No. 2018-119438-A

IN THE COURT OF APPEALS OF THE STATE OF KANSAS

IN THE MATTER OF THE EQUALIZATION APPEAL OF KANSAS STAR CASINO, L.L.C. FOR THE YEAR 2016 IN SUMNER COUNTY, KANSAS

IN THE MATTER OF THE EQUALIZATION APPEAL OF KANSAS STAR CASINO, L.L.C. FOR THE YEAR 2017 IN SUMNER COUNTY, KANSAS

REPLY BRIEF OF APPELLANT AND BRIEF OF CROSS-APPELLEE

APPEAL FROM THE KANSAS BOARD OF TAX APPEALS
DOCKET NOS. 2016-2148-EQ, 2016-2149-EQ, 2017-3172-EQ,
AND 2017-3173-EQ

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REPLY TO STATEMENTS OF FACT

Appellant ("Kansas Star" or "Taxpayer") incorporates by reference its Statement of Facts from Brief of Appellant in this matter. In further reply to Appellee's (the "County") Statement of Facts, Kansas Star states as follows:

At page 3 of its Brief of Appellee, the County discusses the details of various proposals through the three rounds of bidding in the south central gaming zone. The projects discussed in the first round of bidding (Harrah's, Penn National, and Marvel) were made before the Great Recession at the end of 2008. Harrah's, the presumptive winning bidder, withdrew its bid after the recession began. R. Vol. 1, part 1, pp. 157-158, ¶ 14. Development proposals in subsequent rounds of bidding were much less expensive with fewer and smaller amenities.

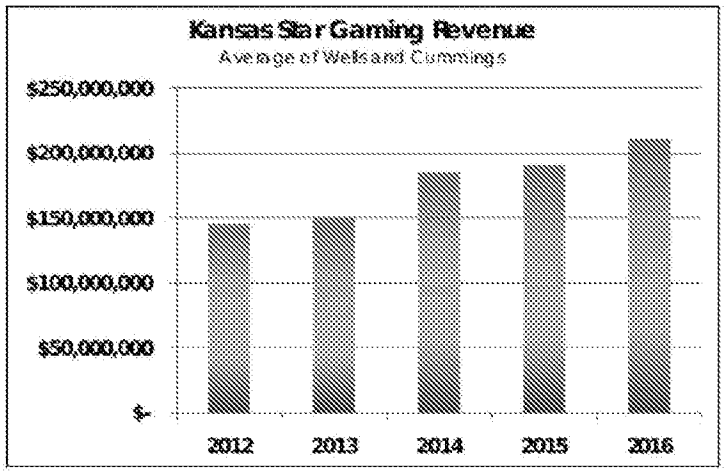
At page 4 of its Brief of Appellee, the County notes that Crossroads Consulting projected before the opening of the Kansas Star Casino that the arena would host 26 to 31 events per year and that Cory Morowitz prepared a market study, indicating that such events would generate $9 to 10 million in additional gaming revenue per year. The County leaves out that Morowitz prepared an earlier report in which he projected that the arena would host just 12 equine events per year and obtain just $2.152 million in additional gaming revenue from such events. R. Vol. 16, Ex. 648, p. 8656. He revised that report at the request of Peninsula Gaming (the original developer of the Casino) with the assumption of increased events as posited by Crossroads. *Id.* Of further note, the County, at page 8 of its Brief of Appellee, provides a quote from Tim Lanier, Kanas Star's former arena director, from a November 2014 issue of the Wichita Eagle. In that article, Lanier is quoted as saying that he expected only 10 to 12 equine events per year.

The County also fails to note that neither projection came to fruition. Kansas Star has little success attracting equine events, and they do not generate revenue at or near the pre-opening projections. R. Vol. 61, pp. 172-174, 208-209, 272-276. As discussed at length in Kansas Star's

Brief of Appellant, the arena loses money and does not drive higher gaming revenues to offset such losses.

At page 5 of its Brief of Appellee, the County notes Macomber's opinion that the arena was always understood to be a "loss leader," which would not make money on its own. While that narrow quote is accurate, it ignores the fact that the relevant consultants *did* expect the arena to drive gaming revenues, which would result in higher profitability for the overall project. R. Vol. 10, Ex. 616, pp. 70-71. Specifically, Peninsula Gaming originally projected that tourist visitation would increase nearly 250% from 99,911 in 2012 (Phase 1a, temporary casino only) to 240,461 by full build-out in 2016. *Id.* at p. 71. Peninsula further projected that the arena would increase gaming spend (*i.e.*, revenue) from tourists by nearly 500% from $6,007,106 to $28,237,904 over that time period. *Id.* Finally, Peninsula believed that the addition of the arena amenities would increase overall profit (stated as net income, rather than EBITDA, in the projections) from $13 million in 2012 to over $43 million in 2016. R. Vol. 10, Ex. 616, p. 83. Thus, the value of the arena was not in its potential to generate a profit on its own, but to generate additional gaming revenue from tourists who would otherwise not patronize the casino. In reality, that never happened.

Bliss evaluated the pre-opening projections for the Subject Property, noting that three different expert consulting groups, including two independent consultants, concluded that the overall revenues at the Subject Property would increase with additional build-out of amenities from Phase 1a through Phase 2. As shown in this chart, the average gaming revenue estimates from Wells Gaming Research and Cummings Research Associates projected that the Subject Property would increase gaming revenues from less than $150 million in 2012 (Phase 1a, temporary casino only) to over $200 million in 2016 (Phase 2, full build out).



R. Vol. 60, Ex. 356, p. BLISS_109.

Peninsula Gaming itself estimated that gross revenues would rise from $123,370,043 in 2012 to $225,944,173 in 2016, as shown in the table below:

Year	2012	2013	2014	2015	2016
Gaming	$ 118,907,922	$ 147,529,372	$ 165,812,555	$ 190,727,438	$ 202,342,739
Non-Gaming	$ 4,462,121	$ 15,431,307	$ 17,296,026	$ 21,906,553	$ 23,601,434
Gross Revenue	$ 123,370,043	$ 162,960,679	$ 183,108,581	$ 212,633,991	$ 225,944,173

R. Vol. 60, Ex. 356, p. BLISS_109. As noted by Bliss, the experts believed-- at least at the time of the bidding process in 2010—that the non-gaming amenities, including the arena and equine events center, would "drive attendance, admissions, and subsequently revenue at the subject." R. Vol. 60, Ex. 356, p. BLISS_110. "In reality, the casino operation did not require years to achieve stabilized gaming revenue levels," and the Subject Property "effectively achieved stabilized gaming revenues in its first year of operation … with no support from ancillary buildings, which were non-existent in 2012." R. Vol. 60, Ex. 356, p. BLISS_110. As such, Bliss concluded that Kansas Star Casino's revenues "were not materially increased, nor do they significantly benefit from the presence of the completed existing indoor-arena, conference center and events pavilion." R. Vol. 60, Ex. 356, p. BLISS_112. Morowitz concurred, explaining that "I'm just observing reality that gaming revenue reached market projections before the arena opened, then it declined."

R. Vol. 62, p. 559. "They were satiating demand without the arena." R. Vol. 62, p. 559. The "project has reached its maturity and the prospect of additional development to drive gaming revenue is minimal." R. Vol. 60, Ex. 353, p. 18.

At page 8 of its Brief of Appellee, the County claims that Kansas Star "has never *attempted* to hold the types of equestrian events projected by Crossroads." (Emphasis added). The County provides no citation for this assertion because it doesn't exist. Instead, the County merely cites the record for the fact that Kansas Star hosted four equine events in 2014, five in 2015, and three in 2016 and used the arena for 36-38 days per year total, rather than Crossroads' projection of 99-117 days. Nothing in the record supports the County's assertion that Kansas Star did not *attempt* to use the arena to its maximal and optimal capacity. The record is replete with evidence that Kansas Star used the arena to the best of its ability in an attempt to maximize overall profitability, but the results never matched the projections. The arena lost money operationally and never generated any gaming revenue to offset its operation losses and overhead, as was originally projected.

First, it must be reiterated that only Crossroads projected 26-31 equine events per year and over 100 days per year of arena usage. Morowitz projected only 12 equine events per year, and Tim Lanier, as noted above, was quoted as late as November of 2014 (shortly before the opening of Phase 2) that he expected only 10-12 events per year.

Second, Scott Schroeder, Kansas Star's Director of Finance, testified extensively about Kansas Star's efforts to attract equine and non-equine events, the poor financial performance of those events, and the lack of observable increases in gaming revenue from such events, and the problems associated with having an arena that could accommodate three times as many patrons as the casino. *See* Brief of Appellant, pp. 8-13. Specifically, Schroeder testified that equine events

are not well attended and that most attendees are participants along with their families (not spectators). R. Vol. 62, pp. 381-382. He also testified that Kansas Star attempts to attract good equine events, and that if such events were available, Kansas Star would book them "all day long." R. Vol. 62, p. 182. Schroeder explained that Kansas Star offers to hold events itself or to lease out the space to others to hold events, but that it has few takers for either option. R. Vol. 62, pp. 383-386. Kansas Star would gladly host larger events for more money (as Jortberg suggested it should do in his testimony), but, according to Schroeder, "[t]he market hasn't supported it so far." R. Vol. 62, p. 390. Schroeder stated unequivocally that if Kansas Star could use the arena more to generate more profit (gaming or otherwise), it would. R. Vol. 62, p. 391. He further discussed the various challenges of attracting shows generally. R. Vol. 62, pp. 391-395.

Third, Morowitz, Kansas Star's gaming industry expert, testified that the arena was far too big for the size of the casino, that the Wichita market was already well-served by other arenas, and that the arena lost money on the shows that it held and did not generate additional gaming revenue to offset those losses. *See* Brief of Appellant, pp. 21-24.

Finally, the County offers no evidence whatsoever to contradict the testimony of Schroeder and Morowitz. The County offered no evidence that if Kansas Star merely "attempted" to hold more shows, it could achieve greater profitability. In fact, neither of the County's experts who testified about the operations of the arena have any experience in the equine industry. Jortberg testified that has no experience in the equine industry, he has never run an equine event center, he doesn't understand the market for equine events in Kansas or the Midwest area, he doesn't know how many competitors exist for such events, and he doesn't know how many such events are held in the area. R. Vol. 62, pp. 327-328. Percy testified that he has never worked in the equine industry, and has never appraised an equine event arena. R. Vol. 61, pp. 59-60.

REPLY TO ARGUMENTS AND AUTHORITIES

I. Standard of Review.

The County's recitation of the law regarding standard of review of BOTA decisions is accurate. However, Kansas Star also notes that BOTA is the foremost authority on property tax valuation in the state, and its judgments concerning appraisal and appraisal practice are entitled to deference and should not be disturbed on appeal absent clear error. *See Marriott Corp. v. Bd. of County Commissioners of Johnson County*, 25 Kan. App. 2d 840, 842 (1999) (holding, *inter alia*, that BOTA should be given "great credence and deference when it is acting in its area of expertise."); *see also In re Graham-Michaelis Corp.*, 27 Kan. App. 2d 467, Syl. ¶ 1 (2000) (same); *In re Equalization Proceeding of the Amoco Prod. Co. for the Years 2001 & 2001 from Grant County*, 33 Kan. App. 2d 329, 343 (2005) (quoting *In re Tax Refund Application of Affiliated Property Services, Inc.*, 19 Kan. App. 2d 247, 250 (1993)) ("[W]hen we deal with BOTA decisions, because of its expertise, we overturn them rarely. 'In order for the court reviewing a decision by BOTA to find a lack of substantial evidence, the decision must be so wide of the mark that it is outside the realm of fair debate.'").

II. BOTA's Depreciation does not comport with USPAP.

The Parties agree, for the same reasons as in the 2015 case (which was decided by the Court of Appeals *after* BOTA rendered its decision in this matter), that BOTA's decision is not supported by evidence and appropriate USPAP-compliant analysis. As discussed below, the parties vehemently disagree about what the proper depreciation analysis should be, but both parties agree that remand is appropriate for further findings.

III. Kansas Star's Claim that the Arena and conference center amenities are obsolete due to superadequacy is correct, but should be remanded to BOTA for such determination.

The County's depreciation analysis is built entirely on a house of cards. That house of cards is the incorrect assumption that Kansas Star's contractual obligations under its management contracts are the only "legally permissible" use of a casino in south central Kansas for any subsequent purchaser of the real estate. For the reasons stated in the subparts below, the County is wrong, and, without its house of cards, its entire analysis falls apart.

Before delving into the details, though, it is important to note that this Court has already addressed this issue. In the 2015 appeal of this property, a panel of this Court already determined—based upon a substantially similar record with the same appraisers using the same methodologies—that

> [t]he parties provide extensive support for their competing positions in their briefs and ask us to adopt their position on functional obsolescence; however, it is not our role to calculate functional obsolescence. Rather, remand to BOTA for further proceedings is appropriate. Given the opposite conclusions each side advocates and BOTA's attempt to choose a middle ground, we emphasize that our holding does not compel BOTA to adopt one of the party's positions and that a figure somewhere in between 100 percent and 0 percent might be supported by the record in this case. On remand, BOTA would have to explain its rationale for supporting a figure in between the parties' positions; it would have to point to evidence in the record supporting its figure; and its rationale would have to be USPAP compliant.

In re Equalization Appeal of Kansas Star Casino, L.L.C. for the Year 2015, No. 116,782, *29 (Kan. Ct. App. July 20, 2018 (unpublished)). The County's position is that, as a matter of law, the property cannot suffer from any deprecation. This is not a matter of law. As stated above, BOTA is the foremost authority on property tax in Kansas, and its opinion in areas of appraisal practice are entitled to great credence and deference. As previously held by this Court, "it is not our role to calculate functional obsolescence." *In re Equalization Appeal of Kansas Star Casino, L.L.C. for the Year 2015*, No. 116,782, *29 (Kan Ct. App. July 20, 2018 (unpublished). "Rather, remand

to BOTA for further proceedings is appropriate." *Id.* Accordingly, this is an issue that should be first decided by BOTA, then reviewed with deference by this Court. As such, the County's argument is premature and should be disregarded pending remand. As already noted by this Court in the cited material from the prior year appeal of this same property, both parties provided "extensive support" for their positions, and BOTA may use its discretion, within legal and evidentiary limits, to decide the proper amount of depreciation to attribute to the arena and convention portion of the subject property. The County's assertion that this is a legal issue for which only one outcome is possible has already been rejected.

Furthermore, this Court's recent decision concerning the Hollywood Casino is equally instructive. In that case, this Court upheld BOTA's order finding that the property was worth substantially less than the cost to construct. *See In re Equalization Appeal of Kansas Entertainment, L.L.C., for the Tax Year 2015*, Case No. 117,406 (Kan. Ct. App. Dec. 21, 2018). If the County's position that an approved casino cannot, as a matter of law, suffer from any functional obsolescence if it conforms to the current owner's management contract, then that case also could not have been so decided.

In short, evidence was presented to support the appraisal judgments and arguments of both sides in this case. BOTA is well within its authority to determine which evidence is most persuasive and most in-line with recognized appraisal practice. The matter should be remanded for such findings.

a. KELA and the Management Contract Require *Appellant* (but not a subsequent hypothetical purchaser) to maintain the ancillary facilities.

The flaw in the County's argument is in the first sentence of this subsection, wherein the County states: "Resolution of the functional obsolescence issue begins with KELA and *Appellant's*

management contract, the interpretation of which present questions of law." Brief of Appellee, p. 22 (emphasis added).

First, as stated above, and as will be made clear with the rigorous appraisal analysis below, this is not a pure issue of law. K.S.A. 79-505 requires that the director of property valuation adopt rules and regulations prescribing appropriate standards for the performance of appraisals in connection with ad valorem taxation in Kansas. Theserules and regulations must, at a minimum, require that "appraisals be performed in accordance with *generally accepted appraisal standards* as evidenced by the appraisal standards promulgated by the appraisal standards board of the appraisal foundation." (Emphasis added). Establishing and interpreting "generally accepted appraisal standards" is a factual issue—or at least a mixed question of law and fact. If appraisal standards were purely a matter of law, the testimony of review appraisers, such as Sellers, would be prohibited as providing only legal opinions. BOTA is the expert agency with regard to appraisal standards and the trial court for property tax matters. As such, its decision should be accorded weight and deference in those determinations.

Second, KELA and *its requirements for management contracts* are certainly important in determining whether and to what extent a casino property may suffer from functional obsolescence. However, Kansas Star's personal contractual obligations with the state lottery, which do not run with the land and are not transferable to any other entity, are not determinative of that issue.

Kansas Star's management contract requires *Kansas Star* to build and operate its casino consistent with its management contract. However, the question here is not whether the facility is consistent with Kansas Star's management contract. The question is what would a future purchaser pay for Kansas Star's real estate. As a matter of law, Kansas Star cannot alienate its management

contract. K.S.A. 74-8734(m). That is, Kansas Star may not sell or transfer its management contract to a future purchaser. Any future purchaser must negotiate and obtain a management contract from the Kansas Lottery in accordance with KELA. As a practical matter, that means a future purchaser would have to obtain the Kansas Lottery's consent to operate the casino via one of three methods: (1) negotiate a new management contract, (2) agree to an amended version of Kansas Star's contract, or (3) agree to assume Kansas Star's management contract, as is. Any of these options would require basic compliance with KELA and the consent of the Kansas Lottery.

Without any evidence whatsoever, the County assumes that the only possible option is for the next operator to assume Kansas Star's management contract "as-is." The County contends that anything else would be "speculative." However, any of the three potential options is equally "speculative" because all require the consent of the Kansas Lottery, and the Kansas Lottery has provided no testimony or other evidence of what it would, or would not, approve. Additionally, speculating upon what the Kansas Lottery would or would not do is simply unnecessary. The appraisal question at issue is what uses of the land are legally permissible. It is certainly legally permissible (with Kansas Lottery approval) to operate a casino at the subject site without an arena. Whether the arena would be replaced with another amenity or not is irrelevant because even without the arena, the subject property has multiple ancillary amenities to comply with KELA's lottery gaming enterprise standards, including a hotel, multiple restaurants, and a live music venue in the Tin Lizzard bar/lounge space. It is equally legally permissible for a subsequent owner (with Kansas Lottery approval) to operate the property as is with the arena. The question, then, is an appraisal question of which is the highest and best improvement. While Taxpayer would assert that the evidence is clear that the property is less profitable with the arena, as stated by this Court, BOTA is the proper entity to first to address the issue.

b. KELA and the management contract are not disregarded under a proper highest and best use analysis.

The parties disagree about the highest and best use of the Subject Property. The County contends that the operation of the Subject Property "as is," with all of the ancillary amenities, is the only legally permissible use of the property. As such, the County asserts that the existing improvements are the ideal improvements, which supports the County's claim that the property suffers from no obsolescence. The County fundamentally misunderstands KELA, the "ideal improvement" appraisal concept, and Kansas law on fee simple valuation.

i. KELA does not require an arena to operate a casino.

First, it is "legally permissible" to build and operate a casino pursuant to KELA without the existing amenities. KELA does not require any non-casino amenities. KELA permits the Lottery Commission "to approve a management contract with a prospective lottery gaming facility manager to manage a lottery gaming facility or lottery gaming enterprise." K.S.A. 74-8734(e). As defined in KELA, a "lottery gaming facility" is just a casino, whereas a "lottery gaming enterprise" is a casino and ancillary lottery gaming facility operations. Said more simply, the Lottery Commission may approve just a casino, or a casino with amenities.

However, even if KELA did allow the Lottery Commission to approve only lottery gaming enterprises (casinos with ancillary amenities), the casino building itself (from which Bliss deducts no obsolescence) includes multiple restaurants and bars, and is attached to a hotel, which amenities alone easily satisfy KELA's definition of "ancillary lottery gaming facility operations" without the arena. *See* K.S.A. 74-8702(a) (describing "Ancillary lottery gaming facility operations" to include "*restaurants, hotels, motels, museums or entertainment facilities*.") (emphasis added). Thus, even assuming some amenities are required by KELA, the Subject property includes multiple restaurants, bars, and a hotel, which are ancillary amenities as defined by KELA.

The County, then, argues that the Kansas Lottery, in three rounds of bidding, approved contracts with an arena or event space. First, those arena and event spaces that were approved were of markedly differing sizes and qualities. The first round of bidding included much larger proposals because it occurred pre-recession. Subsequent proposals were much smaller and more realistic. The second round, resulted in one final proposal, which offered a 20,000 square foot mixed-use conference and event space that could accommodate up to 1,200 people. Said another way, it offered a flexible conference space that was one-eighth the size of the subject arena (165,000 sf) and less than one-fifth of the capacity (6,596). As noted by the County, this was approved by the Kansas Lottery and would have been the south central Kansas casino's main amenity, but for some infighting amongst the joint venture partners, which resulted in withdrawal of the proposal. The County's suggestion that Kansas Star's management contract is the only management contract that has been or would be approved is clearly not accurate.

Additionally, it must be noted that all of these proposals were submitted before any casino was opened in south central Kansas and without the knowledge that the market does not, in fact, need or want an arena at the casino site. The County has essentially given up its argument that the arena generates any meaningful revenue or profit for the overall project, so it is uncontroverted that the arena is a money-losing anchor on the overall operations. Instead, the County is left to argue that the Kansas Lottery would never award any management contract to any entity under any circumstances that did not include this exact money-losing arena–no smaller, no larger. Even setting aside the reality that the Kansas Lottery *has* approved a smaller event venue (20,000 square foot conference space in round 2), the understanding of which amenities drive tourism and gaming revenue now are much more well-known because there are five years of operating history from the Kansas Star Casino. Five years of operating history has shown that the arena generates very little

revenue and no profit from its own operations, generates no measurable gaming revenue, and causes the overall project to lose millions of dollars in profit every single year.

The final considerations in determining which project is selected for the management contract is determined by three statutory factors: "which contract best [1] maximizes revenue, [2] encourages tourism and [3] otherwise serves the interests of the people of Kansas." K.S.A. 74-8736(b). When the Kansas Star project was selected for the management contract in 2010, every consultant who reviewed the project *believed and reported* that the arena and equine event center amenities would increase overall revenue, increase gaming revenue substantially, drive substantial tourism, and increase the overall profitability of the project. ***None of these things happened.*** The County's suggestion that the Kansas Lottery, if faced with negotiating a new management contract (which it would have to do in the event the facility sold), would find that the existing arena maximizes revenue, encourages tourism, or otherwise serves the interests of the citizens of Kansas, is nonsense and inconsistent with the evidence. The County points to ***no evidence anywhere in the record*** to support any one of these factors.

Of note, the Court of Appeals' recent decision in the Hollywood Casino tax appeal describes the Hollywood Casino as follows: "The approximately 245,000-square foot building includes a Las Vegas-style casino with a 94,444-square foot gaming floor; a steak house, buffet, sports bar, mid-level restaurant, coffee shop, and VIP lounge; office and administrative space; 1,253 covered parking spaces; and additional surface parking." *In re Equalization Appeal of Kansas Entertainment, L.L.C., for the Tax Year 2015*, Case No. 117,406, *2-*3 (Kan. Ct. App. Dec. 21, 2018). These amenities and features are very similar to the subject property *without the arena* and *without the hotel*. Hollywood's north east gaming zone was subject to the same minimum investment requirements as the south central zone. As such, the arena is neither a legal requirement of KELA, nor a practical requirement for obtaining a management contract.

ii. Kansas Star's personal contractual obligations are not land use restrictions.

The County next asserts that Kansas Star's management contract is "restriction or requirement imposed upon the use of real estate by the state or federal government or local governing bodies" which is part of the "Fair Market Value" definition in K.S.A. 79-503a. In support of this argument, the County cites *Ottawa Housing* and *Paola Sundance* cases in which the Court of Appeals and BOTA considered whether low income housing restrictions were "restriction on the use of real estate" pursuant to an earlier version of that statute. Based on this, the County concludes "the management contract certainly imposes *requirements on the Appellant* for the use of the subject property, and those requirements are, without question, imposed by the State, and therefore should have been analyzed by BOTA under K.S.A. 79-503(j)." Brief of Appellee, p. 27; emphasis added. The flaw in the County's argument is in its logical flow, which reveals an apparent non-sequitur.

Specifically, K.S.A. 79-503a(j) provides that "restrictions or requirements imposed upon the use of real estate" must be considered in determining fair market value. However, as stated by the County, the management contract *does not* impose any restriction or requirement upon "the use of the real estate." Instead, the management contract "imposes *requirements on the Appellant* for the use of the subject property." That is, the requirements imposed are not upon the land, but rather upon Kansas Star.

This is not a distinction without a difference, but rather is the fundamental issue here. Kansas Star's management contract is not a land use restriction, at all. It is not property, does not bind the land, does not run with the land, is not binding on any future purchaser, and is otherwise unrelated to the real estate. It is merely an agreement by Kansas Star to build and operate the state's casino. The fact that the management contract requires Kansas Star to build and operate the

project that it proposed and that such proposed project happens to be on the subject site does not make this a land use restriction. It is not a requirement imposed upon the land itself. Rather, the management contract is a personal contractual obligation of Kansas Star. If Kansas Star were to sell the land, the right to operate the state's casino does not transfer with the land as of right. If Kansas Star chose to breach its contract, the Kansas Lottery would have no rights against the land. At most the Lottery could simply enforce its contract rights against Kansas Star Casino L.L.C. as an individual entity. Kansas law is clear that personal contractual obligations are not part of the fee simple interest in real estate. *See In re Equalization Proceedings of Amoco Production Co.*, 33 Kan. App. 2d 329, 344 (2004) (holding that contracts on an existing gas processing plant amount to encumbrances, which must be disregarded for determining fair market value); *see also In re Tax Protest of Strayer*, 239 Kan. 136, (1986) (holding intangible interests are not taxable for property tax purposes; K.S.A. 79-102 (stating that intangible property rights are not taxable); *In the Matter of the Protest of Premier Petroleum*, Inc., Docket No. 2006-8559-PR, at *10-11 (Kan. Ct. Tax App. August 28, 2009) (Appendix 1).

Low income housing restrictions, on the other hand, are not merely personal contracts—they include easements that bind the land. As discussed by the Court in *Ottawa Housing*, the subject apartment complex

> was built under a contract with the federal government to provide low-income housing. The contract provides Ottawa Housing with tax credits, and, in return, Ottawa Housing is required to rent the apartments at a reduced rate to persons who earn less than 60% of the median income for Franklin County. This restriction limits the available pool of tenants to those who earn less than $15,372, with an hourly rate not to exceed $7.39. The contract *requires the property* to maintain the rent restrictions for 16 years.

In re Equalization Appeal of Ottawa Housing Ass'n, L.P., 27 Kan. App. 2d 1008, 1009 (Kan. Ct. App. 2000) (emphasis added). Thus, low income housing restrictions are "restrictions or

requirements on the use of land" as specified in K.S.A. 79-503a(j). The management contract, however, is not.

In a last gasp attempt to shoehorn Kansas Star's personal obligations into the value of the real estate, the County cites the Appraisal of Real Estate, 14th edition, arguing as follows:

> This position is further bolstered by the Appraisal Institute's text, which makes clear that a property's legally permissible use must "conform to the land's current zoning classification and local building codes **along with any other relevant** regulatory **or contractual** restrictions on land use. 14th Ed., p. 334 (emphasis added).

Brief of Appellee, p. 28.

The County—again—fundamentally misunderstands Kansas property tax law and basic appraisal practice. First, the County's citation to the 14th edition is inapposite. It is true that *in non-property tax contexts* appraisers must take into account private contractual restrictions in valuing real estate. For example, if an appraiser is valuing an apartment complex for a financing transaction, then he must determine the impact of the existing leases on market value. Said another way, he is valuing the *leased fee* property interest. However, where the property interest being valued is the *fee simple* interest—as in property tax appeals—then such private contractual restrictions must be ignored. The most obvious and common example of this are leases. Kansas law is longstanding and clear that leases are not part of the fee simple interest of real property. *See In re Prieb Properties, L.L.C.*, 47 Kan. App. 2d 122, 131, (2012). (holding, in the context of sale leaseback agreements "[i]t is clear, therefore, that the fair market value statute values property rights, not contract rights."). The 14th Edition also explains this distinction:

> The real property rights to be appraised are singled out among the relevant characteristics of the property because, like the appropriate type and definition of value for the assignment, the property rights appraised are a fundamental element of the assignment. An oversight in the analysis of some other characteristic of the property may or may not have a noticeable effect on the ultimate opinion of value, but a poor understanding of what precisely is being valued guarantees a critical error in the development of the appraisal.

> In all appraisal assignments, the interest to be valued is determined by the needs of the client. The fact that a property is leased does not mean the appraiser must value a leased fee or leasehold estate. The appraisal problem to be solved is a question of which stick (or sticks) in the bundle the client needs to have valued. It is often the case that no one entity actually holds that set of sticks.

The Appraisal of Real Estate, Appraisal Institute, p. 69 (14th ed. 2013) (Appendix 2). The fact that the County peddles this clearly out-of-context and inapplicable quote as evidence generally recognized appraisal practice is further indictment of how the County has handled Taxpayer's valuations since its construction in 2011. Fundamentally, the County doesn't know or care what Kansas law requires it to value—it is simply placing the highest value that it can justify (and sometimes higher) on the subject property and seeing how much of such value will "stick" in the appeal process.

c. The subject property suffers from substantial superadequacy as a matter of fact.

In its Brief of Appellant, Kansas Star cites voluminous and largely uncontroverted evidence that the subject property suffers from functional obsolescence. That evidence does not need to be recounted here because the County does not dispute it. Instead, the County again asserts that the presence, absence, and amount of superadequacy is a pure issue of law—it is not. Kansas law requires the application of generally accepted appraisal practices. K.S.A. 79-505(b). However, which appraisal methodologies are generally accepted is part of the factual question that must be answered. "BOTA is a specialized agency that exists to decide taxation issues [and its] decisions should be given great credence and deference when it is acting in its area of expertise." *Marriott Corp. v. Bd. of County Commissioners of Johnson County*, 25 Kan. App. 2d 840, 842 (1999) (quoting *In re Tax Appeal of Boeing Co.*, 261 Kan. 508, Syl. 3, (1997). "[An appellate court] may not try a case de novo or substitute its judgment for that of an administrative agency." *Id.* "A rebuttable presumption of validity attaches to all actions of an administrative agency and the

burden of proving arbitrary and capricious conduct lies with the party challenging the agency's action. [Citations omitted.]" *Id.* (quoting *Kaufman v. Kansas Dept. of SRS*, 248 Kan. 951, 961 (1991)). This Court has made clear, in the context of contested valuation arguments presented by various appraisal experts:

> It appears to us that to decide valuation, BOTA or the trial court could have decided to adopt the opinions of the County's witnesses or the opinions of the Marriott's witnesses. As the finder of fact, that was their prerogative. We are not a finder of fact, and we will not revisit the question of which witnesses were the most credible and most believable.

Id. at 843. Similarly, in the 2015 appeal of this matter, this Court made clear that it is not its role to calculate functional obsolescence. *In re Equalization Appeal of Kansas Star Casino, L.L.C. for the Year 2015*, No. 116,782, *29 (Kan. Ct. App. July 20, 2018 (unpublished)). Based on the evidence presented and arguments made in that case, which were materially identical to the evidence and arguments made in this case, the Court was clear that it was not ordering BOTA to find in favor of either party, but rather to rule in a manner consistent with its factual findings and cite such evidence for this Court to review. *Id.* If the Court had agreed with the County that this matter could be decided as an issue of law, then the Court would not have remanded the case. It would have simply ruled in the County's favor. The County is merely re-hashing the same arguments in different clothing with the hope that the Court will rule differently.

CONCLUSION

For the reasons stated herein and in the Appellant Brief filed herein, BOTA's order should be reversed.

Respectfully submitted,

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BRIEF OF CROSS-APPELLEE

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STATEMENT OF THE ISSUES

I. BOTA's land value determination is USPAP compliant, supported by substantial competent evidence in light of the record as a whole, and is not unreasonable, arbitrary or capricious.

II. BOTA did not err by declining to include entrepreneurial incentive.

III. BOTA's decision should be remanded for further findings on depreciation.

STATEMENT OF FACTS

The statements of fact from Appellant Brief, pp. 2-29, and the Reply Brief of Appellant, pp. 1-6, *supra* are incorporated herein by reference.

ARGUMENTS AND AUTHORITIES

I. Standard of Review.

Kansas Star incorporates its comments regarding Standards of Review from its Reply Brief of Appellant, above. (*See* p. 6.)

II. BOTA's land value determination is USPAP compliant, supported by substantial competent evidence in light of the record as a whole, and is not unreasonable, arbitrary or capricious.

The County argues that the Court should overturn BOTA's determination that the value of the commercial land component of the subject property is $76,000 per acre ($10,170,000 total). The County bases this argument on the fact that adjustments to the sales were based partially on analysis of the Gerlach and Wyant tract sales, which ultimately formed the subject property. According to the County (and Leslie Sellers), this is inappropriate because appraisers must use only the total assemblage, and not the individual sales, to analyze the transaction. There are two primary issues with the County's argument. First, Leslie Sellers is wrong. Second, the County is simply asking this Court to re-weigh the evidence and reach a different conclusion than BOTA.

With respect to Sellers' testimony, he is simply wrong. As quoted by the County, Leslie Sellers testified as follows:

> [W]hen we teach this type of analysis in our course work, we teach appraisers that it's inappropriate when you're using sales from an assemblage to cherry pick a sale out as a comparable because the buying decision from that site by the buyer or the developer was about how much he paid for the total site. And let me give you an example outside of this area.
>
> Let's say you have a real estate developer that's building a shopping center and they're buying nine sites to assemble for this shopping center. The problem with picking out one sale is that he starts out and he buys two or three sites, but by the time he gets to the end of it, the holdout seller, he ends up paying double what he would have paid per acre or per square foot for the other tracts. Well, many times the developer doesn't necessarily have a problem paying that price so long as his total investment for the site is under the threshold he needs to make the deal work.
>
> So if you're going to use those same sites as a comparable, we teach the appraisers that you must assemble them and then take the average of all of them together. You can't just pick that last guy out and say, well, they paid $500,000 an acre for this property when if you took the whole thing together it might have been $175,000 an acre.
>
> In this case where it becomes an issue is when we lay the sales out and there's an adjustment made for size to one of the comparables. It's - - improper for them to do that because of the same economic theory.

Brief of Appellee and Brief of Cross Appellant, p. 35 (citing R. Vol. LXIII, pp. 779-781).

In fact, though, The Appraisal of Real Estate textbook, of which Leslie Sellers was a reviewer, specifically provides the opposite—that appraisers should *avoid* using the sum value of an assemblage to develop an opinion of market value of the whole. Specifically, it provides:

> Appraisers should also recognize that a buyer who purchases the ~~a~~-site with the intent to assemble it with other parcels might have to pay a higher-than-market value for that site, particularly for properties acquired near the end of the assemblage period, sometimes called *holdouts* or *hold-out parcels*. Appraisers should *avoid summing the costs of the component parts* (*i.e.,* the smaller parcels) *to develop an opinion of the market value of the whole* (*i.e.,* the larger assembled parcel). Conversely, they should avoid assigning the unit value of the whole to the components without other market evidence to support those conclusions.

The Appraisal of Real Estate, Appraisal Institute, pp. xi, 364 (14th ed. 2013); emphasis added. Appendix 2.

Here, BOTA (and Bliss) followed the strictures of the Appraisal of Real Estate textbook in avoiding summing the costs to derive the value of the whole. One must also note that the assemblage itself is not being valued. Since 63 of the acres are classified as agricultural and valued as use-value (rather than fair market value) by law, then the only portion being valued as commercial-use land at market value is 132 acres, which is essentially the Gerlach tract.

Second, the County is simply asking this Court to reweigh the evidence. BOTA (and Bliss) relied upon five sales of land that were ultimately used for casino development in the state and made adjustments and judgments concerning those sales on a variety of factors. The County is asserting (wrongly) that two of those sales and adjustments to just one factor (size) are flawed. Even if the County's (and Sellers') assemblage analysis were correct (which it is not), these are just two of many factors that BOTA and Bliss considered in valuing the land. The only alternative value offered was from Jortberg, who valued the 132 acres of commercial land at the full assemblage acquisition price of both Wyant and Gerlach tracts, which totaled 201.2 acres. (R. Vol. 3, Ex. 327, p. 134 of 496). In addition to wrongly using an assemblage value, Jortberg also failed to adjust that value to the actual size of the commercial-use land. Based upon all of the evidence presented, BOTA's decision is well-supported.

Importantly, this Court already considered and rejected this exact argument in the 2015 appeal of this same property. In that case, the Court considered whether BOTA's adoption of the same land valuation analysis by the same appraiser for the same property was supported by the evidence and/or arbitrary to capricious. The Court held that:

> we are unpersuaded by the County's arguments that BOTA's decision was unreasonable, arbitrary, or capricious. BOTA's land value conclusion of $76,500 per acre is supported by substantial evidence in the record.

In re Equalization Appeal of Kansas Star Casino, L.L.C. for the Year 2015, No. 116,782, *38 (Kan Ct. App. July 20, 2018 (unpublished). The Court should again uphold BOTA's land value determination.

III. BOTA did not err by declining to include entrepreneurial incentive.

The County argues that BOTA erred in declining to add entrepreneurial incentive on top of actual construction costs in the cost approach.

First and foremost, the burden is on the County to support its value. The Taxpayer has no obligation to counter points that are not established by the County, and BOTA was correct to find that the County did not sustain its burden. That being said, the County is both legally and factually wrong.

Legally, BOTA previously concluded that "organizational costs" in lieu of developer's profit were not appropriate to add to actual construction costs of this purpose-built casino. *In re Matter of the Equalization Appeals of Kansas Star Casino, L.L.C. for the Year 2012*, Docket Nos. 2012-3909-EQ *et seq.*, at *20 (Kan. Ct. Tax App. February 25, 2014) (Appendix 3). That decision was upheld by this Court. *In re Matter of the Equalization Appeals of Kansas Star Casino, L.L.C. for the Year 2012*, Case No. 111,650, at *23 (Kan. Ct. App. November 20, 2015) (Appendix 4).

Similarly, this Court upheld BOTA's determination that the County did not meet its burden to establish the need for or the amount of entrepreneurial incentive in the 2015 appeal of this property. *In re Equalization Appeal of Kansas Star Casino, L.L.C. for the Year 2015*, No. 116,782, *40-41 (Kan Ct. App. July 20, 2018 (unpublished) (Appendix 5).

This result is supported by The Appraisal of Real Estate, 14th ed., p. 574, which provides that "the terms *entrepreneurial profit* and *entrepreneurial incentive* are used in the application of

the cost approach to refer to the normal and expected component of value included in a value estimate when an appraiser adds in an amount of typical, *expected project profit*." (Emphasis added) (Appendix 2). "For certain types of specialized owner-occupied improvements, such as public buildings, no entrepreneurial incentive may ever be realized because *the owner neither anticipates nor wants a profit.*" (*Id.*, emphasis added) Quite simply, where an owner builds a purpose-built property to serve his business needs, he has no expectation of a profit. Therefore, the entrepreneurial incentive is zero. Interestingly, Sellers agrees that some debate exists about when and how to add entrepreneurial incentive for such properties, notably public buildings and religious facilities. R. Vol. 63, pp. 788-789. He further admitted that other appraisers believe that entrepreneurial incentive is not necessary to add to certain owner-occupied properties, although he asserts that he has only observed it in property tax appeals. R. Vol. 63, p. 789.

Kansas Star built the subject property as a purpose-designed building to acquire a 15-year management contract to operate the state's casino. Jackson testified that he evaluated entrepreneurial incentive and determined that casino owners do not expect a return on their real estate investments because they consider them depreciating assets and that profit is expected to come from the business operations. R. Vol. 63, pp. 645-648. Under these circumstances, it is reasonable to assume that Kansas Star never expected a profit on its real estate and the next purchaser would not expect to pay an incentive fee to acquire the real estate. Rather, casinos anticipate business operating profits to cover any construction expense.

Factually, the County ignores the reality that, even if entrepreneurial incentive were expected and added to reproduction cost, it has to be tested for depreciation and obsolescence to determine whether any incentive would be realized as entrepreneurial profit. Jackson explained that

> the casino is an operation that's effectively being run for the business aspects of it, the going concern of the property. Casino operators do not look to the real estate for profit. They consider real estate more to be a depreciable asset, an asset that can depreciate, not a part of the value component that appreciates. And because of that, that they look for profit from the gaming enterprise within the structure but not the structure itself, we consider entrepreneurial incentive, look to the market. The market does not consider, the casino owners don't consider it to be contained within the actual real estate, so therefore we did not include it.

R. Vol. 63, p. 646-647. Jackson concluded:

> Well, we considered the incentive but we determined that there was no profit based upon the market participants' view of how they deal with real estate.

R. Vol. 63, pp. 647-648.

Sellers agrees that entrepreneurial incentive is the first thing lost to depreciation—if the property is not worth more than its replacement cost, then the entrepreneurial incentive is lost entirely. R. Vol. 63, pp. 792-793.

Said another way, entrepreneurial incentive is not realized upon sale if the building value does not exceed cost. Jortberg didn't perform any recognized obsolescence analysis, let alone test the entrepreneurial incentive to determine whether it survives such an analysis. As BOTA has consistently concluded, the property value is negatively affected by obsolescence, resulting in a value below cost. Accordingly, the entrepreneurial incentive, if any, would be lost to obsolescence. The fact that half of the real estate ***detracts*** from the enterprise value shows that any entrepreneurial incentive would be written off as obsolescence. One cannot design a dysfunctional building and expect to receive a profit for his efforts.

For these reasons, BOTA did not err in declining to add entrepreneurial incentive.

IV. BOTA's decision should be remanded for further findings on depreciation.

The parties agree that BOTA's depreciation analysis is not USPAP compliant—albeit for very different reasons—and that the matter should be remanded for further findings. The errors in

BOTA's depreciation findings and the County's assertions regarding highest and best use are fully briefed in Part III of Taxpayer's Reply Brief of Appellant, *supra*.

CONCLUSION

For the reasons stated herein and in the Brief of Appellant, the County's Cross-appeal should be denied, BOTA's decision should be overturned, and the Court should find that the fair market value of the subject property is consistent with the Bliss Appraisal.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 23rd day of October, 2019, a true and correct copy of the above and foregoing was e-mailed to the following:

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APPENDIX

1. *In re Matter of the Protest of Premier Petroleum, Inc.,* Docket Nos. 2006-8559-PR (Kan. Ct. Tax App. August 28, 2009)

2. The Appraisal of Real Estate, 14th ed., pp. xi, 69, 364, 574

3. *In re Matter of the Equalization Appeals of Kansas Star Casino, L.L.C. for the Year 2012*, Docket Nos. 2012-3909-EQ *et seq.* (Kan. Ct. Tax App. February 25, 2014)

4. *In re Matter of the Equalization Appeals of Kansas Star Casino, L.L.C. for the Year 2012*, Case No. 111,650 (Kan. Ct. App. November 20, 2015).

5. *In re Equalization Appeal of Kansas Star Casino, L.L.C. for the Year 2015*, No. 116,782 (Kan. Ct. App. July 20, 2018 (unpublished))

6. *In re Equalization Appeal of Kansas Entertainment, L.L.C., for the Tax Year 2015*, Case No. 117,406 (Kan. Ct. App. Dec. 21, 2018)

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:

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. 135th St.	2005	$717,384
W. 135th St.	2006	$717,384
W. 135th 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 Rechtfertig, a convenience store business consultant. Mr. Rechtfertig had acted as Premier's agent in negotiating the July 2005 transaction involving the subject properties. In addition to Mr. Rechtfertig'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. Rechtfertig 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. Rechtfertig, 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. Rechtfertig 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. Rechtfertig, 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. Rechtfertig 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. Rechtfertig, margins on fuel sales are generally low, so profits must be made on in-store sales.

Mr. Rechtfertig 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. 135th Street	2005	$652,747
2007-10146-PR	W. 135th Street	2006	$652,747
2007-7319-EQ	W. 135th 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

SEAL

ATTEST:

JOELENE R. ALLEN, SECRETARY

CERTIFICATION

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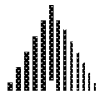
IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.

Joelene R. Allen

Joelene R. Allen, Secretary



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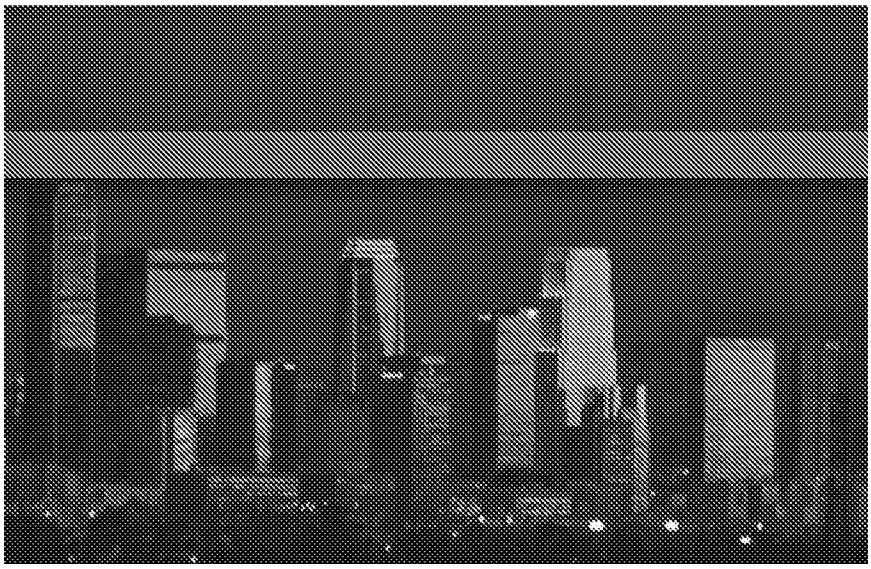

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7

Identifying the Rights to Be Appraised

In the introductory step of the valuation process, the appraiser's identification of the rights to be appraised is the practical application of the bundle of rights theory in a real property appraisal assignment. As discussed earlier in the book, the *bundle of rights* is a metaphor for the complete collection of the individual ownership interests. For example, within the bundle of rights, the right to use the real estate is separate and distinct from the right to sell the real estate, the right to lease it, and many other rights.

The sticks in the bundle of rights each have some type of value. For example, the owner of the fee simple estate (i.e., the holder of the complete set of sticks in the bundle) can trade the rights to occupy a certain amount of space within an existing building on the land in exchange for rent. In this way, the familiar relationship of landlord to tenant can be thought of as an exchange of property rights, and the appraiser can develop an opinion of the market value of the right to use and occupy the leased premises. This right does not cease to exist when the owner of the fee simple estate separates it from the complete bundle of rights. Rather, it is held by someone else, in this case the tenant.

The real property rights to be appraised are singled out among the relevant characteristics of the property because, like the appropriate type and definition of value for the assignment, the property rights appraised are a fundamental element of the assignment. An oversight in

ability of assembly or consider whether the appraisal should be based on the assumption that such an assembly would be made. For example, suppose a large petrochemical plant could be built on a site that has been created by assembling several smaller tracts. The individual tracts may not have had the potential for such a large-scale industrial use separately, and therefore they may have had lower unit values for alternative uses.

If an appraiser concludes that the appraisal should be based on the assumption that the site will be assembled with other parcels of land, the costs and timing of achieving the assemblage and the economic demand for the assembled property must be taken into consideration. In the example of the petrochemical plant, assembling the complete site might take several years. Although the assemblage would allow the smaller parcels to accommodate the larger use, the time delay may be too long for the developer or user of the proposed petrochemical plant.

Appraisers should also recognize that a buyer who purchases a site with the intent to assemble it with other parcels might have to pay a higher-than-market value for that site, particularly for properties acquired near the end of the assemblage period, sometimes called *holdouts* or *hold-out parcels.* Appraisers should avoid summing the costs of the component parts (i.e., the smaller parcels) to develop an opinion of the market value of the whole (i.e., the larger assembled parcel). Conversely, they should avoid assigning the unit value of the whole to the components without other market evidence to support those conclusions.

Applicability and Limitations of Valuation Techniques

Sales comparison is usually the preferable methodology for developing an opinion of site value. When this method is used, most of the techniques for selecting comparable sales and making adjustments that are described in Chapter 18 can be applied to site valuation. When there are not enough sales of similar parcels for the application of sales comparison, alternative methods such as market extraction, allocation, and various income capitalization techniques may be used. The income capitalization techniques applied can be divided into direct capitalization techniques (i.e., land residual and ground rent capitalization) and yield capitalization techniques (i.e., the subdivision development method using discounted cash flow analysis).

Sales Comparison

Sales comparison may be used to value land that is actually vacant or land that is being considered as though vacant for appraisal purposes. Sales comparison is the most common technique for valuing land, and it is the preferred method when comparable sales are available. To apply this method, data on sales of similar parcels of land is collected, analyzed, compared, and adjusted to provide a value indication for the site being appraised. In the comparison process, the similarity or dissimilarity of the parcels is considered.

of output as the market moves toward equilibrium where market price equals the sum of the opportunity costs of all resources used in production. In contrast, the terms *entrepreneurial profit* and *entrepreneurial incentive* are used in the application of the cost approach to refer to the normal and expected component of value included in a value estimate when an appraiser adds in an amount of typical, expected project profit.

As a market-derived figure, an estimate of entrepreneurial profit or entrepreneurial incentive is only as reliable and precise as the available market data warrants. For example, for several years following the economic downturn in 2008, a dearth of new construction left appraisers with little current data on development activity, making estimates of entrepreneurial incentive difficult to forecast. Nevertheless, most market areas have a typical or appropriate range of expected reward that can be determined through market research, usually through interviews with developers and other market participants about anticipated, acceptable, and actual levels of profit achieved in the market. The range of profit will vary for different types of structures and with the nature or scale of a given project. The entrepreneurial incentive for a proposed development may be higher where creative concepts, greater risk, or unique opportunities have market acceptance. Less risky, more standard competitive projects may merit a lower measure of profit. For example, the first speculative high-rise office park in a suburban market is likely to require greater entrepreneurial incentive than a new residential subdivision development in a community with demonstrable population growth.

The stage of development, and the different levels of risk and expertise that may be required at different stages, can affect the amount of entrepreneurial profit earned. For example, an entrepreneur can start earning a reward from the start of the project. This reward can increase

Contributions of the Entrepreneur, Developer, and Contractor

In analyzing the components of reward and compensation received (or anticipated) by an entrepreneur, appraisers may choose to further distinguish between the concepts of project profit, entrepreneurial profit, developer's profit, and contractor's profit:

- *Project profit* is the total amount of reward for entrepreneurial coordination and risk.
- *Entrepreneurial profit* refers to the portion of project profit attributable to the efforts of the entrepreneur, distinct from the efforts of the developer, if one is present. In projects in which the entrepreneur and the developer are one and the same, the entrepreneurial profit is equivalent to total project profit.
- *Developer's profit* represents compensation for the time, energy, and expertise of an individual other than the original entrepreneur--usually, in large projects, the person responsible for managing the overall development process.
- *Contractor's profit* (including subcontractors' fees) is essentially a portion of the project's overhead and is not usually reflected in the entrepreneurial reward.

The measure of project profit used in cost approach calculations usually includes both a developer's profit and an entrepreneurial profit. The profit a contractor receives is often already reflected in the fee a contractor charges and would therefore be included in the direct costs.

BEFORE THE COURT OF TAX APPEALS
STATE OF KANSAS

IN THE MATTER OF THE EQUALIZATION APPEALS OF KANSAS STAR CASINO, L.L.C. FOR THE YEAR 2012 IN SUMNER COUNTY, KANSAS	Docket Nos. 2012-3909-EQ & 2012-3910-EQ

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 October 29 and 30, 2013. Taxpayer, Kansas Star Casino, L.L.C., appeared by its counsel of record Jarrod C. Kieffer and Lynn D. Preheim of Stinson Morrison Hecker LLP. Sumner County appeared by its counsel of record David R. Cooper and Teresa L. Watson of Fisher, Patterson, Sayler & Smith, L.L.P.

After considering all of the evidence and arguments presented, the Court finds and concludes as follows:

The Court has jurisdiction of the subject matter and the parties, as equalization appeals have been properly and timely filed pursuant to K.S.A. 79-1448 and K.S.A. 79-1609. The parties agree that the County has the burden of proof as the subject property is owner-occupied commercial property. *See* K.S.A. 79-1609; Prehearing Order.

The subject matter of these appeals is real estate and improvements commonly known as Kansas Star Casino, 777 Kansas Star Drive, Mulvane, Sumner County, Kansas, also known as Parcel ID# 096-022-04-0-00-00-002.00-0 and real estate at East 149th Ave North, Mulvane, Sumner County, Kansas, also known as Parcel ID# 096-022-04-0-00-00-003.01-0. The tax year at issue is 2012. The relevant valuation date is January 1, 2012.

I.

In April 2007, the Kansas legislature passed the Kansas Expanded Lottery Act (Senate Bill 66)("Act"), K.S.A. 74-8733 *et seq.* Pursuant to the Act, the Kansas lottery may operate one gaming facility in each gaming zone: the northeast, south

central, southwest and southeast. The Kansas lottery commission may approve management contracts with one or more prospective lottery gaming managers to manage, or construct and manage, on behalf of the state, a lottery gaming facility.

The Act requires the lottery commission to adopt a procedure for receiving, considering and approving proposed management contracts and to adopt standards to promote the integrity of the gaming and finances of the lottery gaming facilities. Generally, the Act provides requirements for the management contracts, creates the lottery gaming facility review board, and provides for county elections regarding permitting the operation of a lottery gaming facility within the county. The Act provided that the size of the proposed facility, the geographic area in which such facility is to be located, and the proposed facility's location as a tourist and entertainment destination should be taken into consideration among other factors. K.S.A. 74-8734.

On July 19, 2007, Paul Treadwell and Mark Linder as buyers entered into an Option Agreement to purchase the Gerlach tract from Mr. and Mrs. Gerlach. The agreement provided for a $50,000 option fee as consideration for the exclusive right and option for 48 months to purchase the tract. The purchase price was $25,000 per acre less the option fee and certain other prorations. (Exhibits #6 and #16)

On September 12, 2007, Foxwoods Development Company, LLC acquired the Treadwell and Linder purchase option for the Gerlach tract by an Assignment of Purchase Option according to an Assignment & Assumption Agreement dated July 15, 2010. (Exhibit #6) (A copy of the September 12, 2007 Assignment of Purchase Option was not provided as evidence. As a result, the price paid by Foxwoods to acquire the purchase option from Treadwell and Linder is not known.)

The Gerlach tract is adjacent to both Interstate 35 (I-35/Kansas Turnpike) and U.S. Highway 81. Exit 33 of I-35/Kansas Turnpike was located near the northeast corner of the tract. (Exhibits #357 and #4)

In 2008 and 2009, rounds one and two of the bidding process with the Kansas Racing and Gaming Commission (KRGC) took place. In round 3 in 2010, the two finalists for the south central gaming zone was Global Gaming and Peninsula Gaming Partners, LLC (Peninsula Gaming).

On July 15, 2010, Peninsula Gaming acquired the purchase option for the Gerlach tract from Foxwoods Development Company, LLC in exchange for a $5,300,000 assignment fee. Peninsula Gaming acknowledged it was responsible for paying the option exercise price of approximately $3,700,000 directly to the property owners in order to exercise the option and acquire the property. (Exhibits #6 and 16)

On July 16, 2010, Double Down Development, L.C. as buyer and Peninsula Gaming as guarantor entered into an Option Agreement to purchase the Wyant tract from the trustees of the Wyant Revocable Trust. The agreement provided for a $250,000 option fee as consideration for the exclusive right and option for 6 months to purchase the tract. The agreement also provided for option extension for an additional $50,000. The purchase price was $8,000,000 less a proration of taxes. The option fee(s) were not to be applied to the purchase price. (Exhibit #5 and #114)

An Escrow Agreement dated July 11, 2010 between Peninsula Gaming as buyer and Double Down Development, L.C. as seller explained that a binding letter of intent had been entered into pursuant to which buyer would acquire certain real estate rights from seller. Peninsula Gaming as buyer agreed to make a deposit of $875,000. In the event Peninsula Gaming was selected by the Review Board and approved by KRGC as a lottery gaming facilities manager, then seller Double Down Development, L.C. was entitled to the deposit.

The July 16, 2010 binding letter of intent provided for Peninsula Gaming Partners, LLC's (either directly or through a wholly-owned subsidiary) acquisition of certain real estate rights (option agreements) from Double Down Development, L.C.[1] One of the option agreements was for the Wyant tract. Also included were option agreements for the Storey tract at K-53 and Hydraulic (east side of I-35) and the Grother tract at the southwest corner of K-53 and U.S. Highway 81.[2] (Exhibits #115 and #357)

The Wyant tract is adjacent to U.S. Highway 81 and Kansas Highway 53 at the southeast corner of the intersection of the highways. The Wyant tract is adjacent to the Gerlach tract to the north. (Exhibits #357 and #4)

In the south central gaming zone, locations for proposed gaming facilities were located at or around Exit 19 (Wellington exit) and Exit 33 (Mulvane exit) of I-

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[1] Double Down also agreed to assist Peninsula Gaming in obtaining a gaming license. In addition to the escrow deposit, Peninsula Gaming agreed to pay a non-refundable fee of $625,000, and if it received a gaming license, a success fee of $1,750,000 to Double Down. Further if it received a gaming license, Peninsula Gaming agreed to pay Double Down 1% of EBITDA on a monthly basis for 10 years and for period of time Double Down had the exclusive right to negotiate with Peninsula Gaming for owning, developing, and operating the hotel. (Exhibit $115, p. 115) Kansas Star Casino, LLC and Double Down apparently did enter into a hotel development agreement in May 2011 to jointly invest in KSC Lodging, LC to construct a hotel. (Exhibits #30-31) No hotel existed on the subject property as of January 1, 2012.

[2] The Option Agreement Summary indicates that the Storey tract option was effective May 7, 2010 with an initial option fee of $30,000 and price of $3,437,500 or $65,000 per acre. The Option Agreement Summary indicates that the Grother tract option was effective May 25, 2010 with an initial option fee of $10,000 and price of $2,750,000 or $55,000 per acre. (Exhibit #115)

35/Kansas Turnpike. Exhibits #356-359 illustrate various proposed locations by various entities during the three rounds of the application process.

On October 19, 2010, Peninsula Gaming entered into a Lottery Gaming Facility Management Contract ("Agreement") with the Kansas Lottery. (Exhibit #19)

In January 2011, the Kansas Racing and Gaming Commission (KRGC) approved the lottery gaming facility management contract with Peninsula Gaming Partners, LLC. (Exhibit #89)

According to the sales validation questionnaires (SVQ), Taxpayer Kansas Star Casino, LLC acquired the Wyant tract on March 2, 2011 and the Gerlach tract on March 3, 2011. The sale price reflected on the SVQ completed by Mr. Wyant was $8,000,000. The sale price reflected on the SVQ completed by Mr. Gerlach was $3,631,250. (Exhibit 502, pp. 39, 47)

Kansas Star Casino, LLC is a wholly-owned subsidiary of Peninsula Gaming, LLC. (Exhibit #1, p. 10)

Construction groundbreaking occurred on March 7, 2011. Construction of the facility occurred in stages. Phase 1 of construction was proposed in two parts. Phase 1A was the equestrian and event center, which was used as a temporary casino. Phase 1B was the permanent casino facility with conversion of the temporary casino area into the equestrian and event center. The temporary casino opened December 26, 2011. As of the valuation date of January 1, 2012, the subject property included the temporary casino (Phase 1A) and a partially-constructed permanent casino (Phase 1B). A hotel (Phase 2) was not in existence on January 1, 2012.

Prior to tax year 2012, the Gerlach tract (145.5 acres known as Parcel ID# 096-022-04-0-00-00-003.00-0) and the Wyant tract (55.7 acres known as Parcel ID# 096-022-04-0-00-00-002.00-0) had separate parcel identification numbers and were classified and valued as agricultural land.

For tax year 2012, the Parcel ID# 096-022-04-0-00-00-002.00-0 under appeal includes approximately 195.50 acres of land with casino improvements encompassing both the Gerlach and Wyant tracts. The two tracts were combined into one parcel number for tax year 2012. The County's appraised value being appealed is $90,797,500.

For tax year 2012, Parcel ID# 096-022-04-0-00-00-003.01-0 is a new parcel number describing approximately 2.0 acres of land which had been a part of the

Gerlach tract. (Exhibit 502, p. 54) Parcel ID# 096-022-04-0-00-00-003.01-00 is now a Mulvane sewer and water station and a future public safety station. No improvements were listed on the parcel for tax year 2012. The County's appraised value being appealed is $202,500. The County's total appraised value for the subject properties is $91,000,000.

The *Prehearing Order* provides that the County asserts the total fair market value of the subject properties is $95,800,000 as determined by its expert appraiser and the Taxpayer asserts the total fair market value of the subject properties is $64,300,000 as determined by its expert appraiser.

II.

Della Rowley, registered mass appraiser (RMA), current Geary County Appraiser and former Sumner County Appraiser, testified on behalf of Sumner County. At the time of the appraisal for tax year 2012, Rowley was the Sumner County Appraiser. Rowley explained that she was not qualified to appraise a casino, so she sought assistance from an appraiser with experience in appraising casino properties, Richard E. Jortberg, MAI.

At the time of making the original appraisal, the County knew of the existence of the options and had the SVQ's and the Taxpayer's development budget. (Exhibit #508, p. 639) The County was also aware that the Act required Taxpayer to agree to expend $250,000,000 as a minimum investment including a $25,000,000 privilege fee.

Rowley considered the highest and best use of the property to be a casino and determined the cost approach to be the best valuation methodology because there were no Kansas casino sales for a sales comparison approach and the improvements were only partially complete. The County treated the permanent casino facility (Phase 1B) as being 43% complete as of January 1, 2012.

With respect to the land value for the cost approach, the County relied upon the Taxpayer's project budget line item "(2) Land Acquisition Costs" of $20,250,000 from its Summary of Proposal. (Exhibit #508, p. 639; Exhibit #507, p. 430) Rowley reviewed land listed for sale in the proximity. Rowley asserted that there was no explanation at the informal level from Taxpayer regarding its assertion of a land value of $11,500,000 versus the $20,250,000 budget. With respect to the improvement value, the County relied upon actual costs provided by Taxpayer. (Exhibit #502, p.111; Exhibit #506, pp.342, 344) The County did not allow for any depreciation as the improvements were new. The improvement value excluded the "Transportation Access" budget item of $7,540,000 for the new exit from the I-35/Kansas Turnpike to the subject property and the balance of "Utilities" of

$8,771,383. (Exhibit #506, p. 342) The improvement value included the cost of the large sign near the interstate. On cross-examination, Rowley asserted that she can deviate from the 2012 PVD Personal Property Guide without a just cause analysis if the sign meets the three-prong fixture test.

Richard E. Jortberg, MAI appraiser with a temporary practice permit in Kansas, also testified on behalf of the County. Jortberg testified that he has been appraising casinos for taxing authorities in Colorado since 2000 and had worked for casinos before that. Jortberg performed an appraisal of the subject property and concluded a fair market value of the fee simple interest of $95,800,000 as of January 1, 2012. (Exhibit #7)

Jortberg testified that he considered all three approaches to value: the sales comparison approach, the cost approach and the income approach. He concluded that the cost approach was most meaningful in light of the lack of comparable sales and the income approach in part reflecting a business enterprise value (BEV), not solely a fee simple interest in the real property value. Jortberg used the income approach as a test of reasonableness for the cost approach. He concluded that because the income approach exceeded the cost approach, it is economically feasible to construct the property. He did not rely upon the income approach for his final opinion of value because it reflected the value of the business enterprise, not the fee simple estate of the real property.

Jortberg performed a highest and best use analysis and concluded that as a vacant site the maximally productive use would be to build a casino on the subject site. Predicated on the "as vacant" assumption, a casino use is physically possible, legally permissible and financially feasible. He argues that it is clear from EBITDA/Gross Revenue ratios and the Wells Gaming Research revenue estimates that the subject site is excellent for casino gaming. The highest and best use of the property as improved presupposes the existing improvements are developed on the site. Jortberg concluded that the existing use is the highest and best use as improved.

For the land value in the cost approach, Jortberg relied upon the adjusted sale prices of the Gerlach and Wyant properties (inclusive of the price for the option assignment) for a value of roughly $17 million. He stated that the best location is a real property characteristic. Peninsula invested approximately $7.7 million for a tollbooth exit/transportation access and approximately $9 million for utility improvements and extensions to the site. In his opinion, the added cost of the tollbooth exit/transportation access is not additive in terms of value because it requires visitors to pay a toll, but the infrastructure improvements are additive in terms of an increase in value. Jortberg concluded a subject land value of $26 million rounded.

Jortberg's reproduction cost new estimate was based on the actual costs reported by the developer on worksheets provided to the County by Kansas Star. Those costs totaled $65,034,379. He considered the sign to be part of the real property stating that it is attached to the site and is integral to the casino facility. He treated the expense of trailers as soft costs. Jortberg included additional soft costs of $1.6 million to account for organizational, administrative and legal costs. On cross-examination, Jortberg admitted that he did not know specifically what items were included in this category. He also included interim financing costs of $3,186,685 based upon an assumption that 70% of the project cost would be financed by the developer during construction. Financing costs were calculated based upon a 1% origination fee on 70% of reproduction cost and 6% interest for 12 months on 70% of reproduction cost. He asserted that these costs are required to reflect the cost to the owner/developer to manage the development process. He applied no physical or functional/external depreciation. Jortberg's conclusion of value of the subject property based upon the cost approach was $95,800,000 rounded.

Taxpayer identifies several areas of contention in the cost approach. (Exhibit #352) Taxpayer asserts that the County has overvalued the land asserting that sales of comparable agricultural land suggest a value of $3,500 per acre. With respect to construction hard costs, Taxpayer argues that the signage is not part of the real property and that the trailers were rented for KRGC office space not associated with construction. With respect to construction soft costs, Taxpayer disagrees with Jortberg's inclusion of a developer's profit and construction financing costs.

Scott Cooper, General Manager of Kansas Star, testified regarding the bidding process that occurred leading up to construction of the Kansas Star. Peninsula Gaming developed the Kansas Star. The Peninsula Gaming business entity was sold to Boyd Gaming in November 2012.

As a consultant to the Gaming Review Board in 2009, Cooper was involved in the review process in the second round of bidding. The Gaming Review Board and its consultants were charged with analyzing the applicants in all four zones. No one was awarded the contract in the second round. Each bid or proposal was required to have a site selection, and he was aware of many site proposals. The proposals involved essentially two interchanges on the Kansas Turnpike/I-35 known as Exit 33 Mulvane and Exit 19 Wellington (further south from Wichita). The bidding process also had a minimum investment requirement of $225 million plus a $25 million license fee for a total of $250 million. Each proposal was required to describe what was going to be built and a timeline. To his knowledge, there was no problem with the bidders obtaining conditional zoning for any of the proposed sites

conditional on obtaining the management contract. In order to make a proposal, all bidders had to demonstrate control of their site selections and they used options to accomplish this.

In 2010, Cooper went to work for Peninsula Gaming as general manager of a casino in Iowa with the intention of someday working in new development. Cooper explained that the Iowa casino is on 10 acres and asserted that 195 acres is not needed to operate a casino. He identified the Kansas opportunity for Peninsula Gaming and helped assemble its proposal.

The enabling legislation required approval of gaming by the county or the city in which the proposed casino was to be located. Cooper asserted that Sumner County wanted the casino location to be at the county seat of Wellington at Exit 19 and asserts that it only approved sites at Exit 19. As a result, Peninsula Gaming approached the City of Mulvane regarding the site at Exit 33. Prior to Peninsula Gaming's involvement, the City of Mulvane had annexed property along Hwy K-53 from the city to the turnpike. Cooper explained that state revenue analysts/consultants concluded that the sites at Exit 33, closer to Wichita, would be more profitable than sites at Exit 19. Peninsula Gaming attempted to acquire the Brewer tract, but was unable to agree to a price. (Exhibit #357) As a result, Peninsula Gaming exercised other options. Peninsula Gaming also proposed an alternate site because of the uncertainty of the annexation which was being challenged in court. The alternate site was the site outlined on Exhibit 358 and the parcel above the outlined parcel.[3] It had been the Harrah's proposed site. Peninsula Gaming picked up the option after Harrah's dropped out of bidding. All the proposed sites were agricultural ground. Most of the money paid for the subject site was paid after the management contract was awarded to Peninsula Gaming.

Cooper testified that the Kansas Racing and Gaming Commission (KRGC) trailers were on-site during construction for use by the KRGC. The KRGC licenses employees and provides oversight of a casino's internal controls and compliance with regulations. The KRGC was licensing employees and vendors, reviewing departmental operating procedures, and overseeing placement of cameras. Kansas Star was required to provide a location for the KRGC. The KRGC was not involved in the actual construction.

With respect to the organizational costs listed on Line 7 of Exhibit 507, p. 430, of the project development budget, Cooper testified that this budget was an

[3] Exhibit 358 shows the alternate site. Cooper explained that the entirety of the proposed site is not outlined in green. The site also included land above it adjacent to K-53. The site is at K-53 and Oliver Road. Exit 33 is to the left of the photo. Exhibit 359 shows Exit 19.

early budget and the estimate of $154 million for Phase 1A is short nearly $30 million from the actual cost of around $180 million. He was involved in providing information for Line 7 and describes the line item of "Organization, Administrative and Legal Expenses" as pre-opening expenses such as regulatory fees to the KRGC and Kansas Lottery and pre-opening payroll, marketing, training, and uniforms. The expenses included were not related to construction in any way. He did not know why $20.25 million was included for land acquisitions in the budget.

Cooper testified that the City of Mulvane paid for the utilities to be brought to the site. There is a special assessment on the parcel, however, so Kansas Star can pay for this cost over time. On cross examination, it was clarified that the special assessments covered water and sewer. Gas and electric utilities were not included in the special assessment cost.

On cross-examination, Cooper testifies that he does not know what Peninsula Gaming paid to Double Down for the option it held for the Wyant Tract. (Exhibit #5) Exhibit #4 is an aerial photograph of the subject property and shows the turnpike exit's new configuration with a tollbooth that empties directly into the Kansas Star parking lot. It also shows access roads to U.S. Highway 81 and Kansas Highway 53 located on what was known as the Wyant tract. The facility was open for 12 days in December 2011. For clarification, Peninsula Gaming's reports reflect calendar years and the Kansas Lottery reports reflect state fiscal years. As a result, the fiscal 2012 Kansas Lottery report includes revenue for the first six months of 2012 and 12 days of 2011. Cooper agreed that revenues exceeded projections. Cooper was not involved in site selection, but testified that it makes sense that a location closer to the turnpike and the ability to add a toll plaza would be desirable. The marquee sign is used to drive traffic to the facility. He was not aware of any plans to subdivide the subject parcel and sell off what used to be the Wyant tract.

Cooper explained that development of the next phase including the equestrian facility and meeting space is planned for the southern part of the property where there is currently a parking lot (on what was known as the Gerlach tract). Taxpayer has a total of 29 billboards scattered on state highways and in Wichita with some on turnpike.

Laird Goldsborough, commercial appraiser, MAI, and state certified general appraiser, with Shaner Appraisals, Inc. testified on behalf of Taxpayer. Goldsborough testified that he had not appraised a casino before, but he believed that he complied with the USPAP competency provision. A casino property is a special use property. He was asked to arrive at a fair market value conclusion of the real property, not the enterprise value of the casino. Goldsborough and another appraiser in his office participated in the preparation of the summary appraisal report. (Exhibit #1) Goldsborough considered all three approaches to value: the

sales comparison approach, the income approach and the cost approach. He relied upon the cost approach. He rejected the sales comparison approach due to a lack of comparable sales or lack of sufficient data. He also rejected the income approach because the casino had been open only two weeks, and more importantly, the property is a special-use property used by an owner-user and these types of properties typically sell based on a multiplier of EBITDA on a going-concern basis, not on rental income of the real estate.

The cost approach involves estimating the value of the land, estimating the replacement cost of the improvements, deducting depreciation as necessary, and then adding the land and improvement values together. Goldsborough agreed with the County that the cost approach is the most applicable and reliable approach and stated that the opinions of value of the improvements are fairly similar. Both Jortberg and Goldsborough agreed that no depreciation needed to be applied. On the other hand, Goldsborough contended that the County overvalued the land based upon his review of comparable sales.

Except for the casino, there has been little commercial development in the area. The land in the area is primarily agricultural land. In his opinion, Goldsborough asserted that there is no justification for the difference in value between $4,500 an acre and $143,000 per acre other than the management contract. In the appraisal report, Goldsborough asserted that the Wyant tract is vacant and is considered to be excess land. He contended at hearing that the tract is not critical to the operation of the casino and it could be sold separately.

In his opinion, the highest and best uses of the subject site as if vacant is agricultural use and/or holding for future commercial development. Goldsborough concluded that only these two uses meet the possible use, permissible use and feasible uses tests. As improved, Goldsborough concluded that the existing use as a casino is maximally productive and is the highest and best use of the site assuming the management contract is in place.

The land value is the major point of contention in the differing opinions of value. Goldsborough asserted that the management contract is the driver of the purchase price and the land is not worth $26 million without the management contract. It is his understanding that the value of the management contract has to be separated from the real estate in order to appraise the real estate. Goldsborough cited the Kansas Expanded Lottery Act which states that a management contract shall not constitute property. K.S.A. 74-8734(m). He testified that he used the definitions of taxable property found in K.S.A. 79-101 and K.S.A. 79-102. (Exhibit #351) In his cover letter included in the appraisal report, Goldsborough stated as follows:

> "In other words, the management contract is not tied to the real estate, but rather the business enterprise. The highest and best use of the subject land prior to development was agricultural, and should the management contract be terminated or the owner decide to move the gaming operations to another site, the highest and best use would return to being agricultural. The owner paid a significant premium for the land not because of its physical attributes, but because the land had been previously optioned by potential gaming operators that the owner wanted to exclude from the marketplace. The property would not have sold at these prices to any entity other than that of a State-approved gaming facility manager, and therefore cannot be considered to have been sold in an open and competitive market." Exhibit #1, p.3

Goldsborough testified that at the time of the award of the management contract to Peninsula Gaming, all that had been paid by Peninsula Gaming was $300,000 on the Wyant tract and $1.2 million to Foxwoods Development for the Gerlach tract for the assumption. Peninsula Gaming had paid no money to the seller Gerlach prior to the management contract award. Peninsula Gaming ultimately paid the Gerlach's $3.6 million for the tract. He did not consider the $5.3 million to be part of the purchase price because it was paid to Foxwoods Development for contract rights to buy the property and not paid to the seller Gerlach.

Goldsborough explained that K.S.A. 79-503a defines fair market value for purposes of this appraisal as follows:

> "'fair market value' means the 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 that the parties are acting without undue compulsion."

He testified that he had to consider whether there was undue compulsion. In his opinion, the management contract is undue compulsion. Without the management contract, the subject tracts never would have sold above agricultural land value. Before this case, Goldsborough had never heard of a management contract, but he asserts that it would probably be defined as "investment value" in appraisal terminology. Referring to *The Appraisal of Real Estate*, Appraisal Institute, 29 (13th ed. 2008), he argued that the difference between the two land values can be attributed to "investment value" or "[t]he specific value of a property to a particular investor or class of investors based on individual investment requirements; distinguished from market value, which is impersonal and detached."

Relating to tax treatment, Goldsborough asserted that his review of agricultural land comparables showed county-appraised values range between $216 per acre to $333 per acre, while a commercial land comparable is valued at $564 per acre.[4] The subject tract is valued at $101,370 per acre. His report stated as follows:

> "The county-appraised land value appears to be based primarily on the subject's recent sales prices, with a premium added for the costs to exercise option agreements and to obtain assignment rights. The recent sale prices, however, were well above fair market value because both the buyer and the site had already been approved by the Kansas Lottery Commission for development of a south-central zone gaming facility, and the owner was acting under undue compulsion to pay a higher price due to this fact." Exhibit #1, p. 51.

Goldsborough defined the primary parcel as 139.4 acres. He reviewed sales of vacant land in Sumner County of 50 acres or more occurring in 2010 and 2011. All the sales had an agricultural use and the sale prices ranged from $540 per acre to $3,300 per acre. Goldsborough noted that none of the sales had interstate frontage similar to the subject, and therefore, the sales were considered to be slightly inferior to the subject in terms of potential commercial development. For this reason, he concluded an estimated value of $3,500 per acre or $487,900 for the 139.4 acres. Goldsborough also stated that the excess land is similar in all respects to the primary parcel and concluded a similar fair market value per acre or an estimated value of $3,500 per acre or $195,650 for 55.9 acres. His land value conclusion was $685,000 rounded. Goldsborough asserted that the actual costs to acquire the land did not represent the fair market value of the land.

Goldsborough opined that the best support of the cost value for the subject's improvements is the total of actual costs as of the valuation date. As of January 1, 2012, Goldsborough summarized the hard and soft costs provided by the owner to total $63,578,595. Entrepreneurial profit or developer's profit was not included in the estimate. In his opinion, "[t]he subject building is a special-use property being developed by a user-owner, and all motivation for profit is derived from the business enterprise, not the real estate." Exhibit #1, p. 60. Utilizing his land value estimate of $685,000, the cost approach indicated a value of $64,300,000 rounded.

Goldsborough also used the Marshall Valuation Service as a source for calculating the replacement cost of the subject improvements and as a check on the contractors' estimates. As an average quality arena building with partial costs of

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[4] The Court notes that land devoted to agricultural use is valued at its "use value" pursuant to K.S.A. 79-1476, not its fair market value. As a result, the comparison is not particularly relevant.

Phase 1B, the Marshall Valuation Service estimate for the cost of improvements and his land value indicated a value of $60,180,000 rounded. Goldsborough did not apply any accrued depreciation (curable physical deterioration, incurable physical deterioration, functional obsolescence, or external obsolescence). Goldsborough concluded that the value indication by the cost approach is $64,300,000 because there is no stronger indication of a new property's value than its actual construction costs and the Marshall Valuation Service results support the reported costs.

Goldsborough did not include the cost of signage in the cost total because it is considered personal property pursuant to K.S.A. 79-102 and the Kansas Personal Property Valuation Guide. The sign is a high definition video board. Goldsborough agreed that it serves the purpose of the casino, but asserted that its removal would not decrease the value of the real property. Goldsborough also did not include the cost of the Kansas Racing and Gaming trailers because their purpose was not associated with construction. Further, he believed that the organizational costs were related to the opening of the operation, not related to development of the real property.

On cross-examination, Goldsborough admitted that the use of the subject property changed from agricultural use to commercial use and that the management contract or zoning did not appear to be in jeopardy at the time of valuation. He explained that he included the cost of on-site utilities in his appraisal, but not off-site utilities. He acknowledged that Double Down is the developer of the hotel, but stated that he does not know what Peninsula Gaming paid Double Down for the option for the Wyant property. He agreed that Peninsula Gaming voluntarily entered into the option agreements or acquired the options agreements. Goldsborough was aware that the subject property changed hands by selling the business prior to completion of his appraisal, but he did not have information regarding the value attributed to the real estate in the sale to Boyd Gaming. He was aware that there are water dispersement canals around the edges of the property ending at the southeast corner of the parcel. (Exhibit #4) He was aware that significant engineering efforts were made to deal with the water run-off from the northwest portion of the parcel and that there is a water retention structure on the southeast corner to deal with water from the entire parcel. Goldsborough was not aware that egress from the Gerlach tract became an issue during round 2 of proposals because neighbors objected to all the traffic exiting to Highway 81 across from a residential area and that it became necessary to acquire the Wyant tract to allow egress.

On re-direct, Goldsborough asserted that options are not sales and that the zoning alone did not allow gaming; the management contract was needed.

William Kimmel, MAI appraiser with a temporary practice permit in Kansas, performed a review appraisal of Jortberg's appraisal. (Exhibit #11) Kimmel was familiar with appraisals of casino properties. Kimmel argued that Jortberg overstated the value of the land because he failed to exclude value attributable to the management contract. Kimmel asserted that the options for the subject property were not exercised until after the management contract was awarded validating the opinion that the option prices were only viable with the intangible management contract. Kimmel stated that the management contract is an intangible, like business enterprise value, and is not taxable. Without the management contract, Kimmel opined that the land value would be closer to agricultural value.

Jortberg also performed a review appraisal of Goldsborough's appraisal and concluded that the report conclusion is not consistent with appraisal principles with regard to land valuation and valuation of the highest and best use of the subject property. (Exhibit #8) Jortberg also questioned the competency of the appraisers to appraise the subject property in light of its specialized nature and the lack of any other casino valuation assignments in the appraisers' qualifications.

III.
Law Governing Ad Valorem Tax Valuations

All real and tangible personal property in Kansas is subject to taxation on a uniform and equal basis unless specifically exempted. Kan. Const. art. XI, § 1(a); K.S.A. 79-101. It is the duty of the legislature to provide for a uniform and equal rate of assessment and taxation. *See id.* Pursuant to its constitutional dictate, the legislature has enacted a statutory scheme to ensure property is appraised for ad valorem tax purposes in a uniform and equal manner. Central to this statutory scheme is the requirement that property be appraised at fair market value as of January 1 of each taxable year, unless otherwise specified by law. K.S.A. 79-1455.

Fair market value is defined as the 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 that the parties are acting without undue compulsion. K.S.A. 79-503a. In determining fair market value the appraiser must consider various factors enumerated in K.S.A. 79-503a(a) to (k). The *ad valorem* tax appraisal process also shall conform to generally accepted appraisal procedures adaptable to mass appraisal and consistent with the definition of fair market value, unless otherwise specified by law. K.S.A. 79-505.

The director of the property valuation division (PVD) for the State of Kansas is required to adopt rules and regulations prescribing appropriate standards for performing appraisals in accordance with generally accepted appraisal standards,

as evidenced by the standards promulgated by the Appraisal Standards Board. *See* K.S.A. 79-505. The Appraisal Standards Board publishes USPAP.

It is the role of this Court to provide an impartial venue for the resolution of tax disputes. The Court hears the parties' arguments and weighs all of the evidence in accordance with the Kansas Administrative Procedures Act (KAPA) and the code of civil procedure. *See* K.A.R. 94-5-1. The Court must render decisions based on substantial competent evidence in light of the record as a whole, including determinations of veracity, and must decide cases solely on the evidence presented. *See* K.S.A. 77-621(c); K.S.A. 77-526(d). The presentation of evidence in proceedings before this Court need not adhere strictly to the Kansas rules of evidence. *See* K.S.A. 77-524(a). The objective is to provide the parties with a reasonable opportunity to be heard.

Further, the Court of Tax Appeals is a quasi-judicial administrative body and may therefore rely upon its own expertise in assessing the evidence before it. *See Hart v. Board of Healing Arts of State,* 27 Kan. App. 2d 213, 217-18, 2 P.3d 797 (2000). As our sister tax court of Minnesota has explained, "The quality of the work, the adherence to relevant meaningful industry standards, the witness's comportment and persuasiveness on the stand, their candor and ability to explain their analysis are among the significant factors in determining credibility." *Johnson Matthey Advanced Circuits v. Cty. of Wright,* 2003 WL 21246379 at 9 (Minn. Tax, May 22, 2003).

Of course, in considering the credibility of evidence in each case, the Court is mindful of the standards of appraisal practice embodied in USPAP. The Court recognizes that when valuation evidence so deviates from USPAP that it becomes materially detrimental to a party's overall opinion of value, the evidence may be unreliable as a matter of law. See *In re Amoco Production,* 33 Kan. App. 2d. 329, 337, 102 P.3d 1176 (2004); *see also Board of Saline Cty. Comm'rs v. Jensen,* 32 Kan. App. 2d 730, 88 P.3d 242, *rev. denied* 278 Kan. 843 (2004) (holding that a valuation premised on an appraisal approach expressly prohibited by USPAP is erroneous as a matter of law).

K.S.A. 79-102 defines "real property" and "real estate" to "include not only the land itself, but all buildings, fixtures, improvements, mines, minerals, quarries, mineral springs and wells, *rights and privileges appertaining thereto.*" (Emphasis added.) Because real property is defined to include all rights and privileges appertaining thereto, it is the "fee simple interest" that is valued for purposes of *ad valorem* taxation in the State of Kansas. *See also In re Prieb Properties, L.L.C.,* 47 Kan. App. 2d 122, 130-31, 275 P.3d 56 (2012). The "fee simple interest" denotes "absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by governmental powers of taxation, eminent domain,

police power, and escheat." *The Appraisal of Real Estate*, Appraisal Institute, at 111-112 (13th ed. 2008). "Stated another way, '[o]wnership of the fee simple interest is equivalent to ownership of the complete bundle of sticks [property rights] that can be privately owned.'" *Prieb*, 47 Kan. App.2d at 130 *citing* The Appraisal of Real Estate, p.112.

In Kansas, the fair market value of real property for ad valorem taxation purposes is based upon the highest and best use of the property. PVD Directive #99-038. "Highest and best use" is the reasonably probable and legal use of vacant land or an improved property which is physically possible, appropriately supported, financially feasible, and that results in the highest value. The highest and best use must meet four criteria: legal permissibility, physical possibility, financial feasibility, and maximum productivity. *The Appraisal of Real Estate*, Appraisal Institute, at 278-279 (13th ed. 2008); *Yellow Freight System, Inc., et al. v. Johnson County Board of Co. Comm'rs*, 36 Kan. App. 2d 210, 217, 137 P.3d 1051, *rev. denied* (2006).

IV.
Cost Approach

Upon review of the evidence, the parties agree that the cost approach is the appropriate methodology to value the subject property. Both Jortberg and Goldsborough found insufficient comparable sales data to perform a sales comparison approach. Further, an income approach utilizing income from the casino operations provides a business value including both real estate and business enterprise value. Jortberg properly noted that his income approach did not value only the real estate and it was not relied upon for a determination of value for ad valorem taxation purposes. He performed an income approach analysis for purposes of checking the reasonableness of the cost approach (i.e. does income support cost). Goldsborough noted that special use properties such as the subject are not leased commercial property, so there are no market rents from which to perform a real estate only income approach. These opinions both considered the income approach and appropriately discounted reliance on the income approach for *ad valorem* taxation purposes in this particular case.

The cost approach is based on the principle of substitution which provides that an informed buyer will pay no more for a property than the cost to acquire a similar site and construct improvements of like desirability and utility. The cost approach estimates market value by estimating the replacement cost (or reproduction cost) of the improvements, subtracting depreciation (physical, functional and external estimated by varying methods), and then adding the land value. *The Appraisal of Real Estate*, Appraisal Institute, at 379-380 (13th ed. 2008). By its very nature, "the cost approach produces an opinion of value of the fee simple

interest in the real estate." *Id.* at 378. It values all of the interests and rights in the real property.

Replacement Cost of Improvements

As a starting point, we begin by addressing the replacement cost of the improvements. Generally, the parties agree that use of the actual cost of the improvements is appropriate. Upon review, we find that a replacement cost of $63,578,600, including hard and soft costs reported by Taxpayer, does not include any of the disputed items and is the most appropriate starting point. Exhibit #1, p.59.

Signage

The parties disagree whether the marquee sign is part of the real estate or is personal property. The County treated the sign as real estate and added its cost to the replacement cost of the improvements, while Taxpayer asserts that the sign is personal property, and therefore, should not be included in the real estate value for purposes of taxation.

Article 11, Section 1 of the Kansas Constitution delineates how property shall be classified for purposes of *ad valorem* taxation. Under this section, property subject to taxation is divided into two principle classes – real property and tangible personal property. Both classes contain several subclasses, each with its own assessment rate. *See also* K.S.A. 79-1439.

For purposes of *ad valorem* taxation, the terms of classification are further defined by statute. "Real property," "real estate," and "land" are defined "not only the land itself, but all buildings, fixtures, improvements, mines, minerals, quarries, mineral springs and wells, rights and privileges appertaining thereto." K.S.A. 79-102. "Personal property" is defined as "every tangible thing which is the subject of ownership, not forming part or parcel of real property." *Id.*

As a practical matter, everything found on a given tract of real estate, with the exception of the raw ground, is or at one time was personal property. Buildings and other such improvements are, in essence, amalgams of lumber, cement, bricks, glass, piping, shingles, nails and other building materials. These materials lose their identity as separate items of personal property when they are combined and become part of the real estate by accession. In contrast, a fixture is an item that retains its separate identity when it becomes part of the realty. In short, "a fixture is a former chattel which, while retaining its separate physical identity, is so connected with the realty that a disinterested observer would consider it to be a part thereof." *See* 5 American Law of Property §19.2 (Casner ed. 1952). *See also*

35A Am. Jur. 2d Fixtures §2.

There is no bright-line rule for determining under what conditions a chattel loses its character as personal property and becomes a fixture of the freehold. That "determination can only be made from a consideration of all the individual facts and circumstances attending the particular case." *In re Equalization Appeals of Total Petroleum, Inc.*, 28 Kan. App. 2d 295, 300, 16 P.3d 981 (2000) *citing Kansas City Millwright Co., Inc. v. Kalb*, 221 Kan. 658, 664, 562 P.2d 65 *modified* 221 Kan. 752, 564 P.2d 1280 (1977).

As the Kansas Supreme Court observed long ago, it is "frequently a difficult and vexatious question to ascertain the dividing line between real property and personal property and to decide on which side of the line certain property belongs." *Atchison, Topeka & Santa Fe Ry. V. Morgan*, 42 Kan. 23, 27-28, 21 P. 809 (1889).

To ascertain whether personal property has become a fixture, Kansas has adopted a long standing common law test known as the "fixtures test." The three-part test requires consideration of the following: "(1) annexation to the realty; (2) adaptation to the use of that part of the realty with which it is attached; and (3) the intention of the party making the annexation." *Total Petroleum*, 28 Kan. App. 2d at 299-300 (citing *Stalcup v. Detrich*, 27 Kan. App. 2d 880, 10 P.3d 3 [2000]). The three-part fixtures test is not conducive to rigid application and must be applied within the context of the legal problem and the individual facts presented. "[T]here appears to be no single statement in our law defining fixtures which is capable of application in all situations." *Kansas City Millwright*, 221 Kan. at 664.

As a general rule under K.S.A. 79-1456, county appraisers are required to follow the guides established by the director of property valuation. "The county appraiser may deviate from the values shown in such guides on an individual piece of property for just cause shown an in a manner consistent with achieving fair market value." K.S.A. 79-1456.

The 2012 Personal Property Valuation Guide (Guide) promulgated by the director of the Property Valuation Division (PVD) states in part as follows:

> "The 'Kansas Real and Personal Property Reference' section is a guideline for classifying property in the state of Kansas. If we all follow it in general, we will promote uniformity. It lists many types of properties and the classification for each one.
>
> It is possible that the county appraiser will be faced with a unique situation or property that is not addressed in the Kansas Reappraisal Manual. In that case, the county appraiser shall

> utilize the 3-pronged fixture law test set forth in Directive 92-011 to determine whether the property is real or personal." *Id.* at iii. (Exhibit 348.)

In the "Kansas Real and Personal Property Reference" section excerpted from the Kansas Reappraisal Manual, the Guide explains that the basic factors for classifying items are their designed use and purpose. For example, the Guide explains that items directly used and whose primary purpose is for a manufacturing process are normally considered personal property. "Other factors which must be given consideration in classifying items as real or personal property are the manner in which they are affixed and the intention of the party who affixed them." *Id.* at v. The Guide lists improvements to land normally considered real property to include items such as retaining walls, private roads, paved areas, culverts, bridges, fencing, reservoirs, ditches, private storm and sanitary sewers, private water lines, and yard lighting. The Guide then provides a list of miscellaneous yard items with an indication of whether they are real or personal property. All three sign items [i.e. Sign-Business (attached to building), Sign (free standing), and Sign-Advertising (billboard)] are listed as personal property. *Id.* at vi.

It is quite clear that the Guide treats signage as personal property. Although the statutes and Guide allow for deviation from the Guide, the County has not provided sufficient evidence to show that this is a unique situation or that there is good cause to deviate from the Guide. The County provided little to no evidence that the sign satisfies the three-prong fixture test. No evidence of affixation or adaptation was presented. Further, there is no evidence of intention by the owner for the sign to be permanently attached. As a result, we conclude that the signage is personal property, and for purposes of the real estate valuation at issue in this appeal, the cost of the signage should not be included in the replacement cost estimate of the improvements.

KRGC Trailer Cost

Both direct (hard) costs and indirect (soft) costs must be considered to develop cost estimates for a building. *The Appraisal of Real Estate*, Appraisal Institute, at 386 (13th ed. 2008). Direct costs include expenditures for labor and materials used in construction of the improvement, and indirect (soft) costs are "[e]xpenditures or allowances for items other than labor and materials that are necessary for construction but are not typically part of the construction contract." *Id.* at 387. Soft costs may include administrative costs, professional fees, financing costs and the interest on construction loans, and taxes. *Id.* at 387.

Jortberg included the cost to rent KRGC trailers as a soft cost, but the County did not present evidence regarding the use or purpose of the trailers. On

the other hand, Cooper had personal knowledge regarding the purpose of the trailers and testified that the Kansas Racing and Gaming Commission's use of the trailers was related to its oversight of the casino's internal controls including licensing employees and vendors, reviewing departmental operating procedures, and overseeing placement of cameras, but not construction. Based on the weight of the evidence, we conclude that the evidence does not show that the trailers were associated with the construction process or with the supervision of construction. Therefore, the cost associated with the KRGC trailers should not be included as a soft cost when determining the replacement cost of the improvements.

Organizational Costs

Jortberg included additional soft costs of $1.6 million to account for organizational, administrative and legal costs listed on Line 7 of the project development budget. The County, however, presented no evidence associating the costs listed with the construction process or with the supervision of construction. Cooper was personally involved in providing information for Line 7 and described the line item as pre-opening expenses such as regulatory fees to KRGC and Kansas Lottery and pre-opening payroll, marketing, training, and uniforms. According to Cooper's testimony, the expenses included were not related to construction. Based upon the weight of the evidence, the County failed to satisfy its evidentiary burden, and the costs listed on Line 7 should not be included as a soft cost because they were not construction related or necessary for construction of the improvements.

Financing Costs

Jortberg included an additional soft cost of $3,186,685 to account for financing costs during construction. No temporary interim financing was listed on the budget, but it was estimated by Jortberg based upon a 1% origination fee on 70% of reproduction cost and 6% interest for 12 months on 70% of reproduction cost. Goldsborough did not include an interim financing cost in his appraisal.

As stated previously, indirect (soft) costs may include interim financing costs and the interest on construction loans. *Id.* at 387. The County's evidence, however, for calculating the costs was flawed. The calculation did not address interest accruing only from the date of a draw and improperly assumed a twelve month financing cycle. The County presented no evidence to support the assumption that a developer, or an owner in this market, would borrow funds to construct the casino. There is no other evidence to support an appropriate amount of interim financing costs. In light of the flaws, we find the County did not present sufficient evidence to support the inclusion of this additional soft cost.

Improvement Value

Neither party applied any depreciation to the estimated replacement cost of the improvements. Consequently, based upon the previous analyses, we conclude that the appropriate replacement cost new less deprecation of the subject improvements is $63,578,600.

Land Value

The parties agree that the highest and best use of the subject property as improved is its current use as a casino. As explained previously, the fair market value of real property for *ad valorem* taxation purposes is based upon the highest and best use of the property. "Highest and best use" is the reasonably probable and legal use of vacant land or an improved property which is physically possible, appropriately supported, financially feasible, and that results in the highest value. The highest and best use must meet four criteria: legal permissibility, physical possibility, financial feasibility, and maximum productivity. *The Appraisal of Real Estate*, Appraisal Institute, at 278-279 (13th ed. 2008); *Yellow Freight System, Inc., et al. v. Johnson County Board of Co. Comm'rs*, 36 Kan.App.2d 210, 217, 137 P.3d 1051, *rev. denied* (2006). The current use as a casino meets these four criteria.

The primary disagreement relates to the proper methodology to value the subject land. The County's original appraisal relied upon the budget estimate of $20.25 million, and Jortberg's appraisal relied upon the costs of the land including special assessments for a land value of $26 million. Taxpayer argues that the land value should be determined relying upon sales of comparable agricultural land in Sumner County, or $3,500 per acre ($685,000).

Management Agreement

Upon review, the County established by a preponderance of the evidence that the subject property is the best casino site in the southeast gaming zone and would have value even without Taxpayer possessing the management agreement (as long as the management agreement for this zone has not otherwise been awarded). This is established by the independent evaluators who determined that Exit 33 was superior to Exit 19; an option agreement on the Gerlach tract executed only three months after the legislation passed; Taxpayer selecting the subject parcel as its proposed site; and the State of Kansas's selection of Taxpayer's proposal with the proposed site for the management agreement. K.S.A. 74-8734(e) establishes that location is a significant factor to be considered by the State in selecting a proposal and proposed site for the management agreement. K.S.A. 79-503a(c) also establishes the effect of location on value as a factor to be considered in determining fair market value. Location is a real property characteristic.

Taxpayer frames its argument by claiming that one must remove the value of the management contract from the real estate value and that the land value determination should be made as though the land were vacant and available only for agricultural and/or future commercial uses other than a casino. This argument, however, is premised upon additional presumptions that are not appropriate.

In addition to the assumption that the parcel is vacant, Taxpayer's argument presumes that a casino could not be constructed on the subject parcel. This additional presumption improperly ignores the law in effect on the valuation date. The Act allows gaming in this location subject to limitations enumerated in the law. In a highest and best use analysis, all actual market facts must stay the same, only the property at issue is assumed to be vacant. One should not make other assumptions of fact that suspend reality, such as assuming another casino in the southeast region exists or that the state law has changed. Another casino did not exist in the market (southeast region) on the valuation date. If the subject casino did not exist and the subject parcel was vacant, the facts would be similar to those existing just prior to Taxpayer's purchase of the parcels. The state law allowing certain gaming facilities would still be state law, and no other casino would exist in the southeast region. We find Jortberg's highest and best use analysis for the subject parcel, as vacant, is the appropriate analysis as casino/gaming development is physically possible, legally permissible, financial feasible and maximally productive.

Taxpayer states that it never would have exercised the options and purchased the two tracts if it was not awarded the management contract.[5] We do not doubt that statement. Taxpayer's leap in logic, however, is that the purchase price includes a value for the management contract that must be removed. We do not agree.[6] In one sense, the Act is analogous to zoning in that the Act is a restriction or requirement imposed upon the use of real estate by the state or federal government or local governing bodies. *See* K.S.A. 79-503a(j). For example, commercial zoning as opposed to residential zoning in many instances enhances the

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[5] The use of options by the market participants does not undercut the conclusion that the subject site is the optimal casino site in this zone. The use of options simply recognizes a vast risk/reward disparity between buying the subject property outright before approval of a proposal versus the risk that another proposal at another site is approved and receives the management agreement. If Taxpayer had purchased the subject property outright and no proposal was approved, it could re-sell the property to the next proponent but with no gain or perhaps a loss. If Taxpayer had purchased the subject property and another proposal at another site were approved, then the value of the subject property would drop precipitously as there can only be one casino in the zone. Thus, the risk/reward in that scenario dictates the use of options.

[6] From another perspective, the money paid by Taxpayer for the Wyant and Gerlach tracts was consideration for, and purchased only, interests in land. Wyant, Gerlach, and the option holders did not sell a management contract to Taxpayer.

fair market value of land. Required zoning is not a tangible property and yet it enhances value of real property, and such enhanced value is properly included in the value of real property.[7] In this case, by virtue of the state government allowing gaming through adoption of the Act the value of the subject parcels have been enhanced.

This constitutes an enhancement of the real estate's value by changing its permissible use. It does not constitute value on an intangible, or placing a value on the management agreement, as asserted by Taxpayer. We recognize that K.S.A. 74-8734(m) of the Act states that the management agreement is not to be considered property, but K.S.A. 74-8734(m) addresses judgment liens (involuntarily liens), executions on property (involuntarily liens), mortgages (voluntarily liens), transfers, and assignments – in other words, actions that would encumber or otherwise reduce or eliminate the State of Kansas's control of the situation. Nothing in K.S.A. 74-8734(m) indicates that it is addressing issues of *ad valorem* property taxation and any possible enhanced real property value as a result of the Act.

Potential gaming operators, including Taxpayer, and property owners determined the market price paid for land in this location for a casino in an open and competitive market. In light of the available evidence, the price ultimately paid by Taxpayer, a willing buyer, is substantial evidence and is the best evidence presented to estimate the fair market value of the land. *Wolf Creek Golf Links, Inc. v. Board of County Comm'rs Johnson County*, 18 Kan.App.2d 263, 266, 853 P. 2d 62 (1993). The price paid for agricultural land is not reflective of the highest and best use of the subject parcel if it were vacant because its highest and best use is not as agricultural land. To value the subject property as agricultural land value would be to ignore reality.

As explained previously, it is the "fee simple interest" that is valued for purposes of *ad valorem* taxation in the State of Kansas. *In re Prieb Properties, L.L.C.*, 47 Kan. App. 2d 122, 130-31, 275 P.3d 56 (2012). "Stated another way, '[o]wnership of the fee simple interest is equivalent to ownership of the complete bundle of sticks [property rights] that can be privately owned.'" *Prieb*, 47 Kan. App.2d at 130 *citing* The Appraisal of Real Estate, p.112.

> "The bundle of rights concept compares real property ownership to a bundle of sticks. Each stick in the bundle represents a separate right or interest inherent in the ownership. These individual rights

[7] Zoning is a government requirement that can also be in doubt in some situations and can drive the use of options by market participants. Ultimately, a requested change in zoning can enhance the value of real property once it is granted (usually after the option is granted, but before the option is exercised). This is similar to the situation here with the use of options and the award of the management agreement.

> can be separated from the bundle by sale, lease, mortgage, donation, or another means of transfer. The complete bundle of rights includes the following:
>
> - The right to sell an interest
> - The right to lease an interest
> - The right to occupy the property
> - The right to mortgage an interest
> - The right to give an interest away"
>
> *The Appraisal of Real Estate*, Appraisal Institute, at 112 (13th ed. 2008).

The option held by Foxwoods Development for the Gerlach tract was an encumbrance that had to be dealt with as part of the purchase transaction in order for Taxpayer to purchase the full fee simple interest. Foxwoods held one of the rights in the bundle of sticks (i.e. the right to sell/purchase an interest). In other words, to acquire the fee simple interest in the Gerlach tract, Taxpayer purchased the entire bundle of fee simple rights from two sellers – the Gerlachs and Foxwoods Development.[8] The amount received by the Gerlachs represented the price paid to them for their *encumbered* fee interest; the amount received by Foxwoods Development, the option holder, represented the price paid for the encumbrance (i.e. the option to purchase); and together these two amounts represent the price paid for the full bundle of fee simple rights, $8,931,250 ($3,631,250 + $5,300,000).

Based upon the weight of the evidence presented, we conclude that the County met its burden of production to include the full $5,300,000 as part of the land acquisition cost because the option assignment on its face supports this approach. Nothing in the option assignment documentation suggests the $5,300,000 was consideration for non-competition and nothing in the documentation prevented the option holder, Foxwoods Development, from presenting an alternative proposal to the State of Kansas at some other site. Although Taxpayer raised the non-competition aspect, Taxpayer provided no specific documentation or testimony to establish the value of the non-competition portion of the option assignment amount and those facts were particularly within the control of Taxpayer.

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[8] The definition of "fair market value" found in K.S.A. 79-503a must be read *in pari materia* with the statutory scheme for *ad valorem* property valuation. As a result, the "willing seller" must be read to include all owners of the rights in the property to achieve transfer of the fee simple interest. In this case, the willing seller of the full fee simple interest includes both the Gerlachs and Foxwoods.

With respect to the Wyant tract, the County's expert witness Jortberg concluded that the tract sold for $8,000,000. Jortberg relied upon the adjusted sale prices of the Gerlach tract, inclusive of the price for the Gerlach option assigned, and the sale price of the Wyant tract for a land value of $16,931,250, or roughly $17 million. Based on the weight of the evidence, the Court concludes that a preponderance of evidence supports a land value of $16,931,250.[9]

Excess Land

Upon review, the Court finds that the part of the subject parcel formerly known as the Wyant tract is not excess land. Contrary to Goldsborough's statements, the area is not vacant. The area contains two roads from the casino in the southern portion of the subject parcel to adjoining highways, and it serves the purpose of providing access to U.S. Highway 81 and access to Kansas Highway 53. Taxpayer took distinct steps to acquire the Wyant tract, separate from the Gerlach tract, and then combined the two parcels into one parcel. The area is necessary for ingress and egress to avoid the residential neighborhood to the west, and the road configuration does not support a contention that there is any intent to sell off part of

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[9] The Court notes that the relationship between Double Down and Peninsula Gaming was not fully explained at hearing. We find it unnecessary to make specific conclusions or allocations regarding the Wyant option since the County did not ask us to include all or part of the $3,250,000 referenced in the Letter of Intent exhibits between Peninsula Gaming and Double Down relating to the Wyant tract. (Exhibit #115) It appears that Double Down may have held one of the rights in the bundle of sticks (i.e. the right to purchase the property). Difficulties arise in that the letter of intent and exhibits referred to options on two other tracts with no allocation and Double Down agreed to assist Peninsula Gaming in obtaining a gaming license. In addition to the escrow deposit of $875,000, Peninsula Gaming agreed to pay a non-refundable fee of $625,000, and if it received a gaming license, a success fee of $1,750,000 to Double Down. Further if it received a gaming license, Peninsula Gaming agreed to pay Double Down 1% of EBITDA on a monthly basis for 10 years and for period of time Double Down had the exclusive right to negotiate with Peninsula Gaming for owning, developing, and operating the hotel. Kansas Star Casino, LLC and Double Down apparently did enter into a hotel development agreement in May 2011 to jointly invest in KSC Lodging, LC to construct a hotel. Although no witness at hearing was able or willing to testify about the land acquisition costs of $20,250,000 listed by Peninsula Gaming in its project budget provided to the County (Exhibit 507, p.430), the documentation presented reveals that Peninsula Gaming appears to have paid the following prior to commencement of operations:

Gerlach Option Assignment Cost:	$ 5,300,000
Gerlach Exercise Price:	$ 3,700,000 (rounded)
Wyant Exercise Price:	$ 8,000,000
Wyant Option Assignment Costs(?):	
Escrow Deposit	$ 875,000
Non-refundable Fee	$ 625,000
Success Fee	$ 1,750,000
Total Land Acquisition Costs:	$20,250,000.

the tract. The area appears capable of development of additional casino-related amenities. There is also evidence to suggest that the tract is necessary for proper drainage of the entire site. It has not been platted. If Taxpayer truly believed that the Wyant tract was excess land not needed for the casino development, why did Taxpayer pay over $8 million for the land. Taxpayer's actions here speak louder than words.

Undue Compulsion

Taxpayer also argues that the management contract constitutes undue compulsion, and as a result, the purchase price of the land does not satisfy the definition of fair market value found in K.S.A. 79-503a. "Fair market value" is defined as the 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 that the parties are acting without undue compulsion. *See* K.S.A. 79-503a.

It is a fundamental rule of statutory construction that the intent of the legislature governs if that intent can be ascertained. *In re Appeal of LaFarge Midwest/Martin Tractor Co., Inc.*, 293 Kan. 1039, 1045, 271 P.3d 732 (2012)(citation omitted). To determine legislative intent, the court must first examine the language used in the statute, giving common words their ordinary meaning. *LaFarge*, 293 Kan. at 1045; *In re Appeal of Wedge Log-Tech, L.L.C.*, 48 Kan. App.2d 804, 812, 300 P.3d 1105, *rev. denied* (2013). "When the plain language of a statute is unambiguous, we are to give effect to that language without resorting to principles of statutory construction or legislative history." *In re Application of TransCanada Keystone Pipeline, L.P.*, 48 Kan. App. 2d 838, 843, 301 P.3d 335, *rev. denied* (2013).

The *ad valorem* tax appraisal process also shall conform to generally accepted appraisal procedures adaptable to mass appraisal and consistent with the definition of fair market value, unless otherwise specified by law. K.S.A. 79-505.

According to *The Appraisal of Real Estate*, Appraisal Institute, 23 (13th ed. 2008), the most widely accepted definitions of market value assume that the willing buyer and willing seller are not under "undue duress" or are acting "without compulsion." This is consistent with our statutory definition. Our statutory definition in K.S.A. 79-503a, however, does not define "undue compulsion." Black's Law Dictionary 305 (8th ed. 2004) defines "compulsion" as "[t]he act of compelling; the state of being compelled," "[a]n uncontrollable inclination to do something" or "[o]bjective necessity; duress." Black's Law Dictionary 300 (8th ed. 2004) defines "compel" as "[t]o cause or bring about by force, threats, or overwhelming pressure."

Black's Law Dictionary 542 (8th ed. 2004) defines "duress" broadly as "a threat of harm made to compel a person to do something against his or her will or judgment."

Taxpayer in this case voluntarily and purposefully sought the award of the management contract from the Kansas Lottery. No person, entity or government forced Taxpayer to seek the management contract. There is no evidence that Taxpayer was under duress or compulsion to make proposals for the contract. It was entirely voluntary. It was a business decision by Taxpayer. Taxpayer proposed the location. The Kansas Lottery's acceptance of Taxpayer's voluntary proposal does not result in duress or compulsion.

The fact that Taxpayer was awarded the management contract is best described as Taxpayer's economic motivation to pursue the land purchase. A buyer's economic motivation to pursue a particular purchase because it makes economic sense given the potential profits is not undue compulsion. If it were undue compulsion, then virtually all purchases of commercial property would be invalidated as possible indications of fair market value because the buyer intends to use the property for an economic benefit.[10] We conclude that Taxpayer was not under "undue compulsion" to purchase the subject land.

Taxpayer cites to a definition of "investment value" in the *The Appraisal of Real Estate*, Appraisal Institute, 28-29 (13th ed. 2008) asserting that this may properly describe the subject's sale price. "Investment value" is defined as the "specific value of a property to a particular investor or class of investors based upon individual investment requirements; distinguished from market value, which is impersonal and detached." *The Appraisal of Real Estate*, Appraisal Institute, 28-29 (13th ed. 2008) states as follows:

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[10] For example: Assume a parcel of land for sale on the open market is located across the street from a large metropolitan hospital and is zoned for both commercial and residential use. There is a doctor licensed by the state to practice medicine interested in placing his business on the parcel – great location for his medical practice and good potential for profit. The parcel, however, is also available to a home buyer to build a home, but the location is less desirable to said home buyer due to traffic and the more commercial location. Ultimately, the doctor purchases the parcel on the open market at a price negotiated and acceptable to the seller because the price is significantly higher than the price offered by the home buyer. In an analysis of the sale price and whether it reflects market value, one does not ignore the actual sale price just because the doctor has a medical license and has economic motivations to purchase the property. Further, this example illustrates the concept of highest and best use. The sale price is not valuing the doctor's medical license. The doctor is merely the potential buyer willing to pay the most for the property in the open market without undue compulsion (i.e. maximally productive). The same is true here. The sale price is not reflecting a value of the management contract, it is reflecting the real property value at the highest and best use of the property. Kansas Star was the potential buyer willing to pay the most for the property.

> "Investment value represents the value of a specific property to a particular investor. As used in appraisal assignments, investment value is the value of a property to a particular investor based on that person's (or entity's) investment requirements. In contrast to market value, investment value is value to an individual, not necessarily value in the marketplace.
>
> Investment value reflects the subjective relationship between the particular investor and a given investment. It differs in concept from market value, although investment value and market value indications sometimes may be similar. If the investor's requirements are typical of the market, investment value in this case will be the same as market value.
>
> When measured in dollars, investment value is the price an investor would pay for an investment in light of its perceived capacity to satisfy that individual's desires, needs, or investment goals. To render an opinion of investment value, specific investment criteria must be known."

Goldsborough's testimony regarding his opinion that the difference between the two land values (agricultural value and sale price) can be attributed to "investment value" is not persuasive. Goldsborough had not appraised a casino prior the present assignment and had never heard of a management contract. He failed to properly consider the highest and best use of the property and ignored the fact that sale prices were established in the open and competitive market. There is no evidence that Taxpayer's investment criteria differed from other potential casino operators who were in the market. As explained above, Taxpayer's ultimate award of the management contract constitutes economic motivation to purchase the property, but it does not invalidate the sale for purposes of a fair market value analysis.

Off-Site Utilities

In his land value analysis for the cost approach, the County's expert witness Jortberg added the approximately $9 million cost for utility improvements and extensions to the site asserting that infrastructure improvements are additive in terms of an increase in value. According to Cooper, the actual cost for these off-site improvements were paid for by the City of Mulvane and the subject property is assessed special assessments to reimburse the city over time.

Again, we refer to the statutory definition of fair market value. "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. 79-503a.

Of particular relevance on this point, K.S.A. 79-503a also provides that in cases of real property subject to a special assessment, the fair market value "shall not be determined by adding the present value of the special assessment to the sales price." By implication, this provision instructs that the cost of public improvements benefitting a particular tract of real estate is not necessarily equivalent to the measure of value contributed to the property by the improvements. Beyond this negative declaration, the statute provides no meaningful guidance.

As a practical matter, however, this Court recognizes that appraisals of land improved by public infrastructure financed through special assessment obligations require careful analysis of both the costs and the benefits associated with those improvements. Appraisals of this kind are necessarily matters of forecast. Estimates should incorporate real-world principles of capital budgeting and should consider the present value of expected net cash flows less the total cost of development, giving due consideration to things such as risk, carrying costs, and profit expectations.

Although public improvements from off-site utilities may add value to the real estate, the County's method for calculating the value on a dollar-for-dollar value-to-cost value enhancement is improper. There was no other evidence presented to support an appropriate amount of value enhancement from the off-site utilities. In sum, the County failed to provide sufficient evidence to determine the contributing value of the improvements and the concomitant impact of the outstanding special assessment obligations. In the absence of substantial evidence, the $9 million added to the land value for off-site infrastructure improvements should be excluded.

Conclusion

In summary of our analysis and based upon the weight of the evidence presented, the Court finds that the replacement cost new less depreciation of the improvements is $63,578,600 and the land value is $16,931,250 resulting in a total cost approach estimate of $80,509,850. The Court concludes that a rounded value of $80,510,000 best reflects the fair market value of the fee simple interest of the subject property for tax year 2012.[11]

IT IS THEREFORE ORDERED that, for the reasons stated above, the appraised value of the subject property for tax year 2012 is $80,510,000.

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. 2013 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 of the Court, Kansas Court of Tax Appeals, Eisenhower State Office Building, Suite 1022, 700 SW Harrison St., Topeka, KS 66603. *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.

[11] Of the total value, $202,500 should be allocated to Parcel ID# 096-022-04-0-00-00-003.01-00 and the remaining $80,307,500 should be allocated to Parcel ID# 096-022-04-0-00-00-002.00-0.

IT IS SO ORDERED

THE KANSAS COURT OF TAX APPEALS

SEAL

ATTEST:

SAM H. SHELDON, CHIEF JUDGE

JAMES D. COOPER, JUDGE

RONALD C. MASON, JUDGE

JOELENE R. ALLEN, SECRETARY

CERTIFICATION

I, Joelene 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 Nos. 2012-3909-EQ and 2012-3910-EQ, and any attachments thereto, was placed in the United States Mail, on this 25th day of February, 2014, addressed to:

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

Joelene R. Allen

Joelene R. Allen, Secretary

No. 111,650

IN THE COURT OF APPEALS OF THE STATE OF KANSAS

In the Matter of the Equalization Appeal of
KANSAS STAR CASINO, L.L.C.
for the Year 2012 in Sumner County, Kansas.

SYLLABUS BY THE COURT

1.

This court reviews a decision from the Court of Tax Appeals in the manner prescribed by the Kansas Judicial Review Act, K.S.A. 77-601 *et seq.*

2.

In reviewing the evidence in light of the record as a whole, this court does not reweigh the evidence or engage in de novo review. The term "in light of the record as a whole" is statutorily defined to include the evidence both supporting and detracting from an agency's finding. K.S.A. 2014 Supp. 77-621(d). Thus, this court must determine whether the evidence supporting the agency's factual findings is substantial when considered in light of all the evidence.

3.

The burden of proving the invalidity of agency action is on the party asserting invalidity.

4.

The central tenet of the cost approach is the principle of substitution: an informed buyer will pay no more for a property than the cost to acquire a similar site and construct improvements of like desirability and utility. An appraiser is to estimate market value

under the cost approach by (1) estimating the value of the land, (2) estimating the replacement cost of the improvements, (3) subtracting depreciation as necessary, and (4) adding the land and improvement values together.

5.

Under Kansas law, real property is appraised at its fair market value. For the purposes of ad valorem taxation, the fair market value of a property is based on the property's highest and best use. The highest-and-best-use analysis is performed assuming the subject property is vacant. Four criteria are used to evaluate a property's highest and best use: (1) physical possibility; (2) legal permissibility; (3) financial feasibility; and (4) maximum productivity.

6.

Economic conditions, such as unforeseen or heavy expenses affecting a property owner, do not cause such owner's ad valorem taxation to change because such circumstances do not affect the value of the owner's real property. Conversely, an economic factor that actually changes the value of an owner's real property properly alters the owner's ad valorem taxation rate.

7.

Kansas law requires the fee simple interest in a property be valued for the purposes of ad valorem taxation. A fee simple interest is absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat.

8.

In Kansas, fair market value means the amount 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 that the parties are acting without

undue compulsion. Kansas has not statutorily defined "compulsion," so instead a court should rely on the term's plain meaning.

9.

The Court of Tax Appeals may not rely on an approach to value that is expressly prohibited by the Uniform Standards of Professional Appraisal Practice. However, Uniform Standards of Professional Appraisal Practice violations that are not materially detrimental to an appraiser's overall opinion of value are not fatal to a county's case.

10.

The determination of whether property is real or personal must be made on a case by case basis. The test for determining whether personal property becomes a fixture is: (1) annexation to the realty; (2) adaptation to the use of that part of the realty with which it is attached; and (3) the intention of the party making the annexation. The county bears the burden of proving the appropriate classification of a commercial sign as either personal or real property.

11.

In the context of real estate appraisal, "soft costs" or indirect costs are expenditures or allowances for items other than labor and materials that are necessary for construction but are not typically part of the construction contract.

Appeal from the Court of Tax Appeals. Opinion filed November 20, 2015. Affirmed.

Lynn D. Preheim and *Jarrod C. Kieffer*, of Stinson Leonard Street LLP, of Wichita, for appellant.

David R. Cooper and *Andrew D. Holder*, of Fisher, Patterson, Sayler & Smith, L.L.P., of Topeka, for appellee.

Before MALONE, C.J., GREEN and POWELL, JJ.

POWELL, J.: Kansas Star Casino, L.L.C. (Kansas Star) appeals from the ruling by the Kansas Court of Tax Appeals (COTA) that the appraised value of its property, a 195.5 acre tract of land located in the northeast corner of Sumner County and used for casino operations, was $80,510,000 for the tax year 2012. In reaching its conclusion, COTA determined that the value for Kansas Star's land was $16,931,250. This amount was based on the actual price Kansas Star's parent company paid for the land. On appeal, Kansas Star argues that COTA erroneously inflated the value of its land and that the land should have been valued based on sales of agricultural property in the surrounding area. The County cross-appeals, arguing COTA erred in declining to include various additional costs as part of its valuation. After a careful review of the record, we agree with COTA's ruling in all respects and therefore affirm.

FACTUAL AND PROCEDURAL BACKGROUND

A. *An Overview of the Kansas Expanded Lottery Act and the Single Management Contract*

The Kansas Legislature enacted the Kansas Expanded Lottery Act (KELA), K.S.A. 74-8733 *et seq.*, in 2007. KELA divided the state into four gaming zones: northeast, south central, southwest, and southeast, each of which would be allowed to have only a single gaming facility management contract. K.S.A. 2014 Supp. 74-8734(a), (d). Sedgwick County and Sumner County comprise the south central gaming zone. K.S.A. 2014 Supp. 74-8702(f).

KELA established a process under which the State owns the casino's gaming operations but hires a gaming facility manager via a management contract to construct and own the casino improvements and infrastructure as well as to manage the gaming operations. Specifically, KELA provides that the management contract shall "allow the

lottery gaming facility manager to manage the lottery gaming facility in a manner consistent with this act and applicable law, but shall place full, complete and ultimate ownership and operational control of the gaming operation of the lottery gaming facility with the Kansas lottery." K.S.A. 2014 Supp. 74-8734(h)(17). Further, "[a] lottery gaming facility manager, on behalf of the state, shall purchase or lease for the Kansas lottery all lottery facility games. All lottery facility games shall be subject to the ultimate control of the Kansas lottery in accordance with this act." K.S.A. 2014 Supp. 74-8734(n)(2). KELA also created a Lottery Gaming Facility Review Board (Review Board) that was charged with evaluating lottery gaming facility management contracts. K.S.A. 2014 Supp. 74-8735(a), (h).

Potential gaming facility managers' casino proposals had minimum infrastructure requirements, including a $225 million minimum investment amount for the south central gaming zone. K.S.A. 2014 Supp. 74-8734(g)(2). Management contracts were to be for an initial maximum term of 15 years, and the winner of the management contract in the south central gaming zone was required to pay a privilege fee of $25 million in order to be selected as the lottery gaming facility manager for that zone. K.S.A. 2014 Supp. 74-8734(h)(1), (6). KELA mandated that the approved management contract contain provisions for payment of 22% of gaming revenues to the State, 2% to the problem gambling and addictions grant fund, 2% to the county in which the casino was located, and 1% to the other county in the zone. K.S.A. 74-8734(h)(12), (13), (16). KELA also specified that the "management contract shall not constitute property, nor shall it be subject to attachment, garnishment or execution, nor shall it be alienable or transferable, except upon approval of the executive director, nor shall it be subject to being encumbered or hypothecated." K.S.A. 2014 Supp. 74-8734(m).

Under KELA, once a management contract is approved by the Review Board, the contract has to be submitted to the Kansas Racing and Gaming Commission (KRGC) for

a background check and final approval. K.S.A. 2014 Supp. 74-8736(e). Facility managers and their employees must also be licensed and certified. K.S.A. 2014 Supp. 74-8751.

B. *Selection of the South Central Zone Gaming Facility Manager*

The selection of the south central zone gaming facility manager was a lengthy process that encompassed three rounds of proposals. Potential gaming facility manager proposals included a proposed site for the casino. However, none of the proposed casino sites were purchased by the prospective applicants prior to the award of the management contract. Instead, various entities entered into option agreements to purchase the tracts at prices substantially above market value if, and only if, the site were part of the proposal selected for the management contract. All the proposed casino sites presented throughout the bidding process were agricultural-use properties. The entities that submitted proposals to the Kansas Lottery also applied for zoning at the proposed sites, and such zoning was granted to the proposed tracts.

The first round of bids occurred in 2008. The approved proposal's site for the casino was located on the combined Wyant and Brewer tracts in Sumner County. However, the first approved proposal was withdrawn due to the economic downturn during the 2008 recession.

Beginning in 2009, Scott Cooper, who served as an analyst for the Review Board, assisted in evaluating proposals during the second round of bidding. In the second round, the Kansas Lottery approved the bid of a gaming facility manager group with a prospective location immediately south of the Wyant and Brewer tracts—the Gerlach tract located in Sumner County. However, due to infighting within the management group, no management contract was awarded.

In 2010, Peninsula Gaming (Kansas Star's parent company) hired Cooper to develop and expand its gaming operations in the United States. Cooper helped Peninsula assemble a proposal for the third round of bidding. Peninsula submitted its bid alongside two other prospective gaming facility managers.

For its bid, Peninsula chose to acquire purchase options for two abutting tracts: the Wyant tract (selected for the management contract in round one) and the Gerlach tract (selected for the management contract in round two). The owners of the Gerlach tract initially entered into a purchase option agreement with Paul Treadwell and Mark Linder just after the legislature passed KELA, wherein they agreed to sell the tract for $25,000 per acre, or approximately $3,631,250. Treadwell and Linder assigned the option to Foxwoods Development Company, L.L.C. (Foxwoods) in 2007. Foxwoods sold the Gerlach tract option to Peninsula on July 15, 2010, for $5,300,000. Six days later, on July 16, 2010, Peninsula and Double Down Development entered into an option agreement with the owners of the Wyant tract for a purchase price of $8,000,000.

Peninsula Gaming was awarded the management contract on October 19, 2010. It exercised its option for the Wyant tract on March 2, 2011, and its option for the Gerlach tract the next day. The Wyant and Gerlach tracts together comprise the Subject Property.

C. *Land value appraisal and appeal*

Kansas Star, a wholly-owned subsidiary of Peninsula and the gaming facility manager for the south central zone, was transferred ownership of the Subject Property and began operating the Kansas Star Casino there beginning December 26, 2011; as of January 1, 2012, the Subject Property consisted of an operating temporary casino and a partially constructed permanent casino. The Kansas Star Casino is situated on the southern Gerlach tract, while the northern Wyant tract is undeveloped aside from ingress and egress roads.

The County appraised the Subject Property at $91,000,000. Kansas Star appealed this appraisal to COTA. Following Kansas Star's appeal, the County hired Richard Jortberg as its litigation appraiser, who valued the Subject Property at $95,800,000. Kansas Star hired its own appraiser, Laird Goldsborough, who valued the Subject Property at $64,300,000. In deciding the appeal, COTA partially relied on Jortberg's appraisal and appraised the Subject Property at $80,510,000, including $16,931,250 in land value. Kansas Star now appeals COTA's land valuation of $16,931,250. The County cross-appeals, arguing COTA erred in declining to include various additional costs as part of its valuation of the Subject Property.

DID COTA OVERVALUE THE SUBJECT PROPERTY?

Kansas Star argues COTA improperly valued the Subject Property because the land would never be worth $86,605 per acre without KELA and the management contract. Kansas Star essentially asserts that it paid an inflated price for the Subject Property due to the unique circumstances of the management contract and that without the management contract the Subject Property's value would be substantially less. Thus, according to Kansas Star, the value attributable to the management contract should be subtracted from the property value of the Subject Property for the pulposes of ad valorem taxation.

This court reviews a decision from COTA in the manner prescribed by the Kansas Judicial Review Act, K.S.A. 77-601 et seq. This court may grant relief pursuant to K.S.A. 2014 Supp. 77-621, the pertinent portions ofwhich provide:

> "(c) The court shall grant relief only if it determines any one or more of the following:

"(4) the agency has erroneously interpreted or applied the law;

"(5) the agency has engaged in an unlawful procedure or has failed to follow prescribed procedure;

. . . .

"(7) the agency action is based on a determination of fact, made or implied by the agency, that is not supported to the appropriate standard of proof by evidence that is substantial when viewed in light of the record as a whole, which includes the agency record for judicial review, supplemented by any additional evidence received by the court under this act; or

"(8) the agency action is otherwise unreasonable, arbitrary or capricious."

In reviewing the evidence in light of the record as a whole, this court does not reweigh the evidence or engage in de novo review. The term "in light of the record as a whole" is statutorily defined to include the evidence both supporting and detracting from an agency's finding. K.S.A. 2014 Supp. 77-621(d). Thus, this court must determine whether the evidence supporting the agency's factual findings is substantial when considered in light of all the evidence. *Sierra Club v. Moser*, 298 Kan. 22, 62-63, 310 P.3d 360 (2013).

On appeal, "[t]he burden of proving the invalidity of agency action is on the party asserting invalidity." K.S.A. 2014 Supp. 77-621(a)(1); see *Milano's Inc. v. Kansas Dept. of Labor*, 296 Kan. 497, 500, 293 P.3d 707 (2013). Finally, when reviewing agency action pursuant to K.S.A. 2014 Supp. 77-621(c), this court takes into account the rule of harmless error. K.S.A. 2014 Supp. 77-621(e); *Sierra Club*, 298 Kan. at 47.

Kansas Star and the County agree that the cost approach was the appropriate method for valuing the Subject Property. The central tenet of the cost approach is the principle of substitution: an informed buyer will pay no more for a property than the cost to acquire a similar site and construct improvements of like desirability and utility. The Appraisal of Real Estate, Appraisal Institute, 379-80 (13th ed. 2008). An appraiser

estimates market value under the cost approach by (1) estimating the value of the land, (2) estimating the replacement cost of the improvements, (3) subtracting depreciation as necessary, and (4) adding the land and improvement values together. See *City of Wichita v. Eisenring*, 269 Kan. 767, 774, 7 P.3d 1248 (2000). With respect to COTA's cost approach analysis, Kansas Star challenges only the land value component of the analysis.

A. *COTA Correctly Determined the Highest and Best Use of the Subject Property*

Under Kansas law, real property is appraised at its fair market value. K.S.A. 79-501. For the purposes of ad valorem taxation, the fair market value of a property is based on the property's "highest and best use." See *In re Equalization Appeal of Johnson County Appraiser*, 47 Kan. App. 2d 1074, 1091-92, 283 P.3d 823 (2012). The highest-and-best-use analysis is performed assuming the Subject Property is vacant. See *In re Tax Appeal of Yellow Freight System, Inc.*, 36 Kan. App. 2d 210, 218, 137 P.3d 1051, *rev. denied* 282 Kan. 790 (2006). Four criteria are used to evaluate a property's highest and best use: (1) physical possibility; (2) legal permissibility; (3) financial feasibility; and (4) maximum productivity. *Yellow Freight System, Inc.*, 36 Kan. App. 2d at 217. As the parties do not dispute that operating a casino on the Subject Property is physically possible, financially feasible, and maximally productive, the critical issue is whether it would have been legally permissible to operate a casino on the Subject Property assuming the property were vacant.

Kansas Star claims we must remove the value of the management contract from the land value and that such value must be determined as though the land were vacant and available only for purposes for other than a casino. We disagree. We assume operating a casino on the Subject Property would be legal if the land were vacant because on January 1, 2012 (the valuation date), Kansas Star held the management contract for the south central gaming zone, meaning under KELA it was the only entity legally capable of operating a casino on that date. As COTA accurately explained in its order, "[i]n a

highest and best use analysis, all actual market facts must stay the same, only the property at issue is assumed to be vacant." If all actual market value is presumed to be the same, then it must also be assumed no other entity is permitted to build another casino in the south central gaming zone. If this were not so, the market value of the surrounding agricultural land would fluctuate as other potential gaming facility managers enter into option contracts with the landowners in preparation for bidding for the management contract. Therefore, we agree with COTA's determination that the highest and best use of the Subject Property was operation as a casino because operating a casino was legally permissible for Kansas Star in addition to the other highest-and-best-use requirements.

With the highest and best use of the Subject Property established as a casino, COTA ultimately determined that the land value of the Subject Property was $16,931,250. Given the lack of comparable property due to the unique situation created by KELA and the one-and-only management contract, COTA determined the actual sales price for the Subject Property was substantial evidence and the best evidence of its fair market value. It arrived at the land value total by adding the $8,000,000 purchase price of the Wyant tract, the $5,300,000 price paid to Foxwoods to acquire its option on the Gerlach tract, and the $3,631,250 paid to the Gerlachs to acquire their property. The sum of these figures represents the price Kansas Star paid for the Subject Property in order to obtain a fee simple interest in the Subject Property and build and operate a casino on it. COTA's decision complies with Kansas law.

B. *Kansas Star's Various Arguments Do Not Defeat COTA's Original Determination*

Kansas Star seeks to upend this relatively straight-forward analysis through various arguments. Specifically, Kansas Star asserts (1) COTA erred in failing to exclude value attributable to the management contract from the real property value of the Subject Property, (2) COTA improperly included the $5.3 million paid to Foxwoods to acquire the option to purchase the Gerlach tract, (3) COTA ignored that Kansas Star purchased

the Subject Property under undue compulsion, and (4) COTA erroneously determined that the Subject Property had no excess land. We will discuss each argument in turn.

1. *COTA did not err in failing to exclude value attributable to the management contract from the real property value of the Subject Property*

Kansas Star explains that the $16,931,250 it paid for the Subject Property was not only for the land itself, but also for intangible interests apart from the land. According to Kansas Star, because the impact of the management contract on the sales price was not accounted for, COTA's land value does not comply with the Uniform Standards of Professional Appraisal Practice and is thus in violation of Kansas law. See K.S.A. 2014 Supp. 79-503a(k) ("The appraisal process utilized in the valuation of all real and tangible personal property for *ad valorem* tax purposes shall conform to generally accepted appraisal procedures."); K.S.A. 79-504; K.S.A. 2014 Supp. 79-505.

Essentially, Kansas Star asks us to classify the management contract as an intangible circumstance that artificially inflated the value of the Subject Property that Kansas Star willingly purchased. Kansas Star asserts that the management contract did not raise the literal value of the land because it did not alter the land outside of the framework established by KELA. For support Kansas Star cites *State ex rel. Stephan v. Martin*, 227 Kan. 456, 466, 608 P.2d 880 (1980), where our Supreme Court explained that "property tax is based on the value of the property itself, not on the income or economic condition of the property's owner."

Kansas Star's reliance on *Martin* is unpersuasive (and perhaps detrimental) because the management contract is *not* an "economic condition" that renders its alteration of the Subject Property's value irrelevant for the purposes of ad valorem taxation. In *Martin*, the Kansas Supreme Court struck down K.S.A. 1979 Supp. 79-342, a law that granted "a partial exemption from taxation to certain items of farm machinery

and equipment, according preferential tax treatment to some owners." 227 Kan. at 468. In doing so, our Supreme Court explained that "'the severe economic crisis' confronting individual farmers and ranchers [that prompted K.S.A. 1979 Supp. 79-342] confuses economic conditions affecting property owners with economic factors affecting the value of property," and as such K.S.A. 1979 Supp. 79-342 was unconstitutional under art. 11, § 1 of the Kansas Constitution. 227 Kan. at 466, 468.

In other words, *Martin* stands for the proposition that economic conditions, such as unforeseen or heavy expenses affecting a property owner, do *not* cause such owner's ad valorem taxation to change because such circumstances do not affect the value of the owner's real property. Conversely, an economic factor that *actually changes* the value of an owner's real property properly alters the owner's ad valorem taxation rate. Thus, Kansas Star's reliance on *Martin* is misplaced because the management contract creates precisely the hypothetical situation that would necessitate a change in an owner's ad valorem tax rate under *Martin*: a literal change in the value of the Subject Property.

The change in the Subject Property's value due to the management contract is evident because Kansas Star willingly and in the competitive free market paid $16,931,250, which is far more than market value of the surrounding tracts that were not eligible for casino development. The added value of the Subject Property, while undoubtedly caused by KELA and the management contract, does not represent value that is separate from the Subject Property's property value and exempt from ad valorem taxation.

2. *COTA did not err in including the $5.3 million option acquisition payment on the Gerlach tract as part of the value of the Subject Property*

Next, Kansas Star contends that the $5.3 million paid to Foxwoods to acquire the Gerlach tract purchase option should not have been included in COTA's valuation of the

Subject Property. Specifically, Kansas Star argues that the $5.3 million should have been excluded from the Subject Property's value because (1) the entire portion of the $5.3 million had not been paid to Foxwoods by the date of valuation and (2) purchasing Foxwood's option also served to remove Foxwoods as a potential gaming facility manager competitor, meaning the $5.3 million was consideration for more than just the value of the Gerlach tract option.

The County answers this argument by correctly pointing out that Kansas law requires the fee simple interest in a property be valued for the purposes of ad valorem taxation. *In re Equalization Appeal of Prieb Properties*, 47 Kan. App. 2d 122, 132, 275 P.3d 56 (2012). A fee simple interest is "'[a]bsolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat.' [Citation omitted.]" 47 Kan. App. 2d at 130.

Thus, COTA properly recognized that in order for Kansas Star to acquire the requisite fee simple interest in the Gerlach tract, it had to pay $3,631,250 to purchase the tract itself and $5.3 million to acquire the option held by Foxwoods. Without buying the option, there would have been an encumbrance on the Gerlach tract, and Kansas Star would not have possessed a fee simple interest.

Kansas Star's arguments do not alter this conclusion. Although Kansas Star's obligation to pay Foxwoods $5.3 million had not fully matured at the time of the land valuation, this does not change the fact that Kansas Star and Foxwoods determined in an open and competitive market that Foxwood's property interest in the Gerlach tract was worth $5.3 million. As previously discussed, in this situation the price paid for the Subject Land was a proper proxy for determining the value of the land for ad valorem taxation.

Additionally, we are unpersuaded by Kansas Star's argument that the entire $5 .3 million paid for the Gerlach option should not have been included in COTA's valuation of the Subject Property because the transaction simultaneously removed Foxwoods as a competitor as Kansas Star has not met its burden of proof . It is possible that Kansas Star paid an inflated price for Foxwood's option in order to mle out Foxwoods as a potential facility gaming manager, meaning the consideration paid for the option itself and the actual value of the Gerlach tract was lower than COTA's appraisal . However, as COTA accurately noted, "[n]othing in the option assignment documentation suggests the $5,300,000 was consideration for non-competition and nothing in the documentation prevented [] Foxwoods from presenting an alternative proposal to the State of Kansas at some other site ." COTA also correctly explained that Kansas Star did not present documentation or evidence establishing what portion of the $5 .3 million was attributable to noncompetition . It is Kansas Star's burden to prove COTA erred, and it has not done so with the evidence it provided. See K.S.A. 2014 Supp. *77-621(a)(l), Mlano's* Inc., 296 Kan. at 500 .

3. *COTA did not err in determining Kansas Star did notpurchase the Subject Properly under undue compulsion*

Kansas Star next argues that COTA erred in determining that no undue compulsion existed in the acquisition of the Subj ect Property . Elaborating, Kansas Star explains that once it had been awarded the management contract it had tvvo choices: (1) sacrifice a lucrative management contract or (2) buy the Subject Properly at an excessively high price . Kansas Star proceeds to analogize its purchase of the Subj ect Property to a distressed sale involving a seller in financial difficulty . Kansas Star cites no legal authority to support this argument .

In Kansas, "'[f] air market value' means the amount 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 that the parties are acting without *undue compulsion ."* (Emphasis added .) *Sunflower Racing, Inc . v. Board of Wyandotte County Comm'rs,* 256 K an . 426, 444, 885 P .2d 1233 (1994), see K .S.A. 2014 Supp . 79-503a. K ansas has not statutorily defined "compulsion," so we instead rely on the term's plain meaning. See *Moser v. Kansas Dept. ofRevenue,* 289 Kan. 513, 516, 213 P.3d 1061 (2009).

COTA defined "compulsion" as follows:

> "Black's Law Dictionary 305 (8th ed . 2004) defines 'compulsion' as '[t]he act of compelling, the state of being compelled,' '[a]n uncontrollable inclination to do something' or '[o]bjective necessity, duress .' Black's Law Dictionary 300 (8th ed . 2004) defines 'compel' as '[t]o cause or bring about by force, threats, or overwhelming pressure .' Black's Law Dictionary 542 (8th ed . 2004) defines 'duress' broadly as 'a threat ofharm made to compel a person to do something against his or her will or judgment ."'

K ansas Star's argument entirely ignores that it entered into the options for the Subj ect Property voluntarily in an open and competitive market . There is no evidence in the record indicating K ansas Star was forced to pay a certain price for the W yant and Gerlach tracts, nor is there any indication K ansas Star was somehow forced to exercise its options for the W yant and Gerlach tracts after being awarded the management contract . W e agree with COTA that K ansas Star was not acting under undue compulsion when it purchased the Subj ect Property .

4. *COTA did not err when it determined tNe Subject Property contained no excess land*

COTA determined the portion of the Subj ect Property that was formerly the W yant tract was not excess land because (1) the tract contained ingress and egress roads that connected the Subj ect Property to U .S. Highway 81 and K ansas Highway 53, (2) the

evidence suggested the Wyant tract was necessary for drainage, (3) the Wyant tract was capable of development of casino-related amenities, and (4) Kansas Star paid $8 million for the Wyant tract, leading to the inference that the land was required for casino development .

Kansas Star takes issue with COTA's determination because the Wyant tract is not being used for casino development and, if Kansas Star desired, could be sold. Kansas Star minimizes the presence of the Wyant tract's ingress and egress roads by pointing out that the Gerlach tract has highway access to Highway 81 and the Kansas Tumpike. Further, the Wyant tract's drainage capabilities, according to Kansas Star, are irrelevant because there is little evidence in the record establishing whether the Wyant tract was necessary for the Gerlach tract's drainage. Finally, Kansas Star points out that 195 acres, the total area of the Subj ect Property, is not necessary for operation of a casino . Aside from citing a secondary source, Kansas Star again provides no legal support for its argument.

The County responds by citing the testimony of Kansas Star's expert, Goldsborough, who testified that the roads on the Wyant tract were used for ingress and egress, meaning there was evidence in the record that the Wyant tract was not excess land. It also cites evidence in the record that the Wyant tract is required for drainage . A reasonable person could agree that the Wyant tract serves the Gerlach tract in both capacities, meaning COTA possessed sufficient evidence for its determination . See *In re Protests 0/"Oak/till Land* Co., 46 Kan . App. 2d 1105, 1114, 269 P .3d 876 (2012) .

Even if COTA erred in valuing the Wyant and Gerlach tracts together, this error would be harmless because the Wyant tract would have been valued at $8 million regardless of whether it was assessed simultaneously with the Gerlach tract . As previously discussed, the unique situation presented by KELA and the management contract meant that prices of surrounding land parcels were not an appropriate measure of land value, rather, the actual price paid for the Wyant tract was the proper measure of

land value in this situation . As the Wyant tract would have been properly valued at $8 million regardless of whether it was assessed together or separately from the Gerlach tract, we need not provide a remedy for the harmless error . See *Sierra Club,* 298 Kan. at 47.

DID COTA ERR In RELYn~1G on JORTBURG'S APPRAISAL?

Kansas Star next asks this court to reverse COTA on the grounds that COTA erroneously relied on Jortburg's appraisal of the Subject Property . According to Kansas Star, COTA acted in error because Jortburg's land appraisal was unsupported by the record and did not conform to the Uniform Standards of Professional Appraisal Practice (2012-2013 ed.) (USPAP), meaning it should have been wholly disregarded . Specifically, Kansas Star asserts that Jortburg's appraiser violated USPAP Standards Rules l-l, 1-4, and 2-1 .

USPAP Standards Rule 1-1 requires appraisers to "employ those recognized methods and techniques that are necessary to produce a credible appraisal, . . . not commit a substantial error of omission or commission, . . . and not render appraisal services in a careless or negligent manner . . . that, although individually might not significantly affect the results of an appraisal, in the aggregate affects the credibility of those results ." Standards Rule 1-4 requires appraisers to "collect, verify, and analyze all information necessary for credible assignment results ." Finally, Standards Rule 2-1 requires that appraisers report their findings and assumptions clearly and accurately in a manner not misleading .

Because the USPAP Standards are embodied in the statutory scheme of valuation through K.S.A. 2014 Supp. 79-505 and K.S.A. 79-506, an erroneous determination that an appraisal adhered to USPAP would be considered an error of law . See *In re Protests of*

City of Hutchinson/Dillon Stores for Taxes Paid in 2001 and 2002, 42 Kan. App. 2d 881, 891-92, 221 P.3d 598 (2009).

In *Board of Saline County Comm'rs v. Jensen*, 32 Kan. App. 2d 730, 736, 88 P.3d 242, *rev. denied* 278 Kan. 843 (2004), this court held that the Board of Tax Appeals (renamed COTA at the time of this appeal) may not rely on an approach to value that is expressly prohibited by USPAP. However, USPAP violations that are not "materially detrimental" to an appraiser's overall opinion of value are not fatal to a county's case. See *In re Equalization Proceeding of Amoco Production Co.*, 33 Kan. App. 2d 329, 337, 102 P.3d 1176 (2004), *rev. denied* 279 Kan. 1006 (2005); *In re Equalization Appeal of Prieb Properties, L.L.C.*, No. 2004-3806-EQ, 2007 WL 5005139, at *5 (Kan. Bd. Tax. App. 2007).

Jortburg's alleged errors fall into two groups: (1) those COTA relied upon in valuing the Subject Property and (2) those COTA expressly rejected or ignored.

First, Kansas Star argues that Jortburg's appraisal did not comply with USPAP Standards 1-1 and 1-4 because his cost analysis failed to exclude land value that was actually attributable to the management contract. COTA specifically cited Jortburg's appraisal in determining the Subject Property was worth $16,931,259. However, as explained, COTA properly valued the Subject Property without reducing its value due to the management contract. Thus, Jortburg's conclusion—that the $16,931,259 Kansas Star paid for the Subject Property was for the land only and was not consideration for the management contract—was not a violation of USPAP because his conclusion was adequately explained and correct.

Second, Kansas Star complains of various errors in Jortburg's appraisal that were either expressly rejected or ignored by COTA. Kansas Star maintains that although these errors did not affect COTA's ultimate decision, they are errors nonetheless because they

are contrary to USPAP, therefore invalidating Jortburg's *entire* appraisal report and necessitating a remand.

COTA is not required to wholly reject an appraisal that contains non-USPAP compliant errors that are not materially detrimental. See *In re Amoco*, 33 Kan. App. 2d at 337. Rather, such errors in an appraisal go to the weight of the evidence, not the evidence's admissibility. *In re Prieb Properties*, 2007 WL 5005139, at *5. As COTA relied on portions of Jortburg's appraisal that were accurate and USPAP compliant to reach a well-reasoned and correct conclusion, we find Jortburg's appraisal was not materially flawed.

Even assuming Jortburg's appraisal was otherwise non-USPAP compliant in the manner claimed by Kansas Star, such deficiencies could not have harmed Kansas Star because COTA rejected or ignored those portions of Jortburg's appraisal. For instance, Kansas Star claims that Jortburg's appraisal erroneously included $9 million in off-site utilities, yet this conclusion was rejected by COTA and the $9 million was not included in COTA's ultimate valuation. Therefore, even if Jortburg's appraisal contained errors sufficient to invalidate it, we need not order a remand because COTA's error was harmless. See *Sierra Club*, 298 Kan. at 47.

DID COTA UNDERVALUE THE SUBJECT PROPERTY?

In its cross-appeal, the County argues COTA undervalued the Subject Property. The County asserts that COTA erred by (1) finding that the marquee sign was personal property that could not be included in its valuation, (2) failing to treat costs associated with the rental of KRGC trailers as soft or indirect costs in determining the replacement cost of the improvements, (3) failing to treat the additional $1.6 million in organizational costs as soft costs in determining the replacement cost of the improvements, and (4)

failing to treat the additional $3.1 million in financing costs as soft costs in determining the replacement cost of the improvements. We will assess each argument in order.

A. *COTA correctly concluded Kansas Star's marquee sign was personal property*

The County contends COTA erred in determining the marquee sign was not real property subject to *ad valorem* taxation. For support, the County principally points to Jortburg's testimony that the marquee sign was attached firmly to the ground, would cause damage if removed, would be expensive to replace, adds value to the operation of the casino, and was integral to the casino facilities. It also relies on testimony from Cooper and Goldsborough that the sign would direct traffic to the facility, would require significant effort and funds to replace if removed, and was so big it could be seen from great distance.

Kansas Star counters with two arguments: first, it asserts that the Property Valuation Division (PVD) of the Kansas Department of Revenue, which promulgates rules and regulations binding on county appraisers pursuant to K.S.A. 79-1456, has stated that the following categories are personal property: "Sign-Business (attached to building)," "Sign (free standing)," and "Sign-Advertising (billboard)." It also claims that PVD has never categorized any form of commercial signage as real property. Accordingly, based on the PVD's classification of commercial signs, Kansas Star argues COTA properly determined that its marquee sign was personal property.

Second, Kansas Star makes the better argument that the County did not meet its burden of proof with respect to the classification of the marquee sign. We agree. The County bears the burden of proving the appropriate classification of the marquee sign as either personal or real property. See *In re Camp Timberlake, LLC*, No. 111,273, 2015 WL 249846, at *6-7 (Kan. App. 2015) (unpublished opinion). While the guidelines cited by Kansas Star above stress that the determination of whether property is real or personal

must be made on a case by case basis, the guidelines also state that an appraiser must be faced with a "unique situation or property" to deviate from the guide and use the three-pronged fixture test. That test under Kansas law for determining whether an asset is real or personal property was explained in *In re Equalization Appeals of Total Petroleum, Inc.*, 28 Kan. App. 2d 295, 299-300, 16 P.3d 981 (2000): "[T]he test for determining whether personal property becomes a fixture is: '(1) annexation to the realty; (2) adaptation to the use of that part of the realty with which it is attached; and (3) the intention of the party making the annexation.' [Citations omitted.]" After examining the record, we must agree with COTA that the County failed to provide sufficient evidence to carry its burden of proof on this point. Unlike in *Total Petroleum*, which contained numerous and detailed facts describing the construction of the fixtures at issue, here the County points only to testimony that is largely conclusory in nature. Therefore, we will not disturb COTA's finding that the marquee sign was personal property.

B. *COTA correctly concluded the rental of trailers for the KRGC was not a soft cost*

Second, the County argues that the $20,000 cost associated with trailer rentals for the KRGC is a soft cost because Kansas Star, pursuant to the management contract, was required to accommodate KRGC employees during the construction process. In the context of real estate appraisal, "soft costs" or indirect costs are "[e]xpenditures or allowances for items other than labor and materials that are necessary for construction but are not typically part of the construction contract." The Appraisal of Real Estate, Appraisal Institute, 386 (13th ed. 2008).

Kansas Star responds that although it was obligated to accommodate KRGC employees through trailer rentals during the construction process, these employees were not necessary for the construction of the casino. For support, Kansas Star cites Cooper's testimony that the KRGC employees were not involved in any way with the construction. Although the KRGC employees' presence was necessary for licensing and approval of

vendors, this requirement related to the management contract, not the construction of the casino itself. As such, COTA was correct in determining that the $20,000 for the trailer rentals was not a soft cost subject to ad valorem taxation.

C. *COTA correctly concluded the $1.6 million in organizational, administrative, and legal costs was not a soft cost*

Third, the County argues COTA erred in concluding that $1.6 million cost in organizational, administrative, and legal expenses was not included as soft costs for the Subject Property. For support, the County cites Jortburg's testimony that this cost "reflect[ed] the cost to the owner/developer to manage the development process" and "if those organizational fees weren't spent . . . you really wouldn't have completed a project."

Cooper, however, testified that the $1.6 million was for business start-up and preopening expenses, such as "regulatory fees, preopening payroll, preopening marketing, preopening training and the uniforms that our employees would wear once we opened up." He also testified that none of these expenses were construction-related. Based on Cooper's testimony, we agree with COTA that the $1.6 million was not a soft cost.

D. *COTA correctly concluded that the financing costs were not soft costs*

Fourth, the County argues COTA erred when it concluded that financing costs totaling $3,186,685 were not soft costs. As previously explained, soft costs may include interim financing costs. But here, in determining the financing costs were not soft costs, COTA explained:

> "The County's evidence, however, for calculating the costs was flawed. The calculation did not address interest accruing only from the date of a draw and improperly assumed a

> twelve month tinancing cycle . The County presented no evidence to support the assumption that a developer, or an owner in this market, would borrow funds to construct the casino . There is no other evidence to support an appropriate amount of interim financing costs . In light of the flaws, we find the County did not present sufficient evidence to support the inclusion of this additional soft cost ."

The County explains that COTA lacked substantial evidence for its finding because Jortberg's calculations included $3,186,685 for financial costs . However, this argument confuses the County's burden ofproof . COTA excluded the financing costs from the soft costs precisely because it *lacked* substantial evidence to make that finding . Specifically, the accuracy of Jortburg's projected financing costs was called into question because Jortburg based his calculations on 12 months of financing charges as opposed to the actual 9-month production cycle . This means his projected financing costs may have been artificially inflated, resulting in COTA's determination that the County failed to accurately calculate the financing costs . Due to these circumstances, the County's argument that COTA lacked substantial evidence to exclude the financing costs as a soft cost is without merit .

Affirmed.

NOT DESIGNATED FOR PUBLICATION

No. 116,782

IN THE COURT OF APPEALS OF THE STATE OF KANSAS

In the Matter of the Equalization Appeal of
KANSAS STAR CASINO, L.L.C.
for the Year 2015 in Sumner County, Kansas.

MEMORANDUM OPINION

Appeal from the Board of Tax Appeals. Opinion filed July 20, 2018. Affirmed in part, reversed in part, and remanded with directions.

Jarrod C. Kieffer, *Lynn D. Preheim*, and *Frank W. Basgall*, of Stinson Leonard Street LLP, of Wichita, for appellant/cross-appellee Kansas Star Casino, L.L.C.

David R. Cooper and *Andrew D. Holder*, of Fisher, Patterson, Sayler & Smith, L.L.P., of Topeka, for appellee/cross-appellant Sumner County.

Before POWELL, P.J., ATCHESON and BRUNS, JJ.

POWELL, J.: In what has thus far been an annual event, Kansas Star Casino, L.L.C. (Kansas Star) once again appeals from the ruling by the Board of Tax Appeals (BOTA) which established a valuation for ad valorem tax purposes for its real property located in Sumner County, Kansas. The present appeal concerns the 2015 tax year. This court has recently considered appeals in three prior tax years. See *In re Equalization Appeal of Kansas Star Casino*, 52 Kan. App. 2d 50, 362 P.3d 1109 (2015), *rev. denied* 307 Kan. 987 (2017) (2012 tax year); *In re Equalization Appeal of Kansas Star Casino*, No. 115,587, 2018 WL 2748748 (Kan. App. 2018) (unpublished opinion) (2013 tax year); *In re Equalization Appeal of Kansas Star Casino*, No. 116,421, 2018 WL 2749734 (Kan. App. 2018) (unpublished opinion) (2014 tax year). While a number of the issues

are new, the parties continue to hotly contest BOTA's findings on points in which Kansas Star's and Sumner County's views are widely divergent.

In its latest appeal, Kansas Star complains that BOTA erred (1) by finding that the arena portion of the casino complex should be depreciated by only one-third rather than finding the arena was obsolete and (2) by classifying 12.69 acres of the property used for drainage as commercial property. Sumner County cross-appeals, arguing (1) BOTA improperly classified 63.5 acres of the property as agricultural land; (2) BOTA's land value of $76,500 per acre is not supported by substantial evidence and is unreasonable, arbitrary, and capricious; (3) BOTA's decision to apply a 35% depreciation rate is an erroneous application of the law, is not supported by substantial evidence, and is unreasonable, arbitrary, and capricious; and (4) BOTA's decision to reject the County's inclusion of a 12.5% entrepreneurial profit is not supported by the record and is unreasonable, arbitrary, and capricious. For reasons we more fully explain below, we agree with the parties that BOTA's depreciation calculation is unsupported by the record and must be reversed and remanded for reconsideration. We affirm BOTA in all other respects.

FACTUAL AND PROCEDURAL BACKGROUND

Kansas Star is one of four state-sponsored gaming enterprises in Kansas authorized under K.S.A. 74-8733 et seq., the Kansas Expanded Lottery Act (KELA), and is located in the south central gaming zone. In 2007 the Legislature passed KELA which divided the state into four gaming zones—northeast, south central, southwest, and southeast—and authorized the Kansas Lottery to operate a single gaming facility in each zone. K.S.A. 2017 Supp. 74-8734(a), (d), and (h)(19). Sedgwick County and Sumner County comprise the south central gaming zone. K.S.A. 2017 Supp. 74-8702(f). Kansas Star is the gaming facility manager for the south central gaming zone, and its casino is located on property it owns in the far northeast corner of Sumner County near the

Sedgwick County line. Kansas Star operates the gaming facility as the Kansas Star Casino and Arena Events Center.

A. *The Subject Property*

Kansas Star's gaming facility sits on two formerly separate tracts of land, referred to as the Wyant and Gerlach tracts. The property is located in the city of Mulvane in Sumner County, near the border with Sedgwick County, but the land is in a rural, mostly undeveloped area located 8 miles west of Mulvane. The property was annexed into the Mulvane city limits during the management contract bidding process so the property could be zoned for casino use. The land around the casino is sparsely populated and used mostly for farming.

Peninsula Gaming, Kansas Star's former parent company, acquired both the Wyant and Gerlach tracts in July 2010, for a total purchase price of $17 million, and then combined the tracts into a single parcel of land consisting of 201.2 acres. The site was zoned as a Planned Use Development (PUD), which allows for casino gaming. After replatting the property for purposes of the PUD, the size of the combined tract was measured to be approximately 197.5 acres. The acreage was divided by the County into two parcels: 195.31 acres as the main parcel and approximately two acres for an EMS station. The two-acre tract for the EMS station was leased to the City of Mulvane for a period of 99 years beginning in December 2011. We will refer to the main tract as comprising 195.5 acres for rounding-up purposes as has been done in previous litigation.

The 195.5 acres held by Kansas Star is more land than is necessary for the casino itself, and Kansas Star planned to use the undeveloped land for other projects. The northwest corner of the commercial-use property is largely unimproved with the exception of two driveways. At the time Kansas Star acquired the total site, it planned to use the excess land for an RV park, a maintenance building, livestock feed and supply

improvements, and other commercial development. However, those plans for future development were never realized after Kansas Star determined the market was satiated in these areas. For the 2015 tax year, Sumner County classified the entire 195.5-acre parcel as commercial and industrial.

Of the 195.5 acres of the main parcel subject to valuation, 63.5 acres were directly used for the production of agricultural crops during 2015. On December 20, 2013, Kansas Star entered into a lease agreement allowing Mark Hardison to farm approximately 63.5 acres originally planned for future development in exchange for mowing the drainage areas and $1 in consideration. Hardison planted soy beans on the leased acreage in 2014 and both soy beans and wheat in 2015. None of the 63.5 acres has been used as part of the casino operations. Because the property sits on low ground and the water table is high, two drainage areas are used as drainage wasteland for the agricultural-use acreage. The remaining 119 acres are dedicated to the casino or in support of the casino.

B. *The Arena*

Construction of Kansas Star's facility was done in three phases. During Phase 1A—December 26, 2011, to December 21, 2012—Kansas Star conducted gaming operations in a temporary casino housed in its arena while the permanent casino was being constructed. The permanent casino opened in December 2012—completing Phase 1B of the project—after which time Kansas Star began the process of converting the arena space from a temporary casino back into an arena and equine event center. The gaming floor space in the permanent casino is more than double the gaming floor space in the temporary casino.

Phase 2 of the project consisted of construction of a conference center, a maintenance building, and an open-air event pavilion which included a covered arena and 183 horse stalls. The arena building has 2,263 permanent seats with an additional 1,933

seating capacity on the lower risers. Additional seating is available for the arena floor in "concert mode," for a total seating capacity of 6,596. The first event, a concert, was held on June 29, 2013.

The arena component of the property has not proven to be profitable, and Kansas Star has concluded that the arena is fundamentally incompatible with its gaming operations. It now markets half house and smaller shows at the arena because of the losses sustained when booking full house shows. Revenue data provided in the record shows that gaming revenue decreases during large events held at the arena. High-end players are less likely to visit the casino during these events due to full parking lots, long lines, and big crowds.

Equestrian events held at the arena have typically lost more money than the concerts and other entertainment events. Dan Ihm, vice president and general manager for Kansas Star, testified that Kansas Star has hosted only nine equine events in two years because "they're just too costly." The equestrian events have a lot of expenses associated with them, and many potential clients considering the arena have thought the price was too expensive. Kansas Star is open to hosting more equine events, but it has not had success in attracting many.

Kansas Star's initial proposal called for eight buildings, consisting of six separate barn buildings with approximately 500 stalls, one indoor warm-up arena, and an outdoor practice arena. After the planned arena and equine event center proved to be unprofitable, Kansas Star negotiated with the Kansas Lottery to amend its management contract, and Phase 2 was modified to allow for the funds dedicated to that portion of the project to be shifted away from additional arena investment and toward conference space. The conference space opened in early January 2015, after the date of valuation in this case.

Kansas Star's arena is one of four arenas in the Wichita area competing in a saturated arena market and is at a competitive disadvantage due to its location. Ihm described the very competitive nature of the market and testified that the arena operated at a loss of $575,000 in 2014. However, this loss was less than projected by Kansas Star in its gaming proposal submitted during the bidding process for the casino management contract. Kansas Star projected operating loss for the arena for the first four years of operation of (1) $790,170 in 2013; (2) $711,332 in 2014; (3) $689,428 in 2015; and (4) $534,046 in 2016. Kansas Star invested approximately $20 million in Phase 2 construction but did not see any significant increase in revenue or earnings before interest, tax, depreciation, and amortization (EBITDA).

Ihm testified that if Kansas Star had not been contractually obligated by the contract and bid process to build and operate the arena, he would not have built either the equine facility or the concert venue in order to maximize the profitability of the casino. In fact, casino revenue peaked in the summer of 2013 with the "grand opening bump" but then steadily fell after that, leveling off in 2015.

C. *The Appraisals*

As it had in prior tax years, Sumner County hired Richard Jortberg, MAI, to appraise the subject property for tax year 2015. The County originally valued the property at $176.4 million based on a mass appraisal performed by Jortberg. But Jortberg later performed a full appraisal report, valuing the property at $167 million. Kansas Star appealed this value to BOTA where the County had the evidentiary burden to show the validity and correctness of its valuation of the property. See K.S.A. 2017 Supp. 79-1609. Kansas Star retained Bliss Associates appraisers Robin Marx, MAI, and Robert Jackson, a Kansas certified general appraiser, to appraise the property. Based on their report, Kansas Star asserted a value of around $76 million, including a value of $11,970 for the acreage dedicated to agricultural use.

1. *The County's appraisal expert*

Jortberg has numerous years of experience appraising casinos for the taxing authorities in Colorado, and he has appraised Kansas Star's property for the County for four years. Jortberg considered all three approaches to value—the sales comparison approach, the cost approach, and the income approach—but he concluded the cost approach was the most appropriate methodology. The cost approach has three components: (1) land value; (2) reproduction/replacement costs; and (3) depreciation.

To calculate land value, Jortberg performed a highest and best use analysis and concluded that it would be physically possible, legally permissible, financially feasible, and maximally productive to use the subject property for gaming/casino purposes, as it was the property's highest and best use, both as vacant and improved. Jortberg decided not to rely on a sales comparison approach because of a lack of comparable sales that would provide a good indication of transaction-based value.

Jortberg relied on five comparable sales to derive land value: (1) the acquisition of the Wyant tract; (2) the acquisition of the Gerlach tract; (3) the unexercised option for the nearby Storey/Mangus tract; (4) the unexercised option for the nearby Grother tract; and (5) the speculative sale of the Boot Hill Casino property in Ford County. He also reviewed land sale activities in other gaming markets. Jortberg eventually dismissed the Boot Hill sale as a valid comparison because it was a speculative sale without gaming approvals and was in a smaller market. He also dismissed the unexercised option agreements because they were in inferior locations and were acquired to forestall competition for the management contract. Jortberg ultimately concluded that the $17 million price that Kansas Star paid to acquire the property was the best evidence of its value.

Unlike in 2014, Jortberg did not adjust the land value for any market conditions in 2015

> "[b]ecause in [2014] it massively exceeded—significantly exceeded their initial proforma, and I adjusted the land value upwards. And this year, there was a drop in revenues. So they're closer to the proforma. It's inappropriate to have an increase in land value when they're achieving the results that were initially projected on that timeline."

Jortberg testified that Kansas Star's agricultural lease was not relevant to his land valuation because the predominant use of the property was casino gaming, not agriculture. Jortberg also explained that the lease could be canceled with 30 days' notice and was not a long-term encumbrance on the property. Jortberg noted that the agricultural lease did not generate any income for Kansas Star, but it might reduce costs because Hardison mowed the drainage ditches.

Jortberg determined that the entire 195.5 acres, including the mostly unused northwest tract, were necessary and important to Kansas Star because of long-term gaming potential. Jortberg explained that it benefits the casino to have land ready for additional entertainment elements. In addition, much of the unused acreage has been designated as drainage easements, which are also necessary to the property. Jortberg concluded the unused acreage was not excess land because it could be used for future expansion, and the former general manager of Kansas Star had told Jortberg that he had no intent to sell the unused acreage. Jortberg concluded the $17 million paid to acquire the subject property was the best evidence of its value. He valued the 195.5 acres at $86,957 per acre.

For the second step of the cost approach, Jortberg calculated the reproduction/ replacement cost of the subject property. Jortberg started with actual construction costs reported by Kansas Star and applied an adjustment for inflation of 3%. He then applied a

12.5% entrepreneurial incentive to the reproduction cost, which he explained was appropriate because an entrepreneur would expect to receive a profit over and above its investment costs as incentive for developing the property. He concluded that reproduction costs new were about $155.6 million.

For the final step, Jortberg considered depreciation and applied a $1.11 million allowance for physical depreciation. He calculated this amount by using the Marshall Valuation Service (MVS) curvilinear depreciation tables. He concluded the functional/economic obsolescence amounted to $3.8 million. Jortberg used the MVS curvilinear depreciation table rather than straight-line depreciation because he believed the straight-line depreciation would inaccurately reflect changes in value over time.

In analyzing functional obsolescence, Jortberg explained that functional obsolescence has two parts. First, he recognized a reduction in value of $3.8 million, derived from items torn out during the arena renovation, architectural fees that were written off, and some demolition. Second, Jortberg determined the arena was not superadequate because (1) it was built by a highly experienced professional gaming company; (2) arenas were a typical amenity for casinos; (3) studies by the developer indicated that the arena would drive visitation to the property and provide a positive economic benefit; and (4) building the arena was a legal requirement of the taxpayer's management contract. Jortberg also concluded there was no economic obsolescence because there was no evidence that the value of the property was negatively affected by external factors.

Jortberg considered but did not apply the sales comparison approach to value. When asked if he was able to find comparable sales to allow him to value the property, Jortberg responded:

> "The gaming industry is an income driven industry. It's not a sales comparison approach industry. So when you look at the sales comparison approach, look at EBITDA multipliers, . . . it's really not an estimate of value because it's not like a residential market where there are so many sales. We draw important valuation conclusions from the sales."

Jortberg also considered the income approach to value. Under this approach, he first determined Kansas Star's stabilized earnings before interest, tax, depreciation, and amortization (EBITDA) and an appropriate EBITDA multiplier range. By multiplying EBITDA and the EBITDA multipliers, Jortberg concluded that the stabilized enterprise value or going concern value fell within a range of $545 to $725 million, which he rounded to a midpoint of $630 million. Jortberg acknowledged that he was not a fan of the allocation approach in this case and he did not rely on it. He also recognized that his allocation percentages would be a bit off because he was applying typical market allocation percentages to a monopoly property, which has more-than-typical intangible value.

After reconciling his valuations, Jortberg concluded the cost approach analysis was the best indicator of value because it was based on actual costs.

2. *Kansas Star's appraisal experts*

Marx and Jackson collectively prepared an appraisal for Kansas Star on behalf of Bliss Associates. Marx had previous experience working with casino properties, and both Marx and Jackson had experience appraising special use properties. Jackson testified on behalf of Kansas Star.

In approaching the appraisal, Jackson valued the property using two extraordinary assumptions: (1) the management contract was in place and would be renewed after its expiration at the conclusion of the initial 15-year term; and (2) the management contract

was transferable to a qualified third-party purchaser with no additional privilege fee. Consistent with these assumptions, Jackson determined that the highest and best use of the property was the current use as a mixed-use gaming and entertainment development.

Like Jortberg, Jackson considered all three approaches to value but reached conclusions only in the cost and income approaches. Jackson's cost approach included a land value analysis, replacement cost analysis, and an obsolescence/depreciation analysis. Beginning with land value, Jackson looked at the five available casino-site land transactions in Kansas, consisting of sales of the Gerlach and Wyant tracts; the two tracts that comprise the Boot Hill Casino in Dodge City, Kansas; and the Hollywood Casino in Kansas City, Kansas.

Jackson valued the 119.8 acres of land at $76,500 per acre, or about $9.1 million. Jackson testified this value was reasonable in light of the Gerlach tract purchase price of $8.9 million because the improved commercial area was essentially contained within the boundaries of the former Gerlach tract. In contrast to Jortberg, Jackson did not include the land devoted to agricultural use in the $76,500 per acre figure. The stipulated value of the 63.5 acres subject to the agricultural lease was $11,970.

Jackson then estimated reproduction costs for the property's improvements, using Kansas Star's actual construction costs. Jackson found the relevant construction costs equaled $135.5 million and then adjusted those costs for inflation to estimate reproduction costs. For replacement cost new, Jackson used an inflation-adjusted reproduction cost of the improvements to the subject property—$348.90 per square foot or about $146.1 million. Jackson did not make an entrepreneurial incentive adjustment.

Jackson applied a 4% allowance for physical depreciation, noting that the subject property was 2 years old and estimated to have a 50-year economic life. Jackson concluded that replacement cost new less depreciation of the subject property was $67.3 million.

Jackson performed a combined functional and external obsolescence analysis and concluded that 52% of the real estate was obsolete due to superadequacy. In other words, $72.9 million was applied to account for the requirements of Kansas Star's license to operate the casino. As noted, Kansas Star was required to have the convention center, arena, and pavilion as part of its gaming contract. In addition, the net operating income had declined from levels achieved during the grand opening. Jackson extracted the real estate costs that were not supportive of value and deducted them as obsolescence. Jackson explained that there was a misconception that a property built by experienced developers would not have functional obsolescence soon after it is built because "[p]eople do make mistakes in every industry, and the gaming industry is no different." In this case, Jackson believed that Kansas Star's ancillary facilities were fully obsolete because they had not generated revenue sufficient to justify their construction.

Jackson determined that a 52% deduction for functional and external obsolescence was appropriate. He reached this number by finding that $70 million in improvements were attributable to the casino—about 48%—leaving 52% for ancillary facilities. Jackson found that all of the ancillary facilities were built as a required element of the Kansas Star's legal obligations under its contract and under KELA.

After combining the land value ($9.1 million) and reproduction costs less depreciation ($76.5 million), Jackson deducted an additional $497,839 in costs associated with the equine facility which was not yet complete as of the valuation date. Under the cost approach, Jackson concluded the value of the property was $76 million.

Jackson distinguished between the developed land necessary for the support of casino operations and the undeveloped land dedicated to agricultural use and drainage. Jackson classified 119 acres as developed and 76 acres as undeveloped. When asked why he included the 12.69 acres of drainage within the agricultural classification, Jackson explained:

> "[I]t's initially intended through the PUD to be part of the drainage for if they do develop that northern site. Now, they have not done that, and its current [use] is ag . . . . Per, I believe it's the PVD designations, they have within it a what's called the non-productive classification for agricultural land, and it's also called wasteland. And one of the [criteria] that they have for it is area of land that has habitual ponding or wet and is not productive. And as a result the land on the north side that is dedicated for drainage of . . . what would be the improvements if they were built is effectively considered waste or nonproductive land per the PVD classifications."

During cross-examination, Jackson acknowledged the PUD for the property specifies what the drainage easements may be used for and that in order to change its overall use, it would need to be changed by the PUD.

Jackson also performed an income approach to estimate the value of the property. Because the property is an atypical monopoly operation, the allocation approach presented unique issues. Jackson explained that the limited license monopoly created a higher EBITDA than in a typical market.

Under this approach, Jackson explained that he started with Kansas Star's projected stabilized EBITDA of $79.5 million. Next, Jackson reviewed numerous casino sales to determine an average EBITDA multiplier of 7.7%. Jackson applied a 7.7% multiplier to his industry-average $29.25 million EBITDA estimate, which led to a going concern estimate of $225 million. Jackson estimated Kansas Star's actual going concern value by multiplying the stabilized EBITDA of $79.5 million by a multiplier of 7% (the

actual indicated figure of the casino's portfolio sale), which led to a going concern estimate of $556 million. Finally, Jackson applied a 30% real estate allocation percentage to his market or typical casino figure, which generated real estate values of $67.6 million. After completing final calculations and adjustments under parallel methods, Jackson concluded values of $76.6 million under one method and $83.5 million under the other. Under the income approach, Jackson reached a final estimated value of $75.55 million.

Jackson ultimately relied on the cost approach because of the availability of actual cost information. Jackson noted that Bliss "put a heavier weight on the cost approach and relied upon it." The Bliss appraisal valued the subject property at $76 million.

Kansas Star also presented expert testimony from Cory Morowitz, a gaming consultant. Morowitz testified about the effects of the monopoly market in the south central Kansas gaming zone and on the development and value of the subject property. Specifically, Morowitz testified that the south central gaming zone was one of the few true monopoly opportunities left in the country, with modest tax rates and costs of entry. This environment allowed an operator to generate larger-than-typical profit margins. Kansas Star reaps the benefit of being close to the Wichita population but fairly far from any competitors. Because of this, Kansas Star did not need to spend a significant amount of money on marketing. Morowitz noted that Kansas Star's marketing expense was less than 5%, compared to up to 40% spent in competitive markets.

Morowitz analyzed the license fees paid by gaming operators throughout the country and concluded that the $25 million license fee charged by the State of Kansas was about $24 million less than it could have charged, so it essentially gave the companies "some money to play with in their bid." Morowitz explained that the bidders

for the south central gaming zone's management contract would have a very high rate of return because of the low license fees, the monopoly in the area, and the reasonable tax rate.

While the south central gaming zone presents an excellent opportunity, it is also somewhat limited. Morowitz testified that although the Kanas Star has the Wichita-metro area easily satiated, it has few prospects for additional revenue by drawing visitors from other areas because the closest significant population bases are already well served. Because of this, Morowitz saw no real opportunity for future development. Moreover, additional development at the site could be a potential distraction because it could take away the time and money that visitors planned to spend on gaming.

Morowitz testified that he believed Kansas Star was underutilizing the arena compared to other casinos because it typically operated at half capacity or less. However, he noted that the arena had too many seats in comparison to Kansas Star's casino capacity, which essentially crowded out gaming demand. Morowitz explained that the data indicated the arena events tended to decrease the number of more lucrative gamers in favor of casual, less lucrative gamers, resulting in a net loss in gaming revenue. Morowitz said that "the bottom line is the casino actually lost revenues on event days" so "it clearly is not working as designed." Morowitz was unable to find any evidence that Kansas Star's arena was contributing revenue or profitability to the overall operation.

D. *BOTA's Decision*

Despite applying the income approach in 2013 and 2014, BOTA reverted back to the cost approach in 2015.

In first resolving the parties' dispute regarding the classification of the real estate, BOTA determined the 63.5 acres leased to Hardison should be classified as land devoted

to agricultural use. BOTA explained: "There is no evidence that any recreational use is being made of the portions that are farmed. Mr. Hardison is farming the property by growing grain crops. The evidence does not show that it is being done for personal purposes."

BOTA rejected Kansas Star's assertion that a portion of the acreage set aside for drainage and storm water retention should also be classified as agricultural. BOTA concluded: "The Board finds that the need for these drainage areas is due to the commercial activities on the subject property, namely the buildings and parking lots. Furthermore, no agricultural activities take place on these areas. Therefore, those properties should remain classified as 'Commercial.'"

Regarding the land value of the remaining commercial acreage, BOTA acknowledged that Kansas Star paid approximately $87,000 per acre in 2011, but it adopted Jackson's per-acre figure of $76,500. BOTA found Jackson's figure to be more persuasive, reasoning:

> "Mr. Jackson also considered the same sales as Mr. Jortberg but also considered a second Dodge City sale and the sale of the property for the Hollywood Casino in Kansas City, Kansas. These sales all adjust to $76,500 per acre. The Board finds that Mr. Jackson's land value is more persuasive as it considers the sales of those properties besides the subject property and makes proper adjustments to account for differences in time, size, amenities, and location."

Applying the $76,500 per acre figure to the 132 acres classified as commercial resulted in a land value of $10.1 million.

In comparing the two appraisals, BOTA found that "Jackson's appraisal for the Taxpayer carries more weight than Mr. Jortberg's appraisal done for the County." In rejecting Jortberg's entrepreneurial profit adjustment, BOTA noted:

> "[T]he evidence does not show that if it were appropriate to include [an adjustment for entrepreneurial profit] in the first place, 12½% would be the proper figure. In this case, due to the circumstances of the subject property being a build-to-suit, owner-occupied property, any development costs are a part of the business rather than the real estate."

BOTA also adopted Jackson's physical depreciation figure of 4%, finding that it "better accounts for the age of the subject property and its economic life."

In estimating functional and economic obsolescence, BOTA was presented with two strikingly contrasting views. The County asserted the ancillary facilities suffered from no obsolescence, while Kansas Star claimed the facilities were fully obsolete. BOTA rejected both of the experts' obsolescence opinions, stating:

> "The evidence shows that the arena, convention center, and equine center do not contribute to the overall profit of the subject property. In fact, they detract from it. Therefore, some allowance should be given to account for this economic obsolescence. Mr. Jackson's report indicated that the arena was over built by two thirds; consequently, the 52% economic obsolescence figure used by Mr. Jackson, should be reduced by a third to 35%."

After accounting for depreciation, BOTA concluded the fair market value of the commercial portion of the subject property was $101.5 million as of January 1, 2015.

The County filed a motion for reconsideration, arguing (1) BOTA's decision to adopt Jackson's land value of $76,500 per acre was not supported by substantial evidence; (2) BOTA's classification of 63.5 acres of the subject property as agricultural was an error of law; and (3) BOTA's decision to apply a 35% depreciation rate constituted an error of law and was not supported by substantial evidence. The County argued that BOTA's decision was unreasonable, arbitrary, and capricious. BOTA denied reconsideration, merely noting that "no evidence or arguments are offered that would

persuade the Board that the original order should be modified or that reconsideration should be granted."

Kansas Star filed a petition for judicial review; the County filed a cross-petition.

Standards of Review

As both parties have done in the present case, a taxpayer has the right to appeal an order of BOTA by filing a petition for judicial review with the Court of Appeals or the district court under K.S.A. 2017 Supp. 74-2426(c). We review BOTA's decision in the manner prescribed by K.S.A. 77-601 et seq., the Kansas Judicial Review Act (KJRA).

K.S.A. 2017 Supp. 77-621(c) sets out eight standards under which a court shall grant relief. In this case, the parties are relying on K.S.A. 2017 Supp. 77-621(c)(4), (c)(7), and (c)(8) to support their arguments that relief should be granted.

K.S.A. 2017 Supp. 77-621(c)(4) requires a court to grant relief if the agency "erroneously interpreted or applied the law."

K.S.A. 2017 Supp. 77-621(c)(7) requires a court to grant relief if "the agency action is based on a determination of fact, made or implied by the agency, that is not supported to the appropriate standard of proof by evidence that is substantial when viewed in light of the record as a whole." K.S.A. 2017 Supp. 77-621(d) defines "in light of the record as a whole" to include the evidence both supporting and detracting from an agency's finding. A reviewing court must determine whether the evidence supporting an agency's factual findings is substantial when considered in light of all the evidence but does not reweigh evidence or engage in de novo review. K.S.A. 2017 Supp. 77-621(d); *Redd v. Kansas Truck Center*, 291 Kan. 176, 183-84, 239 P.3d 66 (2010). "Substantial competent evidence possesses both relevance and substance and provides a substantial

basis of fact from which the issues can be reasonably determined." *Frick Farm Properties v. Kansas Dept. of Agriculture*, 289 Kan. 690, 709, 216 P.3d 170 (2009).

Finally, K.S.A. 2017 Supp. 77-621(c)(8) requires a court to grant relief if BOTA's "action is otherwise unreasonable, arbitrary or capricious." The burden of proving arbitrary and capricious conduct lies with the party challenging the agency's action. *Sierra Club v. Moser*, 298 Kan. 22, 47, 310 P.3d 360 (2013).

While the County bore the burden of proof before BOTA under K.S.A. 2017 Supp. 79-1609, on appeal the burden of proving the invalidity of BOTA's actions is on the party asserting the invalidity. K.S.A. 2017 Supp. 77-621(a)(1); *In re Equalization Appeal of Wagner*, 304 Kan. 587, 597, 372 P.3d 1226 (2016). When reviewing an agency action as set forth in K.S.A. 2017 Supp. 77-621(c), we take into account the rule of harmless error. K.S.A. 2017 Supp. 77-621(e); *Sierra Club*, 298 Kan. at 47.

Tax statutes are to be construed strictly in favor of the taxpayer. *In re Tax Appeal of Harbour Brothers Constr. Co.*, 256 Kan. 216, 223, 883 P.2d 1194 (1994); *In re Tax Protest of Jones*, 52 Kan. App. 2d 393, 396, 367 P.3d 306 (2016), *rev. denied* 305 Kan. 1252 (2017). Interpretation of a statute is a question of law over which appellate courts have unlimited review. *Unruh v. Purina Mills*, 289 Kan. 1185, 1193, 221 P.3d 1130 (2009). In making the unlimited review of a Kansas statute, no deference is given to the agency's interpretation. See *Douglas v. Ad Astra Information Systems*, 296 Kan. 552, 559, 293 P.3d 723 (2013); *Ft. Hays St. Univ. v. University Ch., Am. Ass'n of Univ. Profs.*, 290 Kan. 446, Syl. ¶ 2, 228 P.3d 403 (2010). This ruling has been specifically applied to decisions of BOTA. See *In re Tax Exemption Application of Kouri Place*, 44 Kan. App. 2d 467, 472, 239 P.3d 96 (2010).

When determining the validity of an assessment of the valuation of real property for uniformity and equality in the distribution of taxation burdens, the essential question

is whether the standards prescribed in K.S.A. 2017 Supp. 79-503a have been considered and applied by taxing officials. *Krueger v. Board of Woodson County Comm'rs*, 31 Kan. App. 2d 698, 702-03, 71 P.3d 1167 (2003), *aff'd* 277 Kan. 486, 85 P.3d 686 (2004).

The test for finding arbitrary and capricious conduct is determining "'whether [a] particular action should have been taken or is justified,'" such as the reasonableness of an agency's exercise of discretion in reaching a determination or whether the agency's action was without foundation in fact. *Kansas Dept. of Revenue v. Powell*, 290 Kan. 564, 569, 232 P.3d 856 (2010); *Kansas Racing Management, Inc. v. Kansas Racing Comm'n*, 244 Kan. 343, 365, 770 P.2d 423 (1989). "Flipping a coin, for example, would be incompatible with weighing of evidence or drawing conclusions necessary to support [the] decision. That would be true without regard to the soundness of the outcome, and a court would act within its authority to vacate the result as arbitrary." *R.W.D. #2 v. Board of Miami County Comm'rs*, No. 105,632, 2012 WL 309165, at *10 (Kan. App. 2012) (unpublished opinion). An order is arbitrary and capricious if it is unreasonable or without foundation in fact. *Citizens Utility Ratepayer Bd. v. Kansas Corporation Comm'n*, 47 Kan. App. 2d 1112, 1124, 284 P.3d 348 (2012).

> "A challenge under K.S.A. 2010 Supp. 77-621(c)(8) attacks the quality of the agency's reasoning. See *Kansas Dept. of Revenue v. Powell*, 290 Kan. 564, 569, 232 P.3d 856 (2010) (stating that agency may have acted arbitrarily when it fails to properly consider factors courts require it to consider to guide its discretionary decision); *Wheatland Electric Cooperative*, 46 Kan. App. 2d 746, Syl. ¶ 5 (providing factors to consider when determining whether agency acted within its discretion); Gellhorn & Levin, Administrative Law and Process in a Nutshell, p. 103 (5th ed. 2006) ('[T]he emphasis in arbitrariness review [is on] the *quality of an agency's reasoning.*')." *In re Protests of Oakhill Land Co.*, 46 Kan. App. 2d 1105, 1115, 269 P.3d 876 (2012).

General concepts of ad valorem taxation

All real and tangible personal property in Kansas is subject to taxation on a uniform and equal basis unless specifically exempted. Kan. Const. art. 11, § 1(a); K.S.A. 79-101. The Kansas Legislature has enacted a statutory scheme to ensure property is appraised for ad valorem tax purposes in a uniform and equal manner. Central to this statutory scheme is the requirement that property be appraised at fair market value as of January 1 of each taxable year, unless otherwise specified by law. K.S.A. 79-1455.

When determining ad valorem valuation, Kansas law requires valuation of the fee simple interest, which is defined as

> "'[a]bsolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat.' The Appraisal of Real Estate, p. 114 (13th ed. 2008). Stated another way, '[o]wnership of the fee simple interest is equivalent to ownership of the complete bundle of sticks [property rights] that can be privately owned.' The Appraisal of Real Estate, p. 112. . . .
>
> "Kansas tax statutes do not use the term 'fee simple'; however, it is clear that the legislative intent underlying the statutory scheme of ad valorem taxation in our State has always been to appraise the property as if in fee simple, requiring property appraisal to use market rents instead of contract rents if the rates are not equal. K.S.A. 79-501 requires that each parcel of real property be appraised for taxation purposes to determine its fair market value. In turn, K.S.A. 2010 Supp. 79-503a defines 'fair market value' as 'the 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 that the parties are acting without undue compulsion.' (Emphasis added.) It is clear, therefore, that the fair market value statute values *property* rights, not *contract* rights." *In re Equalization Appeal of Prieb Properties*, 47 Kan. App. 2d 122, 130-31, 275 P.3d 56 (2012).

The concept that Kansas law requires valuation of the fee simple interest is consistent with K.S.A. 79-102, which states: "[T]he terms 'real property,' 'real estate,' and 'land,' when used in this act, except as otherwise specifically provided, shall include not only the land itself, but all buildings, fixtures, improvements, mines, minerals, quarries, mineral springs and wells, rights and privileges appertaining thereto." This definition requires that all rights and privileges in real property are to be valued. However, "[f]or purposes of ad valorem taxation, Kansas law requires the valuation of the fee simple estate and not the leased fee interest." 47 Kan. App. 2d 122, Syl. ¶ 6.

In determining the ad valorem valuation, Kansas law assumes a hypothetical sale as of January 1 of the applicable tax year. K.S.A. 2017 Supp. 79-503a. "Each year all taxable and exempt real and tangible personal property shall be appraised by the county appraiser at its fair market value as of January 1 in accordance with K.S.A. 79-503a." K.S.A. 79-1455. As such, the Kansas statutory scheme "is a surrogate for a real marketplace event; the statute requires the appraiser to 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." *Hixon v. Lario Enterprises, Inc.*, 19 Kan. App. 2d 643, 646-47, 875 P.2d 297 (1994), *aff'd as modified* 257 Kan. 377, 892 P.2d 507 (1995). This pretend transaction is often referred to as a hypothetical sale of the subject property.

Key to determining a value for this hypothetical sale is fair market value. K.S.A. 2017 Supp. 79-503a defines fair market value and provides guidance on the factors used to determine fair market value.

> "'Fair market value' means the 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 that the parties are acting without undue compulsion. In the determination of fair market value of any real property which is subject to any special assessment, such value shall not be determined by adding the

present value of the special assessment to the sales price. For the purposes of this definition it will be assumed that consummation of a sale occurs as of January 1.

"Sales in and of themselves shall not be the sole criteria of fair market value but shall 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 taking into account all restrictions imposed by the state or federal government and local governing bodies, including, but not limited to, restrictions on property rented or leased to low income individuals and families as authorized by section 42 of the federal internal revenue code of 1986, as amended;

"(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 or rental values restricted by the state or federal government or local governing bodies, including, but not limited to, restrictions on property rented or leased to low income individuals and families, as authorized by section 42 of the federal internal revenue code of 1986, as amended;

"(i) sale value on open market with due allowance to abnormal inflationary factors influencing such values;

"(j) restrictions or requirements imposed upon the use of real estate by the state or federal government or local governing bodies, including zoning and planning boards or commissions, and including, but not limited to, restrictions or requirements imposed upon the use of real estate rented or leased to low income individuals and families, as authorized by section 42 of the federal internal revenue code of 1986, as amended; 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."

This list of factors is nonexclusive.

Fee simple interest is also to be considered in determining hypothetical conditions under which a January 1 sale would take place. The hypothetical sale must include only the sticks in the bundle of rights and may not include intangible interests or enterprise value. See K.S.A. 79-102; *In re Tax Protest of Strayer*, 239 Kan. 136, 142-43, 716 P.2d 588 (1986) (intangible property interests not taxable for property tax purposes).

Appraisals for ad valorem taxation purposes must be performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). K.S.A. 79-506(a). In addition, the ad valorem appraisal process must "conform to generally accepted appraisal procedures and standards which are consistent with the definition of fair market value unless otherwise specified by law." K.S.A. 2017 Supp. 79-503a.

DID BOTA ERR IN DEPRECIATING THE ARENA BY ONE-THIRD RATHER THAN FINDING THE ARENA WAS OBSOLETE?

Kansas Star first argues that BOTA erred as a matter of law and relied on a fact not supported by the evidence when it determined that Jackson's 52% economic obsolescence figure should be reduced by one-third to 35%. Kansas Star asserts this adjustment was unreasonable, arbitrary, and capricious. The County agrees that BOTA's depreciation analysis is unsupported by substantial competent evidence and merits reversal.

Under the third step of the cost approach, an appraiser estimates the amount of depreciation, if any, for a property's improvements. Depreciation has three primary components: (1) physical deterioration, (2) functional obsolescence; and (3) external obsolescence. The Appraisal of Real Estate, Appraisal Institute, 614 (14th ed. 2013).

Functional obsolescence can take two forms: functional inadequacy and functional superadequacy. Functional inadequacy is a deficiency in the structure,

materials, or design of an improvement, such as too few bathrooms in a residence or low warehouse ceiling heights. The Appraisal of Real Estate, Appraisal Institute, 623 (14th ed. 2013). Functional superadequacy is "some aspect of the subject property [that] exceeds market norms" or special features built to the owner's specifications that "would not appeal to the market in general," such as an expensive in-ground swimming pool in a low-cost neighborhood or a warehouse building with excess office space. The Appraisal of Real Estate, Appraisal Institute, 623 (14th ed. 2013).

Even though the parties agree that BOTA erred on this issue, Kansas Star and the County have polar opposite views about whether the improvements on Kansas Star's property are superadequate. As in prior years, the County asserts that the subject property suffers from no superadequacy, while in contrast Kansas Star argues that the ancillary facilities are 100% superadequate because they do not generate revenue sufficient to justify their construction.

"Superadequacy" is some aspect of the property that exceeds market norms, such as "special features . . . that would not appeal to the market in general." The Appraisal of Real Estate, Appraisal Institute, 623 (14th ed. 2013). The Appraisal Institute advises as follows:

> "A superadequacy is a type of functional obsolescence caused by something in the subject property that exceeds market requirements but does not contribute to value an amount equal to its cost. The superadequacy may have a cost to carry (i.e., higher operating costs) that must be considered. A superadequacy is only curable if it can be removed and value is added (or costs reduced) to the property . . . by its removal." The Appraisal of Real Estate, Appraisal Institute, 624 (14th ed. 2013).

Kansas Star points to an example of superadequacy in The Appraisal of Real Estate and likens its arena to a swimming pool at an apartment complex that costs $5,000 a year to maintain but for which the apartment complex receives no additional rent. But

the County points out that the flaw in this argument is that the apartment complex is not legally required to have a pool. Here, the removal of the arena would violate KELA and Kansas Star's management contract. So without the arena, Kansas Star would be putting its gaming license at risk.

K.S.A. 2017 Supp. 79-503a(j) provides that factors to be considered in assessing fair market value include "restrictions or requirements imposed upon the use of real estate by the state or federal government or local governing bodies." Because of this, the County asserts that Kansas Star's position—that a hypothetical sale between a buyer and a seller would include a 100% reduction in value for ancillary facilities that are legally required and fundamentally intertwined with the real property's value—is without merit. Kansas Star responds that it is not suggesting that the ancillary facilities should be removed but that they do not add value to the subject property.

While BOTA rejected both appraisers' depreciation analyses, it found the property suffered from some economic obsolescence and reduced Jackson's economic obsolescence figure of 52% by one-third to 35%.

Kansas Star asserts that BOTA's one-third reduction is based on an incorrect interpretation of Morowitz' testimony. The Bliss appraisal indicated that Kansas Star had 2.9 arena seats per gaming position at its casino, whereas the average for 23 other casino/arena properties was only 0.84 seats per gaming position. Morowitz' report indicated that the subject property's ratio of gaming positions to arena seats was three times higher than the average of similar casinos. But Kansas Star contends that this information was only the first step of Morowitz' analysis and this evidence is not synonymous with a conclusion that the arena is only two-thirds overbuilt. Kansas Star asserts BOTA erred by taking the additional step and reducing the award by one-third when the evidence does not support such a conclusion.

The County suggests that BOTA's conclusion is not USPAP compliant. "Each parcel of real property shall be appraised at its fair market value in money, the value thereof to be determined by the appraiser from actual view and inspection of the property." K.S.A. 79-501. "The appraisal process utilized in the valuation of all real and tangible personal property for ad valorem tax purposes shall conform to generally accepted appraisal procedures and standards which are consistent with the definition of fair market value unless otherwise specified by law." K.S.A. 2017 Supp. 79-503a.

"K.S.A. 79-505 and K.S.A. 79-506 require that appraisal practice be governed by [USPAP]. These standards are embodied in the statutory scheme of valuation, and a failure . . . to adhere to them may constitute a deviation from a prescribed procedure or an error of law. [Citations omitted.]" *In re Tax Appeal of Brocato*, 46 Kan. App. 2d 722, 727, 277 P.3d 1135 (2011). USPAP requires that an appraiser "be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal." USPAP, Standard 1-1(a).

The County asserts that if either party had suggested that superadequacy could be measured by comparing seats-per-gaming position, then that methodology would have been challenged as a violation of USPAP. As a previous panel of this court determined, BOTA must also comply with USPAP: "[USPAP] standards are embodied in the statutory scheme of valuation, and a failure by BOTA to adhere to them may constitute a deviation from a prescribed procedure or an error of law." *Board of Saline County Comm'rs v. Jensen*, 32 Kan. App. 2d 730, 735, 88 P.3d 242 (2004).

Our role is not to reweigh evidence. Findings that are supported by substantial evidence will be upheld even though evidence in the record would have supported contrary findings. *Chowning v. Cannon Valley Woodwork, Inc.*, 32 Kan. App. 2d 982, 987, 93 P.3d 1210 (2004). But BOTA's factual findings must have support in the record.

BOTA's conclusion that the arena was two-thirds overbuilt is not supported by the evidence. The Bliss appraisal concluded that the arena was 100% obsolete because it contributed no value to the overall property. But BOTA referred to "Mr. Jackson's report" in concluding that the arena was overbuilt by two-thirds. Neither party disputes that this was an error in fact. The only evidence that the arena was two-thirds overbuilt was from Morowitz, who stated in his report that the size of the Kansas Star Arena "is inappropriate relative to its casino and hotel operations" and "as much as two-thirds of the arena's capacity may not be needed or is functionally obsolete." As explained by Kansas Star, this was only the first step Morowitz took in his analysis, not his final conclusion.

More important than the factual error, there was no evidence that BOTA's methodology of comparing Kansas Star's seats-per-gaming position to casino/arena gaming enterprises in competitive markets was an appropriate method for measuring depreciation. In calculating depreciation for functional obsolescence, the Appraisal Institute provides a five-step formula: (1) identify the cost of the existing item; (2) deduct depreciation previously charged; (3) if functional obsolescence is curable, add up all of the costs associated with curing the item, and if incurable, add value of the loss; (4) if curable, subtract cost of the proper item if included in new construction, and if incurable, subtract depreciated cost of the proper item if included in new construction; (5) add up all the entries to derive the total functional obsolescence attributable to each factor. The Appraisal of Real Estate, Appraisal Institute, 627 (14th ed. 2013). Both parties presented competing evidence about calculating depreciation. Morowitz' stand-alone option that the arena was two-thirds overbuilt is a fact that appears in the record, but merely reducing the economic obsolescence figure by one-third is not an accepted method of calculating functional obsolescence. BOTA's decision to rely on a single data point in its calculations ignores the record as a whole and does not comply with approved appraisal practices.

BOTA's conclusion that Jackson's 52% economic obsolescence figure should be reduced by one-third is not supported by evidence that is substantial when considering the record as a whole. Further, BOTA misapplied the law when it failed to comply with USPAP in calculating functional obsolescence. Because of these errors, BOTA's decision was unreasonable, arbitrary, and capricious and must be reversed. The parties provide extensive support for their competing positions in their briefs and ask us to adopt their position on functional obsolescence; however, it is not our role to calculate functional obsolescence. Rather, remand to BOTA for further proceedings is appropriate. Given the opposite conclusions each side advocates and BOTA's attempt to choose a middle ground, we emphasize that our holding does not compel BOTA to adopt one of the party's positions and that a figure somewhere in between 100 percent and 0 percent might be supported by the record in this case. On remand, BOTA would have to explain its rationale for supporting a figure in between the parties' positions; it would have to point to evidence in the record supporting its figure; and its rationale would have to be USPAP compliant.

DID BOTA ERR IN CLASSIFYING 12.69 ACRES OF DRAINAGE AREA AS COMMERCIAL AND INDUSTRIAL?

Next, Kansas Star argues that BOTA improperly classified 12.69 acres of drainage as commercial and industrial, claiming the drainage area serves the agricultural land, not the casino. This dispute is significant because Kansas taxes land classified as devoted to agricultural use at a lower rate than land classified as commercial and industrial.

The Kansas Constitution provides for seven classes of real property: residential, agricultural, vacant lots, real property owned and operated by a not-for-profit, public utility, commercial and industrial, and other. Kan. Const. art. 11, § 1. Classification determines the assessment rate and, for land devoted to agricultural use, valuation methodology. The Kansas Constitution provides:

> "Land devoted to agricultural use may be defined by law and valued for ad valorem tax purposes upon the basis of its agricultural income or agricultural productivity, actual or potential, and when so valued such land shall be assessed at the same percent of value and taxed at the same rate as real property subject to the provisions of section 1 of this article." Kan. Const. art. 11, § 12.

All nonagricultural land is valued at fair market value as defined in K.S.A. 2017 Supp. 79-503a, but land devoted to agricultural use is valued according to an income-based formula. K.S.A. 2017 Supp. 79-1439; K.S.A. 2017 Supp. 79-1476. Accordingly, whether land is devoted to agricultural use is a question of statutory interpretation over which we exercise unlimited review. *Unruh*, 289 Kan. at 1193.

Under K.S.A. 2017 Supp. 79-1439(b), taxing authorities are required to classify real property as one of seven classes and then assess taxes at a percentage specified by the statute. The burden of proof to establish proper classification of the subject property lies with the County. K.S.A. 2017 Supp. 79-1609.

In *In re Equalization Appeal of Camp Timberlake*, No. 111,273, 2015 WL 249846, (Kan. App. 2015) (unpublished opinion), the taxpayer argued that Johnson County erroneously classified his property as commercial instead of agricultural. On appeal, the *Camp Timberlake* panel held that the county had the initial statutory burden to prove the valuation of the property as commercial property, but the party asserting a different classification must come forward with evidence supporting its position. 2015 WL 249846, at *6-8. The panel also distinguished between the burden of proof of the classification of the property and the burden of production of affirmatively arguing for a different classification.

> "'The burden of proof is not to be confused with the burden of going forward with the evidence. The burden of proof is always on the party asserting an affirmative of an issue and remains with him throughout the trial. Even though it may be incumbent upon the

> other party to proceed with the introduction of evidence at some stage of the proceedings, the burden of going forward with the evidence does not change the burden of proving a disputed issue.' [*Jenson*,] 205 Kan. at 467." *Camp Timberlake*, 2015 WL 249846, at *8.

Kansas Star bears this burden here.

Of the total acreage of the 195.5-acre tract, approximately 41.64 acres are set aside for drainage. Kansas Star agrees that about 28.95 of the drainages acres were properly classified as commercial property but contends the remaining 12.69 acres should have been classified as land devoted to agricultural use. The County classified the entire 195.5-acre parcel as commercial and industrial for tax year 2015.

BOTA considered the land used for drainage and storm water retention and concluded: "The Board finds that the need for these drainage areas is due to the commercial activities on the subject property, namely the buildings and parking lots. Furthermore, no agricultural activities take place on those areas. Therefore, those properties should remain classified as 'Commercial.'"

K.S.A. 2017 Supp. 79-1476 defines "land devoted to agricultural use" as "land, regardless of whether it is located in the unincorporated area of the county or within the corporate limits of a city, which is devoted to the production of plants, animals or horticultural products." There is no minimum size requirement or a requirement of a profit. *Board of Johnson County Comm'rs v. Smith*, 18 Kan. App. 2d 662, 666, 857 P.2d 1386 (1993). The use of the surrounding properties is not relevant. 18 Kan. App. 2d at 667.

Kansas Star concedes that the 12.69 acres are not used for farming. But it relies on a June 30, 1998 Division of Property Valuation (DPV) memorandum indicating that the

drainage should have been classified as nonproductive agricultural waste. However, the DPV memorandum relied on by Kansas Star was superseded by a later DPV memorandum issued on December 17, 2013, which clarified that "[w]aste is only appropriate within the classification of land devoted to agricultural use."

The County points to a May 15, 2013 DPV memorandum as additional support for its position that the land was properly classified as commercial. The DPV memorandum, titled "Classification of Non-Productive Land within a Single Agricultural Operation," addressed the issue of proper classification for nonproductive areas of a tract predominantly used for agriculture: "The non-use of a portion of a commercial building does not lead to a mixed-use classification, even though the non-used area can be clearly identified." The County extends this reasoning and argues that the 12.69 acres of drainage do not have to actively serve a commercial purpose in order to be classified as commercial.

Kansas Star points to evidence in the record about the slope of the property and information as to how the water drains. But the fact remains that the 12.69 acres are part of the commercial tract, not the tract leased for agricultural purposes. The County presented evidence of a casino operating on the portion of the property containing the drainage areas. Even though Kansas Star presented evidence that drainage came from the property subject to agricultural use, the County is not required to assign separate property classifications for portions of a property primarily used for commercial and industrial purposes.

Because the 12.69 acres of drainage is not part of the acreage leased for agricultural use, BOTA's conclusion that it should be classified as commercial and industrial is supported by substantial competent evidence.

DID BOTA ERR IN CLASSIFYING 63.5 ACRES AS AGRICULTURAL?

The County argues that BOTA misapplied Kansas law by classifying 63.5 acres of the property as land devoted for agricultural use. It is undisputed that the 63.5 acres were leased to a farmer before the date of valuation, and he grew crops on the land in the year prior to and on the date of valuation. BOTA ruled that the acreage was properly classified as land devoted to agricultural use and appraised its value as $11,970 as stipulated to by the parties. Again, this dispute is significant because land classified as agricultural is taxed at a lower rate than land classified as commercial and industrial.

Real property is classified according to its use on January 1 of each year. For land devoted to agricultural use which has seasonal uses, the classification should be based annually upon the overall use during the prior year or operating period. See K.S.A. 2017 Supp. 79-1476; DPV Directive #99-038.

Under the Kansas Constitution, "[l]and devoted to agricultural use" is valued based on income production rather than the price a willing buyer would pay a willing seller (fair market value). Kan. Const. art. 11, § 1(a). However, the Kansas Constitution gave the Legislature the power to define what constitutes land devoted to agricultural use. Kan. Const. art. 11, § 12. The Legislature has defined agricultural land as land "devoted to the production of plants, animals or horticultural products." K.S.A. 2017 Supp. 79-1476. In interpreting the Legislature's use of the word "production," this court has concluded that the term "certainly suggest[s] that some activity must be taking place. The constitutional provision speaks of land *devoted* to agricultural use, and the statute speaks of land devoted to the *production* of agricultural goods." *In re Protests of Oakhill Land Co.*, 46 Kan. App. 2d 1105, 1115-16, 269 P.3d 876 (2012); see Kan. Const. art. 11, § 1(a); *In re Equalization Tax Appeal of Miami County Appraiser*, No. 106,659, 2012 WL 2149829, at *1 (Kan. App. 2012) (unpublished opinion).

In 1995, the Legislature specifically exempted from the definition of "land devoted to agricultural use"

> "those lands which are used for recreational purposes, other than that land established as a controlled shooting area pursuant to K.S.A. 32-943, and amendments thereto, which shall be deemed to be land devoted to agricultural use, suburban residential acreages, rural home sites or farm home sites and yard plots whose primary function is for residential or recreational purposes even though such properties may produce or maintain some of those plants or animals listed in the foregoing definition." K.S.A. 1995 Supp. 79-1476.

BOTA rejected the County's assertion that this exception applied to the leased acreage because there was no evidence that any recreational use was being made of the portions that were farmed.

The County identifies two cases in support of its position that BOTA erred in its ruling. First, in *In re Tax Protest of Jones*, 52 Kan. App. 2d 393, 367 P.3d 306 (2016), a taxpayer sought review of a BOTA decision upholding the County's residential classification of his entire 10.4-acre property that consisted of a residence and 9 acres used for growing hay. The taxpayer argued that pursuant to the applicable DPV directives, the County was required to separately classify the portions of the property that were put to different uses. The *Jones* panel disagreed, noting that regardless of DPV directives to the contrary, "K.S.A. 2013 Supp. 79-1476 specifically *excludes* from an agricultural classification suburban residential acreages or rural home sites . . . which have as their primary function a residential purpose." 52 Kan. App. 2d at 398.

Second, in *Flint Oak Ranch v. Elk County Comm'rs*, No. 72,316, unpublished opinion filed August 25, 1995, another panel of this court considered whether a portion of the taxpayer's 2,800-acre commercial hunting resort—used for raising game birds and growing grain to feed the birds—should have been separately classified as agricultural.

The panel concluded that it should not be classified as agricultural because K.S.A. 79-1476

> "clearly states that land is not devoted to agricultural use if it is 'used for recreational purposes' and its 'primary function is for . . . recreational purposes even though such properties may produce or maintain some of those plants or animals listed in the foregoing definition.' The language of the statute definitively excludes land whose primary function is recreational although the land is also used for agricultural pursuits." Slip op. at 6.

The County here asserts that—like the hunting resort in *Flint Oak Ranch*—there is no genuine dispute that the primary function of the 195.5-acre tract is commercial gaming, a recreational activity.

Kansas Star counters that these cases are distinguishable because the exception applies only when the uses are intermingled rather than distinct. In both *Jones* and *Flint Oak Ranch*, the properties had overlapping and intermingled uses. Here, the 63.5 acres devoted to agricultural use is separate and distinct from the acreage supporting the casino. Hardison has the sole legal right to occupy and farm the 63.5 acres. Kansas Star also relies on *Smith*, 18 Kan. App. 2d at 671, where a panel of this court held that commercial land developers were legally entitled to segment portions of their land and devote them to agricultural use even if the sole purpose of doing so was to reduce their property taxes.

We agree with Kansas Star on this point. The County seems to view the entire 195.5-acre tract as a whole and fails to recognize that a portion of the property has been leased. Kansas Star asserts the County has "skipped the general rule for mixed-use property classification and jumped right to the exception." DPV Directive #99-038 provides that property with multiple uses should be classified according to each use, but the directive also allows for an exception where such uses "are so intermingled as to defy

classifying identifiable, physical portions of the property." In that case, the predominant use dictates the classification of the intermingled use.

Parenthetically, we note that the Legislature modified K.S.A. 79-1476 subsequent to *Jones*. The statute now allows portions of suburban residential acreages, rural home sites, or farm home sites to be given a mixed-use classification and requires a county appraiser to determine the amount of the parcel which is used for agricultural purposes and value such parcel as land devoted to agricultural use. L. 2016, ch. 112, § 17. This further bolsters our view that unless a portion of the land devoted to agricultural use is so intermingled with some other use, that portion of the property can be taxed at the agricultural use value rate.

Here, the land does not have an intermingled use. The 63.5 acres leased for agricultural purposes are separate, distinct, and easily identifiable from the tract devoted to commercial use. The County appraiser, Cindy Magill, agreed that the 63.5 acres of leased land was devoted to agricultural use in 2014 and as of January 1, 2015. Magill was not aware of any gaming activity occurring on the farmed acreage.

Magill also agreed that a single tax parcel can have more than one use, and she agreed that the commercial and agricultural use areas of the subject property can be individually identified. Moreover, Magill conceded that her office classified other tax parcels in the county with mixed commercial and agricultural classifications when those pursuits were distinguishable. Multiple examples of such properties were identified during her testimony. For example, Magill acknowledged one instance where a company operates an elevator and farm ground on a 60.7-acre tract. In that case, 33.5 acres relating to the grain elevator are classified as commercial, while the remaining 27.2 acres are classified as agricultural. Magill admitted that more than half of this tract was predominantly commercial, but she assigned a mixed-use classification anyway.

The entire 195.5 acres of the property has a mixed use, and 63.5 acres are easily identifiable as land devoted to agricultural use. BOTA did not err in so classifying those acres.

DID BOTA ERR IN VALUING THE LAND AT $76,500 PER ACRE?

The County argues that BOTA's land value of $76,500 per acre is not supported by substantial competent evidence in light of the record as a whole and is unreasonable, arbitrary, and capricious. The County focuses on two assertions: (1) BOTA's stated rationale in support of its conclusion is arbitrary; and (2) BOTA should have adopted the land purchase price as the only evidence of value. Kansas Star responds that the County is merely asking us to reweigh the evidence in its favor. We agree with Kansas Star.

The County's expert, Jortberg, testified that the $17 million purchase price—$86,957 per acre—was the best evidence of land value. Conversely, Kansas Star's expert, Jackson, separately valued the section of property he determined was for gaming purposes and considered the necessity of various adjustments such as market conditions, location, and utilities. Jackson asserted a land value of $76,500 per acre.

BOTA found Jackson's analysis more persuasive than Jortberg's, in part because Jackson considered a second Dodge City sale and the sale of the property for the Hollywood Casino in Kansas City. The County claims that neither of these transactions were arm's length transactions and points out that Jackson testified he did not emphasize either transaction in his analysis. The County also points to evidence distinguishing the Dodge City sale as comparable and asserts that the County's reasoning in adopting Jackson's conclusion was arbitrary and capricious.

"An agency's action is arbitrary and capricious if it is unreasonable, without foundation in fact, not supported by substantial evidence, or without adequate

determining principles." *Denning v. Johnson County Sheriff's Civil Service Board*, 46 Kan. App. 2d 688, 701, 266 P.3d 557 (2011), *aff'd* 299 Kan. 1070, 329 P.3d 440 (2014). The County does not dispute the fact that there is evidence in the record supporting Jackson's conclusion; rather, it attacks the credibility of that determination.

The County also criticizes BOTA's finding that Jackson's land value analysis was more persuasive because he made the proper adjustments to account for differences in time, size, amenities, and location. The County argues that BOTA's reliance on this fact was in error because Jackson's land value conclusion was based only on a 119.8-acre tract—he did not include the 12.69 acres of drainage area he thought should have been classified as agricultural—and not BOTA's 132 acres of commercial land.

Kansas Star counters that we should reject the County's criticism. First, the change from 119.8 acres to 132 acres is de minimus and would not have affected Jackson's adjustments. And even if adjustments were made, Kansas Star claims it would have resulted in a lower per-acre value because larger tracts tend to sell for less per acre. Thus, the effect would have been a lower overall price per acre for the subject property. There is no evidence cited by Kansas Star supporting this argument, but it seems reasonable that the change in per-acre value would be minimal.

Ultimately, we are unpersuaded by the County's arguments that BOTA's decision was unreasonable, arbitrary, or capricious. BOTA's land value conclusion of $76,500 per acre is supported by substantial evidence in the record. Any adjustment due to the classification of the drainage area as commercial property would have been insignificant.

DID BOTA ERR IN ADOPTING A 35% DEPRECIATION RATE?

The County also argues, but for different reasons, that BOTA's depreciation calculation is unsupported by evidence in the record as a whole. The County's position is

the extreme opposite of that of Kansas Star and asserts that the property suffers from no functional obsolescence—in this instance superadequacy—because KELA and the gaming contract entered into by Kansas Star require an arena and the other supporting facilities. As we have already explained in our analysis of Kansas Star's complaint on BOTA's treatment of depreciation—that depreciation should be at 100%—BOTA's decision is unsupported by the record as a whole. Remand is appropriate on this issue.

DID BOTA ERR BY REJECTING THE COUNTY'S INCLUSION OF 12.5% ENTREPRENEURIAL PROFIT?

Finally, the County argues BOTA erred by rejecting the 12.5% entrepreneurial profit Jortberg included in calculating the replacement cost when new.

Entrepreneurial incentive is "the amount an entrepreneur expects or wants to receive as compensation for providing coordination and expertise and assuming the risks associated with the development of a project." The Appraisal of Real Estate, Appraisal Institute, 573 (14th ed. 2013). In explaining the concept of entrepreneurial incentive, the Appraisal Institute has stated that "any building project will include an economic reward (above and beyond direct and indirect costs) sufficient to convince an entrepreneur to take on the risk associated with that project in the market." The Appraisal of Real Estate, Appraisal Institute, 573 (14th ed. 2013). When using the cost approach of appraisal, the Appraisal Institute references a need to estimate "the current cost to construct a reproduction of (or replacement for) the existing structure, including an entrepreneurial incentive or profit." The Appraisal of Real Estate, Appraisal Institute, 562 (14th ed. 2013).

BOTA rejected the County's 12.5% entrepreneurial profit figure, explaining that "due to the circumstances of the subject property being a build-to-suit, owner-occupied

property, any development costs are a part of the business rather than the real estate." BOTA also noted the evidence did not support Jortberg's figure.

The County notes the Appraisal Institute advises:

> "Some appraisers also observe that entrepreneurial profit often represents a theoretical profit in build-to-suit, owner-occupied properties. The owner-occupant may consider any additional operating profit due to the property's efficient design to be an incentive. However, the entrepreneurial profit might only be realized years after the property is built when it sells to a similar owner-occupant at a premium because the property is suitable and immediately available, unlike new construction or conversion of a different property." The Appraisal of Real Estate, Appraisal Institute, 575 (14th ed. 2013).

In other words, entrepreneurial incentive is not realized upon the sale of property if the building value does not exceed the cost.

Jackson testified that even if entrepreneurial incentive were expected and added to reproduction cost, it had to be tested for depreciation and obsolescence. He explained:

> "[E]ntrepreneurial profit is earned after the completion of the construction is done. And at that point if you have obsolescence, well, then now you have a property that is obsolete where it's not worth as much as the construction cost. So the first dollar of entrepreneurial profit would immediately be wiped out if there's any obsolescence present because that is indicative of the fact that the value is less than the cost to construct."

The County admits that Jortberg did not include specific data corroborating his conclusion that a 10-15% profit range was typical and merely asserts that Kansas Star presented no evidence to the contrary. But the burden is on the County to support its value, and the County points to no evidence in the record supporting its position that BOTA erred in rejecting its 12.5% figure for entrepreneurial incentive. Therefore, the

County has failed to show that BOTA's decision is not supported by substantial evidence or is otherwise unreasonable, arbitrary, or capricious.

CONCLUSION

In conclusion, we reject virtually all of the parties' challenges to BOTA's decision and, therefore, affirm BOTA's order in almost all respects, except as to the parties' claims regarding depreciation and functional obsolescence, particularly as it relates to superadequacy. On that issue, we find that BOTA's determination to apply a 35% depreciation rate for functional obsolescence is unsupported by the evidence contained in the record as a whole. Accordingly, we reverse BOTA on its functional obsolescence calculation and remand the matter to BOTA with directions to reconsider the issue of depreciation and functional obsolescence.

BOTA's final order is affirmed in part, reversed in part, and remanded with directions.

NOT DESIGNATED FOR PUBLICATION

No. 117,406

IN THE COURT OF APPEALS OF THE STATE OF KANSAS

In the Matter of the Equalization Appeal of
KANSAS ENTERTAINMENT, L.L.C.,
for the Tax Year 2015 in Wyandotte County, Kansas.

MEMORANDUM OPINION

Appeal from the Board of Tax Appeals. Opinion filed December 21, 2018. Affirmed.

Linda Terrill, of Property Tax Law Group, LLC, of Overland Park, for appellant/cross-appellee Kansas Entertainment, L.L.C.

Jarrod C. Kieffer and *Christina J. Hansen*, of Stinson Leonard Street LLP, of Wichita, for appellee/cross-appellant Wyandotte County.

Before MCANANY, P.J., PIERRON and LEBEN, JJ.

PER CURIAM: Kansas Entertainment, L.L.C. (Taxpayer) appeals from the ruling by the Kansas Board of Tax Appeals (BOTA) establishing the ad valorem valuation of the Taxpayer's real property in Kansas City for the 2015 tax year.

The Hollywood Casino is located on the Taxpayer's property, which is situated on the edge of the Kansas Speedway. The property consists of two parcels that comprise one economic unit. The relevant valuation date is January 1, 2015. The Taxpayer sought review by BOTA under K.S.A. 2017 Supp. 79-1609.

BOTA conducted an evidentiary hearing, at which the Unified Government of Wyandotte County/Kansas City, Kansas (Unified Government) bore the burden of proof. The Unified Government claimed that the fair market value of the property was $157 million. This valuation was based on an appraisal performed by Suzanne Mellen and Shannon Okada, both appraisers for HVS Consulting and Valuation Services, an appraisal and consulting firm that caters to the hospitality industry. The Unified Government also presented testimony from Kevin Bradshaw, supervisor of the commercial real estate section in the Wyandotte County Appraiser's Office. The Taxpayer relied on the testimony of its retained valuation expert, David Lennhoff, who opined that the fair market value of the property was only $68.6 million.

Following BOTA's evidentiary hearing, BOTA determined that the income methodology was the best method to determine the value of the property. BOTA generally adopted Lennhoff's income approach, under which the total going concern was valued and then allocated to real, personal, and intangible property. But BOTA made a few changes to Lennhoff's calculations—substituting values for 2014 anticipated revenue and earnings before interest, tax, depreciation, and amortization (EBITDA)—and valued the property at $102 million. The Taxpayer's petition for judicial review and the Unified Government's cross-petition bring the matter to us.

On appeal, the Taxpayer contends that BOTA erred by modifying Lennhoff's appraisal by using values with no evidentiary support and with little explanation. The Taxpayer argues that BOTA's adjustments are not supported by substantial evidence and are therefore unreasonable, arbitrary, and capricious.

The Unified Government filed a cross-petition for review, arguing: (1) BOTA erred in holding that Lennhoff's income allocation approach was a better indicator of value than Mellen's management fee approach; and (2) BOTA erred in adopting a

valuation approach that relied on evidence that BOTA previously ruled was irrelevant and undiscoverable.

Because BOTA's decision is based on substantial competent evidence, because BOTA did not commit reversible err in adopting the methodology of the Taxpayer's expert over that of the Unified Government's expert, and because the Unified Government has failed to show that including the selling price of one particular casino owned by a Real Estate Investment Trust (REIT) in the data set of casino sales transactions significantly altered BOTA's decision, we affirm.

The Property

One of four state-sponsored gaming enterprises in Kansas authorized under the Kansas Expanded Lottery Act (KELA) is located on the property. See K.S.A. 2017 Supp. 74-8733 et seq. In 2007, the Legislature passed KELA, which divided the State into four "gaming zones"—northeast, south central, southwest, and southeast—and authorized the Kansas Lottery to operate a single gaming facility in each zone. K.S.A. 2017 Supp. 74-8734(a), (d), and (h)(17). Wyandotte County is in the northeast gaming zone. K.S.A. 2017 Supp. 74-8702(f). The State has set minimum infrastructure investment requirements for proposed casino projects. The statutorily required minimum investment in the northeast gaming zone is $225 million. K.S.A. 2017 Supp. 74-8734(g)(2). The State also required the installation of a minimum of 2,000 slot machines in the casino.

Hollywood Casino, located on 101 acres of land, opened in February 2012. The approximately 245,000-square foot building includes a Las Vegas-style casino with a 94,444-square foot gaming floor; a steak house, buffet, sports bar, mid-level restaurant, coffee shop, and VIP lounge; office and administrative space; 1,253 covered parking

spaces; and additional surface parking. The casino floor has 2,000 slot machines, 40 banked gaming tables, and 12 poker tables.

The property is situated in the Village West retail development area next to the Kansas Speedway in Kansas City. Village West is located at the intersection of I-70 and I-435 in Wyandotte County. The Kansas Speedway and the Village West development have transformed the area into a major tourist destination that attracts approximately 10 million visitors annually.

Hollywood Casino's primary competition includes four full-service riverboat casinos in the Kansas City area. Hollywood Casino's competitors have food and beverage amenities, but according to the Unified Government's expert, Hollywood Casino's restaurants are generally of higher quality. Hollywood Casino is designed to "cater to high-end players in addition to mass players." In its valuation report, HVS described Hollywood Casino as "state of the art," and offering a "sophisticated, contemporary, and inviting atmosphere."

BOTA Proceedings

1. *Suzanne Mellen, the Unified Government's appraisal expert*

Suzanne Mellen is employed by HVS as the Senior Managing Director of the Consulting and Valuation Division and President of the Gaming Services Division. Mellen has the MAI, CRE, and FRICS appraisal designations. She is also a member of the International Society of Hospitality Consultants and a fellow of the Cornell Center for Real Estate and Finance. Mellen has written and lectured on many hospitality property related topics and specializes in appraising hospitality-related assets, including hotels, casinos, resorts, and arenas. David Lennhoff, the Taxpayer's expert, recognizes Mellen as

a leading expert in the field of casino appraisal. Mellen and HVS have appraised casinos in nearly every United States jurisdiction, internationally, and for a wide variety of purposes. Shannon Okada, also an employee of HVS, helped prepare the valuation report.

Using the income approach, Mellen: (1) projected revenue and operating expenses for the property; (2) deducted a management fee to remove any intangible property value; (3) deducted a reserve for replacement to allow for a return of personal property; (4) capitalized the income stream through both (a) an earnings before interest, tax, depreciation, and amortization (EBITDA) multiplier process and (b) a 10-year discounted cash-flow analysis; and (5) subtracted the value of personal property to arrive at a real estate value of $157 million.

As a part of her analysis, Mellen forecasted nongaming revenue and expenses using the best available data in the absence of Hollywood Casino's actual financial information. She projected the casino's EBITDA would be $33,993,000 (23.2%) for 2015, $33,539,000 (22.9%) for 2016, then modestly increasing in future years, and stabilizing at a 22.7% EBITDA margin.

On this point, the Unified Government had formally requested detailed financial information for the subject property in July 2015, a year before the BOTA hearing. Following two motions to compel and several rounds of supplemental production, the Taxpayer finally produced the financial information a couple of months before the evidentiary hearing. The production of documents came too late for Mellen to prepare a revised report, but Mellen indicated that if she had received the financial information sooner, "it is highly likely that we would have forecast a higher EBITDA margin" because "the financial statements indicate that this is a more profitable operation than we had . . . forecasted in our appraisal."

In concluding her analysis, Mellen reconciled the income and cost approaches to value to arrive at a real and personal property value of $187 million. Following the management fee methodology, she reduced the real property and tangible personal property value of $187 million by approximately $30 million, resulting in a final valuation under the income approach of $157 million.

2. *David Lennhoff, the Taxpayer's appraisal expert*

Lennhoff has earned six of the seven designations offered by the Appraisal Institute and is a nationally recognized expert in the Uniform Standards of Professional Appraisal Practice (USPAP). His practice is devoted to complex appraisal issues. Some examples include being retained as a methodology expert and review appraiser of the Flight 93 crash site for condemnation; valuing the Gettysburg Tower at the Gettysburg National Battlefield Park on behalf of the Department of Justice; and appraising the Alaska Pipeline. He has experience in casino appraisal, having appraised the Kansas Star Casino twice and two other out-of-state casinos.

Like Mellen, Lennhoff chose the income approach as the best method for appraising the subject property. The income approach for a casino property combines the income and sales comparison approaches to find a value for the underlying real estate alone.

For his income approach, Lennhoff used an allocation approach in which he estimated the value of the total business enterprise and then allocated a percentage of the total value to the real property.

Lennhoff's calculation began with the subject property's 2014 total annual revenue of $143,390,489. He used this number because of his finding that the revenue "has sort of

plateaued." He conceded that Hollywood Casino showed increases of 4.86% in 2013 and 2.42% in 2014, but he weighed that against the fact that the overall Kansas City gaming revenues decreased approximately 2.7% year-over-year in both 2012-13 and 2013-14.

Next, relying on information concerning broad averages of national and international casino operators, Lennhoff estimated a market EBITDA margin of 20%.

Next, Lennhoff determined the EBITDA multiplier, which he extracted from 12 sales of casino going concerns. The EBITDA multipliers from those transactions ranged from 7.16 to 8.82, with a median of 7.68 and an average of 7.78. Lennhoff arrived at an EBITDA multiplier of 7.75 based on casino sales across the country, settling on a number roughly at the midpoint of the data set and giving the greatest weight to the most recent transactions in the industry.

Using this total annual revenue, EBITDA margin, and EBITDA multiplier, Lennhoff determined a total business enterprise value of approximately $222 million.

The final step in the income approach is to determine how much of the value of the total assets of the business is attributed to real estate and separate that value from other business assets. Lennhoff considered three sources to determine how much of the casino's value was attributable to the real estate: (1) studies of casino sales; (2) analyses of similar property types and the contribution to value made by the real estate in those situations; and (3) an analysis of 10K filings by similar businesses.

Lennhoff reviewed: (1) a study by William Kinnard regarding separating real property from the business; (2) racetrack sales with or without flagship races; and (3) purchase price allocations of casino property in transactions across the country. The study of casino property transactions showed that the real property contributed between 23%

and 38% of the total value. Lennhoff concluded that in this case 30% of a casino's value is attributable to the real property. From this he derived a real property valuation of $66.7 million.

Lennhoff then assigned an 80% weight to his income allocation approach "because it better answers the question" of how much the real estate contributes to the assets of the business. He concluded that a reconciled value of the fee simple interest in the real estate was $68.6 million.

3. *Scott Biethan, the Unified Government's appraisal review expert*

Scott Biethan, CBRE Hotels consulting and gaming services expert, conducted an appraisal review. He testified that Lennhoff's income approach was incorrectly performed for several reasons. First, Lennhoff took Hollywood Casino's 2014 revenue as the starting point for an EBITDA reconstruction and failed to account for the trend of increasing revenues:

> "The area of disagreement is that when I reviewed and looked at his report, I see that net revenues from 2012 through 2014 have been increasing and—you know, and I heard the testimony and discussion around his thoughts of the market, but there was not a—a detailed analysis of the subject property related to the market and where those revenues might be in 2015.
>
> "And, you know, as we understand, you know, buyers and [sellers] and market participants, they're really looking at a forward number, and that's very important. And when the property has been trending forward historically, the question of why you would not have considered a—a higher number on a going forward basis is a question that I didn't—that I didn't see answered nor would I agree with just leaving it flat. I would have, you know, thought there would have been a lot more consideration to growing the revenue in 2015 to use as the basis for the income approach."

Second, Biethan did not agree with the 20% EBITDA margin used by Lennhoff, noting that it jumped out at him as low and unsupported. Lennhoff selected 20% based on his review of a number of broad averages of public information regarding various gaming companies. Biethan thought Lennhoff should have gathered specific data to compare the style of casino, market conditions, and the location to support his EBITDA margin.

Finally, Biethan took issue with Lennhoff's 30% allocation to the real estate, explaining that the allocation to real estate is not widely used as a method to appraise property in the gaming industry.

4. *Projected revenue and economic concerns*

The parties disagreed about the projected revenue and economic forecast for the Hollywood Casino. The Unified Government pointed to evidence showing a projected growth in revenue. But the Taxpayer highlighted evidence showing a saturated market with little room for economic growth.

From its opening in 2012 through fiscal year 2015, this casino increased its revenue and profits each year. Moreover, its EBITDA and EBITDA margin both increased annually every year for the first three years of operation. Its fiscal year ends on June 30 each year, so fiscal year 2013 includes figures for the last half of 2012. Its actual net revenues from 2013 to 2015 are:

- $133,253,000 in 2013,
- $140,771,000 in 2014, and
- $151,453,000 in 2015.

The property had actual EBITDA margins of 29% in 2013, 31.1% in 2014, and 32.9% in 2015. The Taxpayer projected further EBITDA margins of 33.3% for 2016 through 2018.

The casino's financial data through fiscal year 2015 and projections through 2018 show that revenues were increasing and that trend was expected to continue. In a forecasted statements of operations, the Taxpayer represented the projected income of the casino as follows:

- $156,611,000 for 2016,
- $159,847,000 for 2017, and
- $161,445,000 for 2018.

Hollywood Casino's increase in revenue and projected increase contrasted with the overall Kansas City gaming market which experienced a general post-recession decline, interrupted only by a one-year increase of 7% due to the opening of the Hollywood Casino in 2012. Mellen explained that Hollywood Casino's market share had increased in a relatively saturated market by taking demand from the other casinos in the area.

In contrast, Lennhoff testified that the overall conditions for gaming on a national level are not very good, with national forecasts showing a "saturated flat" market with very little increase.

BOTA's Decision

BOTA issued a summary decision in which it found the methodology used by Lennhoff to be the best method of determining the fair market value. The Unified Government requested a full and complete opinion under K.S.A. 2017 Supp. 74-2426(a).

In the complete opinion that followed, BOTA explained that it found the Lennhoff appraisal to be the "best indicator of value as it is the best methodology presented for determination of the subject real estate value." BOTA accepted Lennhoff's EBITDA multiplier of 7.75% and his conclusion that the real estate makes up 30% of the value of the total assets of the business. But in adopting Lennhoff's approach, BOTA made two changes to Lennhoff's calculations.

First, BOTA rejected Lennhoff's forecast of net revenues and instead found Mellen's 2015 revenue estimate of $146,254,000 to be more accurate. BOTA explained: "Lennhoff failed to project any increase in the Taxpayer's total revenue. This is at odds with the Taxpayer's actual revenue that has been increasing annually. Therefore, we find Mellen's 2015 total revenue determination to be more accurate than that sponsored by Lennhoff."

Second, BOTA found Lennhoff's EBITDA margin of 20% "inconsistent" with the casino's actual performance. Mellen estimated an EBITDA margin in her 10-year discounted cash-flow approach of 27.5% to 27.9%. But Mellen testified that if she had received all of the figures requested in discovery at the time she prepared her valuation, she would have increased the EBITDA margin a little. The property had actual EBITDA margins of 29% in 2013, 31.1% in 2014, and 32.9% in 2015. BOTA placed "primary weight" on the property's actual performance and adopted an EBITDA margin of 30%.

After applying these inputs to Lennhoff's methodology, BOTA concluded the 2015 appraised value of the subject property was $102 million.

Motions for Reconsideration

The Taxpayer filed a motion for reconsideration under K.S.A. 2017 Supp. 74-2426(b). It claimed that BOTA erred in selecting "bits and pieces from the Mellen Method." It asked BOTA to reconsider and adopt Lennhoff's appraisal in full, with an appraised value of the real estate of $68.6 million.

The Unified Government also filed a motion for reconsideration, asserting that BOTA's conclusion that the Lennhoff allocation approach is the "best indicator of value" was erroneous and directly conflicted with its prior discovery ruling that sales data held by a nonparty Real Estate Investment Trust (REIT) was irrelevant to valuing the subject property.

BOTA denied both motions for reconsideration. With regard to the Unified Government's argument that BOTA's prior discovery ruling was inconsistent with its conclusion, BOTA noted that it denied the Unified Government's motion due to relevance and noted that the discovery request was directed to nonparties to this action. BOTA noted that the scope of discovery differs significantly between parties and nonparties, and the Kansas Rules of Civil Procedure do not apply to nonparties. See *In re Cusumano*, 162 F.3d 708, 717 (1st Cir. 1998); *Bio-Vita, Ltd. v. Biopure Corp.*, 138 F.R.D. 13, 17 (D. Mass. 1991).

BOTA also rejected the Taxpayer's position that it must adopt an appraisal in its entirety. BOTA reaffirmed its decision to adjust Lennhoff's method by using two figures to make an adjustment to value. It noted that BOTA is required to render decisions based on substantial competent evidence in light of the record as a whole, and it is "duty bound" to "implement warranted adjustments when supported by substantial credible evidence."

The Taxpayer filed a petition for judicial review, and the Unified Government filed a cross-petition for judicial review under K.S.A. 2017 Supp. 74-2426(c)(4)(A), which permits a review of BOTA's decision by the Court of Appeals without prior judicial review by the district court.

Standards of Review

In this review our role is not to conduct a de novo examination of the fair market value of the subject property for ad valorem tax purposes. Instead, we review BOTA's decision in the manner prescribed by the Kansas Judicial Review Act (KJRA), K.S.A. 2017 Supp. 77-601 et seq., which defines the scope of review of state agency actions. See K.S.A. 2017 Supp. 74-2426(c).

The Unified Government bears the burden of proof before BOTA under K.S.A. 2017 Supp. 79-1609. But on appeal, the burden of proving the invalidity of the agency's actions and decision is on the party asserting the invalidity. K.S.A. 2017 Supp. 77-621(a)(1); *In re Equalization Appeal of Wagner*, 304 Kan. 587, 597, 372 P.3d 1226 (2016). Further, when reviewing an agency action as set forth in K.S.A. 2017 Supp. 77-621(c), we take into account the rule of harmless error. K.S.A. 2017 Supp. 77-621(e); *Sierra Club v. Moser*, 298 Kan. 22, 47, 310 P.3d 360 (2013).

In our review, we construe tax statutes strictly in favor of the taxpayer. See *In re Tax Appeal of Harbour Brothers Constr. Co.*, 256 Kan. 216, 223, 883 P.2d 1194 (1994); *In re Tax Protest of Jones*, 52 Kan. App. 2d 393, 396, 367 P.3d 306 (2016), *rev. denied* 305 Kan. 1252 (2017). The interpretation of a statute is a question of law over which we have unlimited review. *Unruh v. Purina Mills*, 289 Kan. 1185, 1193, 221 P.3d 1130 (2009). In reviewing Kansas statutes, we no longer defer to the agency's interpretation. See *Douglas v. Ad Astra Information Systems*, 296 Kan. 552, 559, 293 P.3d 723 (2013);

In re Tax Exemption Application of Kouri Place, 44 Kan. App. 2d 467, 472, 239 P.3d 96 (2010). But this principle applies only to the interpretation of statutes.

Under K.S.A. 2017 Supp. 74-2426(c), BOTA is an agency subject to KJRA review. Under the KJRA, K.S.A. 2017 Supp. 77-621(c) sets out eight standards under which an appellate court may grant relief. In this case, the parties are relying on K.S.A. 2017 Supp. 77-621(c)(4), (c)(7), and (c)(8) to support their argument that relief should be granted. See *In re Tax Appeal of Brocato*, 46 Kan. App. 2d 722, 727, 277 P.3d 1135 (2010).

- K.S.A. 2017 Supp. 77-621(c)(4) requires us to grant relief if the agency erroneously interpreted or applied the law.

- K.S.A. 2017 Supp. 77-621(c)(7) allows us to grant relief if the agency action is based on a determination of fact, made or implied by the agency, that is not supported by evidence that is substantial when viewed in the light of the record as a whole. "[I]n light of the record as a whole" includes evidence both supporting and detracting from an agency's finding. K.S.A. 2017 Supp. 77-621(d); *Redd v. Kansas Truck Center*, 291 Kan. 176, 183-84 239 P.3d 66 (2010). To be substantial competent evidence, the evidence must provide a substantial basis in fact from which the issues can be reasonably determined. *Frick Farm Properties v. Kansas Dept. of Agriculture*, 289 Kan. 690, 709, 216 P.3d 170 (2009). To find that a decision is not supported by substantial evidence requires that the decision be "so wide of the mark as to be outside the realm of fair debate. [Citation omitted.]" *In re Equalization Appeal of Prieb Properties*, 47 Kan. App. 2d 122, 137, 275 P.3d 56 (2012). We are specifically instructed not to "reweigh the evidence or engage in de novo review." K.S.A. 2017 Supp. 77-621(d).

- Finally, K.S.A. 2017 Supp. 77-621(c)(8) requires us to grant relief if BOTA's action is otherwise unreasonable, arbitrary, or capricious.

The Taxpayer's Contentions on Appeal

The Taxpayer agrees with BOTA's decision to adopt Lennhoff's income approach methodology as the better way to arrive at a value for the subject property. But the Taxpayer argues that BOTA erred when it made two adjustments to Lennhoff's appraisal by using two different values that increased Lennhoff's estimate of value. The Taxpayer asserts this adjustment is not supported by substantial evidence and is otherwise unreasonable, arbitrary, and capricious.

BOTA found Lennhoff's income approach represented the "best indicator of value." It found Lennhoff's methodology to be "more comprehensive and compelling than that of County expert witness Suzanne [Mellen]." But BOTA made two adjustments to Lennhoff's income approach by using different values for (1) the casino's anticipated revenue and (2) its EBITDA margin.

Lennhoff used actual revenue of $143,390,489. He estimated the EBITDA margin to be 20% based on an industry-wide survey of average profits for casino operators. Finally, he extracted an EBITDA multiplier of 7.75 from a nationwide sampling of casino sales, using roughly the midpoint of the data set and giving the greatest weight to the "most recent transactions in the industry."

Both parties agree that the casino revenues and the EBITDA margin are factors to be considered when appraising the fair market value of the casino. Both appraisers use the casino's revenues as the starting point for their income approaches. The issue before

us is whether BOTA erred in modifying Lennhoff's valuation by using its own values for expected revenue and the EBITDA margin in order to reach its own valuation of the real property. BOTA explained its reasoning for these modifications:

> "In his income approach, however, Lennhoff failed to project any increase in the Taxpayer's total revenue. This is at odds with the Taxpayer's actual revenue that has been increasing annually. Therefore, we find Mellen's 2015 total revenue determination to be more accurate than that sponsored by Lennhoff. Further, Lennhoff's EBITDA margin of 20% is inconsistent with the Taxpayer's actual performance. Mellen determined an EBITDA margin in her 10 year discounted cash flower approach of 27.5% to 27.9%. Further, the subject property had an actual EBITDA margin of 31% in 2014 and 33% for 2015, with forecasted EBITDA margins of 33% for years 2016 to 2018. Giving primary weight to the subject property's actual performance, we find an EBITDA margin of 30% is in order."

The Taxpayer takes issue with BOTA's findings, noting that BOTA is charged with separately stating findings of fact, conclusions of law, and the reasons for its decision. See K.S.A. 77-526(c). But BOTA is not required to render the explanation for its findings in detail so long as the explanation is "specific enough to allow judicial review of the reasonableness of the order." *Zinke & Trumbo, Ltd. v. Kansas Corporation Comm'n*, 242 Kan. 470, 475, 749 P.2d 21 (1988); *Rhodenbaugh v. Kansas Employment Sec. Bd. of Review*, 52 Kan. App. 2d 621, 631, 372 P.3d 1252 (2016) (explaining that under K.S.A. 77-621, the court must "review the agency's explanation as to why the evidence supports its findings"), *rev. denied* 306 Kan. 1319 (2017).

BOTA did not change Lennhoff's valuation formula, it merely applied different values into the formula for projected revenue and the EBITDA multiplier. In its decision, BOTA provided a reason for each of the modifications:

- BOTA stated that it rejected Lennhoff's revenue projection of $143,390,489 because he did not account for an increase in revenue despite the fact that revenues had increased each year and were projected to increase in fiscal year 2015. Thus, BOTA found Mellen's 2015 revenue projection of $146,254,000 to be more accurate.
- BOTA adopted an EBITDA margin of 30%, which was higher than the number relied on by either appraiser. But BOTA explained that it based its number on actual and forecasted EBITDA multipliers for the Hollywood Casino.

Finding BOTA's reasoning clear, our role is to determine whether each of these modifications is supported by substantial competent evidence in the record. See *In re Tax Appeal of Dillon Stores*, 42 Kan. App. 2d 881, 891-92, 214 P.3d 707 (2009) (upholding BOTA's adjustment for freezer space/cooler space that was not accounted for in the appraisal). Our task is not to reweigh evidence. We will uphold findings that are supported by substantial evidence even though evidence in the record supports contrary findings. *Chowning v. Cannon Valley Woodwork, Inc.*, 32 Kan. App. 2d 982, 987, 93 P.3d 1210 (2004). As noted earlier, for a decision to lack substantial competent evidence, it must be "so wide of the mark as to be outside the realm of fair debate." *Dillon Stores*, 42 Kan. App. 2d at 889.

The law does not require BOTA to adopt either party's appraisal in full so long as there is evidence in the record to support BOTA's adjustments. In *Dillon Stores*, BOTA made an upward adjustment to the taxpayer's appraisal because it failed to adequately account for the value of the freezer/cooler space. A panel of this court affirmed BOTA's ruling even though the taxpayer had not asked for the adjustment, reasoning that the adjustment was derived from information contained in the record. 42 Kan. App. 2d at 888-89.

The USPAP valuation standards are a part of our statutory valuation scheme, and BOTA's failure "to adhere to them may constitute a deviation from a prescribed procedure or an error of law." *Dillon Stores*, 42 Kan. App. 2d at 890. In *In re 2013 Equalization Appeal of Kansas Star Casino*, No. 115,587, 2018 WL 2748748, at *10 (Kan. App. 2018) (unpublished opinion), the appellant complained that BOTA picked values from the competing valuation reports "without providing expert testimony to establish the proper relationship between the data points." A panel of our court concluded that BOTA was not required to adopt either party's appraisal report in full provided that any adjustment to value is supported by evidence in the record. 2018 WL 2748748, at *11.

Here, BOTA adopted Lennhoff's methodology, and neither party has effectively argued how a substitution of the two values—projected revenue and EBITDA margin—invalidated the methodology or deviated from the USPAP standards. Because there is nothing in the record to indicate—nor does either party argue—that BOTA's adjustments violated USPAP standards, we find BOTA did not err in adjusting these values provided that the adjustments are supported by substantial evidence.

BOTA found Lennhoff's projected revenue to be too low. It based its reasoning on the fact that the casino's revenue had increased every year, and Lennhoff's projected revenue did not account for an increase in revenue. Instead, BOTA adopted Mellen's 2015 projected revenue number. This modification is clearly supported by evidence in the record.

The record also supports BOTA's modification to the EBITDA margin. BOTA specifically rejected Lennhoff's EBITDA multiplier of 20% as too low because it was not consistent with the casino's actual performance. Mellen estimated the EBITDA margin to

be in the range of 27.5% to 27.9%. But Mellen did not receive all of Hollywood Casino's financial information until well after she completed her valuation report. At the hearing, Mellen testified that she would have projected a higher EBITDA margin if she had received Hollywood Casino's full financial information at the time of her valuation. She testified:

> "[T]he income and expense statements that we received of the subject property reflect a modestly higher gaming revenue that we had projected. But the most market contrast to our own projections of what the subject property—how the subject property has been performing, because we had no—really, no basis to understand exactly how this hotel is performing, that it's significantly more profitable than we had projected. We were projected at 27 percent EBITDA and this property is throwing about a 33 percent EBITDA margin, and that makes for a significant different in EBITDA and net income available to be generated by the property."

Biethan criticized Lennhoff's valuation primarily because he thought the forecasted revenue and EBITDA margin were too low. Biethan's testimony supports the adjustments that BOTA made to Lennhoff's values.

The property had actual EBITDA margins of 29% in 2013, 31.1% in 2014, and 32.9% in 2015. BOTA placed "primary weight" on the property's actual performance and adopted an EBITDA margin of 30%. This modification to the EBITDA margin is supported by evidence in the record.

In *In re 2014 Equalization Appeal of Kansas Star Casino*, No. 116,421, 2018 WL 2749734 (Kan. App. 2018) (unpublished opinion), the income allocation approach to value used by Lennhoff and approved by BOTA was the same methodology used here. A panel of this court did not explicitly rule on the methodology because it found no support for BOTA's decision to use median numbers from the information in both appraisals. The

court found BOTA's method to be its "version of splitting the baby." 2018 WL 2749734, at *19. The court rejected BOTA's figures and agreed with the Unified Government's argument that "BOTA seems to have selected figures out of thin air and provided no explanation for its 21% profit margin." 2018 WL 2749734, at *20.

In contrast, the adjustments made to Lennhoff's methodology in our present case are supported by evidence in the record. BOTA did not change Lennhoff's method. It merely used different values in the same formula relied on by Lennhoff to reach the valuation of the property. BOTA did not rely on arbitrary or median numbers to determine revenues or the EBITDA margin. Rather, the record contains substantial evidence, in light of the record as a whole, in support of BOTA's adjustments. Additionally, the parties have not shown that BOTA acted arbitrarily or unreasonably in adjusting the final valuation of the subject property.

The Unified Government's Contentions in its Cross-Appeal

In its cross-appeal, the Unified Government first argues that BOTA erred in not adopting Mellen's management fee approach over Lennhoff's approach to value.

When reviewing whether a decision by a fact-finder is supported by substantial competent evidence, we do not reweigh the evidence, pass on the credibility of witnesses, or resolve conflicts of evidence. *In re Guardianship & Conservatorship of Burrell*, 52 Kan. App. 2d 410, 419, 367 P.3d 318 (2016); see K.S.A. 2017 Supp. 77-621(d). Thus, we will uphold findings that are supported by substantial evidence even though there is evidence in the record that supports contrary findings. *Chowning*, 32 Kan. App. 2d at 987.

The Unified Government complains that BOTA adopted Lennhoff's approach without any clear rationale. But in adopting Lennhoff's approach, BOTA stated that Lennhoff's approach was "more comprehensive and compelling" than Mellen's approach. It noted that Lennhoff's income approach methodology, with warranted adjustments, was "the best indicator of value as it is the best methodology presented for determination of the subject real estate value." On appeal, the Unified Government has the burden to show that BOTA's decision to adopt Lennhoff's approach is not supported by the evidence, is contrary to law, or is arbitrary and capricious.

Both parties agree with BOTA that the primary challenge in this case "lies in properly distilling the market value for the subject real estate from the market value of the business enterprise/going concern." This is a challenging task because casinos are rarely sold as business enterprises separate and apart from the underlying real estate. Rather, they are sold as going concerns with the underlying real estate included in the sale price.

Several approaches can be used to separate intangible ongoing business values from the real and personal property values. Those approaches include: (1) the cost approach; (2) the management fee approach; (3) the market participant survey approach; and (4) the parsing of income approach. The Appraisal of Real Estate, Appraisal Institute, 711-13 (14th ed. 2013). Both parties here relied on an income approach: Mellen used the management fee approach and Lennhoff relied on the income capitalization approach. Mellen's management fee approach is known as the Rushmore model.

> "The Rushmore model is a method of valuing hotels. It was developed in Hotels and Motels: A Guide to Market Analysis, Investment Analysis, and Valuations, a book written by Stephen Rushmore, MAI, published in 1992. The book is now published by

the Appraisal Institute." *Marriott Corp. v. Board of Johnson County Comm'rs*, 25 Kan. App. 2d 840, 843, 972 P.2d 793 (1999).

The Unified Government provides two main reasons for its position that BOTA erred in adopting Lennhoff's approach: (1) Mellen's approach was superior for determining fair market value; and (2) Lennhoff's approach was flawed and required adjustments.

In support of Mellen's approach, the Unified Government claims:

- The management fee approach—which operates under a theory that the subtraction of the management fee removes all intangible value—is the generally accepted method of valuing hospitality properties among appraisers and courts;
- Lennhoff's approach is the source of much controversy, with critics asserting that Lennhoff's method is designed to minimize real estate value and lessen property tax appeals;
- Lennhoff did not use the same approach in his appraisal of the Kansas Star Casino; and
- The management fee approach is the preferred method of appraising hotel properties in Kansas.

In its appellate brief the Unified Government gives a detailed analysis of the two approaches, compares the approaches, and concludes that Mellen's approach is the superior method. In comparing Mellen's Rushmore approach to Lennhoff's approach to value, the Unified Government argues that "Rushmore developed what is now *a* widely-accepted approach for valuing the real property components of hospitality properties." (Emphasis added.) Mellen testified that her approach "has become the commonly

accepted approach" in casino valuations. According to the Unified Government, "[f]or decades, courts have recognized the Management Fee Approach as *an* accepted method for determining the fair market value of a property's real property components." (Emphasis added.) The Unified Government argues that Lennhoff's approach to value "certainly has not been endorsed as superior to the well-recognized, widespread, and longstanding Management Fee Approach for valuing hospitality properties."

While asserting the widespread popularity of the Management Fee Approach, the Unified Government does not provide us with any authority in the context of a casino valuation declaring Lennhoff's approach to be so deficient as to require reversal of a BOTA valuation decision based upon it. Our role is not to determine which approach is superior. Rather, we are limited to determining whether substantial competent evidence supports BOTA's ruling. *Chowning*, 32 Kan. App. 2d at 987.

The Unified Government relies on *Marriott Corp.* for the proposition that the Rushmore Method—used by Mellen in her appraisal—is the preferred method to determine the value of hotels in Kansas. In that case, the attack—unlike here—was on the propriety of the Rushmore Method. The court in *Marriott Corp.* recognized the Rushmore model for valuing hotels as "a valid method for determining the fair market value of the hotel in this case." 25 Kan. App. 2d 840, Syl. ¶ 4. The court did not state it is the only proper method of valuation. It did not state that it is the preferred method, as represented by the Unified Government. In fact, in arriving at its valuation in *Marriott Corp.* BOTA stated:

> "'While we find that the county's use of the Rushmore method represents the fair market value of the property in this case, we stop short of saying that the Rushmore model is THE method to value all hotels. We do find that, in this instance, however, the

> Rushmore method was supported by the county's own figures and does represent the fair market value of the subject property.'" *Marriott Corp.*, 25 Kan. App. 2d at 844.

In reaching its conclusion, the court in *Marriott Corp.* recognized it should not substitute its judgment for that of BOTA and stated there is nothing in the record "to indicate the Rushmore method was so inappropriate and so badly flawed that its use requires a reversal of the valuation of the Marriott." 25 Kan. App. 2d at 844.

The Unified Government notes that the *Marriott Corp.* court cited numerous cases outside of this jurisdiction approving of the Rushmore approach. See, e.g., *Hull Junction Holding Corp. v. Princeton*, 16 N.J. Tax 68, 84 (1996); *Prudential Ins. v. Tp. of Parsippany*, 16 N.J. Tax 58, 60 (1995). But none supports the Unified Government's position that BOTA erred in adopting Lennhoff's appraisal methodology in this case.

We find the *Marriott Corp.* holding more supportive of the Taxpayer's position rather than the Unified Government's position because it appropriately identifies the role of this court in reviewing BOTA's determination of the proper valuation method. As in *Marriott Corp.*, the party challenging BOTA's ruling has failed to show that the adopted valuation method was inappropriate or badly flawed.

The Unified Government also cites various cases in which Lennhoff's appraisals were rejected by various courts outside of this jurisdiction:

- *Vienna Metro LLC v. Bd. of Supervisors*, 86 Va. Cir. 421, at *2 (Va. Cir. 2013) (noting that Lennhoff employed adjustments in his appraisal which seriously undermine the credibility of his opinion).
- *GGP - Maine Mall, LLC v. City of South Portland* (South Portland Board of Assessment Review's Findings of Fact and Conclusions of Law on

Petitions for Tax Abatement, August 17, 2011) (the Board notes that other jurisdictions have expressed misgivings about Lennhoff's Business Evaluation Approach).

- *RRI Acquisition Co., Inc. v. Supervisor of Assessments of Howard County*, No. 03-RP-HO-0055, 2006 WL 925212, at *6 (Md. Tax 2006) (court rejects Lennhoff's impermissible adjustments to the Rushmore approach).
- *Chesapeake Hotel LP v. Saddle Brook Tp.*, 22 N.J. Tax 525, 532-33 (2005) (Lennhoff's proposed adjustments are not persuasive).
- Tennessee State Board of Equalization's Initial Decision and Order in *In re Wolf-chase Galleria Ltd. Partnership* for Tax Years 2001, 2002, and 2003 (August 26, 2003 and March 16, 2005) (ALJ finds that Rushmore persuasively argues that Lennhoff's methodology for separating the real property from the hotel's value understates the value of the real property).
- *Merle Hay Mall v. Board of Review*, 564 N.W.2d 419, 424 (Iowa 1997) (business enterprise value theory is not a generally recognized appraisal method).

But none of these cases shows that Lennhoff's methodology or approach in this case was flawed. They are all fact-specific and none involves the valuation of real estate underlying a casino. Both parties agree that Lennhoff is widely accepted as an appraisal expert regarding special use properties. The Unified Government merely asserts that its expert is superior.

The Unified Government attacks Lennhoff's approach as a violation of Kansas law, asserting that it fails to take into account any of the specific aspects of the real estate. See K.S.A. 2017 Supp. 79-503a (definition of fair market value includes a list of factors that should be considered in valuing property, including the size of land, improvements,

and the effect of location on value). The Unified Government asserts that Lennhoff's approach fails to take into account improvements, amenities, or location. The Unified Government further complains that Lennhoff failed to conduct any market participant interviews. See The Appraisal of Real Estate, Appraisal Institute, 712-13 (14th ed. 2013) (in valuing specific property types, appraisers may interview market participants to ascertain how buyers and sellers of the properties valued or allocated intangible assets in pricing decisions). And the Unified Government claims that by failing to conduct the interviews, Lennhoff ignored a whole category of insightful information. Finally, the Unified Government attacks the Kinnard Study that Lennhoff relies on in conducting his market study analysis.

This comprehensive attack to Lennhoff's approach illustrates why our court's role on appeal is limited. With a broader standard of review, parties could endlessly pick apart every aspect of a methodology or the specific data relied on by the appraiser to reach his or her conclusions as to value. Despite all of this information, we find the Unified Government has failed to show that BOTA's decision is not supported by the evidence, is contrary to law, or is arbitrary or capricious. Lennhoff's methodology was accepted by BOTA as a credible and comprehensive approach to value in this case, and the Unified Government has failed to show otherwise. Our role is not to reweigh the evidence.

Finally, the Unified Government argues that BOTA erred in adopting Lennhoff's valuation approach because it relied on evidence that BOTA had determined to be irrelevant and nondiscoverable.

In its discovery request, which BOTA denied, the Unified Government sought sales and lease information from Penn National Gaming—an out-of-state nonparty—about real estate transactions relating to Penn's casino properties held by Gaming and Leisure Properties, Inc. in a publicly traded REIT. Penn is a publicly traded Pennsylvania

corporation and is "several layers beyond any direct joint venture equity ownership of [Kansas Entertainment]."

- One of Penn's many subsidiaries is Penn Tenant, LLC, a Pennsylvania limited liability company.
- One of Penn Tennant's many subsidiaries is Delvest, LLC, a Delaware limited liability company.
- One of Delvest's many subsidiaries is PHKI.
- PHKI owns 50% of the Taxpayer, Kansas Entertainment.
- Kansas Entertainment owns the Hollywood Casino at the Kansas Speedway.

The Unified Government argued that the sought-after information included relevant sales data of the real estate component of casinos that would assist the Unified Government in establishing the value of the Taxpayer's property. Neither the Taxpayer nor either of its joint venture owners has an interest in the REIT. The requested documents were in the sole possession of Penn, and the Taxpayer did not have a right to demand them. The Taxpayer argued that the sales data from Penn's REIT-owned properties were not relevant to the valuation issue.

BOTA denied the Unified Government's discovery request for two reasons: (1) that valuation of other properties owned by the Taxpayer's parent corporation or subsidiaries was not relevant to the valuation of the subject property; and (2) the discovery request attempted to obtain documents from nonparties not involved in the joint venture. BOTA's order on the Unified Government's second motion to compel states:

> "The Board finds that the request made of the Taxpayer is overly broad and that nothing is presented to show that the valuation of other properties owned by the parent

> corporations or subsidiaries of the subject property's owners are relevant to the valuation of the subject property. In addition, the Unified Government's discovery request attempts to obtain documents from non-parties.
>
> . . . .
>
> "Here, the Unified Government is seeking information from entities that are not part of the joint venture which includes the subject property."

BOTA concluded that the sales information about Penn's REIT-owned properties was irrelevant in the valuation of the Taxpayer's property, and the Unified Government claims it relied on this ruling in proceeding to the hearing.

As part of Lennhoff's income approach, he estimated the business enterprise value of Hollywood Casino using "broad averages of national and international casino operators." Lennhoff then evaluated the percentage of the property allocated to real estate—i.e., the percentage of the total enterprise value that is typically real estate. In determining the allocation percentage applicable to the subject property, Lennhoff relied primarily on casino sales to arrive at an allocation of 30%. BOTA adopted this conclusion. In relying on sales from across the country, Lennhoff included one property that was sold to Penn and later transferred to Penn's REIT.

As a preliminary matter, the Unified Government fails to show how this issue was preserved for appeal. Because this is an evidentiary matter, the Unified Government was required to state its objection on the record to the complained-of evidence. If no objection was made, then this issue has not been preserved for appeal. K.S.A. 60-404 generally precludes an appellate court from reviewing an evidentiary challenge absent a timely and specific objection made on the record. *Foster v. Stonebridge Life Ins. Co.*, 50 Kan. App. 2d 1, 25, 327 P.3d 1014 (2012). We find this evidentiary issue was not properly preserved because the Unified Government failed to make a specific objection to the admission of Lennhoff's appraisal based on the discovery ruling.

Even so, the Unified Government has failed to show reversible error. The scope of discovery differs significantly between parties and nonparties. The relevance standard of Kansas Rules of Civil Procedure is not the sole measure of discovery requests to nonparties. See *Bio-Vita, Ltd.*, 138 F.R.D. at 17. "To obtain discovery from nonparties, a party must establish that its need for discovery outweighs the nonparty's interest in nondisclosure." 138 F.R.D. at 17; see *In re Cusumano*, 162 F.3d at 717 ("Although discovery is by definition invasive, parties to a lawsuit must accept its travails as a natural concomitant of modern civil litigation. Non-parties have a different set of expectations. Accordingly, concern for the unwanted burden thrust upon nonparties is a factor entitled to special weight in evaluating the balance of competing needs.").

Here, Lennhoff apparently considered one sale that might have been discoverable in the Unified Government's discovery request. But in looking at the record as a whole, we fail to see—and the Unified Government fails to explain—how considering this one transaction had any significant effect on Lennhoff's valuation of the Taxpayer's property. When reviewing an agency action under K.S.A. 2017 Supp. 77-621(c), we take into account the rule of harmless error. K.S.A. 2017 Supp. 77-621(e); *Sierra Club*, 298 Kan. at 47. The Unified Government does not explain how Lennhoff considering this one sale among all the others affected BOTA's valuation decision.

The information regarding the REIT-owned casino was used to calculate the portion of the purchase price that was allocated to the real estate. Lennhoff's allocation conclusion was based on the average of numerous casinos. The evidence in this case consisted of hundreds of pages of appraisals and exhibits, as well as about 900 pages of testimony. The fact that the selling price of one REIT-owned casino made it into the data set is harmless without a showing that it significantly altered the results. Here, the Unified Government contends that its trial strategy would have changed if it had that

information, but it does not show that it was prejudiced by the inclusion of the number in Lennhoff's appraisal. Any error was harmless.

Affirmed.