

PPE CASINO RESORTS MARYLAND LLC

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IN THE

vs.

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MARYLAND TAX COURT

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SUPERVISOR OF ASSESSMENTS  
OF ANNE ARUNDEL COUNTY

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Nos. 14-RP-AA-0503 (1-2)  
and 14-RP-AA-1276

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## MEMORANDUM AND ORDER

The disputed assessments before the Court are for the property known as the Maryland Live! Casino ("Subject Property"). The Subject Property, which was constructed in 2012, is located in Anne Arundel County at the Arundel Mills Mall in Hanover, Maryland. This appeal consists of two assessments: the 2012 Full Year New Construction Pick-Up ("NCPU"), which is effective as of July 1, 2012 with a date of finality of January 1, 2011 and the 2014 Levy Year, which is effective as of July 1, 2014 with a date of finality of January 1, 2014.

The current assessment of the Subject Property is as follows:

1. Assessment as of January 1, 2011 for the 2012 NCPU
  - a. Land: \$85,000,000
  - b. Improvements: \$155,955,400
  - c. Total: \$240,955,400
  
2. Assessments as of January 1, 2014 for the 2014 Levy Year
  - a. Land: \$85,000,000
  - b. Improvements: \$194,414,800
  - c. Total: \$279,414,800

PPE Casino Resorts Maryland LLC ("Petitioner" or "Taxpayer") based on its appraisal contends that the fair market values for the Subject Property should be as follows:

1. Market Value as of January 1, 2011 for the 2012 NCPU
  - a. Land: \$14,000,000
  - b. Improvements: \$158,400,000
  - c. Total: \$172,400,000
2. Market Value as of January 1, 2014 for the 2014 Levy Year
  - a. Land: \$15,000,000
  - b. Improvements: \$176,450,000
  - c. Total: \$191,450,000

The Supervisor of Assessments of Anne Arundel County (the "Supervisor") based on its appraisal contends that the fair market values of the Subject Property are as follows:

1. Value as of January 1, 2011 for the 2012 NCPU
  - a. Land: \$65,000,000
  - b. Improvements: \$155,955,400
  - c. Total: \$220,955,400
2. Value as of January 1, 2014 for the 2014 Levy Year
  - a. Land: \$70,000,000
  - b. Improvements: \$194,414,800
  - c. Total: \$264,414,800

The Maryland LIVE! Casino ("Casino") is located on 9.28 acres, immediately adjacent to the Arundel Mills Mall in Hanover, Maryland. It is improved with a seven-level parking garage and a 333,164 square foot casino which was completed in the summer of

2012. In 2013, a poker room expansion was completed, increasing the casino size to 347,964 square feet.

In the 2008 general election, voters in Maryland ratified a constitutional amendment authorizing video lottery terminals ("VLTs") in five locations in the State – Anne Arundel County, Baltimore City, Cecil County, Alleghany County and Worcester county. The constitutional amendment authorized no more than 15,000 statewide VTLs. Up to 4,750 VTLs were allocated for the Anne Arundel County site. The Anne Arundel County location had to be within two miles of Maryland Route 295. Table games, such as craps, blackjack and roulette, were not part of the original authorization. Maryland law permitted the casino operators to retain thirty-three (33%) percent of VTL proceeds, with sixty-seven (67%) percent of gross revenues generated by VTLs retained by the State.

In December of 2008, the Maryland Video Lottery Facility Location Commission ("Lottery Commission") requested proposals for the newly authorized video lottery operation licenses. There were two prospective bidders for the Anne Arundel County License. The first was the Laurel Racing/Maryland Jockey Club, which owned the Laurel Racetrack and wanted to place a VTL facility at that location. The second was the Taxpayer. Although the Taxpayer considered a number of different sites in Anne Arundel County, ultimately, Taxpayer's license application requested a VLT facility at the Arundel Mills Mall. Taxpayer submitted its bid to the Lottery Commission for the Anne Arundel County License and paid a nonrefundable licensing fee of \$28.5 million in February 2009.

Prior to filing for its gaming license, Taxpayer reached out to Simon Property Group to negotiate a deal to acquire a site at Simon's Arundel Mills Mall for the Casino. Although negotiations took place prior to the application being filed by the Taxpayer, the Ground Lease was not executed until April of 2009. Under the terms of the Ground Lease,

Petitioner leased the Subject Property for ninety-nine years, subject to various rights of termination and obtained the right to construct the casino as well as the obligation to construct a parking facility. The parking garage was required to be of sufficient size to provide for the needs of the Taxpayer, the Landlord, and the tenants of the Arundel Mills Mall. In addition, the employees and customers of the Arundel Mills Mall were allowed to utilize the parking garage without charge.

The Ground Lease contained a number of contingencies including: the award by the Lottery Commission of a license to the Taxpayer; the enactment of a zoning amendment and the Taxpayer obtaining all necessary permits and conditional use or special exception approvals from Anne Arundel County.

After numerous obstacles, lawsuits and other legal challenges, as well as a public referendum, the lease commenced on the date the casino opened to the public on June 6, 2012.

The 99-year Ground Lease includes two (2) annual payments that the Petitioner is required to make to the Landlord. Petitioner is required to pay a minimum annual rent of \$2 million, less a \$1,500,000 annual credit for the agreed cost of the parking garage constructed by the Petitioner. The minimum annual rent increases by one percent each January 1<sup>st</sup> while the Ground Lease is in effect. In addition, the Taxpayer is required to pay the Landlord one percent of annual gross revenues generated by the casino from its gaming and retail sales ("Percentage Rent"). The Percentage Rate component is variable throughout the duration of the Ground Lease and is directly correlated to the operation of the casino business enterprise.

The Petitioner has the right to terminate the Ground Lease after fifteen years and

every ten years thereafter. The Landlord has the right to terminate the Ground Lease if the Petitioner elects not to seek a renewal of the casino license for the Subject Property when the first extended or renewed term of the license expires. The Landlord may exercise this right within 180 days of the date that the Petitioner ceases to permanently operate VLTs on the Subject Property as a result of the expiration of the license, but only if, at the time of the cessation, an affiliate of the Petitioner holds a casino license for a location in Anne Arundel County that is not the Arundel Mills Mall and operates a facility there with VLTs.

The central issue presented by this case is whether a document self-titled "Ground Lease" should be used as a measure to assess the fair market value of the land for ad valorem tax purposes. The argument centers on whether the ground lease is an accurate measure of the value of the land. Under standard appraisal methodology, income producing real property can be valued using the capitalization of income method or the sales comparison approach. The Petitioner analyzed sales in conjunction with the cost approach, and the Respondents used the direct capitalization approach to value the land.

Maryland courts have addressed the issue of what constitutes a lease. "Leases are contracts and, as such, are to be construed by application of the well-established rules of contract interpretation." *Middlebrook Tech, LLC v. Moore*, 157 Md. App. 40, 849 A.2d 63 (2004). "Maryland follows the law of objective contract interpretation." *Sy-Lene of Wash., Inc. v. Starwood Urban Retail II*, 376 Md. 157, 829 A.2d 540 (2003). "When a contract's language is expressed in clear and unambiguous terms, the court will not engage in construction, but will look solely to what was written as conclusive of the parties' intent." *Moore*, 157 Md. App. 40, 849 A.2d 63 (2004).

An analysis of the document at issue suggests that it could be a typical ground

lease. First, the document is self-labeled a ground lease. Second, the parties are referred throughout as “landlord” and “tenant.” Third, the first section of the document is captioned “Grant of lease” and grants a leasehold interest in the subject property. However, the percentage rent language of the ground lease suggests a business arrangement between the parties which must be considered in determining the value of the Subject Property.

In *Supervisor of Assessments v. Ort Children Tr. Four*, 294 Md. 195, 448 A.2d 947 (1982), the Court of Appeals considered the issue of using leases as tools for property valuation. In *Ort*, a property was owned subject to a long-term lease with a contract rent, which was no longer reflective of the market. The subject property could have technically been rented out at more than twice the amount fixed in the current lease. The Supervisor raised the taxable value of the subject property and the Tax Court reduced the taxable value, based on the actual low rental rate. The Court held that the tax statutes could not be “construed as impliedly compelling the total rejection of any weight being given to contract rent...” Relevant to the present case, *Ort* held that contract rent must be considered in the assessment of property value.

The Court in *Ort*, cited *Rogan v. Cty. Comm’rs of Calvert Cty.*, which quoted Justice White in *San Francisco National Bank v. Dodge*, 197 U.S. 70, 25 S. Ct. 384, 386, 49 L. Ed. 669. Justice White stated, “the market value of property is the value a willing purchaser will pay for it to a willing seller in open market, eliminating exceptional and extraordinary conditions giving the property temporarily an abnormal value.” Further, *Ort* cited *Springfield Marine Bank v. Prop. Tax Appeal Bd.*, 44 Ill. 2d 428, 256 N.E.2d 334 (1970), which provided guidance on the weight that might be given to a lease. “In determining the value of the property, rental income may of course be a relevant factor...However, it cannot be the controlling factor, particularly where it is admittedly

misleading as to the fair cash value of the property involved.” Additionally, the Court in *Ort* stated, in regards to the lease at issue in the case, “it should be pointed out that the lease between Sears and the Trust was an arms-length, bona fide transaction and that it is agreed between the parties that the rent as originally established was an economic rent at the time. Thus, we are not concerned here with the effect a difference in those factors might produce in some other case.” The obvious implication is that differences in the aforementioned factors may be a concern in the present case.

In *Supervisor of Assessments v. Berman*, 81 Md. App. 675, 569 A2d 706 (1990), the taxpayer had leased an area of a shopping mall under a long-term lease through an arms-length transaction. A central issue in *Berman* was how much consideration should be given to the lease in determining market value. The Tax Court in *Berman* cited *Ort* stating, “the analysis which prohibits any consideration of contract rent is at odds with the willing seller/willing purchaser approach to market value for property tax purposes.” The Tax Court’s opinion had additionally cited *Ort*, “Although *Ort* does not mandate that contract rent must be used to value income producing property when a long-term lease is involved, it does require that the effect of the lease be considered in any value.” The Court of Special Appeals in *Berman* held that the Tax Court’s interpretation of *Ort* in the *Berman* case was correct.

The case law, cited herein, establishes that in the assessment of a property for tax purposes a lease on the subject property must be considered. However, while the cases reference lease as an item that must be considered for its effect on the value of a property, they do not present a clearly defined standard or bright-line rule for consideration of a lease. In the present case, there are multiple compelling reasons as to why the lease should not be the sole controlling document in assessing the property value.

Relevant to this case, the semiannual date of finality for the 2012-2013 assessment was July 1, 2012. However, because the assessments were mid-cycle, the valuation date was January 1, 2011. The lease was drafted at some point during, or prior to, the year 2009. The casino itself opened on June 6, 2012. Hence, there was no certainty as to what the percentage factor would be when the lease was drafted or on the valuation date, being that the date was approximately one and a half years before the casino was opened. The lease was negotiated to arrive at a total rent value that was unknown when the lease was drafted, due to the uncertain future gross income, and hence could not have been an expression of the land's value as determined by the parties.

The Supervisor argues that the best evidence of value is the ground lease, where the parties themselves determined the value of the land. The Court agrees that evidence of the ground lease should be used if it is actual evidence of what a willing buyer would pay a willing seller for the land or the value of the land. However, the facts in this case do not lend themselves to the idea that such a conclusion could be made here. The New Jersey Tax Court analysis of a case is illuminating on the matter. In *Lawrence Assocs. V. Lawrence Twp.*, 5 N.J. Tax 481 (1983), the court held that where a mall had not yet opened for business the income stream (from percentage rent) that would be analyzed by a potential investor was "speculative." The court held that the reproduction cost approach, due to factors such as the speculation involved, produced the most reliable indication of value. While the present case is not similar in all respects, the recognition that percentage rent is "speculative," where a business has not yet opened, is instructive and persuasive here.

The parties in actuality only agreed to a definite payment of \$2,000,000 increasing

at 1% annually, with an annual credit of \$1,500,000. Arguably, then the land was then only worth a guarantee of \$500,000 annually, with a 1% annual increase based on \$2,000,000, under the willing buyer and willing seller standard. The parties to the lease did not know how much the gross revenue of the casino would eventually total and how certain factors outside their control might affect the gross revenue. Granted, it is certain that the parties anticipated the casino would generate some monies and the financial and other investments of time and effort to build the casino are a testament to that. However, as the court in *Lawrence* noted, percentage rent is speculative. In this case, it could in theory have been any number, including technically zero. Hence, the lease is not a reflection of the land's value as presented by the Respondents.

The percentage rent factor in this case was purely speculative and unknown due to the Casino being a new enterprise. Had the parties to the lease owned similar casinos in a similar locale, it might be arguable that they had an idea of what the gross revenue would be. Had the casino already existed and was relocating, an argument too could be made. In such scenarios, where the percentage rent value could be ascertained, it might be sensible to attribute an actual dollar figure to the percentage rent prior to knowing what the actual dollar figure is. In such a scenario, where an approximation based on past revenues could be made, it is arguably an indicator of what the land might be worth. However, where the gross income, and through that the eventual rental payments, are unascertainable at the time of the lease's signing and in actuality are a measure of the success (or lack thereof) of a business venture, the rental payments are hardly an expression of the land's value.

The income method is only reliable when the property itself is the income producer, *The Valuation of Leaseholds for Ad Valorem Property Tax Purposes-The Reasonable*

*Assessor Standard*, 1968 Wash. U.L.Q. 136 (1968). The Maryland Tax Court has addressed the issue of business value being included when valuing a property. In *Whitestake Assocs. V. Supervisor of Assessments*, 1990 Md. Tax LEXIS 16, this Court stated that "While the income approach is generally the method of choice for income producing properties, care must be taken to avoid an analysis of the business rather than the real estate on which it is operated. This concern is particularly true when dealing with marinas and boat yards where income is not necessarily reflective of real estate value. Additionally, in *Inner Harbor Marina of Baltimore, Inc. v. Supervisor of Assessments of Baltimore City*, 1991 Md. Tax LEXIS 10, 1991 WL 322991, the Court opined "[The Tax Court] must carefully distinguish real estate income from business income and real estate expenses from business expenses."

The lease in the present case is a percentage lease and derives approximately two-thirds of the ground rent from business oriented percentage rent. Hence, the problem inherent with using the lease is that it leads to a valuation of the operating business. If the income of the Casino dropped from its current numbers, the requisite property assessment would theoretically have to change, perhaps drastically. Such a possibility shows that a valuation using the lease is an analysis of the business more so than the property.

The Petitioner demonstrated that the law, as it currently stands, precludes the sale of the land as it is currently being used. The Respondents' assessment suggests a value in use to a particular landlord because the lease is almost certainly worth more to the current landlord than any potential willing buyer. The Petitioners presented compelling evidence, combined with expert testimony, that the land cannot be sold as it is currently being used. The Petitioners argument does not end with the land being declared

valueless. It simply means that the land should be valued absent use of the lease or income stream as that money will almost certainly not continue to the next willing buyer, should there be one.

Additionally, even in the unlikely scenario where a willing buyer could be found for the property as its currently being used, the buyer would have to have a casino license or be approved in some fashion to take advantage of the income stream. The overwhelming majority of the revenue of the rent revenue is tied to the casino's business operations and the income stream is worth significantly less without the percentage rent. Overall, it's an unlikely proposition that a piece of land cannot ever be sold, as the Petitioner's expert testified. In conclusion, it seems that the income stream gives the leaseholder a temporary and abnormal relative value in the lease, that is actually a figure of business value that could not easily be replicated by some other willing buyer.

The Maryland statutory scheme does not require one method of evaluation over another. The courts have repeatedly echoed the willing purchaser and willing seller approach to arrive at the value of a property. The methods used by the Respondents to determine the value of the land did not amount to a valuation of the land. The case law has made clear that, although a lease must be considered in the valuation of property, it might not necessarily be determinative of value. A lease agreed to by two parties which includes non-cognizable percentage rent amount indicates that the parties, as well as the market, could not determine the value of the land by capitalizing the rent payments. Additionally, a lease whose majority of rent payments is clearly the product of a business enterprise should not be used in assessing a property's value. Further, when the value of a lease flows from the business income stream through a percentage rent factor, the value of a lease is almost certainly only attributable to the current landlord and is not

indicative of the land's value. For the aforementioned reasons, the Respondents' method of valuation should not be used.

Petitioner did not use the lease to value the land but instead analyzed sales of the land under the cost approach. Ronald Lipman, Petitioners' expert, opined that the cost approach is particularly relevant to the Subject Property, since it includes significant intangible value, which must be excluded from the real estate assessment. The International Association of Assessing Officers ("IAAO"), which recognizes casinos as properties that often have intangible value, identifies the cost approach as useful in valuing such assets because "it inherently excludes intangible value." The first step of the cost approach is to "[e]stimate the value of the site as though vacant and available to be developed to its highest and best use." Mr. Lipman concluded that "the highest and best use of the land as if vacant is for development consistent with commercial, office, and retail uses in the Arundel Mills neighborhood, and the most probable buyer would be a commercial developer. After concluding the highest and best use, Mr. Lipman reviewed all relevant methodologies to valuing the land as though vacant and concluded that the two most applicable are the sales comparison approach and the direct capitalization approach. Mr. Lipman concluded that the direct capitalization approach was unreliable for the following reasons:

1. Lack of comparable information to develop market rent and appropriate capitalization rate;
2. The fact the Subject Property's rental income is business generated;
3. Risks from intrastate and interstate competition;
4. The fact much of the income from this approach to value would rely on percentage rent, which is business income;

Mr. Lipman employed the sales approach and found twenty-seven sales between December 2000 and November 2010 within the Subject Property's immediate vicinity. Mr.

Lipman also researched land sales involving the Horseshoe Casino in Baltimore City and the MGM National Harbor Casino in Prince George's County, which provided confirmation of his values, thereby proving the reasonableness of his sales comparison approach.

The sales were reviewed in detail in his appraisal report and at trial, and after adjustments were made, Mr. Lipman concluded a per acre market value as of the 2012 NCPU's January 1, 2011 date of finality to be \$1,500,000. Applied to the Subject Property's 9.28 acres, the market value of the land as vacant was estimated to be \$14,000,000. For the 2014 Levy Year's January 1, 2014 date of finality, Mr. Lipman's sale comparison approach yielded a value of \$1,600,000 per acre. Applied to the Subject Property's 9.28 acres, the market value of the land as vacant was estimated to be \$15,000,000.

Mr. Lipman also used two casino land transfers to test the reasonableness of the land value he concluded in his comparable sales analysis. The first transfer in Baltimore City's condemnation of the land that would eventually house the Horseshoe Casino and supporting garage. The condemnation price of the land where the Horseshoe Casino was constructed is relevant to the value of the Subject Property because it provides evidence of the market value of land specifically intended for casino use. The total transfer price was \$11,276,000, which, when applied to the Horseshoe Casino's land area of 7.162 acres, indicates an unadjusted value of \$1,574,475 per acre. Mr. Lipman opined that given the fact Baltimore City knew this site would become a casino and the City stood to sign a lucrative ground lease with the casino developer, it is very likely the per acre price was above market. Nevertheless, the unadjusted per acre price supports Mr. Lipman's comparable sales analysis.

Mr. Lipman also examined the MGM National Harbor Casino in Prince George's

County and after making adjustments to reflect the differences between the properties, concluded a value of \$1,600,000 per acre. Finally, Mr. Lipman considered vacant land sales in Las Vegas, Nevada to confirm the reasonableness of the market value he concluded from the comparable sales.

Lastly, the Court is required to examine the improvement values as argued by the parties. The improvement values that Petitioner and Supervisor arrive at are as follows:

1. Improvement Value as of January 1, 2011 for the 2012 NCPU
  - a. Petitioner: \$158,400,000
  - b. Supervisor: \$155,955,400
2. Improvement Value as of January 1, 2014 for the 2014 Levy Year
  - a. Petitioner: \$176,450,000
  - b. Supervisor: \$194,414,800

The Petitioner accepts the Supervisor's 2012 NCPU improvement value of \$155,955,400. However, Petitioner disputes the Supervisor's assessed improvement value for the 2014 Levy Year due to a failure to take any functional obsolescence deduction.

The Court agrees with the Petitioner that a functional obsolescence deduction is appropriate given that the property was constructed in two phases. When the Subject Property was initially constructed, no table games were permitted in the State of Maryland and the casino was designed to house only VLTs. When table games were legalized, Petitioner had to undertake extensive and expensive expansion in order to accommodate the new gaming options, including construction of a multi-story "Poker Room" addition constructed over a loading dock. The original casino was constructed at a cost of approximately \$187 per square foot but the Poker Room cost \$633 per square foot to construct. These costs reflect the design and engineering challenges resulting from

having to construct the addition after the original building was completed. These costs reflect a negative impact on value and Mr. Lipman's calculation of \$6,600,000 in functional obsolescence is reasonable.

In addition, Petitioner was required to replace the parking that was lost to construct the Subject Property and Petitioner does not benefit from the parking they were required to replace and are under a continuing obligation to permit the owner of the Arundel Mills Mall to use those spaces free of charge. Therefore, the cost of those additional garage spaces must be deducted from the cost of the Subject Property improvements. The Subject Property took away 1,276 parking spaces from the Arundel Mills Mall, each of which had to be replaced. Based on the \$72,000,000 it cost to construct the parking structure at the Subject Property, each of the 4,161 spaces at the casino cost about \$17,300 to build. Adjusted for the 2014 Levy Year date of finality, Mr. Lipman estimates the cost to be about \$17,730 per space as of January 1, 2014. The resulting total cost to construct the spaces deducted to the Arundel Mill Mall is \$22,600,000. The total resulting depreciation for both the Poker Room and parking garage is \$29,200,000.

Accordingly, it is this 26<sup>th</sup> day of December, 2017, by the Maryland Tax Court ORDERED that:

1. Full Cash Value as of January 1, 2011 for the 2012 NCPU
  - a. The land assessment be reduced to \$14,000,000.
  - b. The improvement assessment of \$155,955,400 be affirmed.
  - c. The total assessment be reduced to \$169,955,400.

2. Full Cash Value as of January 1, 2014 for the 2014 Levy Year
  - a. The land assessment be reduced to \$15,000,000.
  - b. The improvement assessment be reduced to \$176,450,000.
  - c. The total assessment should be reduced to \$191,450,000.

CC: Eric S. Kassoff, Esq.  
Jason Fetterman, Esq.  
William K. Hammond, Esq.  
Kent Finkelsen, Administrator

**CERTIFIED TRUE COPY**  
**TEST:** John T. Hearn, Clerk

**NOTICE:** You have the right of appeal from the above Order to the Circuit Court of any County or Baltimore City, wherein the property or subject of the assessment may be situated. The Petition for Judicial Review **MUST** be filed in the proper Court within thirty (30) days from the date of the above Order of the Maryland Tax Court. Please refer to Rule 7-200 et seq. of the Maryland Rules of Court, which can be found in most public libraries.