

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

IN THE MATTER OF THE
EQUALIZATION APPEALS OF
KANSAS STAR CASINO, L.L.C.
FOR THE YEAR 2012 IN
SUMNER COUNTY, KANSAS

Docket Nos. 2012-3909-EQ
& 2012-3910-EQ

ORDER

Now the above-captioned matters come on for consideration and decision by the Court of Tax Appeals of the State of Kansas. The Court conducted a hearing in these matters on October 29 and 30, 2013. Taxpayer, Kansas Star Casino, L.L.C., appeared by its counsel of record Jarrod C. Kieffer and Lynn D. Preheim of Stinson Morrison Hecker LLP. Sumner County appeared by its counsel of record David R. Cooper and Teresa L. Watson of Fisher, Patterson, Saylor & Smith, L.L.P.

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

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

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

I.

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

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

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

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

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

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

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

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

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

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

The July 16, 2010 binding letter of intent provided for Peninsula Gaming Partners, LLC's (either directly or through a wholly-owned subsidiary) acquisition of certain real estate rights (option agreements) from Double Down Development, L.C.¹ One of the option agreements was for the Wyant tract. Also included were option agreements for the Storey tract at K-53 and Hydraulic (east side of I-35) and the Grother tract at the southwest corner of K-53 and U.S. Highway 81.² (Exhibits #115 and #357)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

II.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

“fair market value’ means the amount in terms of money that a well informed buyer is justified in paying and a well informed seller is justified in accepting for property in an open and competitive market, assuming that the parties are acting without undue compulsion.”

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

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

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

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

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

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

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

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

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

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

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

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

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

III.

Law Governing Ad Valorem Tax Valuations

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

Fair market value is defined as the amount in terms of money that a well informed buyer is justified in paying and a well informed seller is justified in accepting for property in an open and competitive market, assuming that the parties are acting without undue compulsion. K.S.A. 79-503a. In determining fair market value the appraiser must consider various factors enumerated in K.S.A. 79-503a(a) to (k). The *ad valorem* tax appraisal process also shall conform to generally accepted appraisal procedures adaptable to mass appraisal and consistent with the definition of fair market value, unless otherwise specified by law. K.S.A. 79-505.

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

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

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

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

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

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

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

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

IV. *Cost Approach*

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

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

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

Replacement Cost of Improvements

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

Signage

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

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

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

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

35A Am. Jur. 2d Fixtures §2.

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

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

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

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

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

“The ‘Kansas Real and Personal Property Reference’ section is a guideline for classifying property in the state of Kansas. If we all follow it in general, we will promote uniformity. It lists many types of properties and the classification for each one.

It is possible that the county appraiser will be faced with a unique situation or property that is not addressed in the Kansas Reappraisal Manual. In that case, the county appraiser shall

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

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

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

KRGC Trailer Cost

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

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

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

Organizational Costs

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

Financing Costs

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

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

Improvement Value

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

Land Value

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

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

Management Agreement

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

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

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

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

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

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

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

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

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

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

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

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

can be separated from the bundle by sale, lease, mortgage, donation, or another means of transfer. The complete bundle of rights includes the following:

- The right to sell an interest
- The right to lease an interest
- The right to occupy the property
- The right to mortgage an interest
- The right to give an interest away”

The Appraisal of Real Estate, Appraisal Institute, at 112 (13th ed. 2008).

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

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

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

With respect to the Wyant tract, the County's expert witness Jortberg concluded that the tract sold for \$8,000,000. Jortberg relied upon the adjusted sale prices of the Gerlach tract, inclusive of the price for the Gerlach option assigned, and the sale price of the Wyant tract for a land value of \$16,931,250, or roughly \$17 million. Based on the weight of the evidence, the Court concludes that a preponderance of evidence supports a land value of \$16,931,250.⁹

Excess Land

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

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

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

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

Undue Compulsion

Taxpayer also argues that the management contract constitutes undue compulsion, and as a result, the purchase price of the land does not satisfy the definition of fair market value found in K.S.A. 79-503a. "Fair market value" is defined as the amount in terms of money that a well informed buyer is justified in paying and a well informed seller is justified in accepting for property in an open and competitive market, assuming that the parties are acting without undue compulsion. See K.S.A. 79-503a.

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

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

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

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

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

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

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

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

“Investment value represents the value of a specific property to a particular investor. As used in appraisal assignments, investment value is the value of a property to a particular investor based on that person’s (or entity’s) investment requirements. In contrast to market value, investment value is value to an individual, not necessarily value in the marketplace.

Investment value reflects the subjective relationship between the particular investor and a given investment. It differs in concept from market value, although investment value and market value indications sometimes may be similar. If the investor’s requirements are typical of the market, investment value in this case will be the same as market value.

When measured in dollars, investment value is the price an investor would pay for an investment in light of its perceived capacity to satisfy that individual’s desires, needs, or investment goals. To render an opinion of investment value, specific investment criteria must be known.”

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

Off-Site Utilities

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

Again, we refer to the statutory definition of fair market value. “Fair market value” is defined as that amount in terms of money that a well informed buyer is

justified in paying and a well informed seller is justified in accepting for property in an open and competitive market, assuming the parties are acting without undue compulsion. K.S.A. 79-503a.

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

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

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

Conclusion

In summary of our analysis and based upon the weight of the evidence presented, the Court finds that the replacement cost new less depreciation of the improvements is \$63,578,600 and the land value is \$16,931,250 resulting in a total cost approach estimate of \$80,509,850. The Court concludes that a rounded value of \$80,510,000 best reflects the fair market value of the fee simple interest of the subject property for tax year 2012.¹¹

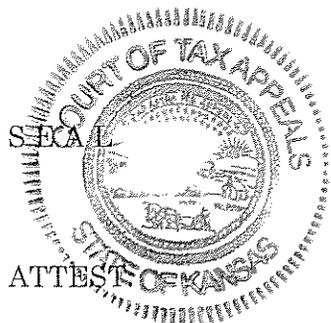
IT IS THEREFORE ORDERED that, for the reasons stated above, the appraised value of the subject property for tax year 2012 is \$80,510,000.

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

Any party to this action who is aggrieved by this decision may file a written petition for reconsideration with this Court as provided in K.S.A. 2013 Supp. 77-529. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Court's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for reconsideration shall be mailed to: Secretary of the Court, Kansas Court of Tax Appeals, Eisenhower State Office Building, Suite 1022, 700 SW Harrison St., Topeka, KS 66603. A copy of the petition, together with any accompanying documents, shall be mailed to all parties at the same time the petition is mailed to the Court. Failure to notify the opposing party shall render any subsequent order voidable. The written petition must be received by the Court within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute). If at 5:00 pm on the last day of the specified period the Court has not received a written petition for reconsideration of this order, no further appeal will be available.

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

IT IS SO ORDERED



THE KANSAS COURT OF TAX APPEALS

Handwritten signature of Sam H. Sheldon in cursive.

SAM H. SHELDON, CHIEF JUDGE

Handwritten signature of James D. Cooper in cursive.

JAMES D. COOPER, JUDGE

Handwritten signature of Ronald C. Mason in cursive.

RONALD C. MASON, JUDGE

Handwritten signature of Joylene R. Allen in cursive.
JOYLENE R. ALLEN, SECRETARY

CERTIFICATION

I, Joeline R. Allen, Secretary of the Court of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket Nos. 2012-3909-EQ and 2012-3910-EQ, and any attachments thereto, was placed in the United States Mail, on this 25th day of February, 2014, addressed to:

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



Joeline R. Allen, Secretary