

REPRESENTATIVE FOR PETITIONER:

Vicki L. Norman, Baker & Daniels, LLP

REPRESENTATIVE FOR RESPONDENT:

Marilyn Meighen, Meighen & Associates, PC

**BEFORE THE
INDIANA BOARD OF TAX REVIEW**

Kerasotes Showplace Theatres, LLC))	Petition No.: 27-023-06-1-4-00825
)	Parcel No: 270336402001102023
Petitioner,)	
)	
v.)	
)	County: Grant
)	
Grant County Assessor,)	Township: Pleasant
)	
Respondent.)	Assessment Year: 2006

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

July 15, 2009

FINAL DETERMINATION

The Indiana Board of Tax Review (“Board”) having reviewed the facts and evidence, and having considered the issues, now finds and concludes the following:

FINDINGS OF FACT AND CONCLUSIONS OF LAW

INTRODUCTION

1. This case requires the Board to weigh competing valuation opinions from different appraisers where the main difference lies in how those appraisers treated a portfolio transaction in which Kerasotes Showplace Theatres, LLC sold and leased back the subject property and sixteen other theaters. Kerasotes's appraisers gave little weight to the allocated sale price and contract rent stemming from that portfolio transaction, while the Grant County Assessor's appraiser relied heavily on those facts. Because there is little evidence to show how the buyer determined the sale price that was allocated to the subject property and the Board is persuaded that market rent is significantly lower than the property's contract rent, the Board finds for Kerasotes.

PROCEDURAL HISTORY

2. On June 27, 2008, the Grant County Property Tax Assessment Board of Appeals ("PTABOA") issued its determination denying Kerasotes's request to reduce the subject property's assessment. On July 28, 2008, Kerasotes timely filed its Form 131 petition asking the Board to review that determination. Indiana Code §§ 6-1.1-15 and 6-1.5-4-1 give the Board jurisdiction over Kerasotes's appeal.
3. On February 4, 2009, the Board's designated administrative law judge, Jennifer Bippus ("ALJ"), held an administrative hearing in Marion, Indiana. She did not inspect the subject property.
4. The following people were sworn in as witnesses:
For Kerasotes:
Michael C. Lady, Integra Realty Resources
James Seet, Integra Realty Resources

For the Assessor:

Tamara Martin, Grant County Assessor
Nancy Leming, Grant County Chief Deputy Assessor

Gary Landrum, Grant County Deputy Assessor
Leo Lichtenberg, Partner, Sr. Appraiser, Will L. Stump & Associates

5. Kerasotes offered the following exhibits:
 - Petitioner Exhibit 1 – Petitioner’s Brief,
 - Petitioner Exhibit 1A – Copy of property record card,
 - Petitioner Exhibit 1B – Summary appraisal report prepared by Michael C. Lady and James Seet,
 - Petitioner Exhibit 1C – “Appraiser’s Sources Referenced Throughout Appraisal Report [:] IBIS World Industry Report – Motion Picture and Video Exhibition in the US – November 30, 2005[;] Paid Admission History for 2002-2008 for the Subject Property[;] Gross Income, Total Expenses and Net Income for the Subject Theatre for years 2001 through 2006[;] Yearly Box Office Statistics for years 1980 through 2008[;] Retail Real Estate – The Motion Picture & Theater Industry Overview – December 2009[;] Claritas Site Reports – Demographic Quick Facts Report for Subject Property,”
 - Petitioner Exhibit 1D – January 19, 2009, letter from James M. DeBruzzi to Vickie Norman,
 - Petitioner Exhibit 1E – Definition of “sale-leaseback,”
 - Petitioner Exhibit 1F – Sales disclosure form,
 - Petitioner Exhibit 1G – Petitioner’s Response to Assessor’s Request for Production of Documents,
 - Petitioner Exhibit 1H – Business tangible personal property assessment returns.

6. The Assessor offered the following exhibits:
 - Respondent Exhibit A – Restricted appraisal report prepared by Leo Lichtenberg,
 - Respondent Exhibit B – Appraisal review by Leo Lichtenberg

7. The Board recognizes the following additional items as part of the record of proceedings:
 - Board Exhibit A – Form 131 petition and attachments,
 - Board Exhibit B – Notice of appearance by Vicki Norman,
 - Board Exhibit C – Notice of appearance by Marilyn Meighen,
 - Board Exhibit D – Notice of hearing
 - Board Exhibit E – Hearing sign-in sheet.

8. The PTABOA valued the subject property’s land at \$1,593,900 and its improvements at \$6,227,100 for a total assessment of \$7,821,000.

9. On its Form 131 petition, Kerasotes requested values of \$552,000 for land and \$3,775,500 for improvements for a total assessment of \$4,237,500. At the hearing, Kerasotes requested a total assessment of \$4,200,000.

FINDINGS OF FACT

A. The Subject Property

10. The subject property contains a 12-screen multiplex theater on 6.9 acres of land behind the North Park Mall in Marion. Kerasotes built the theater and site improvements in 2000, spending \$6,487,110. *Pet'r Ex. 1B at 2*. Although there is some dispute about the theater's exact size, it is between 35,801 square feet and 39,762 square feet. *See Pet'r Ex. 1B at 2, 45; Resp't Ex. B at 51*. It is the only theater in Grant County, and its nearest competitors are 25 miles away in Huntington, Muncie, and Kokomo. *Lady testimony; Pet'r Ex. 1B at 25*.
11. On September 19, 2005, Kerasotes entered into a sale-leaseback transaction with Realty Income Corporation and its subsidiary Crest Net Lease, Inc. (collectively "Crest Net"). In that transaction, Crest Net paid \$200 million to buy a portfolio of 17 theaters, which it concurrently leased back to Kerasotes. *Lady testimony; Pet'r Ex. 1B at 2*. Crest Net determined the value for both the portfolio and the individual theaters, and Kerasotes agreed to those amounts. *Pet'r Ex. 1D*. As a result, \$7,821,836 was allocated to the sale of the subject property. *Id.; Pet'r Ex. 1F*.
12. The leases involved fully equipped theatres that Kerasotes had operated under its brand for at least five years. *Lady testimony*. Each lease was "triple net," meaning that Kerasotes pays each property's (1) taxes, (2) insurance, and (3) operating expenses and typical maintenance. *Lichtenberg testimony; Pet'r Ex. 1B at 59*. The subject property's lease covers 20 years with three five-year renewal options. *Id.* The annual rent is \$633,568.68, or \$17.70 per square foot. *Pet'r Ex. 1B at 59*.

13. On May 12, 2008, Crest Net sold the subject property to a Florida-based company, EDB Properties, LLC, for \$7,679,620. *Lichtenberg testimony; Resp't Ex. A at 14.*

B. Lady and Seet Appraisal

14. Kerasotes engaged Michael C. Lady and James Seet from Integra Realty Resources to appraise the subject property. *Pet'r Ex. 1B.* Lady is a Member of the Appraisal Institute (“MAI”) and an Indiana Certified General Appraiser. He has extensive experience in appraising commercial properties, including theaters. *Lady testimony; Pet'r Ex. 1B at Addendum A.* Seet is an Indiana Certified General Appriaser. *Pet'r Ex. 1B, addendum A.* Lady and Seet certified that they developed their opinion and prepared their summary appraisal report in conformity with the Uniform Standards of Professional Appraisal Practice (“USPAP”). *Pet'r Ex. 1B at cover, 71.*
15. In their report, Lady and Seet estimated the retrospective market value-in-use of a fee simple interest in the subject property at \$4,200,000 as of January 1, 2005. *Pet'r Ex. 1B at cover letter.* Their value conclusion differed significantly from the price allocated to the subject property in the 2005 portfolio sale because the portfolio price reflected contract rents— rather than market rents—for net leases of the individual portfolio properties. *Id. at 2; Lady testimony.*

1. Lady and Seet’s treatment of the 2005 portfolio sale and resulting lease

16. Lady and Seet explained that, over the past 10 years, a national investment market in net leases has evolved as more international investment capital has sought real estate associated with brand names that have established operating records. *Id.* In cases where a property includes specialized furniture and fixtures and has limited alternative uses, the fee simple value, as determined by typical retail rents for properties with comparable physical characteristics, can be significantly lower than the leased fee value based on contract rent. *Id.* Thus, as Lady and Seet explained, sale-leasebacks have become a popular technique for movie exhibitors to finance converting their theaters to larger

facilities with more screens, stadium-style seating, digital-projection capabilities, and multiple concession areas. *Pet'r Ex. 1B at 24-25*. In fact, most sales and leases within the industry are now sale-leasebacks. Also, most of the movie theaters involved in sale-leaseback transactions are already equipped and operated by national exhibitors, and the transactions do not seem to allocate income between real estate, "FF&E," and intangible value. *Id.*

17. Lady and Seet believe that the same was true for the transactions in this case. While the portfolio sale contracts and concurrent leases do not explicitly address those facts, the theaters were fully equipped and, in many cases, had been operated for at least five years under Kerasotes's brand. *Lady testimony; Pet'r Ex. 1B at 2*. And Lady and Seet did not have any information showing that Crest Net gave separate consideration either for furniture, fixtures and equipment, or for intangible value assigned to the properties being associated with a nationally branded movie exhibitor. *Id.* Lady and Seet therefore concluded that the subject property's contract rent did not reflect market rent for real estate only. *Id.*

2. Lady and Seet's valuation approaches

18. In estimating the property's value, Lady and Seet considered and developed the cost, sales-comparison, and income approaches. They estimated values of \$4,480,000, \$3,940,000 and \$4,190,000, respectively under those approaches. *Pet'r Ex. 1B*.

a. The cost approach

19. Lady and Seet estimated that the subject property's land was worth \$75,000 per acre or \$518,000 in total. *Id. at 42-43*. They looked at two different data sets in valuing the subject property's improvements—(1) typical construction costs from *Marshall Valuation Service* ("MVS"), and (2) Kerasotes's actual costs. *Lady testimony; Pet'r Ex. 1B at 44-52*. Using MVS data, Lady and Seet estimated a replacement cost new of \$6,056,273. *Pet'r Ex. 1B at 45*. In doing so, Lady and Seet used a January 1, 2005, unit

cost of \$130.23 per square foot, which they applied to a total area of 35,801 square feet. *Id. at 44-45.* Because the MVS data only included direct costs, Lady and Seet added 3% for indirect costs and 10% for entrepreneurial incentive. *Id.*

20. Lady and Seet then used the age/life method for estimating depreciation and determined that the theater building and site improvements had depreciated 13% and 25%, respectively. *Id. at 48-49.* Lady and Seet also determined that the improvements suffered from functional and economic obsolescence. Based on what the Lady and Seet described as the industry rule of thumb that a population of 10,000 is required to support one screen, the subject property's market should not support 12 screens. *Pet'r Ex. 1B at 26, 34.* Lady and Seet therefore viewed the subject property's 12 screens as a super-adequacy—a form of functional obsolescence. *Lady testimony; Pet'r Ex. at 34.* They also felt that Kerasotes's declining revenues between 2002 and 2006 showed that the subject property suffered from obsolescence. Ultimately, they estimated functional and economic obsolescence totaling 20%. *Id.; Pet'r Ex. 1B at 47 – 48.*
21. Kerasotes's actual costs were greater than the typical costs that Lady and Seet estimated using MVS data. The biggest difference was Kerasotes's site-improvement costs, which were 120.2% more than Lady and Seet estimated using MVS data. *Lady testimony; Pet'r Ex. 1B at 52.* Lady and Seet attributed that difference largely to extraordinary costs for off-site drainage and therefore relied on their MVS-based estimate. *Pet'r Ex. 52; Lady testimony.*
22. In conjunction with their cost-approach analysis, Lady and Seet also used lease constants to estimate the annual rent that potential investors might require from the subject property. According to Lady and Seet, developers and investors often use a lease constant to estimate the rental rate necessary to obtain a return of, and a desired return on, capital invested in constructing or acquiring property. A lease constant can be abstracted from market data where construction costs for net-leased properties are known. Lady and Seet used lease constants from five properties that were built in 2005-2006. Those lease constants ranged from 7.52% to 9.11%, with an average of 8.27%. Applying those lease

constants to the subject property's MVS costs, its rent should be between \$9.41 per square foot and \$11.40 per square foot. *Pet'r Ex. 1B at 53.*

b. The sales-comparison approach

23. In their sales-comparison analysis, Lady and Seet focused on sales of theaters that: (1) were most similar to the subject property in physical characteristics, effective age and condition, and size, and (2) were not involved in sale-leaseback transactions. *Pet'r Ex. 1B at 4, 54; Lady testimony.* Lady acknowledged that finding comparable properties was a difficult task; he and Seet had to determine whether the sales were individual sales or part of portfolio transactions and whether real property rights were the only thing transferred. Lady and Seet excluded sales involving synthetic leases where the buyers were really looking at the seller-lessee's creditworthiness and cash-flow rather than at the real estate being sold. *Lady testimony.* Because Lady and Seet could not find any non-leaseback theater sales in Indiana, they analyzed six out-of-state sales from local markets that they believed were similar to Marion. *Lady testimony; Pet'r Ex. 1B at 55-57.* Only one involved a sale-leaseback. Nonetheless, the sales had a wide range of prices per screen and Lady and Seet did not inspect all of the properties. They therefore concluded that the sales-comparison approach was the least reliable approach for estimating the subject property's value. *Lady testimony; Pet'r Ex. 1B at 54-58.*

c. The income approach

24. Under their income-capitalization analysis, Lady and Seet first estimated market rent for the subject property. Although they looked at Kerasotes's actual contract rent of \$17.70 per square foot, that number raised a "red flag" because it represented 27.5% of the property's gross revenues. *Lady testimony; Pet'r Ex. 1B at 27-28.* By contrast, the national standard for theaters was only 11.5%. *Id.*
25. Lady and Seet therefore looked for comparable properties from which they could estimate market rent. They selected three Indiana theaters about which they had first-

hand knowledge. *Lady testimony*. The first was Metropolis One Theater in Plainfield. It is a “build to suit” property with 18 screens situated in a new open-air lifestyle mall in a major growth area on the west side of Indianapolis. *Id.*; *Pet’r Ex. 1B at 59-60*. *Lady testimony*. The second property was Kerasotes Show Place Theater in Indianapolis. Like the subject property, it is a new 12-screen theater, built to suit for Kerasotes in 2000. *Lady testimony*. It is located in Glendale Town Center, which has recently been redeveloped. The center has a major anchor tenant (Macy’s) and a new Target store. *Id.* The third property was a free-standing theater from Valparaiso that was built in 1977. That theater sits on the southwest corner of a community shopping center. *Id.*

26. The per-square-foot base rents ranged from \$7.87 for the older theater in Valparaiso to \$23.18 for the new megaplex in Plainfield, with the Glendale Kerasotes theater in the middle at \$13.50. *Pet’r Ex. 1B at 60*. All three leases also contained percentage-rent clauses. For the Plainfield and Valparaiso theaters, that rent was 8% of sales above specified levels. For the Glendale Kerasotes, it was 10% of annual sales over annual rent. *Pet’r Ex. 1B at 60*. All three leases also included charges for CAM.¹

27. Lady and Seet found that a reasonable market rent for the subject property was between the \$7.87-per-square-foot rate for the Valparaiso theater and the \$13.50-per-square-foot rate for the Glendale Kerasotes theater. Although the Glendale Kerasotes theater is similar to the subject property in many respects, it is in a superior market with better demographics and better projected revenue. *Pet’r Ex. 1B at 62*. Lady and Seet therefore settled on \$11-per-square-foot as reasonable market rent. *Id.* They found additional support for that estimate by looking at: (1) leases of non-theater commercial properties, (2) the subject property’s gross revenues from 2005, and (3) the lease constants developed under their cost-approach analysis. The non-theater leases showed rent ranging from roughly \$9.38 per square foot to \$12 per square foot. Similarly, market rent of \$11 per square foot represents 16.1% of the property’s gross revenues, which is more than the 11.5% national average. *Pet’r Ex. 1B at 65*. And, as discussed above, the lease

¹ Although Lady and Seet did not define the term “CAM,” the Board assumes that they were referring to common-area-maintenance costs.

constants from other properties translated to a range of \$9.41 to \$11.40 per square foot. *Pet'r Ex. 1B at 53, 65.*

28. Because their market-rent estimate was based on a triple-net lease, Lady and Seet only subtracted structural maintenance expenses of \$0.15 per square foot and a management fee of 3% from the property's effective gross income. *Pet'r Ex. 1B at 66.* They, however, did subtract vacancy and collection losses of 5%, which translates to a hypothetical vacancy period of one year over a 20-year lease term. *Id.*
29. In developing a capitalization rate, Lady and Seet looked at three theater sales, which yielded an average capitalization rate of 6.86%. *Pet'r Ex. 1B at 67-68.* Because those transactions were all sale-leasebacks, Lady and Seet assumed that a capitalization rate based on market rent would be higher. *Id. at 68.* They therefore applied a band-of-investment analysis, which involved estimating typical financing terms as well as a return on equity capital sufficient to attract investors. *Id.* Using that method, they arrived at a capitalization rate of 8.5%. *Id.*
30. Because the subject property is an investment property and there was reasonable data on market rent, expenses, and rates of return, Lady and Seet gave the greatest weight to their income-approach estimate (\$4,190,000). *Pet'r Ex. 1B at 70.*

C. Review Appraisal

31. The Assessor engaged Leo Lichtenberg, a certified general real estate appraiser, to review Lady and Seet's appraisal. Although Mr. Lichtenberg was unsure whether he had ever appraised a theater, he has appraised, and done market analyses for, various commercial properties. *Lichtenberg testimony.*
32. Lichtenberg identified a number of admittedly minor issues with Lady and Seet's appraisal, such as insignificant math errors, internal inconsistencies, and incomplete reporting. *See Lichtenberg testimony; Resp't Ex. B at 4.* Lichtenberg also had some

more pointed criticisms of Lady and Seet's specific analyses. For example, he thought that Lady and Seet should have used Kerasotes's actual construction costs instead of MVS values in their cost-approach analysis. *Lichtenberg testimony; Resp't Ex. B at 4*. And he took issue with their statement that Kerasotes's lease did not reflect market terms even though the lessee and lessor had agreed to those terms. Lichtenberg also noted that James DeBruzzie, Kerasotes's CFO, recognized that one of the main concerns of a buyer in a sale-leaseback transaction is the amount of rent coverage that the lessee's cash flow can provide. *Lichtenberg testimony; Pet'r Ex. 1D*. According to Lichtenberg, parties to a triple-net lease generally agree to terms that reflect rent-coverage ratios between 1.5 and 2 times a property's trailing cash flow. *Resp't Ex. B at 2*. Lady and Seet reported rent of \$633,569 and a trailing cash flow for 2004 of \$1,107,688, which equals a rent-coverage ratio of 1.75. *Id.*

33. Lichtenberg similarly questioned Lady and Seet's rent analysis for the Glendale Kerasotes theater. Based on what Lady and Seet reported as the subject property's gross sales for 2005, Lichtenberg reasoned that the Glendale theater would be able to generate \$1,904,000 in gross sales above rent. *Lichtenberg testimony; Resp't Ex. B at 4*. Under the lease's 10% overage provision, that level of gross sales would increase the theater's rent from \$13.50 per square foot to \$18.65 per square foot. *Id.* Lady and Seet, however, did not consider that overage rent in their analysis. Although Lichtenberg did not know if the theater actually generated overage rent, he believed that it generated rent that was close to industry standards. He based that belief on the fact that he had worked at the theater that it replaced. *Lichtenberg testimony*.
34. Overall, Lichtenberg found that Lady and Seet's value conclusion was "appropriate and reasonable given the data and analyses presented." *Resp't Ex. B at 5*. But he felt that Lady and Seet's conclusions "may be more representative of a [m]arket [v]alue for a second-generation user, not a [v]alue in [u]se" because they did not give any consideration to the allocated price from the 2005 portfolio sale or to the lease that Crest Net and Kerasotes entered into as part of that transaction. *Lichtenberg testimony; Resp't Ex. B at 5*. In Lichtenberg's opinion, that sale and lease better represented the property's

value in use than did Lady and Seet's value estimate. *Id.*; see also, *Resp't Ex. A at 62, 72; Lichtenberg testimony.*

D. Lichtenberg's Appraisal

35. The Assessor also engaged Lichtenberg to perform his own appraisal of Kerasotes's property. Lichtenberg estimated both the subject property's fee simple value and its leased fee value at \$7,450,000 as of January 1, 2005. *Resp't Ex. A at 76.* Like Lady and Seet, Lichtenberg certified that he developed his analyses and conclusions in conformity with USPAP. *Id. at 77.* Also like Lady and Seet, Lichtenberg considered all three generally accepted valuation approaches, while ultimately giving the most weight to his conclusions under the income approach. *Id. at 75.* Unlike Lady and Seet, though, Lichtenberg found that the sales-comparison approach was also strong indicator of the subject property's value. *Id.*
36. Lichtenberg estimated the following values under the three approaches: \$7,680,000 (cost), \$7,820,000 (sales-comparison), and \$7,810,000 (income). He reconciled those values to \$7,800,000. Because Lichtenberg's reconciled value was based on market and economic conditions as of the March 1, 2006, assessment date, he then trended that number to a value as of January 1, 2005. *Id. at 75.*
37. Under the cost approach, Lichtenberg estimated a higher value for the subject land as if vacant (\$830,000) than Lady and Seet did (\$518,000).² Lichtenberg used MVS data to estimate the subject improvements' replacement costs. His analysis, however, differed from Lady and Seet's in three main respects. First, Lichtenberg used a larger building area—39,762 square feet—and he broke that area into "Theater Cinema" and "Balcony" classifications. *Resp't Ex. A at 51.* Second, he used a higher per-square-foot base price (\$174.96) than Lady and Seet did (\$130.23).³ Finally, because the subject theater can

² Lichtenberg estimated the land's value as of March 1, 2006, while Lady and Seet estimated the land's value as of January 1, 2005.

³ Once again, the difference may not be as stark as it first appears because Lichtenberg used March 1, 2006, costs while Lady and Seet used January 1, 2005, costs.

generate a rental-income stream within the same range as the rent generated by comparable theaters, Lichtenberg found that the building did not suffer from any functional or external obsolescence. *Resp't Ex. A at 50; Lichtenberg testimony.*

38. Lichtenberg next estimated the subject property's value using the sales-comparison approach. He considered over 100 theater sales from throughout the United States and picked the five that involved theaters that he felt were most comparable to the subject property. *Id.* One of those sales—a sale of a Kerasotes theater from South Bend, Indiana—was part of the same 2005 portfolio sale that included the subject property. *See Resp't Ex. A at 15, 54.* Based on his qualitative analysis of relevant differences between the comparable properties and the subject property, Lichtenberg felt that the South Bend Kerasotes theater and a theater from Beaver Creek, Ohio most closely resembled the subject property. Those two sales indicated a value range of \$210 and \$263 per gross square foot. *Id. at 62.* Because Lichtenberg felt that the allocated sale price from the 2005 portfolio transaction was the best indicator of the subject property's value and also fell within the range derived from comparable sales, he settled on that sale price (\$7,820,000(rounded)) as his sales-comparison approach estimate. *Resp't Ex. A at 62.*
39. To determine market rent under his income-approach analysis, Lichtenberg looked to six comparable theaters from around the country. As far as he knew, each property's lease was entered into as part of a sale-leaseback transaction. *Lichtenberg testimony.* Once again, Lichtenberg included the South Bend Kerasotes theater that was part of the same portfolio transaction as the subject property. Lichtenberg found that the rent for the six theaters showed a "tight range" of \$11.12 to \$24.30 per gross square foot. *Resp't Ex. A at 72.* Because the subject property's contract rent of \$17.34 per square foot fell within that range, he used that contract rent to estimate the property's potential gross income. *Id.; Lichtenberg testimony.*
40. The remainder of Lichtenberg's income analysis was similar to Lady and Seet's. Lichtenberg used a vacancy and collection loss, although his estimate was only 2% compared to Lady and Seet's estimate of 5%. *Resp't Ex. A at 72-73.* Similarly,

Lichtenberg recognized management expenses, although his estimate was only 1% compared to Lady and Seet's estimate of 3%. *Id. at 73*. Unlike Lady and Seet, however, Lichtenberg did not subtract any capital expenses for reserves, because his market-extracted capitalization rates were based on net operating income before capital expenses. *Id.* As to those capitalization rates, Lichtenberg looked at six theater sales from May 2004 through November 2006. Those sales yielded rates ranging from 6.3% to 8.65% with an average of 7.59%. *Id. at 74*. Lichtenberg felt that the most comparable sale was the Kerasotes theater from South Bend, which reflected a capitalization rate of 7.86%. *Id.* Lichtenberg also looked at capitalization rates published by *Korpaz Real Estate Investor Survey*. Ultimately, Lichtenberg concluded that an appropriate capitalization rate for the subject property was between 7.75%, which yielded a March 1, 2006, value of \$7,931,471 and 8%, which yielded a value of \$7,683,613.

41. Ultimately, Lichtenberg found that his reconciled value of \$7,800,000 as of March 1, 2006, was very close to the subject property's allocated sale price from the portfolio transaction between Kerasotes and Crest Net. He therefore concluded that his estimate was reasonable. *Resp't Ex. A at 75*. In fact, Lichtenberg acknowledged that the difference between his appraisal and Lady and Seet's appraisal lay mainly in how the respective appraisals treated the 2005 portfolio transaction and corresponding lease. Lady and Seet valued the subject property's fee simple interest without considering Kerasotes's lease, whereas Lichtenberg felt that lease was one of the most important considerations for valuing a property like the subject property. *Lichtenberg testimony*. Lichtenberg paraphrased several terms from the lease to explain why he felt that way. For example, the lease was for what Lichtenberg referred to as the "vanilla box"—the furniture, fixtures, and equipment were Kerasotes's property. *Lichtenberg testimony*. And, while Kerasotes had the first right to purchase the subject property and all offers had to go through Kerasotes, page 43 of the lease specified that it was a true lease rather than a financing lease, capital lease, or deed of trust. *Id.*

CONCLUSIONS OF LAW AND ANALYSIS

A. Objections

42. The parties made three objections, all of which the ALJ took under advisement.
43. The Assessor objected to Petitioner's Exhibit 1(C)(iii)—statements showing the gross income, total expenses, and net income that the subject property generated for Kerasotes from 2001 through 2006. *Meighen objection*. According to the Assessor, that information was irrelevant because Crest Net—not Kerasotes—owned the property on March 1, 2006. In the Assessor's view, the relevant question was the amount of rent that the property produced for Crest Net, not what Kerasotes made from operating the property. *Id.* Kerasotes responded that the income and expense information was relevant because Kerasotes owned the property on January 1, 2005—the relevant valuation date for March 1, 2006, assessments. *Norman response*. Also, Lady testified that investors buy property based on income that it can produce, and Kerasotes's information showed a decrease in that income. *Id.*
44. The Board overrules the Assessor's objection. Lady and Seet relied on the information in question in appraising the subject property. At a minimum, that information is relevant to determining whether their valuation opinion is credible. Indeed, as discussed below, the income that Kerasotes generated from the property bears on one of the central questions in this appeal—whether Kerasotes's lease calls for above-market rent.
45. Kerasotes made two objections of its own. First, Kerasotes objected to Lichtenberg paraphrasing portions of Kerasotes's lease with Crest Net. *Norman objection*. Because the lease itself was not in evidence, Kerasotes argued that Lichtenberg's references to selected portions from the lease could be taken out of context. *Id.* The Assessor responded that Lichtenberg was just providing information that he had gathered in performing his appraisal. *Meighen response*.

46. The Board overrules Kerasotes's objection. Much as Lady relied on Kerasotes's income and expense information in appraising the subject property, Lichtenberg relied on the lease. And he was identifying portions of the lease that he found relevant. Significantly, Kerasotes did not claim Lichtenberg misrepresented any of the lease's terms or that the original lease itself was the best evidence of its contents. Instead, Kerasotes simply feared that Mr. Lichtenberg might create a misleading impression of the overall lease by reading only selected portions. Kerasotes, however, could have avoided that risk by offering the lease in its entirety as a rebuttal exhibit.
47. Finally, Kerasotes objected to Lichtenberg's testimony about Crest Net's May 12, 2008, sale of the subject property to EBD. Once again, the Board overrules Kerasotes's objection. Lichtenberg was simply reading from his appraisal report, which had already been admitted into evidence without objection. Nonetheless, Kerasotes is correct about one thing—a sale that occurs significantly after the relevant valuation date for a given assessment lacks probative value absent some explanation about how the sale relates to the appealed property's value as of the relevant valuation date. *See Long v. Wayne Twp. Assessor*, 821 N.E.2d 466, 471 (Ind. Tax Ct. 2005)(finding that taxpayers' 2003 appraisal lacked probative value in an appeal from their property's 2002 assessment). But that goes more to the sale price's weight than to its admissibility.

B. Burden of Proof

48. A taxpayer seeking review of an assessing official's determination must make a prima facie case proving both that the current assessment is incorrect and what the correct assessment should 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). If a taxpayer meets that burden, the assessing official must offer evidence to impeach or rebut the taxpayer's evidence. *See American United Life Ins. Co. v. Maley*, 803 N.E.2d 276 (Ind. Tax Ct. 2004); *Meridian Towers*, 805 N.E.2d at 479. But the burden of persuasion remains at all times with the taxpayer.

Thorntown Tel.Co. v. State Bd. of Tax Comm'rs, 629 N.E.2d 962, 965 (Ind. Tax Ct. 1995).

49. The taxpayer's burden of proof, however, must be viewed in the context of Indiana's assessment system. Indiana assesses real property based on its true tax value, which the 2002 Real Property Assessment Manual defines as "the market value-in-use of a property for its current use, as reflected by the utility received by the owner or a similar user, from the property." 2002 REAL PROPERTY ASSESSMENT MANUAL at 2 (incorporated by reference at 50 IAC 2.3-1-2). To determine a property's true tax value, Indiana assessing officials generally use a mass-appraisal version of the cost approach set forth in the Real Property Assessment Guidelines for 2002 – Version A. That Guidelines-based determination is presumed to be accurate. *See* MANUAL at 5; *Eckerling v. Wayne Twp. Assessor*, 841 N.E.2d 674, 676 (Ind. Tax Ct. 2006). A taxpayer, however, may rebut that presumption with evidence that is consistent with the Manual's definition of true tax value. MANUAL at 5. A market value-in-use appraisal prepared according to the Uniform Standards of Professional Appraisal Practice ("USPAP") often will suffice. *Id.*; *Eckerling*, 841 N.E.2d at 678. A taxpayer may also offer actual construction costs, sales information for the subject or comparable properties and any other information compiled according to generally accepted appraisal principles. MANUAL at 5.
50. Regardless of the method used to rebut an assessment's presumed accuracy, a party must explain how its evidence relates to the subject property's market value-in-use as of the relevant valuation date. *O'Donnell v. Dep't of Local Gov't Fin.*, 854 N.E.2d 90, 95 (Ind. Tax Ct. 2006); *see also Long* 821 N.E.2d at 471. For March 1, 2006 assessments, that valuation date was January 1, 2005. 50 IAC 21-3-3.

C. Kerasotes Proved that the Subject Property's Assessment Should be Reduced to \$4.2 Million

51. Kerasotes successfully rebutted the current assessment's presumption of correctness. Indeed, both Kerasotes and the Assessor offered market-value-in-use evidence reflecting a value lower than the property's \$7,821,000 assessment—Kerasotes offered Lady and Seet's expert opinion that the property was worth \$4.2 million, while the Assessor offered Lichtenberg's expert opinion that it was worth \$7.45 million. The Board therefore must decide which of the two opinions it finds more credible.
52. The two appraisals differ in several ways. For example, the appraisers chose different base rates in applying the cost approach. Similarly, Lady and Seet found that the subject improvements suffered from functional and economic obsolescence while Lichtenberg did not. Lady and Seet also differed from Lichtenberg both in the amount of expenses that they included in determining the subject property's net operating income and in how they calculated a capitalization rate. Most of the differences, though, were relatively minor.
53. Instead, one fundamental issue accounts for the large disparity in appraisers' respective value estimates—Lady and Seet found that the allocated sale price and lease provisions from the September 19, 2005, portfolio sale did not reliably show the subject property's market value-in-use, while Lichtenberg gave the allocated sale price and contract rent from that transaction the greatest weight in determining the property's value. In fact, Lichtenberg's reliance on that transaction pervaded his analysis under all three valuation approaches. He even used another property that was sold in the same portfolio transaction as a key comparable under both his sales-comparison and income-capitalization analyses.
54. Lady and Seet based their skepticism about the portfolio sale and accompanying lease largely upon the general nature of sale-leaseback transactions. Because sale-leasebacks are frequently used as a financing tool, and in the theater industry usually involve fully

equipped theaters operated by brand-name exhibitors, Lady and Seet believed that the sale prices and lease payments from those transactions are often based partly on income attributable to things other than real estate. *Pet'r Ex. 1B at 24-25*. Thus, in looking for rent and sales comparables, Lady and Seet looked for properties that had not been involved in sale-leaseback transactions.

55. Lady and Seet also felt that those general concerns pervaded the 2005 portfolio transaction at issue in this case. First, Kerasotes's CFO said that Crest Net used a financial institution, Bank of America, to represent Kerasotes's portfolio of 17 theaters, and Crest Net determined the values both of the portfolio as a whole and of the individual theaters. *Pet'r Ex. 1D*. Second, Lady and Seet did not have any information showing that Crest Net gave separate consideration for intangible value assigned to the properties being associated with a nationally branded movie exhibitor. Third, Lady and Seet believed that Kerasotes's lease payments raised a "red flag," because, when viewed as a percentage of gross revenue, those payments were more than twice the national industry average.
56. Lichtenberg, by contrast, felt that the subject property's allocated sale price and the contract rent were very reliable indicators of its value, especially under a value-in-use scenario.
57. After considering both views, the Board finds Lady and Seet's skepticism about sale-leaseback transactions generally, and about the 2005 portfolio transaction specifically, more persuasive. Lady and Seet thoughtfully described the sale-leaseback market, and explained the danger that, in a given transaction, the sale price and corresponding lease payments may reflect the value of things other than real estate. At a minimum, then, one would expect an appraiser to approach data from sale-leaseback transactions with caution. Lady and Seet did that by avoiding sale-leaseback transactions when identifying comparable rental properties. By contrast, Lichtenberg used what he acknowledged were probably leases from sale-leaseback transactions for his comparable rental properties

without indicating that he looked into those transactions to make sure that the rental rates did not reflect payments for things other than real property.

58. Of course, the central question is not whether sale-leasebacks generally reflect something beyond the inherent value of real estate, but whether the portfolio sale and leaseback in this case did. The parties gave few details about that transaction. For example, while Kerasotes offered a letter from its CFO, James DeBruzzi, that letter focused more on sale-leaseback transactions in general than on the portfolio transaction at issue in this case. *See Pet'r Ex. ID.* But, as Lady and Seet explained, the significant disparity between Kerasotes's lease payments and the industry standard raised a red flag. Without more information about what Crest Net considered in arriving at the subject property's allocated sale price, the Board gives that sale price and the lease payments derived from it little probative weight.
59. True, not every fact points to that conclusion. Some of the Assessor's evidence tends to undercut Kerasotes's position that the portfolio transaction was more like a financing transaction than a market-value sale. For example, Lichtenberg paraphrased from page 43 of the subject property's lease, which asserted that it was a true lease rather than a financing lease, capital lease, or deed of trust. By characterizing the lease as a true lease rather than some type of financing transaction, Kerasotes and Crest Net may have sought to gain income-tax or other advantages. But the Assessor did not offer any evidence to show how Kerasotes or Crest Net actually treated the transaction for income tax purposes. More importantly, Lady and Seet's market-rent analysis raised significant concerns about whether the allocated sale price and resulting lease terms actually related to the subject property's market value. Lichtenberg did not overcome those concerns merely by paraphrasing isolated terms from the lease.
60. Lichtenberg, however, also highlighted some problems with Lady and Seet's market-rent analysis. Most significantly, Lady and Seet appeared to ignore the possibility of overage rent for the Glendale Kerasotes theater—one of the two properties that they found to be most comparable to the subject property. In the end, though, Lady and Seet amply

supported their market-rent estimate by checking it against the industry average for rent as a percentage of gross revenue and against rental rates based on market-derived lease constants.

61. In fact, Lichtenberg's own review appraisal and testimony casts doubt on how firmly he believed that the subject property's lease reflected market rent. Although Lichtenberg determined that the subject property's contract rent and market rent were the same, he also said that Lady and Seet's value conclusion was "appropriate and reasonable," but that their conclusions "may be more representative of a [m]arket [v]alue for a second-generation user, not a [v]alue in [u]se." *Lichtenberg testimony; Resp't Ex. B at 5*. Thus, Lichtenberg, and through him the Assessor, apparently contend that, under a market value-in-use standard, one should use the subject property's contract rent to estimate the property's value, even if that rent exceeds what Crest Net could have leased the property for had it not been encumbered by Kerasotes's long-term lease.

62. Although the parties did not cite, and the Board does not find, any Indiana cases directly on point, courts from other jurisdictions have struggled with similar questions. *See e.g., Rhodes v. Hamilton County Board of Revision*, 117 Ohio St. 3d 532, 885 N.E.2d 236 (Ohio S.Ct., 2008); *Walgreen Co. v. City of Madison*, 311 Wis. 2d 158, 752 N.W.2d 687 (Wisc. S.Ct. 2008). In *Walgreen*, 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. The taxpayer in that case operated under a business plan where it worked with developers who: (1) found sites for the taxpayer's stores, (2) bought out existing businesses, (3) bought the sites, and (4) developed the sites with super adequacies to suit the taxpayer's needs. *Id.* at 690. Thus, the taxpayer'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.*

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

64. But Wisconsin's manual did not provide for increasing a property's assessment when contract rent is above market rates. The court distinguished that situation 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). *But see Rhodes*, 885 N.E.2d at 236 (holding that a property's sale price reflected its market value because, in purchasing a fee simple interest in the property, the buyer acquired all component rights of that interest, including the right to collect payments under a long-term above-market lease).

65. The Board is persuaded by the Wisconsin Supreme Court's analysis. True, the court's decision was based upon Wisconsin law, which calls for property to be assessed based on

its market value rather than its market value-in-use. And the court also interpreted specific provisions from that state's assessment manual that have no correlatives under Indiana's Manual or Guidelines. But the court's 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 that one must ignore a property's actual contract rent. Indeed, the income approach is based upon investor behavior, and in determining how much they will pay for a property, investors look at the income stream that 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.

66. 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 the Board need not 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.
67. Thus, neither the subject property's allocated sale price from the portfolio transaction nor the contract rent based on that sale price is reliable evidence of the property's market value-in-use.
68. Finally, the price from Crest Net's May 12, 2008, sale of the subject property to EBD is similarly unpersuasive. Because Lichtenberg and the Assessor failed to explain how that price related to the subject property's market value-in-use as of the relevant January 1, 2005, valuation date, it lacks probative value. *See Long* 821 N.E.2d at 471 (holding that 2003 appraisal lacked probative value in an appeal from an assessment that was based on a January 1, 1999, valuation date). Even if the Assessor had explained that relationship,

the 2008 sale price no more shows the subject property's market value-in-use than does the allocated sale price from the 2005 portfolio transaction. EDB logically paid a premium because it received more than just real property rights in the transaction; it also received the contractual right to collect above-market rent from a nationally branded, creditworthy exhibitor.

Summary of Final Determination

69. The competing expert opinions boil down to how the respective appraisers treated the subject property's allocated sale price from the 2005 portfolio sale-leaseback transaction and the lease payments that were based on that allocated sale price. Lichtenberg relied heavily on the allocated sale price and contract rent, while Lady and Seet gave them little weight. Because there is little evidence to show how Crest Net determined the allocated sale price and the contract rent is significantly higher than market rent, the Board is more persuaded by Lady and Seet's opinion. The Board therefore finds that the subject property's true tax value for March 1, 2006, was \$4,200,000. The property's assessment must be reduced to that amount.

The Final Determination of the above captioned matter is issued by the Indiana Board of Tax Review on the date first written above.

Commissioner, Indiana Board of Tax Review

Commissioner, Indiana Board of Tax Review

Commissioner Terry G. Duga dissents in separate opinion.

IMPORTANT NOTICE

- 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>>