



STATE TAX COMMISSION OF MISSOURI

ST. LOUIS BOA PLAZA, LLC and) Appeal No 19-20160 to 19-20162
ST. LOUIS PLAZA LLC,)
)
Complainants,)
)
v.)
)
MICHAEL DAUPHIN, ASSESSOR,)
CITY OF ST. LOUIS, MISSOURI,)

ORDER AFFIRMING HEARING OFFICER DECISION UPON APPLICATION FOR REVIEW

HOLDING

On December 17, 2021, Senior Hearing Officer Eric S. Peterson (Hearing Officer) entered a Decision and Order (Decision) affirming the decision of the Board of Equalization of the City of St. Louis (BOE). St. Louis BOA Plaza, LLC and St. Louis Plaza, LLC (Complainant) subsequently filed an Application for Review of Hearing Officer’s Decision and Order. Michael Dauphin, Assessor of the City of St. Louis, Missouri, (Respondent) filed an Opposition to Complainant’s Application for Review. Complainant filed a Reply.

We AFFIRM the Decision and Order of the Hearing Officer. The decision of the Hearing Officer is hereby incorporated into our Decision without further reference.

FACTS AND PROCEDURAL HISTORY

The subject property consists of three parcels (collectively BOA Plaza) totaling 3.2 acres and located on Market Street in the City of St. Louis, Missouri. The parcels are improved with a 30-story Class A office building constructed in 1982 with 735,579 square feet of rentable space. The building includes 375 covered parking spaces. St. Louis BOA Plaza, LLC purchased BOA Plaza in 2009 for \$47,850,000. The BOE assigned the following TVMs to the three parcels comprising BOA Plaza:

Parcel 1890000150	\$28,151,900
Parcel 1890000250	\$644,100
Parcel 1960000150	\$14,075,900

The BOE set a true value in money (TVM) of the subject property at \$42,871,900 as of January 1, 2019. Complainant timely appealed to the State Tax Commission (STC) on the issue of overvaluation. The issue of overvaluation was presented at an evidentiary hearing on March 4, 2021, to the Hearing Officer who affirmed the BOE’s determination.

Complainant contends that the TVM of the subject property was \$25,000,000 as of January 1, 2019. To support the opinion of value, Complainant offered the following exhibits:

Exhibit	Description
A	Appraisal Report of Thomas H. Slack, MAI
B	Written Direct Testimony of Slack
C	Written Rebuttal Testimony of Slack
D	Written Sur-rebuttal Testimony of Slack

Complainant presented the testimony of Certified General Real Estate Appraiser Thomas H. Slack, MAI (Slack). He is a designated member of the Appraisal Institute (MAI).

In developing the income approach, Slack reviewed the property's actual income and expenses as well as reviewed market data. Slack estimated gross rental at \$17.50 per square foot for the Class A Office space. Slack amortized tenant improvement costs over the average lease term to conclude annual tenant improvement costs of \$3.40, resulting in an annualized "effective" rental rate of \$14.10 per square foot. Slack analyzed vacancy rate data and also considered the subject property's historical vacancy rates. Slack concluded a vacancy and collection loss rate of 15% was appropriate after comparing the subject property's vacancy rate and the market vacancy rates. Slack analyzed the subject property's actual expenses as well as comparable property expenses to arrive at a total expense per square foot of \$7.66. The resulting net operating income (NOI) prior to any adjustments was \$7.97 per square foot or \$5,864,202. Slack included no pass-through income as he stated the market rent assumes a base year with no expense reimbursements.

Slack valued BOA Plaza by the sales comparison approach and income approach with emphasis on the income approach. Slack did not utilize the cost approach. Slack concluded the respective indicated values from the income and sales comparison approaches were \$24,200,000 and \$25,700,000, respectively, with a reconciled estimated value of \$25,000,000 as of January 1, 2019.

In both approaches to value, Slack made adjustments to separate the fee simple value from the "leased fee" value. This is done to value the property as if it were vacant,

therefore, all the expenses of leasing the property including leasing fees and tenant improvements would be deducted to arrive at the TVM, irrespective of the subject property's actual occupancy rate or the "market" occupancy rate. Based upon this approach, Slack deducted \$5,509,928 in leasing commissions, approximately \$15,000,000 in tenant improvements and attributed no pass-through income to BOA Plaza.

Slack also included deferred maintenance in his analysis. An addendum to Slack's Appraisal was a condition assessment report completed by Johnson Controls that recommended replacement of an 860-ton centrifugal chiller with a new 260T heat recovery chiller at an estimated cost of \$505,200. The Johnson Controls bid states that the replacement would improve "building comfort," reduce energy consumption, and reduce the risk of equipment failure. The bid further sets out \$365,750 in rebates and cost savings that would inure to the property.

Respondent contends that the TVM of the subject property as found by the BOE of \$42,871,900 as of January 1, 2019, should be affirmed. To support the contention, Respondent offered the following exhibits:

Exhibit	Description
1	Appraisal Report of Ryan Brennan
2	Brennan's Written Direct Testimony
3	Brennan's Written Rebuttal Testimony

Respondent presented the testimony of Ryan Brennan (Brennan). Brennan is employed with the Assessor's Office of the City of St. Louis. Brennan's report is subject

to the exception to licensure of appraisers in Section 339.501.5(3)¹. The Hearing Officer overruled Complainant's objections to the exhibits on grounds of lack of foundation and admitted the exhibits into the record.

Brennan developed the sales comparison and the income approaches. Brennan did not develop the cost approach. In developing the income approach, Brennan reviewed the property's actual income and expenses as well as reviewed the market data. Brennan estimated the gross market rent for office space was \$16.75 per square foot with retail space at \$17.00 per square foot and storage space at \$9.00 per square foot.

Brennan included income from parking and miscellaneous sources based on the financial records of BOA Plaza from 2016 through 2018. Based on this analysis, Brennan attributed to BOA Plaza \$469,775 in parking income and \$95,603 in miscellaneous income. (Ex. 1 at 54-55)

Brennan estimated pass-through income of \$0.80 per square foot based on the median pass-through income generated by four other buildings in the downtown central business district. This results in pass-through income of \$582,007.

Brennan analyzed the subject property's actual expenses as well as comparable property expenses to arrive at a total expense per square foot of \$7.50.

The final component of Brennan's expense analysis considered estimated expenses for replacement reserves and a community improvement district (CID) special assessment. Surveys indicated the average replacement reserve for downtown St. Louis central business

¹ All statutory citations are to RSMo 2000, as amended.

district office space was \$0.29 per square foot. Brennan estimated replacement reserves at \$0.25 per square foot, for an annual total of \$183,895 (739,579 square feet x \$0.25 per square foot = \$183,895). The CID charge for 2019 for was \$61,034.

Brennan reconciled the \$47,800,000 value indicated by the sales comparison approach and the \$47,500,000 value indicated by the income approach into a final value estimate of \$47,500,000. (Ex. 1 at 78)

CONCLUSIONS OF LAW

Complainant's Points on Review

In its Application for Review, Complainant asserts that the Hearing Officer's Decision was erroneous because the Hearing Officer:

1. admitted Respondent's evidence of value;
2. did not accept the methodology of Complainant regarding determination of a market-based rent in the income approach;
3. did not accept the methodology of Complainant regarding use of parking income in determining the property's net operating income;
4. did not accept the methodology of Complainant regarding the use of capital expenditures/deferred maintenance in determining the value of the property; and
5. did not accept the methodology of Complainant regarding the use of pass-through income in determining the property's net operating income.

Standard of Review

A party subject to a Decision and Order of a hearing officer of the STC may file an application requesting the case be reviewed by the STC. Section 138.432. The STC may then summarily allow or deny the request. Section 138.432. The STC may affirm, modify,

reverse, set aside, deny, or remand to the Hearing Officer the Decision and Order of the Hearing Officer on the basis of the evidence previously submitted or based on additional evidence taken before the STC. Section 138.432.

The Commission reviews the hearing officer's decision and order de novo. *Lebanon Properties I v. North*, 66 S.W.3d 765, 770 (Mo. App. 2002); *Union Electric Company, d/b/a Ameren Missouri, v. Estes*, 2020 WL 3867672 (Mo. St. Tax Com., July 2, 2020); *AT&T Mobility, LLC, v. Beverly Alden, Assessor, Caldwell County, Missouri, et al.*, 2020 WL 3867819 (Mo. St. Tax Com., July 2, 2020). "The extent of that review extends to credibility as well as questions of fact." *Lebanon Properties I*, 66 S.W.3d at 770. The Commission "is free to consider all pertinent facts and estimates and give them such weight as reasonably they may be deemed entitled to." *St. Louis Cty. v. State Tax Comm'n*, 515 S.W.2d 446, 450 (Mo. 1974).

There is a presumption of validity, good faith and correctness of assessment by the BOE. *Hermel, Inc. v. STC*, 564 S.W.2d 888, 895 (Mo. banc 1978); *Chicago, Burlington & Quincy Railroad Co. v. STC*, 436 S.W.2d 650, 656 (Mo. 1968); *May Department Stores Co. v. STC*, 308 S.W.2d 748, 759 (Mo. 1958). This presumption is a rebuttable rather than a conclusive presumption. The presumption of correct assessment is rebutted when the taxpayer presents substantial and persuasive evidence to establish that the BOE's assessment is erroneous and what assessment should have been placed on the property. *Id.*

The taxpayer in a STC appeal bears the burden of proof. The taxpayer is the moving party seeking affirmative relief. Therefore, Complainant bears the burden of proving by substantial and persuasive evidence the vital elements of the case, i.e., the assessment was

“unlawful, unfair, improper, arbitrary, or capricious.” See, *Westwood Partnership v. Gogarty*, 103 S.W.3d 152 (Mo. App. E.D. 2003); *Daly v. P.D. George Co.*, 77 S.W.3d 645 (Mo. App E.D. 2002); *Reeves v. Snider*, 115 S.W.3d 375 (Mo. App. S.D. 2003); *Industrial Development Authority of Kansas City v. State Tax Commission of Missouri*, 804 S.W.2d 387, 392 (Mo. App. W.D. 1991). *Substantial evidence* can be defined as such relevant evidence that a reasonable mind might accept as adequate to support a conclusion. *Cupples Hesse Corp. v. State Tax Commission*, 329 S.W.2d 696, 702 (Mo. 1959). *Persuasive evidence* is evidence that has sufficient weight and probative value to convince the trier of fact. *Cupples Hesse Corp.*, 329 S.W.2d at 702. The persuasiveness of evidence does not depend on the quantity or amount thereof but on its effect in inducing belief. *Brooks v. General Motors Assembly Division*, 527 S.W.2d 50, 53 (Mo. App. 1975). "For purposes of levying property taxes, the value of real property is typically determined using one or more of three generally accepted approaches." *Snider*, 156 S.W.3d at 346. The three generally accepted approaches are the cost approach, the income approach, and the comparable sales approach. *Id.* at 346-48. The STC has wide discretion in selecting the appropriate valuation method but "cannot base its decision on opinion evidence that fails to consider information that should have been considered under a particular valuation approach." *Id.*, at 348.

STC's Ruling

For the reasons that follow, the STC finds Complainant's arguments to be unpersuasive. The STC, having thoroughly reviewed the whole record and having considered the Hearing Officer's Decision, the Application for Review of Complainant,

Respondent's response opposing the Application for Review and Complainant's Reply and supporting briefs, affirms the Hearing Officer's decision.

Complainant's First Point on Review

In his Decision, the Hearing Officer thoroughly analyzed the admissibility of Respondent's evidence, finding that Brennan had "consulted acceptable sources to verify sales data," "Complainant cross-examined Brennan extensively regarding the foundation for his report and testimony . . . to undermine the credibility," and "any residual basis for excluding the evidence is negated because the facts are determined by an administrative hearing officer rather than a jury." We agree with these findings and conclude no error in the admission of Respondent's evidence into the record.

Complainant's Second and Fifth Point on Review

Complainant's Second and Fifth Points on Review both relate to the use of Fee Simple Interest v. Leased Fee Interest in the appraisal and the resulting analysis. Complainant's contention is that property should be appraised as if it were unencumbered by any leases or interests in the property.

The assessor values property in fee simple interest. An estate in fee simple is ownership of all the rights in a property. A lease conveys property rights to another. The tenant receives a leasehold interest that allows the tenant the right to use and occupy the property under conditions. The fee ownership remains with the owner of the property. For ad valorem purposes, the property to be assessed consists of the land and improvements and the possessory interests in the property. Section 137.115.1. In most cases, the value of the leased fee and the value of the leasehold should approximate the value of the fee simple

unencumbered by a lease.

The Hearing Officer found that Complainants' proposed value is premised on the assumption a "fee simple estate means absolute ownership *unencumbered by any other interest or estate*, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat." (Compl. Br. at 1, 15) (citing Appraisal Institute, *The Dictionary of Real Estate Appraisal* 90 (6th Ed. 2015)). Based on this assumption, Complainants deduct \$5,509,928 in leasing commissions, approximately \$15,000,000 in tenant improvements, and attribute no pass-through income to BOA Plaza. The net result is an approximately \$20,500,000 deduction accounting for leasing commissions already paid, tenant improvements already in place, and a reduced NOI estimate that does not account for income actually generated by the property.

Complainants assert their proposed value is based on standard appraisal practice. Slack, however, testified he is unsure whether the Kansas standards he utilized to appraise BOA Plaza are uniform "from state to state[.]" (Tr. 1. At 32:22-23) Complainants' assertion that estimating TVM of BOA Plaza requires an assumption the property is "unencumbered" by leases is not based on Missouri law. Consequently, the deduction of approximately \$20,500,000 accounting for leasing commissions already paid, tenant improvements already in place, and a reduced NOI estimate does not account for income actually generated by the property. The Hearing Officer properly found that Complainant's evidence is not credible and does not constitute substantial and persuasive evidence of the TVM of BOA Plaza as of January 1, 2019.

The income approach determines value by estimating the present worth of what an

owner will likely receive in the future as income from the property. The income approach is based on an evaluation of what a willing buyer would pay to realize the income stream that could be obtained from the property when devoted to its highest and best use. This approach is most appropriate when valuing investment-type properties and is reliable when rental income, operating expenses and capitalization rates can be reasonably estimated from existing market conditions.

Commercial real estate lease agreements may contain terms in which, in addition to rent payments, the tenant agrees to pay expenses. Terms may include the tenant paying the expenses or paying an additional amount based upon increases in the expense items from the initial lease period.

Complainant's appraiser developed the income approach to value. The appraiser, in doing so, did not include expense reimbursements, also known as pass through income, in his calculation because he estimated rental rates as of January 1, 2019, which would mean it is the base year with no reimbursements. (Ex A, P.44) Complainant's appraisal sets out that there was expense reimbursement and escalation revenue of \$2,884,530 from the subject property in 2018. (Ex A, p.38). Respondent's evidence showed pass through expense income of the subject property of \$1,558,550 in 2018. (Ex 1, p.56)

As established, Complainant cites no authority for the proposition that valuing a property with market data entails an assumption that leases are reset to commence on the valuation date. A leading appraisal treatise specifically states that pass-through "[e]xpense recoveries are usually treated as separate revenue items[.]" *Appraisal of Real Estate* 472. This authority undermines Complainants' unsupported argument.

Further, there is no evidence Complainants attribution of zero pass-through income assumption reflects economic reality. Both Slack and Brennan testified leases in buildings like BOA Plaza *do not* share a common base year lease and *do* generate pass-through income. (Tr. 2 53:16-25; 54:1-2 and 89:3-4) There is no evidence supporting the conclusion market participants wholly ignore pass-through income by valuing established multi-tenant office buildings on the counter-factual assumption that all leases are reset to the purchase date.

Complainants also argue that pass-through income is necessarily "non-existent in a fee simple analysis" because market rents factor in market expenses. (Compl. Br. at 18). Missouri law requires consideration of economic realities when estimating the TVM of real property for purposes of *ad valorem* taxation. *Mo. Baptist Children's Home*, 867 S.W.2d at 513. Both experts testified that BOA Plaza and buildings like it typically generate pass-through income. The evidence establishes that, in reality, BOA Plaza generates pass-through income. This income factors into the value of the BOA Plaza real estate.

Complainant's Third Point on Review

Complainant's Third Point on Review is that the Parking Income of BOA Plaza should not be considered in the valuation of the property. Complainant's appraiser included parking income and storage income in his calculation under "other income." (Ex A p. 44) Respondent presented evidence that Parking Income was included in the calculation for determining the value of the property. Complainant now contends that both were incorrect and that the Parking Income should not be included. Complainant's

contention is without support and is not persuasive.

Complainant's Fourth Point on Review

Complainant's Fourth Point is that the Hearing Officer did not accept the methodology of Complainant regarding the use of capital expenditures/deferred maintenance in determining the value of the property.

After developing his sales comparison and income approaches to value, Complainant's appraiser made an adjustment to the indications of value for capital expenditures/deferred maintenance. The adjustment made was a negative \$505,000 based on a bid by Johnson Controls to install new HVAC equipment. "Deferred maintenance" refers to "items in need of immediate repair on the effective date of the appraisal ... for the building to continue to function as it should and to be marketable to potential buyers." *The Appraisal of Real Estate* 618. "Short-lived items," by contrast, "have not reached the end of their total useful life expectancy and are not completely deteriorated, but they are substantially depreciated in comparison with the overall structure." *Id.* at 619. The distinction is crucial because "substantial deferred maintenance items typically require lump-sum adjustments in the sales comparison and income capitalization approaches[.]" *Id.* Short-lived items are typically accounted for by "replacement reserves" set aside to fund predictable, periodic replacement of building components. *Id.* at 485.

The Johnson Controls bid states the new HVAC equipment would improve "building comfort," reduce energy consumption, and reduce the risk of equipment failure. (Ex A at 59). None of the stated project objectives are consistent with "items in need of immediate repair" so that BOA Plaza could "continue to function as it should and to be

marketable to potential buyers.” *The Appraisal of Real Estate at 618*. Slack and Brennan both testified that a buyer would consider the Johnson Controls bid. The bid, however, shows \$365,750 in rebates and cost savings that offset the \$505,200 initial budget estimate, resulting in an estimated “simple payback” period of 2.32 years. (Ex A at 59) Slack’s adjusted expense estimate (Ex A at 47) accounts for some potential value accruing to BOA Plaza as a result of the proposed HVAC work but this value is negated by the wholesale deduction of the entire \$505,000 projected cost. There is no substantial and persuasive evidence establishing this as a deduction for deferred maintenance.

Summary and Conclusion

The Hearing Officer determined the TVM based upon the substantial and persuasive evidence in the record. STC finds that a reasonable mind could have conscientiously reached the same result as the Hearing Officer based on a review of the entire record.

ORDER

The Decision and Order of the Hearing Officer, including the findings of fact and conclusions of law therein, is incorporated by reference, as if set out in full, in this final decision of the STC. The decision of the BOE and the Hearing Officer determining the TVM of the subject property at \$42,871,900.

Judicial review of this Order may be had in the manner provided in Sections 138.432 and 536.100 to 536.140 RSMo within 30 days of the mailing date set forth in the Certificate of Service for this Order.

If judicial review of this decision is made, any protested taxes presently in an escrow account in accordance with this appeal shall be held pending the final decision of the courts

unless disbursed pursuant to Section 139.031.8 RSMo.

If no judicial review is made within thirty days, this decision and order is deemed final and the Collector of the City of St. Louis, as well as the collectors of all affected political subdivisions therein, shall disburse the protested taxes presently in an escrow account in accord with the decision on the underlying assessment in this appeal.

SO ORDERED February 23, 2024.

Gary Romine, Chairman

Victor Callahan, Commissioner

Debbi McGinnis, Commissioner

Certificate of Service

I hereby certify that a copy of the foregoing has been electronically mailed and/or sent by U.S. Mail on February 23, 2024, to:

Complainant(s) and/or Counsel for Complainant(s), the County Assessor and/or Counsel for Respondent and County Collector.

Stacy M. Ingle
Legal Assistant



STATE TAX COMMISSION OF MISSOURI

ST. LOUIS BOA PLAZA, LLC and)
ST. LOUIS PLAZA LLC,)
)
Complainants,) Appeal Nos. 19-20160 through)
) 19-20162)
v.) Parcel Nos. 1890000150, 1890000250,)
) and 1960000150)
MICHAEL DAUPHIN, ASSESSOR,)
CITY OF ST. LOUIS, MISSOURI)
)
Respondent.)

DECISION AND ORDER

BOA Plaza LLC, (Complainant) appeals the City of St. Louis Board of Equalization's (BOE) decision finding the true value in money (TVM) of the subject commercial properties on January 1, 2019, was \$42,871,900. Complainant alleges overvaluation and asserts the TVM on January 1, 2019, was \$25,000,000. Complainant did not produce substantial and persuasive evidence of overvaluation. The BOE decision is AFFIRMED.²

Complainant was represented by attorney Peter Corsale. Respondent was represented by attorney Abby Duncan. Both parties filed a post-hearing brief and a reply

² Complainant timely filed a complaint for review of assessment. The State Tax Commission (STC) has authority to hear and decide Complainant's appeal. Mo. Const. art. X, sec. 14; Section 138.430.1, RSMo 2000. All statutory citations are to RSMo 2000, as amended.

brief.

FINDINGS OF FACT

1. The Subject Properties. The subject properties consist of three tax parcels (collectively "BOA Plaza") on a 3.2 acre site in downtown St. Louis, Missouri. As of January 1, 2019, the site was improved with a class A, 30-story, multi-tenant office building with 735,579 square feet of rentable space. The building was constructed in 1982 and includes 375 covered parking spaces. St. Louis BOA Plaza, LLC purchased BOA Plaza in 2009 for \$47,850,000.

2. Assessment and Valuation. The BOE determined the TVM of BOA Plaza was \$42,871,900 as of January 1, 2019. The BOE assigned the following TVMs to the three tax parcels comprising BOA Plaza:

Parcel 1890000150	\$28,151,900
Parcel 1890000250	\$644,100
Parcel 1960000150	\$14,075,900

The 2019 BOE value is the same value applied in the 2017 assessment. (Ex. A at 15)

3. Complainant's Evidence. Complainant introduced Exhibits A through D. Each exhibit was admitted into evidence. The exhibits are as follows:

Exhibit A	Appraisal Report of Thomas H. Slack, MAI
Exhibit B	Slack's Written Direct Testimony
Exhibit C	Slack's Written Rebuttal Testimony
Exhibit D	Slack's Written Sur-rebuttal Testimony

Slack Appraisal

Slack determined the highest and best use of BOA Plaza was continued use as a multi-tenant office building. (Ex. A at 28) Slack valued BOA Plaza by the sales

comparison approach and income approach, with emphasis on the income approach. (Ex. A at 54; Ex. B at 62)³ Slack concluded the respective indicated values from the income and sales comparison approaches were 24,200,000 and \$25,700,000, with a reconciled estimated value of \$25,000,000 as of January 1, 2019. (Ex. A at 55)

In both approaches to value, Slack made adjustments to separate the fee simple value from the "leased fee" value. (Ex. A at 32, 54; Ex. C at 7) The leased fee value is based on the value of the in-place leases. Slack testified his methodology is based on standards applied in Kansas property tax appeals. (Tr. 1 at 31:20-23; 33:3-5)⁴ These standards assume the property is "vacant and available and there for you, you must account for all the costs to lease the property up ... from zero to whatever it is." (Tr. 1 at 32:18-22) Slack acknowledged he is "not sure that that's not necessarily uniform, but from state to state, that's the way it became there." (Tr. 1. at 32:22-23)

Consistent with these standards, Slack made a property rights adjustments in the sales comparison approach accounting for tenant improvement allowances and leasing commissions necessary to achieve market occupancy. Slack made corresponding deductions in the income approach. (Ex. A at 32-34; 54; Tr. 1 at 33:1-5) The resulting

³ All citations to written testimony are to the numbered question and answer.

⁴ Slack's testimony was in reference to questions regarding the subject property in appeal 19-20159, which was heard in conjunction with the instant appeals. Counsel for Complainant confirmed that "[t]he only difference between this testimony and that testimony would be the deferred maintenance and the final value, but everything else I believe is equally applicable to Bank of America." (Tr. 1 at 34:5-9) Slack subsequently testified that Complainants' counsel correctly stated that "all the prior testimony" regarding the treatment of leasing commissions and tenant improvements is equally applicable to BOA Plaza. (Tr. 1 at 38:8-12)

\$22,500,000 difference in the parties' value estimates stems largely from Slack's leasing commission and tenant improvement deductions.⁵

Sales Comparison Approach

Slack analyzed six comparable properties located in the downtown St. Louis central business district. The unit of comparison was price per rentable square foot. Each comparable property sold with in-place leases. (Ex. A at 32)

Slack made property rights adjustments by quantifying tenant improvement and leasing commission costs based on rent rolls and lease renewals from BOA Plaza and the Metropolitan Square building, another class A, multi-tenant office building located in the downtown St. Louis central business district. The annualized tenant improvement paid by the landlord in these buildings averaged \$2.97 per square foot. Slack concluded the "106-month average term of new leases results in a [tenant improvement cost] of \$26.24 per square foot." (Ex. A at 33)⁶ Leasing commissions for the 89% of BOA Plaza occupied by paying tenants totaled \$5,659,450. (Ex. A at 33)⁷ The property rights adjustments for the six comparable sales ranged from zero to -40%. (Ex. A at 36)

Slack acknowledged leasing commissions for the occupied space "have been paid"

⁵ Respondent's appraiser concluded the TVM of BOA Plaza as of January 1, 2019, was \$47,500,000.

⁶ The tenant improvement cost of \$26.24 is calculated as follows: $[(\$2.97 \times 106) / 12 = \$26.24]$. In the income capitalization approach, Slack utilized tenant improvement costs of \$23.76. (Ex. A at 54)

⁷ In the income approach, Slack concluded the leasing commission was \$8.71 per square foot, or \$5,509,928 based on 86% market occupancy. $(\$8.71 \times 735,579 \times 0.86 = \$5,509,928)$. (Ex. A at 53)

and that "[a] buyer does not have to pay commissions for as long as the lease being purchased is in force." (Ex. A at 33) Slack also noted that once the tenant improvement allowance is spent, tenants pay above market rent. (Ex. A at 32) As of January 1, 2019, almost all tenants with long-term leases signed before 2013 were paying over \$19 per square foot in part because the "lease terms reflect free rent concessions or tenant improvements to be amortized in rent payments." (Ex. A at 32) Slack noted the "value of the leased fee is substantial," (Ex. A at 33), and that "the leases in force at the subject property clearly add substantially to the fee simple value." (Ex. A at 34)

Slack also adjusted the comparable properties to account for differences in age, size, parking, and deferred maintenance. Slack estimated \$505,000 in deferred maintenance based on a "Preliminary Financial Analysis" provided by Johnson Controls. Johnson Controls proposed installing new HVAC equipment to improve "building comfort" and reduce energy consumption. (Ex. A at 35, 54) The \$505,200 "initial budge estimate" was offset by \$365,759 in estimated rebates and savings; specifically, a \$140,930 Ameren customer rebate, \$105,700 in estimated annual energy savings, and \$119,120 in estimated annual capital cost avoidance. (Ex. A at 59) The Johnson Controls proposal does not show that as of January 1, 2019, the new chiller was required for the building to function properly. Slack accounted for reserves for replacement implicitly with a slightly higher capitalization rate. (Tr. 2 at 55:12-25; 56:1-2)

Slack concluded Sales 1, 2, and 3 are "the most reliable indicators of value." (Ex.

A. at 35)8 Slack's conclusions regarding Sales 1, 2, and 3 are summarized as follows:

	Subject Property	Sale 1	Sale 2	Sale 3
Address	800 N. Broadway	100 N. Broadway	200 N. Broadway	701 Market
Age	37	44	35	34
Occupancy	92%	42%	73%	89%
Rentable SF	735,579	510,202	337,088	401,625
Sale Price	N/A	\$19,900,000 \$39.00 per SF	\$19,000,000 \$56.37 per SF	\$35,000,000 \$87.15 per SF
Property Rights Adjustment		-15%	-30%	-35%
Age Adjustment		7%	-2%	-3%
Size Adjustment		-5%	-10%	-10%
Parking Adjustment		0%	-5%	-5%
Deferred Maintenance		0	-1.7%	-1.2%
Total Adjustment		2%	-18.7%	-19.2%
Adjusted Fee Simple Value		\$34	\$32	\$46

Based on the range of values and the fact Sales 1 and 2 indicated a narrower range of \$32 to \$34 per square foot, Slack concluded the market value of BOA Plaza was \$35 per square foot of rentable area. Multiplying BOA Plaza's 735,579 square feet of rentable area by \$35 per square foot yields an estimated value of \$25,700,000. (Ex. A at 35)

8 Sales 4 and 5 were sold for renovation. Slack applied no property rights adjustment to these sales. Sale 6 is a smaller building with 98% occupancy. Slack applied a -40% adjustment to account for the leased fee value. (Ex. A at 36)

Income Approach

Slack estimated market rent by reviewing recent new leases and lease renewals at BOA Plaza, surveyed lease rates in peer properties, and confidential lease information from a nearby building. (Ex. A at 40-43) Slack concluded market rent was \$17.50 per square foot. (Ex. A at 43; Ex. B at 44) Slack amortized tenant improvement costs over the average lease term to conclude annual tenant improvement costs of \$3.40, resulting in an annualized "effective" rental rate of \$14.10 per square foot. (Ex. A at 43; Ex. B at 44)

In addition to rental income, Slack concluded BOA Plaza generates \$0.65 per square foot in parking income and \$0.22 per square foot in miscellaneous income from storage, antenna rentals, and late fees. (Ex. A at 44)

Slack attributed no pass-through income to BOA Plaza. (Ex. A at 44; Ex. C at 3) Pass-through income is received by the owner when tenants assume responsibility for their pro-rata share of increased expenses following the base year. (Ex. C at 3; Tr. 1 at 22:22-25; 23:1-6) Slack testified that "in a fee simple appraisal, appraisers value the property as if there are all new leases beginning on the tax date. Thus, there are no first-year expense reimbursements." (Ex. C at 3)

Slack concluded the subject property's market-based vacancy loss was 14% with an expected credit loss of 1%. The 14% vacancy loss is based on BOA Plaza's actual occupancy and surveyed rates for the downtown St. Louis central business district. (Ex. A at 43-44)

Slack estimated pre-tax operating expenses by reviewing the expenses at comparable office buildings and at BOA Plaza. The comparable expenses ranged from

\$6.51 to \$9.53 per square foot. Because of variations in expense accounting, Slack emphasized the actual expenses incurred at BOA Plaza as representative of market-based expenses. (Ex. A at 46) Slack concluded the market-based operating expenses for BOA Plaza were \$7.66 per square foot. (Ex. A at 48) The expense estimate included an approximately \$0.10 per square foot reduction in utility expenses on the assumption the proposed HVAC work would be completed. (Ex. A at 47)

Based on the foregoing market rent and expense analysis, Slack estimated a net operating income (NOI) of \$3,823,512:

(Ex. A at 48)	Effective Rent	\$14.10 per square foot
	Vacancy/Credit Loss	(- 15%)
	Other Income/Parking	\$.82 per square foot
	Expenses	(- \$7.66 per square foot)
	NOI	\$3,823,512 (\$5.20 per square foot)

Slack estimated the capitalization rate by consulting recent sales and surveys, with an emphasis on surveys. Slack emphasized surveys because sales typically involve leased properties, which is inconsistent with his assumption the value of a fee simple interest is based on an "unencumbered" property. (Ex. A at 50) Slack concluded the pre-tax capitalization rate was 9.50%, which is consistent with the mid-range of surveyed capitalization rates for class A office buildings in the downtown St. Louis central business district. Adding the 3.14% effective tax rate yields a loaded capitalization rate of 12.64%. (Ex. A at 52)

Slack divided the NOI (\$3,823,512) and capitalization rate (0.1264) to calculate an

initial value estimate of \$30,256,710.⁹ After deducting deferred maintenance (\$505,000) and leasing commissions (\$5,509,928), Slack calculated an indicated value of \$24,241,781, rounded to \$24,200,000. (Ex. A at 54)

Reconciliation

Slack reconciled the \$25,700,000 value indicated by the sales comparison approach and the \$24,200,000 value indicated by the income approach into a final value estimate of \$25,000,000.

4. Respondent's Evidence. Respondent introduced Exhibits 1, 2, and 3. The exhibits are as follows:

Exhibit 1	Appraisal Report of Ryan Brennan
Exhibit 2	Brennan's Written Direct Testimony
Exhibit 3	Brennan's Written Rebuttal Testimony

Complainant objected to Brennan's appraisal report and written direct testimony on grounds it lacked foundation. Respondent's exhibits are admitted into evidence.

Brennan Appraisal

Like Slack, Brennan determined the highest and best use of BOA Plaza was continued use as a multi-tenant office building and that the income approach was the best indicator of value. (Ex. 1 at 34; 77-78) Unlike Slack, Brennan made no deductions for leasing commissions or tenant improvement allowances because the 92% actual occupancy rate of BOA Plaza exceeded the 86% market occupancy rate. Further, unlike Slack, Brennan did not deduct deferred maintenance for the proposed HVAC work. Finally,

⁹ Dividing Slack's NOI estimate (\$3,823,412) by his estimated capitalization rate (0.1264) yields \$30,248,513, not \$30,256,710.

unlike Slack, Brennan attributed \$582,007 in pass-through income to subject property, which was added to the NOI. The net result is that Brennan estimated the January 1, 2019, TVM of BOA Plaza was \$47,500,000, or \$22,500,000 more than Slack's \$25,000,000 value estimate. (Ex. 1 at 78)

Sales Comparison

Brennan analyzed five comparable properties located in the St. Louis downtown central business district. The primary unit of comparison was price per rentable square foot. (Ex. 1 at 74, 76) Brennan adjusted the comparable sales for difference in time of sale, size, parking, quality, age, and economic characteristics. The average adjusted price is \$69.97 per square foot, with a median of \$62.01. Brennan concluded the market value of BOA Plaza was \$65 per square foot of rentable space. Multiplying BOA Plaza's 735,579 square feet of rentable area by \$65 per square foot yields an estimated value of \$47,800,000. (Ex. 1 at 76)

Income Approach

Brennan estimated market rent for BOA Plaza's office, retail, and storage space based on leases in other office buildings in the downtown St. Louis central business district, on recent leases at BOA Plaza, and surveyed lease rates. (Ex. 1 at 41-54)

Brennan considered seven leases at other office buildings in the downtown St. Louis central business district. The base rent for the comparable leases ranged from \$15.00 to \$19.00 per square foot. Brennan adjusted for differences in lease dates, building size, parking availability, lease length, and the quality and condition of the building. The adjusted rents ranged from \$14.69 to \$20.81 per square foot, with an average of \$17.02 per

square foot and a median of \$16.31 per square foot. Brennan also noted a recent BOA Plaza lease stating a rental rate of \$18.50 per square foot. Brennan concluded market rent for BOA Plaza office space was \$16.75 per square foot. (Ex. 1 at 48)

Brennan estimated market rent for the BOA Plaza retail space and storage areas by comparing similar retail and storage area leases. (Ex. 1 at 50-53) Brennan estimated the market rent of the BOA Plaza retail space at \$17.00 per square foot and the market rent of the storage space at \$9.00 per square foot. (Ex. 1 at 53)

Based on the foregoing, Brennan estimated the potential rental income was \$12,269,462 ($[727,509 \text{ sf office} \times \$16.75] + [1,382 \text{ sf retail} \times \$17.00] + 6,688 \text{ sf storage} \times \9.00) = \$12,269,462). (Ex. 1 at 54)

Brennan added income from parking, miscellaneous sources, and pass-through income for tenant contributions to maintenance. For parking and miscellaneous income, Brennan calculated the median amount generated by BOA Plaza from 2016 through 2018. Based on this analysis, Brennan attributed to BOA Plaza \$469,775 in parking income and \$95,603 in miscellaneous income. (Ex. 1 at 54-55)

Brennan estimated pass-through income of \$0.80 per square foot based on the median pass-through income generated by four other buildings in the downtown central business district. Multiplying \$0.80 by the market occupancy results in \$582,007 in pass-through income; i.e., $(727,509 \text{ square feet} \times \$0.80 = \$582,007)$.

Brennan estimated operating expenses by considering the operating expenses at BOA Plaza from 2016 through 2018 and a survey of operating expenses incurred in 2018 by five nearby office buildings. The median expense at BOA Plaza in 2016, 2017, and

2018 was \$8.02. The median expense at the five comparable buildings during 2018 was \$7.15 per square foot. Brennan concluded market expenses for BOA Plaza were \$7.50 per square foot, or \$5,516,843 ($\$7.50/\text{sf} \times 735,579$ square feet). (Ex. 1 at 57)

The final component of Brennan's expense analysis considered estimated expenses for replacement reserves and a community improvement district (CID) special assessment. Surveys indicated the average replacement reserve for downtown St. Louis central business district office space was \$0.29 per square foot. Brennan estimated replacement reserves at \$0.25 per square foot, for an annual total of \$183,895 ($739,579$ square feet \times \$0.25 per square foot = \$183,895). The CID charge for 2019 for was \$61,034. (Ex. 1 at 57)

Brennan's reconstructed income and expense statement is summarized as follows:

Potential Rental Income	\$12,269,462 (739,579 x \$16.75 sf)
Vacancy and Collection Loss	-15% (\$1,840,419)
Effective Rental Income	\$10,429,043
Parking Income	\$469,775
Pass Through Income	\$582,007
Miscellaneous Income	\$95,603
Effective Gross Income	\$11,576,428
LESS Expenses with Management	(\$5,516,843; \$7.50/sf)
LESS Reserves	(\$183,895; \$.25/sf)
LESS CID	(\$61,034)
Stabilized NOI	\$5,814,656

Finally, Brennan estimated a direct capitalization rate based on surveyed rates, the band of investment method, and five sales of nearby multi-tenant office buildings. (Ex. 1 at 58-61) The surveys indicated capitalization rates ranging from 5%-10%. Rates in the downtown St. Louis central business district office trended toward the higher end of this range. (Ex. 1 at 58) The band of investment method indicated a rate of 9.13%. (Ex. 1 at

59) The comparable sales indicated a rate of 9.05%. (Ex. 1 at 60-61) Brennan concluded a capitalization rate of 9.1% reflected "the economic reality of the subject." (Ex. 1 at 61) Adding the effective tax rate of 3.14% resulted in a loaded capitalization rate of 12.24%. Dividing Brennan's estimated NOI (\$5,814,656) by the loaded capitalization rate (.1224) yields an estimated value of \$47,505,360, which Brennan rounded to \$47,500,000. (Ex. 1 at 61)

Reconciliation

Brennan reconciled the \$47,800,000 value indicated by the sales comparison approach and the \$47,500,000 value indicated by the income approach into a final value estimate of \$47,500,000. (Ex. 1 at 78)

5. Value. The TVM of the subject property on January 1, 2019, was \$42,871,900.

CONCLUSIONS OF LAW

1. Assessment and Valuation. Commercial real property is assessed at 32% of its TVM as of January 1 of each odd-numbered year. Section 137.115.5(1)(c). "True value in money is the fair market value of the property on the valuation date, and is a function of its highest and best use, which is the use of the property which will produce the greatest return in the reasonably near future." *Snider v. Casino Aztar/Aztar Mo. Gaming Corp.*, 156 S.W.3d 341, 346 (Mo. banc 2005) (internal quotation omitted). The fair market value is "the price which the property would bring from a willing buyer when offered for sale by a willing seller." *Mo. Baptist Children's Home v. State Tax Comm'n*, 867 S.W.2d 510, 512 (Mo. banc 1993). "True value in money is defined in terms of value in exchange not value in use." *Tibbs v. Poplar Bluff Assocs. I, L.P.*, 599 S.W.3d 1, 7 (Mo. App. S.D. 2020)

(internal quotation omitted). "Determining the true value in money is an issue of fact for the STC." *Cohen v. Bushmeyer*, 251 S.W.3d 345, 348 (Mo. App. E.D. 2008).

"For purposes of levying property taxes, the value of real property is typically determined using one or more of three generally accepted approaches." *Snider*, 156 S.W.3d at 346. The three generally accepted approaches are the cost approach, the income approach, and the comparable sales approach. *Id.* at 346-48; *see also St. Louis Cty. v. Sec. Bonhomme, Inc.*, 558 S.W.2d 655, 659 (Mo. banc 1977). The STC has wide discretion in selecting the appropriate valuation method but "cannot base its decision on opinion evidence that fails to consider information that should have been considered under a particular valuation approach." *Snider*, 156 S.W.3d at 348.

2. Evidence. The hearing officer is the finder of fact and determines the credibility and weight of the evidence. *Kelly v. Mo. Dep't of Soc. Servs., Family Support Div.*, 456 S.W.3d 107, 111 (Mo. App. W.D. 2015). The finder of fact in an administrative hearing determines the credibility and weight of expert testimony. *Hornbeck v. Spectra Painting, Inc.*, 370 S.W.3d 624, 632 (Mo. banc 2012). "Although technical rules of evidence are not controlling in administrative hearings, fundamental rules of evidence are applicable." *Mo. Church of Scientology v. State Tax Comm'n*, 560 S.W.2d 837, 839 (Mo. banc 1977).

Complainants objected to Brennan's appraisal report and written direct testimony for lack of foundation because they are based on sales data from reports prepared by other appraisers.¹⁰ (Tr. 2 at 130:16-131:15) Complainants argue *State ex rel. Missouri Highway*

¹⁰ Complainants' pre-hearing objections to Brennan's written direct testimony and appraisal report were overruled by an order dated December 15, 2020. Notably, like

& Transp. Comm'n v. Sisk, 954 S.W.2d 503, 508 (Mo. App. 1997) and *State ex rel. State Highway Comm'n v. Berkeley Sch. Dist.*, 618 S.W.2d 195, 197-98 (Mo. App. 1981) establish Brennan's testimony and report are inadmissible. (Compl. Br 13-14) *Sisk* and *Berkeley* are materially distinguishable.

In *Sisk*, the circuit court excluded evidence of a comparable sale for lack of foundation because the appraiser relied on another appraiser's recitation of sale data. Critically, the sale was subject to a confidentiality clause precluding verification. *Sisk*, 954 S.W.2d at 507. Under those circumstances, *Sisk* held the circuit court did not abuse its discretion by excluding evidence of the comparable sale due to lack of foundation. *Id.* at 509-10. Unlike *Sisk*, Complainants did not show the data included in Respondent's Exhibits 1 and 2 were unverifiable due to a confidentiality clause or a similar obstacle precluding verification.

Berkeley held the circuit court erred in admitting an appraiser's testimony regarding four comparable sales because the testimony was based on "unreliable" information from an "unknown person" in the appraiser's office. *Berkeley*, 618 S.W.2d at 198. The appraiser conceded he had "no recollection of confirming [the sales], so they must have been confirmed by someone in my office." *Id.* Thus, the purported verification was purely speculative and may have never happened.

Unlike the appraiser in *Berkeley*, who had "no recollection" of undertaking any inquiry to verify the sales at issue, Brennan verified data by reviewing rent rolls, income

Brennan, Slack acknowledged it "was necessary to rely on information and data furnished by others." (Ex. A at 2)

and expense statements, and other appraisals. (Tr. 2 at 130:3-14) Brennan's verification is consistent with the general rule that an appraiser "may base his opinions in part upon his investigation and his inquiries concerning other sales even though such sources constitute hearsay and would ordinarily be inadmissible." *Berkeley*, 618 S.W.2d at 197.¹¹ The fact Brennan consulted acceptable sources to verify sales data distinguishes this case from the purely speculative verification in *Berkeley* and demonstrates his report and testimony fall within the general rule permitting appraiser to verify sales by reference to otherwise inadmissible information.

The impetus for excluding Brennan's testimony and report is further diminished because the facts regarding trustworthiness can "be developed on cross-examination and [may] weaken or destroy the value of the opinion." *Carlson*, 463 S.W.2d at 78 (internal quotation omitted); *see also Barron*, 400 S.W.2d at 37 (noting "any deficiency ... goes to the weight of his testimony, not the qualification"). Complainant cross-examined Brennan extensively regarding the foundation for his report and testimony and therefore had ample opportunity to undermine the credibility of his report and testimony.

Finally, any residual basis for excluding the evidence is negated because the facts are determined by an administrative hearing officer rather than a jury. *Cf. State v.*

¹¹ *See also State ex rel. State Highway Comm'n v. Carlson*, 463 S.W.2d 74, 77 (Mo. App. K.C. 1970) (noting "that the customary standards and trade channels used by the business community at appraisals of land value, although to a great extent based on information derived from others and therefore founded on hearsay, have been safely relied on"); *State ex rel. State Highway Comm'n v. Barron*, 400 S.W.2d 33, 38 (Mo. 1966) (holding "[t]he examination of market reports, and information acquired from others, as to sales of property qualifies a witness to testify as to values").

Sladek, 835 S.W.2d 308, 313 (Mo. banc 1992) (noting that in matter not tried to a jury, "a certain amount of latitude in the admission of evidence is allowed, and [...] the rules of exclusion are less strictly enforced"). For these reasons, Complainants' objection to Brennan's appraisal report and testimony is overruled. Brennan's appraisal report and testimony are admitted into evidence.¹²

3. Complainant's Burden of Proof. The taxpayer bears the burden of proof and must show by a preponderance of the evidence that the property was misclassified or overvalued. *Westwood P'ship v. Gogarty*, 103 S.W.3d 152, 161 (Mo. App. E.D. 2003). The BOE's valuation is presumptively correct. *Tibbs*, 599 S.W.3d at 7. The "taxpayer may rebut this presumption by presenting substantial and persuasive evidence that the valuation is erroneous." *Id.* (internal quotation omitted). The taxpayer also must prove "the value that should have been placed on the property." *Id.* "Substantial evidence is that evidence which, if true, has probative force upon the issues, and from which the trier of fact can reasonably decide the case on the fact issues." *Savage v. State Tax Comm'n*, 722 S.W.2d 72, 77 (Mo. banc 1986) (internal quotation omitted). Evidence is persuasive when it has "sufficient weight and probative value to convince the trier of fact." *Daly v. P.D. George Co.*, 77 S.W.3d 645, 651 (Mo. App. E.D. 2002); *see*

¹² Section 138.060 applies to the City of St. Louis and provides "the assessor shall not advocate nor present evidence advocating a valuation higher than that finally determined by the assessor or the value determined by the board of equalization, whichever is higher, for that assessment period." Respondent's Exhibits 1 and 2 conclude the TVM of the subject property exceeds the value set by the BOE. Respondent does not advocate a value higher than that determined by the BOE. (Ex. 1 at 6; Resp. Br. at 30-31) Exhibits 1 and 2 are admissible as evidence for sustaining the value assigned by the BOE. 12 CSR 30-3.075(1).

also *White v. Dir. of Revenue*, 321 S.W.3d 298, 305 (Mo. banc 2010) (noting the burden of persuasion is the "party's duty to convince the fact-finder to view the facts in a way that favors that party").

4. Complainant Did Not Produce Substantial and Persuasive Evidence of Overvaluation.

Complainants' proposed value is premised on the assumption a "fee simple estate means absolute ownership *unencumbered by any other interest or estate*, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat." (Compl. Br. at 1, 15) (citing Appraisal Institute, *The Dictionary of Real Estate Appraisal* 90 (6th Ed. 2015)). Based on this assumption, Complainants deduct \$5,509,928 in leasing commissions, approximately \$15,000,000 in tenant improvements, and attribute no pass-through income to BOA Plaza. The net result is an approximately \$20,500,000 deduction accounting for leasing commissions already paid, tenant improvements already in place, and a reduced NOI estimate that does not account for income actually generated by the property.

Complainants assert their proposed value is based on standard appraisal practice. Slack, however, testified he is unsure whether the Kansas standards he utilized to appraise BOA Plaza are uniform "from state to state[.]" (Tr. 1. At 32:22-23) Complainants' assertion that estimating TVM of BOA Plaza requires an assumption the property is "unencumbered" by leases is not based on Missouri law. Consequently, Slack's appraisal is not credible and does not constitute substantial and persuasive evidence of the TVM of BOA Plaza as of January 1, 2019.

Fee Simple

Complainants assert a fee simple interest exists only if it is "unencumbered" by a lease. Complainants further assert separating the fee simple value from the leased fee value means the "juxtaposed market leases must all start at the date of valuation." (Compl. Br. at 17). This assumption underlies Complainants' deduction of all leasing commissions and tenant improvement allowances and the conclusion that BOA Plaza generates zero pass-through income.

Complainants' definition of "fee simple" is based on an industry-specific dictionary, not Missouri law. (Compl. Br. at 15) (citing *The Dictionary of Real Estate Appraisal* 90). Missouri law defines "fee simple absolute" as "the entire title; it is the most extensive interest one may have in property, comprehends an absolute estate in perpetuity, and is potentially infinite." *Vaughan v. Compton*, S.W.2d 328, 331 (Mo. 1950); *see also Kimberling N., Inc. v. Pope*, 100 S.W.3d 863, 873 (Mo. App. S.D. 2003) (noting fee simple defines a legal "estate without end or limitations" and which is "the largest estate a person can possibly have"). A fundamental aspect of the fee simple estate is the "absolute power and right to sell, use or otherwise dispose of said property[.]" *Vaughan*, 235 S.W.2d at 331. When an owner exercises the "absolute power and right" to lease real property, the owner retains the fee simple interest and grants a temporary possessory interest to the lessee. *See Santa Fe Trail Neighborhood Redevelopment Corp. v. W.F. Coehn & Co.*, 154 S.W.3d 432, 440 (Mo. App. W.D. 2005) (holding that a written agreement created a lease and the owners "held a fee simple interest in the [p]roperty, while [the lessee] was granted

a possessory interest therein for only a limited term).¹³ The power to encumber real property with a lease is therefore both a fundamental aspect of the fee simple interest, *Vaughan*, 235 S.W.2d at 331, and a principal way of realizing the value of real property. *Mo. Baptist Children's Home*, 867 S.W.2d at 513. Complainants cite no law requiring real property to be valued on the hypothetical assumption it is "unencumbered" or conditioning the income approach on an assumption all leases are reset to commence on the valuation date.

Missouri law instead utilizes a "realistic approach" requiring consideration of "economic realities" when estimating the TVM of real property for purposes of *ad valorem* taxation. *Id.* at 512-513. Chief among these economic realities is that the TVM of real property is in part a function of the income it generates. *Id.* at 513. It follows that a realistic estimate of market value may account for both contract and market rent. *Id.* A categorical rule barring consideration of contract rent "hypothesizes an unrealistic market" by assuming "properties now subject to long-term below-market leases are suddenly available to rent." *Id.* at 513.

Like the failure to consider the effect of a long-term lease, Complainants' approach hypothesizes an unrealistic market by assuming all leases are reset to the valuation date as if the entire property is suddenly available to rent. No evidence supports this assumption.

¹³ See also *Bussen v. Del Commune*, 195 S.W.2d 666, 668 (Mo. 1946) (holding the rights conferred by the lease of property held in fee simple are "wholly possessory" and "do not in any wise affect or involve the title to real estate"); *Forder v. Davis*, 38 Mo. 107, 111 (Mo. 1866) (holding a city was a necessary party in an ejectment action because it "had only granted a leasehold, and the fee simple still remained in the city").

Both Slack and Brennan testified leases in buildings like BOA Plaza *do not* share a common base year. (Tr. 2 53:16-25; 54:1-2 and 89:3-4) Complainants' lease-reset assumption ignores economic realities and rests on a counter-factual assumption that all leases are reset to commence on January 1, 2019.

Complainants nonetheless assert that assuming all leases commence on the valuation date is necessary to "match the two sides of the equation (leases and expenses)" to obtain a "constant and pure" NOI estimate. According to Complainants, proceeding without the lease-reset assumption "would force the appraiser to determine when leases come off and on the roll ... thus disrupting the value of the fee." (Compl. Br. at 17).

Of course, a persuasive estimate of the TVM of BOA Plaza as of January 1, 2019, necessarily relies on contemporaneous estimates of market rent, expenses, other income, and occupancy. These general market data, derived both from BOA Plaza and comparable properties, are the constituent elements of the NOI that is capitalized at a market rate to estimate value under the income approach. This "relatively straightforward" calculation requires the STC to "project the net income stream that could reasonably be anticipated by an investor/purchaser, discounting future dollars to present levels in order to compensate for risk and the elapsed time required to recapture the initial investment." *Equitable Life Assur. Soc. of U.S./Marriott Hotels, Inc. v. State Tax Comm'n*, 852 S.W.2d 376, 380 (Mo. App. 1993). At no point in this "relatively straightforward" calculation is there an assumption that all leases in an established multi-tenant office building share the same base year. Instead, direct capitalization is based on a single-year income stream representing a projection of the income that can be "reasonably be anticipated by an investor/purchaser"

over time. *Id.*; see also Appraisal Institute, *The Appraisal of Real Estate* 492-93 (14th ed. 2013) (noting direct capitalization "processes a single year's income into an indication of value" and must account for "the stability of the property's income stream").¹⁴ The projected market occupancy factored into the NOI estimate dispenses with Complainants' concern that an appraiser would have "to determine when leases come off and on the roll ... thus disrupting the value of the fee." (Compl. Br. at 17)

The property rights adjustments in Slack's sales comparison approach illustrate the deficiency in Complainants' position. Slack applied progressively larger negative adjustments as the occupancy of the comparable sales increased. For instance, Sale 1 was 42% leased while Sale 3 was 89% leased. Slack applied a negative 15% adjustment to Sale 1 and a negative 35% adjustment to Sale 3. A negative adjustment accounts for a comparable property's superior feature and permits a like-kind comparison to the subject. The necessary implication of a larger negative adjustment for higher occupancy is that comparable sales with occupancy similar to BOA Plaza are considered less comparable

¹⁴ Complainants' position that all leases are assumed to commence on the valuation date is further undermined by the fact they fail to account for it in their capitalization rate analysis. Complainants' lease-reset assumption yields a potentially more durable income stream and shorter investment recapture period. For instance, the income from a property 85% occupied by tenants with new eight-year leases is potentially more durable than that from a similar property 85% occupied by similar tenants with leases whose average remaining term is considerably shorter. Because the appropriate capitalization rate is in part a function of investment risk, *Equitable Life Assur. Soc. of U.S./Marriott Hotels, Inc.*, 852 S.W.2d at 380, Complainants' assumption that all leases are reset as if new should result in a *lower* capitalization rate resulting in a *higher* value estimate. See also, *The Appraisal of Real Estate* at 493 (noting the direct capitalization rate is influenced by the "overall level of risk" measured in part by "the stability of the property's income stream").

while properties with lower vacancy are considered more comparable. Thus, under Complainants' analysis, Sale 3, with an occupancy *most comparable* to the BOA Plaza, is considered the *least comparable* and a negative 35% adjustment is applied to the sale price. This analysis reflects the assumption that valuing the fee simple interest requires an assumption the property is "unencumbered" and the value estimate must "account for all the costs to lease the property up ... from zero to whatever it is." (Tr. 1 at 32:18-22) As established, neither Missouri law nor the economic realities of BOA Plaza requires that assumption. The unavoidable result of Complainants' assumption and analysis is a substantial underestimation the TVM of BOA Plaza. Analysis of the proposed deductions for leasing commissions and tenant improvements necessary to achieve market occupancy and the attribution of zero pass-through income confirms this conclusion.

Leasing Commissions

Leasing commissions are an expense affecting the net income generated by a property. Appraisal Institute, *The Appraisal of Real Estate* 484 (14th ed. 2013). Slack deducted \$5,509,928 in leasing commissions, reflecting the total estimated costs of all leasing commissions necessary to achieve market occupancy. (Ex. A at 54; Tr. 1 at 30:1-25; 31:1-3)

Complainants' evidence does not persuasively establish the necessity of deducting the total of all leasing commissions "to lease the property up ... from zero to whatever it is." (Tr. 1 at 32:18-22) There is no evidence the occupancy of BOA Plaza has been zero at any time relevant to January 1, 2019, valuation date. To the contrary, as of January 1, 2019, BOA Plaza's 92% actual occupancy exceeded the 86% market occupancy rate. As

Slack acknowledged, the leasing commissions necessary to achieve market occupancy "have been paid" and a purchaser of BOA Plaza would pay no leasing commissions for any of the occupied space. (Ex. A at 33) Complainants' proposed \$5,509,928 leasing commission deduction – representing the total estimated cost "to lease the property up ... from zero to whatever it is" – is not supported by substantial and persuasive evidence.

Tenant Improvements

A tenant improvement allowance is a rent concession provided by the owner at the beginning of the lease for the construction of tenant improvements. *The Appraisal of Real Estate* 474. While tenant improvement allowances are a cost, Complainants' wholesale deduction of all tenant improvements expended to achieve market occupancy is unpersuasive.

First, the evidence shows many tenant improvement allowances have been spent, with those tenants paying above market rent. (Ex. A at 32) Under these circumstances, analysis of the effective rent received due to rent concessions is "a moot point" because, for instance, "concessions granted in the first two years of the lease" have no bearing on "the income generated in the third year[.]" *The Appraisal of Real Estate* at 448. The evidence shows most of the tenant improvement allowances were paid and the improvements were in place as of January 1, 2019. Specifically, Slack concluded the 2018 BOA Plaza rent roll shows "over 570,000 square feet of tenants having leases with four plus years remaining" and that the "tenant improvements have all been paid or expired and market or above-market rent is being paid." (Ex. A at 33) Applying 86% market occupancy to the 735,575 square feet of rentable space yields a market occupancy of

632,595 square feet. If 570,000 square feet are occupied by long-term tenants whose tenant improvements have been paid, then only 62,595 square feet – approximately 10% of market occupancy – is occupied by tenants whose tenant improvement costs have not yet been fully paid. As of January 1, 2019, these tenant improvements were in place and enabled the property to generate market or above-market rent. A purchaser would not be incur tenant improvement costs on the remaining 90%. Complainants' evidence does not persuasively establish that an informed, willing seller would deduct from the sale price the total cost of all previously paid tenant improvement allowances. Drawing this factual conclusion requires the illogical assumption that an informed seller would freely surrender substantial economic benefits by essentially twice paying for tenant improvements. *Cf. Mo. Baptist Children's Home*, 867 S.W.2d at 514 (noting it "is contrary to all logic" to assume "a business enterprise will freely surrender substantial economic benefits...").

Second, Complainants' deduction of the all past tenant improvement costs assumes the improvements add no value to BOA Plaza. "Property permanently affixed to the real estate, or which has become a part thereof, generally speaking, becomes taxable to the owner as a part of the real estate, at least until its removal (if permitted as between the lessor and lessee)." *Greene Cty. v. Hermel, Inc.*, 511 S.W.2d 762, 771 (Mo. 1974). Slack indicates the tenant improvements add no value to the real estate, but supports this assertion with a single lease renewal. (Ex. A at 40) A single lease is an insufficient sample size to establish the "economic realities," *Mo. Baptist Children's Home*, 867 S.W.2d at 513, and "existing market conditions," *Snider*, 156 S.W.3d at 347, necessary for a persuasive value estimate. The insufficiency of a single lease is consistent with Slack's conclusion that two

recent leases with 87-month terms formed an "inadequate sample" to determine the average lease term. (Ex. A at 53) Complainants' deduction of the all past tenant improvement costs is not required by law and is not based on substantial and persuasive evidence.

Pass-Through Income

Respondent asserts BOA Plaza generates \$582,007 in pass-through income. (Ex. 1 at 55) The pass-through income contributes to the NOI and, therefore, increases the TVM. Slack asserts there can be no pass-through income because a fee simple valuation presupposes "base year expense stops as if all are new current leases." (Ex. A at 44)

As established, Complainant cites no authority for the proposition that valuing a property with market data entails an assumption that leases are reset to commence on the valuation date. A leading appraisal treatise specifically states that pass-through "[e]xpense recoveries are usually treated as separate revenue items[.]" *Appraisal of Real Estate* 472. This authority undermines Complainants' unsupported argument.

Further, there is no evidence Complainants attribution of zero pass-through income assumption reflects economic reality. Both Slack and Brennan testified leases in buildings like BOA Plaza **do not** share a common base year lease and **do** generate pass-through income. (Tr. 2 53:16-25; 54:1-2 and 89:3-4) There is no evidence supporting the conclusion market participants wholly ignore pass-through income by valuing established multi-tenant office buildings on the counter-factual assumption that all leases are reset to the purchase date.

Complainants also argue that pass-through income is necessarily "non-existent in a fee simple analysis" because market rents factor in market expenses. (Compl. Br. at 18)

Again, Missouri law requires consideration of economic realities when estimating the TVM of real property for purposes of *ad valorem* taxation. *Mo. Baptist Children's Home*, 867 S.W.2d at 513. Both experts testified that BOA Plaza and buildings like it typically generate pass-through income. Further, Complainants tacitly concede the theoretical congruence of market rent and expenses yields to the practical reality of "market inefficiencies" resulting in pass-through income. (Compl. Br. at 2) The evidence establishes that, in reality, BOA Plaza generates pass-through income. This income factors into the value of the BOA Plaza real estate.

Deferred Maintenance

Complainants proposed value includes a \$505,000 deduction for deferred maintenance deduction based on a bid by Johnson Controls to install new HVAC equipment. (Ex. A at 35, 54) "Deferred maintenance" refers to "items in need of immediate repair on the effective date of the appraisal ... for the building to continue to function as it should and to be marketable to potential buyers." *The Appraisal of Real Estate* 618. "Short-lived items," by contrast, "have not reached the end of their total useful life expectancy and are not completely deteriorated, but they are substantially depreciated in comparison with the overall structure." *Id.* at 619. The distinction is crucial because "substantial deferred maintenance items typically require lump-sum adjustments in the sales comparison and income capitalization approaches[.]" *Id.* Short-lived items are typically accounted for by "replacement reserves" set aside to fund predictable, periodic replacement of building components. *Id.* at 485.

The Johnson Controls bid states the new HVAC equipment would improve

"building comfort," reduce energy consumption, and reduce the risk of equipment failure. (Ex. A at 59) None of the stated project objectives are consistent with "items in need of immediate repair" so that BOA Plaza could "continue to function as it should and to be marketable to potential buyers." *The Appraisal of Real Estate* at 618. Slack and Brennan both testified a buyer would consider the Johnson Controls bid. Considering the bid, however, shows that it itemizes \$365,750 in rebates and cost savings that offset the \$505,200 initial budget estimate, resulting in an estimated a "simple payback" period of 2.32 years. (Ex. A at 59) Slack's adjusted expense estimate, (Ex. A at 47), accounts for some potential value accruing to BOA Plaza as a result of the proposed HVAC work but this value is negated by the wholesale deduction of the entire \$505,000 projected cost. The most persuasive inference from the Johnson Controls bid is that the proposed HVAC work is an elective capital investment with non-offset costs covered by replacement reserves and a "payback" period of slightly more than two years.¹⁵ Neither Slack's testimony nor the Johnson Controls proposal is substantial and persuasive evidence establishing any deduction for deferred maintenance.

CONCLUSION AND ORDER

Complainant did not produce substantial and persuasive evidence rebutting the BOE presumption and "showing the value that should have been placed on the property." *Tibbs*, 599 S.W.3d at 7. The BOE's decision is affirmed. As of January 1, 2019, the TVMs for the three parcels comprising BOA Plaza were as follows:

Parcel 1890000150	\$28,151,900
-------------------	--------------

¹⁵ Brennan's assumption of \$183,895 in reserves for replacement would cover the \$139,450 in non-offset costs in performing the proposed HVAC work. (Ex. 1 at 57)

Parcel 1890000250	\$644,100
Parcel 1960000150	\$14,075,900
Total	\$42,871,900

Application for Review

A party may file an application for review of this decision within 30 days of the mailing date set forth in the certificate of service for this decision. The application "shall contain specific detailed grounds upon which it is claimed the decision is erroneous." Section 138.432. The application must be in writing, and may be mailed to the State Tax Commission of Missouri, P.O. Box 146, Jefferson City, MO 65102-0146, or emailed to Legal@stc.mo.gov. A copy of the application must be sent to each person listed below in the certificate of service. ***Failure to state specific facts or law upon which the application for review is based will result in summary denial.*** Section 138.432.

Disputed Taxes

The Collector of the City of St. Louis, and the collectors of all affected political subdivisions therein, shall continue to hold the disputed taxes pending the possible filing of an application for review, unless the disputed taxes have been disbursed pursuant to a court order under the provisions of section 139.031.

SO ORDERED December 17, 2021.

Eric S. Peterson
Senior Hearing Officer
State Tax Commission

Certificate of Service

I hereby certify that a copy of the foregoing has been electronically mailed and/or sent by U.S. Mail on December 17, 2021, to:

Counsel for Complainant, Peter Corsale, pcorsale@mlklaw.com
Counsel for Respondent, Abby Duncan, duncana@stlouis-mo.gov
Assessor, Michael Dauphin, dauphinm@stlouis-mo.gov
Collector, Gregory Daly, showerst@stlouiscity.com
Clerk, Beverly Fitzsimmons, fitzsimmons@stlouis-mo.gov

Elaina Mejia
Legal Coordinator