they do not take into consideration locational attributes. He gives most consideration to sales in Iowa. He provides a chart of sales and the associated capitalization rates. (Ex. 5, p. 48). Based on his analysis, he determined a capitalization rate of 9.00% and after loading this rate for taxes; his conclusion is a capitalization rate of 9.31%. His opinion of value by the income approach is \$1,200,000.

In his reconciliation of value, Krentler gave all consideration to the sales comparison approach and determined an opinion of \$1,100,000 for the subject property as of January 1, 2013.

***The Cook Appraisal***

Cook completed all three approaches to value. His conclusions were as follows:

<b>Sales Approach</b>	<b>Income Approach</b>	<b>Cost Approach</b>	<b>Final Opinion of Value</b>
\$3,390,000	\$2,680,000	\$2,570,000	\$2,890,000

Beginning with the cost approach, Cook’s primary considerations for selecting land sales included: financing and terms of sale, date of sale, location, size/shape,

topography, and related factors. (Ex G, p. 27). He ultimately selected four sales from Cedar Rapids. The following chart summarizes the sales information.

	Date of Sale	Sale Price	Site Size	SP/SF	Adjusted SP/SF
Subject	N/A	N/A	73,174	N/A	N/A
1 – 3050 Wiley Blvd, Unit 1	Oct-13	\$750,000	62,554	\$11.99	\$11.63
2 – 3030 Wiley Blvd, Unit 4	May-13	\$450,000	50,159	\$8.97	\$8.97
3 – 1855 Edgewood Rd SW	Dec-11	\$1,000,000	110,206	\$9.07	\$9.07
4 – 2340 Edgewood Rd SW	May-10	\$950,000	93,926	\$10.11	\$10.82

Cook testified he made few adjustments to the land sales because there was no compelling market evidence to suggest adjustments were necessary. He did make time (market) adjustments to Sales 1 and 4. Sale 1 required a downward adjustment because it sold after the effective date of value in an increasing market. Sale 4 as the most dated sale, having occurred in May 2010, and Cook adjusted it 7% upward. He concluded a value of \$10 per-square-foot (\$730,000) for the subject site.

Cook relied on the *MARSHALL VALUATION SERVICE COST MANUAL* to determine a replacement cost new of the subject improvements. In his opinion, the subject property is a good quality drug store and MARSHALL has specific costs associated with drug stores. Moreover, within the cost analysis, he considers the quality of the property and MARSHALL has specific multipliers to adjust for the complexity/quality of the property, such as offsets and architectural features. The adjustment is identified as a floor area/perimeter multiplier. He applied a 0.890 multiplier for this factor. (Ex G, p. 31). Ultimately, he determined a replacement cost new of \$1,949,969, which includes site improvements and landscaping. (Ex. G, p. 31).

He determined physical depreciation for the subject property based on the age/life method, arriving at 5% depreciation for the building improvements and 13.33% depreciation for the site improvements.

Cook explained that he did not find any functional or external/economic obsolescence associated with the subject property. After considering depreciation Cooks conclusion of value by the cost approach was \$2,570,000.

Turning to the sales comparison approach, Cook testified regarding his reasons for and method of choosing comparable sales. He stated a motivating factor for choosing sales is tied to his previous involvement in and awareness of several Iowa district court and appellate court cases involving the valuation of other real property. Essentially, he testified that his understanding of the law requires him to search for sales that are going concern sales, and consider the on-going use of the property as a profitable enterprise without adding value exclusive to the present owner. He explained that he is not appraising a Walgreens, but rather, he is appraising the value of a “high-dollar, very successful, regional/national drug store” and not just any generic retail property. He asserts the subject property has features that need to be considered when selecting comparable properties.

Cook selected five sales located in Cedar Rapids, Muscatine, Coralville, and Iowa City. The following chart summarizes the sales information.

	Date of Sale	Sale Price	Gross Building Area (GBA)	Year Built	SP/SF	Adjusted SP/SF
Subject	N/A	N/A	14,739	2010	N/A	N/A
1 - Cedar Rapids	Dec-11	\$4,191,045	13,850	1999	\$302.60	\$226.95
2 - Cedar Rapids	Aug-12	\$4,773,695	13,280	2011	\$359.46	\$269.60
3 - Muscatine	May-11	\$3,235,294	15,060	2001	\$214.83	\$236.31
4 - Coralville	Apr-13	\$3,000,000	12,277	2000	\$244.36	\$219.92
5 - Iowa City	May-13	\$4,181,355	17,982	2000	\$232.53	\$232.53

Sale 1 is a Walgreens property in Cedar Rapids with its sale occurring in December 2011. Cook adjusted this sale downward 25% because in his opinion the leased fee interest was above market value.

Sale 2 is a CVS Drugstore that sold in August 2012. It was also adjusted downward for 25% for its leased-fee interest. When questioned by Edgewood-Johnson questioned Cook regarding how he arrived at the 25% adjustment for these properties, Cook explained that using essentially a paired sales analysis, when comparing Sale 1 and Sale 2 to the other sales he selected for analysis, their unadjusted sale prices per-square-foot, were roughly 25% higher.

Cook notes that Sale 3, a Walgreens in Muscatine, was also a leased fee sale, however it sold for significantly less than the other like drug stores (Sale 1 and 2). Edgewood-Johnson asked Cook if the rent on this property was above market – and Cook agreed it was. It further questioned why he did not adjust this sale by 25% for its leased fee interest like he did to Sale 1 and 2. Cook explained that the *rent* was above-market, and required adjustment in his income analysis, but the sale price per-square-foot was the primary consideration in the sales analysis. In this case, the sale price per-square-foot was much lower than other similar Walgreen sales (Sales 1 and 2) and did not support an adjustment. Moreover, he believes this property is located in an inferior community with a lower traffic count. Sale 4 was the transfer of a property operated as a Harley Davidson business. He acknowledged a prior sale of this property, for \$2,400,000, was between family members and he gave it no consideration. However, there was a subsequent sale between Warrior Enterprises and the Meyers Family; he considers this an arm's length transaction despite acknowledging that it was not fully exposed to the market. While he acknowledges that Warrior Enterprises bought the business as well as the real estate, Cook clarified that he verified the transaction with the seller who confirmed this price reflects only the real estate. He states the property sold as a leased-fee; however, similar to Sale 3 he found no evidence that this sale required an adjustment based on its comparison to other leased fee sales.

Lastly, he submitted a Staples in Iowa City (Sale 5); and like Sale 3 and 4, based on the sale price, he did not find support for an adjustment to reflect its leased-fee status.

The Board of Review asked Cook if he used “dark sales.” He defines a dark sale as a property that has significant vacancy for a period of time. Cook explained that he did not. In his opinion, while using a dark sale is not prohibited, the less akin the sale is to the property being appraised, including the property's vacancy, the less value it adds to a sales comparison analysis. He explained that a dark sale is the ultimate distressed property. As a result, an appraiser has to worry about commissions, as well as the risks associated with the property in relation to continued vacancy or costs of renovation, which would affect the sale price. In his opinion, comparing a dark property to an

occupied property would require significant adjustments and ultimately call into question the comparability of those sales.

Based on his research and analysis, his adjusted sales ranged from roughly \$220 per-square-foot to \$270 per-square-foot. He concluded his opinion of value by the sales comparison approach at the lower end of this range at \$230 per-square-foot or \$3,390,000 rounded.

Cook also completed the income approach. He explained that similar to the sales comparison approach, he valued the property, not as a Walgreens, but rather as an occupied property by a similar regional/national type operator. He used five comparable leases to determine a market rent for the subject property. The following chart summarizes these leases.

	Annual Rent	Lease Date	Building Size	Rent/SF	Adjusted Rent/SF
Subject	N/A	N/A	14,739	N/A	N/A
1 - 1705 Boynan St Iowa City	\$91,000	2013	6,500	\$14.00	\$14.00
2 - 2551 Heartland Pl Coralville	\$182,400	2009	12,800	\$14.25	\$15.68
3 - 820 S Riverside Dr Iowa City	\$376,322	2009	18,049	\$20.85	\$20.85
4 - 3325 16th Ave SW Cedar Rapids	\$350,790	2011	13,850	\$25.23	\$19.00
5 - 1703 Park Ave Muscatine	\$332,912	2011	15,060	\$22.11	\$18.79

Lease 1 is located in Iowa City and the tenant is a US Cellular Office. Cook notes that although this space is used as an office, you can also go in and buy a phone. In his opinion, this is a retail location, but also does not think there is a lot of difference between office and retail rents in this location.

Lease 2 is a stand-alone retail building similar in size to the subject, located in Coralville, and occupied by Goodwill. Cook states this is a well-located property, although it is “mid-block” with good exposure to Highway 965 and near a large complex of retail operations. Cook explained the lease that was analyzed was the 2009 lease and he did not adjust it for date of sale because he did not have clear evidence to support a time adjustment.

Lease 3 is in Iowa City on Riverside Drive and is an operating Staples.

Leases 4 and 5 are properties occupied by Walgreens. Cook adjusted both of these sales down 25% for being leased fee sales.

The adjusted rents range from \$14.00 to \$20.85, and he reconciled at \$18.00 or \$265,302 gross rental revenue, which he notes is below the sale-leasebacks that Walgreens is actually paying.

Cook explained that he looked at sixty-two stores each over 10,000 square feet and found 321,782 square feet of vacant space that included a K-Mart, which since sold. Removing the K-Mart from the analysis, the area wide vacancy drops from 9.6% to 5.75%. Cook reconciled a vacancy rate of 6%. (Ex G. p. 39).

Cook noted the subject property is not vacant and has a long-term lease with options; if he were valuing the subject as a leased-fee Walgreens, he would not include vacancy. However, because he is determining a fee-simple value, he explains that there would be a risk of vacancy and it needs to be included in the analysis.

Cook included insurance, management, utilities, maintenance, and reserves. He did not include the real estate taxes, but rather loaded them into the capitalization rate. He developed an operating income statement and determined a net operating income (NOI) of \$228,018 or \$15.47 per-square-foot.

Using market extraction and reconciling the results to the mortgage equity technique, he determined a capitalization rate of 8.25%; adjusted to a rounded 8.5% after loading for the tax rate. Cook emphasizes that the median national capitalization rate for Walgreens was 6.28% and drugstores overall were 6.93%. (Ex. G, p. 42). He explained that he included this information to contrast what he is using for a market-rate capitalization rate (8.25%) and what stores with a triple B rate, such as Walgreens, are actually paying. His conclusion by the income approach was \$2,680,000 rounded.

In reconciling the three approaches to value, Cook explained that the use of leased fee sales in the sales comparison approach, even after adjustments, may have affected the conclusion of value under that method. Because of this, the sales comparison approach 35% weight; the cost approach 35% weight; and the income approach 30% weight. (Ex. G, p. 45). His final opinion is \$2,890,000 rounded, or roughly \$196 per-square-foot.

Edgewood-Johnson questioned Cook, asking him if his conclusions included any special value to Walgreens or any use-value to Walgreens. Cook replied he did not include any special use value. Rather, his conclusions of value represent the value of

the property as occupied, in its current use. He recognizes that appraiser's use the term "use value" and that the courts refer the term "value in use"; as such, the terminology creates confusion. Nevertheless, he was clear that his conclusions do not include any special use value associated with the Walgreens business or goodwill in his appraisal.

## **Conclusions of Law**

PAAB has jurisdiction of this matter under Iowa Code sections 421.1A and 441.37A (2013). PAAB is an agency and the provisions of the Administrative Procedure Act apply to it. Iowa Code § 17A.2(1). This appeal is a contested case. § 441.37A(1)(b). PAAB considers only those grounds presented to or considered by the Board of Review, but determines anew all questions arising before the Board of Review related to the liability of the property to assessment or the assessed amount. §§ 441.37A(1)(a-b). New or additional evidence may be introduced, and PAAB considers the record as a whole and all of the evidence regardless of who introduced it. § 441.37A(3)(a); *see also Hy-Vee, Inc. v. Employment Appeal Bd.*, 710 N.W.2d 1, 3 (Iowa 2005). There is no presumption that the assessed value is correct. § 441.37A(3)(a).

### ***General Principles of Law Applicable to Assessment of Real Property***

In Iowa, property is assessed for taxation purposes following Iowa Code section 441.21. Iowa Code subsections 441.21(1)(a) and (1)(b) require property subject to taxation to be assessed at its actual value, or fair market value. *Soifer*, 759 N.W.2d 778.

*"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, neither being under any compulsion to buy or sell and each being familiar with all the facts relating to the particular property.

§ 441.21(1)(b). In determining market value, "[s]ales prices of the property or comparable property in normal transactions reflecting market value, and the probable availability or unavailability of persons interested in purchasing the property, shall be taken into consideration." *Id.* Using the sales price of the property, or sales of

comparable properties, is the preferred method of valuing real property in Iowa. *Id.*; *Compiano*, 771 N.W.2d at 398; *Soifer*, 759 N.W.2d at 779; *Heritage Cablevision v. Bd. of Review of Mason City*, 457 N.W.2d 594, 597 (Iowa 1990). “[A]bnormal transactions not reflecting market value shall not be taken into account or shall be adjusted to eliminate the effect of factors which distort market value.” § 441.21(1)(b). Abnormal transactions include, but are not limited to, foreclosure or other forced sales, contract sales, or discounted purchase transactions. *Id.*

“[A]lternative methods to the comparable sales approach to valuation of property cannot be used when *adequate* evidence of comparable sales is available to *readily* establish market value by that method.” *Compiano*, 771 N.W.2d at 398 (emphasis added). “Thus, a witness must first establish that evidence of comparable sales was not available to establish market value under the comparable-sales approach before the other approaches to valuation become competent evidence in a tax assessment proceeding.” *Id.* (citing *Soifer*, 759 N.W.2d, at 782); *Carlson Co. v. Bd. of Review of Clinton*, 572 N.W.2d 146, 150 (Iowa 1997). The first step in this process is determining if *comparable* sales exist. *Soifer*, 759 N.W.2d at 783. If PAAB is not persuaded as to the comparability of the properties, then it “cannot consider the sales prices of those” properties. *Id.* at 782 (citing *Bartlett & Co. Grain Co. v. Bd. of Review of Sioux City*, 253 N.W.2d 86, 88 (Iowa 1977)).

Whether other property is sufficiently similar and its sale sufficiently normal to be considered on the question of value is left to the sound discretion of the trial court.

*Id.* at 783 (citing *Bartlett & Co. Grain*, 253 N.W.2d at 94).

Similar does not mean identical and properties may be considered similar even if they possess various points of difference. *Id.* (other citations omitted). “Factors that bear on the competency of evidence of other sales include, with respect to the property, its ‘[s]ize, use, location and character,’ and, with respect to the sale, its nature and timing. *Id.* (other citations omitted). Admitted sales must be adjusted “to account for differences between the comparable property and the assessed property to the extent

any differences would distort the market value of the assessed property in the absence of such adjustments. *Id.* (other citations omitted).

However, where PAAB is convinced that comparable sales do not exist or cannot readily determine market value than other factors such as cost and income can be used. § 441.21(1)(b); *Compiano*, 771 N.W.2d at 398 (citing *Soifer*, 759 N.W.2d at 782); *Carlson Co.*, 572 N.W.2d at 150; § 441.21(2).

Finally, assessors are permitted to consider the use of property as a going concern in its valuation. *Riso v. Pottawattamie Cnty. Bd. of Review*, 362 N.W.2d 513, 517 (Iowa 1985). When an assessor values property as a going concern, “he is merely following the rule that he must consider conditions as they are.” *Soifer*, 759 N.W.2d at 788 (quoting *Maytag Co. v. Partridge*, 210 N.W.2d 584, 590 (Iowa 1973)). The assessor is “recognizing the effect of the use upon the value of the property itself. He is not adding on separate items for good will, patents, or personnel.” *Id.*

Presumably another competent retail store could step into Walgreen’s shoes and operate this property.” *Maytag Co.*, 210 N.W.2d at 591.

### ***Claim of Over-Assessment***

To prevail on a claim that an assessment is for more than authorized by section 441.21(1), the law requires two showings. *Heritage Cablevision*, 457 N.W.2d at 597. First, the record must show the property is over assessed; and second, what the fair market value of the property should be. *Id.*; *Boekeloo*, 529 N.W.2d at 276-277. If PAAB “determines the grounds of protest have been established, it must then determine the value or correct assessment of the property.” *Compiano*, 771 N.W.2d at 397. Here, PAAB “makes its independent determination of the value based on all the evidence.” *Id.*

## ***Burden of Proof***

Initially, the burden of proof in an assessment protest rests with the taxpayer, who “must establish a ground for protest by a preponderance of the evidence.” *Compiano v. Polk Cnty. Bd. of Review*, 771 N.W.2d 392, 396 (Iowa 2009). However, if the taxpayer “offers competent evidence by at least two disinterested witnesses that the market value of the property is less than the market value determined by the assessor, the burden shifts to the board of review to uphold the assessed value.” *Id.* at 396-97; § 441.21(3). Failure to shift the burden of proof is not equivalent to failing to satisfy the burden of proof. *Id.* at 397. “Ultimately, the burden of proof is one of persuasion” which “comes into play after all of the evidence is introduced at hearing.” *Id.* at 397 n.3.

“The statute not only requires two disinterested witness, it also specifically requires the evidence offered by a disinterested witness to be competent before the burden of proof shifts to the board.” *Id.* at 398. “Evidence is competent under the statute when it complies with the statutory scheme for property valuation for tax assessment purposes.” *Id.* “[M]arket-value testimony by a taxpayer’s witness under a comparable-sales approach is ‘competent’ only if the properties upon which the witnesses based their opinions were comparable.” *Soifer v. Floyd County Bd. of Review*, 759 N.W.2d 775, 783 (Iowa 2009) (noting “If the distorting sale factors or the points of difference between the assessed property and the other property are not quantifiable so as to permit the required adjustments, the other property will not be considered comparable.”); *Boekeloo*, 529 N.W.2d at 279; *Bartlett & Co. Grain*, 253 N.W.2d at 88. If they are, an opinion would “constitute ‘competent evidence’ and the burden of persuasion” shifts, “otherwise it does not shift.” *Bartlett & Co. Grain*, 253 N.W.2d at 88; *Soifer*, 759 N.W.2d at 783. However, the *Soifer* Court also stated the approach followed in Iowa is “[W]here the properties are reasonably similar, and a qualified expert states his opinion that they are sufficiently comparable for appraisal purposes, it is better to leave the dissimilarities to examination and cross-examination than to exclude the testimony altogether.” *Id.* (internal citations omitted). Just because the evidence is competent, however, does not mean it is credible. *Homemakers Plaza, Inc. v. Polk Cnty. Bd. of Review*, 2013 WL 105220 (Iowa Ct. App. Jan. 9, 2013) (citing *Soifer*, 759 N.W.2d at 785).

“Factors that bear on the competency of evidence of other sales include, with respect to the property, its ‘[s]ize, use, location and character,’ and, with respect to the sale, its nature and timing. *Id.* at 783 (other citations omitted). Likewise, “[t]he use to which comparable properties are put need not be identical to the use of the assessed property.” *Hy-Vee Food Stores, Inc. v. Carroll Cnty. Bd. of Review*, No. 3-546 / 12-1526 (Iowa Ct. App. October 2, 2013) (unpublished) (citing *Soifer*, 759 N.W.2d at 785). “Nonetheless, a difference in use does affect the persuasiveness of such evidence because ‘as differences increase the weight to be given to the sale price of the other property must of course be correspondingly reduced.’ ” *Soifer*, 759 N.W.2d at 785 (quoting *Bartlett & Co. Grain*, 253 N.W.2d at 93).

### ***Analysis***

It is uncontroverted that Walgreen’s business model is to enter into long-term leases for their built-to-suit properties. It would also appear their rent is then typically above market. PAAB must determine from the record the subject property’s fee simple value for assessment. Fee simple interest is absolute ownership unencumbered by any other interests or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power and escheat. (Ex. 2, p. 2).

The record contains three appraisals, two of which suggest the market value of the property is below the current assessment, and another which suggests the current assessment, at the very least, is reasonable. The three appraisers approached the assignment similarly; all developing the sales comparison approach; and two of the appraisers (Anderson and Cook) developed all three approaches to value.

First, Edgewood-Johnson contends that only fee-simple sales should have been used as comparable sales in this case. In support of this contention, Edgewood-Johnson cites the Appraisal Institute. (Ex. 2, p. 6; APPRAISAL INSTITUTE, *THE APPRAISAL OF REAL ESTATE* (14th ed. 2013)). However, the citation does not suggest properties that have different types of rights at the time of sale should never be used, but rather that these different sales may require diligence and research. Moreover, the same source notes, “[a]lthough it is usually not recommended that the sale of a leasehold interest be compared to a fee simple estate, the limited availability of sales of directly

comparable interests sometimes makes this necessary.” APPRAISAL INSTITUTE, THE APPRAISAL OF REAL ESTATE 407. In this case, Cook used leased-fee sales. He adjusted two of the leased-fee sales downward 25% for this factor and declined to adjust a third leased-fee sale asserting his analysis of it compared to the other sales did not support such an adjustment. Additionally, in his reconciliation of value, Cook acknowledged the use of the leased-fee sales in his sales comparison approach may have driven the conclusion of value by this approach upward. Therefore, he gave the approach the less weight in his final conclusion of value.

As it pertains to the remaining appraisals and evidence, even if fee-simple sales are preferred because they may require no adjustment for the type of sale, the fee-simple sales must still be reasonably comparable properties to result in a reliable and credible indication of value for the subject property. If fee-simple sales are selected that are simply not comparable to the subject property, they are no more reliable or credible than leased-fee or other types of sales.

We find that Anderson and Krentler both concluded a value approximating a fee-simple interest. However, the fee simple value they concluded was not of a property resembling or similar to the subject property. Rather, their value conclusions more-or-less represent the fee simple interest of a vacant, retail building, which was vacant for a much longer period of time than the subject property’s estimated exposure time and fails to capture the on-going current use of the subject property. Moreover, their conclusions represent the value of a property that is of inferior quality and design than the subject property. Essentially, Anderson and Krentler failed to account for conditions as they currently are and capture the going-concern value of the subject property.

The sales upon which Anderson and Krentler relied are generally inferior to the subject in location, quality, and condition. All were vacant for significant periods prior to purchase and much longer than either appraiser estimated as the exposure period for the subject. We further question their use when acknowledging other sales that occurred in the Cedar Rapids area included in the Board of Review record. (See Barron Corporate Tax Solutions, Ad Valorem Consulting Report, pp. 4-5).

Additionally, with only one exception, neither appraiser adjusted their selected comparables to reflect any modifications made by the buyer to convert the property into

an operating retail enterprise. The subject is undoubtedly an operating retail enterprise and Iowa law has consistently held that a property is to be assessed at its going concern value. *Riso*, 362 N.W.2d at 517. Yet, without giving any consideration to the amounts expended by the purchaser to convert the vacant comparable properties into an operating retail enterprise, Anderson's and Krentler's appraisals more or less value the subject as if it were a vacant building with no operating retail enterprise.

We are unconvinced by Edgewood-Johnson's analogy of the subject property to a residential property. (Appellant's Post-Hearing Reply Brief, p. 3). This is not a situation involving a residential property that, in most cases, still has roughly full utility to the buyer, despite the fact that the buyer may wish to make some modifications upon purchase. An unmodified, vacant retail space does not have the same utility to a commercial buyer or renter needing shelving, counter space, signage, restroom facilities, and other business specific modifications to successfully operate a retail enterprise.

Krentler and Anderson's income approaches suffer from a similar deficiency. Anderson determined a rental rate using properties of inferior quality, condition, and location. While he indicated in his report that he made adjustments to account for these differences, the adjustments are neither shown nor apparent in his reconciled rental rate that falls below the rents of the properties most comparable to the subject.

For his part, Krentler identified his adjustments to his rent comparables, but we find his adjustments do not reliably reflect the subject's fair market rent. It is telling that Krentler's reconciled rental rate is at or lower than five of the eight *unadjusted* rentals he selected for comparison. Moreover, four of his five selected comparables in the Cedar Rapids metro area, which includes Marion, have unadjusted rental/listing rates at or above Krentler's reconciled rental rate.

In particular, Comparable Rental 7 demonstrates that Krentler's reconciled rental rate does not reflect the subject's fair market rent. It is undisputed that this property is in inferior condition, quality, and is much older than the subject. Nonetheless, Krentler's reconciled rental rate of \$9.00 PSF falls below the unadjusted \$9.67 rental rate of this property.

Additionally, because we do not consider the rental and sale properties sufficiently similar, relying on them to extract a capitalization rate would lead to an artificially high rate. Both Anderson and Krentler determined similar overall rates at 9.23% and 9.31% respectively. Even assuming their average capitalization rate of 9.27% is more reliable than Cook's capitalization rate of 8.50% -- applying this to Cook's NOI of roughly \$228,018, results in a conclusion higher than the current assessment and does not support the assertion that the subject property is assessed for more than authorized by law.

Turning to the cost approach, only Anderson and Cook determined a value using this method. We conclude that Anderson's unexplained 76.98% economic obsolescence adjustment was patently unreasonable for the subject property.

Assuming, without deciding, the sales considered by Anderson and Krentler are sufficiently comparable to be considered competent evidence and shift the burden of proof to the Board of Review, we ultimately conclude that the Board of Review has sustained its burden of showing that the assessment is not excessive. We find that Anderson's and Krentler's appraisals are not credible reflections of the subject property's going concern, fair market value as of January 1, 2013. Their selection of sales and lease properties is questionable. Many of the properties bear little resemblance to the subject and most had extended periods of vacancy prior to sale. Moreover, we are not persuaded their adjustments to these sales and leases adequately account for the subject's current condition, quality, and use, and therefore their conclusions result in an undervaluation of the subject property. In contrast, Cook's appraisal relied upon properties that are more comparable to the subject and more closely approximates the going-concern value required by law.

While Edgewood-Johnson focuses its arguments on deficiencies it asserts exist in Cook's appraisal, the fact remains that the property's assessment of \$2,212,656 is set well below the amount Cook concludes as the fair market value. Against this backdrop, Edgewood-Johnson's assertion that Cook's appraisal methodology overvalues the property does not also mean the assessment is excessive. Because of the lack of reliable and credible evidence showing the property is assessed for more than authorized by law, we affirm the assessment.

## Order

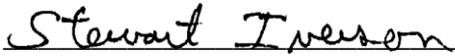
IT IS THEREFORE ORDERED the January 1, 2013, assessment of the subject property as set by the Board of Review is affirmed.

This Order shall be considered final agency action for the purposes of Iowa Code Chapter 17A (2015). Any application for reconsideration or rehearing shall be filed with PAAB within 20 days of the date of this Order and comply with the requirements of PAAB administrative rules. Such application will stay the period for filing a judicial review action. Any judicial action challenging this Order shall be filed in the district court where the property is located within 20 days of the date of this Order and comply with the requirements of Iowa Code sections 441.38; 441.38B, 441.39; and Chapter 17A.

Dated this 21st day of September, 2015.



Karen Oberman, Presiding Officer



Stewart Iverson, Board Chair



Jacqueline Rypma, Board Member

Copies to:

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