

**BEFORE THE COURT OF TAX APPEALS
STATE OF KANSAS**

IN THE MATTER OF THE PROTEST
OF PREMIER PETROLEUM, INC.
FOR THE YEAR 2005 IN JOHNSON
COUNTY, KANSAS

Docket No. 2006-8559-PR *et al.*

ORDER

Now the above-captioned matters come on for consideration and decision by the Court of Tax Appeals of the State of Kansas. The Court conducted a hearing in these matters on January 23, 2009. The taxpayer, Premier Petroleum, Inc. ("Premier"), appeared by and through its attorney of record, James McIntyre. Johnson County appeared by and through its attorney of record, Kathryn Myers.

This court has jurisdiction pursuant to K.S.A 2008 Supp. 79-2005.

I.

These consolidated appeals involve the valuation, for purposes of *ad valorem* taxation, of two owner-occupied convenience store/fuel station properties. The tax years in question are 2005, 2006 and 2007. The parcels under appeal are described as follows:

Real estate and improvements known as 13705 College Blvd,
Johnson County, Kansas; County Parcel ID: DP07800000
0001A (hereinafter the "College Boulevard property")

and

Real estate and improvements known as 16610 W. 135th Street,
Olathe, Johnson County, Kansas; County Parcel ID:
DP48220000 0001A (hereinafter the "W. 135th Street property")

Following are the docket numbers, property addresses, tax years at issue, and original appraisal values for each appeal:

COTA Docket #	Property	Tax Year	Value Appealed
2006-8560-PR	W. 135 th Street	2005	\$758,500
2007-10146-PR	W. 135 th Street	2006	\$772,590
2007-7319-EQ	W. 135 th Street	2007	\$795,730
2006-8559-PR	College Blvd	2005	\$919,100
2007-10145-PR	College Blvd	2006	\$830,000
2007-7318-EQ	College Blvd	2007	\$951,190

II.

The county appraised both the W. 135th Street and College Boulevard properties using the Kansas Department of Revenue, Property Valuation Division's approved computer assisted mass appraisal (CAMA) system. At the hearing, the county introduced CAMA appraisal reports for both properties. The county prepared these reports in accordance with K.S.A. 2008 Supp. 79-504, invoking jurisdictional exceptions to the 1992 Uniform Standards of Professional Appraisal Practice (USPAP) under Standards 6-7 and 6-8 of that publication. The county's reports were prepared by Linda Clark, CAE, RMA, with assistance from other personnel in the Johnson County Appraiser's office.

The county valued both properties using the same methodology. The county determined the highest and best use of the properties to be the current use, as there was no evidence that an alternative use would yield a higher net return to the properties. Both properties are currently used as convenience and fuel retail stores. Premier provided no evidence that the properties' highest and best use was anything other than their current use.

According to Ms. Clark, retail buildings in Johnson County are ordinarily bought and sold as income producing investment properties and thus the income approach is generally considered the most reliable method for estimating fair market value. The county did not utilize the income approach in valuing the subject properties, citing a lack of relevant market information. The county also did not perform a complete sales comparison approach because its mass appraisal system does not include an automated sales comparison module for commercial properties. The county nevertheless did consider comparison sales in an effort to determine whether the county's appraisements were in line with similar properties. Ms. Clark testified that her analysis of comparison sales raised no concerns with respect to valuation uniformity or equality.

The county relied on the cost approach in valuing both properties for all three tax years in issue. According to the county, the cost approach is often used for retail

buildings in the absence of reliable income and expense information, or if there is insufficient reliable sales data.

Ms. Clark explained how the cost approach is applied by the county through the CAMA system. First, the county determines the current cost of replacing the improvements, and estimates the degree of depreciation, including physical depreciation as well as functional and economic obsolescence. Next, the county deducts the amount of accrued depreciation from the cost of replacing the improvements. The resulting figure is added to the land, or site, value to obtain an estimate of value for the entire real estate parcel.

The table below summarizes the county's cost-approach data for the subject properties for all three years at issue.

Property	Tax Year	Land Value	Improvement Value	Total Value Appealed
W. 135 th St.	2005	\$430,910	\$339,190	\$770,100
W. 135 th St.	2006	\$430,910	\$357,230	\$788,140
W. 135 th St.	2007	\$430,910	\$389,170	\$820,080
College Blvd.	2005	\$374,080	\$394,500	\$768,580
College Blvd.	2006	\$374,080	\$395,800	\$769,880
College Blvd.	2007	\$374,080	\$405,260	\$779,340

In addition to its CAMA-based appraisal evidence, the county also presented independent appraisal reports for the subject properties prepared by Laird Goldsborough, MAI, of Shaner Appraisals, Inc. The appraisal reports had been prepared on behalf of Peoples Bank in connection with Premier's financing for a July 2005 transaction involving the subject properties. The effective date of both appraisals is June 1, 2005.

Premier objected to admission of the independent appraisals on the basis of hearsay and foundation, noting that the reports were not introduced through the appraiser who prepared the reports and that the appraiser was not present at the hearing for cross examination. This court overrules the taxpayer's objection.

Under the Kansas Administrative Procedures Act (KAPA), technical rules of evidence need not apply, and "evidence need not be excluded solely because it is hearsay." K.S.A. 77-524(a); *Winston v. State Dept. of Social and Rehabilitation Serv.*, 49 P.3d 1274 (2002). In the interest of giving the parties reasonable opportunity to be heard and to present relevant evidence, we find it appropriate to

admit the independent appraisal reports over Premier's objection. The reports were prepared by an MAI-licensed appraiser for purposes unrelated to the present tax appeal and were certified in accordance with USPAP. The signed certifications evidence the appraiser's recognition of his professional ethical obligations, prescribed by USPAP, in developing and reporting his appraisal work product. It also should be noted that the county offered the independent appraisal reports as corroborative evidence, not as the sole evidentiary basis for the county's case. We find that the independent appraisal reports, although technically hearsay, bear satisfactory indicia of reliability to be admitted and considered as evidence of fair market value. The fact that the appraiser who prepared the reports was not present at the hearing to provide testimony goes to the weight, not the admissibility, of the evidence.

We also note, and give consideration to, the limiting language contained in the letters of transmittal attached to the independent appraisals reports, cautioning that the reliability of the appraisements may be impacted by the degree of departure from USPAP guidelines. In particular, the letters note that an income approach analysis was not included in the appraisal report because of a lack of pertinent information.

The independent appraisals are fee simple appraisals. They state in the "General Assumptions and Limiting Conditions" section that the appraiser's opinion of value applies to land and improvements only and that trade fixtures and other personal property are not included. According to the reports, as of June 1, 2005, the value of the W. 135th Street property was \$860,000, and the value of the College Boulevard property was \$830,000.

At the hearing, Ms. Clark announced that the county had decided to make downward adjustments to its value recommendations based on new information and analysis. The county now recommends that this court adopt the following valuations:

Property	Tax Year	County Recommendation
W. 135 th St.	2005	\$717,384
W. 135 th St.	2006	\$717,384
W. 135 th St.	2007	\$717,384
College Blvd.	2005	\$768,580
College Blvd.	2006	\$768,580
College Blvd.	2007	\$779,340

III.

Premier's valuation evidence consisted of testimony from the owner, Aeshad Chaudhri, and testimony from Daniel Rechtsfertig, a convenience store business consultant. Mr. Rechtsfertig had acted as Premier's agent in negotiating the July 2005 transaction involving the subject properties. In addition to Mr. Rechtsfertig's testimony, Premier presented documentary evidence relating to the sale, including copies of the executed offers to purchase the subject properties and a copy of the promissory note between Premier and the lender.

Mr. Rechtsfertig testified that Premier purchased the subject properties in July 2005 as part of a package deal involving four convenience store properties. Two of the properties are located in Missouri and are not a part of this consolidated appeal. He testified that the total purchase price for all four properties was approximately \$2 million, including personal property, and that no business enterprise value or goodwill was included in the purchase price.

According to Mr. Rechtsfertig, a number of key factors generally go into an investor's decision to purchase a convenience and fuel retail store. These factors include traffic volume, proximity to competitors, fuel pricing issues, parking and pedestrian access, site size and location, and credit card use demographics.

Mr. Rechtsfertig explained that in July 2005 Premier purchased the subject properties from Equilon, a Shell Oil Company affiliate. At the time of the transaction, he explained, petroleum companies were trying to divest their Kansas City operations because they were losing money in the convenience store business. Their approach was to sell off so-called "non-strategic" locations so that more profitable locations could be packaged and sold to investors in structured deals.

According to Mr. Rechtsfertig, the subject properties were designated non-strategic locations for a number of reasons. The properties had "prolific exposure to competition," particularly from QuikTrip. They had parking issues, which restricted customer inflow. They also were located in an area with a heavy credit-card-use demographic. Mr. Rechtsfertig explained that credit card usage is a growing challenge for convenience stores because of rising fees and because, when a customer pays for fuel at the pump, the customer is less likely to come into the store and purchase other products. According to Mr. Rechtsfertig, margins on fuel sales are generally low, so profits must be made on in-store sales.

Mr. Rechtsfertig testified that the July 2005 transaction was advantageous to Premier because Alpha Petroleum, a petroleum supply company with common ownership, needed to guarantee service to the stores and add volume to its

enterprise. At the time, Alpha Petroleum was attempting to increase its volume so that it could qualify as a Shell wholesaler. Mr. Rechtfertig explained that these dynamics were the reason the special warranty deeds transferring the subject properties included a brand covenant.

The brand covenant contained in both deeds are identical:

- d) Subject to Article f) below, for 10 years from the date of closing Grantee agrees that if the Premises is used for the sale of motor fuel, the motor fuel must be purchased from Grantor, or Grantor's successor or assigns, ("Brand Covenant") and the Station must be operated pursuant to the terms and conditions of the Supply Agreement, or its replacement.
- e) Grantee shall use, improve, lease, sell, encumber or transfer the Premises subject to the Brand Covenant. Grantee may not assign its rights or obligations under the Brand Covenant without the prior written consent of Grantor. The Brand Covenant runs with the land or leasehold interest, as applicable, and will appear as a recorded item in the property records of the Premises, and is for the benefit of, and binds, the successors in interest and assigns of Grantee. Grantor's failure to enforce any breach of the Brand Covenant is not a waiver of the Brand Covenant or of any subsequent breach thereof. All purchasers, lessees, and possessors of all or any portion of the Premises and their respective heirs, successors, assigns will be deemed by their purchase, lease, or possession to be in accord with, and shall agree to the terms of, the Brand Covenant.
- f) Grantee will be excused from complying with the Brand Covenant if Grantor elects to do a market withdrawal in accordance with the Petroleum Marketing Practices act from a geographic area that includes the Premises.
- g) If Grantee fails to comply with the Brand Covenant for any reason whatsoever, Grantor may pursue any and all actions to enforce the terms of the Brand Covenant and pursue any and all remedies available at law or in equity.

Mr. Rechtfertig testified that the brand covenant was requested by Premier because it protected Alpha Petroleum. He said that Premier received no additional

consideration or incentives for agreeing to be bound by the restriction.

Mr. Chaudhri's testimony was that the subject properties are "tough locations" because of their proximity to competition and because of fuel pricing issues. According to Mr. Chaudhri, the biggest problem is that the subject properties do not have the wherewithal to be competitive with fuel pricing because the stores are independent Shell-branded retailers. He explained that retailers backed by big oil have more flexibility with their pricing because they are able to integrate their profits and losses into the overall corporate income structure. Unbranded independent retailers also enjoy a competitive advantage because they do not have to pay charges assessed by the petroleum company for marketing the brand.

IV.

Because the subject property is owner-occupied commercial property, the county has the burden of initiating the production of evidence to prove by a preponderance of the evidence the validity and correctness of its valuation. K.S.A. 2008 Supp. 79-2005(i). No presumption exists in favor of the county appraiser with respect to the validity and correctness of its determination. *Id.*

Each parcel of non-agricultural real property in Kansas is appraised at its fair market value. K.S.A. 2008 Supp. 79-501. The term "fair market value" is defined as that "amount in terms of money that a well informed buyer is justified in paying and a well informed seller is justified in accepting for property in an open and competitive market, assuming the parties are acting without undue compulsion." K.S.A. 2008 Supp. 79-503a.

By statute, certain factors are to be considered in determining fair market value for purposes of *ad valorem* taxation:

Sales in and of themselves shall not be the sole criteria of fair market value. Sales are to be used in connection with cost, income and other factors including but not by way of exclusion:

- (a) The proper classification of lands and improvements;
- (b) the size thereof;
- (c) the effect of location on value;
- (d) depreciation, including physical deterioration or functional, economic or social obsolescence;
- (e) cost of reproduction of improvements;
- (f) productivity;

- (g) earning capacity as indicated by lease price, by capitalization of net income or by absorption or sell-out period;
- (h) rental or reasonable rental values;
- (i) sale value on open market with due allowance to abnormal inflationary factors influencing such values;
- (j) restrictions imposed upon the use of real estate by local governing bodies, including zoning and planning boards or commissions; and
- (k) comparison with values of other property of known or recognized value. The assessment-sales ratio study shall not be used as an appraisal for appraisal purposes.

K.S.A. 2008 Supp. 79-503a

Although the county has the burden of production, in this case it is useful to begin our analysis with Premier's evidence. Premier's valuation recommendations are based entirely on a multi-property transaction involving the subject properties and two other properties located in Missouri. The transaction occurred July 2005. Premier asserts that the purchase price allocations set forth in the contracts to purchase the subject properties is the best evidence of fair market value for all three tax years in question.

An arm's-length sale should be given substantial weight in determining market value for tax purposes. *Wolf Creek Golf Links, Inc. v. Johnson Board of Co. Comm'rs*, 18 Kan. App. 2d 263, 266, 853 P.2d 62 (1993). The sale price given by a willing purchaser to a willing seller is not conclusive but is "substantial evidence" of the value of real estate for appraisal purposes. *Board of Co. Commr's of Shawnee County v. Brookover*, 198 Kan. 70, 77, 422 P.2d 906 (1967).

We acknowledge that in any real estate valuation analysis, it is important to consider the recent sales history of the subject property. Still, there are myriad variables that come into play affecting the price finally agreed upon by the parties to a real estate transaction. That is why the preferred method of estimating fair market value is to analyze a wide range of appraisal data, not just a single sale.

Also, it should be noted that the July 2005 sale of the subject properties occurred after the effective date of the 2005 appeal. The statutory scheme for *ad valorem* tax valuation "is a surrogate for a real marketplace event..." *Hixon v. Lario Enterprises*, 875 P.2d 297, 300 (1994). The county appraiser must "pretend, in effect, that each piece of property is sold on January 1 of the year in which the appraisal is done in an arms length transaction." *Id.*

According to USPAP, post-effective-date sales data may be considered for the purpose of confirming market trends that would have been considered by a buyer and seller as of the effective date of the appraisal. *See* USPAP (SMT-3). Without evidence that post-effective-date data is consistent with and confirmed by market expectations as of the effective date, however, the effective date should be the cut-off date for market data. *See id.*

The July 2005 sale was not offered as evidence of any trend or market condition as of the effective date of the 2005 appeal. In fact, Premier offered no evidence of market conditions that would have been considered in a hypothetical sale of the properties by a buyer and seller as of the effective date of the 2005 appeal (January 1, 2005). Thus, evidence of the July 2005 sale of the subject properties should be given little weight in our determination of fair market value for the 2005 tax year.

Aside from timing issues, the terms of the July 2005 sale should be analyzed carefully to determine whether that sale was in fact a *bona fide*, arm's-length transaction. There are a number of factors that suggest it was not. First, the subject properties were sold as part of a package deal, making it difficult to distill the price of the component parts from the aggregated price of the whole. Second, the relationships between Equilon, Premier and Alpha Petroleum calls into question whether the sale was in fact an arms length transaction. And, finally, the brand covenant contained in the deed, which affects all three companies, binds the owner of the subject properties, and all successors and assigns, to a 10-year exclusive dealing arrangement with Equilon. While there is no evidence that the parties dickered over the brand covenant during the course of negotiations, there is no way to confirm with any reasonable degree of certainty how that aspect of the deal might have affected the purchase price.

Based on the totality of the circumstances surrounding the July 2005 sale, we conclude that the sale prices allocated to the real estate portions of subject properties are of limited probative value in determining the properties' fair market value for the tax years in issue.

We turn now to the valuation evidence presented by the county. The county's appraisal relies primarily on the cost approach. The cost approach is based on the general assumption that the market value of improved real property is approximately equal to the value of the land plus the cost of replacement of the improvements, less accrued depreciation from all sources. Like all valuation methodologies, the cost approach is market based. As a practical matter, it is reasonable to assume that a reasonable buyer would not pay more to buy a parcel of land and then erect a building on it than he would pay to buy a parcel of land with a

comparable building already in place. Although the cost approach may be a useful tool in mass appraisal, the difficulty in determining proper allowances for depreciation, particularly functional and economic and obsolescence, makes the approach less reliable than the sales comparison and income approaches.

County witness Clark testified that in determining the land value of the subject properties, she considered all vacant commercial land sales. For all three tax years, Ms. Clark determined that the land values for the College Boulevard property and W. 135th Street property were \$374,080 and \$430,910, respectively.

With regard to physical depreciation, Ms. Clark provided testimony and CAMA tables which charted the physical wear and tear on the properties. The county's physical depreciation calculations were not disputed, and no evidence was presented that would call into question the accuracy of those calculations.

The focus of the dispute concerning the county's cost analysis was non-physical depreciation. The parties did not dispute that the properties faced challenges in the local market because of parking issues and exposure to other retailers with various competitive advantages. These issues were referred to by the parties during the hearing, in general terms, as "obsolescence."

Functional obsolescence, or depreciation resulting from the inadequacy or superadequacy of improvements, should be considered in any real estate appraisal under the cost approach. In the present case, anecdotal evidence was presented concerning problems with design and functionality of the structures and ground improvements. However, no evidence was presented concerning what measures could be taken to cure these problems. Nor was there any evidence presented to quantify the total loss in value, or excess costs incurred, as a result of these problems. The county did, however, make downward adjustments to the construction grade of both stores. And for the College Boulevard property, the county made an additional downward adjustment to the condition and functional utility of the lube center facility. Without evidence to substantiate Premier's claim that additional adjustments are appropriate to account for functional obsolescence, we find no reasonable basis for rejecting the county's adjustments.

Nevertheless, the court finds evidence of adverse conditions caused by external factors that affect both properties. Some of these external factors are fundamentally linked to the real estate, while others appear to be linked to the business enterprise operating on the premises. For example, the competitive disadvantages occasioned by wholesale pricing strategies and Premier's decision to become a branded independent retailer are not properly considered in this appeal because they are enterprise value considerations. The unprofitable nature of a business enterprise, or adverse economic conditions confronting a business owner, is

not synonymous with obsolescence affecting the property itself and is not properly considered in property tax valuation. *See State ex rel. Stephan v. Martin*, 608 P.2d 880, 889 (Kan. 1980) (citing *Northern Natural Gas Co. v. Dwyer*, 492 P.2d 147 (Kan. 1971, cert. denied 406 U.S. 967 (1972)).

It is, however, appropriate to consider depreciation to the real estate caused by external factors (economic obsolescence). Here, based on the limited evidence presented, we find the best way to account for allowable economic obsolescence is through the subject land valuations. We find that economic obsolescence has been accounted for in the land value assigned by the county to the College Boulevard property. We find, however, that proper allowances for economic obsolescence were not made in the county's appraisal of the W. 135th Street property. It is undisputed that the W. 135th Street property is exposed to prolific competition from properties whose site sizes, configurations and locations are superior to the subject's. According to the evidence, the 135th Street property is flanked by two QuikTrip properties, which divert customers from the subject property. The court finds that a 15% downward adjustment to the county's land valuation is appropriate to account for economic obsolescence suffered by the W. 135th Street property. This adjustment is supported by both the anecdotal evidence as well as by the W. 135th Street site value set forth in the Shaner appraisal.

In sum, this court is faced with the challenge of determining fair market value based on a wide range of evidence of varying degrees of probative value. Premier's valuation recommendations are of limited weight because they are based on a multi-property transaction involving the subject properties as well as two properties in Missouri. That transaction occurred in July 2005 and involved a number of unique circumstances surrounding the relationship of the parties and the terms of their purchase agreement. Other than the July 2005 transaction, Premier offered no appraisal analysis. The county's valuation recommendations are somewhat problematic too, however, because the county's CAMA appraisals are based on just one appraisal methodology, the cost approach, with very little supporting data or analysis.

Still, in addition to CAMA appraisal evidence, the county also offered an independent fee appraisal for each of the subject properties. The fee appraisals utilized both the cost approach and the sales comparison approach, but omitted the income approach. These fee appraisals support the county's appraised values; in fact, they support more aggressive valuations.

Based on the weight of the evidence, we conclude that county's recommendations (with a 15% downward land adjustment for economic obsolescence to the W. 135th parcel) are the best evidence of fair market value.

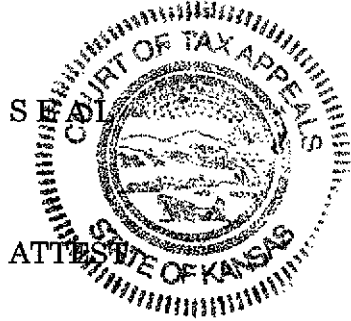
IT IS THEREFORE ORDERED that, for the reasons stated above, the appraised values of the subject properties for tax year 2005, 2006 and 2007 are as set forth in the table below.

COTA Docket #	Property	Tax Year	Final Value
2006-8560-PR	W. 135 th Street	2005	\$652,747
2007-10146-PR	W. 135 th Street	2006	\$652,747
2007-7319-EQ	W. 135 th Street	2007	\$652,747
2006-8559-PR	College Blvd	2005	\$768,580
2007-10145-PR	College Blvd	2006	\$768,580
2007-7318-EQ	College Blvd	2007	\$779,340

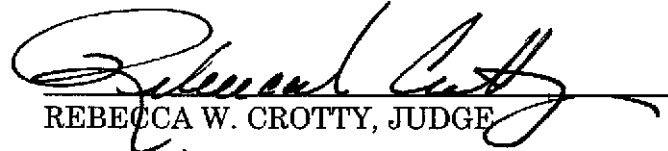
IT IS FURTHER ORDERED that the appropriate officials shall correct the county's records to comply with this Order, re-compute the taxes owed by the taxpayer and issue a refund for any overpayment.

Any party to this action who is aggrieved by this decision may file a written petition for reconsideration with this Court as provided in K.S.A. 2008 Supp. 77-529. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Court's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for reconsideration shall be mailed to: Secretary, Court of Tax Appeals, Docking State Office Building, Suite 451, 915 SW Harrison St., Topeka, KS 66612-1505. A copy of the petition, together with any accompanying documents, shall be mailed to all parties at the same time the petition is mailed to the Court. Failure to notify the opposing party shall render any subsequent order voidable. The written petition must be received by the Court within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute). If at 5:00 pm on the last day of the specified period the Court has not received a written petition for reconsideration of this order, no further appeal will be available.

IT IS SO ORDERED.



THE KANSAS COURT OF TAX APPEALS


REBECCA W. CROTTY, JUDGE


J. FRED KUBIK, JUDGE


TREVOR C. WOHLFORD, JUDGE PRO TEM


JOELENE R. ALLEN, SECRETARY

CERTIFICATION

I, Joeline R. Allen, Secretary of the Court of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket No. 2006-8559-PR *et al* and any attachments thereto, was placed in the United States Mail, on this 28th day of August, 2009, addressed to:

Premier Petroleum, Inc.
Premier Petroleum In
PO Box 27229
Overland Park, KS 66213

James Hudson, Tax Representative
Hudson Consulting Services
PO Box 3175
Wichita, KS 67201

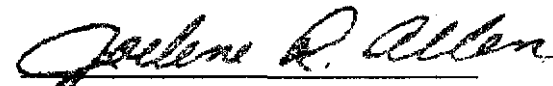
James McIntyre, Attorney
Law Office of James T McIntyre
PO Box 2434
Wichita, KS 67201

Paul Welcome, Johnson County Appraiser
Johnson County Appraiser Office
11811 S Sunset Dr, Ste 2100
Olathe KS 66061

Kathryn Myers, Johnson County, Assistant County Counselor
Johnson Co Admin Bldg
111 S Cherry, Ste 3200
Olathe KS 66061-3441

Charles Letcher, Johnson County Treasurer
Johnson Co Admin Bldg
111 S Cherry, Suite 1500
Olathe KS 66061-3486

IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.


Joeline R. Allen, Secretary