**S T A T E   O F   M I C H I G A N**

**C O U R T   O F   A P P E A L S**

---

| | |
|---|---|
| ART VAN FURNITURE, INC.,<br><br>Petitioner-Appellant, | UNPUBLISHED<br>March 27, 2007 |
| v<br><br>CITY OF WARREN,<br><br>Respondent-Appellee. | No. 265675<br>Tax Tribunal<br>LC No. 00-292170 |

---

Before: Markey, P.J., and Murphy and Kelly, JJ.

PER CURIAM.

In this case involving the taxable value of property, petitioner appeals by right from an order of the Michigan Tax Tribunal granting respondent's motion for reconsideration and amending an earlier order issued by the tribunal. For the reasons set forth below, we affirm.

The underlying facts are not in dispute. This matter arises out of respondent's assessment of the taxable value of petitioner's property for the tax years 2002 and 2003. The subject property is an industrial warehouse and distribution center that is zoned industrial but is classified for commercial assessment purposes. The site is large—consisting of approximately 52.65 acres—and includes a retail showroom and approximately 712,000 square feet of warehouse.

Respondent originally assessed the true cash value of Petitioner's property as $45,300,000 in 2002 and $46,500,000 in 2003. Petitioner, however, contended that the true cash value of its property was only $30,000,000 in both years. Using the income-capitalization approach to valuation, the tribunal found that the true cash value of the property was $33,600,000 in 2002 and $33,936,000 in 2003. On reconsideration, the tribunal agreed with the prior tribunal's application of the income-capitalization approach but concluded that it was palpable error for the prior tribunal to include an effective tax rate of 2.69 percent that was not supported in the record. As a result, the true cash value of petitioner's property rose to $41,489,000 in tax year 2002 and $41,903,800 in tax year 2003. Petitioner subsequently filed a motion for reconsideration that was denied.

In general, "[t]he income-capitalization approach measures the present value of the future benefits of property ownership by estimating the property's income stream and its resale value (reversionary interests) and then developing a capitalization rate which is used to convert the estimated future benefits into a present lump-sum value." *Meadowlanes Ltd Dividend Housing*

*Ass'n v City of Holland*, 437 Mich 473, 485 n 20; 473 NW2d 636 (1991). This approach has been described as follows:

> "The income approach is based on the premise that there is a relation between the income a property can earn and its value. A large number of commercial properties are purchased and leased to tenants by the owner who does not get the advantages arising from his own occupancy of the property. Consequently, the future net income the property is capable of earning is the main benefit to the owner. For this reason the worth of the property to prospective purchasers is based largely upon its income. In addition to income earned annually during an ownership term, another important benefit is the net amount received from the sale of property when ownership is terminated. The earning potential of the property at that time will directly affect its sale price. The net income earning capacity of the property now and at ownership termination is, therefore, an important gauge of its value. The income approach to value translates the estimated future income of a property into total present value by the use of the various data and organized mathematical computations." [*Antisdale v City of Galesburg*, 420 Mich 265, 276-277 n 1; 362 NW2d 632 (1984) (quoting 2 State Tax Comm Assessor's Manual, Ch X, p 1).][1]

In this case, the first tribunal used data from both petitioner's and respondent's experts to adjust the income-capitalization approach to reflect the following: $5.50 per square foot as income to the property, 7.5 percent vacancy and credit loss, 3 percent management, and $0.25 per square foot reserves for replacement. The tribunal capitalized the net operating income of $4,273,368 using a rate, based on the parties' data, and also added a 2.69 percent effective tax rate for a discounted rate of 12.72 percent. This resulted in an indicated value of $33,595,660, and a true cash value of $33,600,000 for tax year 2002 and $33,936,000 for tax year 2003.

On reconsideration, the second tribunal found that while the first tribunal had "utilized a combination of both parties' valuation theories, in accordance with case law," the inclusion of an effective tax rate in determining the final capitalization rate was not based on the record. The second tribunal reasoned that because the parties' experts had testified that the reasonable rental of the property by an owner-investor would be "triple net" or "nnn" under the income approach,

> the Tribunal must reduce the rental income by the expenses likely to be incurred. In a net lease, those expenses will only involve three items. The first deduction is an allowance for vacancy and potential credit losses. The second expense is for management. The third expense is for replacement. The deduction of expenses

---

[1] The Michigan State Tax Commission Assessor's Manual, applies the following formula for the valuation of property under the income-capitalization approach: Property Value = (net income/capitalization rate). 3 State Tax Comm Assessor's Manual, Ch VIII, p 8. The net income of a property takes into account factors such as the gross income, vacancy rate, and total operating expenses likely to be incurred by the property owner/lessor. *Id.*

> leaves a net operating income for capitalization. Since this is a net lease, there will be no addition of an effective tax rate to the capitalization rate in that the real property taxes are not an expense to the Lessor.

We believe that the second tribunal correctly determined that the inclusion of an effective tax rate in the final capitalization rate was not supported by evidence in the record. The record shows that petitioner's and respondent's expert appraisers each determined that the market rent for the entire building area of petitioner's property was $5.50 per square foot, based on triple net lease terms, with the hypothetical tenant paying maintenance costs, taxes, and insurances. Neither expert included an effective tax rate in his calculation of the final capitalization rate.

Moreover, it appears that the incorporation of an effective tax rate would have been inappropriate in this case. Generally, real property expenses are not an expense to the lessor in a triple net lease agreement. See, e.g., *Chrysler Realty Corp v Royal Oak*, 111 MTT 651 (2002). This is because in a triple net lease, the tenant assumes responsibility for all expenses, including real estate taxes. *Id.* Therefore, there is no need for the addition of an effective tax rate to the capitalization rate. *Id.*

Petitioner argues that because the property at issue is currently owner-occupied and not under a net lease, the accepted appraisal theory mandates that the effective tax rate be added to the capitalization rate to account for the owner-occupant's real estate tax expense. However, although there was evidence presented to the tribunal that petitioner's property was owner-occupied, the income-capitalization models both appraisal experts used assumed that it was a hypothetical leasehold.

Finally, petitioner contends that both tribunals applied a "flawed capitalization methodology" when they utilized the income-capitalization approach to value petitioner's property. On reconsideration, the second tribunal found that these findings were supported by competent, material, and substantial evidence on the record—including evidence presented by petitioner's own expert appraiser. After examining the record, we agree.

In sum, because the valuation evidence before the tribunal was based on an income-capitalization approach in which petitioner's property was subject to a net lease, it was not error for the second tribunal to exclude the effective tax rate from the final capitalization rate on reconsideration. The inclusion of the 2.69 percent effective tax rate was not supported by competent, material, and substantial evidence on the whole record, and was therefore an "error of law," *Great Lakes Div of Nat'l Steel Corp v City of Ecorse*, 227 Mich App 379, 388; 576 NW2d 667 (1998), which was properly corrected on reconsideration.

We affirm.

/s/ Jane E. Markey
/s/ William B. Murphy
/s/ Kirsten Frank Kelly