

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

IN THE MATTER OF THE EQUALIZATION
APPEALS OF KANSAS STAR CASINO, L.L.C.
FOR THE YEAR 2013 IN SUMNER COUNTY,
KANSAS

Docket Nos. 2013-2795-EQ
& 2013-2796-EQ

FULL AND COMPLETE OPINION

Now the above-captioned matters come on for consideration and decision by the Board of Tax Appeals of the State of Kansas. The Board conducted a hearing in these matters on December 9-11, 2014. Taxpayer, Kansas Star Casino, L.L.C., appeared by its counsel of record Jarrod C. Kieffer and Lynn D. Preheim of Stinson Leonard Street L.L.P. Sumner County, Kansas (the "County") appeared by its counsel of record David R. Cooper and Andrew D. Holder of Fisher, Patterson, Saylor & Smith, L.L.P. Full submission of these matters occurred on February 6, 2015, when post-hearing *Proposed Findings of Fact And Conclusions of Law* were filed.

The Board certified a *Summary Decision* on February 19, 2015. On March 5, 2015, the County timely filed a *Request for a Full and Complete Opinion* pursuant to K.S.A. 74-2426(a).

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

The Board has jurisdiction of the subject matter and the parties, as equalization appeals have been properly and timely filed pursuant to K.S.A. 79-1448 and K.S.A. 79-1609. The parties stipulate that the County has the burden of proof. The subject property is owner-occupied commercial property. See K.S.A. 79-1609; *Prehearing Order* at 4.

The subject matter of these appeals is real estate and improvements commonly known as Kansas Star Casino, 777 Kansas Star Drive, Mulvane, Sumner County, Kansas, also known as Parcel ID# 096-022-04-0-00-00-002.00-0 and real estate at East 149th Ave North, Mulvane, Sumner County, Kansas, also known as Parcel ID# 096-022-04-0-00-00-003.01-0. The tax year at issue is 2013. The relevant valuation date is January 1, 2013.

The subject property is a casino and arena events center located on approximately 195.5 acres in Mulvane, Kansas. For tax year 2013, the County

valued the subject property at \$226,000,000.¹ At hearing, the former county appraiser could not recall the details regarding how she arrived at that value. No written appraisal for the original \$226,000,000 valuation was presented. Sumner County presented an appraisal by Richard Jortberg, MAI, concluding a fair market value of \$140,000,000 as of January 1, 2013 relying upon the cost approach. In its *Proposed Findings of Fact and Conclusions of Law*, the County argues that its expert's opinion of land value and improvement value are not the best evidence and asserts that Deloitte and Touche figures should be relied upon in the cost approach resulting in a rounded value of \$154,000,000. The County ultimately contends that the fair market value of the subject property is \$154,000,000. Taxpayer presented an appraisal by David C. Lennhoff, MAI, CRE, FRICS, concluding a fair market value of \$62,100,000 as of January 1, 2013 relying upon the cost approach and income approach (allocation to real estate) with the most weight placed upon the allocation of the income approach. Taxpayer contends that the fair market value of the subject property is \$62,100,000.

I.

In April 2007, the Kansas legislature passed the Kansas Expanded Lottery Act (Senate Bill 66) ("KELA"), K.S.A. 74-8733 *et seq.* Pursuant to KELA, the Kansas lottery may operate one gaming facility in each gaming zone: the northeast, south central, southwest and southeast. The Kansas lottery commission may approve management contracts with one or more prospective lottery gaming managers to manage, or construct and manage, on behalf of the state, a lottery gaming facility.

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

Lottery gaming facility proposals had minimum investment requirements, including a \$225 million minimum investment amount for the south central gaming

¹ The parties present their evidence as one economic unit. There are actually two parcel identification numbers under appeal. Parcel ID# 096-022-04-0-00-00-002.00-0 includes approximately 195.50 acres of land with the casino and arena improvements and was valued at \$225,797,500. Parcel ID# 096-022-04-0-00-00-003.01-00 is 2.0 acres leased to the city of Mulvane for a sewer, water and public safety station and was valued at \$202,500. The County's total appraised value for the subject properties was \$226,000,000.

zone. K.S.A. 74-8734(g)(2). Initial management contracts were to be for a term of 15 years, and the successful bidder of the management contract in the south central gaming zone was required to pay a fee of \$25 million for the privilege of being selected as the lottery gaming facility. K.S.A. 74-8734(h). Approval from a city or county for zoning and planning of a proposed site was required. K.S.A. 74-8734(o). KELA requires the south central gaming facility manager pay 22% of gaming revenues to the state, 2% to the problem gambling and addictions fund, and 3% to local jurisdictions. K.S.A. 74-8734(h)(11), (12), and (16). KELA also states that the "[m]anagement contract shall not constitute property, nor shall it be subject to attachment, garnishment or execution, nor shall it be alienable or transferable, except upon approval by the executive director, nor shall it be subject to being encumbered or hypothecated." K.S.A. 74-8734(m).

There were three rounds of bidding for the award of the south central zone management contract. There were many land sites proposed over the course of the three rounds of bidding. The proposed sites were generally located near Exits 19 and 33 of the Kansas Turnpike. Exit 19 is near Wellington, the county seat of Sumner County, and Exit 33 is near Mulvane. Sumner County preferred that any casino be located at Exit 19, rather than Exit 33. Sumner County refused to approve Peninsula Gaming's project at the subject site, and even filed suit against Mulvane to challenge Mulvane's annexation and approval of the subject site.

Conditional zoning for gaming use was granted for all the proposed sites, and local zoning was readily obtainable. All the proposed casino sites in Sumner County were controlled by options, rather than being purchased outright by the casino proponents. These options would only be exercised if the management contract were awarded for such site.

Harrah's was selected during the first round of bidding, but Harrah's withdrew its proposal prior to finalization of the management contract. Harrah's round one proposal was to build a casino on a combination of the Wyant and Brewer tracts with ancillary golf course and nature trail facilities on other tracts. The Gerlach tract was not part of the Harrah's proposal.

In the third round of bidding, Kansas Star was selected as the lottery gaming facility manager for the south central gaming zone in January 2011. Kansas Star's proposal included the Wyant and Gerlach tracts. Kansas Star had initially wanted the Brewer tract and attempted to negotiate with the owner, but Kansas Star was unable to reach an agreement with the owner.

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

On July 19, 2007, shortly after the enactment of KELA, Paul Treadwell and Mark Linder entered into an Option Agreement to purchase the Gerlach tract from Mr. and Mrs. Gerlach. The agreement provided for a \$50,000 option fee as consideration for the exclusive right and option for 48 months to purchase the tract. The purchase price was \$25,000 per acre less the option fee and certain other prorations. On September 12, 2007, Treadwell and Linder assigned the option to Foxwoods Development Company, LLC.

During round three of bidding, Peninsula Gaming negotiated with Foxwoods to purchase the option agreement. On July 15, 2010, Peninsula Gaming and Foxwoods entered into an Assignment & Assumption Agreement, whereby Peninsula Gaming purchased the option for the Gerlach tract. Foxwoods received \$1,250,000 at the time of the assignment. The agreement provided for the payment of an additional \$4,050,000 to be paid if Peninsula Gaming was awarded the management contract and other conditions were met. Assuming all the conditions were met, the total paid to Foxwoods would be \$5,300,000. Peninsula Gaming was responsible for paying the option exercise price of approximately \$3,700,000 directly to the property owners in order to exercise the option and acquire the property. In addition, Peninsula Gaming also effectively removed Foxwoods as a competitor and encouraged Foxwoods to promote Peninsula Gaming's proposal to the Kansas Lottery.

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

On July 16, 2010, Peninsula Gaming hired Double Down Development, L.C. to promote its application for the south central gaming zone management contract. As part of its promotion duties, Double Down was to negotiate for the land purchase options for three tracts of land, including the Wyant, Storey, and Grother tracts. On the same date, Double Down as buyer and Peninsula Gaming as guarantor entered into an Option Agreement to purchase the Wyant tract from the trustees of the Wyant Revocable Trust. The agreement provided for a \$250,000 option fee as consideration for the exclusive right and option for 6 months to purchase the tract. The agreement also provided for option extension for an additional \$50,000. The purchase price was \$8,000,000.

On October 19, 2010, Peninsula Gaming entered into a Lottery Gaming Facility Management Contract ("Agreement") with the Kansas Lottery. (Exhibit #19) In January 2011, the Kansas Racing and Gaming Commission (KRGCC) approved the lottery gaming facility management contract with Peninsula Gaming Partners, L.L.C. (Exhibit #89)

Taxpayer Kansas Star Casino, L.L.C. acquired the Wyant tract on March 2, 2011 and the Gerlach tract on March 3, 2011. The sale price reflected on the sales validation questionnaire (SVQ) completed by Mr. Wyant was \$8,000,000. The sale price reflected on the SVQ completed by Mr. Gerlach was \$3,631,250. (Exhibit #502, pp. 39, 47) The tracts were combined into one parcel prior to January 1, 2012.

The subject property was constructed in phases. Phase 1a was the construction of the arena with temporary casino finishes; phase 1b was the construction of the permanent casino; and phase 2 was the conversion of the arena from the temporary casino to the permanent arena. As of the valuation date of January 1, 2013, phases 1a and 1b were complete. The hotel is owned and operated separately from the subject property and is not included in the subject valuation.

Kansas Star Casino, L.L.C. was a wholly-owned subsidiary of Peninsula Gaming, L.L.C. (Exhibit #1, p. 10) Publicly traded Boyd Gaming Corporation acquired Peninsula Gaming in November 2012 for approximately \$1.45 billion. The transaction was a total enterprise purchase, which included multiple gaming properties, personal property, and all intangibles associated with the ongoing operations. It was not a "real estate-only" purchase, but rather a total enterprise acquisition of a gaming company with multiple operation casinos.

II.

Della Rowley, current Geary County Appraiser and former Sumner County Appraiser, testified on behalf of Sumner County. At the time of the county appraisal for tax year 2013, Rowley was the Sumner County Appraiser.

Rowley stated that she was not qualified to appraise a casino, so she sought assistance from an appraiser with experience in appraising casino properties, Richard E. Jortberg, MAI. Rowley asserts that the best information available to her for purposes of estimating fair market value was the project budget (p. 430) presented to the city and county. She contends that the County's 2012 and 2013 valuations were based on this project budget. The valuation Rowley placed on the subject property for tax year 2013 was \$226,000,000 (\$202,500 and \$225,797,500). Rowley did not change the value at the informal hearing.

On cross-examination, Rowley states that she does not consider zoning when she values a property. Rowley claims to have used the cost approach, but admits that she did not do an appraisal of the subject property prior to issuing the 2013 valuation notice. In fact, she cannot recall specifically how she arrived at the value. Rowley also admits that she does not know what value the County is now seeking for the subject property.

Richard E. Jortberg, MAI, performed an appraisal of the subject property and concluded that the fair market value of the fee simple interest was \$140,000,000 as of January 1, 2013. Jortberg's appraisal report relied on an extraordinary assumption that the information relied on in the report was accurate because not all the information desired was available from the property owner or its representatives. "The appraiser reserves the right to modify the value of the subject property if additional information is obtained." Exhibit #522, p. 2 of cover letter.

Jortberg considered all three approaches to value: the sales comparison approach, the cost approach, and income approach. Jortberg found a lack of comparable sales to the subject property's unique status as the sole casino operation in the area. Jortberg used the income approach as a test of reasonableness for his cost approach analysis and concluded that because the Taxpayer's business enterprise value far exceeded the value derived under this cost approach analysis, the cost approach was appropriate.

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

Jortberg's cost approach consists of land value and reproduction cost. For the land value, Jortberg began with the rounded \$17,000,000 price, including option and assignment costs, which was paid to acquire the Wyant and Gerlach tracts. Because the subject property's actual gaming revenues were ten percent higher than projected before the management contract was awarded and before construction began, Jortberg also included a ten percent adjustment, \$1,700,000, to the \$17,000,000 purchase price, which he explained was based on the subject property proving itself ten percent more capable of successful casino operation than anticipated. Jortberg concluded a land value of \$18,700,000.

Jortberg testified that the land value is derived from the enabling legislation, the KE LA, the property's location as the closest property in Sumner County to Wichita, its accessibility from numerous highways, its visibility, established utility extensions and infrastructure, and its functionality and development potential. Jortberg determined that the subject property contained no excess land because it was platted as a single unit and because selling any part of the land would constrain future expansion. He was aware the Taxpayer had discussions about using a portion of the land as an RV park for equine events and other retail uses are possible.

Jortberg compared the subject property to the sales prices in unexercised options for the nearby Storey and Grother tracts, as well as the price paid for the

Boot Hill Casino in Dodge City, Kansas. Jortberg explained that the options for the Storey and Grother properties were relevant because at the time they were agreed upon, KELA would have permitted gaming on these properties. Based on these comparisons, Jortberg determined the price paid to acquire the subject property was the best evidence of its value. Jortberg did not consider the Kansas City market to be comparable because it is a highly competitive gaming market, whereas the Taxpayer is the only entity permitted to operate a casino in the subject area. He also determined that sales of vacant farm ground were not comparable because the subject property's highest and best use was not agricultural.

Jortberg used reproduction costs in lieu of replacement costs. He explained that the difference between replacement and reproduction costs is that replacement costs do not include any functional difference between one property and another, whereas reproduction costs capture the cost to replace the facility exactly. Jortberg admitted that reproduction costs, unlike replacement cost, may capture functional obsolescence in the cost of the improvements, including superadequacy. He further agreed that a minimum investment requirement could lead a person to build a superadequate facility with functional obsolescence, and because of that, analyzing functional obsolescence was an important topic. Although replacement costs are generally less than reproduction costs, Jortberg asserted that because the construction contracts for this property were let during a recession, he believed it was highly unlikely this property could be replaced for the price Taxpayer actually paid.

Jortberg based his reproduction costs analysis on Taxpayer's costs as reported in an audit by Deloitte and Touch L.L.P. He added the total price of the three guaranteed maximum price ("GMP") construction contracts for the subject property's phase 1a (\$60.8 million), phase 1b (\$52.9 million), and phase 2 (\$6.4 million) for a total cost of \$120,100,000. Jortberg admitted that the numbers might include cost items that were no longer at the property, such as the temporary casino finishes, which were torn out after the permanent casino was constructed. Jortberg also did not account for the fact that phase 2 was not complete as of the valuation date. The audit report stated that \$5.4 million of the \$6.4 million phase 2 construction contract had not been completed. Jortberg further admitted that he did not deduct non-real estate items, such as food service equipment, toll plaza allowances, and temporary assets totaling \$13.9 million included in the GMP contracts. Jortberg asserted that he used actual costs instead of cost estimates from the Marshall Valuation Service because in his experience, Marshall Valuation's estimates for the gaming industry were not reflective of actual costs.

Jortberg did not include any soft costs or entrepreneurial incentive/profit in his valuation. He agreed that entrepreneurial incentive could have been properly included in his valuation.

Jortberg did not include any deduction of functional obsolescence or external depreciation because the subject property is a new facility designed by experienced gaming operators. He pointed out that Boyd Gaming purchased the subject property as part of its acquisition of Peninsula Gaming, and the Ernst & Young report and the Deloitte and Touche audit both reflect a value basis at cost or higher.

With respect to depreciation and obsolescence, Jortberg analyzed both the arena and casino as a single unit without accounting for the mixed use nature of the property. Jortberg acknowledged several recognized methods of calculating depreciation, such as market extraction, capitalization of income deficiency and comparison of reproduction and replacement cost. With regard to functional obsolescence, Jortberg failed to analyze any potential superadequacy of construction, which superadequacy was a potential issue because of the KE LA minimum investment requirement. He stated that "the appraiser notes no functional obsolescence," but performed no recognized appraisal analysis to determine whether functional obsolescence existed.

With regard to economic obsolescence, Jortberg stated in his report that none existed because "as will be noted, the enterprise value far exceeds the value of the real property." Jortberg performed no recognized appraisal analysis to determine whether economic obsolescence existed. Jortberg explained that he does not deduct functional or economic obsolescence unless the enterprise value is less than the reproduction or replacement cost.

With a land value of \$18,700,000 and improvement value of \$120,100,000, Jortberg's cost approach indicated a total value of \$138,800,000 for the subject property.

Jortberg performed an income approach determining the total value of the business enterprise – not the value of the real estate only. Jortberg estimated stabilized income and EBITDA for the operations of the casino and estimated an EBITDA multiplier from market data regarding casino sales. He estimated stabilized annual gaming revenue for the subject property at \$202 to \$209 million based upon pre-construction revenue projections at full build out in 2016. Jortberg found a range of EBITDA of 18% from Colorado casino statistics, 23.4% average from publicly traded companies, 26% to 37% from the Macomber study, and the subject's actual 48% operating margin. Jortberg concludes that a wide EBITDA margin somewhere between 30 and 50 percent is appropriate for the subject property and he concluded a central tendency estimate of 40%. Multiplying the revenue of \$202 to \$209 million by 40% results in a stabilized EBITDA of \$81 to \$84 million. An EBITDA multiplier is then applied to arrive at an estimate of enterprise value. Jortberg reviewed EBITDA multipliers from publicly traded gaming stocks which averaged 12.54, but showed great volatility in the range from 4.24 to 20.27. He also reviewed EBITDA multipliers from recent casino sales

transactions showing a range from 7.0 to 12.4 with an average of 8.1 from all the sales and an average of 7.4 from the 2012 transactions. Jortberg used a range from 7.4 to 9.0 resulting in a value range of \$607 to \$630 million for the estimated stabilized enterprise value of the subject property. Jortberg concluded a rounded \$620 million for the estimated enterprise value of the subject property.

Wendy Runde, former assistant manager for Kansas Star Casino, testified on behalf of Taxpayer. According to Runde, the subject arena includes an equine facility and conference center. Runde explained that Taxpayer downsized the number of planned equine stalls from 600 to 183 and redirected construction funds to the conference center because of profitability concerns. She agreed these facilities are a tourism driver that did not previously exist in the market. Runde testified that the arena, as a stand-alone feature, has never been profitable and she does not believe Taxpayer would build the arena today if it had not been required to by including it in the bid for the management contract.

Lori Nelson, regional director of finance for Boyd Gaming, also testified on Taxpayer's behalf. Nelson is responsible for overseeing accounting and finance functions for Peninsula Gaming's five casinos, including the Kansas Star Casino. Nelson testified that Exhibit #539, Attachment B, pp. 1334-1335, comprised a break-out, tied back to its general ledger, of actual costs Taxpayer incurred during phase 1a of construction totaling \$55,218,666.77. Nelson explained that the infrastructure improvements of \$32,132,828.95 were special assessment items Taxpayer does not have title to. She further stated that the land improvements (\$2,010,256.75) were Taxpayer's property. The FF&E (\$37,654,632.39) and vehicles (\$193,576.78) were personal property. Nelson testified that the costs identified in Lennhoff's appraisal – Exhibit #360, pp. 79-80 – reflect the accurate costs for phase 1a and 1b of construction.

Nelson further testified that the Ernst & Young document, Exhibit #531, was an analysis generated as of November 20, 2012, the acquisition date by Boyd Gaming. Nelson explained that the document does not reflect construction costs, but instead a valuation of everything including personal property. The land value of \$20,178,000 was reflective of the \$17.2 million paid by Taxpayer to landowners and option holders and \$3 million in promotion and success fees paid to Double Down. Nelson testified that, as of December 31, 2012, only \$1 million of the \$6.4 million arena conversions costs (phase 2) had been incurred.

David Lennhoff is a nationally-recognized expert in USPAP and holds 6 of the 7 designations offered by the Appraisal Institute over the course of its existence, including the MAI, SRA, SRPA, SREA, RM and AIGRS. Lennhoff has written and taught many of the Appraisal Institute's advanced courses including the course concerning separating of the assets of a going concern, which course he was the lead

developer of. Lennhoff also edited the two business enterprise anthologies that are the required texts for the separating assets course.

In approaching the appraisal problem, Lennhoff stressed that he was only valuing the real estate component of the property. In doing so, Lennhoff asserted that he was not assuming that the management contract does not exist or that it will be revoked. Rather, he asserted that he is simply valuing the real property interest separate from the management contract and other non-realty interests.

Lennhoff's highest and best use analysis conclusion was that the subject property, absent a management contract, should be held to pursue a management contract. Lennhoff concluded that, for purposes of valuing the real estate only, the highest and best use could not be for gaming use because gaming use is not legally permissible without the management contract in place.

Lennhoff concluded that the mere enactment of the KELA did not create a premium value for the subject property, but rather that the premium price paid for the subject was for the inclusion of the management contract. Lennhoff explained that only KELA gave people the option to obtain management contracts, and in response to that option, not one single market participant paid a premium for land without the management contract. All of the potential sites in the south central gaming zone were optioned, subject to obtaining the management contract. In the absence of the management contract, none of the options were exercised. Lennhoff contended that the opportunity to seek a management contract is reflected in his value, but the value attributable to the management contract is not.

Lennhoff performed a cost approach and a combined income/sales approach to value for the subject property. Lennhoff's cost approach included a replacement cost analysis, land value analysis, and an obsolescence/depreciation analysis. For his land analysis, Lennhoff reviewed large vacant, well-sited tracts, which tracts he asserted are comparable to the subject property without the management contract, including a potential commercial site near Wichita and the Boot Hill sales. Lennhoff concluded a land value of \$10,000 per acre, or \$2,000,000 rounded total land value. While this is higher than the typical agricultural values of \$3,000 per acre, Lennhoff's conclusion was influenced by the \$12,500/acre sale of a potential commercial site near Wichita, and the \$10,000/acre speculative purchase of the Boot Hill casino site.

Lennhoff then estimated replacement cost, using both actual costs and Marshall Valuation Service (MVS). The MVS estimate, when adjusted, was very similar, but slightly higher than actual costs. Lennhoff used the higher MVS estimate as replacement cost of \$111,294,683. Lennhoff agreed that the property has no physical depreciation. Lennhoff asserted that he used the recognized method of market extraction for his depreciation/obsolescence estimate. He utilized

separate extraction for the arena and the casino portions of the property. With regard to the casino, Lennhoff relied on the 2001 sale of the Sam's Town Casino property in Kansas City, Missouri analyzing the cost to build the property and its sale price. On cross-examination, Lennhoff agreed that there were other competing casinos in the Kansas City area and acknowledged that the 2001 sale did not include the casino business. With regard to the arena, Lennhoff analyzed a 2012 sale of the Pepsi Ice Midwest Arena in Overland Park, Kansas. Based upon these analyses, Lennhoff concluded that the casino was 60% depreciated and the arena was 36 % depreciated. This resulted in a total value concluded via the cost approach of \$60,000,000.

Lennhoff also performed an approach he described as a combined income approach/sales allocation to estimate the value of the subject property. In doing so, Lennhoff calculated the total value of the enterprise by the income approach, then allocated a percentage of the total value to the real property. Lennhoff's appraisal explained that the subject's EBITDA, or net income, is based on actual gross revenue and market derived profit margins. An EBITDA multiplier is extracted from sales of casino going concerns, and this EBITDA multiplier is then applied to the subject's net income to provide an estimate of the market value of the total assets. A market-derived allocation is then applied to estimate a conclusion of market value for the subject's real estate only.

Lennhoff's total assets of the business calculation began with the subject's total gaming revenue from 2012 of \$183,199,183. Although Lennhoff used actual annual income, he did not use actual EBITDA for the property because he was looking for market typical figures, just as you would with market rents or capitalization rates. Lennhoff did not mention the subject's 48% actual profit margin in his written appraisal. Lennhoff relied upon an IBISWorld research study for casino hotels, which reported a profit margin for the industry of 18.8%. This results in a reconstructed EBITDA of \$34,441,584.

Lennhoff explained that "[t]he unit of comparison most widely used in the market place for casinos is the EBITDA multiplier. It is a proxy for the income generating characteristics of a property. EBITDA stands for earnings before interest, taxes, depreciation and amortization. It is essentially NOI, Net operating income, but NOI usually incorporates a deduction for replacement reserves whereas EBITDA does not." Exhibit #360, p. 69. Lennhoff reviewed recent sales of casino going concerns and the EBITDA multipliers reported in each company's 10K annual reports. The EBITDA multipliers ranged from 6.95 to 8.82 with a median of 7.72. Lennhoff gave greatest weight to the Peninsula portfolio transaction that included the subject property and reported a 7.03 EBITDA multiplier. He concluded a multiplier of 7.25, which resulted in a market value of the total assets of the business (MVTAB) of \$249,701,481.

The market value of the total assets of the business (MVTAB) includes value of the real property, tangible personal property, intangible personal property and monetary assets. Lennhoff explained that an allocation segregates the value of the real property from the other assets. Lennhoff considered a study of casino hotels by William N. Kinnard in 1998 concluding casino business revenues represented 80% of MVTAB. He also considered automobile racetracks and concluded that a brand new track in a similarly rural location contributed 25% of the MVTAB. Lennhoff further considered casino 10K annual reports which reported market values of realty portions of recent sales/purchase transactions. The allocations ranged from 23% to 38% with a median of 31%. Lennhoff gave greatest weight to the Peninsula portfolio allocation of 23% which included the subject property and concluded the real property contributed 25% of the MVTAB. Application of a 25% allocation results in a value of \$62,425,370 for the real estate. After the addition of the contribution of excess land, Lennhoff's approach resulted in a rounded value of \$63,000,000 for the subject real estate.

In reconciling the cost approach and the allocation to real estate approach, Lennhoff placed more weight - 70% in this case - to the allocation approach and concluded a market value of \$62,100,000 for the subject real estate as of January 1, 2013. Lennhoff acknowledged that the casino business is very valuable, but the appraisal question is: what is the real property worth absent the contract. Lennhoff further noted that Ernst & Young estimated \$75 million as the value of the real property and that was with a \$20 million land value. If \$18 million were subtracted and one used his \$2 million land value, the value is approximately \$60 million.

On cross-examination, Lennhoff admitted that this is his first casino appraisal, but he has performed casino appraisal reviews. Lennhoff agreed that, with the management contract, the highest and best use of the building would be to operate a casino.

James Vernor, PhD and MAI, testified on behalf of Taxpayer. Vernor prepared a review appraisal of the Jortberg Appraisal report and identified USPAP violations in the report. Vernor testified that Jortberg's description of the property was not sufficient to tell the reader the state of construction as of the valuation date. Vernor further testified that Jortberg's highest and best use analysis was flawed because he used an incorrect maximally-productive analysis and his conclusion that gaming use was the highest and best use was contrary to the legally-permissible requirement. In his opinion, gaming use cannot be permissible unless one assumes the award of the management contract, which is not part of the appraisal. He opined that the legally-permissible use would be to pursue a management contract.

Vernor testified that Jortberg failed to adequately analyze the land sale transaction and he ignored the Boot Hill land sale. Vernor asserted that Jortberg's

ten percent increase of the land value to reflect revenues in excess of projections was in error and not a recognized appraisal practice. Further, Vernor testified that Jortberg's report contained no evidence of any analysis with respect to depreciation and obsolescence. Vernor stated that comparing enterprise value to construction cost is not a recognized method for calculation external obsolescence. Vernor testified that Jortberg's income approach was not helpful because it did not conclude to a value for the real estate only. He stated that multiple methods are taught for separating the real estate value from the total enterprise value, but no such methods were used by Jortberg. Vernor further concluded that Jortberg's overall approach indicated a value in use, rather than a value in exchange. In his opinion, Jortberg's report was not USPAP compliant and the errors impact the credibility of the report.

Curtis Settle, Colorado certified general appraiser, testified on behalf of the County.² Settle reviewed Jortberg's and Lennhoff's appraisals for the purpose to compare and contrast the two appraisals, to analyze the appraisal methodology and to give an opinion of the correctness of the appraisals. Settle explained that he was not looking for conformance with USPAP or Kansas law, but was looking for internal inconsistencies and adequate support. Settle noted that the key element of distinction between the appraisals is their determination of what role the government permission to operate a casino on this property plays in the valuation. Settle testified that in his cost approach, Lennhoff assumed gaming would not be allowed on the property, but in his income approach, he assumed gaming is allowed on the property. Lennhoff's appraisal is based on the premise that gaming permission does not exist, and Settle testified that this is a hypothetical condition because this assumption is contrary to known facts – the subject property is a successfully operating casino.

Settle noted that Lennhoff used the market extraction method for estimating functional and external obsolescence. With respect to the 60% obsolescence for the casino, Settle asserted it is not good appraisal practice to develop a \$33 million adjustment based upon only one sale, especially when it is 12 years old, located in a different market, was no longer operating as a casino, is less than half the size of the subject, and is a converted former manufacturing building. In his opinion, the analysis does not produce a credible indication of the functional/external obsolescence. Settle had similar concerns regarding the arena analysis.

With respect to Lennhoff's allocation based upon public accounting financial documents, Settle explained that it is not good appraisal practice to rely on an accountant's allocation to real estate when estimating value. "The tax motivations

² The Board denied Taxpayer's *Motion to Exclude Curtis Settle as an Expert Witness* finding that Taxpayer would be allowed to cross-examine the witness and provide contrary evidence and the Board would give the testimony and evidence appropriate weight.

of the accounting profession can be quite difference from the market value motivations of the appraisal profession." Exhibit #526, p. 7.

Settle testified that there were a lot of decisions by Lennhoff where a small change in the concluded percentage would have resulted in a dramatic impact on the final value. Lennhoff's appraisal concluded a 18.8% EBITDA percentage disregarding the subject's actual performance, but on the other hand, Lennhoff gave greatest weight to the subject's actual EBITDA multiplier and real estate allocation percentage. Settle also noted that a national accounting firm performed an audit and the December 31, 2012 balance sheet shows the fair value of the real property to be \$180,233,000, yet Lennhoff's appraisal fails to mention this accountant's view of the subject's real property value even though Lennhoff relies on an accountant's allocation to real property as a percent of BEV (Business Enterprise Value). Settle concluded the Lennhoff appraisal lacks credibility because of the limited analysis and internal inconsistencies. Overall, Settle observed no internal inconsistencies in the Jortberg appraisal.

III

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

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

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

"absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by governmental powers of taxation, eminent domain, police power, and escheat." *The Appraisal of Real Estate*, Appraisal Institute, at 111-112 (13th ed. 2008). "Stated another way, '[o]wnership of the fee simple interest is equivalent to ownership of the complete bundle of sticks [property rights] that can be privately owned.'" *Prieb*, 47 Kan. App.2d at 130 citing *The Appraisal of Real Estate*, p.112.

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

IV

Both parties relied on the cost approach as one of the appraisal methodologies for their respective valuations. The cost approach is based on the theory that the market value of an improved parcel can be estimated as the sum of the land value and the depreciated value of the improvements. International Association of Assessing Officers, *Property Appraisal and Assessment Administration* 205 (Ed 1990). An essential component of the cost approach is the estimate of accrued depreciation. Physical deterioration, functional obsolescence, and external (economic) obsolescence are all causes of depreciation. International Association of Assessing Officers, *Property Assessment Valuation* 182 (2nd Ed, 1996). The initial component of the cost approach to be considered is the land value and its influence by the management contract. Both parties presented similar arguments in this appeal to those stated in the prior year appeal. *In the Matter of the 2012 Tax Year Equalization Appeals of Kansas Star Casino, L.L.C. in Sumner County, Kansas*, Docket Nos. 2012-3909 EQ and 2012-3910 EQ. (petition for judicial review filed with Kansas Court of Appeals, Case No. 14-111650-A) This issue was thoroughly examined and discussed in our *Order* dated February 25, 2014 wherein COTA, predecessor to BOTA, found as follows:

"Upon review, the County established by a preponderance of the evidence that the subject property is the best casino site in the south central gaming zone and would have value even without Taxpayer possessing the management agreement (as long as the management agreement for this zone has not

otherwise been awarded). This is established by the independent evaluators who determined that Exit 33 was superior to Exit 19; an option agreement on the Gerlach tract executed only three months after the legislation passed; Taxpayer selecting the subject parcel as its proposed site; and the State of Kansas's selection of Taxpayer's proposal with the proposed site for the management agreement. K.S.A. 74-8734(e) establishes that location is a significant factor to be considered by the State in selecting a proposal and proposed site for the management agreement. K.S.A. 79-503a(c) also establishes the effect of location on value as a factor to be considered in determining fair market value. Location is a real property characteristic.

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

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

Taxpayer states that it never would have exercised the options and purchased the two tracts if it was not awarded the management contract.³ We do not doubt that statement. Taxpayer's leap in logic, however, is that the purchase price includes a value for the management contract that must be removed. We do not agree.⁴ In one sense, the Act is analogous to zoning in that the Act is a restriction or requirement imposed upon the use of real estate by the state or federal government or local governing bodies. See K.S.A. 79-503a(j). For example, commercial zoning as opposed to residential zoning in many instances enhances the fair market value of land. Required zoning is not a tangible property and yet it enhances value of real property, and such enhanced value is properly included in the value of real property.⁵ In this case, by virtue of the state government allowing gaming through adoption of the Act the value of the subject parcels have been enhanced.

This constitutes an enhancement of the real estate's value by changing its permissible use. It does not constitute value on an intangible, or placing a value on the management agreement, as asserted by Taxpayer. We recognize that K.S.A. 74-8734(m) of the Act states that the management agreement is not to be considered property, but K.S.A. 74-8734(m) addresses judgment liens (involuntarily liens), executions on property (involuntarily liens), mortgages (voluntarily liens), transfers, and assignments – in other words, actions that would encumber or otherwise reduce or eliminate the State of Kansas's control of the situation.

³ The use of options by the market participants does not undercut the conclusion that the subject site is the optimal casino site in this zone. The use of options simply recognizes a vast risk/reward disparity between buying the subject property outright before approval of a proposal versus the risk that another proposal at another site is approved and receives the management agreement. If Taxpayer had purchased the subject property outright and no proposal was approved, it could re-sell the property to the next proponent but with no gain or perhaps a loss. If Taxpayer had purchased the subject property and another proposal at another site were approved, then the value of the subject property would drop precipitously as there can only be one casino in the zone. Thus, the risk/reward in that scenario dictates the use of options.

⁴ From another perspective, the money paid by Taxpayer for the Wyant and Gerlach tracts was consideration for, and purchased only, interests in land. Wyant, Gerlach, and the option holders did not sell a management contract to Taxpayer.

⁵ Zoning is a government requirement that can also be in doubt in some situations and can drive the use of options by market participants. Ultimately, a requested change in zoning can enhance the value of real property once it is granted (usually after the option is granted, but before the option is exercised). This is similar to the situation here with the use of options and the award of the management agreement.

Nothing in K.S.A. 74-8734(m) indicates that it is addressing issues of *ad valorem* property taxation and any possible enhanced real property value as a result of the Act.

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

In the Matter of the 2012 Tax Year Equalization Appeals of Kansas Star Casino, L.L.C. in Sumner County, Kansas, Docket Nos. 2012-3909 EQ and 2012-3910 EQ, Order dated February 25, 2014, pp. 21-23.

We again conclude that the value of the management contract is not included in the value of the land as presented by the County, and there is no need to extract it from the consideration paid for the land. As such, the Board concurs with the County's valuation of the land under the cost approach. The Board finds the price paid for the land is driven by mere business motivation and not due to inclusion of the management contract.

For his cost analysis, Lennhoff, on behalf of the Taxpayer, determined his replacement cost by considering both actual costs provided by the Taxpayer as well as a cost analysis based on Marshall Valuation service. Lennhoff concluded a cost of \$110,500,000. Jortberg, for the County, utilized reproduction costs in lieu of replacement costs which were based on Taxpayer costs as reported in an audit by Deloitte and Touche L.L.P. Jortberg concluded a total cost of \$120,100,000.

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

performed no recognized appraisal analysis to determine whether functional or economic obsolescence existed.

Lennhoff relied on the market extraction method for calculating depreciation. In his analysis of functional and external obsolescence of the casino portion of the subject property, Lennhoff relied solely on a 2001 sale of the Sam's Town casino in Kansas City, Missouri. The 2001 sale did not include the actual casino component of the Sam's Town property. The Board finds such analysis is lacking in substance.

For these reasons the Board finds that neither cost approach presented by Taxpayer or the County is reliable or persuasive, and rejects both.

Based on the evidence presented at the hearing and duly weighing such evidence, the Board finds that the income approach estimating a value of the going concern, or business enterprise value, with a market-derived allocation applied to arrive at an estimate of market value for the real estate is the best appraisal methodology presented to estimate the fair market value of the subject real property. Issues regarding depreciation to be applied in the cost approach, in both the Jortberg and Lennhoff appraisals, lead the Board to place less weight on the cost approach. The Board is concerned that Jortberg did not perform recognized appraisal analyses to consider whether functional or economic obsolescence existed. On the other hand, the Board is not convinced that the sale of a closed, former casino in Missouri, a different market, which sold twelve years prior to the valuation date, is a reliable and persuasive basis to estimate functional and external obsolescence for the subject property under its legally permissible highest and best use.

The income approach with an allocation to real estate avoids the deficiencies in the cost approaches regarding land value and estimating depreciation and appropriately considers the highest and best use of the subject property. Both Jortberg and Lennhoff utilize the same income approach methodology to arrive at estimates of business enterprise value or market value of the total assets of the business (MVTAB). The unit of comparison most widely used in the market place for casinos is the EBITDA multiplier (earnings before interest, taxes, depreciation and amortization). In arriving at a fair market value conclusion, the Board relies primarily on Lennhoff's method because he completes the methodology, by applying a market-derived allocation, to estimate market value of the real estate. In weighing the evidence, the Board notes, however, that Jortberg's appraisal did provide additional relevant market evidence regarding profit margins and EBITDA multipliers.

Lennhoff's use of the subject's actual 2012 revenue of \$183,199,913 is reasonable in light of the fact that neither appraiser presented broader market-derived data. In light of the range of margins of publicly traded companies

presented by Jortberg, the Board finds that the market evidence best supports a market profit margin of 24%. Although Lennhoff cited two surveys, the underlying data and ranges were not presented in the appraisal, and the subject's actual operating margin of 48% was not addressed in his written appraisal. The Board agrees that the subject's actual margin should not be the sole determining factor, but it is a property-specific factor that should be considered and may be given some weight. The Board further finds that an EBITDA multiplier of 7.75 is most reflective of the market in light of the median of all transactions presented by Lennhoff (7.72) and the average of the transactions presented by Jortberg (8.10).

With these modifications to best reflect market metrics, the income approach indicates an MVTAB of \$340,751,800. Upon review of the allocation analysis presented by Lennhoff, the recent casino transactions are the most persuasive evidence presented and their allocations to real estate range from 23% to 38%, with a median of 31%. The Board believes that the median of 31% is the most appropriate reflection of market allocation. Application of the 31% allocation results in a value of \$105,600,000, rounded, for the value of the real property.

Acknowledging that the appraisal question presented herein is complex, the Board believes that an appraised value of \$105,600,000 best reflects the fair market value of the subject real property for tax year 2013.

IT IS THEREFORE ORDERED that the appraised value of the subject properties for 2013 is \$105,600,000.

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

This order is a full and complete opinion pursuant to K.S.A. 74-2426(a), and amendments thereto.

Any party who is aggrieved by this order may file a written petition for reconsideration with this Board as provided in K.S.A. 77-529, and amendments thereto. See K.S.A. 74-2426(b), and amendments thereto. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Board's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for reconsideration shall be mailed to the Secretary of the Board of Tax Appeals. The written petition must be received by the Board within 15 days of the certification date of this order (allowing an additional three days for mailing pursuant to statute).

Rather than filing a petition for reconsideration, any aggrieved person has the right to appeal this order of the Board by filing a petition with the court of

appeals or the district court pursuant to K.S.A. 74-2426(c)(4)(A), and amendments thereto. Any person choosing to petition for judicial review of this order must file the petition with the appropriate court within 30 days from the date of certification of this order. See K.S.A. 77-613(b) and (c) and K.S.A. 74-2426(c), and amendments thereto. Pursuant to K.S.A. 77-529(d), and amendments thereto, any party choosing to petition for judicial review of this order is hereby notified that the Secretary of the Board of Tax Appeals is to receive service of a copy of the petition for judicial review. Please note, however, that the Board would not be a party to any judicial review because the Board does not have the capacity or power to sue or be sued. See K.S.A. 74-2433(f), and amendments thereto.

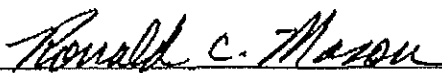
Unless an aggrieved party files a timely petition for reconsideration as set forth herein, this order will be appealable by that party only by timely appeal to the district court or the court of appeals as set forth above.

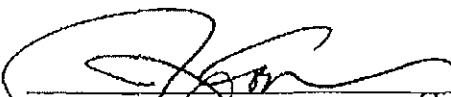
The address for the Secretary of the Board of Tax Appeals is Board of Tax Appeals, Eisenhower State Office Building, 700 SW Harrison St., Suite 1022, Topeka, KS 66603. A party filing any written request or petition shall also serve a complete copy of any written request or petition on all other parties. Please be advised that the administrative appeal process is governed by statutes enacted by the legislature and no further appeal will be available beyond the statutory time frames.

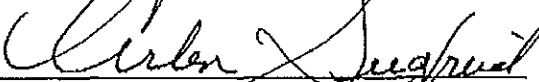
IT IS SO ORDERED

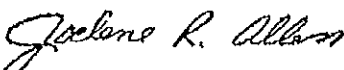
THE KANSAS BOARD OF TAX APPEALS




RONALD C. MASON, BOARD MEMBER


JAMES D. COOPER, BOARD MEMBER


ARLEN SIEGFREID, MEMBER PRO TEM


JOELENE R. ALLEN, SECRETARY

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CERTIFICATION

I, Joelene R. Allen, Secretary of the Board of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket Nos. 2013-2795-EQ and 2013-2796-EQ, and any attachments thereto, was placed in the United States Mail, on this 21st day of May, 2015, addressed to:

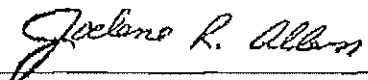
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IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.


Joelene R. Allen, Secretary