

STATE OF MINNESOTA

IN SUPREME COURT

A19-0567

Tax Court

Anderson, J.
Took no part, Lillehaug, Chutich, JJ.

Inland Edinburgh Festival, LLC,

Relator,

vs.

Filed: February 12, 2020
Office of Appellate Courts

County of Hennepin,

Respondent.

Thomas R. Wilhelmy, Christopher A. Stafford, Fredrikson & Byron, P.A., Minneapolis, Minnesota, for relator.

Michael O. Freeman, Hennepin County Attorney, Rebecca L. Holschuh, Assistant County Attorney, Minneapolis, Minnesota, for respondent.

S Y L L A B U S

1. The tax court did not abuse its discretion by deciding to afford no weight to relator's expert opinion on the income approach.

2. The tax court abused its discretion by relying on a single sales transaction, of the subject property, to determine the value of relator's property under the sales-comparison approach.

3. Based on the evidence in the record, a remand is necessary to determine the fair market value of the taxpayer's property.

Affirmed in part, reversed in part, and remanded.

Considered and decided by the court without oral argument.

OPINION

ANDERSON, Justice.

This is a dispute about the value of a shopping center as of January 2, 2015. Relator Inland Edinburgh Festival, LLC sought review in the tax court of respondent Hennepin County's assessed value for Inland's retail shopping center property. The tax court concluded that the market value of Inland's two parcels of improved real estate was higher than either the initial assessed value determined by Hennepin County or the valuation opinion presented by the sole appraiser to testify at trial. On appeal from that decision, Inland argues that the tax court's value determination is excessive because the tax court rejected Inland's expert's opinion under the income approach and relied on a single 2017 sale, of Inland's property, to value the property under the sales-comparison approach. We affirm the tax court's decision to afford no weight to the expert's opinion on the income approach, reverse the tax court's valuation determination based on the sales-comparison approach, and remand for further proceedings.

FACTS

Inland owned real property in Brooklyn Park, improved with a retail shopping center that includes two adjacent strip malls. The shopping center contains an anchor grocery store tenant and sixteen tenant spaces in the malls, of varying sizes, with a total of 91,563

square feet of net rentable area. For property tax purposes, the Hennepin County Assessor estimated the market value of Inland’s property, as of January 2, 2015, to be \$8,384,300. Inland timely petitioned the tax court, challenging the assessment and asserting that the County’s assessed value for the shopping center exceeded its actual market value.

While the tax court proceeding was underway, Inland sold the property on June 1, 2017, for \$9,600,000. The sale was completed as a “like-kind” tax exchange under 26 U.S.C. § 1031 (2018).¹ At the time of the 2017 sale, the shopping center had only a few tenant vacancies, and several leases were at above-market rates.

A trial was held before the tax court on May 2, 2018. During trial, Inland introduced the expert appraisal testimony of Daniel T. Boris, who estimated the 2015 market value of the property at \$7,100,000 using both an income approach and a sales-comparison approach. His initial expert report, which was admitted at trial, contained mathematical errors related to rental rates and other errors that the tax court determined affected his analysis of the value of the property. Inland thus offered into evidence a second report by Boris that corrected some of the errors contained in the initial report.

Before trial, the County notified the tax court that it did not intend to call an expert, and thus asked to be excused from the pretrial requirement to provide an expert report. The County’s request was granted, and at trial, the County called no witnesses and offered only one exhibit—the rent rolls that Inland had produced. The County also waived the prima

¹ A real estate transaction under 26 U.S.C. § 1031 “allows for the equity received from a sale of investment property to be reinvested into ‘like kind’ property of equal or greater value without payment of capital gains tax.” *Dyrdal v. Golden Nuggets, Inc.*, 689 N.W.2d 779, 782 n.2 (Minn. 2004).

facie validity of its initial tax assessment. The County urged the tax court to review the information in the report from Boris and to “take the credible information from that report and disregard the rest.”

In its Findings of Fact, Conclusions of Law, and Order for Judgment and accompanying memorandum of law, the tax court declined to give any weight to Boris’s expert opinion on the income approach based on the computational errors in his report and the lack of an explanation regarding his methodology. The tax court also concluded that Boris’s credibility was undermined by his revised analysis, concluding that the corrections offered at trial were “masquerading wholesale changes in Boris’s opinion as mere ‘corrections’ when they were obviously engineered to support predetermined outcomes.” Then, relying on a single transaction—the June 2017 like-kind exchange of Inland’s property—the tax court found that the fair market value of the property for the January 2015 assessment was \$8,490,720, i.e., approximately \$106,000 higher than the initial assessment by the County Assessor. After granting Inland’s motion for rehearing in part to adjust certain mathematical errors, the tax court otherwise denied that motion, resulting in a final valuation determination for Inland’s property of \$8,461,400, i.e., approximately \$77,000 higher than the initial assessment by the County Assessor. Inland appeals from that decision.

ANALYSIS

This appeal requires consideration of the tax court’s valuation decisions. We generally defer to the tax court’s valuation decision in light of the inexact nature of real property appraisal. *Cont’l Retail, LLC v. Cty. of Hennepin*, 801 N.W.2d 395, 399

(Minn. 2011); *EOP–Nicollet Mall, LLC v. Cty. of Hennepin*, 723 N.W.2d 270, 285 (Minn. 2006). The tax court “brings its own expertise and judgment to the hearing, and its valuation need not be the same as that of any particular expert as long as it is within permissible limits and has meaningful and adequate evidentiary support.” *Montgomery Ward & Co. v. Cty. of Hennepin*, 482 N.W.2d 785, 791 (Minn. 1992). We will sustain the tax court’s factual findings as to market value unless they are clearly erroneous. *Equitable Life Assurance Soc’y of U.S. v. Cty. of Ramsey*, 530 N.W.2d 544, 552 (Minn. 1995). The tax court clearly errs when its decision is not reasonably supported by the record as a whole. *Lewis v. Cty. of Hennepin*, 623 N.W.2d 258, 261 (Minn. 2001). When the tax court has “clearly misvalued the property” or “completely failed to explain its reasoning,” we accord the tax court no deference. *Nw. Nat’l Life Ins. Co. v. Cty. of Hennepin*, 572 N.W.2d 51, 52 (Minn. 1997).

Real property is generally assessed at its “market value,” Minn. Stat. § 273.11, subd. 1 (2018), which is “the price which could be obtained at a private sale” or another “arm’s-length transaction,” Minn. Stat. § 272.03, subd. 8 (2018). Generally, we recognize three basic approaches to determining the market value of real property: (1) the sales-comparison approach, which compares the subject property to similar properties recently sold in actual market transactions; (2) the cost approach, which estimates value by finding the current cost to construct a new facility with the same features as the subject property; and (3) the income approach, which determines the value of income-producing property by capitalizing the income the property is expected to generate over a specific period at a specific capitalization or yield rate. *See Eden Prairie Mall, LLC v. Cty. of*

Hennepin, 797 N.W.2d 186, 192–93 (Minn. 2011); *S. Minn. Beet Sugar Coop. v. Cty. of Renville*, 737 N.W.2d 545, 555 (Minn. 2007). Only the sales-comparison and income approaches are at issue here.

I.

We first consider the tax court’s decision regarding the income approach. In this case, the tax court gave no weight to the value proposed by Boris under the income approach. The tax court concluded that Boris’s opinions lacked foundational reliability based on a failure to properly explain the data on which he relied, a failure to explain the basis for his opinion, and a lack of credibility stemming from numerous errors in the opinions.

The income approach may be indicative of the market value of income-producing properties, such as a retail mall, because “[i]ncome-producing real estate is typically purchased as an investment, and from an investor’s point of view earning power is the critical element affecting property value.” Appraisal Inst., *The Appraisal of Real Estate* 439 (14th ed. 2013); see *TMG Life Ins. Co. v. Cty. of Goodhue*, 540 N.W.2d 848, 852 (Minn. 1995) (explaining that the income approach relies on “the net operating income attributable to the property” and that retail properties generally derive income from rental payments). When the tax court relies solely on one method, as it did here once it assigned no weight to the income approach, it must “clearly explain the weaknesses of the rejected approaches.” *Equitable Life Assurance Soc’y of U.S.*, 530 N.W.2d at 554–55.

Inland argues that the tax court erred when it failed to give the income approach any weight by its wholesale rejection. The tax court did not state that its decision was a

wholesale rejection of this approach as a method of valuing Inland's property; rather, the tax court rejected its application in this case only after identifying a lack of evidentiary support and lack of credibility that deprived those opinions of foundational reliability. *See Cty. of Aitkin v. Blandin Paper Co.*, 883 N.W.2d 803, 810 (Minn. 2016) (noting that an appraisal expert's opinion must have foundational reliability). The tax court is free to accept all or only part of an expert's report to determine valuation, as "property valuation is an inexact science." *Menard, Inc. v. Cty. of Clay*, 886 N.W.2d 804, 821 (Minn. 2016). We therefore afford the tax court broad discretion to rely on or disregard the evidence presented at trial, particularly when credibility is at issue. *Id.*; *Archway Mktg. Servs. v. Cty. of Hennepin*, 882 N.W.2d 890, 896 (Minn. 2016) ("Ordinarily, we defer to the tax court's credibility determinations."). Here, the tax court gave no weight to Boris's use of the income approach because of the methodological inconsistencies, data errors, and general lack of explanation in his report. All of these errors could significantly impact the accurate valuation of Inland's property. Thus, the tax court's credibility determination has adequate support in the record. We therefore hold that the tax court's decision to give no weight to the opinions provided by Boris using the income approach was not clearly erroneous.

II.

Having decided to give the income approach no weight, the tax court was left with only the sales-comparison approach to reach a market value determination for Inland's property. "The tax court may rely on a single method of appraisal when the other methods are not supported by accurate and reliable data." *Archway Mktg. Servs.*, 882 N.W.2d at 894. The sales-comparison approach is indicative of market value because, when a

market exists for a property, an analysis of that market provides the most straightforward way to support an opinion of market value. *Cont'l Retail, LLC*, 801 N.W.2d at 402. A “major premise” of the sales-comparison approach is that “an opinion of the market value of a property can be supported by studying the market’s reaction to comparable and competitive properties.”² *Appraisal Inst., supra*, 377.

Inland contends that the tax court erred in its application of the sales-comparison approach because the court relied solely on the June 2017 sale of the property, as adjusted, to reach a valuation determination. The sales-comparison approach, as the title suggests, analyzes and compares the sale price paid for multiple comparable properties in market transactions. *See, e.g., Archway Mktg. Servs.*, 882 N.W.2d at 894 (explaining that an expert compared the sales of three nonsubject properties in addition to the sale of the subject properties for sales-comparison approach); *KCP Hastings, LLC v. Cty. of Dakota*, 868 N.W.2d 268, 274 (Minn. 2015) (concluding that the tax court did not err by rejecting a valuation under the sales-comparison approach where only noncomparable sales were used in valuation). Then, adjustments are made to reflect differences between the subject property and the comparable properties. *Menard, Inc.*, 886 N.W.2d at 817. The sale price of the property in question may be “an important fact to consider when valuing real estate.” *Archway Mktg. Servs.*, 882 N.W.2d at 895.

In this case, the tax court relied solely on the single sale of Inland’s shopping center in June 2017 to arrive at the valuation. Inland argues that the use of this single transaction

² The parties agreed that the cost approach should not be used in this case and the tax court did not disagree.

is erroneous. We agree. See *Guardian Energy, LLC v. Cty. of Waseca*, 868 N.W.2d 253, 258 (Minn. 2015) (noting that we will not defer to the tax court’s valuation determination when the tax court has clearly misvalued the property); see also *Montgomery Ward & Co.*, 450 N.W.2d at 308 (“Nevertheless, even though there is evidence to support factual findings, this court may order a reversal if, upon reviewing the entire evidence, it is left with a firm conviction that a mistake has been made.”). When making a valuation determination, an assessor must “consider and give due weight to every element and factor affecting the market value” of the property. Minn. Stat. § 273.12 (2018); see also *KCP Hastings, LLC*, 868 N.W.2d at 273. We have often said that the sale of the property being assessed may be “one of the most important elements to be considered.” *Minn. Entm’t Enters., Inc. v. Cty. of Hennepin*, 235 N.W.2d 390, 393 (Minn. 1975) (stating that the sale of property through competitive bidding 15 months after assessment date was considered an important factor to determine value); see also *Archway Mktg. Servs.*, 882 N.W.2d at 896 (stating that tax court erred by failing to adequately explain why it did not consider recent sale of one of the subject properties when determining the property’s value); *Schleiff v. Cty. of Freeborn*, 43 N.W.2d 265, 268–69 (Minn. 1950) (stating that sale of property shortly before assessment was an “important element to be considered”). But we have not previously held that the sale of the subject property *alone* is sufficient to determine market value.³ *Schleiff*, 43 N.W.2d at 268–69 (“However, such sale price, even though the sale

³ In his report, Boris mentioned the dates and sales prices for six other properties sold before or after the assessment date. The tax court did not consider this evidence because Boris made “no comparative analysis among them.”

occurred shortly prior to the assessment, is not *conclusive* as to the market or sale value of the property”).

We need not reach this issue, as the 2017 sale of Inland’s property cannot serve that purpose, at least based on the record before us. A recent sale of the property is probative of market value only when it qualifies as an arm’s-length transaction. *Compare* Minn. Stat. § 272.03, subd. 8 (providing in part that “market value” is defined as the selling price resulting from “an arm’s-length transaction”), *with Archway Mktg. Servs.*, 882 N.W.2d at 894 (“Sales between related parties, such as partners in a joint venture, generally are not indicative of market value.”). Inland sold its property in a tax exchange under section 1031, also known as a like-kind exchange, which occurs when real property of the same type that is used for business or investment is exchanged between owners. *See generally* 26 U.S.C. § 1031; *N. Cent. Rental & Leasing, LLC v. United States*, 779 F.3d 738, 741 (8th Cir. 2015). This unique type of transaction may not represent the property’s fair market value because when business or investment property owners conduct a section 1031 exchange, any property that is of the same nature or character may be traded, even if the properties differ in grade or quality. *See* 26 C.F.R. § 1.1031(a)-1 (2019); *Dyrdal v. Golden Nuggets, Inc.*, 689 N.W.2d 779, 782, n.2 (Minn. 2004). Section 1031 exchanges contain additional tax benefits for business owners because owners can defer recognition of gains or losses in some circumstances, therefore potentially reducing tax liability. *See Dyrdal*, 689 N.W.2d at 782, n.2. Here, there is no information in the record that indicates the motivation of the buyers in the exchange of Inland’s property, including to what extent the price was driven by market forces or tax-saving motives. Thus, we have no way of

determining whether the sale price—\$9,600,000—reflects the fair market value of the property, with or without adjustments.

It may well be that the sale price from a section 1031 property exchange is indicative of the market value for the property at issue. But on this record, with no testimony or other evidence explaining the considerations that went into the sale price for this exchange,⁴ we cannot conclude that the tax court correctly relied on this single transaction for a market value determination of Inland’s property.

Finally, we conclude that the tax court erred in its adjustments made to the 2017 sale price to determine the 2015 market value for Inland’s property. The tax court is not precluded from arriving at a value determination that is lower or higher than the appraisal testimony presented at trial, provided the court adequately explains its reasoning and its determination is supported by the factual record. *Eden Prairie Mall, LLC*, 797 N.W.2d at 194; *Am. Express Fin. Advisors, Inc. v. Cty. of Carver*, 573 N.W.2d 651, 658 (Minn. 1998) (noting that the tax court is not bound to accept the valuation opinion of an appraiser); *Hertz v. Hertz*, 229 N.W.2d 42, 44 (Minn. 1975) (stating that a trial court can make adjustment to an expert’s valuation opinion “if it falls within the limits of credible estimates made by competent witnesses”). In *Eden Prairie Mall, LLC*, we recognized that “the tax court brings its own expertise and judgment in valuation matters, and its

⁴ As of the January 2015 assessment date, several long-term commercial tenant leases, including the grocery store anchor lease, were due for renewal in the next two years. By the time of the June 2017 sale, the grocery store anchor lease and other long-term leases had been renewed. Lease terms could be another factor that a potential buyer in 2015 would consider when purchasing a shopping center, but may not be accounted for under the tax court’s modified sales comparison method to determine market value.

determination need not be the same as the appraisal testimony.” 797 N.W.2d at 194. But our deference to the tax court has limits. This is because “market value determinations involve the exercise of complex and sophisticated judgments of market conditions, anticipated future income, and investor expectations, particularly with respect to income-producing properties.” *Id.*

In this case, the tax court took the June 2017 sale of the property as a “base” and then adjusted that sales price to reach a value determination for the assessment date of January 2, 2015. For example, the tax court adjusted the sales price to account for market condition changes between 2015 and 2017. *See Appraisal Inst., supra*, 379 (noting that economic conditions between the date of sale and the assessment date may affect value because “[p]eriods of economic growth and economic decline influence property values”). The tax court considered, but did not rely on, the methodology and market data Boris used for these adjustments, using instead a modified time-adjustment calculation by extrapolating data from 2016 to 2017. In doing so, the tax court erred because it did not have any market data submitted by the parties on which to rely for periods in which it assigned a value.

Similarly, the tax court made an age adjustment to reflect the shopping center’s purported physical deterioration between January 2015 and June 2017, noting that “[t]here is no dispute that the building was two and a half years older when sold in June 2017, compared to the valuation date of January 2015.” It is, of course, true that the shopping center was older, but the record does not establish what amount, if any, of deterioration occurred between 2015 and 2017 or what effect, if any, the 2-year interval would have on

the market value of the shopping center. Finally, the tax court failed to adequately explain why Boris's opinion, which declined to include an age adjustment, was rejected on this point. *See 444 Lafayette, LLC v. Cty. of Ramsey*, 830 N.W.2d 25, 32 (Minn. 2013) (reversing the tax court's valuation in part because it adopted a new value based on market rates without adequately explaining why it rejected the expert's approach and how the court's adopted valuation reflected market value).

The sale of Inland's property is an important factor to be considered in valuation, but on this record, and given the largely unexplained section 1031 like-kind exchange, it cannot be the only indicia of market value. Further, the support in the record for the adjustments made to the sale price is unclear. Thus, we conclude that the tax court's valuation determination under the sales comparison approach was clearly erroneous.

III.

In summary, the tax court did not err by assigning no weight to Boris's expert opinion on the income approach, but it did err in its valuation determination under the sales comparison approach. Thus, a remand is necessary to determine the market value of Inland's property as of January 2, 2015.

We appreciate the challenges the tax court faced in this case, in which scant reliable evidence was available to make an accurate valuation decision. When the record closed, the tax court had the opinion of a single expert, who prepared a second report (which was also admitted at trial) to correct the substantial errors in the first disclosed report.

Inland's evidence was minimal, to be sure. But the County provided no assistance to the tax court; rather than offering affirmative evidence or an alternative proposed

valuation, the County’s proposed solution at that point was to invite the tax court to pick the best and reject the worst from the evidence offered by Inland in Boris’s report.

We have encouraged the tax court to exercise its independent skill and judgment because of the particular expertise of that court. *See, e.g., Eden Prairie Mall, LLC*, 797 N.W.2d at 194. We have not endorsed the tax court’s exercise of its independent judgment and skill without any credible or reliable evidence from the parties who ask for that court’s decision, nor do we believe the Legislature envisioned that approach. *See S. Minn. Beet Sugar Coop.*, 737 N.W.2d at 559–60 (explaining that on remand the tax court “must determine for itself the market value,” reopening the record as necessary to determine “the true market value”); Minn. R. 8610.0120, subp. 2 (2019) (“If, after the holding of any hearings in any matter, the tax court finds the rights of the parties will be better served by the holding of a further hearing in the matter, the court may order a further hearing . . .”).

Accordingly, on remand, the tax court must decide whether to re-open the record for the purpose of making a value determination based on admissible, credible evidence.⁵

CONCLUSION

For the foregoing reasons, we affirm the tax court in part, reverse the tax court in part, and remand for further proceedings as necessary to determine value.

Affirmed in part, reversed in part, and remanded.

⁵ Inland further argues that we should reverse the tax court and remand for a new trial because the tax court judge was biased, and therefore a fair and impartial tribunal did not preside over these proceedings. We need not reach this issue because we have determined that the tax court’s decision must be reversed and the case remanded for the reasons explained in this opinion.