

REPRESENTATIVE FOR PETITIONER: Paul M. Jones, Jr., Attorney

REPRESENTATIVE FOR RESPONDENT: Marilyn Meighen, Attorney

**BEFORE THE
INDIANA BOARD OF TAX REVIEW**

CVS Pharmacy, Inc. #6637-02,)	
)	Petition No. 73-002-07-1-4-12801
Petitioner,)	Petition No. 73-002-08-1-4-12801
)	
)	Parcel No. 73-11-05-100-323.000-002
v.)	
)	Shelby County, Addison Township
Shelby County Assessor,)	
)	2007 and 2008 Assessments
Respondent.)	

Appeal from the Final Determination of the
Shelby County Property Tax Assessment Board of Appeals

November 15, 2011

FINAL DETERMINATION

The Indiana Board of Tax Review (Board) has reviewed the evidence and arguments presented in this case. The Board now enters its findings of fact and conclusions of law.

ISSUE

Both parties claim the 2007 and 2008 assessment determinations by the Property Tax Assessment Board of Appeals for this CVS retail drug store should be changed. Although they primarily rely on the income capitalization approach to value, CVS and the Assessor reach substantially different conclusions. Did CVS prove the assessments are too high and a more accurate value would be \$1,250,000 for each year, or did the Assessor prove the assessments are too low and more accurate values would be \$3,330,000 for 2007 and \$3,470,000 for 2008?

HEARING FACTS AND OTHER MATTERS OF RECORD

1. The subject property is a CVS general retail store and pharmacy. The Form 131 states that it is located at 327 East Broadway in Shelbyville; however the rest of the evidence has the street address as 200 South Harrison Street.¹
2. The Petitioner initiated an assessment appeal by filing a Form 130. The Property Tax Assessment Board of Appeals (PTABOA) mailed its decision on April 1, 2010. The Petitioner filed a Form 131 with the Board on May 10, 2010.²
3. The PTABOA determined the 2007 assessed value was \$194,700 for land and \$2,180,900 for improvements (\$2,375,600 total). The PTABOA determined the 2008 assessed value was \$194,700 for land and \$2,265,000 for improvements (\$2,459,700 total).
4. The Petitioner contends the total assessed value should be \$1,250,000 for both years. The Respondent, however, contends the total assessed value should be increased to \$3,330,000 for 2007 and \$3,470,000 for 2008.
5. Administrative Law Judges Kay Schwade and Ted Holaday held a hearing on these appeals on April 19, 2011. There was no on-site inspection by the Administrative Law Judges or the Board.
6. Carla Bishop and Rich Correll were sworn as witnesses for the Petitioner. Leo Lichtenberg was sworn as a witness for the Respondent.

¹ A map on page 39 of the Advisio Appraisal shows the subject property is located at the intersection of Broadway and Harrison, which may explain the differing street addresses.

² The Form 130 and the Form 131 both state that the owner of the property is CVS Pharmacy, Inc. #6637-02. But the evidence indicates that statement is not accurate. The owner appears to be SCP 2001A-CSF-19 LLC. The Petitioner's interest in the property appears to be based on a lease of the subject property to Hook-SupeRx, Inc. as the tenant. A provision in that lease makes the tenant responsible for property taxes. Although nobody explained it, there appears to be some sort of business relationship between the Petitioner and Hook-SupeRx, Inc. that is the basis for the operation of this particular CVS store/pharmacy. The Respondent did not dispute the status of CVS as the proper party to bring this case, presumably because CVS is paying the taxes. Consequently, although the record is ambiguous about it, in this instance the Petitioner's status will be accepted as sufficient.

7. The Petitioner presented the following exhibits:
 - Petitioner Exhibit A – Form 130 with attachments for 2007,
 - Petitioner Exhibit B – Form 130 with attachments for 2008,
 - Petitioner Exhibit C – Form 131 with attachments for 2007,
 - Petitioner Exhibit D – Form 131 with attachments for 2008,
 - Petitioner Exhibit E – “Real Property Ad Valorem Report, Market Value In Use”
prepared by Carla Bishop,
 - Petitioner Exhibit F – Memorandum of Law,
 - Petitioner Exhibit G – Subject property record cards,
 - Petitioner Exhibit H – Letter dated April 15, 2011, from Richard Correll regarding
his review of the Advisio Appraisal.

8. The Respondent presented the following exhibits:
 - Respondent Exhibit A-1 – The lease for CVS Store #6637,
 - Respondent Exhibit A-2 – Assessor’s Request for Production of Documents,
 - Respondent Exhibit B – Summary Appraisal Report prepared by ADVISIO Real
Estate Advisors & Appraisers (Advisio Appraisal),
 - Respondent Exhibit C – “Definitions,”
 - Respondent Exhibit D – Sales disclosure form for the subject property dated
December 31, 2001.

9. The following items are recognized as part of the record:
 - Board Exhibit A – Form 131 petitions with attachments,
 - Board Exhibit B – Notice of Hearing,
 - Board Exhibit C – Hearing Sign-In Sheet.

SUMMARY OF THE PETITIONERS' CASE

10. The subject property is used as a CVS general retail store and pharmacy. This store was built in 2002 and is the generation of stores CVS was building from the late 1990's through the early 2000's. The store has a total of 11,100 square feet with 10,125 square feet of net leasable area. It is on 0.91 acres of land. *Bishop testimony.*

11. Carla Bishop is a Certified Member of the Institute for Professionals of Taxation (CMI). She is a Certified Indiana Tax Representative and an Indiana Level II Assessor-Appraiser. She has specific knowledge about, and experiences with CVS—more specifically, the business model, the leases, and other important considerations for the valuation of CVS stores. She is not a licensed appraiser, but Ms. Bishop has taken courses similar to those required for an appraiser. Ms. Bishop is employed by Meritax, LLC. Meritax is a property tax consultant that is representing CVS for a contingent fee. Ms. Bishop, however, does not share in the profits of Meritax. *Bishop testimony.*

12. The Bishop Report applied generally recognized appraisal principles to estimate the fee simple value of the subject property as if unencumbered by a lease. The Bishop Report begins with the following statement:

On behalf of our client, we have prepared a report to the above-referenced location for the purpose of estimating the market value in use as of the assessment dates January 1, 2006 and January 1, 2007 for assessment dates 2007 and 2008 respectively.

The undersigned [Carla Bishop] does hereby certify that this report has been prepared in connection with her employment by Meritax, LLC who represents the taxpayer/owner of the real estate that is the subject of the enclosed submission. The undersigned is an Indiana Certified Tax Representative. Meritax, LLC nor the undersigned is performing an appraisal practice, but is providing valuation services/consulting report as defined in the Uniform Standards of Appraisal Practice (USPAP) as promulgated by the Appraisal Standards Board.

The enclosed valuation services report applies generally recognized appraisal principles and the appraisal methodology of the assessing jurisdiction. The use of the valuation services report is therefore limited and restricted to Ad Valorem tax purposes. This valuation report is to be

used in its entirety and only for the purpose of which it was intended. The statements of fact contained herein, upon which our analysis, opinions and conclusions are based, are, to the best of our knowledge and belief, reliable.

/s/ Carla D. Bishop, CMI
Indiana Certified Tax Representative (#993)
Indiana Level II Assessor-Appraiser

*Bishop testimony; Pet'r Ex. E at 2.*³

13. When CVS decides to enter into a market, it does not use existing retail space. It locates suitable property and a store is built to CVS specifications.⁴ The property is sold to an investor, who leases that store back to CVS. The investor is not interested in the real estate, but rather, is interested in making an investment tied to the creditworthiness of CVS. The sale-leaseback transaction is a financing tool for CVS. Even though the lease states it is a “true lease,” in reality it is a special financing tied to Section 467 of the Internal Revenue Code. Payments are negotiated on the front end of the deal and are structured so that the investor gets a return of the investment long before the term of the lease ends. They call it “rent” and they put it in a “lease,” but the deal they negotiate “has nothing to do with the real estate....” The payments are not just rent for the real estate and are much more than what anybody else would pay as rent for this property. With a sale-leaseback the tenant’s payments have no relationship to the value of the real estate. The payments are based on the business value of CVS itself. In these sale-leaseback transactions, the investors are looking for a highly reliable source of income for a number of years and they have little or no interest in the real estate. *Bishop testimony; Correll testimony.*

³ Although the Bishop Report states “we have prepared a report” and refers to “our analysis, opinions and conclusions,” the evidence does not indicate that anybody else actually worked on it.

⁴ Ms. Bishop explained that CVS puts these transactions into two categories, namely turnkey lease or sale-leaseback, which she testified “both look a lot alike to me.” She testified that in this particular case CVS considered it to be a turnkey lease. But all of the other evidence in this case used the term sale-leaseback. From what was present it is not clear that the two terms are mutually exclusive. If there is a difference, neither party established what it is or how it might be significant. Regardless, to be consistent with the bulk of the evidence and its terminology, we will refer to the relevant transaction involving the subject property as a sale-leaseback.

14. The market value-in-use and the assessment must be based on the fee simple interest in the property, not a leased fee interest. The Indiana Board's decisions in *Kerasotes* and *Schooler* recognize this point. Market rent must be used to properly determine fee simple value of real estate from the income approach. *The Appraisal Of Real Estate* has guidance saying it is a standard appraisal procedure to determine market rent when using the income approach to estimate a fee simple value for a property. *Bishop testimony; Pet'r Ex. E at 4; Jones argument.*
15. A lease in place for a subject property can be considered, but one needs to determine if it actually represents market rent. Only looking at contract rent could lead to valuations that are higher or lower based on the quality of management or motivations in negotiating a particular lease that go beyond the real estate. In this case, nobody else would pay rent at the amount specified in the CVS lease—nothing else in Shelby County has a lease rate at this level. Using the contract rent (lease payments) for the subject property as the basis for an income capitalization approach to value would not lead to a fee simple value. Furthermore, the market rent needs to be the general market, it cannot be determined by examining only other CVS properties because those rates were all negotiated like the transaction for the subject property (with some differences). *Bishop testimony.*
16. In determining market rent, Ms. Bishop considered nine similar free standing retail stores as comparables. Each of the comparables had been built and used as free standing retail drug store properties, but had been vacated by their first generation occupants. They are currently being marketed for continued use as retail locations by second generation occupants. The Addendum to the Bishop Report shows these comparables are former CVS and former Walgreens locations throughout Indiana. The asking rents of those comparable stores range from \$5.00 to \$11.00 per square foot. In addition to the Indiana comparables, Ms. Bishop considered data from 15 comparables from the national market. They had asking rents ranging from \$6.67 to \$12.00 per square foot. The average and the median for all these comparables were both about \$9.00 per square foot. Considering the age and location of the subject property, Ms. Bishop determined a market rent rate would be \$10.00 per square foot if the subject property were leased to someone other than CVS.

According to Ms. Bishop, using \$10.00 served as adjustments for factors such as age, location, and size—with each adjustment being the difference between \$10.00 and the advertised rent rate. For example, the comparable located at 2002 North Arlington was built in 1965 and rents for \$5.00 a square foot. Because the selected market rent rate is \$10.00 a square foot, the adjustment for age and an inferior location is \$5.00 a square foot. The reasoning for each adjustment is explained in the “Comments” section of the chart. *Bishop testimony; Pet’r Ex. E at 4-5.*

17. All these comparables were vacant properties, but Ms. Bishop was uncertain of exact dates for when the properties were vacated. One subsequently was rented to a Dollar General Store. Ms. Bishop acknowledged that the reasons for vacancy should be considered. Nevertheless, she did not know why some of the first generation occupants decided to vacate some of the comparables. She also testified that she did not presume to know why some of the comparables were sitting vacant. When speaking about a former CVS store, Ms. Bishop admitted that she had not checked to determine if restrictions precluded that location from being used as another drug store. *Bishop testimony.*
18. With 10,125 square feet of leasable space and market rent at \$10.00 per square foot, the annual gross potential income for the subject property would be \$101,250 for 2006 and 2007. *Bishop testimony; Pet’r Ex. E at 5.*
19. Then to determine net operating income, Ms. Bishop used a 1% market vacancy and 1% for expenses based on a review of several CVS store appraisals. (Owner’s expenses are minimal because these leases are typically triple net leases where the owner is responsible for very little expense and the tenants pay all real estate taxes, insurance, common area maintenance and utilities.) The resulting net operating income (NOI) according to Ms. Bishop’s calculation would be \$99,235 for 2006 and 2007. *Bishop testimony; Pet’r Ex. E at 5.*
20. The Bishop Report contains the following explanation about selection of the capitalization rate:

The market capitalization rate was selected from the *Korpacz Real Estate Investor Survey*. We reviewed the Fourth Quarter 2005 and Fourth Quarter 2006 reports. The data representing the National Net Lease market was reviewed.

For the January 1, 2006 valuation date the overall capitalization rate (OAR) range from the *Korpacz Survey* was 6.25% to 10.00% with an average of 7.67%. Upon deeper review of the survey responses the range for retail properties can be narrowed to 6.50% to 10.00%. Based upon the data an overall capitalization rate of 8.0% was selected for the subject property.

The *Korpacz Survey* [*sic*] reported for the January 1, 2007 valuation date an overall cap rate (OAR) range of 6.00% to 10.00% with an average of 7.65%. Based upon the data an overall capitalization rate of 8.0% was selected for the subject property.

In addition, Ms. Bishop testified that she also considered the only local market information she could find, a 2006 Golden Corral offering with a 7.75% capitalization rate. The 8.0% capitalization rate she used fits with both sources. *Bishop testimony; Pet'r Ex. E at 6.*

21. Applying the capitalization rate of 8% to the \$99,235 NOI, results in an indicated value of \$1,240,439. Thus, the rounded valuation based on the income capitalization approach would be \$1,250,000 for both years. *Bishop testimony; Pet'r Ex. E at 6.*
22. Ms. Bishop developed the cost approach primarily based on the property record card. The value indicated by the cost approach is \$1,325,000. But the cost approach was not relevant because it is not a strong indicator of how a potential purchaser would value the property. *Bishop testimony; Pet'r Ex. E at 7.*
23. Ms. Bishop did not develop a sales comparison approach because she could not find comparable sales that were not encumbered by a lease. Most of the sales she found involved a long term lease with a credit-worthy tenant so the transaction was the purchase of a leased fee value and not a fee simple value. Of the sales she indentified, only one sale was still used for retail. And one sale cannot be the basis of a sales comparison analysis. *Bishop testimony; Pet'r Ex. E at 7.*

24. Because CVS is an income producing property, the income approach is the best indicator of value and has the most weight. The market value-in-use of CVS is \$1,250,000 for both March 1, 2007 and March 1, 2008. *Bishop testimony; Pet'r Ex. E at 9.*
25. Richard Correll reviewed the Advisio Appraisal that the Respondent claims supports a much higher value. (He did not do a review appraisal for this case and he provided no estimate of value or a range of values for this CVS property.) Mr. Correll is an Indiana Certified General Appraiser with 25 years experience in appraising commercial property—15 years in Indiana. He also has appraised properties in 28 other states. He deals with the leased fee and fee simple issue in appraisals on a regular basis. *Correll testimony.*
26. Indiana's property tax system has some definitions that are in conflict with the rest of the country. Specifically, "market value-in-use" is "somewhat of a conundrum." And "use value" as defined in the *Dictionary of Real Estate Appraisal* really is not "market value-in-use." The "value in use" concept applied in the Advisio Appraisal is not in line with Indiana's "market value-in-use" concept. "Real property has both a use value and a market value, which may be the same or different, depending on the property and the market. *** Use value could be aligned to the enterprise and not have anything to do with markets or exchange. And that's my main point." In most states in this country they use "market value" for assessment. In Indiana assessment is based on "market value-in-use" and that is confusing. *Correll testimony.*
27. Utility of the real estate is not the concept behind the CVS market. Investors buy the leased fee interests in CVS sale-leaseback deals for their yield in relation to their risk. The Advisio Appraisal represents the investment value of CVS rather than market value-in-use of the subject property. The only reason the property would be worth \$3.5 million is the specific 55-page contract that all parties agreed to as a long-term financial instrument. But if we tax that value we are not just taxing the interest in real estate. The problems with the approach in the Advisio Appraisal for the purposes of this case are

explained in more detail in the letter dated April 15, 2011, but this letter is not intended to be a review appraisal. *Correll testimony; Pet'r Ex. H.*

28. The Petitioner is not required to present an appraisal in order to make its prima facie case. The Petitioner presented a USPAP compliant report prepared by a Level II assessor-appraiser valuing CVS as of the appropriate valuation dates. The Respondent's appraisal is flawed because it is valuing something other than the "sticks and bricks." The valuation proposed by the Respondent is valuing intangible items not subject to property taxation. *Jones argument.*

SUMMARY OF THE RESPONDENT'S CASE

29. The Respondent engaged Leo Lichtenberg and his company, ADVISIO, to appraise the subject property. Mr. Lichtenberg is an MAI Appraiser and an Indiana Certified General Appraiser with 19 years experience. Commercial and industrial appraisals make up about 99% of his appraisal work. Those types of properties have included everything from a Village Pantry mini-mart to a military facility. His experience includes appraising other CVS retail stores. *Lichtenberg testimony.*
30. The Advisio Appraisal was prepared by Mr. Lichtenberg in February 2011—including an inspection of the subject property on February 24, 2011. The summary appraisal report was submitted to the Respondent's counsel on March 8, 2011. The initial sections of the Advisio Appraisal at pages 11 and 12 contain the following explanations:

The purpose of this appraisal is to estimate the market value, as of the date of valuation, of the leased fee and fee simple interest for the subject property....

The interest appraised will be the fee simple estate.

A value in use is determined in this appraisal. Value in use is defined as follows: "The value of a property assuming a specific use, which may or

may not be the property's highest and best use on the effective date of the appraisal. Value in use may or may not be equal to market value but is different conceptually." [footnote omitted]. Value in use implies a value to a particular user. In the subject's instance, the particular user is CVS and the specific use is a general retail store and pharmacy.

The Advisio Appraisal used all three approaches to value, but placed more emphasis on the income approach. It concluded that the market value in use of the leased fee interest in the subject property was \$3,330,000 as of January 1, 2006, and \$3,470,000 as of January 1, 2007. It also concluded that the leased fee value in use and fee simple value in use are equivalent. *Lichtenberg testimony; Resp't Ex. B at 3, 5, 11-12, 74.*

31. The development of the cost approach is shown on pages 44 through 52 in the Advisio Appraisal. Comparable land sales indicated the land value of the subject property (0.91 acres) was \$390,000. Then using Marshall Valuation Service cost tables, Mr. Lichtenberg determined the total depreciated replacement cost for the building and site improvements was \$1,387,200. Thus, the total value indicated by the cost approach was approximately \$1,780,000. This approach was considered to be a weak indicator in the final reconciliation of value because "investors typically consider the income and sales comparison approaches as the strongest indicators of value for net leased properties." *Lichtenberg testimony; Resp't Ex. B at 44-52, 73.*
32. The development of the sales comparison approach is shown on pages 53 through 61 in the Advisio Appraisal. Mr. Lichtenberg selected sales of CVS stores with long term leases in place because they reflect the actions of investors. Comparable Sale 1 is a CVS in Dayton, Ohio. It sold in June 2008 for \$2,355,521. It was built in 1997, has 12,608 square feet of leasable area, and approximately nine years remaining on the lease. Comparable Sale 2 is a CVS in Fairborn, Ohio. It sold in May 2008 for \$1,836,000. It was built in 1996, has 10,722 square feet of leasable area, and a little more than eight years remaining on the lease. Comparable Sale 3 is a CVS in Coon Rapids, Minnesota. It sold in May 2007 for \$5,533,087. It was built in 2006, has 12,900 square feet of leasable area, and almost 24 years remaining on the lease. Comparable Sale 4 is a CVS in Fort Washington, Maryland. It sold for \$2,951,000 in April 2007. It was built in

2000, has 10,125 square feet of leasable area, and almost 14 years remaining on the lease. *Lichtenberg testimony; Resp't Ex. B at 53-61.*

33. The subject property was built in 2001, has an average location, and has 10,125 square feet of leasable area. Comparable Sales 1, 3 and 4 have superior locations while Comparable Sale 2 is located in an average location. The comparables range in size from 10,125 square feet to 12,900 square feet, but analysis did not indicate an adjustment for size was required. Comparable Sales 1 and 2 are older properties and are inferior. Comparable Sale 3 is a newer property and is superior. Comparable Sale 4 is similar in age. Comparable Sales 1, 2, and 4 are inferior in terms of the net operating income per square foot of leasable area. Comparable Sale 3 generates a similar net operating income per square foot of leasable area. *Lichtenberg testimony; Resp't Ex. B at 58 and 59.*
34. The sales of comparable properties indicate an adjusted range between \$171.24 and \$443.42 per square foot of leasable area. Comparable Sale 4 is most similar to the subject property and sold for \$301.31 per square foot of leasable area. Comparable Sale 4 was given the most weight, but is tempered somewhat by the higher end of the range. Furthermore, the subject property transferred for \$372.29 per square foot of leasable area. These sales indicate a value of \$350 per square foot of leasable area is reasonable. The value indicated by the sales comparison approach is \$3,540,000 as of March 2008. *Lichtenberg testimony; Resp't Ex. B at 61.*
35. Pages 62 through 72 in the Advisio Appraisal show how a value was developed by using the income capitalization approach, which was considered to be the strongest indicator. *Lichtenberg testimony; Resp't Ex. B.*
36. Because of what he knew from appraising other CVS stores and anticipating a long term lease would be involved, Mr. Lichtenberg obtained a copy of the lease for the subject property that is fundamental to his analysis. “[T]he lease has a lot to do with the value. *** Investors across the market are looking at these properties and they’re saying, ‘What kind of income/revenue stream can I get?’ And then, ‘what is the remaining term of the lease?’” Investors are not willing to pay as much for a property when it has a lease that is

getting ready to expire. Investors will also consider gross sales—if they are good, there is a good chance the lease will be renewed, but if gross sales are not good there is a good chance a property will be vacated at the end of the lease. The lease for the subject property covers the time from December 2001 through January 2024. *Lichtenberg testimony; Resp't Ex. A-1.*⁵

37. The lease references Section 467 Loan provisions, but it also clearly states that both parties agree that the lease is a true lease and is not a financing arrangement. The lease terms are all standard terms with exception to the Section 467 Loan provision. *Lichtenberg testimony; Resp't Ex. A-1 at 9, 13, 14.*
38. Lease Schedule 2, Fixed Rent Amounts, lists the rent for each month until the expiration of the lease in 2024. The annual rent for 2007 and 2008 was \$430,206. That is the same as \$42.49 per square foot, but the rent decreases over time. *Lichtenberg testimony; Resp't Ex. A-1.*
39. Lease Schedule 5, Additional Lease Terms, provides that the “estimated fair market sales value of the building as of the lease commencement date” was \$3,770,492. *Lichtenberg testimony; Resp't Ex. A-1.*
40. In the income capitalization approach, the rent structure of the subject property was compared to other rent comparables. All these comparables are other CVS stores. Rent Comparable 1 is located in Indianapolis. It was built in 2002 with a 22 year lease expiring in 2024 and gets \$25.50 per square foot. Rent Comparable 2 is located in Nashville. It was built in 2004/2005 with a 20 year lease and gets \$27.34 per square foot. Rent Comparable 3 is located in Seymour. It was built in 1997 with a 20 year lease and gets \$16.52 per square foot. Rent Comparable 4 is located in Brownsburg. It was built in 1999 with a 20 year lease and gets \$24.30 per square foot. Rent Comparable 5 is located in Lebanon. It was built in 2000 with a 20 year lease and gets \$28.50 per square foot. *Lichtenberg testimony; Resp't Ex. B at 64 through 68.*

⁵ This lease identifies the tenant as Hook-SupeRx, Inc. As previously mentioned in footnote 2, there appears to be some sort of relationship between Hook-SupeRx and CVS that was not questioned or explained by either party. They simply treated the distinction as irrelevant.

41. Over the entire lease term, the effective rent for the subject property is \$27.20 per square foot. The range of the comparables is \$16.52 to \$28.50 per square foot. The effective rent for the subject property is within the range of the strongest comparables and is considered reasonable. In this instance, leased fee rent is equivalent to fee simple rent. Accordingly, there is no change in value between the fee simple interest and leased fee interest. *Lichtenberg testimony; Resp't Ex. B at 70.*
42. Using \$27.20 per square foot and 10,125 square feet of leasable area, the effective gross income would be \$275,400. An analysis of the market and *Korpaz Real Estate Investor Survey* data indicated a projected vacancy/collection loss of 1%. Because of the lease structure, the owner does incur any operating expenses. There would be management/administrative costs that are estimated at 1%. With those deductions for vacancy/collection loss and management/administrative costs, the *pro forma* net operating income (NOI) would be \$269,920. *Lichtenberg testimony; Resp't Ex. B at 70-71.*
43. The capitalization rate was selected based on indicated capitalization rates of the same sales comparables considered in the sales comparison approach. Those capitalization rates range from 6.22% to 8.26% for other CVS properties in Ohio, Minnesota, and Maryland. The April 2007 CVS sale in Fort Washington, Maryland, with an effective capitalization rate of 7.36% is most similar to the subject because it had approximately fourteen years remaining on its lease. The subject property had slightly more years remaining on its lease. Therefore, a capitalization rate of 7.25% was selected. After applying a capitalization rate of 7.25% to the *pro forma* NOI of \$272,646, the indicated value derived from the income approach is \$3,723,034. This figure was rounded to \$3,720,000. *Lichtenberg testimony; Resp't Ex. B at 72.*
44. In reconciling the three approaches to value, the cost approach is a weak indicator. “[T]he income approach is considered the strongest indicator as it best reflects actual cash flows expected from the property. Specifically, it reflects the rental levels that are being achieved at the subject property. In addition, it reflects current investor

expectations regarding properties like the subject.” *Resp’t Ex. B at 73*. The sales comparison approach supports the income approach. Furthermore, the most recent sale of the subject property is in the same range. Giving equal weight to the income approach and the sales comparison approach, the “retrospective market value in use of the leased fee interest” as of March 1, 2008, was \$3,630,000. *Lichtenberg testimony; Resp’t Ex. B at 73*.

45. The sales comparison approach indicated comparable properties “escalated” by 4% annually or 0.33% monthly. That rate was used to trend the market value in use of the leased fee interest in the subject property back to a value of \$3,470,000 as of January 1, 2007, and \$3,330,000 as of January 1, 2006. *Lichtenberg testimony; Resp’t Ex. B at 74*.
46. In Indiana, assessors are required to value property for its current use and CVS is a fully functioning pharmacy/retail store. The outcome of this case should not be based on how the *Meijer* or *Trimas* cases were decided. Neither *Meijer* nor *Trimas* involved rental property. In both of those cases assessors failed to defend their assessments properly and what was (or was not) in the record was key to those outcomes. In contrast, the Respondent in this case properly presented a substantial case with the Lichtenberg’s testimony and a USPAP compliant appraisal valuing the subject property as of the appropriate valuation dates. It is sufficient to support the result the Respondent has requested. *Meighen argument*.

ANALYSIS

47. To make a case for an assessment to be changed, one must prove the current assessment is incorrect and specifically prove what the correct assessment would be. *See Meridian Towers East & West v. Washington Twp. Assessor*, 805 N.E.2d 475, 478 (Ind. Tax Ct. 2003); *see also, Clark v. State Bd. of Tax Comm’rs*, 694 N.E.2d 1230 (Ind. Tax Ct. 1998).
48. One also must explain how each piece of evidence is relevant to the requested assessment. *See Indianapolis Racquet Club, Inc. v. Washington Twp. Assessor*, 802

N.E.2d 1018, 1022 (Ind. Tax Ct. 2004) (“[I]t is the taxpayer's duty to walk the Indiana Board ... through every element of the analysis”).

49. Real property is assessed on the basis of its “true tax value,” which means “the market value-in-use of a property for its current use, as reflected by the utility received by the owner of a similar user, from the property.” Ind. Code § 6-1.1-31-6(c); REAL PROPERTY ASSESSMENT MANUAL at 2 (incorporated by reference at 50 IAC 2.3-1-2). The Tax Court has emphasized that the goal of our market value-in-use system is to determine “the value of a property *for* its use, not the value *of* its use.” *Stinson v. Trimas Fasteners, Inc.*, 923 N.E.2d 496, 501 (Ind. Tax Ct. 2010) (relating this distinction to the concept of market value-in-use on its most basic level).
50. The cost approach, the sales comparison approach, and the income approach are three generally accepted techniques to calculate market value-in-use. The primary method for assessing officials is the cost approach. MANUAL at 3. Indiana promulgated a series of guidelines that explain the application of the cost approach. REAL PROPERTY ASSESSMENT GUIDELINES FOR 2002 – VERSION A. A value established by use of those Guidelines, while presumed to be accurate, is merely a starting point. Other evidence relevant to market value-in-use can rebut that presumption. Such evidence may include actual construction costs, sales information regarding the subject or comparable properties, appraisals, and any other information compiled in accordance with generally accepted appraisal principles. MANUAL at 5.
51. Whether it is in the context of an appraisal or other information compiled in accordance with generally accepted appraisal principles, it is essential to be precise about the of the interest that is being assessed in order to stay within the proper bounds of tangible property that is subject to assessment and taxation pursuant to Ind. Code § 6-1.1-2-1. More complex situations such as the sale-leaseback transaction in this case require careful consideration to make sure that only the value of the real estate is assessed and not some other business or investment interest. *See Grant Co. Assessor v. Kerasotes Showplace Theatres*, 2011 Ind. Tax LEXIS 26, at *15-16. In *Kerasotes* and this case the

arguments focused on fee simple interests and leased fee interests. Both cases involved a similar question: “[W]hether, under Indiana’s market value-in-use standard, the subject property should be valued according to the terms of its lease (i.e., contract rent) or according to what other similar properties would garner in rent (i.e., market rent).” *Id.*⁶

52. The Board’s determination in *Kerasotes Showplace Theatres v. Grant Co. Assessor*, (July 15, 2009) found the opinion in *Walgreen Co. v. City of Madison*, 311 Wis. 2d 158, 752 N.W.2d 687 (Wisc. S.Ct. 2008), to be particularly persuasive. The Wisconsin Supreme Court addressed the question of whether a retail property leased at above-market rates should be assessed based on that above-market contract rent instead of market rent. *Walgreen*, 752 N.W.2d at 689. Walgreen operated under a business plan where it worked with developers who found sites for its stores, bought out existing businesses, bought the sites, and developed the sites to suit Walgreen’s needs. *Id.* at 690. Thus, Walgreen’s lease payments included compensation for the developer’s financing, land acquisition, construction, and development costs. They also included the developer’s profit margin. *Id.* The parties agreed that the lease terms therefore included above-market rent. *Id.*
53. In rejecting the city’s position that the assessment should have been based on the property’s contract rents, the court explained that Wisconsin assessed real property based on the fair market value of its fee simple interest. *Id.* at 701. Furthermore, Wisconsin’s Property Assessment Manual provided that, when applying the income approach, an assessor must use market rent instead of contract rent. *Id.* at 695-96. The manual and the court, however, both recognized that when contract rents fall below market rents, the value of a property’s leased-fee interest likely falls below the value of its fee-simple interest. *Id.* Thus, earlier cases had found that, when a property is leased for below-

⁶ Nominally, both parties appear to acknowledge that a proper analysis needs to consider market rent. The Board recognizes that the Respondent and the Advisory Appraisal characterize their analysis as being based on “market rent” as determined from other CVS properties. The evidence, however, indicates that the other CVS properties all have sale-leaseback agreements with almost the same contract terms. Therefore, the characterization of the conclusion as “market rent” is based on limited data. The weight of the evidence, however, indicates that real market rent cannot be determined by examining only other CVS properties. (If it is true that CVS leases and CVS sales represent more than the value of the real estate itself, then examining one, or five, or fifty CVS transactions indicates little, if anything, about the general market.) The conclusions of both parties regarding “market rent” are discussed in detail later and are at the heart of the Board’s determination.

market rates, the property's assessment should be reduced correspondingly with the leasehold's reciprocal value. *Id.* at 696.

54. The Wisconsin manual, however, did not provide for increasing a property's assessment when contract rent is above market rates. That situation was distinguished from the below-market-rent scenario, reasoning that a lease is not part of the bundle of rights associated with fee-simple ownership, but rather an encumbrance rendering the fee-owner's estate a partial estate. *Id.* at 696, 700. As the court noted, its view was consistent with the "nationally recognized principle" found in *The Appraisal of Real Estate* (12th Ed.). *Id.* at 690, 703. As the authors of that treatise explained:

A lease never increases the market value of real property rights to the fee simple estate. Any potential value increment in excess of a fee simple estate is attributable to the particular lease contract, and even though the rights may legally "run with the land" they constitute contract rather than real property rights. Conversely, detrimental aspects of a lease may result in a situation in which either or both of the parties to the lease, and their corresponding value positions, may be diminished.

752 N.W.2d at 701 (quoting *THE APPRAISAL INSTITUTE, THE APPRAISAL OF REAL ESTATE* 473 (12th Ed.)) (emphasis added).

55. The Board is persuaded by the Wisconsin Supreme Court's analysis. That decision was based on Wisconsin law, which calls for property to be assessed based on market value rather than market value-in-use, and it interpreted specific provisions from an assessment manual that have no correlatives in Indiana's Manual or Guidelines. Nevertheless, the fundamental reasoning applies equally under Indiana law—real property is assessed based only on the value of the ownership rights in that property, not on the value of any rights that the property owner may have in a related contract. That is not to say one must ignore actual contract rent. Indeed, the income approach is based on investor behavior, and in determining how much they will pay for a property, investors look at the income stream they anticipate the property will reasonably produce. While those income streams are not technically real property rights, they are connected with those rights and say something about their value. But when contract rent significantly exceeds the rent that a property could otherwise bring on the open market, relying on that contract rent instead

of market rent crosses the line between using contractually required income as a tool for estimating a property's inherent value and actually valuing contract rights as part of an assessment. See *Kerasotes*, 2011 Ind. Tax LEXIS 26, at *15-16 (agreeing with the Board's reliance on *Walgreen*).

56. The fact that Indiana assesses property based on market value-in-use rather than purely on market value does not change that conclusion. In many cases, the difference between the two is highly theoretical and difficult to define. But it is not necessary to delve into the finer distinctions between the two to hold that neither standard allows assessors to assess things other than real property rights for ad valorem taxation. *Id.* at *15; *Trimas*, 923 N.E.2d 496, 501.

57. The Petitioner correctly noted that the Board also addressed a similar question in *Schooler v. Boone Co. Assessor*, (May 2010), and concluded that an assessment must be based on the fee simple interest in a property, not a leased fee interest. Significantly, the *Schooler* determination discusses the importance of valuing that interest based on market rent rather than a contract rent that might be higher or lower than actual market rent. The Board noted that courts in other jurisdictions have recognized that absurd results could come from a valuation system that uses actual rent, which might be more or less than market rent: Under such a system “owners who enter into prudent leases are in effect penalized for good negotiating skills, while the lessors with the below-market leases are rewarded for bad management and poor negotiations by a lower valuation.” *Schooler* at 16. “[I]f tax assessments on the same property were to fluctuate according to the varying terms of a lease, the computation of ad valorem taxes on the basis of such assessments would result in a tax penalty for one who, through business acumen or fortuity, succeeds in leasing his property for an amount in excess of its ‘fair market value’ and a tax windfall to one who, through bad business judgment, leases far below his property’s ‘fair market value.’” *Id.* (quoting *Martin v. Liberty Cty. Bd. of Tax Ass’rs*, 262 S.E.2d 609, 612)(Ga. Ct. App. 1979)).

58. Although a small amount of evidence and argument was introduced that relates to other valuation methods, one of the few things upon which the parties seem to agree is the relative importance of the income approach. It is the only approach to value that was developed in the Bishop Report and the approach the Advisio Appraisal identified as the strongest indicator. Both parties attempted to prove that the existing assessments are wrong, but that point alone (even if it is correct) does not mean changes are required because proving a more accurate valuation is also part of making a case.
59. After reviewing all the evidence and arguments, clearly the crux of the dispute is about the application of the income approach to value— and specifically about what market rent for the subject property really is. Further analysis will focus on that point, which the Board finds to be determinative of both the Petitioner’s claim and the Respondent’s claim.

SHOULD THE ASSESSMENTS BE CHANGED TO THE VALUES INDICATED BY THE BISHOP REPORT?

60. The short answer is no.
61. A market value-in-use appraisal, completed in conformance with the Uniform Standards of Professional Appraisal Practice (USPAP) can be the most effective method to rebut the assumption that an assessment is correct, but that is not a requirement to prove a case. As previously noted, several other ways are recognized as possibilities, including other information compiled in accordance with generally accepted appraisal principles. MANUAL at 5. That is not to say, however, that all possible ways to prove market value-in-use have equal weight and credibility. For example, when a licensed appraiser certifies (among other things) that his or her appraisal was completed in conformance with USPAP standards it normally gives that appraisal a certain amount of weight and credibility that may be lacking (or at least not as manifest) in other forms of evidence.
62. In this case, certain points have some negative impact on the credibility of Ms. Bishop and the Bishop Report. It is not absolutely clear whose work the Bishop Report actually

represents. It states “we have prepared a report” and refers to “our analysis, opinions and conclusions.” Other than Ms. Bishop, however, the “we” and “our” is left to speculation. The background and qualifications of Ms. Bishop are in the record, but if the preparation, analysis, opinions, and conclusions of other individuals are involved in the Bishop Report, nothing was done to establish their backgrounds or qualifications.

63. Perhaps the “we” and “our” references were intended to mean Ms. Bishop speaking for her employer, Meritax, and all the work was her own. Admittedly, the record does not indicate that anybody else actually did some of the work. But it was also established that Meritax is a property tax consultant that is representing CVS for a contingent fee. Even though Ms. Bishop testified she does not share in the profits of Meritax, the nature of her employment relationship and the contingent fee create a significant doubt about the true independence, impartiality, and credibility of the Bishop Report.

64. The most important credibility problems regarding the Bishop Report relate to the determination of market rent, which is a key aspect of its income approach and its conclusion about value. It determined that market rent for the subject property would be \$10.00 per square foot based on nine Indiana comparables that were described as similar free standing retail drug stores. Those properties had been vacated by their “first generation” occupants who had been either CVS or Walgreens. Those properties were vacant and being marketed for continued retail use by “second generation” occupants. The asking rents for those comparables ranged from \$5.00 to \$11.00 per square foot. In addition to the Indiana comparables, 15 comparables from the national market were considered. Those had rents ranging from \$6.67 to \$12.00 per square foot, with an average and median at about \$9.00 per square foot. Ms. Bishop explained that \$10.00 per square foot was determined to be a market rent for the subject property and that she considered the difference between that amount and the asking rent for each comparable to be adjustments for factors such as age, location and size. Brief comments such as “smaller/older” and “much older/inferior location” (Pet’r Ex. E at 5) supposedly explained the reasoning for each “adjustment.” While detail is lacking, at least the concept is understandable.

65. But the Respondent raised serious issues about those rent comparables regarding important points that Ms. Bishop admitted were not considered. Ms. Bishop acknowledged that the reasons for vacancy should be considered, but admitted she did not know why some of the first generation occupants decided to vacate. She also admitted that she did not know why some of the comparables were sitting vacant. And she admitted that she had not checked to determine if restrictions on a former CVS store precluded it from being used as another drug store. These failures go to the very heart of any conclusion about comparability of such properties, and therefore, destroy the basic conclusion that \$10.00 per square foot is an accurate market rent. They also destroy the overall reliability of the value conclusion in the Bishop Report or Ms. Bishop's testimony and nothing else the Petitioner presented provides substantial support for the assessed value it requested.
66. The things that Ms. Bishop and the Bishop Report failed to consider in determining market rent are fatal to the Petitioner's case. The weight of the evidence does not support lowering the assessments to \$1,250,000 as the Petitioner requested.

SHOULD THE ASSESSMENTS BE CHANGED TO THE VALUES INDICATED BY THE ADVISIO APPRAISAL?

67. Again, the short answer is no.
68. As previously mentioned, determining market value-in-use for a property that is the subject of a sale-leaseback transaction requires some care to guard against improperly including value that is not in the real estate itself. Part of that care involves recognizing the difference between a fee simple interest and a leased fee interest—assessments must be based on the fee simple interest, not the leased fee interest. Care must also be exercised in recognizing the difference between contract rent and market rent, “ascertain[ing] whether the sales prices/contract rents reflect real property value alone or whether they include the value of certain other economic interests.” *Kerasotes*, 2011 LEXIS 26, at *16. The fundamental problem with the Respondent's case is that it does

include other economic interests in addition to the real property interest. (Mr. Correll's testimony about utility of the real estate not being the concept behind the CVS market and about investors buying the leased fee interests in CVS sale-leaseback deals for their yield in relation to their risk was convincing.)

69. The Respondent and the Advisio Appraisal blurred the distinction between the specific contract and the general market by using only other CVS properties as comparables. While the data is not limited to only the subject property it also is not true market comparables data. Substantial evidence established that CVS regularly operates with the same (or almost the same) kind of sale-leaseback transactions and those transactions involve an investment component. The Respondent, however, failed to establish the investment component in CVS sale-leaseback transactions was factored out of the value conclusions in the Advisio Appraisal. The Respondent also failed to establish how merely examining multiple versions of CVS transactions, where all the sale prices and lease payments represent more than just real property rights, legitimately proves anything about general market sales or rents. The Petitioner ultimately presented a more substantial and convincing case that leased fee rent is not the equivalent to fee simple rent.
70. Because the Petitioner successfully proved that leased fee rent and fee simple rent for the subject property are different, a fundamental conclusion in the Advisio Appraisal's income capitalization approach—that \$27.20 per square foot is the effective rent for the subject property—is not a credible market rent for the real property interest that should be the basis for assessment. As a result, the *pro forma* operating statement, the net operating income, and the value indicated by its income capitalization approach also are not credible. And that was the value the Advisio Appraisal considered to be the strongest indicator.
71. The sales comparison approach in the Advisio Appraisal supported a similar valuation, but suffers from the same type of problem because its conclusion is entirely based on comparables that all were other CVS properties. Lease terms are noted on the

information about each of those properties and there is no indication that they are exceptions to the evidence about CVS consistently using the same business model. Therefore, those selling prices represent more than just the purchase of a fee simple interest in real property and they do not help to prove what a more accurate assessed value for the subject property might be.

72. Sale-leaseback transactions can involve aspects that make them difficult to use as valid indicators of market value-in-use for Indiana assessment purposes. Care must be taken to not include value that is not attributed to the real estate itself. In this case, the Respondent's evidence of a much higher valuation failed to factor that value out. The weight of the evidence does not support raising the assessments to \$3,330,000 and \$3,470,000 as the Respondent requested.

SUMMARY OF FINAL DETERMINATION

73. After weighing all of the evidence regarding the Bishop Report and the Advisory Appraisal, the Board is not convinced that either one presents a more credible or reliable indication of market value-in-use for the subject property than the assessments that were already established for 2007 and 2008. Accordingly, there will be no changes as a result of these assessment appeals.

This Final Determination for the above captioned matter is issued on the date first written above.

Commissioner, Indiana Board of Tax Review

Commissioner, Indiana Board of Tax Review

Commissioner, Indiana Board of Tax Review

- APPEAL RIGHTS -

You may petition for judicial review of this final determination under the provisions of Indiana Code § 6-1.1-15-5, as amended effective July 1, 2007, by P.L. 219-2007, and the Indiana Tax Court's rules. To initiate a proceeding for judicial review you must take the action required within forty-five (45) days of the date of this notice. The Indiana Tax Court Rules are available on the Internet at <<http://www.in.gov/judiciary/rules/tax/index.html>>. The Indiana Code is available on the Internet at <<http://www.in.gov/legislative/ic/code>>. P.L. 219-2007 (SEA 287) is available on the Internet at <<http://www.in.gov/legislative/bills/2007/SE/SE0287.1.html>>