

**COURT OF APPEALS
DECISION
DATED AND FILED**

December 17, 2014

Diane M. Fremgen
Clerk of Court of Appeals

NOTICE

This opinion is subject to further editing. If published, the official version will appear in the bound volume of the Official Reports.

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. See WIS. STAT. § 808.10 and RULE 809.62.

Appeal No. 2013AP2818

Cir. Ct. No. 2010CV1391

STATE OF WISCONSIN

**IN COURT OF APPEALS
DISTRICT II**

WALGREEN CO.,

PLAINTIFF-RESPONDENT,

v.

CITY OF OSHKOSH,

DEFENDANT-APPELLANT.

APPEAL from a judgment of the circuit court for Winnebago County: DANIEL J. BISSETT, Judge. *Affirmed.*

Before Neubauer, P.J., Reilly and Gundrum, JJ.

¶1 REILLY, J. This case examines one skirmish in the war between Walgreen Co. and tax assessors throughout Wisconsin over how real property taxes are assessed against the national drugstore giant. This skirmish is fought

after our supreme court in *Walgreen Co. v. City of Madison (Walgreen/Madison)*, 2008 WI 80, 311 Wis. 2d 158, 752 N.W.2d 687, established the rules of battle. In *Walgreen/Madison*, the court determined that where contractual rights inflate the value of leased retail property, assessors must look to the market to reach their valuations. “[A]n assessor’s task is to value the real estate, not the business concern which may be using the property.” *Id.*, ¶65 (citation omitted).

¶2 The circuit court found that the City of Oshkosh did not follow this rule in valuing Walgreen properties as its assessments relied on sale prices and leases that included contractual rights that inflated the properties’ values. On appeal, the City argues that the court erred as Walgreen did not present evidence that its lease agreements increase its sale prices or provide for above-market rents when compared to other investment-grade real estate, which is the market for Walgreen properties. We affirm the circuit court’s extensive, thorough, and reasoned decision. In confining Walgreen’s market to one that trades in investment-grade real estate rather than looking to the broader retail market for its assessments, the City improperly valued Walgreen’s business concern.

BACKGROUND

¶3 At issue are two stores operated by Walgreen in the City of Oshkosh that were built to Walgreen’s specifications and are subject to long-term leases that allow Walgreen to remain in the properties for decades to come. The store at 315 West Murdock Avenue (Murdock property) was sold in 2005 for \$2,923,459. The store at 950 South Koeller Street (Koeller property) was sold in 2006 for \$4,325,000. The leases for both properties require that Walgreen pay all operating expenses—utilities, property taxes, insurance, and maintenance—and are signed before site development begins. Walgreen’s leases call for it to pay \$18.78 per

square foot for the Murdock property and \$22.12 per square foot for the Koeller property in annual rent.

¶4 The City assessed the Murdock property at \$2,920,500 and the Koeller property at \$4,093,600 in 2009. After Walgreen objected, the City reduced the assessments to \$2,700,000 for the Murdock property and \$3,074,000 for the Koeller property and refunded some of the taxes paid by Walgreen. The assessments remained at the reduced levels for 2010. Walgreen challenged the 2009 and 2010 assessments for both properties, subsequently bringing this Wis. STAT. § 74.37 (2011-12)¹ action for excessive assessments after the City rejected Walgreen's appeals and claims.

¶5 At the court trial, City Assessor Steven Schwoerer testified that in assessing the Murdock property, his valuation "probably" gave most weight to Walgreen's rental payments, and that this valuation was supported when he time-adjusted the 2005 sale price and compared it to sales of other Walgreen properties in the state. For the Koeller property, Schwoerer testified that he based his assessment almost solely on the 2006 sale price.

¶6 Walgreen's expert appraiser, Paul Bakken, valued the Murdock property at \$1,675,000 in 2009 and \$1,585,000 in 2010 and the Koeller property at \$1,750,000 in 2009 and \$1,655,000 in 2010. He based his valuations largely on analyzing what comparable retail properties would receive in rent without considering properties leased by national credit-worthy tenants such as Walgreen. Bakken testified that he gave no weight to the prior sales of the Murdock and

¹ All references to the Wisconsin Statutes are to the 2011-12 version unless otherwise noted.

Koeller properties as the sale prices reflected the added value of leases with above-market rents and custom building features that would not be valued as highly by the broader marketplace. Bakken estimated the 2009 market rent at \$11.50 per square foot for the Murdock property and \$13.25 for the Koeller property.

¶7 The circuit court found that the City's assessments violated the Property Assessment Manual (Manual)² and *Walgreen/Madison* because the assessor had not investigated beyond the sale prices and "utilize[ed] the lease," resulting in "a business value assessment as opposed to a real property assessment." The court ordered a reassessment pursuant to WIS. STAT. § 74.39(1). The City subsequently "reassessed" the properties at the same values of \$2,700,000 for the Murdock property and \$3,074,000 for the Koeller property, and Walgreen objected. The court agreed with Walgreen that the City's reassessments contained the same flaws as the original assessments and that they did not follow *Walgreen/Madison*. Finding Bakken's appraisal to be more consistent with the Manual and case law, the court made adjustments to that appraisal to arrive at valuations of \$2,131,000 in 2009 and \$2,024,000 in 2010 for the Murdock property and \$2,200,000 in 2009 and \$2,097,000 in 2010 for the Koeller property. The court awarded a \$69,548.99 refund to Walgreen. The City appeals.

² State law mandates that the department of revenue prepare and publish the Manual, which "shall discuss and illustrate accepted assessment methods, techniques and practices with a view to more nearly uniform and more consistent assessments of property at the local level." WIS. STAT. § 73.03(2a). The Manual requires amendment "from time to time to reflect ... court decisions concerning assessment practices...." *Id.*

DISCUSSION

¶8 Under WIS. STAT. § 70.32(1), Wisconsin tax assessors must value real property in accordance with the Manual, absent conflicting law. *Walgreen/Madison*, 311 Wis. 2d 158, ¶3. Assessments are presumed correct, *see* WIS. STAT. § 70.49(2), unless they do not conform with the Manual or the law, *Allright Props., Inc. v. City of Milwaukee*, 2009 WI App 46, ¶12, 317 Wis. 2d 228, 767 N.W.2d 567. On appeal, we defer to the circuit court’s findings of fact, but review independently whether those facts establish that the assessor failed to follow the law. *Id.*, ¶13.

¶9 The City contends that the circuit court erred in not presuming its assessments are correct and in not valuing the properties according to their highest and best use as “existing freestanding pharmac[ies].” We disagree as the City’s method of assessing the properties, including its identification of their highest and best use, was based on Walgreen’s business value in direct contravention of *Walgreen/Madison*.

¶10 In *Walgreen/Madison*, our supreme court identified the correct methodology for assessing leased retail property when the leases involve payments significantly above market rental rates. *Walgreen/Madison*, 311 Wis. 2d 158, ¶18. The court defined the question on appeal as whether an assessment of retail property leased at above-market rents should be based on market rents or on the “contract rent” of Walgreen’s actual leases. *Id.*, ¶2. The court concluded that “the assessor must use the market rent, not the contract rent,” and that all of the necessary information could be obtained and verified by the assessor in the marketplace. *Id.*, ¶82.

¶11 The fact that retail property may be income-producing does not render the contractual benefits of an above-market lease equal to a higher property value. *Id.*, ¶47. “[A] lease never increases the market value of real property rights to the fee simple estate.” *Id.* (citation omitted). Any increase in the value of real property attributable to a particular lease constitutes contractual rather than real property rights, even though those rights may run with the land. *Id.*, ¶48.³ This is because “[r]ent is not a right in realty; it is what is exchanged for an encumbrance upon a right in realty.” *Id.*, ¶45. While “a lessor may be more than fully compensated for an encumbrance through above market rent,” that fact “does not transform a lease from an encumbrance to part of the ‘bundle of rights’ appertaining to a property, nor does it transform the rent payments into anything more than compensation for an encumbrance. Rather, it may just make the property owner a wise investor.” *Id.*

¶12 The City argues that its assessments comply with the Manual and *Walgreen/Madison* even though they rely on the contract rents and actual sales of the subject properties because, according to the City’s analysis, Walgreen does not pay above-market rents and its leases do not increase the sale prices of its properties. To reach this conclusion, the City defines the highest and best use of Walgreen’s properties as “their *continued* use as 1st generation freestanding drug stores,” and analyzes Walgreen’s rents and sales against properties with this same use.

³ This is distinguished from when a lease “actually encumber[s] the property” by providing below-market rents. See *Walgreen Co. v. City of Madison*, 2008 WI 80, ¶¶43-44, 46, 311 Wis. 2d 158, 752 N.W.2d 687.

¶13 The problem with the City’s argument is that this narrow definition of highest and best use restricts the market for Walgreen properties to one that, in the City’s own words, includes only “investment grade real estate” where “[t]he value of the investment is determined by the value of the real estate, the creditworthiness of the tenant and the value of the lease itself.” Tellingly, the City’s assessor testified at trial that in order to transform the sale prices of vacant freestanding drug stores into valid sales comparisons for the Walgreen properties, he would “have to do an economic adjustment for the differences in the income stream” so as to “add value to your vacant sale to bring it up to the same quality as your subject.” In other words, the market does not value a property without Walgreen as a tenant as highly as it does a property where Walgreen remains a tenant subject to a long-term lease. The City’s assessment method values “the business concern which may be using the property.” *See id.*, ¶65 (citation omitted). This it cannot do.

¶14 As the evidence presented at trial showed that the City’s assessments relied on above-market sale prices and contract rents and did not comply with applicable law, the circuit court properly found that they should not be afforded a presumption of correctness. The court did not err in rejecting the City’s highest and best use for the properties, which required valuation of Walgreen’s business concern in addition to its real property in contravention of *Walgreen/Madison*.⁴

⁴ A further problem with the City’s argument is that, where its assessment methodology conflicts with *Walgreen/Madison*, it relies on post-*Walgreen/Madison* changes to the Manual and argues that “*Walgreen/[Madison]* must now be interpreted in light of the revised Manual.” This may be true in some circumstances, but not to the point of gutting *Walgreen/Madison*. Where there are conflicts between the Manual and the law, “common law which accurately reflects the state of the law” and WIS. STAT. § 70.32(1) control. *City of West Bend v. Continental IV Fund Ltd. P’ship*, 193 Wis. 2d 481, 487, 535 N.W.2d 24 (Ct. App. 1995).

¶15 Lastly, we address the City’s contention that the circuit court erred in its property valuations by failing to formally identify the highest and best use of the properties and by “[m]aking arbitrary adjustments” to what it considers to be Walgreen’s faulty appraisal. We note that the circuit court’s valuations were within the ranges introduced into evidence by the experts at trial, that the City was given a chance to correct its assessments to comply with the law, and that the City continues to hold up the same assessments as valid that we have determined violate *Walgreen/Madison*. The circuit court did not clearly err in arriving at its valuations; the court admirably shouldered a task that the City refused to perform.

¶16 We decline both parties’ invitation to publish this decision. We do no more here than apply the precedent of *Walgreen/Madison* that “[a]n assessor’s task is to value the real estate not the business concern which may be using the property.” *Id.*, ¶65 (citation omitted). We make no new law nor do we address any novel legal issue. If the City wishes to relitigate *Walgreen/Madison*, this is not the correct forum. See *Cook v. Cook*, 208 Wis. 2d 166, 189-90, 560 N.W.2d 246 (1997).

By the Court.—Judgment affirmed.

Not recommended for publication in the official reports.

