No. 18-119438-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

BRIEF OF APPELLEE AND BRIEF OF CROSS-APPELLANT

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

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ORAL ARGUMENT REQUESTED

30 MINUTES

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NATURE OF THE CASE

This is property tax dispute. The subject property is the Kansas Star Casino, a gaming and entertainment development located in Sumner County, Kansas. The tax years at issues are 2016 and 2017. Sumner County valued the property at $170 million for tax year 2016 and $171 million for 2017. Appellant valued the property at $77,600,000 for 2016 and $77,650,000 for 2017. As has been its practice in the tax appeals involving this property, BOTA adopted neither value, and instead assigned values of $102,659,000 for 2016 and $102,609,000 for 2017. Appellant now appeals certain aspects of BOTA's ruling, while Sumner County cross-appeals others.

STATEMENT OF THE ARGUMENT

BOTA's analysis in this case adopts the logic and reasoning BOTA previously applied in its decision involving the same parties in tax year 2015. This Court has already found, in *In re Kansas Star Casino, L.L.C. for Tax Year 2015*, 2018 WL 3486173, *1 (Kan. Ct. App. 2018) (unpublished) ("*Kansas Star 2015*"), that BOTA's analysis does not comport with USPAP and is unsupported by substantial competent evidence. Accordingly, this case presents a rare instance in which both Appellant and Appellee agree that BOTA's decision must be reversed.

STATEMENT OF THE ISSUES

I. BOTA's depreciation analysis does not comport with USPAP, is unsupported by substantial, competent evidence and should be reversed.

II. Appellant's claim that the ancillary facilities are 100 percent superadequate is erroneous and should not be adopted.

STATEMENT OF FACTS

Appellant's factual description of the subject property is accurate. Sumner County generally agrees with Appellant's chronological description of the timeline of events related to this property, and therefore endeavors not to repeat undisputed facts, and only to provide pertinent supplementary facts, or evidence about which the parties disagree.

I. The Kansas Expanded Lottery Act

Under KELA, the four gaming zones are generally subject to the same requirements, although the south central (Sumner and Sedgwick County) and northeast (Wyandotte County) zones required a $225 million minimum investment in infrastructure, whereas the southeast (Crawford and Cherokee County) and southwest (Ford County) gaming zones required only a $50 million minimum investment. K.S.A. 74-8734(g)(2).

II. Bids for the south central gaming zone's management contract.

The Kansas Expanded Lottery Act ("KELA") split the State of Kansas into four "gaming zones," and allowed the Kansas Lottery ("the Lottery") to operate one "lottery gaming facility"[1] in each zone. K.S.A. 74-8734(a). Under KELA, the Lottery is allowed to enter into "management contracts" with private entities to construct and manage the State's facilities. K.S.A. 74-8734(a), (d). However, these contracts "place full, complete and ultimate ownership and operational control of the gaming operation … with the Kansas lottery." K.S.A. 74-8734(h)(17). All contracts are required to include terms and conditions for "ancillary lottery gaming facility operations," K.S.A. 74-8734(h)(7), defined to mean "additional non-lottery facility game products and services … [which] may include, but are not limited to, restaurants, hotels, motels, museums, or entertainment facility." K.S.A. 74-8702(a). Additionally, the Lottery is the licensee and owner of all software programs associated with lottery facility games, and all such games are subject to the ultimate control of the Lottery. K.S.A. 74-8734(n)(1), (2).

The south central gaming zone's management contract was subject to three separate competitive rounds of bidding. R. Vol. 1, p. 157, Joint Stipulated Facts ¶¶ 13, 14. In the first round, the Lottery approved prospective contracts with (1) Harrah's, (2) Penn National, and (3) Marvel

[1]A "lottery gaming facility" is "that 'portion of a building used for the purposes of operating, managing and maintaining lottery facility games." K.S.A. 74-9702(j).

Gaming. R. Vol. LV, Ex. 120. All three bids included substantial non-gaming amenities.

The Harrah's bid included (1) a convention center, (2) two entertainment venues, including an outdoor amphitheater with 778 seats and room for 5,000 people to stand, (3) an 18-hole golf course; and (4) retail outlets. *Id.* at pp. 4479-80. The Penn National bid included (1) a multi-purpose entertainment venue for live concerts, sporting events, trade shows, banquets, and conventions, with a 1,750 person seating capacity; (2) a 4,000 meeting/banquet space; (3) a spa / fitness center; (4) a pool with a Las Vegas-style cabana deck; and (5) a retail center / Hollywood memorabilia museum. *See id.* at pp. 4497-98. The Marvel Gaming bid included (1) a 40,000 square foot multi-use entertainment venue / convention center, with seating for 2,000 and a conference/meeting center; (2) a health club; (3) indoor and outdoor pools; (4) tennis courts; (5) an off-site guided hunting facility and lodge; (6) a $2.3 million dollar investment in the Wellington Golf Club; and (7) a 10,000 square foot retail center, with at least four retail outlets. *See id.* at pp. 4514-15. Ultimately, the Lottery Gaming Facility Review Board ("LGFRB") selected the Harrah's bid. However, Harrah's subsequently withdrew the bid because of the financial recession. R. Vol. 1, p. 157, Joint Stipulated Fact ¶ 14.

In the second round of bidding, the Lottery approved one contract, with Foxwoods Development, for a casino called the "Chisolm Creek Casino Resort." R. Vol. 1, p. 157, Joint Stipulated Fact ¶ 14. This proposal included a 20,000 foot multi-purpose meeting and entertainment venue, capable of seating 1,200 guests. R. Vol. VII, Ex. 549, pp. 1453-54. Ultimately, however, the Chisolm Creek group withdrew its bid before it could be considered by the LGFRB. R. Vol. 1, p. 157, Joint Stipulated Fact ¶ 14.

In Round 3, the Lottery approved two contracts—one from Peninsula Gaming ("Peninsula"), Apellant's former parent company, and one from Global Gaming. *Id.* at Joint

Stipulated Fact ¶ 14. The competing proposal included:

Peninsula (Kansas Star)	**Global Gaming/Winspirit**
Proposed casino with 1,850 gaming machines, 42 table games, and a 5-table poker room Amenities and ancillary facilities to include 4,200 seat arena/events center with associated equestrian event facilities, 22,000 sf of additional enclosed event space and a 20,000 sf lighted outdoor event arena.	Proposed casino with 1,550 gaming machines and 30 tables Amenities and ancillary facilities to include proposed 320-acre racetrack circuit and renovation of local golf course, 1,400 seat entertainment venue, 8,000 sf convention/meeting space.

Id. at p. 158, Joint Stipulated Fact ¶ 15.

As part of the bidding process, Peninsula hired Crossroads Consulting to analyze its bid and outline the "key objective" of "the potential of the proposed gaming project to draw visitors from beyond a 100-mile radius" and to "create unique synergies among [the project's] elements to promote the State's efforts to further tourism and generate economic activity." R. Vol. XVI, Ex. 649, pp. 8661, 8666. Crossroads estimated the Kansas Star equine/rodeo complex would host approximately 26 to 31 events a year, spanning between 99 to 117 event days per year. *Id.* at 8699. Of these events days, Crossroads estimated 25 to 30 days would be dedicated to "Level 1" events, defined as "regional or national championships that are estimated to average approximately five event days." *Id.* Additionally, the report estimated 48 to 54 event days per year would be dedicated to "Level 2" events, defined as "events which are more moderately sized and average approximately three event days." *Id.* Finally, the report estimated approximately 2-3 event days a year would be dedicated to concerts or festivals, and another 6-8 event days would be dedicated to consumer/expo shows. *Id.*

Peninsula also hired Cory Morowitz to prepare a market study for its proposal. R. Vol. XVI, Ex. 648, p. 8656. Based on the arena/equine center usage projected by Crossroads, Morowitz

projected Kansas Star could see incremental gaming revenue from arena events of $9.3 million by 2016 and $10.13 million by 2018. *See id.* at p. 8656-8657.

The State hired Macomber International to evaluate the parties' competing proposals. In a memo submitted the LGFRB, Macomber noted:

> "I am a little bit confused why there are concerns raised regarding profitability of [the proposed equine events] center. Entertainment and multi-use centers typically do not operate at a profit. They operate at a breakeven level or as a loss leader, the cost of which his considered by most managers/owners to be a marketing tool."

R. Vol. XX, Ex. 694.035, p. 6229. Macomber also noted that in the pro forma Peninsula submitted during the bidding process, it projected the arena as a stand-one entity would sustain operating losses ranging from $790,170 in 2013 to $534,046 in 2016. *See id*; *see also*, R. Vol. X, Ex. 616, p. 88.

III. Bidding for the south central gaming zone's management contract.

Ultimately, the KRGC approved the LGRFB's decision to award Peninsula the management contract. R. Vol. 1, p. 157, Joint Stipulated Fact ¶ 17. The contract between the State and Peninsula is part of the record. R. Vol. X, Ex. 610. KELA requires Kansas Star to pay 22 percent of all gaming revenue to the State, 2 percent to the problem gaming and additions fund, 2 percent to Sumner County, and 1 percent to Sedgwick County. *See* K.S.A. 74-8734(h)(11), (12), (16). Pursuant to § 23 of the contract, Kansas Star must turn over all gaming revenue to the Lottery, daily. *See* R. Vol. X, Ex. 610, p. 15. The State then pays Peninsula its specified percentage of the gaming revenues, no less than on a monthly basis. *See id.* at p. 16, § 26.

Section 14 required Peninsula to "diligently construct the building and related improvements for its Ancillary Lottery Gaming Facility Operations substantially in accordance with [its] Application for Lottery Gaming Facility Manager … . and [its] representations to the Kansas Lottery Commission, Lottery Gaming Facility Review Board, the Kansas Racing and

Gaming Commission, or the governing body of the city or county where the Lottery Gaming Facility is to be located … ." *Id.* at pp. 11-12. The clause further provides:

> "In addition to any other remedy available … under this Agreement, solely with respect to this Paragraph 14, [Peninsula's] failure to substantially perform its Ancillary Lottery Gaming Facility Operations obligations according to objectively verifiable standards (**for example, if the plans provide for the building of a restaurant and the restaurant is not built**) and, provided such failure cannot be disputed in good faith, will authorize the [Kansas Lottery] to withhold payment of [Peninsula's] compensation for which it would otherwise be entitled … less such amounts necessary … to meet all cash operating payments, obligations and liabilities payable pursuant to the Budget and debt service payments payable to third-party lenders …."

Id. at p. 11 (emphasis added).

IV. Business Overview.

Construction of Kansas Star's facility was broken into three phases: Phase 1A, Phase 1B, and Phase 2. Under Phase 1A, which lasted from December 26, 2011 through December 21, 2012, Kansas Star operated a temporary casino out of its arena. R. Vol. I, p. 160, Joint Stipulated Fact ¶ 27. Effective November 20, 2012, as Phase 1A drew to a close, Boyd Gaming purchased Peninsula Gaming for a transaction price of $1.45 billion. Kansas Star and four other gaming properties were included in this transaction. *Id.* at p. 161, Joint Stipulated Fact ¶ 30. Of these properties, Kansas Star was reported by Boyd to be the "jewel" of the portfolio. *See* R. Vol. II, Ex. 326, p. 266.

Phase 1B consisted of constructing the permanent casino, which opened in December 2012. R. Vol. I, p. 160, Joint Stipulated Fact ¶ 27. After casino operations were moved to the permanent facility, the arena was converted to its intended arena configuration, in the first half of 2013. *Id.* The first event at the arena, a concert, was held on June 29, 2013. *Id.*

Phase 2 consisted of constructing a conference center, maintenance building, and open-air event pavilion, which included a covered arena and 183 horse stalls. *Id.* at p. 161, Joint Stipulated Fact, ¶ 28. This was a modification by Boyd (with the State's approval) from Peninsula's original

proposal, which called for six separate barn buildings with 500 horse stalls, one indoor warm-up arena, and an outdoor practice arena. *See id.* Phase 2 was completed in January 2015. *Id.* at p. 161, Joint Stipulated Fact, ¶ 29.

In 2012, Kansas Star's only year operating out of the temporary casino, the facility generated $182.9 million in gaming revenue and $91.493 in earnings before interest, taxes, depreciation, and amortization ("EBITDA"). R. Vol. LX, Ex. 356, p. 112. In 2013, the first full year operating out of the permanent casino, gaming revenue increased to $192.4 million, but EBITDA dropped to $78 million. *Id.* The following chart, taken from the Bliss appraisal, shows the changes in revenues and expenses for 2012 and 2013:

	2012	2013	2014	2015	2016
Revenues					
Gaming	$182,923,000	$192,391,000	$178,283,000	$183,146,000	$179,893,000
Food & Beverage	$5,745,000	$11,441,000	$11,628,000	$11,786,000	$11,822,000
Other	$1,979,000	$3,628,000	$4,157,000	$4,750,000	$4,753,000
Gross Revenues	**$190,647,000**	**$207,460,000**	**$194,068,000**	**$199,662,000**	**$196,468,000**
Less Promotional allowances	$2,685,000	$4,606,000	$5,273,000	$3,994,000	$4,060,000
Net Revenues	**$187,962,000**	**$202,854,000**	**$188,795,000**	**$195,668,000**	**$192,408,000**
Cost and Expenses					
Operating Costs & Expenses					
Gaming	$70,398,000	$77,948,000	$72,863,000	$74,318,000	$74,465,000
Food & Beverage	$3,984,000	$8,813,000	$7,922,000	$8,228,000	$8,516,000
Other	$267,000	$1,912,000	$2,189,000	$1,396,000	$1,337,000
Selling, General & Admin.	$15,526,000	$22,892,000	$18,681,000	$19,977,000	$19,629,000
Maintenance & Utilities	$2,132,000	$3,344,000	$3,400,000	$3,523,000	$3,705,000
Affiliate Management Fee	$3,071,000	$8,357,000	$7,914,000	$8,264,000	$8,057,000
Preopening Expense	$1,086,000	$91,000	$168,000	$280,000	$244,000
Asset Transaction Cost	$5,000	$1,603,000	$211,000	$0	$0
Other Operating Items	$0	$95,000	$325,000	$192,000	$273,000
Total Operating Costs & Expenses	**$96,469,000**	**$124,858,000**	**$113,023,000**	**$116,178,000**	**$116,226,000**
Net Income	**$91,493,000**	**$77,996,000**	**$75,772,000**	**$79,490,000**	**$76,182,000**
Net Income Decrease From 2012		-14.8%	-17.2%	-13.1%	-16.7%

R. Vol. LX, Ex. 356, p. 112. Notably, a substantial portion of the EBITDA decline was associated with cost increases associated with the shift to the permanent casino, including: (1) $7.5 million in increased gaming costs; (2) $4,829,000 in increased food and beverage expenses; (3) $7,366,000 in increased costs associated with "Selling, General & Admin,"; and (4) a $5.286 million increase as part of Boyd's affiliate management fee. As further reflected in the chart, from 2014 to 2016, gaming revenues at Kansas Star decreased from the 2013 high water mark, while EBITDA

remained relatively flat, at between ranging between $75 million and $79.5 million.

A November 20, 2014 article in the Wichita Eagle noted that "the equestrian center was among the prime feature considered by the state when it selected a casino manager for the south-central Kansas gaming zone." R. Vol. VII, Ex. 533, p. 2. The article reflects:

> "'It adds something Kansas doesn't have, said [Tim] Lanier [Kansas Star's former arena director,] who has operated equestrian facilities in Texas and at the South Point casino in Las Vegas. 'No other equestrian site in the state is at this level, with a hotel and entertainment on the site. In Oklahoma City, they don't have what we have because they don't have a hotel on the property, they don't have the entertainment and restaurants that we have on the property.'
>
> "Outside this casino, you have to go Las Vegas to find the same facilities we do,' he said."

Id. The article also reflects that Lanier "expect[ed] the casino to host 10 or 12 equestrian events in 2015, 24 in 2016 and 36 by [2017]," and that "[a] standard horse show brings 3.1 people per horse to an event … so there could well be more than 500 people attending an event at the Kansas Star." *Id.*

In reality, Appellant has never attempted to hold the types of equestrian events projected by Crossroads. In 2013 no equine events were held. R. Vol. LIX, Ex. 334, p. 1. In 2014, Kansas Star hosted four equine events over eight arena days. *See id.* at p. 2. In 2015, after the outdoor pavilion and stalls were constructed, Kansas Star hosted five equine events, over twelve days. *Id.* at p. 3. In 2016, there were three equine events, over eight total days. *See id.* at p. 4. In total, while the Crossroads Study projected Kansas Star would utilize the arena for 99 to 117 event days per year, the arena was actually used for 36 event days in 2015, and 38 event days in 2016. R. Vol. LX, Ex. 353, p. 21.

V. Hearing overview

a. Sumner County's evidence

BOTA conducted its hearing in this matter on October 17 through 19, 2017. Sumner

County first presented evidence through two experts, Richard Jortberg, MAI, who performed the appraisals for the subject property for both tax years, and Dwight Percy, an expert who provided testimony regarding Kansas Star's enterprise value, and the financial impact of Kansas Star's ancillary facilities. Jortberg's appraisal reports are located in the record on appeal at R. Vol. II, Ex. 326 and R. Vol. III, Ex. 327. Percy's reports can be found at R. Vol. XVIII, Exs. 675 and 676. BOTA did not adopt Jortberg or Percy's opinion in its Full and Complete Opinion. R. Vol. I (Part 2), pp. 168-182. Accordingly, while Sumner County continues to disagree with BOTA's conclusion, that testimony is not substantially recounted here. General summaries can be found in Sumner County's proposed findings of fact and conclusions of law submitted to BOTA, R. Vol. I (Part II), pp. 118-156.

b. Appellant's evidence

Appellant presented testimony from Robert Jackson, a certified general appraiser employed by Bliss Associates L.L.C. Jackson collaborated with Robin Marx, MAI, to appraise the subject property (collectively "Bliss"). Bliss determined the subject property's highest and best use, as vacant, was "the development of a casino gaming facility that is appropriately sized and designed to meet the demand of the market, in order to maximize gaming associate revenues, while minimizing capital investment." R. Vol. LX, Ex. 356, p. 95.

Jackson testified that Bliss did not believe KELA required Appellant to construct the specific ancillary facilities that were ultimately built. R. Vol. LXIII, p. 625:3-626:7 Though he acknowledged the management contract required Appellant to build the ancillary facilities included in its bid, Jackson believed it was reasonably probable the Lottery would permit changes, as evidenced by (a) the fact the Lottery permitted Appellant to reduce the number of livestock stalls it was obligated to build from 500 to 183, in exchange for a dollar-for-dollar reallocation of those funds to the construction of a conference center (R. Vol. LXIII, p. 632:3-19); and (b) Clause

37 of the management contract, which Jackson interpreted as permitted Appellant to make changes if the property was damaged or destroyed, with the permission of the Lottery. R. Vol. LXIII, p. 633:2-634:3. As improved, Bliss concluded the highest and best use of the property was its existing improvements. R. Vol. LX, Ex. 356, p. 95

Bliss based its land value conclusion on the assumption there were 121.18 acres of commercial property to be valued. R. Vol. LX, Ex. 356, p. 95. With respect to this acreage, Jackson agreed there were a limited number of comparable land sales in Kansas. R. Vol. LXIII, p. 704:22-705:2. Bliss relied on five sales: (1) the Gerlach site; (2) the Wyant site; (3) one portion of the land acquisition for the Boot Hill Casino in Dodge City, Kansas; (4) the land acquisition for the Hollywood Casino site in Kansas City, Kansas; and (5) the other portion of the land acquisition for the Boot Hill Casino. R. Vol. LX, Ex. 356, p. 97.

Of these sales, Jackson acknowledged that both the Hollywood Casino sale and the second Boot Hill casino sale were not arms-length transactions. R. Vol. LXIII, p. 705:14-20. He further agreed the Dodge City market was not substantially similar to the market for the subject property. R. Vol. LXIII, p. 705:21-25. Nonetheless, Bliss compared the five sales and made a series of subjective adjustments to account for factors such as location, zoning and size. R. Vol. LX, Ex. 356, p. 101. These included a 60 percent downward adjustment ($4.8 million) to the Wyant tract based on its size as compared to the commercial acreage at issue, along with a corresponding 10 percent upward adjustment ($893,125) to the Gerlach tract. *See id.* Bliss placed primary weight on the Wyant and Gerlach tracts and settled on a land value of $76,600 per acre, or **$9,300,000** in total when applied to 121.18 acres, for both tax years. *Id.* at Ex. 356, p. 102.

Bliss estimated reproduction costs based on actual cost data collected by Deloitte & Touche. After accounting for inflation, Bliss's total reproduction cost estimates were **$151,413,380**

(2016) and **$154,413,380** (2017). R. Vol. LX, Ex. 356, pp. 105, 138. Bliss did not include an adjustment for entrepreneurial incentive, based on the premise that with owner-occupied, build-to-suit properties like the subject, profits would be attributable to the business, not the real estate. *See id.* at p. 105.

Bliss concluded the property suffered from significant functional obsolescence, noting:

> "There are several parts of the Kansas Expanded Lottery Act that do not conform to the standard real estate market dynamics of supply and demand. These involve the aspects requiring the casino development to promote '*tourism and economic development*', as opposed to strictly maximizing financial productivity and return on investment."

R. Vol. LX, Ex. 356, p. 107

According to Bliss, the ancillary improvements (the arena, event center, and equine pavilion) are not independently profitable, and have not resulted in an increase to gaming revenues over and above their cost to construct. *Id.* at p. 111. Bliss concluded that all of the ancillary improvements, despite being required by the management contract, were 100 percent functionally obsolete, resulting in reductions in value of **$74,010,860** (2016) and **$73,987,498** (2017). *Id.* at pp. 118, 151

During cross-examination, Jackson agreed Bliss had done no analysis to determine what gaming revenues would have been in 2015 or 2016 if Kansas Star had not built its ancillary facilities. R. Vol. LXIII, p. 718:8-11. He agreed there were no flaws in the quality of the materials used to construct the ancillary facilities. *Id.* at p. 715:13-17. He further agreed that a hypothetical purchaser would be bound by both KELA and the management contract, and would not be interested in purchasing this property if unable to keep the gaming profits. *Id.* at p. 717:1-14.

After adding together land value and reproduction cost estimates, and then deducing depreciation, Bliss concluded that the fair market value for the subject property under the cost approach was $**77,650,000** for tax year 2016 and **$77,600,000** for tax year 2017. Bliss considered

the sales comparison approach, and applied the income approach to a value conclusion. However, given that BOTA (correctly) determined the cost approach should be applied, that analysis is not recounted here.

Cory Morowitz, a gaming consultant and not an appraiser, also testified on Appellant's behalf. Morowitz reviewed the gaming market created by KELA, noting that "[o]f the four licenses offered by the State of Kansas, the South Central license was the most lucrative because it was in an area that has no casinos (greater Wichita) and with a reasonably large population to draw from. Conversely, the other gaming zones either had small populations (South West and South East) or were much more competitive (North East and South East)." R. Vol. LX, Ex. 353, p. 5. Morowitz also reviewed EBITDA margins from 43 casinos, which had an average margin of 22.9 percent, and a median margin of 24.9 percent. *Id.* at p. 8. In comparison to Kansas Star's EBITDA margins, which ranged from 43.4 percent to 50.9 percent, Morowitz noted:

> "It is clear that Kansas Star enjoys an operating margin well in excess of other similarly sized casinos. This difference ... . is largely attributable to the gaming license and its related attributes including its monopoly position, reasonable tax rate and efficient design. Because of these attributes, Kansas Star is more efficient than other casinos and can spend less on marketing."

Id. at p. 11.

Morowitz also analyzed the impact of the arena on gaming operations. Like Bliss, Morowitz agreed the arena is fully functional for its intended purpose. R. Vol. LXII, p. 598:6-15. He performed regression analyses between weekly arena attendance and gaming admissions, gaming revenues, and F&B revenues in 2015 and 2016. R. Vol. LX, Ex. 353, p. 29. Morowitz determined, unsurprisingly, that event days yielded incremental admissions to the casino floor. R. Vol. LXII, pp. 601:25-602:3; R. Vol. LX, Ex. 353, p. 29. He also found that in 2015-2016, the casino generated $541,168 in additional gaming revenues on event days, which he deemed insignificant. R. Vol. LXII, pp. 601:25-602:6; R. Vol. LX, Ex. 353, pp. 33-34. Morowitz similarly

concluded that arena events were associated with $1.2 million in additional Food & Beverage revenue, but indicated that after accounting for comps and costs, the net cash flow likely resulted in $68,000 loss. R. Vol. LX, Ex. 353, pp. 33-34.

Finally, Scott Schroeder, Kansas Star's director of finance, testified on Appellant's behalf. Schroeder explained Boyd Gaming's general accounting practices, including how various expenses are accounted for and attributed amongst Kansas Star's various departments. According to Schroeder, overhead expenses are not allocated amongst the various departments. R. Vol. LXII, p. 362:8-17. If overhead expenses were charged to the arena or events center, neither would be independently profitable. *Id.* at pp. 390:18-23; 397:24-398:5. However, Schroeder indicated, Kansas Star has "no way of knowing exactly who leaves from [arena events] to go over [to the casino] and how much their play was for the day." *Id.* at p. 431:16-21.

c. Sumner County's rebuttal evidence

Sumner County presented rebuttal testimony, primarily, through Leslie Sellers, MAI. Sellers is the chair of the Appraisal Institute's Body of Knowledge Committee, and is the Appraisal Institute' past international president. R. Vol. LXIII, pp. 740:22-741:23. He conducted a review appraisal of the Bliss appraisal report, which is located at R. Vol. XLIII, Ex. 697. USPAP Standard 1-1(a) states: "In developing a real property appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal[.]" R. Vol. XLIII, Ex. 697, p. 26. In total, Sellers identified ten critical errors with the Bliss report, which he found rendered the report not credible under USPAP Standard 1-1(a). *See id.* at p. 4.

Turning first to land value, Sellers concluded that Bliss's subjective size adjustments to the individual Wyant and Gerlach tract sales deviated from recognized appraisal methodology. *See id.* at pp. 24-25. "Generally accepted appraisal practice is to use assemblage land sales only as a total

tract because conditions of sale for the individual tracts can be misleading as an indicator of value when the developer motivations are only for the total development tract price." *Id.* at p. 24. "Further," Sellers explained, "there is no support for the quantified adjustment made to the land sales in the report." *Id.* at p. 25.

During the hearing, Sellers elaborated:

> "[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."

R. Vol. LXIII, p. 779-781.

Sellers also disputed Bliss's decision to exclude an estimate for entrepreneurial incentive, which he found deviated from generally accepted appraisal methodology. *Id.* at p. 10. Sellers pointed out that although Jackson testified the 14th Edition, page 575, Appendix 1, supported Bliss's position, Jackson failed to disclose that the section he had been reading from was referring to public buildings as an example of a specialized owner-occupied building that an owner would not anticipate generating a profit from. R. Vol. LXIII, pp. 746:22-748:20.

Finally, Sellers concluded that Bliss's functional obsolescence analysis deviated from generally accepted appraisal methodology. In his report, Sellers quoted specific language from the Appraisal of Real Estate, 14th Edition, stating:

> "If a new improvement is considered capable of supporting the highest and best use of the land as though vacant, it presumably will have no physical deterioration or obsolescence—i.e., it would be neither an underimprovement nor an overimprovement. Any difference in value between the existing improvement and the idea improvement would be attributable to depreciation, and thus the ideal improvement identified in highest and best use analysis helps appraisers estimate depreciation in the application of the cost approach."

R. Vol. XLIII, Ex. 697, p. 17.

As applicable here, Sellers explained that the Bliss highest and best use, as vacant, analysis deviated from USPAP by failing to account for the requirements of Appellant's management contract. R. Vol. LXIII, pp. 762:11-23; 765:23-768:19; R. Vol. XLIII, Ex. 697, pp. 16-20. Given the overlap between highest and best use and functional obsolescence, Sellers likewise found that "[t]he assertion that the existing improvements are over built conflicts with accepted appraisal methodology requiring the existing improvements to be compared with the ideal improvements in the highest and best use analysis to determine if any depreciation exists." R. Vol. XLIII, Ex. 697, p. 16.

d. BOTA's Full and Complete Decision

BOTA's full opinion is found at R. Vol. 1 (Part 2), pp. 168-182. As pertinent to this appeal, BOTA held:

> "The Board takes judicial notice of it [sic] prior year's decision on the subject property. *In the Matter of the Equalization Appeal of Kansas Star Casino, L.L.C. for the Year 2015 in Sumner County, Kansas*, Docket Nos. 2015-3737-EQ *et al.* In said matter, this tribunal held that the Taxpayer's appraisal (similarly compiled by Bliss) carried more weight than the appraisal of the County's experts (also done by Jortberg). In rejecting the Jortberg appraisal, this tribunal questioned his 12.5% entrepreneurial incentive as the subject property was a build-to-suit, owner-occupied property where the development costs were a part of the business rather than the real estate. The Board, further, found Bliss' 4% physical

depreciation was more appropriate than Jortberg's 1.11% as the subject property had been constructed in phases beginning in 2011.

In this prior tax year's decision, in regard to economic/functional obsolescence, this tribunal held as follows: '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.' *Id.* at p. 5. Ultimately, noting data from the Bliss appraisal, this Board determined that the proper economic obsolescence factor was 35%. *Id.*

. . .

Herein both appraisal experts gave primary reliance to the cost approach with the primary difference lying in their respective economic obsolescence determinations. Jortberg determined that there was little, if any economic obsolescence in the property, while Bliss concluded that the subject property was 52% economically obsolete. After thorough examination of the record, the Board finds substantial credible evidence corroborating the Taxpayer's contentions regarding the substantial economic obsolescence in the subject property. The subject property's actual revenue and expense data further substantiate the Board's prior tax year findings (quoted above) regarding the subject arena and convention center as the subject property's net revenue and net income continued its prior years' downtrend into calendar year 2016.

Overall, the Board finds the evidence presented by Taxpayer witness Cory Morowitz of substantial economic obsolescence in the property to be more persuasive than the evidence presented by the County's witnesses to the contrary and consistent with the subject property's actual financial data. Regarding Dwight Percy's analyses of the connection between arena events and the Taxpayer's overall business, the Board finds Percy's varied machinations and exclusions of possibly relevant financial data in these analyses causes the Board to question the efficacy of his conclusions. The Board, further, finds the testimony of Scott Schroeder persuasive that the subject casino is operated by competent professional management that has implemented various measures to financially optimize the subject arena to less than modest success."

R. Vol. I (Part 2), p. 178.

The Board ultimately found that the fair market value for the subject property was $102,659,000 for tax year 2016 and $102,609,000 for tax year 2017. *See id.* at p. 179. Although the Board's decision does not separate this figure into the various components of the cost approach, the following chart approximates Board's findings:

	2016	2017
Agricultural land value	$9,000	$9,000
Commercial land value	$10,170,000 (rounded)	$10,170,000 (rounded)
Total Land Value:	**$10,179,000**	**$10,179,000**
Total Reproduction Costs:	**$151,413,380**	**$154,656,142**
Physical Depreciation	($9,084,803)	($12,372,491)
Functional/External Obsolescence	($49,848,577)	($49,853,651)
Total Depreciation	**($58,933,380)**	**($62,226,142)**
Total FMV	$102,659,000	$102,609,000

ARGUMENTS AND AUTHORITIES

I. Standard of Review.

Decisions by the Board of Tax Appeals ("BOTA") are governed by the Kansas Judicial Review Act, K.S.A. 77-601 *et seq.* A decision by BOTA is in error if:

> "(i) [BOTA] has erroneously interpreted or applied the law, K.S.A. 77-621(c)(4); (ii) [BOTA] has engaged in an unlawful procedure or has failed to follow prescribed procedure, K.S.A. 77-621(c)(5); (iii) [BOTA's]action is based on a determination of fact, made or implied by [BOTA] that is not supported by evidence that is substantial when viewed in light of the record as a whole, K.S.A. 77–621(c)(7); or (iv) the [BOTA] action is otherwise unreasonable, arbitrary, or capricious, K.S.A. 77–621(c)(8)."

In re Brocato, 46 Kan.App.2d 722, 727, 277 P.3d 1135 (2011).

Appraisal practice is governed by the Uniform Standards of Professional Appraisal Practice ("USPAP"). *In re Johnson Cnty. Appraiser/Privitera Realty Holdings*, 47 Kan.App.2d 1074, 1075, Syll. ¶ 9, 283 P.3d 823 (2012). "These 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." *Saline Cty. Bd. of Cty. Comm'rs v. Jensen*, 32 Kan.App.2d 730, 735, 88 P.3d 242 (2004). Put differently, "BOTA cannot apply a methodology the appraisers themselves could not." *In re Kansas Star Casino, L.L.C. for Tax Year 2014*, 2018 WL 2749734 at *21 (Kan. Ct. App. June 8, 2018) (unpublished) ("*Kansas Star 2014*")

BOTA's decision also constitutes reversible error if it is based on a determination of fact,

made or implied by the agency, that is not supported by evidence that is substantial in light of the record as a whole. K.S.A. 77-621(c)(7). "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. Kan. Dept. of Ag.*, 289 Kan. 690, 709, 216 P.3d 170 (2009). "In light of the record as a whole" means:

> "the adequacy of the evidence in the record before the court to support a particular finding of fact shall be judged in light of all the relevant evidence in the record cited by any party that detracts from such finding as well as all of the relevant evidence in the record, compiled pursuant to K.S.A. 77-620, and amendments thereto, cited by any party that supports such finding, including any determinations of veracity by the presiding officer who personally observed the demeanor of the witness and the agency's explanation of why the relevant evidence in the record supports its material findings of fact."

K.S.A. 77-621(d).

"Arbitrary" means "without adequate determining principal; not done or acting according to reason or judgment." *Eureka Building & Loan Ass'n v. Myers*, 147 Kan. 609, 78 P.2d 68 (1938). "Flipping a coin, for example, would be incompatible with weighing 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." *Rural Water Dist. #2 v. Miami Cnty. Bd. of Cnty. Com'rs*, 2012 WL 309165 (Kan. Ct. App. 2012) (unpublished). "Capricious" means "changing apparently without regard to any laws." *Id.*; *Zinke & Trumbo, Ltd. v. State Corp. Comm'n of State of Kan.*, 242 Kan. 470, 475, 749 P.2d 21 (1988). An administrative order is reasonable if it is supported by substantial competent evidence. *Bluestem Tel. Co. v. Kansas Corp. Comm'n*, 52 Kan. App. 2d 96, 121, 363 P.3d 1115, 1131 (2015). Conversely, 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).

II. BOTA's depreciation analysis does not comport with USPAP, is unsupported by substantial, competent evidence and should be reversed.

As this Court is aware, tax appeals involving the Kansas Star Casino have become an "annual event." *In re Kansas Star Casino, L.L.C. for Tax Year 2015*, 2018 WL 3486173, *1 (Kan. Ct. App. 2018) (unpublished). This is partly because the parties "have polar opposite views about whether the improvements on Kansas Star's property are superadequate." *See id.* at *13. But, another seemingly constant issue is BOTA's failure to apply a depreciation analysis that comports with USPAP and is supported by substantial competent evidence.

A chronological review of the events leading to BOTA's decision is explanatory. In September 2016, BOTA issued a full and complete decision in Kansas Star's appeal for tax year 2015. As to functional obsolescence, BOTA held:

> "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%."

See Kansas Star 2015, 2018 WL 3486173 at *9.

Both parties appealed, arguing that BOTA's decision was neither USPAP-compliant nor supported by substantial competent evidence. As the 2015 appeal progressed, BOTA conducted a joint hearing for tax years 2016 and 2017, beginning in October 2017. The parties relied on same appraisers, who expressed nearly identical opinions.

On May 1, 2018, BOTA issued its full and complete opinion for 2016-2017, which adopted the depreciation analysis from its 2015 decision in whole:

> "While the Board finds the substantial credible evidence supports Bliss' general determination of significant economic obsolescence in this relatively new development, we do, however, find that Bliss' 52% total economic obsolescence determination overshoots the target. Following our derivation of economic obsolescence in the prior tax year's decision, the Board finds that a total economic

obsolescence of 35% is proper for the tax years in issue."

R. Vol. I (Part 2), pp.178-179.

A little over a month later, this Court decided *Kansas Star 2015*. The Court held BOTA's 2015 analysis (1) was not supported by the evidence, and (2) was not USPAP-compliant. *See Kansas Star 2015*, 2018 WL 3486173 at *15-16. More specifically, in 2015 BOTA based its decision on the incorrect premise that Bliss concluded the arena was two-thirds overbuilt. *See id.* at *15. But, as this Court recognized, that conclusion was erroneous because the only person to express that opinion was gaming advisor Cory Morowitz, who is not an appraiser. *See id.*

BOTA's decision for 2016-2017 is particularly flawed because unlike in 2015, in 2016-2017, no witness (including Morowitz) testified the arena was two-thirds overbuilt. The complete lack of factual evidence supporting BOTA's decision, alone, merits reversal. *See e.g.*, *Frick Farm Properties*, 289 Kan. at 709 ("Substantial competent evidence possesses both relevance and substance and provides a substantial basis of fact from which the issues can be reasonably determined.").

Perhaps more importantly, however, in *Kansas Star 2015*, the Court recognized "there [is] 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." 2018 WL 3486173 at *15. *Kansas Star 2015* is directly on point. As this Court has already recognized, if either party had suggested that superadequacy could be measured by comparing seats-per-gaming position, that methodology would have been challenged as a violation of USPAP. BOTA can no more apply a non-USPAP compliant methodology than could the parties. *See Kansas Star 2014*, 2018 WL 2749734 at *16 ("BOTA cannot apply a methodology the appraisers themselves could not."); *Kansas Star 2015*, 2018 WL 2748748 at *16 ("BOTA misapplied the law when it failed to comply with USPAP in calculating functional obsolescence.");

Jensen, 32 Kan. App. 2d at 735 ("[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."). BOTA's depreciation analysis does not comport with USPAP, is not supported by substantial competent evidence, and should be reversed.

III. Appellant's claim that the ancillary facilities are 100 percent superadequate is erroneous and should not be adopted.

While Sumner County agrees that BOTA's decision requires reversal, Sumner County continues to dispute Appellant's contention that its ancillary facilities are 100 percent superadequate. As this Court has previously recognized, the parties have "polar opposite views" on this issue. *See Kansas Star 2015*, 2018 WL 3486173 at *13. This Court has also previously concluded that even where BOTA fails to adopt an appropriate depreciation analysis, "it is not [the Court's] role to calculate functional obsolescence. Rather, remand to BOTA for further proceedings is appropriate." *See id.* at *16.

Sumner County certainly does not dispute this Court's role in the tax appeal process, or to suggest that a remand to BOTA would be improper. However, as of the date of this brief, the following are before the Court:

- Sumner County's appeal from BOTA's decision on remand for tax years 2014 and 2015; and
- Kansas Star's appeal from BOTA's decision for tax year 2016 and 2017.

These appeals and, likely, any decision by BOTA in future tax appeals, will not turn on BOTA's evaluation of the persuasiveness of the parties' competing evidence, but on specific, fundamental questions of law, which can only be resolved by the appellate courts with corresponding instructions on remand to BOTA.

a. KELA and the management contract require Appellant to maintain the ancillary facilities as a matter of law.

Resolution of the functional obsolescence issue begins with KELA and Appellant's management contract, the interpretation of which present questions of law. *CoreFirst Bank & Trust v. JHawker Capital, LLC*, 47 Kan.App.2d 755, 762, 282 P.3d 618 (2012).

In Kansas, commercial gambling is a severity 8, nonperson felony. K.S.A. 21-6406(b)(1). Commercial gaming includes operating or receiving earnings from a "gambling place," K.S.A. 21-6406(a)(1)(1), which is "any place, room, building, vehicle, tent or location which is used for any of the following: Making and settling bets; receiving, holding, recording or forwarding bets or offers to bet; conducting lotteries; or playing gambling devices." K.S.A. 21-6403(f).

To state the obvious, a casino is a "gambling place," and operating a casino is therefore ordinarily unlawful. However, the statutory definition of "bet" exempts "[a] lottery operated by the state pursuant to the Kansas lottery act[.]" K.S.A. 21-6403(a)(5), (b). Likewise, "gambling devices" do not include "[a]ny machine … . used or for use by a licensee of the Kansas racing commission as authorized by law and rules and regulations adopted by the commission or by the Kansas lottery … ." K.S.A. 21-6403(e)(2)(A). In essence, KELA alters the status quo by making it lawful for four, and only four, private entities to manage a lottery gaming facility, although even then, the State maintains ownership and operational control. In the Kansas Supreme Court's words, "[i]n order for casino gambling to be legal, a casino must be owned and operated by the State of Kansas." *In re Tax Appeal of BHCMC*, 307 Kan. 154, 158, 408 P.3d 103 (2017).

By requiring all contracts to include provisions for ancillary gaming facility operations, the Legislature plainly intended to ward off proposals for the types of *de minimus* casinos that operate out of Morton barn buildings in some areas of the country. *See, e.g., Alain Ellis Living Tr. v. Harvey D. Ellis Living Tr.*, 308 Kan. 1040, 1046, 427 P.3d 9 (2018) ("[T]he best and only safe

rule for ascertaining the intention of the makers of any written law, is to abide by the language they have used."); *see also*, K.S.A. 74-8734(e) (requiring consideration of the proposed facility as a "tourist and entertainment destination"). Certainly, Appellant's arena, equine pavilion, and conference center qualify as "ancillary lottery gaming facility operations," although other amenities could arguably satisfy this definition as well. But, regardless of what the State *might* have deemed acceptable in a hypothetical bid, there is no question that Appellant's actual contract required it to build the ancillary facilities at issue, and allows the State to keep all of its gaming revenues if the ancillary facilities are not maintained. *See* R. Vol. X, Ex. 610. § 14.

The Kansas Supreme Court has previously explained that "[t]he management agreement between [a gaming facility manager] and the Kansas Lottery is designed to ensure that both parties **comply with the Kansas Constitution and KELA**." *In re Tax Appeal of BHCMC*, 307 Kan. at 159 (emphasis added). This Court has likewise concluded that "Kansas Star voluntarily included an arena in its bid [for the management contract] and, by doing so, became contractually obliged to build and operate the arena." *In re Kansas Star Casino, L.L.C. for Tax Year 2014*, 2018 WL 2749734 at *15. Therefore, "removal of the arena would violate KELA and Kansas Star's management contract." *In re Kansas Star Casino, L.L.C. for Tax Year 2015*, 2018 WL 2748748 at *14; *see also*, *In re Kansas Star Casino, L.L.C. for Tax Year 2014*, 2018 WL 2749734 at *15 ("[R]emoval of the arena at the casino would result in Kansas Star being in noncompliance with KELA and the management contract, placing its gaming license at risk.").

Sumner County's point is simple. In Kansas, gaming is unlawful, unless conducted in accordance with KELA. KELA allows Kansas Star to operate the State's facility **only** in accordance with the management contract, which required the ancillary facilities be built and maintained. *See* K.S.A. 74-8734(d), (h)(17) (requiring any approved management contract to

"allow the lottery gaming facility manager to manage the lottery gaming facility **in a manner consistent with this act and applicable law**") (emphasis added).

b. KELA and the management contract cannot be disregarded under a USPAP-compliant highest and best use analysis.

A property's highest and best use is the "reasonably probable use of property that results in the highest value." *The Appraisal of Real Estate*, p. 332 (14th ed. 2013) (hereafter, "14th Ed."), Appendix 1. To be reasonably probable, a use must meet three conditions: (1) physical possibility, (2) legal permissibility, and (3) financially feasibility. *See id.* Any use that fails to meet any of these criteria is eliminated from contention. *See id.* Uses that meet all three are compared for utility, with the use that produces the highest value being the "highest and best" use. *See id.*

Physical possibility and legal permissibility can be evaluated in either order, but both must be analyzed before financial feasibility is considered. *See id.* at p. 335. It is self-evident that it is physically possible to build the existing improvements on the subject property. It would also be possible to build a marijuana dispensary. However, because a marijuana dispensary would not be legally permissible, it can be eliminated without evaluating financial feasibility.

The parties' disagreement regarding legal permissibility turns on whether recognized appraisal methodology required the appraisers to consider (a) the requirements of Appellant's actual management contract with the State, as Sumner County asserts, or (b) only the fact that KELA requires *a* management contract, generally, as Appellant contends.

In Kansas, a property's fee simple interest is valued for purposes of ad valorem taxation. *See In re Prieb Properties L.L.C.*, 47 Kan.App.2d 122, 130-31, 275 P.3d 56 (2012). This interest "is equivalent to ownership of the complete bundle of sticks [property rights] that can be privately owned." *Id.* at 130. Because Kansas values the fee simple interest, appraisers generally value income producing property as if it is vacant and available to be leased at market rent, even if the

property is actually subject to lease. *See id.* at 132. BOTA and Appellant's analysis treats the management contract as equivalent to a lease, and analyzes the issue as if Kansas Star could obtain *a* management contract, and not necessarily the management contract actually in place.

As a preliminary aside, though Appellant is correct in noting that the text of KELA (as opposed to the management contract) did not strictly require any particular ancillary amenity, the reality is that over the course of three separate rounds of competitive bidding for the south central management contract, the Kansas Lottery approved six prospective contracts. Every single one included a separate arena / event space. This is hardly surprising, as Appellant's gaming expert, Morowitz, opined that the south central gaming zone presented the most lucrative opportunity of the four gaming zones. R. Vol. LX, Ex. 353, p. 5. The argument that these ancillary facilities were not "required" by KELA is ahistorical literalism, flatly contradicted by the Lottery's actions during the three rounds of bidding in this gaming zone.

In any case, Appellant's suggestion that the actual management contract must be ignored is not supported by Kansas law. The Court of Appeals addressed an analogous issue in *In re Ottawa Housing Assoc., L.P.*, 27 Kan.App.2d 1008, 10 P.3d 777 (2000). *Ottawa Housing* involved an apartment complex that was built pursuant to a contract between the property owner and the federal government, under which the government provided the owner tax credits, in exchange for renting the apartments to low-income tenants. At that time, Kansas's definition of fair market value required consideration of, among other factors, "(j) restrictions imposed upon the use of real estate by local governing bodies, including zoning and planning boards or commissions[.]" K.S.A. 1997 Supp. 79-503a(j). Franklin County valued the complex at $1.538 million, which the taxpayer argued was too high, in light of the rental restrictions imposed by the contract. Citing a general consensus from outside jurisdictions, the Court of Appeals agreed and remanded the case to BOTA

with instructions to consider the contract in place. *See id.*

In *Paola Sundance Apartments*, 2006 WL 5485883 (2006), BOTA considered a separate low-income tax credit complex. BOTA held that, *Ottawa Housing* notwithstanding, the property should be evaluated using market rent data, explaining:

> "Contrary to the references in *Ottawa Housing* to K.S.A. 79-503a(j), the Board finds that the rent restrictions in this case are not 'restrictions imposed upon the use of real estate by local governing bodies, including zoning and planning boards or commissions.' The owner of the subject properties voluntarily entered into a contract in which it agreed to rent the property to low income tenants in exchange for tax credits. First, there are no restrictions placed on the use of the real estate at all. It is a voluntary obligation only. If the property is not leased to low income tenants as required by contract, the owners will not qualify for the tax credits. Nevertheless, there is no restriction on use. Second, the 'restrictions' are not imposed by anyone. They are awarded after the owner applies for them and enters into a contractual agreement. There are more applicants than there are tax credits available. Third, the 'restrictions' are awarded, not by a local governing body, but by federal and/or state agencies. Thus, these low-income housing contract obligations should not be considered a part of K.S.A. 79-503a(j)."

2006 WL 5485883 at *7.

In 2009, following the *Paola Sundance* decision, K.S.A. 79-503a(j) was revised to require consideration of the following as part of fair market value:

> "(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 lease to low income individuals and families, as authorized by section 42 of the federal internal revenue code of 1986, as amended**[.]"

K.S.A. 2009 Supp. 79-503a(j).

The purpose of the 2009 revisions could hardly be clearer. In *Paola Sundance*, BOTA found that low-income housing contracts were voluntary and did not constitute a restriction on use. 2006 WL 5485883 at *7. The statutory reference was changed from "restrictions" to "restrictions *or requirements*[.]" BOTA likewise found K.S.A. 75-503a(j) inapplicable because "the 'restrictions' are awarded, not by a local governing body, but by federal and/or state agencies."

2006 WL 5485883 at *7. The Legislature then expanded the source of the restrictions or requirements from "zoning and planning boards or commissions" to "**the state or federal government or** local governing bodies, including zoning and planning boards or commissions." In short, the 2009 revisions make clear that, as found in *Ottawa Housing*, governmental contracts that require a property to be put to a specific use should be considered as part of the fair market value analysis.

If the Legislature intended for low-income housing contracts to be the lone exception to the rule, it could have said so. Instead, by including the phrase "including **but not limited to,**" the Legislature made clear that K.S.A. 75-503a(j) was not limited to low-income housing contracts. *See* K.S.A. 75-503a(j) (emphasis added); *see also*, *Wing v. City of Edwardsville*, 51 Kan.App.2d 58, 63, 341 P.3d 607 (2014) ("Ordinarily, courts presume that the legislature does not use redundant language, and we try to give meaning to every word in the statute.").

The management contract is not property, and is not transferrable without the State's consent. *See* K.S.A. 74-8734(m). Nonetheless, this Court has previously commented:

> "While the management contract itself is not property, Kansas law recognizes the effect that an intangible asset may have on real property to the extent it enhances its value. See K.S.A. 2017 Supp. 74-8734(m); *In re Tax Appeal of Western Resources, Inc.*, 22 Kan. App. 2d 593, 602, 919 P.2d 1048, *rev. denied* 260 Kan. 993 (1996). Kansas law also recognizes other intangible considerations such as zoning and other use restrictions in valuing property. See K.S.A. 2017 Supp. 79-503a(j); *In re Equalization Appeal of Ottawa Housing Ass'n, L.P.*, 27 Kan. App. 2d 1008, 1013, 10 P.3d 777 (2000)."

In re Kansas Star Casino, L.L.C. for Tax Year 2013, 2018 WL 2748748, *13 (Kan. Ct. App. 2018) (unpublished).

As set forth above, 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. 75-503a(j).

In a broad sense, *Ottawa Housing* recognizes that there are circumstances where it is inherently necessary to consider contractual requirement imposed by the government, for *ad valorem* taxation purposes. Appellant's contract with the State of Kansas, which the Kansas Supreme Court has referred to as "designed to ensure that both parties comply with the Kansas Constitution and KELA," *In re Tax Appeal of BHCMC*, 307 Kan. at 159, presents such a circumstance. 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), Appendix 1.

The Bliss appraisal amorphously suggest the subject property's highest and best use, as vacant, is "a casino gaming facility that is appropriately sized and designed to meet the demand of the maximize gaming associated revenues, while minimizing capital investment." R. Vol. LX, Ex. 356, p. 95. A flaw inherent with this conclusion is that when the Kansas Legislature enacted KELA, it intentionally opted against allowing gaming operators to pursue whatever means they saw fit to maximize profits (*i.e.*, disallowing bidders to present "four walls and a roof" and disallowing bidders to minimize capital investment). Bliss's conclusion that a different, less substantial mix of amenities may be more productive improperly ignores the actual management contract in place, which Kansas law and USPAP require be considered. K.S.A. 75-503a(j); 14th Ed., p. 335, Appendix 1 ("A use may be financially feasible, but this is irrelevant if it is legally prohibited or physically impossible.").

As substantiated through Sellers's review of the Bliss report, failing to consider the management contract in place constitutes a deviation from recognized appraisal theory and is not USPAP-compliant. R. Vol. LXIII, p. 762:11-23; 765:23-768:19; R. Vol. XLIII, Ex. 697, pp. 60-

20. BOTA can no more apply a non-USPAP compliant methodology than could the parties. *See Kansas Star 2014*, 2018 WL 2749734 at *16 ("BOTA cannot apply a methodology the appraisers themselves could not."); *Kansas Star 2015*, 2018 WL 2748748 at *16 ("BOTA misapplied the law when it failed to comply with USPAP in calculating functional obsolescence."). Because BOTA's highest and best use analysis, premised on Bliss's appraisal, does not comport with USPAP, it cannot be adopted.

c. The subject property suffers from no superadequacy a matter of law.

The import of BOTA's flawed highest and best use analysis is substantial. Functional obsolescence is measured by comparing (1) the subject property's actual structure, materials, and design, and (2) the highest and best use and the most cost-effective functional design requirements at the time of the appraisal. *See* 14th Ed., p. 623, Appendix 1. Thus, if BOTA gets its highest and best use analysis wrong, its functional obsolescence analysis is, by necessity, wrong.

Functional obsolescence may take two forms: (1) functional inadequacy, or (2) superadequacy. *Kansas Star 2014*, 2018 WL 2749734 at *15. "Functional inadequacy is a deficiency in the structure, materials, or design of an improvement, such as too few bathrooms or low warehouse ceiling heights." *Id.* (citing 14th Ed., p. 623), Appendix 1. Superadequacy, the type of functional obsolescence in dispute here, 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." *Id.* (quoting 14th Ed., p. 623), Appendix 1.

The fundamental problem with Appellant's position is that in order for its ancillary facilities to be superadequate, they would have to be flawed in comparison to the property's highest and best use. *See* 14th Ed., pp. 623, 626, Appendix 1. Here, however, Appellant's ancillary facilities are required by KELA and the management contract, and fundamentally intertwined with

Appellant's operation as a whole. While Appellant has proffered expert testimony suggesting that its operation could operate more profitably without the ancillary facilities (Sumner County presented evidence disputing this contention), that evidence is irrelevant, given that these ancillary facilities are a required element of Kansas Star's enterprise. "A use may be financially feasible, but this is irrelevant if it is legally prohibited or physically impossible." 14th Ed., p. 335, Appendix 1; *see also*, *In re Kansas Star 2015*, 2018 WL 2748748 at *14 ("[R]emoval of the arena would violate KELA and Kansas Star's management contract.").

The Appraisal Institute has identified a seven-step procedure for assessing functional obsolescence:

1. Identify the functional problem;
2. Identify the component (or components) in the facility, or the lack of a component (or components associated with the problem;
3. Identify possible corrective measures and the related costs to cure;
4. Select the most appropriate corrective measure;
5. Quantify the loss caused by the functional problem, which results in added value if the problem is corrected;
6. Determine if the item is curable or incurable; and
7. Apply the functional obsolescence procedure to calculate the amount of depreciation caused by the functional problem.

14th Ed., p. 626, Appendix 1.

With respect to the first step—identifying the problem—the Appraisal Institute advises that "[i]n many cases, [the functional problem] is readily apparent from the appraiser's site visit and information from the highest and best use analysis or other analyses in the valuation process." *Id.* This passage illustrates that appraisers can frequently determine whether or not specific property components are functionally obsolete, *i.e.*, a "functional problem," based on (a) the highest and

best use analysis, and/or (b) the exercise of professional judgement, as applied to information gleaned during a site visit. *See id.* When an appraiser reaches such a conclusion, there is no further quantitative analysis—steps 2 through 7, above—to conduct.

Here, a USPAP-compliant highest and best use analysis requires the appraisers to conclude that the ancillary facilities are legally required. If, however, the appraisers had discovered that the faucets in the arena's restrooms were made of solid gold, and solid gold faucets were not included in Appellant's bid for the management contract, of course the appraisers would be required to analyze whether solid gold fixtures would appeal to the market in general. But, in reality, no evidence suggests any flaw in the design or materials of Appellant's ancillary facilities. In combination with a USPAP-compliant highest and best use analysis, this leads to only one result: Appellant's ancillary facilities are not superadequate as a matter of law.

CONCLUSION

The Bliss highest and best use analysis improperly ignores the management contract, and correspondingly therefore does not follow recognized appraisal theory, as required by USPAP. This Court should reverse BOTA's decision and remand the case with instructions for BOTA to consider Appellant's management contract as part of its property's highest and best use analysis, as required by USPAP and Kansas law.

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CROSS-APPEAL

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See the "Nature of the Case," *supra*, in the Brief of Appellee

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III. Both Kansas law and USPAP require consideration of Cross-Appellant's management contract as part of the analysis of fair market value.

STATEMENT OF FACTS RELEVANT TO CROSS-APPEAL

The statement of facts set forth in Sumner County's Brief of Appellee, *supra*, is incorporated herein.

ARGUMENTS AND AUTHORITIES

I. Standard of Review

Sumner County incorporates the arguments and authorities identified *supra* in the Brief of Appellee, with respect to the standard of review, herein by reference.

II. BOTA's $76,500 per acre land value is not USPAP-compliant, is not supported by substantial evidence in light of the record as a whole, and is unreasonable, arbitrary, and capricious.

The subject property sits on a 195.31 acre tract. R. Vol. I, p. 160. Of this total acreage, Kansas Star has leased 63.5 acres to Mark Hardison. Sumner County classified the leased acreage as agricultural, and the parties stipulated to a value of $9,000. BOTA upheld Sumner County's classification of the remaining acreage as commercial, [2] but applied Bliss's $76,000 per acre value

[2]Bliss classified 12.69 acres of the remaining acres as agricultural, but BOTA rejected that position. Full and Complete Opinion, R. Vol. I, p. 179. Appellant did not appealed this ruling, and Sumner County therefore does not address it here.

to that total, resulting in a land value of $10,170,000 for both tax years. R. Vol. I (Part II), p. 179. Bliss's analysis derived from five sales—the two parcels that were ultimately combined to become the subject site, two sales that formed the Boot Hill Casino in Dodge City, and the Hollywood Casino sale in Kansas City Kansas. R. Vol. LX, Ex. 356, p. 101. Of these sales, Bliss placed the most weight on the separate sales of the Wyant and Gerlach tracts, which were combined to form the subject property.

The 145.5-acre Wyant tract sold for $8,931,250, or $61,383 per acre. R. Vol. LX, Ex. 356, p. 101. The 55.7-acre Gerlach tract sold for $8 million, or $143,627 per acre. *Id.* To arrive at a $76,000 per acre value from these figures, Bliss relied on subjective, quantitative adjustments, included a 60 percent downward adjustment ($4.8 million) to the Wyant tract based sales price based on its size as compared to the commercial acreage at issue, along with a corresponding 10 percent upward adjustment ($893,125) to the Gerlach tract. R. Vol. LX, Ex. 356, p. 101.

As set forth above, Sumner County presented rebuttal testimony from Leslie Sellers, MAI. Sellers is the past president of the Appraisal Institute, the current chair of the Appraisal Institute's Body of Knowledge Committee.

Among other critical errors, Sellers concluded that Bliss's quantitative size adjustments deviated from recognized appraisal methodology. R. Vol. XLIII, Ex. 697, p. 24-25.

> "Generally accepted appraisal practice is to use assemblage land sales only as a total tract because conditions of sale for the individual tracts can be misleading as an indicator of value when the developer motivations are only for the total development tract price. Using these two sales independently, and only adjusting the one sale (land sale 2), is not following generally accepted appraisal practice and results in a lower value than the data would otherwise indicate."

Id. at p. 24. "Further," Sellers concluded, "there is no support for the quantified adjustment made to the land sales in the report." *Id.* at p. 25.

During the hearing, Sellers elaborated:

> "[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."

R. Vol. LXIII, p. 779-781.

USPAP Standard 1-1 provides that "[i]n developing a real property appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal[.]" R. Vol. XLIII, Ex. 697, p. 26. As Sellers's report and testimony establish, Bliss's subjective land sale adjustments do not comport with recognized appraisal methodology, and thus violate USPAP Standard 1-1. "BOTA cannot apply a methodology the appraisers themselves could not." *Kansas Star 2014*, 2018 WL 2749734 at *21. BOTA's reliance on a land value analysis that does not comply with USPAP constitutes reversible error. *See Jensen*, 32 Kan.App.2d at 735.

Equally problematic is the fact that BOTA's full and complete opinion fails to even so much as mention that Sellers testified as a witness, let alone explain the Board's decision to wholly disregard his testimony. *See* R. Vol. 1, pp. 168-182. BOTA is not required to render the explanation

for its findings in minute detail. However, the explanation must be "specific enough to allow judicial review of the reasonableness of the order." *See Zinke & Trumbo, Ltd., v. State Corp. Com'n of State of Kan.*, 242 Kan. 470, 475, 749 P.2d 21 (1988); *see also*, *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. 77-261, the court must "review the agency's explanation as to why the evidence supports its findings."); *see also Kansas Star 2014*, 2018 WL 2749734 at *19 (explaining that the Court will not supply a reasoned analysis for BOTA's actions that BOTA itself has not given). BOTA's outright disregard for expert testimony from the former international president of the Appraisal Institute and current chair of its Body of Knowledge committee regarding USPAP non-compliance renders its decision unsupported by substantial competent evidence, arbitrary and capricious. *See Kansas Star 2014*, 2018 WL 2749734 at *19 ("BOTA provides little to no explanation for [its] figure, making it impossible for us to determine whether the figure is supported by substantial competent evidence. Accordingly, BOTA's adoption of [the figure] is arbitrary and capricious."). BOTA's decision regarding land value should be reversed.

III. BOTA's decision not to apply an entrepreneurial incentive or profit is not USPAP-compliant, is not supported by substantial evidence in light of the record as a whole, and is unreasonable, arbitrary, and capricious.

BOTA adopted Bliss's conclusion that no entrepreneurial profit or incentive should be applied as part of the cost approach in this case. *See* R. Vol. I (Part 2), p. 177. In their appraisal report, Bliss explained the decision not to include an entrepreneurial incentive as follows:

> "Typically, with build to suit, owner-operated properties that are reliant upon the operation of the associated business located with the real estate for the generation of revenue/income, entrepreneurial profit is not considered part of the overall development costs. This is due to the 'profit' component typically being considered part of the business operation, but not the real estate itself. Therefore, for the purposes of analyzing the fee simple real estate component of the subject's gaming and entertainment development, no separate entrepreneurial profit is considered applicable and none has been included."

R. Vol. LX, Ex. 356, p. 105.

As set forth in Sellers's rebuttal report, Bliss's analysis does not comport with USPAP, and BOTA's adoption of Bliss's analysis therefore constitutes reversible error. The Appraisal Institute textbook provides that the procedure for estimating fair market value under the cost approach includes "estimating the current cost to construct a reproduction of (or replacement for) the existing structure **including an entrepreneurial incentive or profit** ... ." 14th Ed., p. 562, (emphasis added), Appendix 1. "Because the entrepreneur provides the inspiration, drive, and coordination necessary to the overall project, the cost approach **should include** an appropriate entrepreneurial incentive or profit." 14th Ed., p. 571, (emphasis added), Appendix 1. A separate Appraisal Institute textbook, *In Defense of the Cost Approach*, reiterates that entrepreneurial incentive "is a cost, and this cost is just as real as the cost for bricks, concrete, or anything else." R. Vol. XLIII, Ex. 697, p. 10; R. Vol. XLVII, Ex. 700.015.

The Appraisal Institute texts, coupled with Sellers's review appraisal and testimony, make clear that with respect to entrepreneurial incentive, the Bliss appraisal deviates from recognized appraisal methodology, in violation of USPAP Standard 1-1(e), and should be reversed.

IV. Both Kansas law and USPAP require consideration of Cross-Appellee's management contract as part of the analysis of fair market value.

As set forth in Sumner County's response to Appellant's brief, this Court has previously concluded that even where BOTA fails to adopt an appropriate depreciation analysis, "it is not [the Court's] role to calculate functional obsolescence. Rather, remand to BOTA for further proceedings is appropriate." *See Kansas Star 2015*, 2018 WL 3486173 at *16. The fundamental legal errors inherent in BOTA's highest and best and functional obsolescence analysis are set forth fully in Sumner County's response to Appellant's brief, incorporated herein by reference, and thus are not repeated.

CONCLUSION

This Court should reverse BOTA's decision and remand the case with instructions for BOTA to consider Appellant's management contract as part of its property's highest and best use analysis, as required by USPAP and Kansas law.

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Certificate of Service

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APPENDIX

1. The Appraisal of Real Estate, 14th Ed., pp. 332, 334, 335, 562, 571, 575, 623, 626

2. *In re Paola Sundance Apartments*, 2006 WL 5485883 (2006) (unpublished)

3. *In re Kansas Star Casino, L.L.C. for Tax Year 2015*, 2018 WL 3486173 (Kan. Ct. App. 2018) (unpublished)

4. *In re Kansas Star Casino, L.L.C. for Tax Year 2013*, 2018 WL 2748748 (Kan. Ct. App. 2018) (unpublished)

5. *In re Kansas Star Casino, L.L.C. for Tax Year 2015*, 2018 WL 3486173 (Kan. Ct. App. 2018) (unpublished)

6. *Rural Water Dist. #2 v. Miami Cnty. Bd. of Cnty. Com'rs*, No. 105, 2012 WL 309165 (Kan. Ct. App. 2012) (unpublished)

Appendix 1

Appraisal Institute®

Professionals Dedicated to Real Estate Solutions

The Appraisal of Real Estate

Table 18.1 Comparison of Real Estate Market Analyses

Goal/Purpose	
General market study	Identify demand for appropriate potential uses
Marketability study	Identify demand for a particular property
Feasibility analysis	Compare cost and value and analyze if specific market or investor criteria are fulfilled
Highest and best use analysis	Of the appropriate potential uses, determine the use that yields the maximum value
Processes/Steps	
General market study	Perform supply and demand analyses for appropriate potential uses
Marketability study	Follow the six-step process
Feasibility analysis	Calculate *NOI*/cash flows of appropriate potential uses and select appropriate overall capitalization rate/discount rate (based on data collected during market analysis—e.g., residual land value, rate of return, capitalized value of overall property)
Highest and best use analysis	Specify terms of use, timing, and market participants (e.g., user of the property, most probable buyer) and compare values of appropriate potential uses
Results (Data Generated)	
General market study	Forecast oversupply or undersupply and the effect on absorption rates and probable rents or prices for appropriate potential uses
Marketability study	Forecast how a specific property will perform under current or anticipated market conditions
Feasibility analysis	State whether potential uses are feasible based on respective data
Highest and best use analysis	Determine which alternative use (or alternative uses) creates the highest value

processes that measure the economic potential of real estate, although in practice some feasibility analyses may be more involved than highest and best use analyses, have a different focus, or require additional research.

Fundamentals of Highest and Best Use

The analysis of highest and best use is at the heart of appraisals of the market value of real property, but the concept has not always been well understood by practitioners and has long been a source of debate in the professional literature. The essential components of the analysis of highest and best use are contained in the following definition of the term:

> The reasonably probable use of property that results in the highest value.

This simple definition will serve as a point of departure for examining the concept in the rest of this chapter.

To be reasonably probable, a use must meet certain conditions:

- The use must be *physically possible* (or it is reasonably probable to render it so).
- The use must be *legally permissible* (or it is reasonably probable to render it so).
- The use must be *financially feasible.*

Uses that meet the three criteria of reasonably probable uses are tested for economic *productivity*, and the reasonably probable use with the highest value is the highest and best use.

Conceptually, the criteria of highest and best use are self explanatory. For example, *physically possible* uses are land uses that are not unworkable due to some limiting physical characteristic of the land such as inadequate site size, odd shape, irregular topography, or poor soil quality. For example, a steeply sloped site tends to limit the use of the land to only a few possible alternatives. In contrast, a level plot of land with good drainage, soil with adequate bearing capacity, and other physical characteristics to the construction of improvements would likely allow a developer to build many different sorts of facilities. Based on similar logic, *legally permissible* uses would conform to the land's current zoning classification and local building codes along with any other relevant regulatory or contractual restrictions on land use.

The test of *financial feasibility* narrows the number of legally permissible and physically possible uses down further through analysis of the economic characteristics of the potential alternative uses. The remaining options are candidates for the test of *maximum productivity*, which is the final–and deciding–criteria for the highest and best use of both the land as though vacant and the property as improved.

The concept of highest and best use relates to what is done physically with real estate, and physical land use should not be confused with the motivation of owners or users. For example, conservation and preservation are not uses of land. Rather, they are the motivations of individuals or groups for acquiring certain properties. The physical uses in such cases could generally be characterized as "leave the land vacant" or "do not change the historic improvements." A parcel of land encumbered by a conservation easement would have legal limits on use, leaving "no new development" or "development to some limited degree as agreed upon by contract" as the only legally permissible use of the land.

Similarly, assemblage with an adjacent parcel or subdivision are not highest and best uses in and of themselves. While the process of assembling a site with other sites might make the most sense financially for the entity who would benefit from the combination of multiple parcels, assemblage is a motivation for acquiring a property, not a use of the real estate. In other words, an entity might be motivated to purchase a site so that it can be assembled with surrounding parcels to create one large parcel, for which the highest and best use might be, for example, development of a 10-story residential condominium. If the property being appraised is a single site, not a site whose use depends on assemblage with other sites, the highest and best use of the site alone is analyzed as it currently exists by itself. If the property being appraised consists of multiple sites as though sold in one transaction, the highest and best use analysis considers them as one large site.

The same is true of a property suitable for subdivision. The highest and best use of a parcel of land might be for development of 50 single-unit residences. While the parcel must be subdivided to achieve that highest and best use, subdivision in itself is not a use and therefore not the highest and best use.

Testing Highest and Best Use

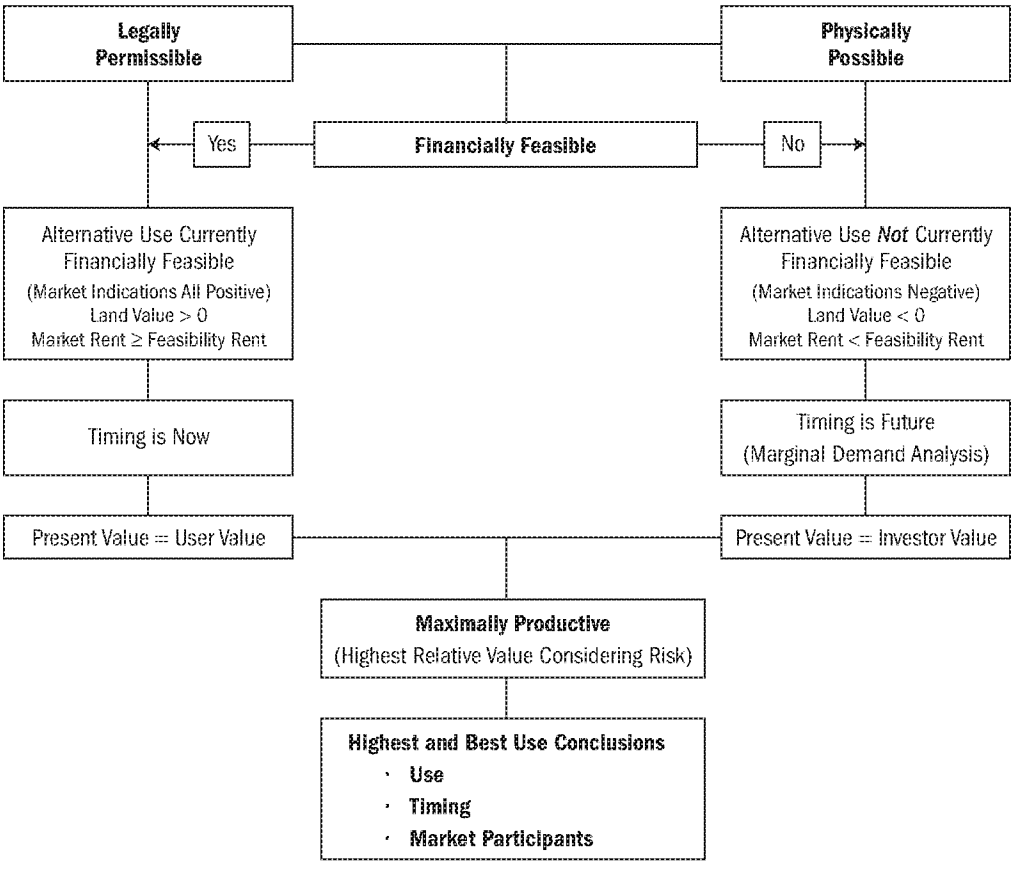
To test alternative uses for the highest and best use, an appraiser usually applies the four criteria in the following order:

1. Legal permissibility
2. Physical possibility
3. Financial feasibility
4. Maximum productivity

In practice, the tests of physical possibility and legal permissibility can be applied in either order, but they both must be applied before the tests of financial feasibility and maximum productivity. A use may be financially feasible, but this is irrelevant if it is legally prohibited or physically impossible.

Figure 16.1 illustrates the relationship of the steps involved in testing alternative use options for both the land as though vacant and the property as improved. Note that neither the test of legal permissibility

Figure 16.1 Testing Alternative Use Options



participants sell rights, not land and buildings. The breakdown into land and building components is important because it creates many issues that would not be relevant in the other approaches, where the land is not separated from the buildings. For example, the allocation of external obsolescence is an issue for the cost approach, but not for the income capitalization and sales comparison approaches.

To apply the cost approach, an appraiser estimates the market's perception of the difference between the property improvements being appraised and a newly constructed building with optimal utility (i.e., the ideal improvement identified in highest and best use analysis). In its classic form, the cost approach produces an opinion of the value of the fee simple estate. If the purpose of the appraisal is to estimate the value of an interest other than fee simple, an adjustment will be required. For example, a property rights adjustment could be made as a lump-sum adjustment at the end of the cost approach. This would be particularly important when the interest appraised is the leased fee encumbered by a long-term lease.

In applying the cost approach, an appraiser must distinguish between two cost bases—reproduction cost and replacement cost—and use one of the two consistently throughout the analysis. The market and physical condition of the appraised property usually suggest whether an exact replica of the subject property (reproduction cost) or a substitute property of comparable size and use (replacement cost) would be the basis of a more suitable comparison. The term *modern equivalent asset* is used in international valuation standards to describe an asset that provides "similar function and equivalent utility to the asset being valued" rather than a replica designed and constructed using current materials and techniques.[1]

cost approach
A set of procedures through which a value indication is derived for the fee simple estate by estimating the current cost to construct a reproduction of (or replacement for) the existing structure, including an entrepreneurial incentive or profit; deducting depreciation from the total cost; and adding the estimated land value. Adjustments may then be made to the indicated fee simple value of the subject property to reflect the value of the property interest being appraised.

Appraisers estimate the cost to construct existing structures and site improvements (including direct costs, indirect costs, and an appropriate entrepreneurial incentive or profit) using one of three traditional techniques:

- the comparative-unit method
- the unit-in-place method
- the quantity survey method

Appraisers then deduct all depreciation in the property improvements from the cost of the new structure as of the effective appraisal date. (Outside the United States, the term *depreciated replacement cost method* is often used to describe the application of the cost approach in this manner.) The amount of depreciation present is estimated using one or more of three fundamental methods:

- the market extraction method
- the economic age-life method
- the breakdown method

1. International Valuation Standards Council, *Technical Information Paper 2: The Cost Approach for Tangible Assets* (London: IVSC, 2012), Paragraph 8, s.v., "Modern Equivalent Asset."

preciation from all causes when that sort of measurement is necessary.

Cost Estimates

To develop cost estimates for the total building, appraisers must consider direct costs (also known as *hard costs*) and indirect costs (also known as *soft costs*). Both direct and indirect costs are essential to a reliable cost estimate. (The traditional data sources and appraisal techniques used to estimate building costs are discussed in Chapter 28.)

direct costs
Expenditures for the labor and materials used in the construction of improvements; also called *hard costs*.

indirect costs
Expenditures or allowances for items other than labor and materials that are necessary for construction, but are not typically part of the construction contract. Indirect costs may include administrative costs, professional fees, financing costs and the interest paid on construction loans, taxes and the builder's or developer's all-risk insurance during construction, and marketing, sales, and lease-up costs incurred to achieve occupancy or sale. Also called *soft costs*.

Direct construction costs include the costs of material and labor as well as the contractor's profit required to construct the improvement on the effective appraisal date. The overhead and profit of the general contractor and various subcontractors are usually part of the construction contract and therefore are direct costs that should always be included in the cost estimate. In more complex projects, where multiple contractors, construction staging, or other complications are involved, a management fee may be required. Indirect costs are expenditures or allowances that are necessary for construction but are not typically part of the construction contract. These costs can include, but are not limited to, the cost of architectural and engineering services, loan origination fees, carrying costs during construction, title insurance fees, appraisal and legal fees, leasing and marketing costs, and developer's overhead and profit. Because the entrepreneur provides the inspiration, drive, and coordination necessary to the overall project, the cost approach should include an appropriate entrepreneurial incentive or profit, which is discussed later in this chapter. A construction contingency is not usually a soft cost but rather a hard cost.

Because the quality of materials and labor greatly influences costs, appraisers should be familiar with the costs of the materials used in the property being appraised. A building can cost substantially more than is typical if items such as walls and windows are overinsulated or thicker slabs are used to accommodate greater floor loads. Many newer structures contain elements that may not be found in older buildings with which they compete. At one time the market may have considered features such as Internet connectivity, networking and telecommunications capabilities, and adequate, reliable power in "smart" office buildings to be high-tech overimprovements. These features may not have contributed as much value as they cost at the time of installation, but as demand for the building materials and features continues to increase so does their contribution to value.

The competitive situation in the local market can also affect cost estimates. Actual contractor bids based on the same set of specifica-

as land is acquired, plans are drawn up, permits are approved, financing is secured, contracts are signed, construction is completed, and units are sold off or leased. It can be difficult to estimate exactly how much entrepreneurial profit would be earned at each stage of construction, although lenders may require interim values that reflect financing costs and taxes during the construction and leasing phases.

In practice, separating the value impact of the entrepreneurial coordination from other market influences can be difficult, particularly during periods of little new construction. To ensure the reasonableness of an estimate of entrepreneurial incentive or entrepreneurial profit, appraisers should carefully examine the source of additional property value over and above the total cost of development and the effects of supply and demand for properties of that type in the subject property's market area. For example, some appraisers point out that the value associated with the amenities of a property may be such that the sale price of the property could significantly exceed the sum of the costs of the land, building, and marketing (e.g., in an overheated seller's market where sale prices are inflated).

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. In this case, entrepreneurial profit is likely to become obscured over time by changing market conditions. For certain types of specialized owner-occupied improvements, such as public buildings, no entrepreneurial profit may ever be realized because the owner neither anticipates nor wants a profit.

The way in which comparable properties have been developed affects the availability of data. Appraisers are sometimes able to calculate entrepreneurial profit from actual comparable costs for speculatively built properties such as condominiums and multifamily developments. In the value estimate of a speculatively built property, entrepreneurial profit represents a return to the entrepreneur for the skills employed and the risks incurred, although the actual return may differ from the anticipated return. In large-scale developments, however, the issue is complicated because the entrepreneurial profit may not reflect the proportionate contributions of the improved site and the improvement to the overall property value. Developers of tract subdivisions, for example, often realize most of their profit on the value of the houses built on the finished lots, not necessarily on the value of the lots, which could be analyzed as a separate investment opportunity with its own separate measure of entrepreneurial profit.

Data on entrepreneurial profit for custom-built properties may not be available if the property owner who contracted the actual builders was

Damage or Vandalism

Damage or vandalism requires special treatment in the estimation of depreciation. The measure of damage is the cost to cure, but damage or vandalism must be treated separately from other forms of physical deterioration because, unlike deferred maintenance, damage is not considered in the estimate of cost new. When damage or vandalism is cured, the life of the damaged component is neither renewed nor prolonged. It is simply restored to its condition prior to the damage.

As an example, consider a brick wall that has been spray-painted with graffiti. The cost of sandblasting the wall to remove the graffiti is $5,000. Nowhere in the overall cost new of the original construction is there a provision for the removal of graffiti. The measure of damage in this instance would be $5,000, the full cost to cure.

Typically, the cost to cure damage is added to the curable physical deterioration and included among the items of physical deterioration in the breakdown method. However, the $5,000 cost to cure is not subtracted from cost when calculating long-lived physical deterioration.

A summary of the depreciated cost of the improvements is shown below:

Total Current Cost of All Improvements		$800,000
Less Depreciation		
Short-Lived Components	$80,000	
Long-Lived Components	+ $163,250	
Total Depreciation		– $243,250
Depreciated Value of Building Improvements		$556,750

Functional Obsolescence

Functional obsolescence is caused by a flaw in the structure, materials, or design of an improvement when the improvement is compared with the highest and best use and the most cost-effective functional design requirements at the time of the appraisal. A building that was functionally adequate at the time of construction can become inadequate or less appealing as design standards, mechanical systems, and construction materials evolve.

Functional obsolescence is attributable to defects within the property lines, in contrast to external obsolescence, which involves conditions outside the property lines and therefore outside the control of the owner and occupants. Functional obsolescence, which may be curable or incurable, can be caused by a deficiency–that is, some aspect of the subject property is below standard in respect to market norms. It can also be caused by a superadequacy–that is, some aspect of the subject property exceeds market norms.

In some cases, a developer or property owner creates functional obsolescence by incorporating special features at the request of the occupant that would not appeal to the market in general. An example of a superadequacy is an expensive, in-ground swimming pool in a neighborhood of relatively low-cost homes. Equally common is functional obsolescence that occurs as a result of changing tastes or market preferences. Too few bathrooms in a residence or warehouse ceiling heights that are below current standards are examples of functional obsolescence due to deficiencies.

than accounting for immediately apparent physical losses. However, the process of identifying and selecting an appropriate treatment for a functional problem is simplified when the problem is broken down into manageable tasks using the framework illustrated in Figure 29.5. The first step is to identify the functional problem. In many cases this is readily apparent from the appraiser's site visit and information from the highest and best use analysis or other analyses in the valuation process. Once the functional problem has been identified, the next step is to determine which building components are causing the problem and identify possible corrective measures (and the associated costs to cure).

Figure 29.5 Analyzing a Functional Problem

1. Identify the functional problem.
2. Identify the component (or components) in the facility, or the lack of a component (or components), associated with the problem.
3. Identify possible corrective measures and the related costs to cure.
4. Select the most appropriate corrective measure.
5. Quantify the loss caused by the functional problem, which results in added value if the problem is corrected.
6. Determine if the item is curable or incurable. (If the value added is equal to or greater than the cost to cure, the functional problem is curable.)
7. Apply the functional obsolescence procedure to calculate the amount of depreciation caused by the functional problem.

In many cases, only one cost-to-cure program will clearly identify the course of action to fix or improve a functional problem. Often there may be no economically feasible or practical method to cure the problem. (This is true especially for superadequate components.) In these cases the component is incurable and the property must endure the loss in value. If there are multiple cost-to-cure alternatives to fix a particular problem, an appraiser should select the most appropriate and cost-effective measure.

The cost to cure must account for the cost to tear out or replace the existing component, the cost of the correct replacement component, any other costs above and beyond the total cost if the component had been included in the initial construction, and any salvage value. Essentially, the final measure is the total cost to cure offset by any salvage value:

Cost to Tear Out or Remove Existing Component
+ Cost of Correct Replacement Component (including Entrepreneurial Incentive)
+ Any Costs Above and Beyond Total Cost if Included in Initial Construction
– Salvage Value (if any)
= Cost to Cure

The next step is to quantify the loss caused by the functional problem associated with the building component. The value loss could be caused by a loss in income, an increase in expenses or operating costs, or a combination of both. Alternatively, the value loss might be quantified by market evidence such as paired data analysis. By definition, the

Appendix 2

2006 WL 5485883 (Kan.Bd.Tax.App.)

Board of Tax Appeals

State of Kansas

IN THE MATTER OF THE EQUALIZATION APPEAL OF PAOLA-SUNDANCE APARTMENTS FOR THE YEAR 2004 FROM MIAMI COUNTY, KANSAS AND IN THE MATTER OF THE EQUALIZATION APPEALS OF MIAMI COUNTY APPRAISER/PAOLA-SUNDANCE APARTMENTS FOR THE YEAR 2005 FROM MIAMI COUNTY, KANSAS

Docket Nos. 2004-8772-EQ, 2005-9276-EQ & 2005-9277-EQ
December 29, 2006

ORDER

***1** Now the above-captioned matters come on for consideration and decision by the Board of Tax Appeals of the State of Kansas.

This Board conducted a hearing in these matters on August 10, 2006. By Order of the Board certified January 25, 2006, the Board consolidated these three appeals for purposes of hearing and adjudication. After considering all of the evidence presented, the Board finds and concludes as follows:

The Board has jurisdiction of the subject matter and the parties as equalization appeals have been filed pursuant to K.S.A. 79-1609. The subject matter of these tax equalization appeals is described as follows:
Docket Nos. 2004-8772-EQ & 2005-9276-EQ

Real estate and improvements commonly known as 202 E. Sundance Drive, Paola, Miami County, Kansas, also known as Parcel ID # 061-132-09-0-40-06-003.43-0 (hereinafter "Sundance I"); and

Docket No. 2005-9277-EQ

Real estate and improvements commonly known as 1010 Industrial Park, Paola, Miami County, Kansas, also known as Parcel ID # 061-132-09-0-40-06-001.01-0 (hereinafter "Sundance II").

The Taxpayer, Paola-Sundance Apartments, appeared by Carol B. Bonebrake, Attorney; Tom Savage, Property Tax Consultant; and Bernie Shaner, Appraiser. The County appeared by David R. Heger, County Counselor; Peggy Stroup, Deputy County Appraiser; and Russ Dillon, Appraiser. The Board admitted County Exhibits # 3, part of # 5, and # 6 through # 9 and Taxpayer Exhibits # 1 and # 2. The Board did not admit County Exhibits # 1, # 2, # 4 and pages 1-13 of # 5.

Sundance I is a 40-unit, frame construction, two story apartment complex built in 1999 and located in Paola, Kansas. Twenty-four (24) units have two bedrooms and sixteen (16) units have three bedrooms. As of 2004, the complex was in average condition.

Sundance I was developed as a Section 42 low-income tax credit housing project. It is subject to a Declaration of Land Use Restrictive Covenants for Low-Income Housing Credits ("Declaration") dated November 24, 1999 between the owner and the Kansas Department of Commerce and Housing ("KDCOH") which is filed of record, runs with the land,

and binds future owners. Pursuant to the Declaration, the Taxpayer agreed to lease 100% of its units to persons whose income is 60% or less than the area's median gross income in accordance with Section 42 of the Internal Revenue Code. The Declaration restricts rents for a period of 30 years; the rent structure is $430 per month for the two bedroom units and $483 per month for the three bedroom units. An amendment of the KDCOH agreement to increase the rental rate, if permitted, would result in the imposition of a penalty upon the owner.

***2** The County originally valued Sundance I at $2,103,890 for tax year 2003. The County lowered the value to $1,543,800 following the informal meeting. The Taxpayer appealed to the Small Claims Division of the Board. The Small Claims Hearing Officer reduced the value to $924,960 based upon the actual income and expenses of Sundance I. The County received a copy of the 2003 decision on July 13, 2004. Neither party appealed the decision.

The County valued Sundance I at $1,543,800 for tax year 2004 and $1,554,500 for tax year 2005. The Taxpayer appealed the 2004 value to the Regular Division of the Board. The Taxpayer appealed the 2005 value to the Small Claims Division. The Small Claims Hearing Officer found that the market for subsidized properties is impacted by restrictions on investors' income return and saleability of the property and reduced the 2005 value to $871,200. The County appealed the Small Claims decision to the Regular Division of the Board of Tax Appeals.

Sundance II is a 40-unit apartment complex constructed in 2003. It is Class D frame, average quality construction consisting of two buildings in a two-story walk-up design. It has thirty-two (32) two bedroom, two bath units and eight (8) three bedroom, two bath units. Sundance II's amenities include a clubhouse, small playground area, laundry room and a manager's office.

Sundance II is a Section 42 project developed for the purpose of providing affordable housing to individuals with low incomes. Sundance II is subject to a Declaration of Land Use Restrictive Covenants for Low-Income Housing Credits ("Declaration") with KDCOH dated June 7, 2001. Pursuant to the Declaration, the Taxpayer and all future owners and operators are subject to restrictions on use, occupancy and transfer of the land and project. KDCOH may void any sale, transfer or exchange if the buyer fails to assume in writing the requirements of the Declaration and Section 42 of the Internal Revenue Code. The owner must comply with the requirements of Section 42 for a 30 year period; all 40 units shall be leased to individuals who qualify as low-income tenants; and the units are rent restricted. The restricted rents are $450 per month for the two bedroom units and $485 per month for the three bedroom units.

The County valued Sundance II at $1,450,000 for tax year 2005. The Taxpayer appealed the 2005 value to the Small Claims Division. The Small Claims Hearing Officer found that the market for subsidized properties is impacted by restrictions on investors' income return and saleability of the property and reduced the 2005 value to $923,600. The County appealed the Small Claims decision to the Regular Division of the Board of Tax Appeals.

Peggy Stroup, Deputy County Appraiser, testified that the County valued the subject properties at fee simple at fair market value. Stroup asserted that fee simple requires that the appraisal be made as unencumbered property including the full bundle of rights. The County's position is that the tax credits or financing should not be considered and that subsidized apartments should be considered no different than any other apartment buildings out there.

***3** The County also called Russell Dillon, a Kansas certified real estate appraiser. Pursuant to the letter of authorization from the County, Dillon was asked to determine the fair market value in fee simple estate of the subject properties without regard to any encumbrances for the years in question. Dillon appraised the properties in fee simple estate utilizing the cost, sales comparison and income approaches. Dillon's opinions of value for Sundance I as of January 1, 2004 was $1,773,300 and as of January 1, 2005 was $1,876,000. His opinion of value for Sundance II as of January 1, 2005 was $2,115,300. (County Exhibits # 6, # 7 and # 8.)

Dillon's cost approaches were based upon the Marshall Valuation Cost Service Manual without any external obsolescence and the Sundance II land sale from May 2002. Dillon considered four sales of similar wood frame, two story, walk-up projects and adjusted the sale prices for differences in time/market conditions, quality/condition and average unit size. Further, Dillon's estimate of market rent used in his income approach was based upon rental rates at properties not rent restricted or encumbered. Dillon asserted that the cost approach was a good indicator of value based upon the age of the properties and the income approach was particularly appropriate based upon the volume of market data.

For Sundance I, Dillon's income approach indicated a value of $1,800,000 for 2004 and 2005. Upon review of three market comparables in Paola and one in Louisburg, Dillon opined that market rent for the two bedroom, two bath units is $575 and the market rent for the three bedroom, two bath units is $675. Dillon asserted that the market suggests that 100% occupancy is being achieved citywide. He utilized a stabilized 95% occupancy level. For tax year 2005, the sales comparison approach indicated a value of $2,000,000 and the cost approach indicated a value of $1,910,000. With a range in value of $1,800,000 to $2,000,000, Dillon concluded a market value opinion of $1,900,000 in fee simple estate as of January 1, 2005. The property includes items of personal property with a depreciated contributory value estimated at $24,000 for a real property value of $1,876,000 for 2005. (County Exhibit # 8) Dillon prepared a supplement to his January 1, 2005 appraisal for January 1, 2004. (County Exhibit # 6) Dillon again completed the cost approach, sales comparison approach and income approach. These methodologies suggested values of $1,800,000, $1,900,000 and $1,800,000, respectively. Dillon concluded a market value opinion of $1,800,000 for 2004. With depreciated contributory value of personal property estimated at $26,700, Dillon's opinion of value for the Sundance I real property was $1,773,300 for 2004.

For Sundance II, Dillon similarly performed the cost approach, sales comparison approach and income approach. These methodologies suggested values of $2,150,000, $2,100,000 and $1,950,000, respectively. Based upon the cost approach due to the age of the property, Dillon concluded a market value opinion in the fee simple estate of $2,150,000 as of January 1, 2005. With depreciated contributory value of personal property estimated at $34,700, Dillon's opinion of the real property value was $2,115,300 for 2005. (County Exhibit # 7)

***4** The County requests that the Board recognize Dillon's appraisals as being in conformance with state law and recognized appraisal practices and find that the appraisals for Sundance I be established at $1,773,300 for 2004 and $1,876,000 for 2005, and for Sundance II be established at $2,115,300 for 2005.

The Taxpayer called Tom Savage, a property tax consultant with Savage & Browning who represents approximately 150 Section 42 properties in various states, to describe the restrictions upon Section 42 properties. Under the Declarations, Sundance I and Sundance II must provide housing for a 30 year period of time at a pre-established rent to tenants who earn 60% or less than the median income. Savage explained that while the Taxpayer could seek to amend the rental amounts, they may do so only if KDCOH, HUD and the IRS approve. Further, any change not so approved would subject the Taxpayer to substantial penalties and allow the IRS to recapture the tax credits. Savage stated that if a property is removed from the Section 42 program before the expiration of the restriction period, the owners have to refund all of the tax credits received plus 12% interest and a penalty. He was aware of only one 26-unit project which sold for $500,000 subject to tax credits and the project stayed in the Section 42 program rented at the restricted rents.

Savage also testified that he was aware of one particular situation where an owner in Montgomery County owned a 100-unit complex in the Section 42 program. The owner found it to be a bad investment because a pool of qualified tenants was not available to occupy the property. There were plenty of people wanting to rent the units, but they made more than 60% of median income. As a result, the owner removed 40 units from the Section 42 program with approval, refunded back to the IRS the income tax credits that had been paid out to that point plus interest, and paid a penalty.

Bernie Shaner, MAI, SRA, appraised the subject properties on behalf of the Taxpayer. Shaner explained that Section 42 properties are unique as they are developed for the purpose of providing housing in areas where there is a shortage

of good affordable housing. He further explained the process of project application, approval and tax credit allocation. He has appraised numerous Section 42 properties and typically there are two values, one for the real estate and one for the tax credits which are not part of the real estate.

Shaner was engaged to appraise the subject properties at fair market value for *ad valorem* taxation purposes. He utilized two of the three traditional approaches to value - the cost approach and the income approach. He did not perform a sales comparison approach due to lack of comparable sales with land use restrictions. Shaner considered both the actual costs of construction of Sundance II and the Marshall Valuation Service Manual costs. He used the higher actual cost of $71.90 per square foot. Sundance II had no physical depreciation because it was essentially new at the time of valuation. Shaner testified that both Sundance I and Sundance II suffered from external obsolescence due to the restrictions placed upon their income production capabilities. He asserted that external obsolescence is measured by the amount of income the property can produce versus its cost. He determined that there was a 63% external obsolescence factor due to the below market rents. Shaner's cost approach conclusions of value were $900,000 for Sundance I for 2004 and $1,100,000 for Sundance II for 2005. (Taxpayer Exhibit # 2.)

***5** Shaner also performed income approaches utilizing the contract rents to which the properties are restricted. He allowed 6% vacancy and collection loss and added $81.00 per unit for miscellaneous income. To determine operating expenses, Shaner reviewed the three-year income and expenses history of the properties, considered the operating numbers of competing properties, and consulted the Institute of Real Estate Management survey for industry average costs of operation. He analyzed each expense item and determined what the stabilized expenses should be for each category. Shaner determined his capitalization rate by analyzing ten sales of apartments, mostly in Johnson County. He asserted that the capitalization rate needed to be above the normal market because the restrictions make it harder to sell Section 42 properties. For 2004, Shaner utilized an 8.5% capitalization rate or overall capitalization rate of 10.07% including the effective tax rate. For 2005, Shaner utilized an 8.0% capitalization rate or overall capitalization rate of 9.57%. Shaner's income approaches indicated values of $855,000 for Sundance I for 2004; $885,000 for Sundance I for 2005; and $905,000 for Sundance II for 2005. Shaner relied upon the income approach to support his opinions of value. The Taxpayer requests that the Board find that the fair market values of Sundance I are $855,000 for 2004 and $885,000 for 2005 and the fair market value of Sundance II is $905,000 for 2005. (Taxpayer Exhibit # 2.)

In Kansas, each parcel of non-agricultural real property is appraised at its fair market value. See K.S.A. 79-501 and K.S.A. 79-1439(a). Pursuant to K.S.A. 79-503a, the term "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 further provides:
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;

(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.

***6** 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 which are adaptable to mass appraisal and consistent with the definition of fair market value unless otherwise specified by law.

K.S.A. 79-505(a)(1) also requires that all appraisals in connection with *ad valorem* taxation be performed in accordance with generally accepted appraisal standards. The Division of Property Valuation adopted Directive # 92-006 incorporating by reference the Uniform Standards of Professional Appraisal Practice, commonly referred to as USPAP. In 1998, the Division of Property Valuation promulgated a Subsidized Housing Appraisal Guide noting concern about the uniform appraisal treatment of subsidized housing projects by Kansas county appraisers. The guide stated that intangibles such as Section 42 tax credits offered by the Internal Revenue Service will not meet the definition of property as stated in K.S.A. 79-501. Further, with respect to the cost approach, the Guide notes these projects suffer from an inordinate amount of external depreciation in comparison to other apartment complexes reflecting a marketplace not having the purchasing power to pay rents that will support the construction cost. However, with respect to the income approach, the Guide instructs appraisers with ample income and expense data to appraise the fair market value utilizing local market derived capitalization rates, rental rates and expenses. The Guide explains that the value sought is the value in exchange for cash and one must ignore rent subsidies, book interest rates and tax benefits.

The Kansas Court of Appeals addressed the issue of the effects of low-income housing contracts when valuing property for *ad valorem* taxation purposes in *In re the Equalization Appeal of Ottawa Housing Assoc., L.P.*, 27 Kan.App.2d 1008, 10 P.3d 777 (2000). The district court had sustained the Board's decision sustaining Franklin County's appraisal and finding that Ottawa Housing's value failed to consider both the benefits and burdens of the low-income housing contract. Franklin County admitted that it did not consider the rental restrictions in its appraisal. Ottawa Housing argued that this admission established that the appraisal was not in conformance with K.S.A. 79-503a(d) and (j). The Court noted that Kansas had not yet addressed the issue, but that several other states had addressed the issue. The Court cited several cases and stated that "[w]ith the exception of cases from Ohio, all of the cases support the proposition that the taxing authority should consider the effects of the low-income housing contract when valuing the property for *ad valorem* taxes." *Id.* at 1011. The Court found that:

These cases apply the general theory that a low-income housing contract is an investment tool for maximizing an investment in real estate. (Citations omitted) Buyers and sellers of real estate consider these tools in determining the market value of real estate. (Citations omitted) This principle corresponds with the Kansas definition of "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." K.S.A. 79-503a. *Id.* at 1013.

*7 Pursuant to K.S.A. 79-1609, with regard to any matter properly submitted to the Board relating to the determination of valuation of residential property, it shall be the duty of the county appraiser to initiate the production of evidence to demonstrate, by a preponderance of the evidence, the validity and correctness of such determination. No presumption shall exist in favor of the county appraiser with respect to the validity and correctness of such determination. Pursuant to Kan. Const. art. XI, § 1, the subject properties are classified as residential property. Therefore, the above duty is placed upon the County.

Pursuant to *Ottawa Housing*, the effects of low-income housing contracts must be considered when valuing property for *ad valorem* taxation purposes. The Board finds that the effects of the low-income housing contracts should be analyzed on a case by case basis in light of the specific property at issue and the relevant marketplace. Contrary to the references in *Ottawa Housing* to K.S.A. 79-503a(j), the Board finds that the rent restrictions in this case are not "restrictions imposed upon the use of real estate by local governing bodies, including zoning and planning boards or commissions." The owner of the subject properties voluntarily entered into a contract in which it agreed to rent the property to low income tenants in exchange for tax credits. First, there are no restrictions placed on the use of the real estate at all. It is a voluntary obligation only. If the property is not leased to low income tenants as required by contract, the owners will not qualify for the tax credits. Nevertheless, there is no restriction on use. Second, the "restrictions" are not imposed by anyone. They are awarded after the owner applies for them and enters into a contractual agreement. There are more applicants than there are tax credits available. Third, the "restrictions" are awarded, not by a local governing body, but by federal and/or state agencies. Thus, these low-income housing contract obligations should not be considered a part of K.S.A. 79-503a(j).

The fair market value of real property should be based upon the highest and best use of the property. See 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 Dictionary of Real Estate Appraisal*, Appraisal Institute, p.135 (4th ed. 2002); *Yellow Freight System, Inc, et al. v. Johnson County Board of County Comm'rs*, 36 Kan.App.2d 210, 217, 137 P.3d 1051, *rev. denied* (2006). As shown by a comparison of the Shaner and Dillon appraisals, the Board finds that the highest and best use of the subject properties is to operate the apartment complexes at market rental rates. In this case, the owner does not even own the tax credits, having sold them previously, but the issue is not one of maximizing the value of the intangibles, it is the value of the real property. The maximum productivity in this case is achieved through offering the units at reasonable market rental rates. This is not a case where there is inadequate market demand for the units, such as may be the case in a depressed or low-income area. The evidence in this matter shows that the market occupancy exceeds 95% in non-subsidized housing.

*8 The Board further notes that the *Ottawa Housing* decision highlights K.S.A. 79-503a(f) and (h) relating to the productivity and rental or reasonable rental values, respectively. Both considerations lead to the same issue - is the productivity or reasonable rental value of the property limited by the housing contract or is it market-based? The County provided clear and convincing evidence that the subject units would reasonably rent for more each month and produce much more income if the owner chose to offer them at market rates, rather than voluntarily restrict the rent. Unlike zoning and planning board restrictions, which place legal restrictions on the use of the property, offering and renting these units at achievable market rates is not illegal. As stated previously, the Board finds that the highest and best use in terms of return to the real estate in this case is to offer the units at market rent. Further, the evidence presented in this matter is that market rents even justify the cost of construction. However, the Board recognizes that once the owner has been granted tax credits, the owner can achieve even greater returns in the form of intangible tax benefits. These intangibles are not taxed because they are not real or tangible personal property. K.S.A. 79-501.

Even though the Taxpayer has sold its tax credits, the Board agrees that the credits are still inextricably intertwined with the real estate due to the contractual obligations. If the owner decides to maximize the return to the real estate, the tax credits must be repaid with penalties, but they are intangible assets. Furthermore, the issue is fee simple value, which is premised on the value of the entire bundle of rights. Sale of the tax credits is no different than the sale of any other

portion of the bundle of rights, such as a transfer of the right to use and enjoy the property through a lease. Neither a below-market or above-market lease is a factor in the fair market value determination for *ad valorem* tax purposes, nor is any incremental value of a high-credit tenant. The typical market lease terms are utilized. If the owner had chosen to keep the benefit of the tax credits, its decision would be whether the market rent at any time would justify fee simple market value use or whether the value to the particular investor is greater because of the combination of the real estate and the intangible tax credits. The Board finds that the owner could sell the properties for the amounts asserted by the County based upon the market evidence, but the owner would net less on the transaction because of its tax credit financing decision. The Board is required to appraise the fair market value of the real property, not the investment value or the value to a particular investor.

The Board finds that the use of market-derived evidence in this case is supported by the ample local market rental data and the high occupancy rates of non-subsidized housing in the local market. Further, the Board finds that the subject properties do not suffer from an inordinate amount of external depreciation in comparison to other apartment projects because the local market in this case does include the purchasing power to pay rents that justify construction. These findings are consistent with guidance provided for the income approach and cost approach by the PVD Guide. After fully considering the effects of the low income housing contract in this case, the Board concludes that substantial competent evidence in light of the record as a whole supports the County's recommended values based upon the Dillon appraisals as reflecting the fair market values of the real estate.

***9** However, the Board notes that the valuation of Sundance I for tax year 2003 was reduced pursuant to a final determination made pursuant to the valuation appeals process. The County did not present documented substantial and compelling reasons to increase the valuation for 2004. As a result, the Board concludes that the valuation of Sundance I shall not be increased for tax year 2004 pursuant to K.S.A. 79-1460(a)(2). The appraised value of Sundance I shall remain $924,960 for tax year 2004.

For the foregoing reasons, the Board concludes that the appraised values of Sundance I are $924,960 for 2004 and $1,876,000 for 2005 and the appraised value of Sundance II is $2,115,300 for 2005.

IT IS THEREFORE ORDERED BY THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS that the appraised values of Sundance I are $924,960 for 2004 and $1,876,000 for 2005 and the appraised value of Sundance II is $2,115,300 for 2005. IT IS FURTHER ORDERED that the appropriate officials are directed to correct the County's records accordingly, re-compute the taxes owed by the Taxpayer and issue a refund for any overpayment.

IT IS SO ORDERED

Rebecca W. Crotty
Chairperson
Thomas H. Slack
Member
J. Fred Kubik
Member
Joelene R. Allen
Secretary
Amelia Kovar-Donohue
Attorney

2006 WL 5485883 (Kan.Bd.Tax.App.)

End of Document

Appendix 3

422 P.3d 689 (Table)
Unpublished Disposition
This decision without published opinion
is referenced in the Pacific Reporter.
See Kan. Sup. Ct. Rules, Rule 7.04.
NOT DESIGNATED FOR PUBLICATION
Court of Appeals of Kansas.

In the MATTER OF the EQUALIZATION APPEAL OF KANSAS STAR CASINO, L.L.C. for the Year 2015 in Sumner County, Kansas.

No. 116,782
|
Opinion filed July 20, 2018.

Appeal from the Board of Tax Appeals.

Attorneys and Law Firms

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.

MEMORANDUM OPINION

Powell, J.:

***1** 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*

***2** 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.

***3** 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*

***4** 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.

***5** 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.

***6** 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.

***7** 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 nonproductive 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.

***8** 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."

***9** 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, $12\,^{1}/_{2}\%$ 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.

***10** 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).

***11** 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).

***12** 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;
>
> ***13** "(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.

***14** "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.

***15** "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.

***16** 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.

***17** 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.

***18** 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.

***19** 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.

***20** 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.

***21** 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.

***22** 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.

All Citations

422 P.3d 689 (Table), 2018 WL 3486173

End of Document

Appendix 4

420 P.3d 496 (Table)
Unpublished Disposition
This decision without published opinion
is referenced in the Pacific Reporter.
See Kan. Sup. Ct. Rules, Rule 7.04.
NOT DESIGNATED FOR PUBLICATION
Court of Appeals of Kansas.

In the MATTER OF the Equalization Appeal of KANSAS STAR CASINO, L.L.C. for the Year 2013 in Sumner County, Kansas.

No. 115,587
|
Opinion filed June 8, 2018.

Appeal from Sumner District Court; R. SCOTT MCQUIN, judge.

Attorneys and Law Firms

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

Before Powell, P.J., McAnany, J., and Hebert, S.J.

MEMORANDUM OPINION

Powell, J.:

***1** Kansas Star Casino, L.L.C. (Kansas Star) appeals from the district court's ruling that established a 2013 valuation for ad valorem tax purposes of $152 million for its real property located in Sumner County, Kansas. Kansas Star argues the district court erred in two principal ways: (1) The court's cost approach to value contained numerous errors; and (2) the court erred by rejecting Kansas Star's appraisal expert's income approach to value. For reasons more fully explained below, we agree that the district court erred in two respects which require a remand: First, the district court erred by miscalculating the acreage of the real estate, meaning that its valuation could be in error as a result; and second, the district court erred by relying solely on the Deloitte and Touche audit of the sale of the Kansas Star Casino to calculate reproduction costs because such audit figures were not intended to reflect actual reproduction costs. We affirm the district court in all other respects.

FACTUAL AND PROCEDURAL BACKGROUND

As this court explained in detail in *In re Equalization Appeal of Kansas Star Casino*, 52 Kan. App. 2d 50, 52-55, 362 P.3d 1109 (2015), *rev. denied* 307 Kan. —— (December 20, 2017), Kansas Star is one of four state-sponsored gaming enterprises in Kansas and is located in the south central gaming zone. In April 2007 the Kansas Legislature enacted K.S.A. 74-8733 et seq., the Kansas Expanded Lottery Act (KELA) to authorize a limited number of casinos to be operated in Kansas. KELA divided the state into four gaming zones: northeast, south central, southwest, and southeast, with a single gaming facility allowed in each gaming 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).

A. *The Property*

Kansas Star is located in a rural area in the northeast corner of Sumner County (the County), near the southern border of Sedgwick County, just east of Highway 81 and immediately west of the Kansas Turnpike/Interstate Highway 35, the two primary highways that carry traffic between Sumner County and Wichita. The subject property consists of real estate, the casino, an arena events center, and other improvements and is largely surrounded by farm land.

The real estate consists of two formerly agricultural-use land tracts known as the Wyant and Gerlach tracts. The casino is situated on the southern Gerlach tract, while the northern Wyant tract is undeveloped aside from ingress and egress roads and permanent drainage easements. Kansas Star and the County both valued the real estate as one economic unit for tax year 2013. The Gerlach tract is a 145.5-acre site purchased via an option contract for $3,631,250 ($25,000 per acre), plus $5.3 million to acquire the purchase option, for a total price of $8.9 million. Kansas Star exercised the purchase option on the 55.7-acre Wyant Tract for $8 million. After land platting and

donations to various entities, the parties agree that the usable combined site is 195.5 acres.

***2** The property was developed and constructed in phases. Kansas Star's initial proposal to the State called for the construction of a casino and an arena that would feature equine events and include approximately 600 horse stalls. While the permanent casino was under construction, Kansas Star operated a temporary casino in this arena, which opened its doors on December 26, 2011. Phase 1A was the construction of the arena with the temporary casino finishes. Phase 1B was the construction of the permanent casino, and phase 2 was the conversion of the arena from the temporary casino to the permanent arena. In December 2012, Kansas Star opened its permanent casino facility, which offers 1,825 electronic gaming machines, 45 table games, and 5 restaurants. As of the January 1, 2013 valuation date, phases 1A and 1B were complete—with the exception of the construction of a hotel—while phase 2 was ongoing. The hotel is owned and operated separately and is not included in the valuation.

At some point during the construction process, Kansas Star received permission from the Kansas Racing and Gaming Commission to change its plans for the arena. It received permission to downsize the number of horse stalls from 600 to 183, and it redirected the construction dollars to a conference and event center that was not proposed in the original gaming contract bid.

B. *Board of Tax Appeal (BOTA) Proceedings*

The appraised value for tax year 2012 was $91 million. For tax year 2013, the County initially valued the subject property at $226 million, nearly double the $127 million acquisition and construction costs for the property. Della Rowley, the Sumner County Appraiser, testified that she came up with the $226 million value, but she did not consider herself qualified to appraise the casino property and she did not perform an actual appraisal. Rowley said the best information available to her for purposes of estimating fair market value was the project budget presented to the City of Mulvane and the County. Not surprisingly, Kansas Star disagreed with the County's proposed value and appealed to BOTA under K.S.A. 2012 Supp. 79-1609. (At the time Kansas Star appealed the County's tax valuation, the agency was known as the Court of Tax Appeals [COTA]. The agency name was changed to Board of Tax Appeals [BOTA] in 2014. L. 2014, ch. 141.)

After the property tax appeal was filed, the County hired Richard Jortberg, MAI, to appraise the property. Jortberg had been retained in 2000 by Gilpin County, Colorado, to value casinos within that county and has appraised approximately 30 to 40 casinos each valuation cycle for the past 12 years. Jortberg is also a licensed Kansas appraiser.

Jortberg performed an appraisal and concluded that the fair market value of the fee simple interest was $140 million. Jortberg considered all three approaches to value: the sales comparison approach, the cost approach, and the income approach. Jortberg found a lack of comparable sales to the property's unique status as the sole casino operation in the area. Jortberg used the income approach as a test of reasonableness for his cost approach analysis and concluded that because Kansas Star's business enterprise value far exceeded the value derived under this cost approach analysis, the cost approach was appropriate. Jortberg performed a highest and best use analysis and concluded that because it would be physically possible, legally permissible, financially feasible, and maximally productive to use the subject property for gaming/casino purposes, it was the property's highest and best use, both as vacant and improved.

Jortberg's cost approach consisted of land value and reproduction costs. For the land value, Jortberg used the $17 million purchase price for the Wyant and Gerlach tracts. However, because the property's actual gaming revenues were 10% higher than projected before the gaming management contract was awarded and before construction began, Jortberg also included a 10% upward adjustment to the purchase price—which he explained as being based on the property proving itself to be 10% more capable of being a successful casino operation than anticipated. Jortberg calculated a total land value of $18.7 million.

***3** Jortberg testified that the property's land value was derived from KELA, the property's location as the closest property in Sumner County to Wichita, the property's accessibility from numerous highways, the property's visibility, its established utility extensions and infrastructure, and its functionality and developmental potential.

Jortberg had difficulty identifying comparable sales, but he ultimately compared the property to the sales prices in unexercised options for the nearby land tracts as well as the price paid for the land for Boot Hill Casino in Dodge City. Jortberg explained the sales prices were relevant because at the time they were agreed upon, KELA would have permitted gaming on those properties. Based on these comparisons, Jortberg concluded the price paid to acquire the property was the best evidence of value.

Jortberg did not include any deduction for functional obsolescence or external depreciation because the property was a new facility designed by experienced gaming operators. He pointed out that Boyd Gaming had purchased the property as part of its acquisition of Peninsula Gaming, the original owner of Kansas Star, and the audits conducted for Boyd Gaming reflected a value basis at cost or higher. With respect to depreciation and functional obsolescence, Jortberg analyzed both the arena and casino as a single unit without accounting for the mixed nature of the property. Jortberg acknowledged several methods of calculating depreciation and functional obsolescence, but he did not analyze any potential superadequacy of construction. Similarly, Jortberg stated in his report that there was no economic obsolescence because "the enterprise value far exceeds the value of the real property." Jortberg further explained that he does not deduct functional or economic obsolescence unless the enterprise value is less than the reproduction or replacement cost.

Jortberg's appraisal also contained an "extraordinary assumption" as to the accuracy of the information he relied on in his appraisal because not all of the information desired was available from the property owner or its representatives. Jortberg wrote in his report:

> "There is one significant extraordinary assumption integrated in this valuation assignment. Not all information desired regarding the valuation of the subject property was available to the appraiser. It is an extraordinary assumption that the information presented in this report is accurate and that no material difference of any kind exists between that which has been included in the report. The extraordinary assumption is necessary since not all information desired was available from the property owner or its representatives. This is a particularly important assumption because of conflicting financial information presented in documents from Deloitte and Ernst and Young related to the subject property. The appraiser reserves the right to modify the value of the subject property if additional information is obtained."

Kansas Star disputes this, noting that it provided all of its construction cost information to the County. Moreover, Jortberg admitted that he did not review the letter provided by Kansas Star containing its construction costs "[b]ecause I had other documents that I had from the Taxpayer that I thought were—that I used."

James Vernor, a registered real estate appraiser and a witness called by Kansas Star, prepared a Uniform Standards of Professional Appraisal Practice (USPAP) review appraisal of the Jortberg appraisal report. Vernor's detailed report identified numerous USPAP violations in Jortberg's report and concluded it was not USPAP compliant. He noted flaws in the land value analysis and a lack of recognized appraisal methodology in the depreciation and obsolescence determination. Vernor expressed concern with Jortberg's method of separating the intangible value from the real estate. Vernor believed that Jortberg should have included a hypothetical condition which could have accounted for how the passage of KELA and the casino management contract affected the value of the subject property. Vernor noted that KELA specified that the management contract not be considered property, but there was nothing in the report that acknowledged that Jortberg was aware of the provision in KELA, that he had read it, or that he tried to follow it. Vernor testified that he believed that Jortberg "missed the whole thrust of that KELA provision and that permeates the land value in his cost approach and ... his treatment or lack of treatment of functional obsolescence in his cost approach." In addition, Vernor criticized Jortberg's classification of the management contract as zoning and the fact that there was not enough research as to whether the Wyant tract was considered excess land.

***4** David Lennhoff, MAI, was retained by Kansas Star to appraise the property. Lennhoff is a nationally recognized expert in the area of separating real estate value from intangible value. Lennhoff performed a cost approach and a combined income/sales approach to the property. Kansas Star contends that the fair market value of the property is $62.1 million based on Lennhoff's appraisal.

Curtis Settle, a Colorado certified appraiser and a witness called by the County, performed a review appraisal of

both Lennhoff's appraisal for Kansas Star and Jortberg's appraisal for the County. Settle found no internal inconsistencies with the Jortberg appraisal, but he did not give an independent valuation for the property. Settle concluded that Lennhoff's appraisal incorrectly reduced the value of the real estate by $49.2 million below the cost of construction "because the State of Kansas allowed construction of a casino on the property." Settle also noted that "even assuming that the Lennhoff appraisal's hypothetical condition is correct, the resulting value conclusion lacks credibility because of the limited analysis and internal inconsistencies."

Before BOTA, the County, which had the burden of proof as to valuation, abandoned the $226 million valuation for the property and, instead, revised its position consistent with Jortberg's appraisal which asserted a value of $140 million. In closing arguments, the County's counsel asserted that that $140 million was an appropriate number but further suggested that an additional 15% for entrepreneurial profit might also be appropriate. Entrepreneurial profit is a market-derived figure showing the amount an entrepreneur expects to receive in addition to the construction costs. However, Jortberg's report specifically excluded any entrepreneurial incentive because owner/operator organizations generally develop casinos for their own specific use and their return was generally based on enterprise value created by the facilities.

BOTA rejected Jortberg's appraisal analysis for failing to apply recognized appraisal analyses to consider whether functional or economic obsolescence existed and, in fact, was not persuaded by either party's treatment of the obsolescence or depreciation issue under the cost approach. BOTA stated:

> "Jortberg failed to analyze any potential superadequacy of construction even though superadequacy was a potential issue given the KELA minimum investment requirement. Instead, Jortberg simply states that 'the appraiser notes no functional obsolescence.' County Ex. #522, p. 54. Jortberg stated in his report that no economic obsolescence existed because the business enterprise value far exceeds the value of the real property. Jortberg performed no recognized appraisal analysis to determine whether functional or economic obsolescence existed."

BOTA ultimately rejected the cost approach presented by both parties' experts and instead concluded that the best appraisal methodology was the income approach, estimating a value of the going concern—or business enterprise value—with a market-derived allocation applied to arrive at an estimated market value. BOTA then modified Lennhoff's income approach by increasing his profit margin and allocation percentages to estimate a fair market value for the property of $105.6 million.

Both sides appealed and sought judicial review by a trial de novo in the district court.

C. *District court proceedings*

***5** Before the district court, no new evidence was presented, and the court considered the matter de novo based upon the BOTA record. The County abandoned all of its prior value determinations and instead picked out portions of the record from a variety of witnesses and exhibits to argue that the true value of the property was $154 million. Specifically, the County argued for a land value of $20 million, a reproduction cost of $113.3 million, and an entrepreneurial incentive of 15% as utilized in Lennhoff's appraisal. The County accounted for zero depreciation or obsolescence for the property—as suggested by Jortberg in his appraisal—for a total value of $154 million.

Because the County's own expert before BOTA had valued the property at less than the initial valuation of $226 million, Kansas Star moved for partial summary judgment on its tax liability and sought a refund of the amount of taxes it paid for value in excess of the $140 million value testified to by the County's expert. The district court denied the motion.

In an order dated January 6, 2016, the district court adopted the County's proposed findings of fact and conclusions of law, with the exception of using the $18.7 million land value contained in Jortberg's appraisal report. The district court also made one adjustment to the County's requested land value and concluded the value of the subject property was $152 million.

Kansas Star timely appeals the district court's order.

Standard of Review

Typically, 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 is to grant relief. Although Kansas Star does not specifically reference the statute, its statement of issues suggests that it is relying on the following provisions of K.S.A. 2017 Supp. 77-621(c)(4) and (7):

> "(4) [T]he agency has erroneously interpreted or applied the law;
>
> ....
>
> "(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."

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. Courts are typically required to determine whether the evidence supporting an agency's factual findings is substantial when considered in light of all the evidence. K.S.A. 2017 Supp. 77-621(d); *Redd v. Kansas Truck Center*, 291 Kan. 176, 183-84, 239 P.3d 66 (2010).

However, in 2014, the Legislature made changes to appeals from BOTA decisions which allow a taxpayer aggrieved by its decision to appeal to the district court and have the case tried de novo, meaning that any issues of law or fact are to be determined anew. K.S.A. 2017 Supp. 74-2426(c); K.S.A. 2017 Supp. 77-618(f). Kansas Star chose this route of appeal in this case. This means our standard of review is a traditional one similar to our review of any district court decision. See *Garvey Elevators, Inc. v. Kansas Human Rights Comm'n*, 265 Kan. 484, 492, 961 P.2d 696 (1998) (traditional standard of review applicable to appeals from district court's de novo review of commission's record); *Reeves v. Equipment Service Industries, Inc.*, 245 Kan. 165, 169-70, 777 P.2d 765 (1989) (given district court's de novo review, appellate court not concerned with agency's decision but only district court's). But see *Pinnacle Point v. Board of Johnson County Comm'rs*, No. 115,026, 2016 WL 4518769, at *8 (Kan. App. 2016) (unpublished opinion) (district court's decision from BOTA order reviewed under KJRA). The parties appear to agree on this point.

***6** While our review for legal errors is unlimited and requires no deference to either BOTA or the district court, our review of the district court's factual findings is different than how we would normally review BOTA's factual findings. See *Reeves*, 245 Kan. at 176 (appellate court may substitute its judgment on questions of law); *Williams v. Excel Corp.*, 12 Kan. App. 2d 662, 664, 756 P.2d 1104 (1988) (same). Whereas our review of BOTA's factual findings requires us to examine facts supporting and detracting from its findings, this is not so for a district court's factual findings. See *Reeves*, 245 Kan. at 176-77 (deferential standard of review of disputed issues of fact). When reviewing a district court's factual findings, our duty is to "view the evidence in the light most favorable to the prevailing party and determine whether there is substantial competent evidence to support the findings of the trial court." 12 Kan. App. 2d at 664; see *Reeves*, 245 Kan. at 176. Accordingly, instead of examining the record to determine if there is evidence contrary to the district court's findings, we simply review the record to determine if there is substantial competent evidence to support the district court's factual findings. *Reeves*, 245 Kan. at 170. "Substantial competent evidence is ' " 'evidence which possesses both relevance and substance and which furnishes a substantial basis of fact from which the issues can reasonably be resolved.' " ' [Citations omitted.]" *Wiles v. American Family Life Assurance Co.*, 302 Kan. 66, 73, 350 P.3d 1071 (2015).

When reviewing whether a district court's decision 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). For a district court's decision to lack substantial competent evidence, it must be "so wide of the mark as to be outside the realm of fair debate." *In re Tax Appeal of Dillon Stores*, 42 Kan. App. 2d 881, 889, 221 P.3d 598 (2009). As such, "[f]indings that are supported by substantial evidence will be upheld by an appellate court 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). We also take into account the rule of harmless error. K.S.A. 2017 Supp. 77-621(c); *Sierra Club v. Moser*, 298 Kan. 22, 47, 310 P.3d 360 (2013).

When construing tax statutes, the statutes must 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). 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. 79-503a have been considered and applied. *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).

DID THE DISTRICT COURT PROPERLY APPLY THE COST APPROACH IN COMPLIANCE WITH GENERALLY ACCEPTED APPRAISAL PRACTICES TO REACH THE FAIR MARKET VALUE FOR THE SUBJECT REAL ESTATE?

Kansas Star first argues that the cost approach adopted by the district court did not comply with generally accepted appraisal practices and that the value reached was not supported by substantial competent evidence. Kansas Star complains that the district court merely adopted the County's "contrived cost approach value proposal" and contends the approach lacks any support in the record. Specifically, Kansas Star notes that none of the witnesses testified that the appropriate value for the subject property was $152 million. The County asserts that the district court correctly adopted the cost approach in valuing the property.

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.

***7** 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. 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).

K.S.A. 79-1455 states: "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." 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.

***8** " '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.

A. *USPAP Compliance*

"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).

B. *Cost approach*

***9** A cost approach tax appraisal consists of three basic elements: (1) land value; (2) replacement or reproduction cost new; and (3) depreciation/obsolescence. The Appraisal of Real Estate, Appraisal Institute, 142, Appendix 1 (14th ed. 2013). "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)." *In re Equalization Appeal of Kansas Star Casino*, 52 Kan. App. 2d at 57. The cost appraisal method is generally applied to land that is improved and "allows for consideration of reproduction cost or replacement cost minus depreciation" of any improvements. 5 Nichols on Eminent Domain § 20.01 (3d ed. 2017).

To estimate fair market value under the cost approach, the appraiser follows four steps: (1) estimate the value of the land; (2) estimate the replacement cost of the improvements; (3) subtract depreciation as necessary; and (4) add the land and improvement values together. 52 Kan. App. 2d at 57.

Following the cost approach method, the district court concluded that the land value of the subject property was $18.7 million and the reproduction cost of the improvements was $133.1 million. The court found the subject property suffered from no depreciation. Accordingly, the district court's final fair market value was $152 million.

1. *Piecemeal approach*

The only two witnesses who offered opinions of value in the record were Jortberg and Lennhoff. Jortberg appraised the subject property at about $140 million, and Lennhoff appraised the property at $62.1 million. The County departed from its expert witness' value of $140 million and came up with its own approach to valuation. The County proposed a land value of $20.178 million (from Kansas Star's accounting reports), $113.3 million for reproduction costs (carrying value for buildings and improvements from Kansas Star's accounting reports), plus a 15% entrepreneurial incentive (from Lennhoff's appraisal), and no deduction for depreciation or obsolescence. The district court rejected using the land value from Kansas Star's accounting report and instead adopted Jortberg's land value but otherwise adopted the County's asserted value. The following table illustrates the cost approach value components from both experts, the County's position of value before the district court, and the district court's order:

	Lennhoff	Jortberg	County	District court
Land value	$2 million	$18.7 million	$20.178 million	$18.7 million
Reproduction cost/ Reconstruction cost	$111.209 million	$128.4 million	$113.283 million	$133.241 million
Entrepreneurial incentive	15%	0%	15%	15%
Depreciation/ Obsolescence	$25.515 million	$0	$0	$0
Total value	$62.1 million	$147 million	$133.5 million	$152 million

The County acknowledges that neither party advocated for a fair market value of $152 million but argues the district court was not required to choose the total value of one of the two competing appraisals.

Kansas Star counters that the highest appraised value was $140 million and asserts that the pick-and-choose value approach is not supported by any witness or testimony in the record. No witness testified that these "cherry-picked" values could be applied in this manner to reach a credible value conclusion, and the only person asserting such a position was the County's counsel as part of his argument before the district court.

Moreover, Kansas Star complains that the district court's method is not supported by the evidence because the act of "appraising is a holistic process." In investigating an appraisal problem, an appraiser should "understand the interrelationships among the principles, forces, and factors that affect real property value in the specific market area." The Appraisal of Real Estate, Appraisal Institute, 36 (14th ed. 2013). Kansas Star argues that the components of an approach to value are interrelated and should not be determined independently in the pick-and-choose manner adopted by the district court. Kansas Star provides the following example:

> ***10** "[I]n an income approach, vacancy percentage will be variable based upon the rental rate. At a rental rate of $1,000 for a given apartment, the owner may expect vacancy of 20%. However, at a rental rate of $900, his vacancy may only be 5%. If one applies a rental rate of $1,000 and a mis-matched vacancy rate of 5% to this apartment, he will conclude to a value that is too high."

Kansas Star cites this example as illustrating the danger in picking values from each appraisal without providing expert testimony to establish the proper relationships between the data points. Kansas Star claims this principle applies when evaluating a subject property under the cost approach and that appraisers must specifically be conscious of the interrelationship between cost and depreciation. According to Kansas Star, the value found for depreciation may be higher or lower depending on whether the appraiser uses reproduction cost or replacement cost. Reproduction cost is the cost to identically reproduce the property being appraised—using the same materials and design—and with all of its "deficiencies, superadequacies, and obsolescence." The Appraisal of Real Estate, Appraisal Institute, 570 (14th ed. 2013). In contrast, replacement cost is the cost to construct a functionally equivalent substitute for the building being appraised. "The use of replacement cost can eliminate the need to measure some, but not all, forms of functional obsolescence such as superadequacies and poor design." The Appraisal of Real Estate, Appraisal Institute, 570 (14th ed. 2013).

> "If reproduction cost or replacement cost is used inconsistently, double-counting of items of depreciation and other errors can be introduced into the analysis. The cost basis selected for a particular appraisal should be clearly identified in the report to avoid misunderstanding and must be applied consistently throughout the cost approach to avoid errors in developing an opinion of value." The Appraisal of Real Estate, Appraisal Institute, 570 (14th ed. 2013).

In its factual findings, the district court identified its costs as reproduction costs but then referred to replacement costs in its analysis section. Jortberg used reproduction costs in his appraisal rather than replacement costs. He explained that replacement costs do not include any functional difference between one property and another, but reproduction costs are the costs to replace the facility exactly. Jortberg admitted that reproduction costs—unlike replacement costs—may capture functional obsolescence in the costs of the improvements, including superadequacy, and agreed that a minimum investment requirement could lead a person to build a superadequate facility with functional obsolescence; thus, analyzing functional obsolescence was important. Although replacement costs are generally less than reproduction costs, Jortberg concluded that because the construction contracts were formed during a recession, he believed it was highly unlikely the property could be replaced for the price that Kansas Star paid for it. Kansas Star identifies the district court's confusion between reproduction costs and replacement costs as error and asserts the district court's conclusion was based on statements of counsel rather than evidence in the record.

The County relies on the holding in *Dillon Stores* for its position that a district court does not have to adopt the expert's opinion, but it may rely on evidence presented to adjust the total value of the subject property. In *Dillon Stores*, a taxpayer argued for a property value within a range of $4.4 to $4.9 million. Although BOTA adopted the taxpayer's appraisal, it determined that the appraisal failed to adequately account for the value of the freezer/cooler space. Thus, even though the amount was not included in the appraisal report, BOTA made a $590,000 upward valuation adjustment to the fair market value. On appeal, a panel of this court affirmed BOTA's ruling even though the taxpayer had not advocated for the adjustment. The panel noted that BOTA's adjustment was derived from information contained in the appraisal report so it was adequately supported by substantial competent evidence. 42 Kan. App. 2d at 888-89.

***11** *Dillon Stores* supports the County's position that Kansas law does not require the district court to adopt either party's appraisal report in full. If there is support in

the record for the district court's finding, a valuation of the subject property that differs from either appraisal expert may be upheld.

2. *Land value*

Kansas Star argues that the district court's adoption of a land value amount of $18.7 million, which was based on Jortberg's appraisal report, is wrong. Kansas Star complains that Jortberg merely added the purchase price of the subject land assemblage (the Gerlach and Wyant tracts) to the payment made by Kansas Star to Foxwoods Development Company for the option to purchase the Gerlach tract, plus a 10% premium for gaming revenue in excess of projections.

Jortberg testified that the land value was derived from KELA, the property's location as the closest casino to Wichita, its accessibility from numerous highways, its visibility, its established utility extensions and infrastructure, and its functionality and development potential. Jortberg determined that the property contained no excess land because it was platted as a single unit and because selling any part of the land would constrain future expansion. He was aware that Kansas Star had considered using a portion of the land as an RV park for equine events or potential retail uses.

In reaching his conclusion as to the value of the land, Jortberg compared the property to the sales prices in unexercised options for the other potential nearby sites, as well as the price paid for the Boot Hill Casino in Dodge City. Jortberg explained that the sales prices for the other nearby properties were the most relevant because at the time they were agreed upon, KELA would have permitted gaming on those properties. Based on these comparisons, Jortberg determined the price paid to acquire the property was the best evidence of its value. He also found that sales of vacant farm ground were not comparable because the subject property's highest and best use was not agricultural.

This court previously addressed the land value dispute in Kansas Star's 2012 property tax appeal and affirmed COTA's determination that land value of the property was about $17 million. 52 Kan. App. 2d at 58. The land value reached by the district court here is consistent with the value reached in *Kansas Star Casino*, 52 Kan. App. 2d at 59-62, and there is substantial competent evidence in the record supporting such a conclusion.

3. *Highest and best use*

In Kansas, the market value of a subject property is based on its highest and best use. *In re Equalization Appeal of Johnson County Appraiser*, 47 Kan. App. 1074, 1090-92, 283 P.3d 823 (2012). A property's highest and best use analysis is evaluated as though the property were vacant. The four factors used to evaluate highest and best use are: (1) physical possibility; (2) legal permissibility; (3) financial feasibility; and (4) maximum productivity. *Kansas Star Casino*, 52 Kan. App. 2d at 57.

Jortberg conducted a highest and best use analysis and concluded that, as vacant, it would be physically possible, legally permissible, financially feasible, and maximally productive to use the subject property for casino and gaming purposes. He concluded that the subject property's highest and best use as improved was as a casino.

***12** Kansas Star initially argues that the district court's highest and best use analysis erroneously assumes that Kansas Star has the management contract in place. But this argument was previously addressed by this court in 52 Kan. App. 2d at 57-58, and we affirmed COTA's conclusion that the subject property's highest and best use, as vacant, was a casino.

Kansas Star now tries to persuade us that the panel in *Kansas Star Casino* was wrong on two key points: (1) Kansas Star is not asserting that the property cannot be used for gaming purposes; and (2) in a fair market value determination of fee simple interest in real estate, the "actual market facts" are not always assumed to be the same.

Kansas Star asserts that *Kansas Star Casino* was incorrect because it should have assumed, for purposes of its highest and best use analysis, that the management contract was available but not yet awarded, rather than actually awarded to Kansas Star. But there is a difference in the analysis from 2012 to 2013. In tax year 2013, the district court did not assume that Kansas Star was in possession of the management contract for its highest and best use analysis. Rather, the district court ruled:

> "Although the Taxpayer's expert accurately points out that KELA would require any purchaser of the vacant property to obtain a management contract before operating a casino, the Court finds that this

> point does not alter its analysis. A 'highest and best use' analysis only requires the Court to assume the subject property is vacant; it does not require the Court to otherwise suspend reality. The proper analysis therefore [is] the Court to consider the facts much as they were just prior to the Taxpayer acquiring the property. In that circumstance, the property would still be properly zoned, state law allowing a gaming facility in the south central gaming zone—KELA—would still be state law, and no other casino would exist in the region. Consequently, the Court agrees that the County's proposed use for the property, vacant, is legally permissible. Because there is no dispute that agricultural uses would also be legally permissible, the Court finds the Taxpayer's proposed use is also legally permissible."

Kansas Star also points to this court's holdings in *Amoco Production Co.*, 33 Kan. App. 2d 329, and *Prieb Properties*, 47 Kan. App. 2d 122, to support its position that when a taxing authority is assessing a property's fair market value, only the fee simple estate should be valued. As an example, Kansas Star points to the effect a lease has on property. If a retail building is leased, then the full fee simple interest is not available for sale as it is subject to the lease. Thus, the only interest that could be sold is the leased fee estate. The problem with Kansas Star's argument is it erroneously equates the district court's highest and best use analysis with its determination of fair market value.

In *Prieb Properties*, the subject property was a single-tenant commercial building, subject to a 15-year build-to-suit lease to Best Buy. While COTA did not consider the actual lease in its assessment of fair market value, the issue in the case was the effect market rental rates had on the value of the property and what the proper market rental rates should be. There is nothing in the case to suggest that the appraisers, COTA, or our court disregarded the property's current use as a Best Buy store when assessing its highest and best use. 47 Kan. App. 2d at 125, 135-39.

***13** In *Amoco Production Co.*, the highest and best use of a gas processing plant was found to be its current use because the plant was actively processing gas pursuant to processing contracts. The panel agreed with the Kansas Department of Revenue's expert appraiser who testified:

> " 'Contracts on an existing gas processing plant amount to encumbrances. They could, they could add value or deduct from value. Therefore, you have to appraise a plant free and clear like an office building. Rents are important but you appraise the property free and clear because those leases may be favorable or disfavorable to the owner. A buyer is going to take that into consideration because they are going to have to live with that long-term. So far as I know ad valorem taxes valuation is based on market value fee simple interest. Like I said yesterday, anything less than fee simple interest is a partial interest ... in the property, not 100%. That's why I didn't consider the fact that we didn't have those contracts that important.' " 33 Kan. App. 2d at 344.

In our view, neither case cited by Kansas Star supports its position that the district court should have disregarded the potential gaming use of the subject property when assessing its highest and best use. In response to Kansas Star's argument, the County explains that a management contract should not be analogized to a long-term lease and is irrelevant to the district court's highest and best use analysis. Supporting the County's argument is the Appraisal Institute's guidance to appraisers which mandates that appraisers apply the four highest and best factors to actual market data and to consider "[p]rivate restrictions, zoning, building codes, historical district controls, and environmental regulations" as part of the highest and best use analysis. The Appraisal of Real Estate, Appraisal Institute, 336, 338 (14th ed. 2013). Kansas Star attempts to clarify its position in its reply brief by stating that it is not asking the court to value the property as if it cannot be used for gaming purposes. Instead, Kansas Star argues the value of the property should reflect the amount that would be paid by a purchaser who could use the subject property as a casino but is not bound to operate a casino at the site. Despite this clarification, Kansas Star fails to show error with the district court's highest and best use analysis.

The district court acknowledged that the property was appraised at a higher value than a neighboring property, but it supported this higher value because KELA created the opportunity for the use of the property as a casino and the prices paid for the property were driven by the property's superior location, along with business motivations derived from KELA. While the management contract itself is not property, Kansas law recognizes the effect that an intangible asset may have on real property to the extent it enhances its value. See K.S.A. 2017 Supp.

74-8734(m); *In re Tax Appeal of Western Resources, Inc.*, 22 Kan. App. 2d 593, 602, 919 P.2d 1048, *rev. denied* 260 Kan. 993 (1996). Kansas law also recognizes other intangible considerations such as zoning and other use restrictions in valuing property. See K.S.A. 2017 Supp. 79-503a(j); *In re Equalization Appeal of Ottawa Housing Ass'n, L.P.*, 27 Kan. App. 2d 1008, 1013, 10 P.3d 777 (2000).

***14** Fair market value is 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. In this case, the value of the property was enhanced by its purpose as a casino. As such, the district court's highest and best use analysis is supported by substantial competent evidence.

4. *Management contract*

Kansas Star next claims the district court's land value is erroneous because it includes value that is attributable, in part, to the management contract. Kansas Star argues the management contract is an economic condition that affects it alone.

Once again, this argument was previously rejected by this court for the tax year 2012 in *Kansas Star Casino*. In that appeal, Kansas Star relied on our Supreme Court's holding in *State ex rel. Stephan v. Martin*, 227 Kan. 456, 466, 608 P.2d 880 (1980), that "property tax is based on the value of the property itself, not on the income or economic condition of the property's owner." This court rejected Kansas Star's reliance on *Martin* in its 2012 appeal, specifically holding that "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." 52 Kan. App. 2d at 60.

Before us, Kansas Star now admits that under *Martin*, KELA is an economic condition affecting the value of real estate at large. Nevertheless, Kansas Star attempts to make a distinction between the management contract (an economic condition solely affecting an individual owner) and KELA (an economic factor affecting the market for real estate at large). Kansas Star maintains that even if KELA affected the Sumner County real estate market as a whole, Kansas Star purchased the land only because it was awarded the management contract.

The district court identified a fundamental flaw in Kansas Star's logic: Kansas Star paid nearly $17 million to acquire only the property rights to the Wyant and Gerlach tracts, and it agreed to that purchase price in advance of being awarded the contract. As such, it does not follow to suggest that Kansas Star paid approximately $17 million to the sellers in exchange for consideration—the management contract—even though the sellers did not own the contract and could not sell or award the contract to Kansas Star. The management contract was an asset that the sellers did not own and could not transfer or confer.

Kansas Star attacks the district court's conclusion, noting that distressed sales of real estate are routinely considered nonmarket transactions. For example, land transactions between adjoining landowners are often considered nonmarket sales because a person will tend to pay a higher price for land that is adjacent to land already owned. Kansas Star maintains that the fact that the management contract was not yet attached to the real estate does not guarantee that the transaction reflected fair market value. Kansas Star asserts that the fact that the price was agreed on prior to the management contract being awarded is irrelevant. If the sale is conditioned on a nonmarket event, then the nonmarket event likely influences the purchase price. Kansas Star maintains that the mere enactment of KELA was not sufficient to entice potential casino operators to purchase the subject property at a price of $84,000 per acre. Rather, potential casino operators were only willing to pay that price if they were awarded the management contract. Accordingly, Kansas Star maintains that the acquisition prices for the Wyant and Gerlach tracts do not reflect fair market value transactions of the fee simple interest.

***15** As nothing has changed from the time of the 2012 tax appeal, we are unwilling to change our conclusion that the management contract was an economic condition affecting the value of the subject property.

5. *Assemblage approach*

Kansas Star next claims that the district court's land value conclusion was based on an "assemblage" approach—merely adding together the purchase prices of various tracts assembled into a larger parcel—which is prohibited by Kansas law and USPAP. Kansas Star asserts that the district court's reliance on this approach is error as a matter of law.

USPAP Standard 1-4(e) provides: "When analyzing the assemblage of the various estates or component parts of a property, an appraiser must analyze the effect on value, if any, of the assemblage. An appraiser must refrain from valuing the whole solely by adding together the individual values of the various estates or component parts." The comments to Standard 1-4(e) state:

> "Although the value of the whole may be equal to the sum of the separate estates or parts, it also may be greater or less than the sum of such estates or parts. Therefore, the value of the whole must be tested by reference to appropriate data and supported by an appropriate analysis of such data."

This USPAP provision was violated in *Dillon Stores*, where the appraiser used the assemblage approach to value but admitted that he failed to test his summation values. In analyzing Standard 1-4(e), the *Dillon Stores* panel stated: "[A] summation approach *may* be acceptable as long as the value of the whole is tested and supported. According to the rule, however, an appraiser *must* analyze or test the effect on value of the assemblage of the various estates or component parts." 42 Kan. App. 2d at 890.

The parties here agree that USPAP prohibits an assemblage approach unless the value of the whole is tested and supported. The question is whether the market would pay the assemblage price of $17 million for the full 195.5-acre subject site as a single parcel.

Kansas Star claims the district court violated USPAP Standard 1-4(e) because its land value analysis was limited solely to determining the prices paid to acquire the Wyant and Gerlach tracts, adding those prices together, and then adding 10% to account for land value attributable to gaming revenues in excess of projections. But the County responds that this position is false, noting that Jortberg's appraisal report reflects that he considered many factors in determining the value of the subject property.

The County points out that Jortberg considered the sales of the Wyant and Gerlach tracts, as well as the unexecuted option agreements for two nearby tracts of land and the land sale for the Boot Hill Casino in Dodge City. Jortberg's appraisal included a matrix wherein he compared various aspects of the subject property as a whole (the combined Wyant and Gerlach tracts), such as size, location, and zoning. Jortberg also made an upward adjustment after combining the purchase prices of the Wyant and Gerlach tracts, noting that a 10% upward adjustment was necessary to account for the fact that as of January 1, 2013, the property had proven itself 10% more valuable than anticipated at the time of purchase. Kansas Star argues that Jortberg's approach did not reflect any attempt to "analyze or test the effect on value of the assemblage of the various estate or component parts." But without using those exact words, Jortberg's testimony reflects that is exactly what he did. Rather than relying solely on any type of assemblage approach, he made an upward adjustment to more accurately reflect the value of the subject property.

***16** Notably, Kansas Star presented testimony from Vernor, who reviewed Jortberg's appraisal for USPAP compliance and concluded that while there were various deficiencies with Jortberg's appraisal, there was no violation of USPAP Standard 1-4(e). Given that there is nothing in the record that shows Jortberg's land value conclusion—which was relied on by the district court—was based on an assemblage approach that violated USPAP Standards, we conclude the district court did not impermissibly apply an assemblage approach.

6. *Purchase price paid for the Wyant tract*

Kansas Star asserts that the $8 million paid to the owners of the Wyant tract was inflated because the owners were the last remaining land owners in the area and could hold out for a price above and beyond fair market value. The County does not dispute that Kansas Star paid more per acre to acquire the Wyant tract than it did to acquire the Gerlach tract or the unexecuted options for other nearby tracts. But Kansas Star acquired the purchase option for the Gerlach tract on July 15, 2010, just one day before it reached an agreement with the owners of the Wyant tract.

Kansas Star basically argues the district court could have viewed the $8 million purchase price for the Wyant tract as either evidence of fair market value or an inflated price due to the Wyant tract owners' status as a hold out. Kansas Star points to the following warning to appraisers:

> "In many situations the conditions of sale significantly affect transaction prices. These atypically motivated sales are not considered arm's-length transactions. For example, a developer may pay more than market value for lots needed in a site assemblage because of the

> plottage value or enhanced development economies expected to result from the greater utility of the larger site." The Appraisal of Real Estate, Appraisal Institute, 410 (14th ed. 2013).

Additionally:

> "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)." The Appraisal of Real Estate, Appraisal Institute, 364 (14th ed. 2013).

Although there is no dispute that appraisers should be cognizant of such factors, Kansas Star has not pointed to evidence in the record that the price of the tract was inflated because of a holdout. There is no evidence that the owners of the Wyant tract knew Kansas Star had acquired the option to the Gerlach tract the previous day or that the owners of the Wyant tract knew that Kansas Star also held the options on other nearby tracts. Any argument that the price of the Wyant tract was inflated because the owners knew they were in a position to hold out is mere speculation. Kansas Star has not met its burden of proof on this point.

Kansas Star bases its position on the proposition that the purchase price of the Gerlach tract was inflated. Kansas Star notes that the Wyant sales price was 250% higher than the per-acre price of any other comparable sale used by Jortberg and almost 1,400% higher than the Boot Hill sale price. Kansas Star claims the inflated sales price created a presumption that the sale should be analyzed for a "hold out" premium.

The district court chose to view the price as evidence of fair market value, and Kansas Star presents nothing beyond mere speculation that this was incorrect. The $8 million price as reflective of fair market value is supported by substantial competent evidence in the record. Even if Kansas Star could point to solid evidence that the $8 million price was due to the "hold out" status, there is also evidence in the record that it reflects fair market value.

7. *Excess land*

***17** Kansas Star next argues that 56 acres in the northeast portion of the Wyant tract is excess land, asserting that the land could be sold and is not necessary to the operation of the casino. The parties agree that the casino is operated solely on the portion of the property referred to as the Gerlach tract. Kansas Star claims the excess land must be evaluated separately for the highest and best use and contributory value.

In its decision, the district court noted that excess land is land that is not needed to serve or support the existing use, citing The Appraisal of Real Estate, Appraisal Institute, 200 (14th ed. 2013). But the district court disagreed with Kansas Star's position that the Wyant tract was excess land, stating:

> "[T]he Court finds that the portion of the subject property formerly known as the Wyant tract is not excess land. Evidence put forth at the hearing reflects that the area contains access roads [and] drainage features necessary to the property. Moreover, the subject property was platted as a single property and, as evidenced by Jortberg's testimony, the Taxpayer has identified the potential uses such as an RV par[k] or other complimentary ventures which would enhance the value of the going concern and failed to manifest any intent to treat the property as excess land."

The district court's ruling follows this court's holding in the 2012 *Kansas Star Casino* appeal, where the panel stated:

> "The County responds by citing the testimony of Kansas Star's expert ... 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. [Citation omitted.]" 52 Kan. App. 2d at 64.

Kansas Star refers to the excess land as "[f]ifty-six acres of land in the northeastern portion of the Wyant tract" rather than referring to the Wyant tract as a whole. But the entirety of the Wyant tract is 55.7 acres. Lennhoff

specifically identified the portion of the property he believed to be "excess" as the Wyant tract. It is apparent that Kansas Star's argument is the same previously raised in the prior appeal.

Kansas Star points to Jortberg's testimony that large casinos with arenas can be located on tracts less than 50 acres and that the Wyant tract is not necessary to support the existing casino. But when asked if the Wyant tract fit the definition of excess land, Jortberg testified that it is not excess land because it has the ability to be used for alternative uses which all enhance the property of the associated usage. Jortberg noted that the general manager of the casino told him that Kansas Star would not sell the property because it might hinder the value of the existing use. Jortberg unequivocally found that the land was needed to serve and support the existing use. Wendy Runde, the former assistant general manager at the Kansas Star Casino, also testified that the Wyant tract contains access roads and water containment features.

In its reply brief, Kansas Star notes that 63.5 acres of the casino site is currently being farmed, is not being used for gaming or commercial activities, and has been classified as agricultural use by BOTA. However, this information was included in the appendix to the reply brief and is not part of the record in this case. Including documents in the appendix of a brief does not make those documents part of the record that can be considered on appeal. *Romkes v. University of Kansas*, 49 Kan. App. 2d 871, 886, 317 P.3d 124 (2014). We will not look outside of the record to see how the land has been used since the appraisal in order to determine whether the district court's ruling was supported by substantial competent evidence as such decisions cannot be based on hindsight.

***18** As evidenced by Jortberg's testimony, Kansas Star may be holding the usable portions of the Wyant tract for future development of ancillary facilities to the casino property. The district court's conclusion that the Wyant tract's access roads and drainage features serve the Gerlach tract and do not qualify as excess land is supported by substantial competent evidence.

8. *Foxwoods payments*

Kansas Star argues that the district court erred by including the Foxwoods Development Company payment in determination of valuation.

Foxwoods, another casino company also competing for the casino management contract, held an option to purchase the Gerlach tract during the prior rounds of casino proposals. Kansas Star's parent company, Peninsula Gaming, acquired the option to buy the 145-acre Gerlach tract from Foxwoods for $5.3 million, to be paid over the course of several years. Jortberg testified that the $5.3 million paid to Foxwoods was part of the consideration paid to acquire the complete set of property rights for the property. Kansas Star argues that the district court erred by including the $5.3 million option price as part of its land value conclusion because some portion of that money may have been paid by Kansas Star to Foxwoods to eliminate Foxwoods as a competitor for the management contract.

Once again, this identical argument was raised and rejected in the prior 2012 tax appeal. This court held that regardless of the timing of the $5.3 million payment, "Kansas Star and Foxwoods determined in an open and competitive market that [Foxwoods'] property interest in the Gerlach tract was worth $5.3 million." *Kansas Star Casino*, 52 Kan. App. 2d at 61. Additionally, the court noted that COTA accurately found that nothing in the option assignment documentation suggested the $5.3 million was consideration for noncompetition and nothing in the documentation prevented Foxwoods from presenting an alternative proposal at some other location and that Kansas Star had not met its burden to show that COTA erred. 52 Kan. App. 2d at 62.

Kansas Star now argues the district court should have adjusted the payments to account for time value of money because the payments were to be made in the future. But no such testimony was found in the record. Jortberg testified that he made no such adjustment because at the time the option agreement was entered into, no one knew when Kansas Star would make its payments to Foxwoods. Kansas Star has not pointed to any evidence from which the district court could find that such an adjustment was necessary or proper.

Here, as in its 2012 tax appeal, Kansas Star again fails to meet its burden of proof. While Kansas Star correctly notes that the County bore the burden of proof to establish the value of the subject property before BOTA, on appeal, it is Kansas Star, the party claiming error on the part of both BOTA and the district court, who has the burden to establish any error by the district court. More specifically,

it is Kansas Star's burden to point to evidence in the record —not merely to cite outside sources—to show the error. There is no evidence supporting Kansas Star's position that the district court should have considered the time value of money and the timing of the payments, but there is ample evidence in the record to support the district court's finding that the $5.3 million option price was part of the value for Kansas Star's fee simple estate.

9. *Undue compulsion*

***19** Kansas Star argues that the district court should have adjusted or rejected the purchase prices for the Wyant and Gerlach tracts because Kansas Star was contractually required to exercise its options on these tracts after being awarded the management contract. Once again, this argument is a repetition of the argument previously addressed and rejected by this court in *Kansas Star Casino*, 52 Kan. App. 2d at 63.

As noted, Kansas law defines fair market value as "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." *Sunflower Racing, Inc. v. Board of Wyandotte County Comm'rs*, 256 Kan. 426, 444, 885 P.2d 1233 (1994); see K.S.A. 2017 Supp. 79-503a. The court noted that compulsion is not statutorily defined, so the term's plain meaning should guide the analysis. *Kansas Star Casino*, 52 Kan. App. 2d at 62-63. COTA relied on Black's Law Dictionary to determine the term's plain meaning and listed the following definitions for compulsion: (1) an uncontrollable inclination to do something; (2) objective necessity or duress; or (3) to cause or bring about by force, threats, or overwhelming pressure. 52 Kan. App. 2d at 63 (citing Black's Law Dictionary 300 [8th ed. 2004]).

After considering the definitions of compulsion, the previous *Kansas Star Casino* panel found no undue compulsion, noting that Kansas Star's argument ignored the fact that it entered into the options for the subject property voluntarily in an open and competitive market. It also found no evidence that Kansas Star was forced to pay a certain price or forced to exercise its options after being awarded the management contract. 52 Kan. App. 2d at 63. This argument has not changed, and Kansas Star points to no evidence in the record supporting its theory of undue compulsion.

10. *Reduction in acreage*

Kansas Star argues that the district court's analysis was erroneous as a matter of law because the acreage for the individual Wyant and Gerlach tracts totaled 201.2 acres, but the total usable acreage for the subject property was 195.5 acres. According to Kansas Star, the district court's failure to reduce the purchase price to account for the lost six acres is a glaring oversight in terms of proper appraisal practice, consistent with the district court's overall analysis.

Jortberg used the actual sale price of the 201.2 acre assemblage as the basis for the land value, with no adjustments. Kansas Star claims there should have been an adjustment for the six acres that were lost during the assemblage process, but there is no explanation by Kansas Star for what happened to those acres or why they were excluded from the final subject property. The County does not concede error, but it also does not dispute it.

Problematically, Kansas Star points to no evidence in the record suggesting that the district court should make such an adjustment beyond its conclusory assertion that the proper calculation should have been for 195.5 acres. Nevertheless, it appears that the 195.5 acres is correct. When miscalculations are mathematical in nature, remand is appropriate with instructions to recalculate the valuation. *In re Equalization Appeal of Tallgrass Prairie Holdings*, 50 Kan. App. 2d 635, 657, 333 P.3d 899 (2014). Under the circumstances here, remand is appropriate to recalculate the land value based upon the correct acreage.

C. *Reproduction costs*

***20** Kansas Star principally argues the district court made two mistakes in its reproduction cost analysis: (1) It incorrectly used generally accepted accounting principles (GAAP) accounting figures as surrogates for actual construction costs despite the availability of actual construction costs; and (2) it added entrepreneurial incentive to reproduction costs of a special purpose property. The County defends the district court by pointing out that Kansas Star's argument as to reproduction costs merely amounts to a complaint that the district court should have weighed conflicting evidence differently.

The district court ruled that the total reproduction cost for the subject property was $133 million, derived from an initial reproduction cost of $113 million and then increased by 15% to account for entrepreneurial incentive.

Kansas Star complains that the only evidence was its initial construction costs, and the district court erred by passing off the "Buildings and Improvements" line item from the financial documents that contain a different figure as a proxy for construction costs. Kansas Star argues that the figures relied on by the district court were capitalized costs for GAAP account purposes and were not equivalent to construction costs. Kansas Star notes that Lori Nelson, who is responsible for the oversight of Kansas Star's financials, testified the audited financial figures were not intended to reflect actual real estate construction costs. Additionally, Settle testified that appraisers should not rely on accounting value estimates because the rules and motivations are not the same.

Jortberg used reproduction costs in lieu of replacement costs. He explained that replacement costs do not include any functional difference between one property and another, whereas reproduction costs capture the cost to replace the facility exactly. Jortberg acknowledged that replacement costs were generally lower than reproduction costs, but he testified that because the construction costs for this property were let during a recession, he believed it was highly unlikely this property could be replaced for the price that Kansas Star actually paid. Jortberg based his reproduction cost analysis on Kansas Star's costs as reported in an audit by Deloitte and Touche LLP. In Jortberg's report, he asserted the reproduction costs were $120 million, so the $113 million figure adopted by the district court was lower than Jortberg's figure.

The district court determined the best evidence of reproduction costs came from the Deloitte and Touche audit of the sale of the Kansas Star Casino from Peninsula Gaming to Boyd Gaming. The audit states that its estimate of building costs and improvements was derived using the cost approach using a direct cost model built of estimates of replacement cost. Kansas Star does not dispute that the audit estimated the value of its improvements to be $113 million, but it argues that a lower figure should have been adopted instead.

We agree with Kansas Star that the district court's conclusion on reproduction costs was not based on accurate evidence. While it is true that the figure adopted by the district court is lower than the $120 million figure testified to by the County's expert, the $113 million figure is unsupported by substantial competent evidence in the record. There appears to be uncontroverted testimony in the record that the audited financial figures were not intended to reflect actual real estate construction costs or reproduction costs. In fact, neither appraiser relied on the figure in the audit in reaching an opinion on the reproduction cost value. Accordingly, except for the figures in the audit, the record lacks sufficient evidence supporting the district court's $113 million value for reproduction costs. As the evidence relied on by the district court was not intended to support an appraisal of reproduction costs, we must find reversible error on this point and remand the issue for reconsideration of reproduction costs.

D. *Entrepreneurial incentive*

***21** As part of its argument on reproduction costs, Kansas Star argues that the district erred including entrepreneurial incentive in the total valuation of the subject property.

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).

After estimating the reproduction costs for this property, the district court made a 15% upward adjustment to account for entrepreneurial incentive. The district court determined it was appropriate to include an adjustment for entrepreneurial incentive because both experts agreed that entrepreneurial incentive should be considered.

Although Jortberg did not include an adjustment for entrepreneurial incentive in calculating total value in his appraisal, he testified that such an adjustment could properly have been included. Lennhoff applied a 15% adjustment for entrepreneurial incentive, which the district court adopted. On appeal, Kansas Star argues that because the district court relied on reproduction costs rather than replacement costs, no entrepreneurial incentive should have been applied. Kansas Star claims the district court cherry-picked the "item from Lennhoff's report to bolster its already overstated reproduction cost."

Kansas Star also claims that an entrepreneurial incentive adjustment is not necessary with special purpose properties that are custom built by an owner-operator for his or her particular operation because such properties are not built by independent developers. Kansas Star gives the example of a refining company building a new refinery. The refining company does not expect a nonexistent developer to make a profit on its real estate investment but, instead, directly hires one or more contractors to build the refinery and generate its profit selling refined fuel and other products. Kansas Star claims the same is true of casinos.

Kansas Star also notes that Jortberg did not include entrepreneurial profit in his report "because owner/operator organizations generally develop casinos for their owner specific use. Their return is generally based on enterprise value created by the facilities." But Lennhoff also testified: "Doesn't matter if it's owner occupied or not owner occupied, what matters is if you're estimating market value[,] there has to be entrepreneurial incentive as a cost if you're estimating market value." Lennhoff further explained that the entrepreneurial incentive might get "wiped out as depreciation," but it had to be considered.

***22** We have some concern that the district court did not consider how entrepreneurial incentive might be accounted for differently depending on whether an appraiser calculated reproduction cost or replacement cost. Lennhoff testified that consideration of entrepreneurial incentive was appropriate, but Lennhoff also considered entrepreneurial profit as part of replacement cost, not reproduction cost. In his report, Lennhoff explains that "distinguishing between replacement and reproduction cost is not as important as appropriately concluding functional and external obsolescence associated with removing the Subject's license agreement/management contract. (Both result in the same indicated value, once functional obsolescence-super adequacy is accounted for)."

While Kansas Star may have a valid concern with the district court's decision to choose values from different appraisers' reports, as some things may be accounted for differently when reaching a total value, it cannot point to definitive caselaw or testimony indicating that the district court erred in including entrepreneurial profit.

Once again, Kansas Star points to BOTA's decision in the 2015 appraisal of this property to support its argument. However, we cannot consider evidence outside of the record from the decision in 2015. See *Romkes*, 49 Kan. App. 2d at 886.

The district court's ruling adopting a 15% adjustment for entrepreneurial incentive is supported by Lennhoff's testimony and appraisal report, meaning there is substantial evidence in the record to support the finding.

E. *Functional obsolescence*

Kansas Star also argues the district court erred by finding that the property does not suffer from functional obsolescence. Essentially, Kansas Star's position is that it was required to build the arena to satisfy its obligations in the management contract, but the arena is effectively worthless and brings down the value of the subject property.

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).

The parties agree that the subject property does not suffer from any physical depreciation, but Kansas Star argues that functional obsolescence exists because half of the real estate contributes no net income or value and the arena loses millions of dollars every year. According to Wendy Runde, the former assistant manager of Kansas Star, the bid for the management contract required Kansas Star to build the arena, but the arena had never been profitable and she did not believe that Kansas Star would build an arena today. Kansas Star claims functional superadequacy is an issue because the casino building is larger than necessary to support the gaming market and the arena is a financial disaster that should never have been built.

Jortberg failed to perform a recognized appraisal analysis to consider whether functional or economic obsolescence existed, but there is evidence in the record supporting the district court's conclusions. Jortberg testified that he did not include any deduction for functional obsolescence or external depreciation because the property was a new facility designed by experienced gaming operators. He pointed out that Boyd Gaming purchased the property as part of its acquisition of Peninsula Gaming, and both the Ernst and Young report and the Deloitte and Touche audit reflect a value basis at cost or higher.

***23** In rejecting any adjustment for functional obsolescence, the district court focused on the following evidence:

- The facility was a new structure that incorporated best construction practices;
- The property was part of a real market transaction (the sale of Peninsula Gaming to Boyd Gaming) that reflected no evidence of functional or economic obsolescence;
- No impairment, obsolescence, or superadequacy was noted in the Deloitte audit;
- Although Kansas Star claims that KELA's $225 million investment threshold forced it to build superadequate components, Kansas Star spent an additional $35 million above and beyond the threshold; and
- When Kansas Star decided to downsize its equine facilities, it did not elect to downsize any portion of the arena, despite now claiming it is functionally obsolete. The alteration resulted in additional conference space.

Kansas Star argues the evidence does not support the district court's findings and the court should have adopted Lennhoff's depreciation analysis.

First, Kansas Star claims the district court erred with its finding that Jortberg found no functional obsolescence because the facility was a new structure that incorporated best construction practices. Kansas Star cites *RAMA Operating Co. v. Barker*, 47 Kan. App. 2d 1020, 286 P.3d 1138 (2012), as support for its assertion that Jortberg's opinion was merely a conclusory statement rather than evidence. In *RAMA Operating Co.*, the issue was whether an opponent to summary judgment could controvert statements of fact with conclusory denials. The conclusory denials were not supported with citation to the record. We reject *RAMA Operating*'s applicability because the evidence relied on by the district court appears in Jortberg's report and in his testimony. Moreover, there is nothing to suggest that Jortberg's opinions were conclusory as he visited the property and conducted a full appraisal of the property.

Second, Kansas Star argues that the use of best construction practices is irrelevant to superadequacy. The Appraisal Institute advises:

> "Functional obsolescence is caused by a flaw in the structure, materials, or design of an improvement when the improvement is compared with the highest and best use and the most cost-effective functional design requirements at the time of the appraisal. A building that was functionally adequate at the time of construction can become inadequate or less appealing as design standards, mechanical systems, and construction materials evolve." The Appraisal of Real Estate, Appraisal Institute, 623 (14th ed. 2013).

Kansas Star claims that special-purpose buildings routinely suffer functional obsolescence from superadequacy because they are tailored to the marketing themes or special needs of the owner-operator. Kansas Star argues the sale of Peninsula Gaming to Boyd

Gaming does not establish that there was no functional or external obsolescence present. As an example, Kansas Star explains that if Walmart acquired Target, one could not conclude that Target's real estate in Topeka would not suffer from functional superadequacy. The County responds that the district court's reliance on this evidence was not wild speculation because the purchaser specifically allocated value to building components, so the district court's reliance on an actual market sale supports its conclusion that the property suffers from no functional obsolescence. We agree.

***24** Third, Kansas Star argues the district court should not have relied on the Deloitte audit because the purpose of such an audit is not to consider obsolescence and superadequacy. Kansas Star claims the term "impairment" is not relevant to depreciation. The County asserts the audit is still relevant because it contains no evidence that the buyer made any adjustment to its estimate of value based on a belief that any component of the improvements did not contribute a value equal to the cost. Again, we agree; even if the Deloitte audit were not considered, it appears there is substantial evidence in the record supporting the district court's conclusion.

Fourth, Kansas Star argues that the district court improperly construed the evidence that Kansas Star reallocated a portion of its construction costs from equine-focused amenities to conference center space as evidence against functional obsolescence. Kansas Star claims this evidence supports its position because the reallocation came after Kansas Star realized the arena was a financial disaster and additional investment would only hinder its profitability. Kansas Star points to testimony from Runde, who said the arena was a losing venue and certainly was not a moneymaker. Runde described the Wichita market as saturated with arenas. Settle also pointed to the lack of bookings and profitability of the arena and admitted that it would not be reasonable to conclude there was no functional obsolescence under these circumstances.

Kansas Star's position is that Lennhoff's conclusion that the property suffered from functional obsolescence is more persuasive than the evidence supporting the district court's conclusion. Lennhoff testified that the casino was more profitable when it operated out of the temporary arena than when the permanent casino was opened, which points to possible superadequate construction. Lennhoff also testified that the arena was a poor idea.

But in using the market extraction technique applied by Lennhoff, the Appraisal Institute warns that "it is important to select sales that are subject to the same (or similar) market influences," and the technique should be used only if sufficient data exists to adequately permit meaningful analysis. The Appraisal of Real Estate, Appraisal Institute, 605, 610 (14th ed. 2013). Lennhoff's market extraction analysis attempted to compare the casino portion of the subject property to the 2001 sale of a nongaming/service area of the former Sam's Town Casino in the Kansas City market. Lennhoff also relied on a sale from 2012 of the Pepsi Ice Midwest Arena, which he admitted had been sold after the arena was closed because of a system chiller failure. In rejecting Lennhoff's comparable sales and his market extraction analysis, the district court stated:

> "[T]he Court finds Lennhoff's reliance on the sale of the back-end of a closed, former casino in [a] wholly different and highly competitive market in Missouri, which sold twelve years prior to the date of valuation, is not a reliable or persuasive basis for determining the subject property has any functional or external obsolescence, much less that this property has depreciated $33,622,049. Likewise, the Court is unconvinced that the sale of an ice arena with a broken chiller system is factually relevant to determining any functional or external obsolescence of the arena improvements to this property."

Jortberg testified that the property did not contain superadequate components. The County's rebuttal expert, Settle, testified that if the arena had been valued in isolation—separate and apart from the casino—it would have obsolescence of some kind. But Settle also said that the entire project was very successful, so looking at it in the aggregate would be different than looking at the individual pieces and parts of the project. The district court found this testimony to be persuasive, explaining:

> ***25** "On this critical issue of functional obsolescence, or super adequacy as framed by the taxpayer, the court is persuaded that the county's evidence and argument is superior to that of the taxpayer. As the county states, the casino is new construction designed and built by experienced gaming facility operators. There should be no functional obsolescence. As to the claim

> of super adequacy, the taxpayer fails to account for the fact that this is property licensed for operation of a monopoly casino under [KELA]. The casino had to be of a certain size in order for the taxpayer to be awarded the management contract. The arena was part of a total package presented to the state in order for Kansas Star to be awarded the management contract. Any purchaser buying the land for purposes of operating a casino under a KELA management contract would have to buy or construct similarly "super adequate" facilities to qualify for the management contract. Finally, as the county notes, when the property in question was purchased by Boyd Gaming there was no indication that any discount was given for any 'external factor ... identified as a source of value loss.' "

The district court's conclusion that the property did not suffer from functional obsolescence is supported by substantial competent evidence. While we acknowledge compelling arguments on both sides of this question, and although Kansas Star has raised questions about some of the evidence relied on by the district court—and construed such evidence in support of its position rather than against—we are not allowed to reweigh conflicting evidence. "Findings that are supported by substantial evidence will be upheld ... even though evidence in the record would have supported contrary findings." *Chowning*, 32 Kan. App. 2d at 987.

DID THE DISTRICT COURT ERR IN REJECTING THE INCOME APPROACH?

Finally, Kansas Star reasserts its position that Lennhoff's income approach was more credible than Jortberg's cost appraisal. Lennhoff, Kansas Star's expert, performed an income approach with allocation to the real estate component.

The district court noted that this approach was sound in theory, but it found the income approach lacking in two ways: (1) Lennhoff used market profit margins and allocation percentages rather than property-specific figures from Kansas Star's business operation; and (2) the market information relied on by Lennhoff was skewed to reach a low value. Lennhoff applied an 18.8% profit margin because the use of competitive market profit margins was necessary to make a true comparison. The district court concluded:

> "[T]he court is unconvinced that Lennhoff's percentage is appropriate in light of evidence from the County showing (1) a 24 percent profit margin from seven publicly traded gaming companies [Jortberg's appraisal report], and (2) that Kansas Star Casino's actual profit margin was 48 percent [Jortberg's appraisal report]. Lennhoff's EBITDA multiplier, 7.25, is equally problematic because if falls well short of the mean EBITDA multiplier, 7.86, for the properties he reviewed. Finally, the Court questions the validity of Lennhoff's 25 percent value, which again was lower than the average of the properties he considered."

Kansas Star attempts to argue that because Lennhoff's income approach analysis was "the only correctly-performed and recognized appraisal analysis," the district court was required to adopt it. Not surprisingly, the County disputes Kansas Star's claim that its cost-approach analysis is non-USPAP compliant.

But even if a cost-approach analysis were not USPAP compliant, Kansas Star has cited no authority suggesting that if a district court were presented with two appraisal reports and found that one was non-USPAP compliant, then it must adopt the competing report. "USPAP violations that are not 'materially detrimental' to an appraiser's overall opinion of value are not fatal to a county's case. [Citation omitted.]" *Kansas Star Casino*, 52 Kan. App. 2d at 65. Kansas Star has not even attempted to show any USPAP violations that were materially detrimental to the district court's overall conclusion.

Kansas Star provides us with details about Lennhoff's income approach and claims it was the more appropriate approach to valuation of the subject property. Without reviewing the details, we see it as merely Kansas Star's attempt to ask us to reweigh the evidence. Again, our role is to determine whether the district court's decision is supported by substantial competent evidence, and, in doing so, we cannot reweigh the evidence, pass on the credibility of witnesses, or resolve conflicts of evidence. *In re Guardianship & Conservatorship of Burrell*, 52 Kan. App. 2d at 419. The district court found the County's cost approach analysis to be more credible. For a district court's 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. There is substantial competent evidence supporting

the district court's decision to reject Lennhoff's income approach to value.

***26** Accordingly, we affirm in part, reverse in part, and remand with directions for the district court to recalculate the land value using the correct lower acreage figure and to reconsider the evidence in the record concerning reproduction costs.

All Citations

420 P.3d 496 (Table), 2018 WL 2748748

End of Document

Appendix 5

420 P.3d 499 (Table)
Unpublished Disposition
This decision without published opinion
is referenced in the Pacific Reporter.
See Kan. Sup. Ct. Rules, Rule 7.04.
NOT DESIGNATED FOR PUBLICATION
Court of Appeals of Kansas.

In the MATTER OF the Equalization Appeal of KANSAS STAR CASINO, L.L.C. for the Year 2014 in Sumner County, Kansas.

No. 116,421
|
Opinion filed June 8, 2018.

Appeal from the Board of Tax Appeals.

Attorneys and Law Firms

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Before Powell, P.J., McAnany, J., and Hebert, S.J.

MEMORANDUM OPINION

Powell, J.:

***1** Kansas Star Casino, L.L.C. (Kansas Star) appeals from the ruling by the Board of Tax Appeals (BOTA) which established a 2014 valuation for ad valorem tax purposes of $97.6 million for its real property located in Sumner County, Kansas. This is the companion case to the 2013 tax year property valuation appeal, *In re Equalization Appeal of Kansas Star Casino*, No. 115,587, issued this same day. (At the time Kansas Star appealed the County's tax valuation, the agency was known as the Court of Tax Appeals. The agency name was changed to the Board of Tax Appeals [BOTA] during the 2014 legislative session. L. 2014, ch. 141. For purposes of consistency, this opinion refers only to BOTA.)

On appeal, Kansas Star complains that BOTA erred (1) by classifying all 195.5 acres as commercial property; (2) by rejecting Kansas Star's expert's cost approach appraisal; and (3) by rejecting both its expert's and Sumner County's expert's income approach appraisals for the property and, instead, applying its own income approach by using average input values for its allocation percentage and EBITDA (earnings before interest, tax, depreciation, and amortization) multiplier. The County cross-appeals, arguing that BOTA's decision to reject the County's expert's opinion on functional obsolescence, particularly as it relates to superadequacy, is not supported by the record and is unreasonable, arbitrary, and capricious. The County also argues that BOTA's income allocation approach analysis, which in effect split the difference between both parties' figures by attempting to use a median number, is not supported by the record and is unreasonable, arbitrary, and capricious.

For reasons more fully explained below, we agree with the parties that BOTA improperly adopted its own income allocation approach to valuing the property by utilizing supposed median figures to establish a 21% profit margin, an EBITDA multiplier of 7.64, and a 30% real estate allocation percentage because such alleged median figures are unsupported by the record. The case is remanded to BOTA for reconsideration of the appropriate figures for profit margin, EBITDA multiplier, and real estate allocation. We affirm BOTA in all other respects.

FACTUAL AND PROCEDURAL BACKGROUND

As this court explained in detail in *In re Equalization Appeal of Kansas Star Casino*, 52 Kan. App. 2d 50, 52-55, 362 P.3d 1109 (2015), *rev. denied* 307 Kan. —— (December 20, 2017), Kansas Star is one of four state-sponsored gaming enterprises in Kansas and is located in the south central gaming zone. In April 2007 the Kansas Legislature enacted K.S.A. 74-8733 et seq., the Kansas Expanded Lottery Act (KELA) to authorize a limited number of casinos to be operated in Kansas. KELA divided the state into four gaming zones: northeast, south central, southwest, and southeast, with a single gaming facility allowed in each gaming 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).

Additional background is also included in the companion case 115,587.

A. *The Subject Property*

***2** The property upon which the casino sits is located on two formerly separate tracts of land, referred to as the Wyant and Gerlach tracts, and is located in the northeast part of Sumner County, nearly adjacent to Sedgwick County and just west of the Kansas Turnpike/ Interstate Highway 35. Peninsula Gaming, Kansas Star's former parent company, acquired both tracts in July 2010 for a total purchase price of nearly $17 million and combined them into a single parcel of land. The property's improvements consist of a casino and an arena building which are located entirely on the Gerlach tract. Because the property sits on low ground, Kansas Star set aside a little over 41 acres for drainage.

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, such as an RV park. However, the plans for future development have not come to fruition. The original plan for an arena and equine event center proved to be unprofitable and unnecessary, so Kansas Star negotiated with the Kansas Lottery to amend its management contract to allow for some funds to be shifted away from arena development and towards conference space.

On December 20, 2013, Kansas Star entered into a lease agreement with Mark Hardison to farm 63.5 acres of the property that had originally been planned for future development, in exchange for mowing the drainage areas and $1 in consideration. After the January 1, 2014 valuation date, Hardison raised soy beans on the property. None of the 63.5 acres was used to operate the casino business. The County classified the entire 195.5-acre parcel as commercial and industrial for tax year 2014.

B. *The Arena*

The arena building was originally constructed as a temporary casino. From December 26, 2011, through December 21, 2012, Kansas Star operated a temporary casino in its arena while the permanent casino was being constructed. The permanent casino opened in December 2012, after which time Kansas Star began the process of converting the temporary casino back into an arena. The permanent casino is 164,790 square feet for a total building area of 327,412 square feet. The casino floor in the permanent casino is 78,000 square feet, which is more than double the gaming floor space in the temporary casino.

The arena is 162,622 square feet with a maximum seating capacity in concert mode of 6,200. Kansas Star held its first concert at the arena on June 29, 2013. However, in the first 9 months of operation, the arena hosted just 16 events. One major event had to be cancelled because of low ticket sales, forcing Kansas Star to make a $200,000 buyout. Kansas Star found that during the events, gaming revenue went down in the casino due to full parking lots, long lines, and crowds. Kansas Star also found the equine events did not produce the expected revenue, so it minimized the focus of the arena as an equestrian center. Dan Ihm, the vice president general manager of the Kansas Star Casino, testified that the arena had a $500,000 operating loss in 2013. This loss represented the total lost on the individual events that were held but did not include fixed overhead expenses such general advertising, maintenance, and utilities.

Materials submitted by Kansas Star during the bidding process for the gaming license projected that the arena would sustain operating losses ranging from $790,170 in 2013 to $534,046 in 2016. Kansas Star cites evidence in the record disputing this expectation and in support of its expectation that the arena would increase revenue. Despite the expectations, the arena does not operate a profit on its own nor does it generate additional gaming revenue. The arena is competing in a saturated market, and all of the other arenas are closer to Wichita. The completion of the arena reduced the casino's profitability in 2013. Wendy Runde, the former assistant manager of the Kansas Star Casino, testified that Kansas Star would be more profitable if the arena had never been built. Ihm testified that Kansas Star was better off operating out of the temporary arena than operating the permanent casino and arena. Ihm said that he would not have built the arena in order to maximize profits.

***3** Kansas Star collected $192.4 million in total revenue in 2013, which exceeded preopening projections for 2014 by more than 15%. However, the EBITDA decreased. Ihm believed the dip in profits was attributable, at least in part, to the addition of nongaming amenities such as restaurants, which carry overhead expenses and are not big revenue drivers. Kansas Star's financial data showed

that operating expenses jumped from approximately $115 million to $157 million. One significant expense increase was an "affiliate management fee" paid by Kansas Star to its parent company, Boyd Gaming, which alone decreased Kansas Star's overall EBITDA.

C. *The Appraisals*

The County valued the property at $153.5 million based on an appraisal performed by Richard Jortberg, MAI. 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. 2013 Supp. 79-1609. Kansas Star asserted a value of $75 million.

1. *The County's appraisal expert*

Jortberg appraised the subject property for tax year 2014. Jortberg has numerous years of experience appraising casinos for the taxing authorities in Colorado. Jortberg considered all three approaches to value: the sales comparison approach, the cost approach, and the income approach.

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 because it was a speculative sale without gaming approvals and was in a smaller market. Jortberg ultimately concluded the $17 million paid to acquire the subject property was the best evidence of its value. But because gaming revenues in 2013 were already 15% higher than projections, Jortberg applied a 15% adjustment of $2.6 million to the $17 million purchase price, making his total land value estimate $19.6 million.

Jortberg determined the reproduction cost for the subject property was $121 million based on actual costs reported in the 2013 Deloitte and Touche audit. He applied a 12.5% entrepreneurial incentive to the reproduction cost.

Jortberg found no evidence of incurable physical depreciation. He did, however, recognize $2.4 million in depreciation based on disposals associated with the conversion of the temporary casino back into the arena. In considering functional obsolescence, Jortberg wrote in his report:

> "[M]arket analysis indicates not only the ongoing construction of event center/entertainment areas at casinos by casino owners but also the demand illustrated for smaller footprint event centers to attract more numerous smaller shows as compared to the very large, publicly supported facilities which are too large for many potential shows."

Jortberg testified the property was not superadequate because (1) the facilities were built using best construction practices and (2) it was necessary to build the existing facilities as they were required by the management contract under KELA. He pointed out that Boyd Gaming purchased the property as part of its acquisition of Peninsula Gaming, Kansas Star's former parent company, and the audits reflected a value basis at cost or higher. Finally, Jortberg noted that during an actual market transaction involving the property, no impairment, obsolescence, or superadequacy was recognized. Jortberg similarly concluded there was no external obsolescence as evidenced by the business enterprise value far exceeding the real property value. After combining land value and replacement costs and then deducting depreciation, Jortberg arrived at a total valuation under the cost approach of $153.5 million.

***4** Jortberg began his income allocation analysis by determining stabilized earnings before interest, tax, depreciation, and amortization (EBITDA), which he calculated based on his review of actual EBITDA for 2012 and 2013, a Wells Gaming research report, and metrics from the Colorado Gaming Commission. He then determined an appropriate EBITDA multiplier range, in this case 7.5 to 9.0, based on transactional data where EBITDA multipliers had been reported. By applying the

EBITDA multipliers to EBITDA, Jortberg concluded the stabilized enterprise value was within the range of $563 to $675 million, which he rounded to a midpoint of $620 million. He then estimated the percentage of the total enterprise attributable to the real estate at 47% based on figures derived from publicly traded casinos. As the next step, Jortberg multiplied that figure by $620 million to derive an estimate for property, plant, and equipment of $291 million. He then subtracted $51.9 million for "Furniture, Equipment, & Other"—as reflected in the 2013 Deloitte and Touche audit—to reach a total valuation under the income approach of $239.5 million.

In completing his income approach, Jortberg performed an allocation analysis with the following caveat:

> "In short, these intangible allocations of value can abusively and incredibly minimize the value of real property, ignoring fundamental principles of economics related to factors of production (land, labor and capital) which are elements of the creation of value. The premise that 'precisely' calculated intangible elements of value are superior metrics of valuation and are gold standards to calculate indirectly the impairment to the real property is fallacious. These methodologies (parsing, allocations, etc.) often ignore the fact that, were the real property not present, there would be no elements of intangible value. That said, intangible value allocations are relevant, and they should be considered on a case by case basis."

Under this approach, Jortberg found the value of the property would be $239.5 million. Jortberg then concluded: "This is clearly an incorrect conclusion because the value of the subject by the Cost Approach was $153.5 million." In his testimony, Jortberg noted that he did not "like any bit" of his allocation approach because there was not a typical marketplace extraction of factors of rates to do allocations. Jortberg explained that if he were evaluating a Hampton Inn—which would have many other similar properties—then it might be appropriate.

After reaching value conclusions under the cost approach ($153.5 million) and income allocation approach ($239.5 million), Jortberg concluded that his cost approach analysis was the best indicator of value because it was based on actual costs.

2. *Kansas Star's appraisal expert*

David Lennhoff, MAI, testified on behalf of Kansas Star. Lennhoff is a nationally recognized expert in the area of separating real estate value from intangible value, and he has held positions and taught at the Appraisal Institute. Lennhoff considered but did not apply the sales comparison approach. Instead, Lennhoff performed a cost approach and a combined income/sales approach to value the property. Lennhoff's cost approach included a replacement cost analysis, land value analysis, and an obsolescence/depreciation analysis.

Lennhoff's land value conclusion was $2 million based on the sales values of five comparable properties. Lennhoff testified that he looked intentionally for comparable sales in an area that "might suggest something other than [agricultural land], but it might have the potential for something else." Lennhoff excluded from his analysis the effect of the market created by KELA because he did not believe it comported with the concept of an open and competitive market. Lennhoff's cost approach analysis considered the property as if the management contract were available but the buyer did not yet have it. None of the properties Lennhoff selected were in Sumner County and, therefore, could not be used for gaming purposes even if the management contract were available but not yet awarded.

Lennhoff also analyzed the Boot Hill Casino property sale—a speculative purchase of the land upon which the Boot Hill Casino was constructed—for a price of $10,391 per acre. Lennhoff concluded that the land value was $10,000 per acre, or a $1.35 million total land value for the 134 acres of nonagricultural land at the property. Lennhoff acknowledged this was substantially higher than typical agricultural values at $3,000 per acre, but his conclusion was influenced by the values of potential commercial sites near Wichita and the $10,000 per acre speculative purchase of the Boot Hill Casino site.

***5** To estimate replacement/reproduction costs, Lennhoff relied on cost estimates from Marshall Valuation Service as well as actual costs as reported by Kansas Star. The replacement and reproduction costs were almost identical: $352 per square foot for replacement costs compared to $356 per square foot for reproduction costs. Lennhoff used the replacement cost of $352 per square foot. Although Lennhoff determined the actual cost of the improvements was $116.6 million,

he relied on Marshal Valuation Service's estimate of $94 million. He then added architectural and design fees of $6 million. Finally, Lennhoff applied an entrepreneurial incentive of $15 million, derived from multiplying $102 million (his combined total for land, improvements, and architecture and design fees) by 15%, which led to a total estimated value of $115 million. Lennhoff did not use the actual costs for construction because he felt they were influenced by the amount KELA required Kansas Star to spend. The total cost of the project submitted to the Lottery Commission was approximately $284 million (though the minimum investment requirement was only $225 million).

Lennhoff found no evidence of physical depreciation. He considered functional/external obsolescence by utilizing the market extraction method. He first compared the Kansas Star Casino to the 2005 sale of the Sports City indoor sporting arena in Blue Springs, Missouri, which he determined had depreciated 68% in value. He then compared Kansas Star's arena to the 2012 sale of the Pepsi Ice Midwest Arena in Overland Park, which had depreciated 37% in value. Based on these comparisons, Lennhoff concluded the subject property was approximately 40% depreciated, resulting in a reduction in value in excess of $46 million.

Lennhoff testified there were substantial market indications of functional obsolescence, noting that the property did not meet original expectations, was a loss leader, and was underutilized. Additionally, Lennhoff noted that his market extraction comparables were conservatively selected. He testified that the Kansas Coliseum sold for only its land value, which would indicate 100% obsolescence. Lennhoff found incompatibility between the arena and casino, which also reflects obsolescence. He noted that on the rare occasions that the arena was used to capacity, it lost money on its operations and discouraged gaming activity at the casino.

With respect to the casino, Lennhoff reviewed real estate-only sales of casinos in Atlantic City, which indicated an average depreciation of 93%. Lennhoff also evaluated the market to determine whether the casino was appropriately sized for its revenue-generating capabilities. Lennhoff compared the revenue per square foot of Kansas Star to the revenue per square foot of the five casinos in Kansas City in order to determine how much space was necessary to accommodate the gaming customer base. The revenue per square foot was substantially higher in Kansas City, with three of the five casinos having revenue per square foot of over $2,000, whereas Kansas Star's revenue per square foot was $1,170 just for the casino portion of the property. Lennhoff also noted that doubling the gaming space from 2012 to 2013 resulted in only a five percent revenue increase, strongly indicating that most of the additional space was unnecessary.

During cross-examination, Lennhoff admitted the Pepsi Ice Arena had been sold because the chiller failed and the owner could not afford to fix it. Also, Lennhoff agreed the fit and finish of the casino was what he would expect from a Midwestern, suburban Class A casino and that the actual improvements were unlikely to be turned into a basketball court or soccer field. Lennhoff explained that he had been unable to find ideal comparables for his market extraction analysis and that his 40% estimate was "[n]ot perfect, but you've got to do something." After combining his land value and cost of improvements and then deducting depreciation, Lennhoff's total valuation under the cost approach was $71 million.

When performing the combined sales/income approach to estimate the value of the property, Lennhoff calculated the total value of the enterprise and then allocated a percentage of the value to the real property. Lennhoff's sales/income analysis began with Kansas Star's gross and net revenues from 2013, $207 million and $202 million, respectively. Lennhoff did not use actual EBITDA for the property because he was looking for market-typical figures to correspond with his market-typical allocation percentages. Lennhoff used three indicators to calculate a market-typical EBITDA margin: IBISWorld's Industry average profit margins for hotel-casinos (18.8%) and nonhotel casinos (22.6%) and a survey of average profit margins of large gaming companies (9.6% average). Lennhoff calculated a market EBITDA margin of 20%, near the highest end of his indicated range.

***6** Lennhoff claimed he "did not want to incorporate the monopoly aspect to [his analysis] because that seems ... to be potentially inconsistent with the definition of market value in Kansas." Lennhoff applied a profit margin of 20%, derived from his review of an IBISWorld publication and profit margins from casinos in competitive markets.

Next, Lennhoff multiplied his EBITDA estimate by a multiplier of 7.5—derived from his review of 10 casino

sales—which led to a value of $304 million. During cross-examination, Lennhoff acknowledged it was less than half the enterprise value reflected in Kansas Star's actual balance sheets but asserted this was represented in an accounting and was due to the monopolistic nature of the property. After calculating enterprise value, Lennhoff applied an allocation percentage of 25%, based on (1) a casino study performed by William Kinnard in 1998; (2) allocation percentages from five motor speedways; and (3) eight casino sales from 2009-2013. From this estimate, Lennhoff calculated the value of the real estate at $76.5 million, or $76.1 million for just the 134.5 acre parcel with improvements (and excluding the 63.5 acres that Kansas Star asserts is agricultural land).

Lennhoff reconciled his value under the cost approach ($71 million) and his value under the income allocation approach valuation ($76.5 million) and ultimately determined the fair market value for the property was $75.4 million.

Kansas Star also presented expert testimony from Cory Morowitz, a gaming consultant. Morowitz testified that because KELA required investors to spend a minimum of $225 million, bidders may have been required to build a project that was bigger than optimal. But based on the potential for an outsized return on investment in KELA's monopoly market, Morowitz testified: "I wouldn't say [bidders for the license] act irrationally, they promise things that they wouldn't build otherwise. So they will bid-up the offer, the ask in order to gain the license."

Morowitz went on to explain that in Kansas Star's case, because of the underserved market and outsized opportunity, a prudent buyer would likely promise to build more than necessary in order to secure the winning bid for the management contract. Morowitz also analyzed the number of arena seats to gaming positions at casinos and determined that the Kansas Star Arena had more seats per gaming position than the comparable casinos he reviewed. Morowitz explained that the prerecession trend to build more than what was needed had changed to the current trend, which is to "figure out what you need to support that local market and be as efficient as possible." Morowitz concluded that the size of the Kansas Star Arena was "inappropriate relative to its casino and hotel operations. Based on the ratio of seats to gaming positions, this suggests that as much as two-thirds of the arena seats may not be needed or are functionally obsolete."

Morowitz also evaluated the casino for functional obsolescence. Morowitz found that the temporary casino in the arena building was "satiating the market demand." But with the opening of the permanent casino/arena combination, which doubled the overall square footage and the casino floor space, Kansas Star saw only a five percent increase in revenue and a decline in EBITDA. Morowitz concluded: "So when I look at that, I say, they're not utilizing their assets correctly. They clearly have built too much, they[ ] could've built less, right, and got[ten] the same results."

D. *BOTA's Decision*

***7** BOTA determined the 63.5 acres leased to Hardison did not qualify as land devoted to agricultural use as of January 1, 2014. In reaching its conclusion, BOTA relied on Division of Property Valuation (DPV) Directive #99-038 and this court's decision in *In re Equalization Tax Appeal of Miami County Appraiser*, No. 106,659, 2012 WL 2149829 (Kan. App. 2012) (unpublished opinion), which state that activity from the prior tax year is to be considered when determining classification of the property. BOTA determined that merely signing a lease to farm was insufficient to establish agricultural activity.

In considering the parties' competing cost approach analyses, BOTA noted that in tax year 2013, it determined that because of purported deficiencies in both appraisers' methodologies, neither appraiser's cost approach was reliable or persuasive. BOTA rejected both of the experts' cost approach analyses, stating:

> "The Board finds that the challenges and deficiencies in accurately valuing the subject land value and estimating depreciation via the cost approach found by the Board in the prior tax year's appeal are similarly present at instant. The instant record is replete with evidence substantiating the Taxpayer's contention that the addition/opening of the casino had a lower than expected financial impact on the Taxpayer's business. Given these findings, the Board finds here, as in the prior tax year's appeal, that the income approach methodology sponsored by appraisers Jortberg and Lennhoff is the best methodology for an accurate determination of the subject property's fair market value."

BOTA chose to calculate its own value using the income approach methodology used by both appraisers. The general formula used by both appraisers to derive fair market value under the income allocation approach was as follows:

1. (Actual revenue) x (estimated profit margin) = (estimate for EBITDA)

2. (EBITDA estimate) x (estimate for EBITDA multiplier) = (estimate for value of going concern)

3. (Estimate for value of going concern) x (estimate for real estate allocation percentage) = (estimate for fair market value).

BOTA began its income allocation approach analysis with Kansas Star's actual revenue for 2013. BOTA found that the median profit margin from a table in Jortberg's report was the best evidence of the profit margin. BOTA explained: "The Board finds that utilizing the subject property's reported actual 2013 revenue with a 21% profit margin as supported by the median drawn from publicly traded properties in the Jortberg appraisal yields an EBITDA of $42,600,000 (rounded)."

After estimating earnings before interest, tax, depreciation, and amortization (EBITDA), BOTA applied an EBITDA multiplier of 7.64 based on median data drawn from transactional data in both appraisals. Finally, BOTA applied a 30% real estate allocation percentage based on the median figure from a table in Lennhoff's report as the most appropriate reflection of market allocation. After applying this figure, BOTA concluded that the fair market value of the property for tax year 2014 was $97.6 million.

Kansas Star timely appealed; the County cross-appealed BOTA's rejection of the County's cost approach and BOTA's income allocation analysis.

Standards of Review

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). Kansas Star filed a petition for judicial review with this court; the County filed a cross-petition for judicial review. We review BOTA's decision in the manner prescribed by K.S.A. 77-601 et seq., the Kansas Judicial Review Act (KJRA).

***8** The KJRA defines the scope of judicial review of state agency actions unless the agency is specifically exempted from the application of the statute. K.S.A. 2017 Supp. 77-603(a); *Ryser v. Kansas Bd. of Healing Arts*, 295 Kan. 452, 458, 284 P.3d 337 (2012). BOTA orders are subject to KJRA review. K.S.A. 2017 Supp. 74-2426(c). While a county bears the burden of proof before BOTA, on appeal, the burden of proving the invalidity of BOTA's actions is on the party asserting the invalidity. K.S.A. 2017 Supp. 79-1609; 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), this court takes 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).

When construing tax statutes, the statutes must 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).

K.SA. 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).

***9** 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." "Because a rebuttable presumption of validity attaches to all administrative agency actions, the burden of proving arbitrary and capricious conduct lies with the party challenging the agency's actions." *In re Equalization Proceeding of Amoco Production Co.*, 33 Kan. App. 2d 329, 333, 102 P.3d 1176 (2004), *rev. denied* 279 Kan. 1006 (2005).

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." *Rural Water Dist. #2 v. Miami County Board of 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).

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).

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

> ***10** " '[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. 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).

K.S.A. 79-1455 states: "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." 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.

***11** " '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.

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 CLASSIFYING 63.5 ACRES AS REAL ESTATE USED FOR COMMERCIAL AND INDUSTRIAL PURPOSES?

Kansas Star first argues that BOTA erred as a matter of law when it classified 63.5 acres of the property as real estate used for commercial and industrial purposes when the land was subject to a farming lease. Kansas Star complains that (1) BOTA improperly placed the burden of proof on Kansas Star and (2) BOTA improperly weighed the evidence. As resolving this question involves statutory interpretation, which is a question of law, our review is unlimited. *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 County classified the entire 195.5 parcel as commercial and industrial for tax year 2014.

***12** On appeal to BOTA, Kansas Star argued that because it had leased approximately 63.5 acres to a farmer before the date of valuation, the leased acreage should have been classified as agricultural. BOTA rejected this argument and ruled that the acreage was properly classified as land for commercial and industrial use. BOTA based its decision on the fact that even though the acreage was under a lease for farming, the leased ground had not been planted with any crop as of the date of valuation and had not been used agriculturally in the prior year.

This dispute is significant because Kansas taxes agricultural land at a lower rate than land classified as commercial and industrial. 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 that is 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.

Real property is classified according to its use on January 1 of each year. For property such as 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. 2014 Supp. 79-1476; DPV Directive #99-038.

A. *Burden of proof*

Kansas Star argues that BOTA improperly found that it bore the burden of proof to show that the property should not be classified as commercial property.

K.S.A. 2017 Supp. 79-1609 states:

> "With regard to any matter properly submitted to the board relating to the determination of valuation of residential property or real property used for commercial and industrial purposes for taxation purposes, it shall be the duty of the county appraiser to initiate the production of evidence to demonstrate, by a preponderance of the evidence, the validity and correctness of such determination."

The County bore the burden of proof to show that the land was classified as commercial property. 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 that 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.

Here, the County introduced evidence that the property had been used as a commercial gaming enterprise since December 2011. As to whether a portion of the property should now be classified as agricultural, the burden was on Kansas Star to produce evidence that a portion of the property had been put to agricultural use.

B. *Evidence of agricultural classification*

***13** 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 take 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 Miami County Appraiser*, 2012 WL 2149829, at *1.

Kansas Star identifies only two pieces of evidence to support its claim. First, it points to the farm lease between Kansas Star and Hardison executed on December 20, 2013, approximately 13 days before the relevant date of valuation. But, as this court has recognized on a number of occasions, "it's not enough just to enter into a lease for someone to farm the property because '[t]he mere existence of a lease allowing production does not demonstrate that any production actually took place.' [*Oakhill Land Co.*,] 46 Kan. App. 2d at 1116." *In re Miami County Appraiser*, 2012 WL 2149829, at *1. Kansas Star must show more than the mere existence of a farm lease.

Next, Kansas Star notes that Ihm testified that Hardison raised soy beans on the property in 2014 and 2015. But as correctly noted by BOTA, under DPV Directive #99-038, the decision to classify a property as agricultural is based on the use of the property during the prior year or operating period. See *In re Miami County Appraiser*, 2012 WL 2149829, at *2 ("Certainly tax valuations for [January 1 of a taxable year] couldn't be based on what happens in fall [of that same year]; the appraiser must send out

the classification and valuation notice each year by March 1."). Accordingly, Ihm's testimony does not establish that either Kansas Star or Hardison performed agricultural activities on the property in the year or operating period prior to January 1, 2014.

Kansas Star also points to Jortberg's testimony in support of its position. Jortberg testified that the property was being used for "interim agricultural use" but it had potential for future commercial development. However, Jortberg did not testify that it was being used for agricultural use on the date of valuation, and he testified that he did not recall whether soy beans had been planted or if there was hay growing on the property as of his visit in January 2014.

Given that Kansas Star failed to present evidence from which BOTA could have properly concluded that the leased acreage was devoted to agricultural use as of January 1, 2014, BOTA's decision was legally correct and supported by substantial competent evidence.

C. *Evidence of commercial use*

Alternatively, Kansas Star argues the County failed to show that the leased acreage was being used for commercial purposes on the valuation date of January 1, 2014. The County, while not disputing that it bore the burden of proving the classification of the property, counters that Kansas Star grossly misstated the requirements imposed on the County to meet this burden.

The County notes that on May 15, 2013, the DPV issued a memorandum to all Kansas county appraisers, titled "Classification of Non-Productive Land within a Single Agricultural Operation," which addressed the issue of proper classification for nonproductive areas of a tract predominantly used for agriculture. In the memorandum, the Division of Property Valuation noted: "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. Rather the classification is based on the devoted and primary use of the property." DPV Directive #99-038 provides: "Real property with varying uses may be assigned more than one classification. If the uses are so intermingled as to defy classifying identifiable, physical portions of the property, then the property should be classified based upon its predominate use." Kansas Star argues the property is not so intermingled that it cannot be separated, but it presented no evidence that the 63.5 acres was devoted to agricultural use during the prior year.

***14** Here, the County presented evidence of a casino operating on the subject property of 195.5 acres, which was valued as a whole. There is no dispute that the subject property's primary use is commercial gaming. At the time Kansas Star acquired the total site, it intended to use the Wyant tract for future development, such as an RV park, a maintenance building, livestock feed and supply improvements, or other types of future development. Instead, in December 2013, Kansas Star leased the land to Hardison for farming.

While the 63.5 acres leased to Hardison may not have been actively used for commercial purposes as of January 1, 2014, there was no evidence that it was used otherwise. The County is not required to assign separate property classifications to nonproductive portions of a property primarily used for commercial purposes. The County presented sufficient evidence of the property's primary use, and BOTA's decision to uphold the County's property classification was supported by substantial competent evidence.

DID BOTA ERR IN REJECTING LENNHOFF'S COST APPROACH?

Kansas Star argues that BOTA erred in rejecting Lennhoff's cost approach for two reasons: (1) BOTA mistakenly found that Lennhoff relied on the same material facts in his 2013 appraisal as he did in his 2014 appraisal, and (2) Lennhoff's cost approach was more credible and should not have been rejected.

A. *A comparison of Lennhoff's 2013 appraisal to his 2014 appraisal*

Lennhoff appraised the property at a value of $71 million based on his market extraction analysis. He opined that Kansas Star's casino and arena were 40% depreciated, resulting in a value reduction in excess of $46 million.

The market extraction method of estimating depreciation "relies on the availability of comparable sales from which depreciation can be extracted. It makes use of direct comparisons with sales of comparable properties." The Appraisal of Real Estate, Appraisal Institute, 605

(14th ed. 2013). However, "the market extraction method should only be used if sufficient data exists and if the quality of that data is adequate to permit meaningful analysis." The Appraisal of Real Estate, Appraisal Institute, 605 (14th ed. 2013).

For tax year 2013, Lennhoff measured depreciation by comparing Kansas Star's casino and arena to (1) the 2001 sale of the back-of-house portion of the Sam's Town Casino in Kansas City, Missouri (later converted to a corporate training facility) and (2) the 2012 sale of an ice arena in Overland Park with a broken chiller system (later converted to a basketball and soccer facility). BOTA found this analysis to be unreliable.

In tax year 2014, Lennhoff again attempted to apply the market extraction method but this time compared the casino and arena to (1) the 2005 sale of an indoor sports arena in Blue Springs, Missouri, and (2) the same sale of the ice arena with the broken chiller system. BOTA again rejected this analysis, stating: "The Board finds that the challenges and deficiencies in accurately valuing the subject land value and estimating depreciation via the cost approach found by the Board in the prior tax year's appeal are similarly present at instant."

Kansas Star claims the facts that Lennhoff relied on in 2014 were materially different from the facts he relied on in 2013, meaning BOTA's decision to reject the 2014 appraisal for the same reasons it rejected the 2013 appraisal was arbitrary and unreasonable. This is an incorrect characterization of BOTA's ruling. When BOTA referenced Lennhoff's 2013 methodology as justification for again rejecting his analysis in 2014, it merely found that Lennhoff's comparable sales were unreliable and unpersuasive, as it found in 2013. In fact, Lennhoff acknowledged the shortcomings in his comparables. When read in context, it is evident that BOTA very much understood the weaknesses in Lennhoff's comparables and simply repeated the same concerns about the lack of reliable comparables as it had in 2013.

B. *Rejection of Lennhoff's cost approach*

***15** Kansas Star next argues that BOTA erred in rejecting Lennhoff's cost approach because it failed to give proper weight to evidence from expert Morowitz, as well Boyd Gaming employees Ihm and Runde. Kansas Star claims the evidence corroborated Lennhoff's conclusion that the subject property suffered from functional obsolescence. The County maintains that Kansas Star's argument is merely another request for us to reweigh the evidence or engage in de novo review, which we cannot do. See K.S.A. 2017 Supp. 77-621(d). BOTA's decision to reject Lennhoff's cost approach was supported by substantial competent evidence.

The County further argues that the notion that superadequacy can adequately be identified by simply evaluating the arena's contribution to overall profitability improperly disregards KELA's effect on fair market value. See K.S.A. 2017 Supp. 79-503a(j) (restrictions or requirements imposed on the use of the real estate by government bodies are factors to consider in determining fair market value). Kansas Star compares its arena to a swimming pool in an apartment complex that costs $5,000 per year to operate but generates no additional revenue. The County notes the flaw with this analogy, pointing out that an apartment complex is not legally required to have a pool, but the removal of the arena at the casino would result in Kansas Star being in noncompliance with KELA and the management contract, placing its gaming license at risk.

Kansas Star argues that it could have adequately served the same gaming market with a smaller facility and no arena, but, through KELA, the Legislature imposed a $225 million minimum investment requirement and further required each of the four casinos to be at a specified destination location. See K.S.A. 2017 Supp. 74-8734(d). KELA required the Lottery Commission to consider (1) the size of the proposed facility; (2) its location as a tourist and entertainment destination; and (3) agreements related to ancillary facilities as part of the approval process. See K.S.A. 2017 Supp. 74-8734(e). Kansas Star voluntarily included an arena in its bid and, by doing so, became contractually obliged to build and operate the arena.

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).

Kansas Star argues that the evidence in the record supports its superadequacy position because the arena has been unprofitable and its overall gaming enterprise made more money in the temporary casino. Kansas Star points to testimony and evidence that the arena is not profitable and decreases the value of the overall subject property. Additional evidence was presented that the arena was oversized relative to the market. But there is also evidence showing that Kansas Star does not operate its gaming enterprise in the same marketplace as casinos that do not have the protections from competition or the building and operation requirements imposed by KELA. Under KELA, Kansas Star was required to build and maintain the casino and arena which it included in its bid that won the license. And in this market, (1) Kansas Star exceeded its revenue projection for 2014 by the end of 2013 by approximately 16.3%; and (2) Kansas Star's actual profit margin was 37.6%, which exceeded the average profit margin for the companies Jortberg reviewed by 14.5% and the average profit margin for the companies Lennhoff reviewed by 18.8%.

***16** The County maintains that in the actual market in which any hypothetical sale of the subject property would take place, a hypothetical buyer would agree to pay, at a minimum, the cost to construct the arena and casino as built because those facilities are integral to any operator's ability to legally conduct a monopoly gaming enterprise on the property. The County's position is confirmed by the real world sale of the property—Boyd Gaming purchased the property as part of its acquisition of Peninsula Gaming —without any recognized reduction in value for either the arena or the casino. BOTA did not err by rejecting Kansas Star's claim that the value of the property had depreciated by 40% as the evidence in the record supports BOTA's conclusion.

DID BOTA ERR IN ADOPTING ITS OWN INCOME ALLOCATION APPROACH TO VALUE?

Both Kansas Star and the County agree that BOTA's income allocation analysis in tax year 2014 is unsupported by substantial competent evidence. For this reason, the parties assert that BOTA's decision is unreasonable, arbitrary, and capricious.

A. *Did BOTA err in rejecting Jortberg's cost approach?*

The County argues that BOTA's decision to reject Jortberg's depreciation analysis is faulty in a number of respects. First, it points to the fact that BOTA's rejection of Jortberg's depreciation analysis in 2013 was overturned by the district court on appeal, theorizing that BOTA's similar rejection of Jortberg's depreciation analysis for 2014 must be faulty as well. For tax year 2013, the district court adopted Jortberg's depreciation analysis, holding:

> "On this critical issue of functional obsolescence, or super adequacy as framed by the taxpayer, the court is persuaded that the county's evidence and argument is superior to that of the taxpayer. As the county states, the casino is new construction designed and built by experienced gaming facility operators. There should be no functional obsolescence. As to the claim of super adequacy, the taxpayer fails to account for the fact that this is property licensed for operation of a monopoly casino under [KELA]. The casino had to be of a certain size in order for the taxpayer to be awarded the management contract. The arena was part of the total package presented to the state in order for Kansas Star to be awarded the management contract. Any purchaser buying the land for purposes of operating a casino under a KELA management contract would have to buy or construct similarly 'super adequate' facilities in order to qualify for the management contract. Finally, as the county notes, when the property in question was purchased by Boyd Gaming there was no indication that any discount was given for any 'external factor ... identified as a source of value loss.' "

We addressed this issue in the companion case 115,587 and found, limited by our standard of review there, that the district court's conclusion that the property did not suffer from functional obsolescence was supported by substantial competent evidence. However, our decision to affirm the district court on the issue of functional obsolescence does not constitute an endorsement. It simply means there was enough evidence in the record to support the district court's finding. The fact-finder is the principal decider in these instances, which means that our conclusion from the tax year 2013 appeal need not be consistent with this 2014 appeal as the fact-finders

are different and our standard of review is deferential. See generally *In re Tax Appeal of Fleet*, 293 Kan. 768, 780-81, 272 P.3d 583 (2012) (collateral estoppel inapplicable for different tax years). Our role is not to make a de novo determination as to the existence of functional obsolescence. In the 2014 tax year valuation, BOTA reached the opposite conclusion of the district court for the 2013 tax year and rejected Jortberg's finding of no functional obsolescence. Our review is limited to evaluating whether BOTA's decision is supported by substantial competent evidence.

***17** BOTA rejected both appraisers' depreciation analyses based in part on its prior analysis of depreciation in tax year 2013. In 2013, BOTA provided the following explanation for rejecting Jortberg's analysis:

> "The Board is not persuaded by either parties' treatment of obsolescence/depreciation under the cost approach. Jortberg failed to analyze any potential superadequacy of construction even though superadequacy was a potential issue given the KELA minimum investment requirement. Instead, Jortberg simply states that 'the appraiser notes no functional obsolescence.' County Exhibit #522, p. 54. Jortberg stated in his report that no economic obsolescence existed because the business enterprise value far exceeds the value of the real property. Jortberg performed no recognized appraisal analysis to determine whether functional or economic obsolescence existed."

In 2014, BOTA summarily explained:

> "The Board finds that the challenges and deficiencies in accurately valuing the subject land value and estimating depreciation via the cost approach found by the Board in the prior tax year's appeal are similarly present at instant. The instant record is replete with evidence substantiating the Taxpayer's contention that the addition/opening of the casino had a lower than expected financial impact on the Taxpayer's business."

BOTA appears to reject Jortberg's cost approach analysis in part because of his alleged failure to consider superadequacy. 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.) But the record shows that Jortberg considered superadequacy. In his 2014 appraisal report, Jortberg explained that he considered and rejected any functional obsolescence:

> "Functional obsolescence may be caused by such items as inadequacy or super adequacy in size, style, mechanical equipment or other physical elements of the property. The appraiser notes no functional obsolescence at the subject property. The facility is new structure which incorporates best construction practices. The market analysis indicates not only the ongoing construction of event centers/entertainment arenas at casinos by casino owners but also the demand illustrated for smaller footprint event centers to attract more numerous smaller shows as compared to the very large, [publicly] supported facilities which are too large for many potential shows."

Jortberg testified that the property was not superadequate because the facilities were built using best construction practices and it was necessary to build the facilities that were ultimately built in order to obtain the management contract under KELA. Moreover, Jortberg noted that during an actual market transaction involving the property, no impairment, obsolescence, or superadequacy was recognized. BOTA's ruling is not entirely clear, but it would be error for BOTA to base its decision to reject Jortberg's approach based on his alleged failure to consider superadequacy.

This notwithstanding, a fair reading of BOTA's opinion suggests that it likely rejected Jortberg's analysis based on its disagreement with his conclusion of no functional obsolescence. By referencing the "lower than expected financial impact" of the arena, BOTA appears to have concluded that there must be some functional/economic obsolescence because a hypothetical buyer would not purchase an arena that does not generate revenue sufficient to justify its cost of construction. The County complains that this conclusion is fundamentally flawed because the arena was projected from the beginning to operate at a loss. The County directs us to the materials submitted by Kansas Star during the bid process projecting that the arena would sustain operating losses ranging from $790,170 in 2013 to $534,046 in 2016. We note, however, that Kansas Star cites evidence in the record disputing this expectation and in support of its expectation that the arena would increase revenue.

***18** A valid depreciation/obsolescence analysis "should reflect how an informed and prudent buyer would react

to the condition and quality of the property and the market in which the property is found." The Appraisal of Real Estate, Appraisal Institute, 597 (14th ed. 2013). Here, the County notes there is a genuine dispute that the market for the subject property is controlled by KELA. Because of this factor, the County asserts that BOTA erred in assuming that a hypothetical buyer would not pay for facilities such as the arena because it did not independently operate at a profit. The County argues that in a hypothetical sale, no discount for the arena would be recognized because the arena is a legal requirement for either the buyer or seller to operate a gaming enterprise in the market. The County asserts that BOTA's rejection of its cost approach analysis disregards KELA's effect on the marketplace and is arbitrary and capricious.

The County's argument, in effect, asks us to reweigh the evidence and make our own determination of the propriety of functional obsolescence. "We ... do not reweigh competing evidence or assess credibility of witnesses. The Board's findings will be upheld ... even though other evidence in the record would have supported contrary findings." *Graham v. Dokter Trucking Group*, 284 Kan. 547, 553-54, 161 P.3d 695 (2007). While we acknowledge the highly conflicted nature of the evidence in this case, there is evidence supporting BOTA's decision to reject Jortberg's analysis based on his conclusion that the property suffers from no functional obsolescence. Numerous witnesses testified as to the depreciation of the arena and the lower than expected revenues from the project. Because there is evidence in the record to support either conclusion, we cannot find error in BOTA's conclusion.

The County also fails to persuade us that BOTA's decision to reject Jortberg's opinion was arbitrary and capricious. The test for arbitrary and capricious conduct is determining whether a particular action should have been taken or justified, such as the reasonableness of an agency's exercise of discretion in reaching a determination or whether the agency's action is without foundation in fact. *Powell*, 290 Kan. at 569. Here, there is no showing that BOTA's decision was not supported by the evidence or that it took a particular action without a basis in the record.

B. *Is BOTA's income allocation approach supported by substantial competent evidence?*

Both parties agree that BOTA's income approach erroneously applied K.S.A. 2013 Supp. 79-503a and K.S.A. 2013 Supp. 79-505 when it did not rely on evidence in the appraisals but merely split the difference and applied a median value with no evidence to support its ruling. Specifically, the County asserts that the income allocation approach adopted by BOTA is not supported by substantial competent evidence and is otherwise unreasonable, arbitrary, and capricious. The County complains that BOTA's decision merely "applies figures that back into ... a resulting mid-range value." This makes our review difficult because BOTA does not have counsel pointing to evidence in the record in support of its findings. Accordingly, we are required to scour the record to determine whether BOTA's income approach is supported by substantial competent evidence.

Both Lennhoff and Jortberg used the income allocation approach in their appraisals, but BOTA did not adopt the approach used by either appraiser. Instead, BOTA established its own input values to reach its final value conclusion of $97.6 million. BOTA explained its decision as follows:

> "The Board finds that utilizing the subject property's reported actual 2013 revenue with a 21% profit margin as supported by the median drawn from publicly traded properties in the Jortberg appraisal yields an EBITDA of $42,600,000 (rounded). The Board further finds that an EBITDA multiplier of 7.64 is appropriate based on median data drawn from transactional data in both appraisals. Upon review of the allocation analysis presented by [Lennhoff], the Board finds that the median of 30% is the most appropriate reflection of market allocation. Application of these income approach inputs results in a value of $97,600,000, rounded, for the subject real property."

***19** Both parties complain that BOTA applied median figures across the board to achieve its value conclusion. Our research has failed to uncover a case employing a similar approach. Generally, when this court has upheld an adjustment to a value that was made by BOTA, it has looked for substantial competent evidence in the record supporting such an adjustment. See *In re Tax Appeal of Dillon Stores*, 42 Kan. App. 2d 881, 888-89, 214 P.3d 707 (2009) (upholding BOTA's adjustment for freezer space/cooler space that was not accounted for in the appraisal). Here, BOTA did not point to substantial evidence in the record supporting its figures; rather, it admitted that

it adjusted the values from the two appraisers to show median values. This appears to be BOTA's version of splitting the baby.

For its first instance of improper splitting of the difference, the County points to BOTA's 21% profit margin figure as unsupported by substantial competent evidence in the record. As has been discussed, the parties disagree as to how Kansas Star's monopoly status should be accounted for in determining fair market value. Jortberg applied a 37.5% profit margin, based on Kansas Star's actual profit margins in 2012 and 2013 (48% and 37.6%, respectively), a review of earnings before interest, tax, depreciation, and amortization (EBITDA) margins for a number of Colorado casinos, a study by Dean Macomber, and EBITDA margins from publicly traded companies. In contrast, Lennhoff ignored Kansas Star's actual profit margin because it occurred in a monopoly market; he instead relied on a 20% margin based on an IBISWorld publication and his review of profit margins from casinos in competitive markets.

BOTA began its income allocation approach analysis with Kansas Star's actual revenue for 2013. BOTA found that the median profit margin from a table in Jortberg's report was the best evidence of the profit margin in this case. BOTA explained: "The Board finds that utilizing the subject property's reported actual 2013 revenue with a 21% profit margin as supported by the median drawn from publicly traded properties in the Jortberg appraisal yields an EBITDA of $42,600,000 (rounded)."

After estimating EBITDA, BOTA applied an EBITDA multiplier of 7.64 based on median data drawn from transactional data in both appraisals. Finally, BOTA applied a 30% real estate allocation percentage based on the median figure from a table in Lennhoff's report as the most appropriate reflection of market allocation. After applying this figure, BOTA concluded that the fair market value of the subject property for tax year 2014 was $97.6 million.

The County complains that BOTA's decision to take the median drawn from publicly traded properties in the Jortberg appraisal results in a reduction of fair market value in excess of $76 million. BOTA chose a 21% profit margin when Kansas Star had an actual profit margin of $37.6%. The County further points to the fact that even if BOTA could justify using the median figure from Jortberg's report, the actual median figure was 21.9%, not 21%, resulting in a difference of valuation of $4.2 million.

The County also points out that this analysis ignores the fact that the property operates in a monopoly market under KELA. As such, any hypothetical sale would occur under this condition, and BOTA is required to consider KELA's effect on the value of the property. See K.S.A. 2017 Supp. 79-503a (identifying components of fair market value that must be considered, including restrictions imposed on the use of the real estate).

Finally, the County complains that BOTA settled for its own income allocation approach and arbitrarily chose a median profit margin from Jortberg's appraisal report as the best number to use. BOTA does not explain how this median number better represents the profit margin that specifically applies to Kansas Star. The County acknowledges that BOTA is not required to render the explanation for its findings in detail, but the explanation must be "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). We must "review the agency's explanation as to why the evidence supports its findings." *Rhodenbaugh v. Kansas Employment Sec. Bd. of Review*, 52 Kan. App. 2d 621, 631, 372 P.3d 1252 (2016). However, "we may not supply a reasoned basis for the agency's action that the agency itself has not given." *Motor Vehicle Mfrs. Assn. v. State Farm Mut.*, 463 U.S. 29, 43, 103 S. Ct. 2856, 77 L.Ed. 2d 443 (1983) (citing *SEC v. Chenery Corp.*, 332 U.S. 194, 196, 67 S. Ct. 1575, 91 L.Ed. 195 [1947]).

***20** The essence of the County's argument is that BOTA seems to have selected figures out of thin air and has provided no explanation for its 21% profit margin. We must agree. BOTA provides little to no explanation for this figure, making it impossible for us to determine whether the figure is supported by substantial competent evidence. Accordingly, BOTA's adoption of a compromise profit margin of 21% is arbitrary and capricious.

C. *Is BOTA's 7.64 EBITDA multiplier supported by substantial competent evidence?*

The County also disputes BOTA's decision to apply a 7.64 EBITDA multiplier as part of its income analysis.

In considering the appropriate multiplier, Lennhoff advocated for an EBITDA multiplier of 7.5, while Jortberg estimated the multiplier to be between 7.9 and 9.5. Again, BOTA selected neither option and applied an EBITDA multiplier of 7.64, summarily explaining: "The Board ... finds that an EBITDA multiplier of 7.64 is appropriate based on median data drawn from transactional data in both appraisals."

The County claims that neither party has been able to replicate BOTA's calculation. Each party's expert analyzed 10 transactions as part of his analysis. Of the 10 Lennhoff reviewed, the average EBITDA multiplier was 7.82 and the median was 7.68. Of the 10 Jortberg reviewed, the average was 8.1, while the median (which Jortberg did not calculate) would have been 7.5. The combined list of data from both experts includes three duplicates. Accounting for each duplicate only once, the median EBITDA multiplier of the combined 17 transactions is 7.68, not 7.64. Because neither party can ascertain how BOTA derived its 7.64 EBITDA multiplier, the County argues that BOTA's conclusion cannot be supported by substantial competent evidence. We agree.

Even assuming BOTA had calculated the median EBITDA multiplier correctly, BOTA did not explain why the median figure was the proper figure to apply. USPAP Standard 1-1(a) requires appraisers to "be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal." Had either appraiser suggested that the applicable EBITDA multiplier could be determined by selecting the median figure from a list of 17 transactions, that methodology might have been challenged as a violation of 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." *Dillon Stores*, 42 Kan. App. 2d at 890. BOTA cannot apply a methodology the appraisers themselves could not.

The record contains no evidence that (a) the Ameristar Casino—the only transaction with a 7.64 EBITDA multiplier—is comparable to Kansas Star; (b) selecting the median EBITDA multiplier from a list of 17 transactions is a statistically significant or persuasive methodology for selecting an EBITDA multiplier; or (c) the median EBITDA multiplier from the parties' combined transactional data is otherwise persuasive evidence in light of the record as a whole. BOTA's decision to apply a 7.64 EBITDA multiplier is unsupported by substantial competent evidence and is arbitrary and capricious.

D. *Is BOTA's 30% real estate allocation percentage supported by substantial competent evidence?*

Finally, the County argues that BOTA applied a 30% real estate allocation percentage—based on the median figure in a chart in Lennhoff's appraisal—that had no support in the record. The record presented contains no evidence that selecting the median figure from a list of eight transactions (1) comports with USPAP; (2) is a statistically significant or appropriate methodology for determining real estate allocation percentage; or (3) is otherwise persuasive evidence in light of the record as a whole. BOTA's decision to apply a 30% real estate allocation percentage is not supported by substantial evidence and is unreasonable, arbitrary, and capricious.

***21** In conclusion, and for the reasons set forth above, BOTA's decision to adopt its own income allocation approach analysis is unsupported by the record, is arbitrary and capricious, and must be reversed.

Affirmed in part, reversed in part, and remanded with directions for BOTA to apply an approach to value that is supported by substantial competent evidence in the record.

All Citations

420 P.3d 499 (Table), 2018 WL 2749734

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Appendix 6

268 P.3d 12 (Table)
Unpublished Disposition
(Pursuant to Kansas Supreme Court Rule 7.04(f), unpublished opinions are not precedential and are not favored for citation. They may be cited for persuasive authority on a material issue not addressed by a published Kansas appellate court opinion.)
Court of Appeals of Kansas.

RURAL WATER DISTRICT # 2,
Miami County, Kansas, Appellant,
v.
MIAMI COUNTY BOARD OF COUNTY COMMISSIONERS, Appellee.

No. 105,632.
|
Jan. 27, 2012.

Appeal from Miami District Court; Amy L. Harth, Judge.

Attorneys and Law Firms

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David R. Heger, county counselor, for appellee.

Before GREENE, C.J., ATCHESON, J., and BRAZIL, S.J.

MEMORANDUM OPINION

PER CURIAM.

***1** Rural Water District No. 2, Miami County, Kansas (Water District), appeals the district court's decision affirming the denial by the Board of Miami County Commissioners (BOCC) of a conditional use permit application for a 146–foot tall, 1–million gallon overhead water storage tank. The Water District argues that the district court erred when it remanded the case to the BOCC for further findings and conclusions; when it interpreted K.S.A.2010 Supp. 12–757(f)(1) to require a vote of 3/4 of all members of the governing body to pass a resolution adopting a zoning amendment; when it failed to consider the statutory presumption of reasonableness as required by K.S.A.2010 Supp. 12–757(a); and when it denied the conditional use permit solely on aesthetic considerations. Finding no reversible error, we affirm.

The Water District is a quasi-municipal corporation that provides water to nearly 14,000 Miami County residents. As part of a project to increase water supply to the area and the ability of the Water District to expand its infrastructure in the future, the Water District filed an application with the Miami County Planning Department (Planning Department) for a conditional use permit (CUP) to construct a 146–foot tall, 1–million gallon overhead water storage tank in rural Miami County.

Planning Department Director Charlene Weiss conducted an extensive review and recommended approval of the application. She specifically found that the water tank would not conflict with the character of the neighborhood or the "Countryside" zoning of the area, the water tank would not reduce the values of nearby property, and the hardship to the Water District by denying the request outweighed any benefit to nearby properties. However, at a planning commission meeting on December 1, 2009, the Commission denied the application without any factual findings.

On December 14, 2009, several property owners who lived or owned property within 1,000 feet of the proposed water tank filed a valid protest petition with the Miami County Clerk's Office under K.S.A.2010 Supp. 12–757(f). Consequently, the Miami Board of County Commissioners (BOCC) could not pass a resolution approving a zoning amendment, such as a CUP, unless "at least a 3/4 vote of all of the members of the governing body" voted to pass the resolution. K.S.A.2010 Supp. 12–757(f)(1).

On December 30, 2009, the BOCC held a public hearing to discuss the CUP. At the beginning of the hearing, one of the five county commissioners recused himself because of a conflict of interest. After hearing extensive testimony from the Water District and several concerned citizens, the BOCC took the matter under advisement until January 6, 2010, where the remaining four county commissioners voted three to one to approve the CUP. Because only three commissioners voted in its favor, the CUP did not receive the required "3/4 vote of all of the members of the governing body," and consequently, it was denied. The BOCC memorialized the denial in Resolution No. R10–01–001.

*2 In the resolution, none of the commissioners who voted for the CUP application's approval stated their reasons. However, the lone commissioner who did not support the CUP application stated "that the proposed water tower would place a burden on the surrounding property owners that was not outweighed by the benefit to the general public and that the water district could find another location that would not prove to be as burdensome."

On January 26, 2010, the Water District filed a petition for judicial review under K.S.A. 12–760(a). In the petition, the Water District argued the BOCC approved the CUP application by a vote of three to one because K.S.A.2010 Supp. 12–757(f)(1) merely required 3/4 vote of "eligible" county commissioners. Additionally, the Water District claimed that the BOCC's denial of the CUP application was unreasonable. The parties filed extensive joint stipulations of facts and agreed on the admission of certain exhibits on April 26, 2010.

The district court filed a pretrial order on April 28, 2010, noting that the joint stipulations and agreed exhibits "constitute all of the evidence to be presented in the trial of this matter." At a hearing on June 28, 2010, the district court determined K.S.A.2010 Supp. 12–757(f)(1) was unambiguous in its mandate that 3/4 of "[a]ll of the members of the governing body" was required to approve the CUP application. Further, the district court cited *City of Haven v. Gregg*, 244 Kan. 117, 766 P.2d 143 (1988), to conclude "[f]our of the five members of the commissioners would need to vote in favor of the [CUP] for the Water District to prevail before the [BOCC] due to the protest petition.

However, the district court reasoned it could not determine the reasonableness of the BOCC's decision because the lone dissenting county commissioner failed to provide sufficient findings of fact to allow the district court to make that determination. The district court noted it "would literally be guessing" concerning the dissenting commissioner's reason for refusing to approve the CUP application. In its journal entry, the district court stated the dissenting commissioner's statement in Resolution No. R10–01–001 lacked "any specificity or reference to any of the recognized criteria cited in *Golden f v. City of Overland Park*, 224 Kan. 591, 598, 584 P.2d 130 (1978),] and is devoid of any basis for the Court to determine the criteria ... used to vote against the approval of [the Water District's] Application." Consequently, the district court remanded the case to the BOCC to make "an appropriate written record of its decision."

In response, the BOCC adopted Resolution No. R10–07–024 on July 21, 2010. In the resolution, the dissenting commissioner stated 17 factors he considered in voting against approval of the CUP application, including the proposed site, the character of the neighborhood, the close proximity to nearby residences, the adverse impact on neighboring property values, and the "definite negative aesthetic impact on the neighboring properties."

*3 The Water District filed a motion to strike the admission of Resolution No. R10–07–024, listed by the Water District as "Exhibit A," from evidence on August 3, 2010, arguing that it was fundamentally unfair to allow the BOCC to supplement its written findings in violation of the parties' joint stipulated facts. Further, the Water District claimed the April 28 pretrial order was binding on the parties and the district court unless modification was required to avoid injustice. Because the district court made no such findings, the pretrial order should not be modified to allow the admission of additional evidence.

The district court held a hearing on October 15, 2010, to discuss the Water District's motion to strike. Although there was no discussion concerning Exhibit A, the district court determined "it had the right and authority to" remand the case for further factual findings and the parties' joint stipulation did not prevent or prohibit the court from requesting additional information from the BOCC.

After the remand on January 7, 2011, the district court filed an order focusing on the reasonableness of the dissenting commissioner's vote. After reviewing the record, the district court rejected all but one of the dissenting commissioner's reasons for denying the CUP application because the reasons were "not supported by the evidence." Citing *Gump Rev. Trust v. City of Wichita*, 35 Kan.App.2d 501, 512, 131 P.3d 1268 (2006), and *Zimmerman v. Board of Wabaunsee County Comm'rs*, 289 Kan. 926, 218 P.3d 400 (2009), the district court determined the dissenting commissioner's aesthetical concerns were reasonable and upheld the

BOCC's decision to reject the CUP application. The Water District timely appeals.

THE REMAND

First, the Water District claims this court's standard of review is de novo because "the true issue presented in this is the binding effect of agreed stipulations when coupled with the final pretrial order, versus the generally recognized ability of the district court to remand a zoning determination for additional facts or amendments to zoning applications."

This issue raises questions of law over which an appellate court has unlimited review. See *State v. Foster*, 290 Kan. 696, 713, 233 P.3d 265 (2010).

The District Court Did Not Err

The Water District quotes *Wentz Equip. Co. v. Missouri Pacific R.R. Co.*, 9 Kan.App.2d 141, 142, 673 P.2d 1193 (1983), *rev. denied* 235 Kan. 1042 (1984) (quoting *Baker v. City of Leoti*, 179 Kan. 122, 126, 292 P.2d 720 [1956]), for the proposition that the district court was bound by the parties' stipulated facts and could only render " 'such judgment as those facts warranted.' " This statement, however, is only partially correct:

> "Trial and appellate courts are not bound by stipulations pertaining to questions of law, or *that have the effect of a stipulation on a question of law.* More specifically, an appellate court is not bound by a stipulation of the parties as to the law that it may address on appeal. Although concessions are often useful to a court, they do not, at least as to questions of law that are likely to affect a number of cases beyond the one in which the concession is made, relieve an appellate court of the duty to make its own resolution of those issues.
>
> ***4** ....
>
> "Although the parties may agree to stipulate to certain facts underlying a question of law, the trial court is not bound by the parties' stipulations in its determination of mixed questions of law and fact. Thus, parties cannot bind a court by stipulating to the legal effect of a factual finding. Stipulations that limit the range of legal issues available for a reviewing court's consideration are permissible, however, so long as the parties do not stipulate as to matters affecting the jurisdiction, business or convenience of the courts. Although litigants may stipulate to facts, they may not stipulate to what the law requires, or to the law that will apply to a given state of facts." (Emphasis added.) 83 C.J.S. Stipulations § 28, pp. 34–35.

Similarly, it is well-settled Kansas law that although parties can stipulate to questions of fact, stipulations "cannot be invoked to bind or circumscribe a court in its determination of questions of law." *In re Estate of Maguire*, 204 Kan. 686, 691, 466 P.2d 358 (1970). In zoning matters, determining the reasonableness of the BOCC's approval or denial of a CUP application is a question of law within the scope of review of the district court. See K.S.A. 12–760(a) (any person aggrieved "may maintain an action in the district court to determine the reasonableness of such final decision"); see *Combined Investment Co. v. Board of Butler County Comm'rs*, 227 Kan. 17, 28–29, 605 P.2d 533 (1980).

In *Landau v. City Council of Overland Park*, 244 Kan. 257, 274, 767 P.2d 1290 (1989), our Supreme Court stated:

> "If, in the view of the trial court, the findings of fact and conclusions of law are deficient under *Golden* and inadequate for a 'reasonableness' determination, the trial court may, in exercising its discretion, select the alternative of remanding the case to the local governing authority for further findings and conclusions."

It follows that the parties cannot stipulate to an underlying fact where the stipulation would have the effect of binding the district court, or appellate court, in its determination of questions of law. While parties may certainly stipulate to questions of fact, they cannot stipulate to the underlying sufficiency or adequacy of those facts the district court utilizes in making its reasonableness determination. Consequently, the parties' factual stipulations did not bar the district court from determining the BOCC's findings of fact and

conclusions of law were inadequate for a reasonableness determination and remanding the case for further findings.

Interpretation of K.S.A.2010 Supp. 12–757(f)(1)

The Water District suggests K.S.A.2010 Supp. 12–757(f)(1) does not require a unanimous vote when one member of the governing body is subject to recusal or disqualification. Instead, the Water District claims 12–757(f)(1) merely requires an affirmative vote from a supermajority of those present at the meeting. This issue involves statutory interpretation. Interpretation of a statute is a question of law over which an appellate court has unlimited review. *State v. Arnett,* 290 Kan. 41, 47, 223 P.3d 780 (2010).

***5** " 'The fundamental rule of statutory construction, to which all other rules are subordinate, is that the intent of the legislature governs.'

" 'An appellate court may consider various aspects of a statute in attempting to determine the legislative intent. The court must first look at the intent as expressed in the language of the statute. When the language is plain and unambiguous, an appellate court is bound to implement the expressed intent. Ordinary words are to be given their ordinary meanings without adding something that is not readily found in the statute or eliminating that which is readily found therein.'

" 'An appellate court must consider all of the provisions of a statute *in pari materia* rather than in isolation, and these provisions must be reconciled, if possible, to make them consistent and harmonious. As a general rule, statutes should be interpreted to avoid unreasonable results.' [Citation omitted]." *State v. McElroy,* 281 Kan. 256, Syl. ¶¶ 2, 3, 4, 130 P.3d 100 (2006).

K.S.A.2010 Supp. 12–757(f)(1), which applies when a valid protest petition has been filed against a zoning amendment, states that "the ordinance or resolution adopting such amendment shall not be passed except by at least a 3/4 vote of all of the members of the governing body." Here, no party disputes the validity or sufficiency of the protest petition.

In its appeal brief, the Water District admits the language of the statute "would seem to require four of the five county commissioners vote in favor of the resolution, no matter what occurs," but argues a county commissioner's recusal or disqualification should be treated as a vacancy. It attempts to distinguish *City of Haven v. Gregg,* 244 Kan. 117, because *City of Haven* involved an abstention from voting, not a disqualification or recusal.

In *City of Haven,* Donald Gregg appealed to the district court after the City of Haven chief of police issued a complaint against him for violating an ordinance that prohibited the sale of alcohol without a city license. He claimed the ordinance was invalid because a majority of the elected members of the city council had not voted for the ordinance's passage as required by K.S.A. 12–3002. In order for an ordinance to be valid, the statute required "a majority of all the members-elect of the council of council cities or mayor and other commissioners of commission cities vote in favor thereof." K.S.A. 12–3002. Of the five elected city council members, only four were present during the vote, but one city council member abstained. Of the three remaining members, two voted in favor of the ordinance. The district court agreed with Gregg and held the ordinance invalid.

On appeal, after discussing the common-law rule regarding an abstention as a vote for the majority, our Supreme Court noted that a statute controls over the common law if there is a conflict. It then determined the legislative intent of K.S.A. 12–3002, as determined from its plain language, was to require a majority of the elected city council members to vote in favor of an ordinance in order to validate the ordinance. 244 Kan. at 122–23.

***6** While *City of Haven* involved K.S.A. 12–3002, the reasoning is the same here. Clearly, K.S.A.2010 Supp. 12–757(f)(1) requires "at least a 3/4 vote of all of the members of the governing body" to pass a resolution containing a zoning amendment. Here, only three of the five county commissioners voted for passage of the resolution, less than the 3/4 required. The legislature could have required the affirmative vote of a supermajority of the governing body present at a meeting at which a quorum is present to pass the resolution; however, it did not do so.

Under the plain language of the statute, regardless of the reason of the failure to vote by a member of the governing body, *i.e.,* abstention, recusal, or disqualification, "at least a 3/4 vote of all of the members of the governing

body" is required to pass a resolution containing a zoning amendment under K.S.A.2010 Supp. 12–757(f)(1).

K.S.A.2010 Supp. 12–757(a)

The interpretation of a statute is a question of law over which this court has unlimited review. *Arnett*, 290 Kan. at 47.

The Water District contends the district court failed to presume its CUP application was reasonable as required by K.S.A.2010 Supp. 12–757(a). It argues that because the application complied with the Miami County Comprehensive Plan, 12–757(a) mandates a presumption that the CUP application was reasonable and that the BOCC had the burden to prove the application was unreasonable. K.S.A.2010 Supp. 12–757(a) states:

> "The governing body, from time to time, may supplement, change or generally revise the boundaries or regulations contained in zoning regulations by amendment. A proposal for such amendment may be initiated by the governing body or the planning commission. If such proposed amendment is not a general revision of the existing regulations and affects specific property, the amendment may be initiated by application of the owner of property affected. *Any such amendment, if in accordance with the land use plan or the land use element of a comprehensive plan, shall be presumed to be reasonable.*" (Emphasis added.)

While the Water District fails to cite any caselaw to support its position, it cites authority that directly contradicts its argument. See *Nash Special K's LLC v. City of Wichita*, No. 100,235, 2009 WL 2500977, at *7–8 (Kan.App.2009) (unpublished opinion). In *Nash*, a development company, Nash Special K's LLC, filed a zoning change application with the City of Wichita. It was undisputed that the application complied with the comprehensive land use plan in the Wichita Land Use Guide. However, the Wichita City Council denied the zoning request by finding, *inter alia,* that too many questions remained concerning the detrimental impacts on the surrounding properties. Therefore, the Wichita City Council determined the request did not comply with the Wichita Land Use Guide.

On appeal, Nash raised the same issue that the Water District raises here: "K.S.A. 12–757(a) commands that any proposed zoning amendment that complies with the applicable land use plan must be presumed reasonable." 2009 WL 2500977, at *7. The *Nash* panel, however, after quoting the statute, determined "an applicant's unapproved proposed amendment can never be presumed reasonable even if it is in accordance with the Land Use Guide." 2009 WL 2500977, at *8.

***7** K.S.A.2010 Supp. 12–757(a) is plain and unambiguous. As contrasted by the use of "proposed amendment" in 12–757(a), the Kansas Legislature clearly intended the presumption of reasonableness to attach only to adopted amendments that comply with the land use plan or the land use element of a comprehensive plan. The Water District's interpretation is unreasonable and not supported by the plain language of the statute. See *McElroy*, 281 Kan. at 262 (statutes should be interpreted to avoid unreasonable results).

Was BOCC's denial of the conditional use permit based solely on aesthetic considerations lawful and reasonable?

The standard of review, which was stated in *Combined Investment Co.*, 227 Kan. at 28, for the district and appellate courts when reviewing decisions on zoning, special use permits, and conditional use permits, is the same:

> " '(1) The local zoning authority, and not the court, has the right to prescribe, change or refuse to change, zoning.
>
> " '(2) The district court's power is limited to determining
>
> (a) the lawfulness of the action taken, and
>
> (b) the reasonableness of such action.
>
> " '(3) There is a presumption that the zoning authority acted reasonably.

" '(4) The landowner has the burden of proving unreasonableness by a preponderance of the evidence.

" '(5) A court may not substitute its judgment for that of the administrative body, and should not declare the action unreasonable unless clearly compelled to do so by the evidence.

" '(6) Action is unreasonable when it is so arbitrary that it can be said it was taken without regard to the benefit or harm involved to the community at large, including all interested parties, and was so wide of the mark that its unreasonableness lies outside the realm of fair debate.

" '(7) Whether action is reasonable or not is a question of law, to be determined upon the basis of the facts which were presented to the zoning authority.

" '(8) An appellate court must make the same review of the zoning authority's action as did the district court.' " *Zimmerman,* 289 Kan. at 944–45 (quoting *Combined Investment Co .,* 272 Kan. at 28).

As determined earlier, the BOCC properly followed the voting procedures in K.S.A.2010 Supp. 12–757(f)(1). Thus, the question is whether the BOCC's decision was reasonable.

Reasonableness is a question of law to be determined on the facts. *Rodrock Enterprises, L.P. v. City of Olathe,* 28 Kan.App.2d 860, 863, 21 P.3d 598, *rev. denied* 271 Kan. 1037 (2001). It is presumed that the zoning authority acted reasonably, and an appellate court may not substitute its judgment for that of the administrative body. *Dowling Realty v. City of Shawnee,* 32 Kan.App.2d 536, 545, 85 P.3d 716 (2004).

Finally, the Water District contends the BOCC's use of aesthetics alone is "improper" and not "appropriate" While it acknowledges K.S.A. 12–755(a)(4) expressly allows governing bodies to adopt zoning regulations to "control the aesthetics of redevelopment or new development," the Water District contends this power was meant to grant the authority to create aesthetic standards and "not to establish the concept of some generalized form of aesthetics as a factor to consider in reviews of zoning change requests." The Water District cites no authority for the above proposition.

***8** Further, the Water District admits that Kansas courts have long allowed governing bodies to consider aesthetics in zoning matters, but argues that without intelligible and uniform aesthetic standards, the zoning decision turned on the subjective, vague, arbitrary, and improper aesthetic concerns of one dissenting county commissioner.

To this end, the Water District attempts to distinguish *Gump Rev. Trust,* 35 Kan.App.2d 501, claiming that in *Gump,* the City had objective evidence of its desire to maintain aesthetic standards by creating a comprehensive plan for the placement of disguised communication towers and had attempted beautification efforts in the area. In contrast, the Water District contends Miami County presented no aesthetic standards or evidence of any beautification efforts in the area of the proposed water storage tank.

Similarly, the plaintiff in *Gump* argued the City's decision to deny the CUP application for the stealth communications tower was "pure subjectivity" because the plaintiff complied with every requirement of the City's master plan. Although noting the lack of similar stealth towers in the area and attempts to beautify the area, the *Gump* court concluded: "While aesthetic considerations may not be as precise as more technical measures and must be carefully reviewed to assure that they are not just a vague justification for arbitrary and capricious decisions, they may be considered as a basis for zoning rulings." 35 Kan.App.2d at 512.

The Water District has the burden of proving by a preponderance of the evidence that the BOCC's decision was so wide of the mark that its unreasonableness lies outside the realm of fair debate. Further, this court can only declare a zoning decision unreasonable unless *clearly* compelled to do so by the evidence. See *Zimmerman,* 289 Kan. at 958.

Here, the dissenting county commissioner expressly noted that "there would be some adverse impact on the neighboring property owners that would, in the applicant's opinion, be outweighed by the benefit to the general public." Further, the dissenting county commissioner stated the water storage tank could "serve as a catalyst for higher residential density" and significantly change the character of

the neighborhood. Additionally, the dissenting county commissioner expressed concern that other rural water storage tanks in southern Johnson County and Miami County were "not located directly across from residential structures."

This aesthetical concern permeates nearly all of the dissenting county commissioner's reasons for denying the CUP application. Consequently, the Water District has not carried its burden of proving the BOCC acted unreasonably.

Affirmed.

ATCHESON, J., dissenting:

***8** I respectfully dissent. This is a peculiar case. The factual circumstances effectively allowed a single member of the Miami Board of County Commissioners to block a permit for the construction of a water tower in a rural area. The planning commission and the other county commissioners favored issuing the permit. So did the professional planning staff. While that result is peculiar, it is not legally objectionable in and of itself. But the commissioner voted to deny the permit based solely on unexplained "aesthetic" considerations. Despite the tremendous deference the courts must afford zoning and land use decisions, I find the commissioner's stated reason wholly arbitrary and, therefore, legally inadequate. The district court upheld the denial of the permit, and the majority replicates that error. I would reverse and remand with directions that the permit issue, since no valid objection has been lodged.

***9** The majority opinion well sets forth the detailed history of this case, and I see no point in repeating that account. I extract several facts especially pertinent to my analysis:

• The Miami County Commission consists of five elected members. In this case, one excused himself because he also served on the rural water district seeking the permit. A valid protest petition had been filed regarding the permit, meaning 3/4ths of the commission had to approve. K.S.A.2010 Supp. 12–757(f)(1). As a result, any one of the remaining four commissioners could deny the permit by voting against it. That would yield a 3–1 vote in favor or 60 percent of the commission—short of the required 75 percent super majority. And that's what happened here. The statute governing the tallying of votes hands such control to a lone official in the procedural circumstances presented here. But 12–757 has nothing to do with the substantive sufficiency of the reasons for the commissioners' votes on issuing the permit.

• Commissioner Ronald E. Stiles voted against the permit. In the county resolution submitted to the district court outlining the reasons for denial, Stiles finds: "The proposed tower would have a definite negative aesthetic impact on the neighboring properties." He noted that three homes would be, respectively, 550, 750, and 1,350 feet from the proposed water tower. The record indicates those residents opposed the permit. Stiles also said that no other water tower in *rural* Miami County or south Johnson County was so close to residences. But he failed to note that similar water towers had been built closer to homes inside the city limits of Paola and Louisburg. Stiles did not otherwise explain the "negative aesthetic impact" of the proposed water tower. Because of the super majority requirement, Stiles' vote against the permit effectively became the position of the county commission, and it is the focal point of the water district's court challenge.

• Building the water tower elsewhere would entail additional costs probably measured in the hundreds of thousands of dollars.

The water tower would be quite large, and I presume most people would consider it visually unappealing. But nobody presented evidence that the water tower would diminish land values.

The nub of the issue is the legal sufficiency of the reason for denying the permit. That is, does the recitation of "negative aesthetic impact" without something more suffice to reject a specific zoning or land use request?

When a county commission considers use permits or zoning changes for particular tracts of land, it acts not in a legislative capacity but in a quasi-judicial one. See *Zimmerman v. Board of Wabaunsee County Comm'rs*, 289 Kan. 926, 946–48, 218 P.3d 400 (2009). Quasi-judicial proceedings may be characterized as those entailing the "exercise of discretion" upon "notice and hearing" taken by a body "empowered to investigate facts, weigh evidence, and draw conclusions as a basis for official action." *Brown v. U.S.D. No. 333*, 261 Kan. 134, 156, 928

P.2d 57 (1996). They typically include at least some of "the normal trapping of a judicial inquiry," such as open hearings and argument or other participation by counsel. 261 Kan. at 156. Apart from those procedural attributes, the difference between legislative policy formulation and quasi-judicial decision making becomes significant in fixing the scope of a court's review of the result.

***10** Legislative actions and quasi-judicial decisions both entail reasons and outcomes. That is, the government actors have reasons for the outcomes they reach. When courts review legislative actions, the reasons are essentially unassailable. Elected officials acting in a legislative capacity can vote a certain way for good reasons, bad reasons, or entirely ridiculous reasons—they can flip coins or read tea leaves if they want. And that does not render the outcome vulnerable on judicial review. Voters, of course, might choose to turn out of office coin-flipping legislators. Judicial review of legislative outcomes is also severely constrained. Assuming the legislation—be it a city ordinance, a county resolution, or a state statute—meets all technical requirements for enactment such as proper notice, single subject, and the like, a court typically must uphold the measure even though it reflects monumentally unsound public policy. See *City of Baxter Springs v. Bryant,* 226 Kan. 383, Syl. ¶ 4, 598 P.2d 1051 (1979). If legislation impinges on a fundamental constitutional right or a suspect class, the courts may look at it more closely.

In reviewing quasi-judicial proceedings, however, the courts may consider both reasons and outcomes. And, indeed, an otherwise proper outcome may be set aside if the reasons betray unacceptable methods or grounds for adopting that outcome. Flipping a coin, for example, would be incompatible with weighing of evidence or drawing conclusions necessary to support a quasi-judicial 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. See *Robinson v. City of Wichita Retirement Bd. of Trustees,* 291 Kan. 266, 271, 241 P.3d 15 (2010) (A decision of a governmental body acting in a quasi-judicial capacity may be said to be arbitrary if it was reached " 'without adequate determining principles [or] not done ... according to reason or judgment.' ").

When a city council or county commission adopts a comprehensive zoning or land use plan, it acts in a legislative capacity. *Golden v. City of Overland Park,* 224 Kan. 591, Syl. ¶ 1, 584 P.2d 130 (1978). But when the same body considers rezoning a particular parcel or issuing a use permit of the sort for the water tower, it engages in quasi-judicial decision making. *Zimmerman,* 289 Kan. at 946 (citing *Golden,* the court characterizes "specific tract rezoning" as a quasi-judicial function.); *Golden,* 224 Kan. at 597. In that instance, the governing body may not rely simply on a yes or no vote on the change but should adopt a written statement of evidence and factors considered in making the decision. 224 Kan. at 597. The purpose is to assist the courts in reviewing that quasi-judicial decision. See 224 Kan. at 597.

When reviewing a quasi-judicial zoning or land use decision, as here, the courts are to look at the reasonableness of the action but, in doing so, must give particular deference to that action. See *Combined Investment Co. v. Board of Butler County Comm'rs,* 227 Kan. 17, 28, 605 P.2d 533 (1980). The court may not substitute its judgment for that of the governmental body. The majority opinion sets forth the eight rules outlined in *Combined Investment Co.* for assessing reasonableness, and I do not repeat them here.

***11** The Kansas appellate courts have recognized that municipal governments may take aesthetics into account in making specific rezoning and land use determinations. *Zimmerman,* 289 Kan. at 951; *Gump Rev. Trust v. City of Wichita,* 35 Kan.App.2d 501, Syl. ¶ 3, 131 P.3d 1268 (2006). But acceptable aesthetic considerations include articulable, objective justifications tied to the particular changes or uses. The *Gump* court pointed out that aesthetic factors often lack the precision of other, more technical zoning standards. 35 Kan.App.2d at 512. Accordingly, they "must be carefully reviewed" to prevent their use as camouflage for "arbitrary and capricious decisions." 35 Kan.App.2d at 512. The Kansas Supreme Court also noted that " '[T]here is an aesthetic and cultural side of municipal development which may be fostered *within reasonable limitations.*' " (Emphasis added.) *Houston v. Board of City Commissioners,* 218 Kan. 323, 329, 543 P.2d 1010 (1975).

For example, Wabaunsee County's zoning decision to ban commercial wind farms, reviewed in *Zimmerman,* could

be supported, in part, on aesthetic grounds where that use would have allowed each farm to install upward of a dozen turbines between 260 and 300 feet tall mounted on large concrete pads. The facilities likely would have been constructed on higher elevations within the county. The facilities, therefore, would have been highly visible structures in the middle of the Tallgrass Prairie and the Flint Hills, recognized scenic attractions of the state. And they reasonably could be considered markedly detrimental to the scenic qualities of those areas. In addition, the pads would have had measurably negative effects on flora, fauna, and the overall ecology of the farms and the surrounding land. See *Zimmerman*, 289 Kan. at 952–53.

While less dramatic, the aesthetics at play in *Gump* were similarly anchored in measurable considerations. There, a provider of cell phone services wanted to install a 165–foot transmitting tower, ostensibly disguised as a flagpole, in an area of Wichita that had undergone "extensive beautification efforts." 35 Kan.App.2d at 503–04. This court upheld the city's denial of the request on aesthetic grounds. An existing regulation limited the height of structures of that type to no more than 85 feet in that part of the city without a special use permit. No permits had been granted. The evidence also showed the provider could furnish city-wide phone coverage without a tower of that height. 35 Kan. App.2d at 511–12.

Those cases illustrate acceptable reliance on aesthetic factors in making zoning and land use decisions. But this case typifies the vice the court warned of in *Gump*. Aesthetics has been played as a trump card to thwart construction of a water tower that appears to be in the public interest and under circumstances not appreciably different from those in which water towers already have been built in the same vicinity. The card is without identifiable suit or rank, yet it has prevailed. That's at least partly because aesthetic considerations, by their very nature, are squishy.

***12** Broadly speaking, aesthetics is the study of beauty and refinement and the discernment of the attributes that form those qualities. But what is pleasing in that respect ultimately defies predictive definition. There is truth in the cliches that one person's trash is another's treasure and beauty lies in the eye of the beholder. What distinguishes the beautiful ultimately rests on subjective judgment, rather than objective evaluation. Judicial process eschews that sort of subjectivity precisely because it confounds rational determination and predictable result.

Commissioner Stiles offered no descriptive explanation of the water tower's "negative aesthetics impact." He did not tie it to height requirements or similar objective criteria of the type involved in *Gump*. Nor did he describe deleterious consequences for a recognized scenic or historic area, as in *Zimmerman*. The closest he came was the proximity of the water tower to residences. That suggests water towers make visually unpleasant neighbors. But the aesthetic impact here would have been no worse than what has already been permitted with water towers in Paola and Louisburg, where those structures are even closer to homes. The proposed water tower apparently would not violate any existing setback or screening requirements. And Stiles muddled his own rationale by suggesting the water tower could prompt construction of more homes in the immediate area—"a catalyst for a higher residential density" in the jargon of the resolution. Thus, he argues simultaneously that the water tower would be unaesthetic, but it would *attract* new homeowners.

What Stiles offered comes across as nothing more than the label "aesthetics" slapped on an I–don't–like–this–and–I'm–not–going–to–vote–for–it position. That would be unobjectionable if he were wearing his legislative-action hat. But he wasn't. He was acting in a quasi-judicial capacity. Stiles' rationale fails the general precepts for acceptable quasi-judicial decision making. It lacks determining principles and, for all appearances, looks to be based on wholly subjective considerations. Quasi-judicial process demands something more. See *Robinson*, 291 Kan. at 271.

Stiles' decision also fails to measure up to the more particularized factors for rezoning decisions outlined in *Combined Investment Co.*, 227 Kan. at 28. Most of those factors really don't apply at all or are otherwise accounted for. Thus, I have acknowledged the deference due the commission's decision and the limited role of the courts in reviewing that decision for reasonableness. And I have noted that the courts cannot substitute their views for those of quasi-judicial bodies. Encompassed in that deference is a presumption of reasonableness (otherwise we wouldn't be deferring and actually *would* substitute our judgment) and a requirement that the rural water district bear the burden of showing unreasonableness (again, that

is bound up in deference to the decision). That essentially accounts for all of the *Combined Investment* factors, save one:

> ***13** "Action is unreasonable when it is so arbitrary that it can be said it was taken without regard to the benefit or harm involved to the community at large, including all interested parties, and was so wide of the mark that its unreasonableness lies outside the realm of fair debate." 227 Kan. at 28.

And it is the crucial factor.

The community benefits of the water tower were well established, and Stiles at least acknowledged them. There apparently was no countervailing harm to the community at large, as there would have been with commercial wind farms atop the Flint Hills in Wabaunsee County. To the contrary, building the water tower on any acceptable alternative site would have been considerably more expensive. Weighed against those considerations, the immediate neighbors of the proposed water tower were unhappy. The *Gump* court noted that although "neighborhood objections" may be considered in rezoning decisions, the ultimate determination rests on " 'the benefit or harm involved to the community at large.' " *Gump,* 35 Kan.App.2d at 511 (quoting *Waterstradt v. Board of Commissioners,* 203 Kan. 317, Syl. ¶ 3, 454 P.2d 445 [1969]). As I have discussed, Stiles' opposition depended upon some undefined, unqualified concern for "negative" aesthetics—the water tower would be unpleasant to look at. But it would be no more unpleasant than those water towers in Paola and Louisburg. And the water tower would not have violated any existing land use regulations. Stiles' position, thus, reflects a level of arbitrariness found unacceptable in *Combined Investment.*

As to the second component of the *Combined Investment* factor, Stiles' position doesn't so much "lie outside the realm of fair debate," as it effectively defies any debate at all. Stiles declared the water tower to be unaesthetic without tying his conclusion to any identifiable standard, past practice, or other even remotely objective measure. In other words, Stiles declared that in his view the water tower would not be aesthetic or pleasing in that location. He offered nothing more than a subjective opinion. A person's subjective opinion on a matter of aesthetics can't really be right or wrong in an objective sense if the person sincerely holds that view. Those opinions are undebatable. It is as if Stiles declared Michelangelo's Pieta to be a beautiful work of art and Beethoven's Ninth Symphony to be a sublime piece of music or, more to the point here, Picasso's Seated Nude and the Beatles' Lucy in the Sky with Diamonds as having "a definite negative aesthetic impact." Nobody can prove otherwise because the propositions, as unadulterated opinion, are unprovable.

It is, however, for that very reason purely subjective reliance on abstract or undefined aesthetics cannot creep into and control quasi-judicial decisions on zoning and land use. Those decisions defy meaningful definition and would thwart judicial review. Because they cannot be proven or disproven, they are inherently arbitrary and essentially impossible to debate as a basis for fashioning those decisions. For that reason, I would hold Commissioner Stiles' expressed reason for denying the use permit legally insufficient under the *Combined Investment* test and contrary to the valid application of aesthetic considerations for land use decisions as reflected in *Zimmerman* and *Gump,*

***14** I hasten to add, however, that aesthetics reflect a valid component of zoning and land use regulation when tied to demonstrable or objective considerations. Preservation of historic buildings or neighborhoods may be considered aesthetic, just as avoiding the visual degradation of the Flint Hills with wind farms has been. Curtailing especially intrusive noises, smells, or sights certainly may be infused with aesthetics, thus justifying stringent limits or outright bans on livestock operations or quarrying adjacent to residential areas. Aesthetics can be incorporated into objective zoning requirements such as setbacks, height restrictions, and prohibitions on incompatible uses in certain zoning classifications. I do not suggest how best to position the line between acceptably defined aesthetic reasons for land use decisions and impermissibly subjective ones. But this case falls on the subjective side when Stiles pointed to no existing requirements consistent with his reason for denying the permit and when past practices in placing water towers near residences undercut that reasoning. The decision was arbitrary and, thus, legally insufficient.

By upholding Stiles' stated position for the outcome here, the majority invites municipal officials opposing a specific zoning or land use request to bulletproof their stance by relying, at least in part, on its "negative aesthetic impact."

This case elevates aesthetics from a fair and appropriate consideration into an unassailable ground for rejection. [1]

All Citations

268 P.3d 12 (Table), 2012 WL 309165

Footnotes

1 Although not material to my view of the case's disposition, I also disagree with the majority's conclusion that the language in K.S.A.2010 Supp. 12–757(a) imputing a presumption of reasonableness to a zoning amendment conforming to a comprehensive land use plan applies only after the amendment has been approved. That particular sentence speaks of "any such amendment," which plainly refers to the immediately preceding sentence discussing "such proposed amendment." The terms "such amendment" and "such proposed amendment" are used interchangeably throughout the statute. The statute, for example, discusses certain zoning changes proposed by groups of landowners and imposes notice and hearing requirements for "such amendments." K.S.A.2010 Supp. 12–757(c). That couldn't possibly refer to the amendment after it had been approved; giving notice and holding a hearing then wouldn't make sense. In short, if a proposed amendment conforms to a comprehensive plan, it comes to the government body with a presumption of reasonableness.