Electronically Filed
2019-07-29 14:40:52
PAAB

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

PAAB Docket No. 2017-052-00176C

Parcel No. 0636301004

Lowe's Home Centers, LLC,

Appellant,

vs.

Johnson County Board of Review,

Appellee.

Introduction

This appeal came on for hearing before the Property Assessment Appeal Board (PAAB) on July 30, 2018. After obtaining a transcript of the proceedings, the parties filed post hearing briefs and the record was closed as of March 16, 2019. Attorney Ryan Gibbs represented Lowe's Home Centers, LLC (Lowes). Assistant Johnson County Attorney Ryan Maas represented the Board of Review.

Lowes owns a commercial property located at 2701 2nd Street, Coralville. The property's January 1, 2017 assessment was set at $11,865,600, allocated as $5,052,400 in land value, and $6,813,200 in improvement value. (Ex. A).

Lowes petitioned the Board of Review claiming the subject property was assessed for more than the value authorized by law under Iowa Code section 441.37(1)(a)(1)(b). The Board of Review denied the petition. Lowes reasserted its claim to PAAB.

Findings of Fact

The subject property is a large commercial retail store built in 2003. It has 131,569 square feet of gross building area (GBA), and a 20,300 square-foot outdoor sales and garden area. The 21.78-acre site is also improved with 310,000 square feet of paving. (Ex. A).

Johnson County Assessor Tom Van Buer testified about the market conditions in Johnson County, the assessment process, and a history of the subject property. Based on his observations, over the last several years the strength of the Coralville commercial market has been increasing, vacancy rates have been low, and there has been a steady increase in rental rates. (Tr. 301, ln. 8 to Tr. 303, ln. 7). Van Buer reported commercial development is occurring where the subject property is located, as well as further north into North Liberty and Tiffin, which are two of the top five fastest growing cities in Iowa. (Tr. 303, ln. 22 to Tr. 305, ln. 5).

Van Buer testified that Iowa law requires assessors to value property as it is actually used. (Tr. 305, ln. 10-21). He explained that he relied on the income approach to determine the subject property's January 1, 2017 assessed value. (Tr. 306, ln. 23 to 307, ln. 24). The cost approach was also developed, but used only to allocate the land value based on the total value determined in the income approach. (Tr. 308, ln. 13 to Tr. 310, ln. 16).

Coralville City Engineer Dan Holderness testified for the Board of Review. Holderness has oversight of the engineering department including the review of site plans to ensure they conform to City codes and ordinances. (Tr. 149, ln. 8 to Tr. 151, ln. 1). He was directly involved with the approval process for the site plans for the subject property. (Tr. 152, ln. 11-14).

Holderness testified about the development agreement that was created and approved between the City of Coralville and Lowes for the subject property. (Exs. D & E). (Tr. 152, ln. 15 to Tr. 156, ln. 18). The site plans include a 65-foot tall interstate pylon sign with Lowes logo that is visible from Interstate 80. (Ex. E, p. C200). (Tr. 156, ln. 19-25). Holderness explained the sign is located on the higher portion of the subject site. (Tr. 157, ln. 7-12). Holderness testified that Lowes initial proposal was to use retaining walls to create the necessary building site while maintaining the required green and open space required by the City. However it was later determined that the retaining walls would be cost prohibitive, so a different approach was agreed upon that included a sustainable earth berm with vegetation. (Tr. 159, ln. 13 to Tr. 160, ln. 1). Lowes has an obligation to install and maintain the landscaping shown on the site plans. (Ex. D, pp. 3-4; Ex. E, p. C500; Tr. 153, ln. 22 to Tr. 155, ln. 10).

As construction commenced, Holderness became aware that the subject building was visible from Interstate 80, which he did not believe was compliant with the approved site plans. (Ex. F, p. 1; Tr. 161, ln. 7-22). Although not conceding its construction was non-compliant with the development agreement, Lowes offered several compromises that included installation of additional plantings. (Ex. F, pp. 2-3; Tr. 161, ln. 22 to Tr. 162, ln. 4).

The record includes two appraisals valuing the property as of January 1, 2017. Laurence Allen, Allen and Associates Appraisal Group, Inc., Troy, Michigan, completed an appraisal for Lowes and testified on its behalf. (Ex. 2). Russ Manternach, Commercial Appraisers of Iowa, Inc., West Des Moines completed an appraisal for the Board of Review. (Ex. B). Both parties submitted Manternach's appraisal and called him as a witness. (Ex. 1, B).[1] Both appraisers are qualified to appraise the property.

The following table summarizes the appraisers' approaches to value and their respective conclusions as of January 1, 2017.

Appraiser	Sales Approach	Income Approach	Cost Approach	Final Opinion of Value
Allen	$5,220,000	$5,100,000	Not Developed	$5,200,000
Manternach	$10,800,000	$11,000,000	$11,300,000	$10,940,000

[1] Exhibit 1 and Exhibit B are both appraisals Manternach completed on the subject property for this property assessment litigation. The appraisals differ slightly, but are substantially similar. Exhibit B corrects for an error in site size in Exhibit 1. (Tr. 257, ln. 14 to Tr. 258, ln. 5). Exhibit B more accurately reflects the correct site size as of January 1, 2017. Unless specifically noted, all references to Manternach's appraisal in the Order will be to Exhibit B.

Allen Appraisal

Allen indicates he is valuing the “as is”, fee simple market value of the subject property. (Ex. 2, pp. 12-13, 15)[2]. He testified the subject property was occupied by Lowes as of January 1, 2017, and that Lowes had no plans to vacate the property or the market area. (Tr. 124, ln. 15 to Tr. 125, ln. 6). He did not identify he was valuing the property under the hypothetical condition it was vacant.

Allen testified that the subject site is in a good location with good traffic exposure, albeit in a small market that he defined as smaller than the Des Moines or Chicago markets. (Tr. 99, ln. 5-21). His appraisal identifies that the subject’s neighborhood is in a growth cycle with projected growth through 2022. (Ex. 2, p. 31). Vacant land in the neighborhood is available for development and there are approved plans for more commercial development. (Ex. 2, p. 31). He acknowledges the neighborhood has an established transportation network and good access to major freeways with a full-service interchange. (Ex. 2, p. 32).

In his highest and best use analysis, Allen stated “[i]t is concluded that the value of the subject property as improved exceeds the market value of the subject property as vacant.” (Ex. 2, p. 62). Allen did not estimate the property’s land value when completing his appraisal. He concluded retail use is the maximally productive use. (Ex. 2, p. 62).

Allen described the subject site as generally irregular. During his on-site inspection, Allen noted that while the improvements were situated on a generally level portion of the site, there were wide variations of elevation on the northern and western portions. (Ex. 2, p. 33). He also observed a water retention area on the southeast portion of the subject site. (Ex. 2, p. 35-36).

Allen noted that the elevation increased approximately 30 feet from the back of the improvements to the top of the hill that buffers the Interstate-80 entrance ramp. (Ex. 3; Tr. 61, ln. 17 – Tr. 62, ln. 4). In Allen’s opinion the topography of this portion of the site limits the improvements’ visibility. (Tr. 62, ln. 25 – Tr. 63, ln. 8). Later, Allen acknowledged that Lowes stanchion sign, with visibility to Interstate 80, is located on this portion of the site. (Tr. 119, ln. 21 to Tr. 120, ln. 5).

[2] Citations for Allen’s appraisal are based on the “page #” in the most upper right-hand corner of Exhibit 2.

There are also 4 acres to the west of the improvements, which Allen testified was a 60-foot hill. (Ex. 3; Tr. 65, ln. 1-11). In Allen's opinion this 4-acre portion of the site did not contribute any additional value to the subject property because it would cost more to excavate the site than the land would be worth. (Tr. 65, ln. 16 to Tr. 66, ln. 8). He also explained that Lowes has been willing to sell the site since 2003 because it does not need it. (Tr. 66, ln. 9-16). Allen did not explain what marketing, if any, Lowes has undertaken in its effort to sell the site. Despite his opinion that portions of the subject site are unusable and have no value, he testified these areas also do not detract value. (Tr. 68, ln. 13-24). Allen testified that the site is very functional and comparable to other property. (Tr. 68, ln. 13-18).

Allen testified that the Iowa Department of Transportation (IDOT) was in the process of acquiring 0.43 acres of the subject site as of January 1, 2017, which it subsequently purchased for $108,000. (Ex. 2, p. 6; Ex. 5, p. 20[3]; Tr. 69, ln 8 to Tr.71, ln. 8). Allen does not believe the IDOT appraisal reflects the market value of the subject site, nor does he believe the $108,000 negotiated price for 0.43 acres is reflective of market value. He acknowledged he did not develop a market value of the subject site. (Tr. 130, ln. 9 to Tr. 132, ln 2). An additional 0.02-acre portion of the site was deeded to the State at approximately the same time for $0. (Ex 2, p. 16).

Allen identified the subject improvements as a big-box store, which he defines as a retail store larger than 80,000 square feet. (Tr. 22, ln. 4-10). In his opinion, it is important to delineate size differences in box retail properties to discern between big-box, mid-box, and junior-box stores. He testified that big-box stores are larger and typically lease for less per-square-foot than junior-box stores; and that junior-box stores have a wider market with more potential users. (Tr. 22, ln. 20 to Tr. 23, ln. 4).

Allen estimated the subject has 553 parking spots, which is less than the 655 spaces required by the City ordinance. (Ex. 2, p. 55-56). Allen testified there is insufficient parking to meet the required ordinance but acknowledged that cities often give variances when it would be a hardship to add additional parking. (Tr. 66, ln. 17 to

[3] Citations for the IDOT appraisal are based on the "page #" in the most upper right-hand corner of Exhibit 5.

Tr. 67, In. 24). Holderness testified that because the subject's site plan was approved, he assumed there was adequate parking for the size of the store. (Tr. 160, ln. 5-15).

Allen developed the sales comparison and income approaches to value in arriving at his January 1, 2017 opinion of fair market value. He did not develop the cost approach asserting it was n**o**t a reliable approach "due to the age of the improvements and the large amounts of obsolescence exhibited in the market for properties such as this, along with the lack of use of this approach by participants in the market for this type of property." (Ex. 2, p. 63). In his opinion, typical buyers of a property like the subject would not purchase it based on a cost analysis and "big box properties similar to the subject generally have a market to large retailers who have their own particular design and layout and façade requirements so that when they're sold, they're sold for quite a bit less than replacement costs," which impacts depreciation. (Tr. 24, ln. 7-21).

1. Allen's Sales Comparison Approach

Allen included seven improved properties for his sales comparison analysis. His primary search criteria for comparable sales included building size. He indicated he preferred big-box stores sold as fee-simple sales so he could forgo making adjustments for leases, lease terms, or tenant quality. (Tr. 26, ln. 20 to Tr. 27, ln. 4). Allen believes it is too difficult to adjust leased fee sales, especially with big-box stores. Allen did not use leased-fee sales "because most of the sales are subject to above market build-to-suit leases and are at prices reflective of the credit of the tenant." (Ex. 2, p. 64). Likewise, he did not use sale/leasebacks. (Ex. 2, p. 64).

He testified there were many fee simple sales available because "a lot of big-box stores have been closing so there's been a number of them on the market." (Tr. 27, ln. 21 to Tr. 28, ln 3). He later testified that a "significant number" of big-box stores are bought for "a lot of different uses," including churches or industrial distribution for example. (Tr. 31, ln. 16-23). He wanted to select comparables that had a similar highest and best use as the subject, which he identified as retail use. (Tr. 31, 24 to Tr. 32, ln. 2). Later, Allen was asked if it was appropriate to say that his search included big-box sales over 80,000 square feet of building area with a requirement that they be for continued retail use. Allen clarified that his concern was retail use, but not necessarily *continued* retail use, which he interpreted to imply that "Lowes is going to continue to operate that after the sale." (Emphasis added). (Tr. 36, ln. 24 to Tr. 37, ln. 9).

Allen also indicated another search criteria was that "these are all home improvement stores….and that's why they're selected." (Tr. 28, ln. 18-22). Other factors included similar sales timeframe, economic location, building size, design, and age. (Ex. 2, p. 64, Tr. 28, ln. 23 to Tr. 29, ln. 4).

Allen's comparable sales are summarized in the following table. (Ex. 2, p. 64-80).

Address	Sale Date	Sale Price	Building Area (SF)	Sale Price/SF	Adjusted SP/SF
Subject			131,074[4]		
1 - Davenport, IA	Dec-14	$6,250,000	147,767	$42.30	$50.32
2 - Brown Deer, WI	Dec-13	$4,000,000	139,571	$28.66	$30.55
3 - Holland Twp., MI	Jan-14	$1,750,000	103,540	$16.90	$18.21
4 - Oswego, IL	Feb-14	$3,650,000	140,061	$26.06	$22.75
5 - Elgin Twp., IL	Apr-16	$5,300,000	139,410	$38.02	$28.77
6 - Ankeny, IA	Jun-14	$1,914,940	66,643	$28.73	$33.87
7 - Clinton, IA	Aug-15	$2,055,000	89,553	$22.95	$36.42

All of the sales were adjusted upward for market conditions (time adjustment) between 2% to 8% and Allen testified that the market has been increasing since 2014. (Ex. 2, pp. 77; Tr. 46, ln. 21 to Tr. 47, ln. 22).

Allen also adjusted the sales for arterial and demographic attributes. He explained that arterial attributes relate to traffic, visibility, and access to the site. (Tr. 48, ln. 2-8). He described the demographic attributes reflect population density and household income within five miles of the subject and each comparable property. This allows him to determine which locations are higher or lower income areas and population density. (Tr. 50, ln. 24 to Tr. 51, ln. 8). We note the combined adjustment of these factors would consider differences in location between the sales and the subject property. Considering these adjustments, Allen considered Sales 4 and 5 to have superior locations as compared with the subject; while the remaining sales had inferior or similar locations.

[4] This reflects only the actual building area and does not include the garden center.

Only one comparable (Sale 6) was adjusted for differences in building size. (Ex. 2, p. 78-79). Allen testified that based on his research, properties with less than 80,000 square feet of building area would be classified as mid-box or junior-box sales, which would sell and lease for more per-square-foot than a big-box store. (Tr. 52, ln. 1-10).

Comparable Sale 1 was a vacant American TV Store that closed in early 2014. The appraisal indicates American TV went into receivership. (Ex. 2, p. 67). Following the purchase, a portion of the building was converted to an Ashley Furniture store. The remainder of the building was still available for lease in 2016. (Ex. 2, p. 67). Allen reported this property "was designed and built as a furniture store with greater levels of finishing than a home improvement store." (Ex. 2, p. 80). Yet he adjusted it upward 3% for age and condition. (Ex. 2, p. 79). Allen testified this is the most proximate sale to the subject property; it had an overall upward 10% adjustment for its location factors which were the arterial and demographic attributes. (Ex. 2, p. 79).

Comparable Sale 2 was a former Lowe's Home Improvement Center that closed in 2011. In Allen's opinion it had similar finish to the subject property and was slightly newer having been built in 2006. It was sold to and subsequently occupied by Walmart. (Ex. 2, p. 68). Allen acknowledged this property sat vacant from 2011 until 2013 when Walmart purchased it. (Tr. 103, ln. 12-18). Allen testified this property is in a "high traffic area with significantly more population density than the subject property." (Tr. 31, ln. 6-9). It was adjusted as being inferior in location to the subject with a net adjustment of +5% for arterial attributes and demographic attributes. (Ex. 2, p. 79).

Comparable Sale 3 was a former Home Depot. This sale had inferior arterial and similar demographic attributes to the subject property. (Ex. 2, pp. 77-78). It was on the market for 2 years before it was purchased in 2013 for $1,250,000 by Rural King, a Midwestern chain of farm and home stores. After purchasing the property, Rural King's business focus changed and it subsequently sold the property to a developer for $1,750,000, who intended to lease a portion of the property to Dick's Sporting Goods. (Ex. 2, p. 69). Allen's recollection was that this property was vacant from early 2011 until its sale to Dick's Sporting Goods in January 2014. (Tr. 104, ln. 3-17). Allen testified that the Dick's Sporting Goods did not need the entire building and the developer leased the remaining space to other tenants. (Tr. 33, ln. 12-17). He also acknowledged that it was a "significant cost to convert" this property to multi-tenant but he did not adjust the sale price to reflect the post-sale renovation. (Tr. 104, ln. 18 to Tr. 105, ln. 2).

Comparable Sales 4 and 5 were both former Lowe's Home Improvement stores located in Illinois. Allen considered both sales superior in overall location. (Ex. 2, p. 79). The Board of Review asserted Lowes closed its store operations for Sale 4 in October of 2011. Allen acknowledged that if that were true, then Sale 4 sat vacant for roughly two-and-a-half years before it transferred. (Tr. 105, ln. 19 to Tr. 106, ln. 2). Allen also testified that Sale 5 had been vacant for five years when it sold. (Tr. 107, ln. 22 to Tr. 108, ln. 6). Sale 4 was converted to multi-tenant use. (Ex. 2, p. 70).

Comparable Sales 4 and 5 sold with restrictive covenants limiting them from being used as a home improvement store for twenty years and five years respectively from the date of sale. Comparable Sale 4 was purchased by an investor and a portion of the building is occupied by Hobby Lobby. (Ex. 2, p. 70).

Allen acknowledged a deed restriction could affect the purchase but reported the restrictive covenants on Sales 4 and 5 "were drafted after the potential purchasers identified what the future use of the property would be and the prices were established." (Ex. 2, p. 74; Tr. 42, ln. 9 – Tr. 43, ln. 16). Additionally, based on interviews with market participants and comparing sales with and without deed restrictions, Allen concluded that deed restrictions do not generally have an effect on the price paid for big- box store properties. (Ex. 2, p. 74-75). In his opinion, the deed restrictions did not conflict with the buyers' plans for the property or affect the sales price for Sales 4 and 5 and he did not make any adjustments to these sales. (Tr. 44, ln. 1-4). We note, however, that Allen only specifically referred to speaking with Lowes, the grantor, about Comparable Sales 4 and 5. (Tr. 43, ln. 17-22). We find Lowes is not an unbiased source for this information because one of its stores is the subject of this appeal.

Allen submitted an analysis of properties that had sold with and without deed restrictions to support his position that no adjustment was warranted. (Ex. 2, pp. 74-75). But this analysis does not adjust for any other differences between the properties which is required to isolate the element of comparison that is being analyzed. It also does not report the length of deed restrictions that are being compared, which could also have an effect on the conclusions. Notably, Comparables 4 and 5 are both former Lowes, located near Chicago, with twenty- and five-year deed restrictions that sold for $3,650,000 and $5,300,000 respectively. Facially, this evidence suggests the length of a deed restriction may have an impact on price.

As it related to Comparable Sales 3, 4, and 5, Manternach testified he assumed these properties are selling for a reason, perhaps because they are non-performing stores, are in a bad location, or are not profitable. (Tr. 265, ln. 19-25). He also noted that because they sold with deed restrictions in place it changes the properties' highest and best use because they cannot be used for what they were designed for and thus are going to sell for "significantly less." (Tr. 266, ln. 1-6).

Comparable Sale 6 was a former Dahl's, situated on an 8.06-acre site, in Ankeny. (Ex. 2, p. 72). Allen selected this sale because of its location in Iowa. He made an upward 30% adjustment to this sale because it was in receivership and as a result had a "lack of marketing" which would have likely resulted in a higher price. (Ex. 2, pp. 75 & 79; Tr. 45, ln. 12 to Tr. 46, ln. 1). In fact, his appraisal reports it was on the market for "less than one day". (Ex. 2, p. 72). He explained this property was "designed and built as a supermarket with higher levels of finishing." (Ex. 2, p. 80). It was adjusted downward 4% for age and condition. (Ex. 2, p. 79). Sale 6 is the only sale Allen adjusted for building size. He adjusted it downward 10%. (Ex. 2, p. 79).

Allen explained that Comparable Sale 6 was purchased by a developer that intended to subdivide the property. (Ex. 2, p. 72). He testified a developer "bought it to make money off selling out-lots and then leasing this property." (Tr. 36, ln. 15-18). After the sale, the site was approved for three, one-acre parcel out-lots, which the developer believed he could sell for between $750,000 and $1,000,000 each. (Ex. 2, p. 72). Despite reporting the original site size of Sale 6, Allen did not report the actual sale price but rather reported an adjusted price of $1,914,940. (Ex. 2, pp. 72 & 79). He testified that he adjusted the actual sale price by projecting a sale of two out-lots, considering leasing commissions and then discounting it 20% for a developer's profit and interest to the profit. (Tr. 38, ln. 7-14; Tr. 112, ln. 18-25). It does not appear that

Allen considered that the subdivision of the property would impact the land-to-building ratio of the property. He made no land-to-building ratio adjustments for this property, or for any other sales comparables he considered. He also does not account for how the subdivision would impact the utility of the original parcel.

The Board of Review asserted the original sale price was around $3,780,000 for 8.06 acres. Allen was unwilling to agree that was the actual sale price but conceded it sold for more than $3,000,000. (Tr. 108, ln. 25 to Tr. 109, ln. 16). Additionally, the Board of Review questioned why Allen would report an adjusted sale price but rely on the original site size. Allen never answered the question. (Tr. 109, ln. 17 to Tr. 110, ln. 13). Manternach testified that this property sold for $3.8 to $3.9 million dollars, which included approximately $600,000 of personal property. (Tr. 209, ln. 4-11).

Sale 7 is a former Target purchased by a local developer who converted the property to a multi-tenant facility with Hobby Lobby as the largest tenant, occupying 55,000 square feet. (Ex. 2, p. 73). Allen testified this property was located in “a major retail area of Clinton” yet this sale received the highest arterial/demographic attribute adjustments of 40%. (Ex. 2, p. 79; Tr. 39, ln.1-2). Allen explained these adjustments were based on his experience. (Tr. 113, ln. 3-19). Allen reports this property “was designed and built as a discount store with higher levels of finish.” (Ex. 2, p. 80). Despite this, he identified it as inferior in age and condition and adjusted it upward 7%. (Ex. 2, p. 79).

Several of the sales (Sales 1, 3, 4, and 7) had known costs to convert the improvements for the use of future tenants, or to be leased as a multi-tenant property. Allen acknowledged it is typical for buyers or developers of big-box stores to re-configure the property after purchase to meet their specific retail or business plan. Despite this, he did not adjust for any expenditure after the sale because, in his opinion, the expenditures do not represent deficiencies in the property but rather customization to fit a specific user’s business retail needs. (Ex. 2, p. 74; Tr. 39, ln. 6 to Tr. 41, ln. 8).

Despite not making adjustments for expenditures after the sale, he identified he made adjustments for age and condition. (Ex. 2, pp. 78-79). Allen testified that his age/condition adjustments were primarily based on age, and asserting there was no significant difference in the amount of deferred maintenance. (Tr. 55, ln. 5 to Tr. 56, ln. 15). In fact, his methodology adjusts "1% per year between the subject and the comparables as of their dates of sale for their differences in age." (Ex. 2, p. 78). Based on his methodology, he made no adjustments for differences in condition. In fact, his appraisal fails to identify the condition of most of his comparables at the time of sale. We note that several of Allen's sales sat vacant for several years and we are skeptical of assuming that they were in a similar physical condition as the subject at the time of their sale.

After adjustments, Allen's comparable properties indicate a range of value of $18.21 to $50.32 per-square-foot. (Ex. 2, p. 79). He considered multiple comparisons of his sales to the subject property, including which ones were most similar in size, age, design, location, and which were the most recent sales. Allen testified that he gave most reliance to Sales 1, 6, and 7 because they were located in Iowa. (Ex. 2, p. 80; Tr. 73, ln. 18-23). He also reviewed data of fifteen Lowes that sold across the country between 2010 and 2014. (Ex. 2, p. 80; Tr. 57, ln. 7-19). After his consideration of the data, he concluded an opinion of value by the sales comparison approach of $39.00 per-square-foot, or $5,111,886. (Ex. 2, p. 81). Allen then added the purchase price of the condemned 0.43-acres to arrive at a final conclusion of value by the sales comparison approach of $5,220,000. (Ex. 2, p. 81). Allen testified that he added in the condemnation value because it was his understanding that a buyer of the subject property on January 1, 2017 would have been entitled to those proceeds. (Tr. 89, ln. 19-24).

<u>2. Allen's Income Approach</u>

In his income approach, Allen identified twenty-one rent comparables. (Ex. 2, p. 83). He analyzed the leases in three categories: build-to-suit, big box, and junior box, which are summarized in the following table.

Lease Type	Low Lease Rate	High Lease Rate	Average Lease Rate
Built-to-Suit	$8.42	$13.50	$10.25
Big Box	$3.00	$6.00	$4.73
Junior Box	$5.50	$8.00	$7.03

Allen reported that it is possible several of the leases included tenant improvements but this information was unable to be verified. (Ex. 2, p. 84). He asserts that if tenant improvements were known and considered it would result in lower rents than he reported. (Ex. 2, p. 84). We find his lack of knowledge about the terms of the leases reduces the reliability of Allen's reported lease rates.

In Allen's opinion, build-to-suit leases reflect a custom building and do not represent market rent for an existing building. Additionally, he noted that junior box stores are typically smaller with higher rents. Therefore, in his opinion, the most relevant comparable leases are existing big-box leases. (Ex. 2, p. 84; Tr. 74, ln. 20 to Tr. 75, ln. 25).

Eleven of Allen's rent comparables were big-box leases, which include two active listings with asking lease prices of $5.00 per-square-foot. (Ex. 2, p. 83). His appraisal contains very little information about his comparable rentals, identifying only their tenant, location, size, and year built. The majority of the properties are older than the subject, some of them significantly so, and appear to be occupied by second-generation occupants. All of them are smaller in size than the subject. Most of the leases are dated; he provides only one lease comparable with a lease start date after January 1, 2015. Allen did not make any quantitative adjustments to these comparables, but suggests he may have considered adjustments in reconciling to his final rent determination.

He also relied on a CoStar[5] survey indicating an upward trend in lease rates from 2011 to 2016. (Ex. 2, p. 84). He believes the active listing would set the upper end of the lease range.

Allen also believed "the most similar comparables is (sic) *assumed* to have higher levels of tenant improvements, of which may have been included in the leases." (Emphasis added). (Ex. 2, p. 85). In his opinion, the subject property reflects a discount or building supply store which would require minimal tenant improvements, further warranting a lower rental rate than presented by his comparables. (Ex. 2, p. 85). We note the entirety of Allen's income approach ignores the subject's garden center area, thus we find reconciling to the lower end of the range unnecessary.

[5] CoStar is a provider of commercial real estate information.

Based on the foregoing, he selected the $4.75 per-square-foot as the most likely market rent for the subject property's 131,074 retail space ($622,602). (Ex. 2, pp. 85 & 87). He did not attribute any rent to the subject property's garden center asserting it is just a concrete pad with a canopy. In his opinion this type of space is not included in the rentable retail space and he has never seen an appraiser include it as such. (Tr. 77, ln. 6-21).

Allen also considered common area maintenance costs (CAM) and insurance as reimbursement income. He testified that typically it is the tenant that pays these costs. (Tr. 78, ln. 10-25). His estimated potential gross income is $851,981. (Ex. 2, p. 87).

Based on a review of the subject market, data from third party providers and conversations with local brokers, Allen estimated a total vacancy/credit loss of 8%. (Ex. 2, p. 85). Allen testified that he relied on an industry publication Dollars and Cents of Shopping Centers, and a survey from the Institute of Real Estate Management to estimate operating expenses totaling $272,555. (Ex. pp. 85-87; Tr. 80, ln. 17 to Tr. 81, ln. 15). He concluded a net operating income (NOI) of $511,267. (Ex. 2, p. 87).

Allen testified that there is no such thing as a fee simple capitalization rate because an unencumbered property, such as a property without a tenant in place, does not generate income. In developing a fee simple capitalization rate, he explained that factors such as the need to locate a tenant, the length of time to locate a tenant, potential tenant improvements, and lease negotiations would need to be considered. In his opinion this typically translates to a higher capitalization rate. (Ex. 2, p. 87; Tr. 82, ln. 5 to Tr. 83, ln. 3). He writes, "without a known tenant there is uncertainty of the strength of the tenant and term of the lease. There are additional uncertainties as to how long it will take to find a tenant and if any significant tenant improvements will be required to secure the tenant." (Ex. 2, p. 87). In his opinion, the best way to capture the risk involved with a fee simple property is to consider big-box stores with short remaining terms on their lease. (Tr. 83, ln. 12 to Tr. 84, ln. 9).

In developing his opinion of a capitalization rate for the subject property, Allen considered the band of investment analysis, investor surveys, and market extraction.

(Ex. 2, pp. 87-90). Using the band of investment, Allen concluded a range of 4.73% to 14.97%, with an average capitalization rate of 8.57%. (Ex. 2, pp. 87-88).

Allen reviewed PRICE WATERHOUSE COOPER's 2016 4th Quarter rates for non-institutional power centers and strip retail centers, and REALTYRATES.COM's 2017 1st Quarter rates for Retail – Free Standing properties. These surveys indicate an average capitalization rate range of 7.17% to 10.79%. (Ex. 2, p. 88). In addition, he considered CBRE's survey for the first half of 2017. (Ex. 2, pp. 88-90). Allen testified that the surveys represented capitalization rates for sales with a tenant in place, typically a credit tenant with a long-term lease. Therefore this analysis does not represent the risk of someone buying a property without a known tenant or lease term in place. (Tr. 86, ln. 12-18). Allen acknowledged that the non-institutional power centers and strip retail centers reported by PRICE WATERHOUSE COOPER refers to tenants that are "not the top credit," whereas Lowes would be classified as an institutional investment because of its "very strong credit." (Tr. 133, ln. 23 to Tr. 134, ln. 12).

He considered five comparable properties located in Michigan and Ohio. He believes this analysis mirrors the risk that is present in fee simple sales because the capitalization rates were extracted from big-box stores that had short-term leases in place when they sold. (Ex. 2, p. 89; Tr. 84, ln. 16-23). The indicated capitalization rates ranged from 17.18% to 28.78%. Allen noted the capitalization rates are high because they reflect the anticipated loss of income from the tenant in place, above market rents, and the cost of finding a new tenant. He acknowledged the upper-end of this range was set by a property that had Kmart as a tenant with two years left on its lease. (Tr. 85, ln.14-25). In fact, we note that three of the properties were Kmarts, which Allen had identified as experiencing a significant number of store closures. (Ex. 2, pp. 58-59). Moreover, based on the rent commence dates these properties are also significantly older than the subject. As a result, we do not believe these sales represent similar risks as the subject.

Allen repeatedly explained and indicated in his appraisal that he was attempting to estimate the higher risks associated with not having a known tenant or knowing how long it will take to find a tenant. Comparatively, he was less concerned with institutional investors who are more driven by the lease payments than the property. (Tr. 87, ln. 2-14). Based on the foregoing, Allen reconciled a capitalization rate of 9.50% and 9.78% when loaded for taxes. (Ex. 2, p. 90).

After capitalizing the NOI, Allen deducted $186,780 for leasing commissions and then added in the $108,000 purchase price of the condemned portion of the subject site. Based on this analysis he concluded an opinion of value of $5,150,000. (Ex. 2, p. 90-91).

To serve as a check on this value, Allen also developed an income analysis whereby he did not load the capitalization rate for taxes, but rather included the taxes as an expense. (Ex. 2, pp. 92). He also deducted for leasing commissions and added in the purchase of the condemned portion of the subject site in this analysis. Allen arrived at a conclusion of value including the taxes of $5,100,000 using this method. (Ex. 2, p. 92).

Allen asserts the lease-up cost deduction is needed to reflect the costs of finding a tenant. However, Allen had earlier acknowledged there was no indication Lowes intended to vacate the subject property or the subject market.

He gave most consideration to his income analysis that included the taxes as an expense and reimbursement, because in his opinion this "most accurately reflects how an investor would buy the property." (Ex. 2, p. 93). He concluded a January 1, 2017 opinion of value by the income approach of $5,100,000. (Ex.2, p. 93).

<u>3. Allen's Reconciliation</u>

Allen gave both the sales comparison and income approaches consideration in his reconciliation, though giving primary weight to the sales comparison approach. His final opinion of value as of January 1, 2017 is $5,200,000. (Ex. 2, p. 94).

Manternach Appraisal

Manternach identified the purpose of his appraisal was to estimate the fee simple market value of the subject property as of January 1, 2017. (Ex. B, p. 6).[6] He determined the property's highest and best use, as if vacant, is for retail or service commercial use. (Ex. B, p. 35). Similarly, he concluded the property's highest and best use, as improved, is for continued retail use. (Ex. B, p. 36). He indicated the "building and associated improvements contribute significant value to the site and have a lengthy remaining life." (Ex. B, p. 36).

He reported the subject property has been owner-occupied since it was constructed and is located in a good retail location. (Ex. B, p. 48). In his opinion the subject property is in a good location for general retail and for a retail home improvement store describing it as being across from a super-regional mall, on an Interstate 80 commercially developed interchange with a Walmart, a Kohl's, and another power center nearby. (Tr. 177, ln. 23 to Tr. 178, ln. 10).

Manternach explained the west portion of the subject site has some steep topography that has a lower contributory value but the majority of the site is relatively level. (Tr. 178 ln. 24 to Tr. 179, ln. 4). He further noted that land-to-building ratio is an important factor for home improvement stores and grocery stores, which require a higher ratio compared to other retail properties. In his experience, home improvement stores are generally at the higher end of the land-to-building ratio range of comparable properties, typically close to a ratio of 4:1 or above. (Tr. 179, ln. 11 to Tr. 180, ln. 12).

Manternach described the subject improvements as having approximately 132,000 square-feet of retail space, which does not include a roofed sales area and roofed garden area. He explained the roofed sales and garden areas have lights, sprinklers, and walls or partial walls. In his experience these areas are common to most home improvement stores. (Ex. B, pp. 32-34; Tr. 180, ln. 18 to Tr. 181, ln. 7). Manternach included these areas in his valuation because they are existing building

[6] Citations for Manternach's appraisal are based on the "page #" in the upper right-hand corner of Exhibit B.

improvements and part of the subject property's real estate. (Tr. 182, ln. 24 to 183, ln. 17).

Manternach described the retail store as typical big-box construction with steel-frame and concrete-panel walls; it also has typical site improvements including roughly 280,000 square-feet of paving. In Manternach's opinion it was built for a home improvement store and is typical of other similar home improvement stores. For this reason, he believes the typical buyer would use it for a home improvement store. (Tr. 181, ln. 9 to Tr. 182, ln. 23). He also noted that he is aware of similar big-box construction in Iowa that has taken place within the last five years and some proposed big-box construction in Dubuque, Cedar Falls, Ames, and Grimes. (Tr. 184, ln. 17 to Tr. 185, ln. 4).

Manternach developed the sales comparison, income, and cost approach to value in concluding an opinion of value for the subject property as of January 1, 2017. Because the subject property is 14-years old, he believes that a buyer would consider what it would cost to buy in a different location, and that a buyer would want to know the value of the underlying land. (Tr. 187, ln. 3-13).

1. Manternach's Cost Approach

To determine the contributory land value, Manternach analyzed and adjusted five land sales located in Iowa, which are summarized in the following table. (Ex. B, pp. 37-39).

Comparable	Site Size (SF)	Sale Date	Sale Price	SP/SF	Adjusted SP/SF
1 - Coralville	197,762	Feb-14	$1,018,253	$5.15	$5.61
2 - Dubuque	894,722	Sep-13	$3,600,000	$4.02	$4.87
3 - Cedar Falls	875,556	Jan-15	$2,626,956	$3.00	$5.61
4 - Altoona	1,484,280	Mar-15	$6,953,050	$4.68	$5.51
5 - Ankeny	767,032	Feb-14	$3,827,490	$4.99	$5.19

Land Sale 1 is the smallest site he considered with slightly less than 5 acres. It is located along Interstate 80 in Coralville. (Ex. B, p. 58). Manternach adjusted this site downward for its smaller size because it is typical to see a decrease in the sales price per-square- foot as sites get larger. (Tr. 191, ln. 20 to Tr. 192, ln. 8).

Land Sale 2 was purchased for the development of a Farm and Fleet store. (Ex. B, p. 59)

Land Sale 3 was a commercial site purchased by a hospital. Manternach testified it is not as good of a location as the subject property but it is near other big-box stores.

Land Sale 4 is the largest site he analyzed and was purchased for the development of an outlet mall. (Ex. B, p. 61).

Land Sale 5 was purchased for big-box retail use as a Sam's Club. (Ex. B, p. 62).

After adjusting the land sales for differences between them and the subject site he concluded an opinion of site value, as of January 1, 2017, of $5,030,000. (Ex. B, p. 39).

Manternach did acknowledge errors in his comparable land sales analysis, noting some time adjustments were incorrect. If corrected, however, his analysis would indicate a higher land value than he reported. (Tr. 282, ln 12 to Tr. 283, ln. 25).

Manternach does not agree with Allen's opinion that the subject has excess land. He explained that while the subject has a large site, it is all required for the current use as a home improvement store. He testified that, theoretically, if the use of the subject property were changed then perhaps some out lots could be parceled and sold off. (Tr. 203, ln. 5 tp Tr. 204, ln. 24). Manternach maintained this position, despite criticism from Lowes. (Tr. 279, ln. 22 to Tr. 282, ln.11).

Manternach relied on MARSHALL VALUATION SERVICE (MVS)[7] for his cost data. He identified the subject property as an above-average quality Class C Warehouse Discount Store in average condition. (Ex. B, pp. 40 & 42; Tr. 195, ln. 20-25). Based on this classification, he determined a base square foot cost of $57.54 for the main building. After adjusting for refinements, he concluded a replacement cost new (RCN) for this portion of the property to be $65.67 per-square-foot. He then added $1,093,792 for the RCN of the roofed sales area, garden center, canopies, and 3% soft costs. (Ex. B, p 42). Manternach did not include any entrepreneurial incentive in his cost new because in his opinion, big-box retail stores are rarely built as speculative investments. (Ex. B, p. 40).

[7] MVS is a national cost manual.

Manternach estimated an effective age of 14 years and an economic life of 40 years. Using the age/life, straight-line method he determined the subject had 35% physical depreciation. He also applied 10% functional obsolescence due to the subject's relatively large building size, which he testified would reflect if the improvements were put to an alternative use. In his opinion, the subject property is functional for its current use. (Ex. B, pp. 40 & 42; Tr. 189, ln. 13-22). After adding in the "as is" value of the site improvements and land value, Manternach concluded an opinion of value by the cost approach of $11,300,000. (Ex. B, p. 42).

2. Manternach's Sales Comparison Approach

Manternach testified the ideal comparable would have almost the same location, land-to-building ratio, age, and type of construction, as well as be fee simple. (Tr. 200, ln. 1-10). In searching for sales, he tried to stay close in location to the subject property. (Tr. 202, ln. 1-7).

Manternach included six improved properties for his sales comparison analysis, which are summarized in the following table. (Ex. B, pp. 43-46).

Address	Sale Date	Sale Price	Building Area (SF)	Sale Price/SF	Adjusted SP/SF
Subject			131,569		
1 - Ames, IA	Aug-15	$3,650,000	60,053	$60.78	$85.93
2 - Cedar Rapids, IA	Mar-10	$5,500,000	105,944	$51.91	$95.09
3 - West Des Moines, IA	Mar-15	$3,500,000	55,386	$63.19	$78.71
4 - Johnston, IA	Dec-14	$5,900,000	146,003	$40.41	$68.76
5 - Omaha, NE	Apr-15	$5,000,000	66,937	$74.70	$99.02
6 - Urbandale, IA	Mar-16	$3,600,000	81,936	$43.94	$70.23

None of the comparables were leased at the time they were sold. (Tr. 13, Ln. 10-12). However, Manternach testified that he "would consider properties that are leased or not leased" as comparables for the subject property and adjust them if necessary. (Tr. 13, ln. 2-6). Manternach adjusted all of the sales upward 3% per year for date of sale, recognizing that retail values have been increasing for the past several years. (Ex. B, pp. 44-45). Sales 1, 2, 3, and 5 were built and operated as grocery stores before they were sold. (Ex. B, pp. 64-66, 69-70).

Sale 1 was a former Dahl's grocery store that was purchased by Walmart for the purposes of assemblage. (Ex. B, p. 64). After the purchase, Walmart razed this parcel as well as its existing adjoining retail property to build a new Super Walmart on the combined sites. In Manternach's opinion, the existing Dahl's store could have been used by another buyer. (Ex. B, p. 64). Manternach adjusted this sale downward to reflect that it was purchased for assemblage. (Ex. B, p. 45). He testified this adjustment was based on his opinion. (Tr. 256, ln 9-13). Manternach agreed that Walmart considered this as a land purchase but the seller had it listed for redevelopment. (Tr. 291, ln. 10 to Tr. 292, ln. 10).

Sale 2 was a former grocery store that was purchased by Theisen's, a farm supply store. (Ex. B, p. 65). After the purchase, Theisen gutted the interior and spent approximately $1,500,000 in renovations. (Ex. B, p. 65). Manternach did not adjust for the renovations. (Tr. 292, ln. 14 to Tr. 293, ln. 19). Lowes was critical of Manternach for including this sale because it sold seven years ago.

Sale 3 was another former Dahl's store. (Ex. B, p. 66). Manternach identified this sale as being distressed and adjusted it upward by 5%. (Ex. B, p. 44-45). It was purchased by Kum & Go[8] because it wanted the front portion of the site for a new store. After the purchase, Kum & Go subdivided the site, built a new convenience store on the front 1.66 acres, and listed the remaining parcel for sale with a $2,000,000 list price. (Ex. B. p. 66; Tr. 207, ln. 25 to Tr. 208, ln. 7; Tr. 250, ln. 19 to Tr. 251, ln. 10). Manternach testified that the remaining real estate was sold and converted to multi-tenant use. (Tr, 207, ln. 25 to Tr. 208, ln. 7).

Lowes noted the remaining portion of Sale 3's site was later sold to Bike World for $1,575,000, asserting it was put to "good retail" use even with a smaller site. Manternach responded that the Bike World property is a completely different type of retail use compared to the subject's home improvement store use that requires a higher land to building ratio. (Ex. 9; Tr. 252, ln. 10 – Tr. 253, ln. 20).

Lowes questioned whether Manternach believed Sale 3's Des Moines market location was inferior compared to the subject property; to which Manternach responded

[8] Kum & Go is a regional convenience store and gas station chain.

- no. He explained he was not comparing the Des Moines metro area to the subject's location, but rather the specific location of Sale 3 compared to the subject's location. (Tr. 228, ln. 10 to Tr. 229, ln. 2). Manternach further explained that the subject is located on an Interstate 80 interchange near other big-box developments. In comparison, Sale 3 is located in a neighborhood that is mostly residential with a lower traffic count. (Tr. 228, ln. 10 to Tr. 229, ln. 2).

Sale 4 was a former American TV & Appliance store that was purchased by Goodwill Industries. (Ex. B, pp. 67-68). Goodwill converted the property into its corporate headquarters, a smaller retail store, warehouse, and training center. (Ex. B, pp. 67-68). Manternach testified that a year prior to this reported transaction an outlot was sold to Kum & Go. He further testified that this property could not be used as a home improvement store and that it would have a "significantly different highest and best use" than the subject. (Tr. 208, ln. 7-15; Tr. 233, ln. 15-20). Manternach acknowledged that American TV had gone into bankruptcy but believes this property sold at a fair price and therefore does not consider it a distressed sale. (Tr. 296, ln.18 – Tr. 297, ln. 8).

Sale 5 was a former grocery store that had been vacant approximately two years prior to its sale. (Ex. B, pp. 69-70). The sale was an auction sale conducted through a private sealed-bid process. (Tr. 297, ln. 20-21). It was purchased by Hobby Lobby, which spent roughly $1,500,000 on a full interior renovation and exterior façade updates. Manternach noted this property had excess land that could be subdivided and sold. (Ex. B, p. 69-70).

Sale 6 was a former K's Merchandise. Hy-Vee purchased the store with the intent of "doing a major renovation" and using the property for an employee training center and possibly on-line store sales and delivery. (Ex. B, pp. 71-72). Manternach testified that this property "sat vacant for a few years." (Tr. 208, In. 19-20). He also acknowledged this property required significant remodeling and that the buyer's changed the use of the building from retail to office. (Tr. 297, ln. 23 to Tr. 298, ln. 23).

Manternach considered Sales 3, 4, and 6 to be inferior in location compared to the subject property. He adjusted them upward between 5% and 10%. He identified

Sale 5 as superior to the subject's location and adjusted it downward 15%. (Ex. B, p. 44).

Despite reporting that Sales 2, 4, 5, and 6 were converted to different uses and required renovations, Manternach did not adjust the sale prices to reflect the renovation costs. He did consider them inferior to the subject in condition and adjusted them all upward by 30%. (Ex. B, p 44). We note these adjustments to Sales 2 and 5 appear to be consistent with the renovation and conversion costs he identified in his sales sheets.

As previously noted, Manternach did not consider the subject property to have excess land. He found all of his comparable sales to have inferior land-to-building ratios compared to the subject property and adjusted them upward between 10% and 40%.

None of the comparables had outdoor sales or garden shops and Manternach adjusted each of them upward 4% to reflect this difference. (Ex. B, p. 44).

After adjustments, Manternach reported a range of value between $68.76 and $99.02 per-square-foot and he reconciled to a value of $82 per-square-foot. Because he adjusted for the outdoor sales and garden areas in his analysis, he multiplied his reconciled price per-square-foot by the main retail building only. His conclusion of value by the sales comparison approach is $10,800,000. (Ex. B, p. 46)

Lowes was critical of Manternach because all of his comparable properties required upward adjustments. Manternach asserts this is reasonable because the subject property has a large land-to-building ratio, is in a good location, and is a relatively new building. (Tr. 227, ln. 5 to Tr. 228, ln. 5; Tr. 256, ln 14 to Tr. 257, ln. 13).

Lowes also criticized Manternach for not relying on any sales of home improvement stores, when he repeatedly testified that the highest and best use of the subject property was for use as a home improvement store. Lowes noted Allen included several sales that were formerly owned and occupied by Lowes and Home Depot with much lower sale prices per-square-foot. As previously noted, Manternach asserts Allen's sales likely sold at a lower price because they may have been non-performing stores, or in poor locations, and that they sold with deed restrictions prohibiting their use as home improvement stores. For these reasons, they would sell for significantly less. (Tr. 264, ln. 21 to Tr. 266, ln. 6).

Lastly, Lowes was critical of Manternach, asserting he did not properly consider the subject property to be vacant at the time it sold. Manternach explained that he assumed the subject property had stable occupancy with a stabilized market rent. He neither assumed that it was 100% leased to a tenant, nor did he assume it was a “dark” store; he did not assume the subject property was vacant. (Tr. 269, ln. 11 to Tr. 271, ln. 19).

3. Manternach’s Income Approach

In Manternach’s opinion, big-box retailers would consider the income or revenue generated by retail sales. (Tr. 189, ln. 23 to Tr. 190, ln. 9). He testified about the importance of selecting proper lease comparables. (Tr. 209, ln. 14-17). Manternach was critical of Allen’s opinion that built-to-suit leases should not be considered in a market rent analysis. In Manternach’s opinion those are relevant leases because a user like Lowes would not pay over market rent for a property, otherwise they would consider building it themselves. (Tr. 210, ln. 5 to Tr. 211, ln. 7). Manternach also testified that older buildings, like what Allen relied on, as well as land-to-building ratios would significantly impact the rent that would be paid for a property. (Tr. 211, ln. 9-17).

Manternach analyzed fourteen, triple-net leases of retail properties located in Iowa to establish a market rent for the subject property. (Ex. B, p. 47-48). The leased properties ranged in size from 12,000 square feet to just over 272,000 square feet of building area and were built between 1979 and 2013. Only three of the lease comparables had building areas larger than 100,000 square feet. Manternach testified that the lower end of the range is set by older properties, which would have been adjusted upward for that factor. (Tr. 212, ln 13-18).

Manternach testified that Lease 2 was a new Mills Fleet Farm that was twice the size of the subject property, was only 4-years old at the time of the lease, and it was a sale/leaseback. (Tr. 212, ln. 19-25). Lowes asked Manternach if he believed Lease 2 would realize a rent of $5.10 per-square-foot if offered on the open market. To which, Manternach answered yes. (Tr. 260, ln. 4-8). Manternach acknowledged that Lease Comparables 9 and 12 were build-to-suit. (Tr. 260, ln. 15 to Tr. 261, ln. 15).

Like Allen, Manternach did not include a lot of information about his comparables. (Ex. B, p. 48). In comparison to Allen's rent comparables, however, Manternach's are more similar in age to the subject. The majority appear to be occupied by first-generation tenants with leases starting between 2005 and 2017.

The lease rates ranged from $4.39 per-square-foot to $11.50 per-square-foot. (Ex. B, p. 48). Although Manternach noted the leases "would be adjusted" for numerous factors, he did not adjust them. Based on this data, he selected a triple-net market rent of $7.50 per-square-foot for the subject property's main building area and $2.50 per—square-foot for the outdoor sales and garden areas. (Ex. B, pp. 48 & 51). He believes the outdoor sales and garden areas would be less than a typical warehouse rent. (Tr. 263, ln. 9-18).

Manternach did not consider any "specific tenants" for the subject property, but rather just considered the property as it is currently improved. (Tr. 213, ln. 15 to Tr. 214, ln. 5). He reiterated that he was "not assuming it's a Lowes or a Home Depot…" (Tr. 219, ln. 24 to Tr. 220, ln. 14).

Manternach's research indicated historical vacancy rates of less than 4% during the last ten years and an average vacancy rate of 2.2% during the past five years. (Ex. B, p. 49). He testified that high vacancy would be an indication the market is struggling, whereas low vacancy, as is present here, would indicate a healthy retail market with limited vacant buildings and a strong demand for retail property. (Tr. 185, ln. 19 to Tr. 186, ln. 1). He estimated a stabilized vacancy and collection loss of 7%. (Ex. B, pp. 48-49). In his opinion, his 7% estimate of vacancy and collection loss is conservative and based on what a typical purchaser would use when estimating a value for the subject property. In his opinion a prospective buyer would not assume the vacancy rate would remain at 2.2%. (Tr. 217, ln. 1-10).

Like Allen, Manternach also included leasing fees in his expenses. Manternach estimated 3% ($28,771) leasing fees to reflect the cost of locating and securing tenants. (Ex. B, p. 50-51). He explained his leasing fee estimate was based on a weighted average over a five or ten-year period. He testified it would be incorrect to include all of the leasing commission incurred as a single-year expense because it would result in an inaccurate estimate. (Tr. 215, ln. 3-24). His total operating expenses were estimated at $106,479, and his NOI was estimated at $852,554. (Ex. B, p.51).

Manternach testified that the larger metropolitan areas in Iowa have seen "very low" capitalization rates and that he considers Iowa's metropolitan areas to have healthy retail markets. He considers the Iowa City, Coralville market to be one of the top five markets in Iowa. (Tr. 211, ln. 18 to Tr. 212, ln. 7). Manternach relied on three major techniques to estimate his capitalization rate: market extraction, the mortgage-equity (band of investment), and investor surveys. (Ex. B, pp. 52-53). The following table is a summary of the data based on these techniques.

Method	Rate Estimate Data
Mortgage-Equity	7.31%
Market Extraction	6.10% to 7.50%
INVESTMENT BULLETIN (Survey)	Retail <$2M – 7.37% $2M to 5M – 7.12% $5M to $15M – 6.88%

The capitalization rates ranged from 6.10% to 7.5% and Manternach selected the top end of the range as his estimated capitalization rate for the subject property. (Ex. B, p. 53; Tr. 217, ln. 18 – Tr. 218, ln. 12). After adjusting for the tax rate, Manternach relied on a 7.74% loaded capitalization rate. His conclusion of value by the income approach was $11,000,000, as of January 1, 2017. (Ex. B, p. 54).

Similar to its criticism about Manternach's use of sales that were not vacant, Lowes criticized the comparables he relied on for his market extraction because they were occupied by tenants when they sold. Manternach again reiterated that he was not assuming the subject property was dark or vacant, but rather that it is occupied. (Tr. 273, ln. 5-24). He further explained that in his opinion an investor would look at this same information. He testified market extraction is only one of three methods he utilized to form an opinion of a capitalization rate. He stated it is common appraisal methodology to use this type of data to support a capitalization rate for a fee simple estate appraisal.

4. Manternach's Reconciliation

Manternach reconciled the three approaches to value. He acknowledged that he gave less consideration to the cost approach than the sales comparison and income approaches. He testified that he gave 45% weight to the sales and income approaches and 10% weight to the cost approach. (Tr. 298, ln. 24 to Tr. 299, ln. 15). His final opinion of value as of January 1, 2017, is $10,940,000. (Ex. B, p. 55; Tr. 220, ln. 19-23).

Iowa DOT Appraisal

As previously mentioned, the record also includes an appraisal commissioned by the Iowa Department of Transportation for the purpose of determining just compensation in a condemnation proceeding involving a former portion of the subject site. (Ex. 5). Five land sales are considered in arriving at a land value estimate for the entire site of $7.00 per-square-foot as of September 14, 2016. (Ex 5, p. 21-24). This would suggest a total land value for the subject of $6,641,187 ($7 PSF x 948,741 SF).

Analysis & Conclusions of Law

PAAB has jurisdiction of this matter under Iowa Code sections 421.1A and 441.37A (2017). 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).

Lowes argued the subject property is assessed for more than authorized by law, as provided under Iowa Code section 441.37(1)(a)(1)(b). 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 v. Bd. of Review of Mason City*, 457 N.W.2d 594, 597

(Iowa 1990). First, the record must show the property is over assessed; and second, what the fair market value of the property should be. *Id*.; *see also Boekeloo vs. Board of Review of City of Clinton*, 529 N.W.2d 275, 276-277 (Iowa 1995). If PAAB "determines the grounds of protest have been established, it must then determine the value or correct assessment of the property." *Compiano vs. Bd. of Review of Polk County*, 771 N.W.2d 392, 397 (Iowa 2009). In that case, PAAB "makes its independent determination of the value based on all the evidence." *Id*.

I. General Principles of Assessment Law

a. Valuation under Iowa Code section 441.21

In Iowa, property is assessed for taxation purposes following Iowa Code section 441.21. Iowa Code subsections 441.21(1)(a-b) require property subject to taxation to be assessed at its actual value, or fair market value. *Soifer v. Floyd Cnty. Bd. of Review*, 759 N.W.2d 775, 778 (Iowa 2009).

> *"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 in arriving at market value." *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 n. 2; *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, discounted purchase transactions, or purchases of adjoining land or other land to be operated as a unit. *Id*.

The first step in this process is determining if *comparable* sales exist. *Soifer*, 759 N.W.2d at 783 (emphasis added). 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). Sales prices 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). "[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).

b. Burden of Proof

Under Iowa law, there is no presumption that the assessed value is correct. § 441.37A(3)(a). Nonetheless, under section 441.21(3) (2017), the party contesting the assessment generally has the burden of proof.

> For assessment years beginning before January 1, 2018, the burden of proof shall be on the complainant attacking such valuation as excessive, inadequate or capricious. […] [W]hen the complainant 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 of proof thereafter shall be upon the officials or persons seeking to uphold such valuation to be assessed.

§ 441.21(3)(b)(1).

As noted in *Compiano*, the statute requires the evidence offered by the disinterested witnesses to be competent to shift the burden of proof. 711 N.W.2d at 398. To be competent, the evidence must comply with the statutory scheme for property assessment valuation. *Id*. The statutory scheme begins with valuation using sales of comparable properties. *Id.*

Lowes did not offer competent evidence from two disinterested witnesses. Therefore, it bears the burden of proof.

c. Consideration of Other Factors Valuation under section 441.21(2)

"A party cannot move to other-factors valuation unless a showing is made that the market value of the property cannot be readily established through market transactions." *Wellmark, Inc. v. Cnty. Bd. of Review*, 875 N.W.2d 677, 682 (Iowa 2016). Where PAAB is convinced comparable sales do not exist or cannot *readily* determine market value, then other factors may be used. § 441.21(2); *Compiano*, 771 N.W.2d at 398 (citing *Soifer*, 759 N.W.2d at 782); *Carlon Co. v. Bd. of Review of City of Clinton*, 572 N.W.2d 146, 150 (Iowa 1997). If sales cannot readily establish market value, "then the assessor may determine the value of the property using the other uniform and recognized appraisal methods," such as income and/or cost. § 441.21(2).

The parties agree that the sales and income approaches can offer a reliable indication of value for the subject property. Lowes asks PAAB to set the subject's assessment at Allen's reconciled value, which gave weight to the sales and income approaches. The parties disagree, however, about the reliability of the cost approach generally and, in particular, the accuracy of Manternach's cost approach.

Lowes argues that, if necessary, consideration can be given to the income approach, but no weight should be given to the cost approaches in this case. Iowa law recognizes no preference between the income approach and cost approach. § 441.21(2). Thus, the weight to be given the cost approach under section 441.21(2) is dependent on its reliability in a particular case. Where there is a question as to whether the other approaches properly value the property in fee simple, however, we note there may be a benefit to consideration of the cost approach. As we previously stated, the cost approach "produces a value indication of the fee simple estate of a property at market rent and stabilized occupancy." THE APPRAISAL OF REAL ESTATE at 638.

As will be discussed, there are issues with the quality and reliability of sales each appraiser used in his analysis and, consistent with the appraisers' opinions, we believe consideration should be given to the other valuation approaches in this case. However, we do give consideration to the sales we find comparable and reliable. *Equitable Life Ins. Co. v. Bd. of Review of City of Des Moines*, 281 N.W.2d 821, 825-26 (Iowa 1979).

Ultimately, however, any consideration of the cost approach in this case will have minimal impact on the final resolution of this matter. Manternach gave the cost approach minimal weight in his final reconciliation and his reconciled value sits between his sales and income approaches.

d. Prohibition Against Special Use Value in section 441.21(2)

Iowa Code section 441.21(2) provides that if the value cannot be determined as provided in subsection (1), then the value can be determined "using the other uniform and recognized appraisal methods, including its productive and earning capacity . . ." However, the following shall not be taken into consideration: "Special value or use value of the property to its present owner; and the goodwill or value of a business which uses the property as distinguished from the value of the property as property." § 441.21(2).

Iowa courts have narrowly interpreted this provision of Iowa code section 441.21(2). *See Wellmark,* 875 N.W.2d at 680 (providing an overview of cases interpreting this subsection). In *Merle Hay Mall*, the Iowa Supreme Court considered the assessment of a mall subject to a below-market lease to an anchor tenant. *Merle Hay Mall v. City of Des Moines Bd. of Review*, 564 N.W.2d 419, 421-22 (Iowa 1997). The mall argued the valuation improperly included business enterprise value. *Id*. at 423. The Court stated that "Unless consideration of the intangibles is prohibited by section 441.21(2), i.e., special use values and goodwill, intangibles may be considered in valuing the real estate with which they are associated." *Id*. at 424 (citing *Post-Newsweek Cable, Inc. v. Bd. of Review*, 497 N.W.2d 810, 814 (Iowa 1993). It then rejected the mall's business enterprise theory. *Id*. at 424-25.

The Court also applied narrow interpretations of section 441.21(2) in *Ruan Center Corp. v. Bd. of Review*, 297 N.W.2d 538 (Iowa 1980) and *Maytag Co. v. Partridge*, 210 N.W.2d 584 (Iowa 1973). In *Ruan*, the Court found that tenant improvements "increased the building value and were not of special value to the particular tenants who installed them." 297 N.W.2d at 541. It noted that "if the tenants sold their leasehold interest, they could charge for the improvements. Upon expiration of the leases, Ruan could charge higher rent because of the improvements than it could if the property remained at building standard construction." *Id*. at 541.

The *Maytag* Court considered the special use provision of section 441.21(2) as it related to machinery. 210 N.W.2d at 590. In rejecting Maytag's argument that the assessment included special or business value, the Court first noted the assessor's duty to value the going concern. *Id*. It noted that subsection 441.21(2) "comes into play when sentiment, taste, or other facts, frequently subjective, give property peculiar value or use to its owner that it does not have to others." *Id*. at 590-91. The Court concluded that "another competent home appliance manufacturer could step into Maytag's shoes and operate this plant." *Id*. at 591.

More recently in *Soifer*, the Court noted that it had adopted a narrow interpretation of subsection 441.21(2). 759 N.W.2d at 786 n. 6 (Iowa 2009). Addressing the subject's fast-food restaurant, the Court stated "the configuration of the building and its placement on the site give this property value for use as a fast-food restaurant. This value is not peculiar to the present owner. It would also have use and value to a purchaser of the property." *Id*.

Lowes does not identify any manner in which the property's assessment or Manternach's valuation includes value prohibited by section 441.21(2).

II. Other fundamental valuation issues

a. Fee Simple

"[T]he proper measure of the value of property is what the property would bring if sold in fee simple, free and clear of any leases." *I.C.M. Realty v. Woodward*, 433 N.W.2d 760, 762 (Iowa Ct. App. 1988) (emphasis added); *Merle Hay Mall v. City of Des*

Moines Board of Review, 564 N.W.2d 419 (Iowa 1997); *Oberstein v. Adair Cnty. Bd. of Review*, 318 N.W.2d 817 (Iowa Ct. App. 1982).

Both appraisers used definitions of fee simple from THE DICTIONARY OF REAL ESTATE APPRAISAL, published by the Appraisal Institute. That text defines Fee Simple Estate as: "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." APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 78 (5th ed. 2010). The same text defines Encumbrance as: "Any claim or liability that affects or limits the title to property. An encumbrance can affect the title such as a mortgage or other lien, or it can affect the physical condition of the property such as an easement. An encumbrance cannot prevent the transfer of possession, but it does remain after the transfer." *Id*. at 67.

We are careful to acknowledge that definitions used by appraisers may sometimes differ from definitions used by Iowa Courts, in Iowa law, or the legal profession generally. As a corollary, appraisers commonly use some terms that have no legal definition, e.g., leased fee.

Black's Law Dictionary defines fee simple as "an interest in land that, being the broadest property interest allowed by law, endures until the current holder dies without heirs." BLACK'S LAW DICTIONARY (10th ed. 2014), fee simple. Fee Simple "represent[s] the entire and absolute interest and property in the land. No one can have a greater interest. The holder of a fee simple holds property clear of any condition, limitation, or restriction." 28 Am. Jur. 2D *Estates* § 13 (2019). A fee simple estate has a potentially infinite duration. *Id*. An owner of a fee simple estate "has the unlimited power to sell, transfer, alienate, or bequeath the property in any lawful manner." 31 C.J.S. *Estates* § 13 (2019). The owner of a fee simple estate "can burden it with a lease . . . and he can receive the land in fee subject to such burdens." *Moore v. McKinley*, 69 N.W.2d 73, 84 (Iowa 1955).

Iowa courts have repeatedly held that existing leases may be evidence of a property's value, but unfavorable leases should not be used to lower assessments. *Merle Hay Mall*, 564 N.W.2d 419 (holding that an unfavorable lease does not reduce a property's assessed value); *Oberstein*, 318 N.W.2d at 819; *I.C.M. Realty*, 433 N.W.2d at 762.

The *Oberstein* Court considered the valuation of a built-to-suit post office location subject to a below-market rent lease. 318 N.W.2d 817. The property owner argued the below-market lease "would be of paramount importance to anyone interested in acquiring the property and detrimental to any sale thereof." *Id*. at 818. It sought a reduction of the assessment as a result of the unfavorable lease, but the Court of Appeals rejected its argument. *Id*. at 818-19. In doing so, the Court surveyed case law supporting its conclusion that the value contemplated by section 441.21 includes the lessor's and lessee's interests. *Id*. at 819-21. It found that "rental income which might be received from a particular lease is some evidence" of the property's value, but "may only be considered in determining what that value would be independent of the existing lease." *Id*. at 821.

Similarly, in *Merle Hay Mall*, the Iowa Supreme Court evaluated the effect of the Mall's long-term, below-market lease to Younkers in the income capitalization approach. 564 N.W.2d at 422. Citing section 441.21(2), the Court noted "production and earning capacity" of the property is a factor to be considered. *Id*. It identified that the Younkers lease is evidence of the property's earning capacity, but acknowledged the property's earning capacity is substantially greater than the amount it presently earns. *Id*. It held that the assessment includes both the lessee's and the lessor's interests and affirmed. *Id*. We note *Merle Hay Mall* discusses leases in the context of the income approach permitted by section 441.21(2), but we find no basis to conclude the actual value contemplated by section 441.21(2) should be any different than the value sought by section 441.21(1).

In determining whether the sales comparison approach could readily establish value in *Wellmark*, the Iowa Supreme Court recognized that one of the Board of Review's experts relied on some comparable properties sold subject to long term leases. 875 N.W.2d at 682. The Court stated this fact "cloud[ed] comparability and rais[es] the question of whether the buyer was interested in the property or the income stream generated by an advantageous lease." *Id*. The Court then concluded the district court properly considered other factors in valuing the property. *Id*.

THE APPRAISAL OF REAL ESTATE indicates that "[i]f the sale of a leased property is to be used as a comparable sale in the valuation of the fee simple estate of another property, the comparable sale can only be used if reasonable and supported market adjustments for the differences in rights can be made." APPRAISAL INSTITUTE, THE APPRAISAL OF REAL ESTATE 406 (14th ed. 2013). It gives the following example:

> For example, consider the appraisal of the fee simple estate in real estate that is improved with an office building. A similar improved property was fully leased at the time of sale, the leases were long-term, and the credit rating of the tenants were good. To compare this leased fee interest to the fee simple estate of the subject property, the appraiser must determine if the contract rent of the comparable property was above, below, or equal to market rent. [] If the market rent for office space is $25 per square foot net and the average contract rent for the comparable property is $20 per square foot net, then the difference between market and contract rent is $5 per square foot.

Id.

THE APPRAISAL OF REAL ESTATE notes the challenges with making adjustments for property rights. "Calculations of appropriate adjustments reflecting differences in property rights may be difficult to develop and support. Properly developed adjustments require significant research and diligence." *Id*. at 407. At the same time, it notes the cost approach "produces a value indication of the fee simple estate of a property at market rent and stabilized occupancy." *Id*. at 638. Similarly, when the fee simple interest of a property is valued using the income capitalization approach, "the presumption is that the property is available to be leased at market rates." *Id*. at 441. Thus, there may be some wisdom in giving consideration to the other valuation approaches where there is a question of whether the adjusted sales fairly reflect the fee simple value sought by Iowa law.

b. Value-in-Use or Value-in-Exchange

"[A]ssessors 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). In *Maytag Co. v. Partridge*, 210 N.W.2d 584 (Iowa 1973), an expert opined that the assessed value of Maytag's machinery should be based on its secondary resale value. The Iowa Supreme Court rejected that approach, noting "the rule is that an assessor must also consider conditions existing at the time and the condition of the property in which the owner holds it." *Id*. at 589. 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.*, 210 N.W.2d at 590). 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*.

The Iowa Supreme Court recently reaffirmed this principle in *Wellmark, Inc. v. Polk County Board of Review*. 875 N.W.2d 636, 670-71 (Iowa 2016). In that case, Wellmark's experts valued the single-occupant corporate headquarters "by using an analysis of multitenant office buildings," reasoning that a purchaser would likely convert the property to a multitenant use. *Id*. at 671. In evaluating the theories of value-in-use and value-in-exchange pertaining to Wellmark's property, the Iowa Supreme Court adopted the view that "value should be based on the presumed existence of a hypothetical buyer at its current use." *Id*. at 683. The Court rejected Wellmark's experts' opinions valuing the property as a multitenant office building and, instead, concluded the property should be valued based on its current use as a single-occupant office building. *Id*. at 682-83.

III. Analysis of Appraisals

Lowes contends that only Allen's appraisal values the property in fee simple. (Lowes Brf. p. 19). It asserts that a lease is an encumbrance and, by assuming the subject was leased, Manternach did not value the fee simple interest. (Lowes Brf. p. 20). Lowes asserts the plain language of section 441.21(1) indicates assessments are to be based off of the value-in-exchange. (Lowes Brf. p. 18). It attempts to differentiate this case from *Maytag*, *Homemakers Plaza*, and *Wellmark*. (Lowes Reply Brf. pp. 5-6).

The Board of Review argues that Iowa law does not equate market value with the value of the fee simple interest as vacant. (Board of Review Brf. p. 3). It asserts Allen valued the property as if vacant, which is not consistent with its current use. (Board of

Review Brf. pp. 5-6). As a result, it argues Allen's appraisal is not competent under the statutory scheme. (Board of Review Brf. p. 7).

First, we note the Lowes' Reply Brief appears to mischaracterize several arguments from the Board of Review's Brief by selectively quoting from it and subsequently providing its own interpretation of these shortened statements. As one example, in the first full paragraph on page 3 of its Reply brief, Lowes argues that the Board of Review's brief fails to recognize Iowa is a fee simple state. Lowes then selectively quotes the Board of Review's brief in, what we believe, is a misleading fashion. In total, the Board of Review's brief simply argues that Iowa law does not value property in fee simple as if vacant. As such, we find portions of Lowes' Reply Brief misleading and caution counsel against such tactics, as it ultimately undermines your credibility before PAAB and is detrimental to your client's interests.

We do not believe there is any dispute that Iowa law requires property to be valued in fee simple. The parties, however, disagree about the particular meaning and application of the term and how that impacts valuation. We believe the ultimate question underlying this dispute is about which appraisal best reflects the property's current use.

The *Wellmark* Court detailed the conceptual and legal arguments surrounding value-in-use and value-in-exchange. *Wellmark*, 875 N.W.2d at 673-75. After surveying case law and statutory mandates, the Supreme Court "embrace[d] the view that the property should be based on its current use." *Wellmark*, 875 N.W.2d at 682. The Court did not explicitly adopt or reject the value-in-use premise. Instead, based on the lack of readily available market for Wellmark's building, the Court stated the ""value should be based on the presumed existence of a hypothetical buyer at its current use." *Id*. at 683. It noted that "[c]urrent use is an indicator that there is demand for such a structure." *Id*.

While section 441.21(1) seeks to value property based on normal, arm's length comparable property sales, the Iowa Courts repeatedly found the resulting value should still represent the property's current use and consider conditions as they are. *Soifer*, 759 N.W.2d at 788 ("assessed property is valued based on its present use, including any functioning commercial enterprise on the property.").

a. Allen's Appraisal

Lowes has not offered the competent testimony of two disinterested witnesses showing the subject's assessment is excessive, therefore it retains the burden of proof under section 441.21(3). Lowe's relies on Allen's appraisal in support of its position. Allen valued the subject property at $5,200,000; roughly $6.6 million less than its 2017 assessed value.

Before addressing the substance of his sales and income approaches, we find flaw in Allen's failure to acknowledge any contributory value of the garden center and other outdoor sales area existing on the subject property. They are existing structures on the property and Lowes has not raised a claim the assessment includes non-assessable property under Iowa code section 441.37. Further, the subject's garden center and outdoor sales area is currently used and is likely to continue to be used. Manternach testified similar garden centers exist at other big-box stores, suggesting a desire in the market for these structures. As a result, we find Allen's failure to account for this value departs from the valuation of the property in its current use. *See Ruan Center Corp. v. Bd. of Review of City of Des Moines*, 297 N.W.2d 538 (Iowa 1980) (holding tenant improvements should be assessed because they could have value to subsequent occupant).

Nonetheless, Allen believes his value represents the property's current use because his comparables sold for continued retail use. (Lowes Brf. p. 5). We note, however, that four of his seven comparables were converted to multi-tenant use after their sale, with some portions remaining vacant. As their use is not consistent with the subject's single-occupant retail use, we find these sales less persuasive. *Hy-Vee, Inc. v. Dallas Cnty. Bd. of Review*, 2014 WL 4937892 (Iowa Ct. App. Oct. 1, 2014) (noting that the use of comparables need not be identical to the subject, but a difference in use affects the persuasiveness of the sale) (citations omitted).

In his sales approach, Allen considered seven sales. In addition to his transactional adjustments, Allen adjusted for physical characteristics. Upon review, and even accounting for the unusable portions of the subject property, there are some material differences in land size and land-to-building ratio between the subject and some of the comparables. Allen did not make adjustments for these differences.

Comparable Sales 1 and 6 were sold under circumstances indicating duress. He adjusted Sale 6 for sales conditions, but did not adjust Sale 1. Sale 6, however, was purchased with the intent to subdivide the property. Having adjusted the sales price for the anticipated outlot sales, it is unclear that Allen considered the impact the subdivision will have on the original parcel's utility. These factors reduce the persuasiveness of these sales and we ultimately give them no weight.

Comparables 4 and 5 sold from Lowes with deed restrictions. We believe his use of sales subject to deed restrictions impairs the reliability of his appraisal as an accurate reflection of the subject's fee simple value in its current use. In *Soifer*, the taxpayers claimed the market value of their property should be reduced because "McDonald's requires buyers of McDonald's properties to agree to a noncompete clause that prevents use of the property for a fast food restaurant for twenty years." 759 N.W.2d at 788. The Iowa Supreme Court rejected that argument, stating, "To eliminate [franchise-to-franchise] sales because McDonald's insists on noncompete clauses when selling properties would ignore the requirement that real estate be valued based on its present use." *Id*. at 789.

At face value, there can be no question that a deed restriction is antithetical to fee simple valuation. Allen attempted to support his lack of adjustment for property rights through a paired-sales analysis and by testifying that Lowes does not believe the deed restrictions it imposes affects the sales prices of properties it sells. First, we are less inclined to be persuaded by what effectively amounts to a self-serving statement from an interested party.

Second, and most importantly, we find flaws in Allen's paired sales analysis. He relies upon three paired sales of big-box stores. (Ex. 2, p. 74-75). He believes the fact that the properties without use restrictions sold for less per-square-foot than properties with use restrictions supports his lack of adjustment. However, that conclusion is only reasonable if the properties are sufficiently alike and the sales transactions are equivalent and normal. Allen did not adjust the comparables for differences that may exist to isolate the element of comparison being analyzed. Therefore, it is impossible to draw a conclusion regarding the effect of the deed restriction. The Home Depot sale used in the second set of paired sales occurred under questionable circumstances and was converted to multi-tenant use. (Ex. 2, p. 69). As it relates to the third set of paired sales, we do not believe the properties are sufficiently alike or the sales transactions are equivalent. The properties differ significantly in size, making an unadjusted per-square-foot comparison questionable. Further, the sale of the Former American TV occurred after American TV declared bankruptcy and vacated the building. (Ex. 2, p. 67). We have concerns about the reliability of that transaction. Lastly, we note that Sales 4 and 5 appear to be comparables in their own right. Sale 4 sold for $26.06 per-square-foot and subject to a twenty-year deed restriction. (Ex. 2, p. 70). Sale 5 sold for $38.02 per-square-foot, subject to a five-year deed restriction. (Ex. 2, p. 71). These sales indicate there may be some market reaction to the deed restrictions.

Of the remaining sales, Sale 3 was converted to multi-tenant use after purchase. Sale 7 required the most adjustments for physical characteristics of all of Allen's sales comparables and was converted to multi-tenant use after the purchase. The change in use reduces the persuasiveness of these sales.

Allen also did not make adjustments for post-sale expenditures made by purchasers to any of his sales. In his opinion, those expenditures were particular to the retailer and were not due to deferred maintenance. (Ex. 2, p. 74).

"A knowledgeable buyer considers expenditures that will have to be made upon purchase of a property because those costs affect the price the buyer agrees to pay." THE APPRAISAL OF REAL ESTATE 412. These expenditures can include, but are not limited to, costs to cure deferred maintenance, costs to demolish and remove a portion of the improvements, and costs for additions or improvements to the property. *Id*. "The relevant figure is not the actual cost that was incurred but the cost that was *anticipated* by both the buyer and seller." *Id*. (emphasis added).

Notably, THE APPRAISAL OF REAL ESTATE does not limit the application of a post-sale expenditure adjustment only to instances of deferred maintenance. Without adjustments, these comparable sales prices essentially reflect the value of vacant buildings potentially in need of remodeling for retail use. As such, we do not believe they reflect the current use of the subject property.

We note that the lack of post-sale expenditure adjustment might have been partially remedied by accounting for differences in condition between the subject property and the comparables. THE APPRAISAL OF REAL ESTATE 413 (discussing differences in adjustments for expenditures made immediately after purchase and condition). Allen's age/condition adjustment, however, was essentially limited to differences in age between the subject and comparables. His report fails to identify the condition of some of his comparables at the time of sale.

Finally, Sale 2 demonstrates single occupant use pre-sale and post-sale, there are no apparent signs of a distressed transaction or deed restrictions, and the property appears to be a reasonable comparable to the subject. Adjusted to $30 per-square-foot, this comparable would support Lowes overassessment claim. We again note, however, that Allen made no adjustments for land size, land-to-building ratio, and the garden center. Therefore, we believe the adjusted sales price for this property would undervalue the subject.

In his income approach, because he valued the subject property as if vacant and available for lease, Allen applied a $186,780 below-the-line, leasing commissions deduction for "the cost of putting a tenant in place." (Ex. 2, p. 82).[9]

Our primary concern with Allen's income approach is his selection of comparable rents and derivation of capitalization rates. His appraisal contains very little information about his comparable rentals, identifying only their tenant, location, size, and year built. The majority of the properties are older than the subject, some of them significantly so. All of them are smaller in size than the subject. Based on the names, the tenants appear to be second-generation occupants. Lastly, most of the leases are dated; he provides only one lease comparable with a lease start date after January 1, 2015. We have no

---

[9] Manternach also accounted for leasing commissions in his income approach. In contrast to Allen, he included leasing commissions as an annual expense. "In direct capitalization, leasing commissions are either treated as a normalized annual expense or included below the line in the reconstructed operating statement, depending on local market convention." THE APPRAISAL OF REAL ESTATE 484.

reason to believe these comparable leases reflect rental rates for the subject as of January 1, 2017.

Allen did not make any quantitative adjustments to these comparables. To the extent his appraisal implies he made qualitative adjustments, there is very little information about his process for doing so. To demonstrate the problem with Allen's market rent determination, we note his estimate of $4.75 per-square- foot is the same as Comparable Lease 6 – an October 2007 lease for a building more than 10 years older than the subject. In total, we do not believe these comparables represent a similar use as the subject and do not accurately represent the subject's market rent as of January 1, 2017.

In deriving a capitalization rate for the subject, Allen considered the band-of-investment technique, investor surveys, and market sales. We find absolutely no reliance can be placed on the capitalization rates Allen derived from the sales he considered. Three of the sales were Kmarts, which Allen identified as having suffered a significant number of store closures. In addition, the sales on which he relied are dated. Lastly, there is no information about these properties and we are unable to conclude they represent a similar risk as the subject.

We have no reason to discount his investor survey or band-of-investment technique. His capitalization rate estimate of 9.5% is above the average indicated by the band-of-investment, is within the range indicated by Realtyrates.com for free standing retail, and is near the upper end of the range indicated by the CBRE capitalization rate survey for stabilized properties in TIER III markets.

Allen's capitalization rate determination was influenced by his opinion about the risks associated with the property were it to become vacant. We comment specifically to note how perceptions of risk can allow an appraiser to increase the capitalization rate and stray from the directive to value the property at its present use. We believe Allen inflated the risk associated with the subject to a degree that exceeds its current risk as an owner-occupied property with no anticipated vacancy, but might also exceed the risk profile of the subject even if it were to become vacant. Based on his testimony, Allen seems to believe that a vacant property is always more risky than an occupied property.

While that may be true as a general rule, there are exceptions and we are careful not to accept an unsupported presumption. THE APPRAISAL OF REAL ESTATES states: "In comparing properties that are encumbered by long-term leases or are essentially fully leased with quality tenants, the appraiser must recognize that these leased properties may have significantly less risk than a competitive property that has shorter-term tenants at market rental rates." *Id*. at 407. However, "the reverse may be true in expanding markets" where sufficient tenants are available for shorter-term leases at higher rental rates. *Id*. This is not to say that we are of the opinion that the subject property would not involve risks if it were to become vacant. We do, however, believe that Allen did not support his opinion of the risks associated with the subject property if it were to become vacant and may have unreasonably inflated those risks.

We are critical of Allen's decision not to, at minimum, estimate the subject's land value. Despite failing to estimate the subject's land value, Allen determined the value of the subject property as improved exceeds its value as vacant in his highest and best use analysis. It is unclear how he came to that conclusion.

We note the other two appraisals in the record include a land valuation close to or exceeding Allen's estimate of the subject property's total value as improved. Manternach estimated land value at $5,030,000 and the Iowa DOT appraisal estimates a value for the site of $7 per-square-foot, or $6,641,187. While Lowes criticizes those land value opinions, it did not offer an opinion of its own.

In his reconciliation, Allen considered the sales comparison approach the "primary indicator of value" and gave less weight to the income approach. (Ex. 2, p. 80).

b. Manternach's Appraisal

Manternach considered six sales in his comparable sales approach. (Ex. B, p. 44). We find Sale 1 represents a land sale and give it no weight. We find Sales 4 and 6 represent distressed transactions and Manternach did not make an adjustment to account for any distortion to the sales price as required by section 441.21(1). Thus, we do not give these sales any consideration. While Sale 3 was also distressed, Manternach made an adjustment for this fact. Nonetheless, the facts indicate the buyer was primarily interested in acquiring the property to build a convenience store on the outlot and had no intention of using the existing improvements. As a result, we do not believe this transaction represents continued retail use and would give it less weight.

Of Manternach's sales, we find Sales 2 and 5 offer the best representation of the subject's fair market value in its current use. Although both sales were vacant prior to their purchase, there is no indication the vacancy was the result of a forced sale or the prior owner's financial distress. The properties were renovated post-sale and Manternach adjusted for differences in condition between the comparables and the subject. The properties were used for single-tenant retail use after purchase, which enhances their persuasiveness. At $95.32 and $99.02, the adjusted prices per-square-foot of these sales indicate the subject's fair market value is approximately $12,700,000.[10]

Lowes heavily criticizes Manternach's land-to-building ratio adjustments because of topography issues associated with the subject's site. While the parties somewhat dispute the amount of the site impacted by topography issues, in Manternach's opinion 15% of the subject site was unusable. (Tr. P. 281). If we were to deduct 15% from the subject's site area, the subject would still have a land-to-building ratio of roughly 6.0 and exceed all of Manternach's comparables. Thus, making an adjustment for land-to-building ratio seems reasonable. Although Lowes can critique the degree of adjustment, its criticisms ring hollow in the absence of a competing land valuation.

Here, while we acknowledge and, in some respects, agree with Lowes concerns, we believe the problems with Manternach's sales and his adjustments are less severe than the problems with Allen's sales. We can question the support for and degree of some of Manternach's adjustments, but we must also recognize that Allen failed entirely to make adjustments that were necessary to valuing the fee simple interest of the subject property in its current use.

In his income approach, Manternach considered thirteen existing leases and one listing. (Ex. B, p. 48). Like Allen's report, Manternach's appraisal also lacks substantial detail regarding these properties. However, we find his lease comparables offer a better

---

[10] ((95.32+99.02)/2) x 131,569 = $12,784,559

indication of the subject's current use and January 1, 2017 market value than those selected by Allen. The buildings are of more similar age as the subject and the tenants appear to consist mostly of first-generation occupants. Notably, Manternach accounted for the value of the roofed sales area and garden center in his income analysis.

To estimate a capitalization rate, Manternach considered comparable sales, mortgage equity analysis, and investor surveys. While limited in detail, we acknowledge that Manternach's comparable sales' capitalization rate estimate did not rely upon tenants with well-documented financial difficulties, such as those Allen used. His capitalization rate estimate is consistent with his mortgage equity analysis and the *Investment Bulletin*.

In estimating the subject's land value at $5,030,000, Manternach relied on five land sales. He then estimated the replacement cost new of the main store, roofed sales area, garden center, and canopies at $9,450,416. He applied physical depreciation of 35% and an adjustment of 10% for functional and external obsolescence. In total, he concluded a value by the cost approach of $11,300,000.

When reconciling to his final opinion of value, Manternach gave consideration to all three approaches. He acknowledged, however, that he gave less consideration to the cost approach than the sales comparison and income approaches. He testified he gave 45% weight to the sales and income approaches and 10% weight to the cost approach. (Tr. p. 299, ln. 10-15). Ultimately, his approaches and reconciled opinion support Lowes assertion that the subject property's 2017 assessed value is excessive.

IV. Conclusion

Having considered the evidence, testimony, briefs, and the record in full, we find that Manternach's appraisal offers the most persuasive evidence of the subject property's market value as of January 1, 2017. We conclude Manternach's reconciled value of $10,940,000 is the most reliable indication of the subject property's market value as of January 1, 2017.

Order

PAAB HEREBY MODIFIES the Johnson County Board of Review's action for the January 1, 2017 assessment to $10,940,000.

This Order shall be considered final agency action for the purposes of Iowa Code Chapter 17A (2017).

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.

Karen Oberman

____
Karen Oberman, Board Member

Dennis R Loll

____
Dennis Loll, Board Member

Elizabeth Goodman

____
Elizabeth Goodman, Board Member

Copies to:

Ryan Gibbs for Lowes by eFile

Ryan Maas for Johnson County Board of Review by eFile

Johnson County Auditor
913 South Dubuque Street
Iowa City, IA 52240