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WALGREEN CO.

Plaintiff,

v.

Case No. 04-CV-1564

CITY OF MADISON,

Defendant.

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DECISION

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I. INTRODUCTION

This is an action pursuant to Wis. Stat. § 74.37(3)(d) seeking a refund of alleged excessive property taxes. In particular, Plaintiff Walgreen Co. (hereafter "Walgreen") asserts that two properties for which Walgreen is responsible for paying the property tax have been assessed well above their fair market value for both 2003 and 2004. In the alternative, Walgreen suggests that the two properties have not been assessed in conformity with the Uniformity Clause of the Wisconsin Constitution.

The City of Madison (hereafter "City" or "Defendant") disagrees with both contentions. Further, it claims that Walgreen's 2004 action is barred by its

failure to comply with Wis. Stat. §§ 70.47(7)(a) and (ae), and that any evidence related to uniformity should be barred because such claim was not raised in the Amended Complaint.

## II. FINDINGS OF FACT

1. Plaintiff Walgreen leases properties at 2909 East Washington Avenue and 3710 East Washington Avenue in Madison, Wisconsin and is responsible for property taxes assessed to such properties.
2. The properties are subject to 60 year leases, terminable after 20 years as follows:
  - a. 2909: Lease dated 2000, current stated rent is \$35,833.33
  - b. 3710: Lease dated 1999, current stated rent is \$29,987
3. The two properties were constructed by a developer at Walgreen's direction and pursuant to Walgreen's business model described *infra*.
4. For 2003, the City of Madison assessed the properties at:
  - a. 2909: \$2,532,000
  - b. 3710: \$4,268,500
5. Walgreen timely appealed the 2003 assessments to the Board of Review. The Board of Review sustained the assessments.
6. Walgreen timely filed claims for excessive assessment which were not acted upon by the City within 90 days.
7. For 2004, the City of Madison assessed the properties at:

a. 2909: \$2,532,000

b. 3710: \$4,400,000

The City of Madison's Board of Assessors later altered the 2004 assessments to:

a. 2909: \$4,618,000

b. 3710: \$3,860,000

8. Walgreen timely appealed these assessments to the Board of Review. At the Board of Review hearing, Walgreen presented estimated valuations, but did not present any evidence supporting its estimated valuations. The Board of Review sustained the 2004 assessments.

9. Walgreen timely filed claims for excessive assessment which were disallowed by the City.

10. The reports prepared by and the testimony given by experts Mr. Vitale and Ms. Drousth apply different standards. Ms. Drousth's assessment factored in the actual leasehold value, whereas Mr. Vitale's fee simple valuation considered other leases in the area, but not the actual Walgreen's lease. Each expert was credible with regard to data relied upon.

11. Additional facts will be presented in the decision as necessary.

### III. ANALYSIS

Before considering the merits of this action, the City's affirmative defense and motion in limine must be considered.

#### A. Affirmative Defense

The City argues that Walgreen failed to comply with Wis. Stat. §§ 70.47(7)(a) and (ae). See Answer and Affirmative Defense to Amended and Supplemental Complaint, ¶ 28. On that basis, the City asserts that Walgreen's claims regarding the 2004 assessments cannot proceed. See Defendant's Trial Brief, p. 2. Walgreen counters that its actions at the Board of Review are not relevant to the current action and that, in any event, it sufficiently complied with Wis. Stat. §§ 70.47(7)(a) and (ae).

The plain language of the relevant statutes establishes that before Walgreen can bring the instant lawsuit, it must comply with the procedures set forth in Wis. Stat. § 70.47.

First, Wis Stat § 70.37(4)(a) states as follows:

No claim or action for an excessive assessment may be brought under this section unless the procedures for objecting to assessments under s. 70.47, except under s. 70.47(13), have been complied with. This paragraph does not apply if notice under s. 70.365 was not given.

(Emphasis added.)

Wis. Stat. § 70.37(4)(a) clearly establishes that compliance with s 70.47 is a condition precedent to the filing of an action for excessive assessment, such as the present one. Moreover, the statute requires something more than mere generalized exhaustion of remedy, i.e. it mandates compliance with the particular procedures set forth in Wis. Stat. § 70.47. To state the obvious, compliance with all procedures under § 70.47 except Wis. Stat. § 70.47(13), includes compliance with the procedures in Wis. Stat. § 70.47(7). Finally, and again to state the obvious, it is apparent that the legislature is capable, when it so chooses, of excusing compliance with portions of Wis. Stat. § 70.47 as a precondition to a Wis. Stat. § 70.47 claim because it excepted Wis. Stat. § 70.47(13).

Second, Wis. Stat. § 70.47(7)(a) itself reinforces the "complied with" requirement of Wis. Stat. § 70.47(4)(a), providing that "[n]o person shall be allowed in any action or proceeding to question the amount or valuation of a property unless ... such person in good faith presented evidence to such board in support of such objections."

Third, while case law has not specifically addressed the procedures in Wis. Stat. §§ 70.47(7)(a) and (ae), it has consistently required compliance with Wis. Stat. § 70.47 as a condition precedent to an action contesting the valuation or assessment of property. See Hermann v. Town of Delavan, 215 Wis.2d 370, 381-382, 572 N.W.2d 855, 859 (1998). Furthermore, the policy favoring "expeditious assessment procedure for correcting errors of judgment by the assessor" is best

advanced by requiring compliance with procedures designed to promote full disclosure and full hearing before the Board of Review. See e.g., id at 392-393, 572 N.W.2d 855, 863-864, Pelican Amusement Inc. v. Town of Pelican, 13 Wis.2d 585, 592, 109 N.W.2d 82, 86 (1961). Likewise, policy disfavoring the “emasculat[i]on” of the procedures in Wis. Stat. § 70.47 is advanced by requiring compliance with such procedures. See Pelican, 13 Wis.2d at 593, 109 N.W.2d 82, 87, Hermann, 215 Wis.2d at 392-394, 572 N.W.2d 855, 863-864.

Finally, Walgreen has not identified any case law supporting a conclusion that a court may ignore lack of compliance with portions of Wis. Stat. § 70.47 or that its provisions may otherwise be disregarded.

We turn, therefore, to the requirements of the particular procedures in question. Wis. Stat. § 70.47(7)(a) states, in relevant portion:

No person shall be allowed in any action or proceedings to question the amount or valuation of property unless such written objection has been filed and such person in good faith presented evidence to such board in support of such objections and made full disclosure before said board, under oath of all of that person's property liable to assessment in such district and the value thereof.

Of particular import here is the requirement that a person “in good faith presented evidence to such board in support of [its] objections.”

“Good faith” is not defined by the statute. Black’s Law Dictionary, however, provides the following definitions:

A state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one’s duty or obligation,

(3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage.

Black's Law Dictionary, 701 (7<sup>th</sup> ed 1999). Because this statute is concerned with ensuring that the Board of Review receives adequate information to assess an objection, the "good faith" required must constitute something more than lack of fraudulent conduct. It is not necessary to select any particular definition from the remaining because Walgreen's presentation does not meet any of them.

At the Board of Review proceeding, Walgreen presented an estimated value of the subject properties, but failed utterly to provide any basis supporting these valuations. More specifically, Walgreen provided valuations based on an estimated \$rent/sq.ft. and capitalization rate, but without any presentation of facts that explained where its estimated numbers originated or why these numbers had any basis in reality. Worse still, Walgreen's failure to produce occurred despite the Board's repeated direct requests for such evidence. Asked about comparables supporting the market rents it used, Walgreen's property tax representative, Mr. Gary Martin responded, "I do not have those." Board of Review transcript (hereafter "Transcript"), 22:24 through 23:7. Asked about how the 9% capitalization rate it used was arrived at, Mr. Martin responded, "But I don't have the information here" and "I don't have the details backing up that 9 percent." Transcript, 23: 8-17. Asked for the basis for its proposition that the Walgreen location was similar to others in the area despite the fact that Walgreen

was paying \$5 a square foot more in rent, Mr. Martin responded, "I don't have the details on that." Transcript 24:8.

Walgreen simply did not give the Board any data from which it could independently conclude that the numbers chosen by the Walgreen for its calculations constituted relevant evidence, that is, "evidence on which responsible persons are accustomed to rely in the conduct of business." City of Madison, Board of Review Procedures, 11. g., Relevant Evidence. Rather, Walgreen's basic position was, "Here are the numbers we used and this is our conclusion -- take it or leave it." This conclusory presentation does not, and could not reasonably be believed to, constitute an honest attempt to present sufficient evidence to support its objections, particularly in a hearing at which, the follow burden of proof applies.

The law presumes that the Assessor has properly performed the Assessor's duties and has assessed all properties fairly and upon an equal basis at the fair market value. The effect of this presumption is to impose upon the property owner the burden of proving that the property in question has not been correctly assessed. The law requires that the property owner present independent evidence relevant to the fair market value. (Emphasis added.)

City of Madison, Board of Review Procedures, 14 Burden of Proof. Given the lack of relevant evidence supporting Walgreen's pro forma, the Board had no choice at the end of the hearing but to sustain the assessments.

Wis. Stat. § 70.47(7)(ae) provides further support for this conclusion. Wis. Stat. § 70.47(7)(ae) states:

When appearing before the board, the person shall specify, in writing, the person's estimate of the value of the land and of the improvements that are the subject of the person's objection and specify the information that the person used to arrive at that estimate.

(Emphasis added.)

This section clearly contains two requirements, i.e. (1) specification of the person's estimate of the value of land and improvements and (2) specification of the information used to arrive at that estimate. The phrase "information ... used to arrive at that estimate" in subsection (2) mandates the production of underlying data. Walgreen failed wholly to present such data

Consequently, by failing to make an even potentially sufficient showing, Walgreen did not demonstrate "honesty in belief or purpose" or "faithfulness to [its] duty or obligation", that is, it did not demonstrate good faith.

Finally, the complete lack of any supporting evidence would also not meet the third good faith definition, i.e. "observance of reasonable commercial standards of fair dealing in a given trade or business." No assessor or appraiser could reasonably claim a good faith effort and simultaneously fail or refuse to provide any evidence to support the numbers used in an assessment.

Walgreen's failed utterly to provide the information required by Wis. Stat. 74(37)(4)(a). Given its conclusory presentation, it had absolutely no chance of prevailing at the hearing. Consequently, a decision overturning the assessments would have been arbitrary and capricious because the Board didn't know

“where the numbers came from.” Transcript, 22:20-21. The record, or lack of record, compels the conclusion that Walgreen was not acting in good faith at the hearing. For this reason, Walgreen may not pursue its action under Wis. Stat. § 74.37 as to the 2004 valuations. Indeed, holding otherwise would likely lead to the “emasculat[i]on” of Wis. Stat. § 70.47 procedures.

#### **B. Motion in Limine**

Immediately prior to trial, the City filed a motion in limine seeking to exclude any evidence related to Walgreen’s allegedly inadequately pled Uniformity Clause challenge. At trial, however, no evidence was admitted which was solely relevant to the City’s Uniformity Clause contentions. Rather, the evidence supporting Walgreen’s Uniformity Clause arguments was relevant and admissible to Walgreen’s overvaluation argument. See State ex rel. Park Place v. Board of Review, 61 Wis.2d 469, 477, 213 N.W.2d 27, 31 (1973). Because evidence relevant to exclusively to the Uniformity Clause Motion in Limine is a null set, the Motion in Limine is denied as moot.

#### **C. Excessive Assessment**

The remaining issues, then, are (1) whether the City’s 2003 valuations of the properties at 2909 and 3710 East Washington Avenue were erroneous, (2) if so, what are the proper valuations, and potentially (3) whether such valuations violate the Uniformity Clause of the Wisconsin Constitution.

##### **1. Standard**

The general standards governing this action are not difficult to state. A Wis Stat. § 74.37(3)(d) action is essentially *de novo*, i.e. the Court may take evidence not presented to the Board of Review and rely upon such evidence in determining the proper valuation of a property. See Nankin v. Village of Shorewood, 245 Wis.2d 86,104, 630 N.W.2d 141, 149 (2001). The Court, moreover, "may make its determination without regard to any determination made at any earlier proceeding." Id. However, "the assessor's assessment is presumed correct if the challenging party does not present significant contrary evidence." Bloomer Housing LP v. City of Bloomer, 257 Wis.2d 883, 891, 653 N.W.2d 309, 312 (Ct. App. 2002). Neither party contends that the Walgreen did not present significant contrary evidence, therefore, the court must decide this issues on the merits of the parties' conflicting valuations.

Property valuation for tax purposes is governed by Wis. Stat § 70.32(1) which states:

Real property shall be valued by the assessor in the manner specified in the Wisconsin property assessment manual provided under s. 73.03(2a) from actual view or from the best information that the assessor can practicably obtain, at the full value which could ordinarily be obtained therefore at private sale. In determining the value, the assessor shall consider recent arm's-length sales of the property to be assessed if according to professionally acceptable appraisal practices those sales conform to recent arm's-length sales of reasonably comparable property; recent arm's-length sales of reasonably comparable property; and all factors that, according to professionally acceptable appraisal practices, affect the value of the property to be assessed.

By "full value" the statute means, "the amount [the property] will sell for upon arms-length negotiation in the open market, between an owner willing but not obliged to sell and a buyer willing but not obliged to buy." Metropolitan Holding Co. v. Bd. of Review of the City of Milwaukee, 173 Wis.2d 626, 631, 495 N.W.2d 314, 316 (1993).

## 2. Evidence and Arguments

Despite the sometimes contentious argument, the parties are in substantial agreement regarding certain threshold matters. First, the parties agree that there has been no useful recent arm's-length sale of the assessed properties or reasonably comparable properties. Second, the parties agree that it is, therefore, appropriate to look to the other assessment approaches: cost and income. See generally, Wisconsin Property Assessment Manual, 7-18 - 7-31. Third, the parties agree that of these two of the approaches, cost is of little assistance in this case. Thus, both parties focus on the proper application of the income approach to the subject properties. There is, however, substantial dispute regarding how the income approach should be applied in this case.

The parties are at their most virulent in attacking the credibility of the opposing assessment expert, each claiming that the others expert valuation should be rejected based on credibility. I find both Ms. Drouth and Mr. Vitale, in general, credible in regards to their assessment reports and testimony. Ms.

Drousth's conclusions, while presented in the less formal document<sup>1</sup>, appear well-founded and reasoned. Her testimony regarding the proper valuation was not, as suggested by Walgreen's counsel, open advocacy. Rather, it was presented as an expert in the field supporting a reasonable conclusion based on reasonable information and assumptions. Mr. Vitale's findings were presented in a clear and carefully documented manner. His testimony and reports suggests attention to detail and reasoned conclusions.

The issue is, then, not whether either expert was biased or incredible. Rather it is which expert applied the correct standard. Most of the difference in the expert valuations was the result of the appraiser factoring in or not factoring in the Walgreen's lease. Mr. Vitale appraised the fee simple interest in the two properties without consideration of the lease, while Ms. Drousth appraised the leased fee interest. Even so, the difference in the assessments is striking.

A brief description of the actual leases is helpful. Walgreen presented evidence of the manner in which the actual rent amounts were derived. The two properties in question were undisputedly built by developers at the direction of Walgreen pursuant to Walgreen's business model. In this business model, Walgreen works with developers to locate Walgreen's stores at prime locations while allowing Walgreen the financial ability to continue to rapidly expand.

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<sup>1</sup> Walgreen asserts on several occasions that Wis. Stat. § 70.32(1) requires assessors to value property in accordance with professionally acceptable appraisal practices. This assertion is used several times to suggest that the failure of Mr. Drousth's report to comply with USPAP written appraisal standards fails to comply with the statute. The assertion is misleading – nothing in Wis. Stat. § 70.32(1) purports to govern proper documentation of valuation conclusions.

Walgreen typically does not purchase and develop locations itself. Rather, Walgreen and developers working on its behalf seek out certain locations that meet Walgreen's strict location requirements. Typically these locations are prime, heavily-trafficked locations, for which Walgreen is willing to, and often does, pay a premium. At times, Walgreen and the developer will buy out and remove an existing business to secure a desired location. The developer purchases the location and develops to suit Walgreen including some superadequacies. Once the development is complete, Walgreen will typically enter into a twenty year lease designed to compensate the developer for all development costs together with a profit margin.

In this case, although the Walgreen lease is technically an encumbrance, it is reality and enhancement. To state the obvious, the value of both of the assessed properties was increased greatly because of the Walgreen lease. Walgreen's is a financially stable lessee, the lease is lengthy (60 years, terminable after 20 years) the lease rent is higher than normal because the property is uniquely accessible and the developer is recovering his development costs on a building that contains the superadequacies demanded by Walgreen.

### **3. Controlling Law**

Initially, the Wisconsin Property Assessment Manual provides what appears to be clear guidance regarding the correct interest to be valued:

A full interest (fee simple interest) in real property can be divided into partial interests. These partial interests can be created by rental property leases as

well as by other factors. To accurately estimate the market value of the full interest in leased property, both the lessor's and the lessee's interest (the leased fee and leasehold interest) must be fully included.

Wisconsin Property Assessment Manual, 7-4. This certainly appears to require a fee simple assessment.

However, when a conflict exists between common law and the Wisconsin Property Assessment Manual, common law controls. See City of West Bend v. Continental IV Fund LP, 193 Wis.2d 481, 487, 535 N.W.2d 24, 26-27 (Ct. App. 1995). In the case of a leased fee interest, particularly one involving a long-term lease, such a conflict does exist. See id. The Wisconsin Court of Appeals has expressly held:

Where property is encumbered by a bundle of rights, we must appraise or assess the property at its value using the current value of those bundle of rights. In this case, we cannot speculate as to what the lease rights might bring on the market, but we must accept the rental payments agreed upon under the negotiated lease terms

Id. at 489, 535 N.W.2d 24, 27 (citation omitted).

Walgreen argues that City of West Bend is distinguishable here because its holding is limited to situations in which the leases were at a market rate when entered into. To the contrary, nothing in the Court of Appeals decision clearly limits its holding as Walgreen suggests. Moreover, it is clear that the City of West Bend decision does not merely restate the holding of Durcel v. City of Manitowoc Board of Review, 137 Wis 2d 623, 405 N.W.2d 344 (1987), but also

incorporates the Wisconsin Supreme Court's decision in Metropolitan Holding Co., 173 Wis 2d 626, 495 N.W.2d 314. See City of West Bend, 193 Wis.2d at 488-489, 535 N.W.2d 24, 27. The City of West Bend Court simply appears to have recognized that the Wisconsin Supreme Court has substantially changed the assessment procedure (i.e. from the Wisconsin Property Assessment Manual's procedure) when any sort of encumbrance significantly alters the value of a property.

The Court finds that the properties here must be subject to an assessment using the full value of the current bundle of rights. Most important, of course, a proper assessment of these properties must take into account the impact of the leases on the value of the property. These leases undisputedly are for a long term, have been reached at arm's-length and run with the land. Furthermore, there is no indication that the leases were entered into for some sort of improper purpose, e.g. to minimize the apparent value of the property. As such, the value of these leases, quite simply, drives the value of the properties to an arm's-length purchaser and must be considered.

Because the Court has found that the assessment of the subject properties must take into account the leases, there is no need to consider whether the leases are "inextricably intertwined." See ABKA LP v. Board of Review of the Village of Fontana-On-Geneva Lake, 231 Wis.2d 328, 603 N.W.2d 217 (1999).

#### 4. Application

Having concluded that Wisconsin law requires the assessment to take into account the leases to which the two properties here are subject, the Court finds that the 2003 assessments contained in Ms. Drousth's reports represent the proper valuations of the subject properties. That is, Ms. Drousth's reports properly captures the full value which could ordinarily be obtained for the properties upon arms-length negotiation in the open market, between an owner willing but not obliged to sell and a buyer willing but not obliged to buy.

As to the 2909 East Washington Avenue property, Ms. Drousth took into account the actual lease amounts and made reasonable assumptions regarding operating expenses in arriving at an estimated net operating income of \$ 387,903. Ms. Drousth then derived a capitalization rate from reasonably comparable properties and creditable reference materials, determining a reasonable capitalization rate of 8.40%. Capitalization of the net operating income results in a value of approximately \$ 4,618,000.

As to the 3710 East Washington Avenue property, Ms. Drousth likewise considered the actual lease figures and made reasonable assumptions regarding operating expenses in determining an estimated net operating income of \$ 324,616. Applying the same reasonable capitalization rate of 8.40 % results in a value of approximately \$ 3,860,000.

## 5. Uniformity Clause

Walgreen argues that if the Court upholds the existing assessment or adopts the City's proposed assessment, such assessments would violate the Uniformity Clause of the Wisconsin Constitution. The City, on the other hand, contends that (1) the Court should not consider the argument because it was waived, (2) there is insufficient evidence of non-uniformity and (3) there is adequate evidence of uniformity.

Wis. Const. Art. VIII, § 1 requires "that the method or mode of taxing real property must be applied uniformly to all classes of property within a tax district." State ex rel. Levine v. Board of Review of the Village of Fox Point, 191 Wis 2d 363, 371, 528 N.W.2d 424, 427 (1995). Thus, even if a taxpayer's property is assessed at a fair market value, the tax may be shown to be non-uniform if other comparable properties were assessed significantly below their fair market value. See id. at 371-372, 528 N.W.2d 424, 427.

Walgreen's Uniformity Clause argument is insufficient. First, the evidence presented by Walgreen does not demonstrate lack of uniformity because the "comparable" properties Walgreen relied upon have not been shown to be comparable to the subject properties. Most importantly, both of the properties at issue are subject to lengthy leases that add considerably to the value of the property. None of the comparable properties had similarly profitable leases. In addition, there has not been a showing of arbitrary or otherwise

unwarranted differential treatment of like properties. See e.g., Duesterbeck v. Town of Koshkonong, 232 Wis.2d 16, 34-35 605 N.W.2d 904, 913 (Ct. App. 1999).

**6. Conclusion**

Because the law requires that the significant leases on the assessed properties be taken into account, and because the credible appraisals of Ms. Drouth take into account these leases, the appraisals performed by Ms. Drouth indicate the "full value" of these properties. Walgreen has not presented sufficient evidence to demonstrate that these appraisals would violate the Uniformity Clause of the Wisconsin Constitution.

**IV. CONCLUSIONS OF LAW**

1. Walgreen has failed to comply with the procedures in Wis. Stat. § 70.47(7)(a) and (ae) with regard to its claims for the 2004 assessments and is, therefore, barred by Wis. Stat. § 74.37(4)(a) from challenging such assessments.
2. Wis. Stat. § 70.32(1) requires the Court to take into account the actual lease terms for the two subject properties.
3. Walgreen has not presented sufficient evidence of Uniformity Clause violation.

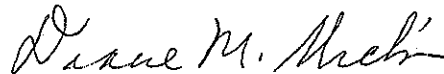
V. JUDGMENT

For the above-stated reasons, the Court adopts the 2003 valuations reached by Ms. Judith Drousth for the properties at 2909 and 3710 East Washington Avenue in Exs. 3 and 4.

IT IS SO ORDERED.

Entered this 26<sup>th</sup> day of June 2006 in Madison, Wisconsin.

BY THE COURT:



DIANE M. NICKS, Judge  
Circuit Court - Branch 5  
Case Nos. 04-CV-1564

cc: ACA Larry W. O'Brien  
Office of the City Attorney  
Room 401, City-County Building  
210 Martin Luther King, Jr. Blvd.  
Madison, WI 53703

Atty. Don M. Mills  
Atty. Robert L. Gordon  
Michael Best & Friedrich, LLP  
One South Pinckney Street, Suite 700  
Post Office Box 1806  
Madison, WI 53701-3501