IN THE SUPREME COURT OF FLORIDA

CASE NO. 75,322

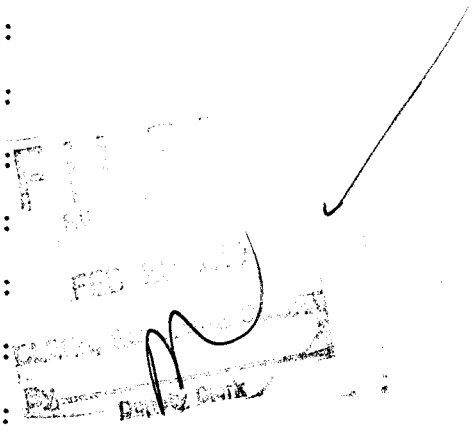
RONALD J. SCHULTZ, as Property Appraiser of Pinellas County, et al.,

Petitioners,

-vs-

TM FLORIDA-OHIO REALTY LTD. PARTNERSHIP, an Ohio Limited Partnership,

Respondent.



INITIAL BRIEF OF AMICUS CURIAE

REBECCA E. WALKER, as

PALM BEACH COUNTY PROPERTY APPRAISER

APPEAL FROM THE DISTRICT COURT OF APPEAL,
SECOND DISTRICT OF FLORIDA

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TABLE OF CONTENTS

INDEX TO APPENDIX

Stricken 5-31.90

CITATIONS OF AUTHORITY

FLORIDA CASES

CASES FROM OTHER JURISDICTIONS

STATUTES AND OTHER MATERIALS

STATEMENT OF THE FACTS

For purposes of this Brief, Amicus Curiae adopts the Statement of Facts and Case contained in the Initial Briefs of Petitioners.

CERTIFIED QUESTION: WHAT IS THE PROPER METHOD OF ASSESSING FOR AD VALOREM PURPOSES INCOME-PRODUCING PROPERTY WHICH IS ENCUMBERED BY A LONG-TERM LEASE WHICH DOES NOT RETURN TO THE OWNER RENT CONSISTENT WITH THE CURRENT RENTAL VALUE FOR SIMILAR PROPERTY?

SUMMARY OF ARGUMENT

Florida real estate is taxed in fee simple. No valuation theory is lawful which results in any interest in that land escaping taxation, such as the leasehold estate enjoyed by a tenant whose contract rent is less than the current market rent for the leased space.

The decision of the Second District Court of Appeal incorrectly characterizes the leases involved in the case of *Century Village v. Walker*, 449 So.2d 378 (Fla. 4th DCA 1984) as short term leases, when in fact they were long term leases and involved a K-Mart, just as the lease in the case at bar. *Century Village* sets forth the correct rule, in harmony with this Court's decisions that all interests in land must be taxed. The Second District Court of Appeal erroneously held that "property" (i.e., in fee simple) and the owner's "leased fee" are legally synonymous.

As early as 1935, this Court has approved decisions requiring the property appraiser to use only market rent in the income approach to value. The effect of the Second District Court's opinion is to value the fee simple at less than its just (market) value, in violation of the Florida Constitution. The decision of the Second District Court of Appeal creates Constitutionally-impermissible classes of property to be assessed at less than market value in fee simple, creates exemptions not permitted by the Constitution, and results in taxation of property at a non-uniform rate. References to the Appendix herein shall be "A-(page number)".

CERTIFIED QUESTION: WHAT IS THE PROPER METHOD OF ASSESSING FOR AD VALOREM PURPOSES INCOME-PRODUCING PROPERTY WHICH IS ENCUMBERED BY A LONG-TERM LEASE WHICH DOES NOT RETURN TO THE OWNER RENT CONSISTENT WITH THE CURRENT RENTAL VALUE FOR SIMILAR PROPERTY?

The answer to this question is, "Any recognized appraisal method or combination of methods which will arrive at the market value of all interests in the property, in fee simple". This Court should proscribe any appraisal technique, such as use of contract rent rather than market rent, which results in a value of less than all interests in the real estate, or in a valuation which is less than the market value of the property in fee simple. This Court should reverse the decision of the District Court of Appeal, Second District, since its ruling is both contrary to the law previously stated by this Court and to sound appraisal practice.

Some terms will be used in this Brief which should be defined:

> *Fee Simple*: "A title in fee simple is the highest quality of estate in land known to law." *State v. Jacksonville Expressway Authority*, 135 So.2d 135 (Fla. 1962)
>
> *Leased or encumbered fee* (or landlord's interest): Rights reserved to the landlord by a lease, principally the right to be paid rent, but typically not including a right to possession. The value of the leased fee is the sum of (1) The present worth of the future net income which the lessor is to receive for the life of the lease (This is the discounted value of the income stream), plus (2) The present worth of the value of the improvements to the land and improvements made by the lessee, if any, which inure to the lessor at the end of the lease, plus (3) the present worth of the land at the expiration of the lease. Today's discounted value of the land and improvements at the expiration of the lease is called the reversion. *County of Los Angeles v. American S & L Association*, 26 Cal.App.3d 7, 102 Cal.Rptr. 439 (Cal.App. 1972).

Leasehold Interest or *Leasehold Estate*: A lease is "a conveyance by the owner of an estate to another of a portion of his interest therein for a term less than his own"; "it passes a present interest in the land for the period specified". *DeVore v. Lee*, 30 So.2d 924 (Fla. 1947). The tenant has the right to the use and occupancy of the premises during the term of the lease so long as the rent is paid, and the right to receive (or through use enjoy the benefit of) any rental income in excess of contract rent during the term of the lease. The tenant's right to occupy real estate may or may not have a value, depending on the difference between the rent reserved in the lease (contract rent) and market rent for similar leased spaces. A "leasehold bonus" is the present value of the sum, over the life of the lease, of the annual difference between market rent and contract rent. Youngman, *Defining and Valuing the Base of the Property Tax", 58 Wash.L.Rev. 713, 726 (1983).*

Contract Rent: Payment for the use of property as designated in a lease. Used to establish the fact that the actual rent designated, or contract rent, may differ from market rent. Boyce, *Real Estate Appraisal Terminology*, American Institute of Real Estate Appraisers and Society of Real Estate Appraisers, 1975, pg. 50. [Cited in 448 A.2d 947 @ 948].

Economic Rent: In appraisal practice, the term has traditionally been used as a synonym for 'market rent', i.e., the rental income that a property would most probably command on the open market, as of the effective date of the appraisal. See Market Rent. *Boyce,* @ 74.

Market Rent: The rental income that a property would most probably command on the open market as indicated by current rentals being paid for comparable space as of the effective date of the appraisal. This is preferred terminology to the term 'Economic Rent' which has traditionally been used in appraisal analysis, even though both are currently considered synonymous. *Id.* @ 136-137.

Capitalization of Income: The theory of capitalization of income into an opinion of value is predicated on the elementary formula "I/R = V", where "I" is the income to be capitalized, "R" is the capitalization or overall rate and "V" is the resulting value. *The Appraisal of Real Estate*, 9th.Ed., American Institute of Real Estate Appraisers, Chicago, 1987.

For example: A depositor in a bank receives a check at

the end of the year for $10, but does not know how much money was on deposit. The depositor knows that the money was earning interest at 10% per annum. (I) $10 / (R) .10 = "V", $100. The terms in the formula may be transposed to solve for any unknown, "I", "V" or "R". For example, if a person has $100 on deposit (V) and the amount of income received after one year (I) is $10, the interest rate (R) may be determined by the formula, "R = I/V"; 10/100 = .10 or 10%. Another investor wants to know how much money will be received if $100 is invested at 10%. The formula is now, "I = V x R". $100 x .10 = $10.

Discounting to present worth: "Near money" is worth more than "far money". Just as a bird in the hand is worth two in the bush, the right to receive one dollar today is more valuable than the value today of the right to receive the same dollar one year hence, and that right is more valuable than the right to receive the same dollar five years hence. Tables have been developed to value these rights. The higher the discount rate, the less the present right of the worth to receive the dollar in the future will be today. The "present worth of one" table for 20 years would be used for example, to compute today's value of the contract rent to be paid under a lease for twenty years. Example: If market rent for a property is $10.00 per square foot per year, and the property consists of 1,000 square feet, the market rent should be $10,000 for the year. If the contract rent under the lease is only $3.00 per square foot, the tenant would pay $3,000 for the year's rent. The economic benefit to the tenant in this example would be $7,000 for the year in question. If the tenant

had the right to occupy the property for ten years, and the 'spread' between economic and contract rent remained $7,000 per year, then the total savings enjoyed by the tenant would be $70,000. However, the right to receive a dollar one year from today is less valuable than the right to receive that dollar today. Assuming the right to $7,000 in income per year for ten years, at 12% interest, the factor from the "present worth of one per period" table is 5.650223. (To put it another way, the present worth of the right to receive $1.00 per year for ten years, at a 12% interest rate, is $5.65.) Multiplying the income of $7,000 times the factor of 5.650223 indicates that in this simple example, the tenant's leasehold estate is worth $39,552.

There are two ways to value a leased property in fee simple: (A) Value the landlord's interest in the property, assuming a contract rent of $3.00 per square foot, or $3,000 and use an appropriate capitalization rate for the value of that income stream for a ten year period. (B) Value the rest of the landlord's interest in the property of using market rent of $10.00 per square foot, and value that income from a period commencing ten years in the future to the end of the property's life. (C) Value the tenant's interest in the property, as above. (D) Add the foregoing three sums together. (A-10) The second and easier way is to use market rent, which avoids the necessity of separately valuing the leased fee and the leasehold estate. (A-10)

If a property has a value in fee simple, it is axiomatic that the sum of the leased fee and the leasehold interest will

equal the value of the property in fee simple.

For clarity, it is vital to have firmly in mind to which interests or group of interests a landowner, appraiser or court is referring when discussing "market value". When the owner of commercial rental property discusses his "property", he is usually referring to a leased fee. If he were to sell "the property", the leased fee is all he or she has for sale unless it is contemplated that the buyer will purchase the interests of any tenants whose contract rent is less than market rent. When a Florida Property Appraiser is valuing the same property, he or she values all interests in the property together, in effect arriving at the value of the property if the titleholder and all the tenants would agree to sell whatever interests they held in the real estate. An appraiser writing a report for a federally guaranteed loan is required by Memorandum 41-C of the former Home Loan Bank Board to precisely describe the interests being appraised. It is more important to carefully describe the interest or interests being valued than it is to discuss the techniques of arriving at the market value of those interests. The inquiry should first be: "Market value -- of what", then "to whom".

The District Court of Appeal, Second District, stated for example:

> *Since at the time of the assessment the lease had a remaining term, with extensions of twenty-six years, its submarket rent could not be renegotiated and raised for twenty-six years. The level of the rental income resulted in a reduction of the property's* fair market value because, since that level was submarket and could not be renegotiated for twenty-six years after the date of the assessment, a willing purchaser of the *property* on that date would have reduced his offering price on account of

> the lease. The longer property is locked into a lease calling for submarket rent, the longer the owner of the *property* must wait to receive from a willing buyer a price for the *property* not reduced by the submarket rent. 14 FLW @ 1728.

Had the District Court of Appeal used the term "leased fee" wherever the word "property" is italicized, it would have made a correct statement. Since it did not differentiate between a leased fee and fee simple, the statement is incorrect.

A. THE PROPERTY TAX IN FLORIDA IS A TAX ON ALL INTERESTS IN PROPERTY, IN FEE SIMPLE, NOT JUST ON THE LANDLORD'S LEASED FEE.

TM Florida-Ohio Realty, Ltd. Partnership (TM herein) could prove the truth of this statement by simply not paying the taxes for two years and allowing the center to be the subject of a tax deed pursuant to Section 197.502, Florida Statutes. The Pinellas County Tax Collector would sell the property at public auction, and a tax deed would convey a fee simple title, free and clear of all interests that previously existed therein, such as K-Mart's and other tenants' leasehold interests, mortgages, and the like. The purchaser at such a tax deed sale would be entitled to immediate physical possession of the property, and any tenants would be dispossessed by the Sheriff. Section 197.562, Florida Statutes. Were the leasehold interest not destroyed by a tax deed, the tenant could remain in possession.

The first decision of this Court which supports the use of market rather than contract rent in the income approach to value

is *City of Tampa v. Colgan*, 121 Fla. 218, 163 So. 577 (Fla. 1935), which held:

> By "fair market value" is meant the amount of money which a purchaser willing but not obliged to buy *the property* would pay to an owner willing but not obliged to sell it, taking into consideration all uses to which the property is adapted and might in reason be applied. ...*Donovan v. City of Haverhill*, 247 Mass. 69, 141 N.E. 564, 30 ALR 358. ... If similar property is commonly bought and sold, the price which it brings is the best test of the value of the land under consideration and the assessors need look no further. *Id.* @ 582, e.s.

The importance of this court having selected *Donovan v. Haverhill, op.cit.* as controlling authority is that it is the seminal case for the proposition that the property tax, whether to the owner or the person in possession, must be an assessment on the entire estate and not upon any interest therein, and that contract rent should be disregarded in favor of market rent. The Massachusetts court stated there:

> Manifestly the entire estate to be taxed may be made up of various tenancies, vested and contingent, as well as leasehold interests, the value of which in many cases would be impracticable to determine. It is plain a deduction of the surrender value of a long term lease from the market value of the estate, ascertained by a sale of the land free of the lease, in many instances would seriously impair the taxable valuation of the estate considered as a whole; and that, the entire estate would escape taxation to the extent of the tax upon the value of the leasehold interest to the estate for the purpose of extinguishment. We do not think a determination of the fair cash valuation of real estate requires the assessors to make such a deduction. ...In the case at bar, the use and enjoyment of the estate are not affected by the fact that the owner of the estate receives less income therefrom than he might receive if he had made other provisions and covenants as to rent and payment of taxes. *Id.* @ 565-6

Ten years after the *Colgan* case, this Court defined a "lease" as "a conveyance by the owner of an estate to another of a portion of his interest therein for a term less than his own", and that "it passes a present interest in the land for the period specified". *DeVore v. Lee*, 30 So.2d 924 (Fla. 1947). Accordingly, there can be no serious contention that a leasehold interest is not an interest in real property.

The next case of importance is *Wolfson v. Heins*, 6 So.2d 858 (Fla. 1942). A private street ran behind Mitchell Wolfson's house on Miami Beach, and he acquired title to it by a tax deed, much to the dismay of his neighbor, Mr. Heins, who sued to confirm easement rights in the property held by him through a deed of conveyance. Held, :

> Where, as in this State, the levy and assessment is on the realty itslf, regardless of the existence of estates in it, an easement is destroyed by the tax sale of the servient estate. As Thompson on Real Property, Vol 5, Perm.Ed., Sec. 2929, page 951 says, "Where the statute makes the lien for taxes a first claim on the property, superior and paramount to any and all claims and liens whatsoever, and the sale was had in conformity with all the statutory requirements, so as to invest the purchaser with the fee simple title to the land, even the claims to homestead and the inchoate right of dower will be divested. Under this rule an easement granted by the owner to a third party will be extinguished by a sale of the servient estate for non payment of taxes." The grantee of the tax deed therefore took a fee-simple title to the private street, free from any easements previously encumbering the land, and this title was conveyed to the Wolfsons. *Id* @ 861.

This Court next confirmed the proposition in *Bancroft Investment Corporation v. City of Jacksonville*, 27 So.2d 167 (Fla. 1946). Land previously owned by the United States had been sold

on the installment plan to Bancroft, and the U. S. government retained title as security for the repayment. The City of Jacksonville attempted to assess the land. This Court held:

> Under Florida taxing statutes, the levy and assessment is on the realty itself, at its full cash value, regardless of the existence of estates in it, Wolfson et al. v. Heins et ux., 149 Fla. 499, 6 So.2d 858 *Id* @ 167.
>
> ...[I]t is clear that in Florida, authorization for the taxation of separate interests in real estate does not exist, except in instances not necessary to be considered here. See Sec. 193.22, Florida Statutes 1941--"Assessment of land, timber and turpentine rights". *Id.* @ 166.

The next case of importance is *McNayr v. Claughton*, 198 So.2d 366 (Fla. 3d DCA 1967). To develop some commercial property in Miami, the owner of a 99-year leasehold built a private street. The tax assessor valued the private street at its just (market) value. The trial Court directed that it be valued according to the actual rent being paid to the fee owner. The District Court of Appeal, Third District stated:

> The plaintiff, appellee, is the holder of the leasehold. It is natural that he should be the party most interested in the tax to be assessed upon the property, inasmuch as by his lease he is bound to pay the taxes. The appellee thus proceeded upon the theory that it was his interest that was being taxed. This is not true because the law requires and assessment of the value not of one interest in the land, but of the land; that is, the assessed value of the land must represent all interests in the land. *Wolfson v. Heins*, 1942, 149 Fla. 499, 6 So.2d 858; *Stack v. City of Hoboken*, 1957, 45 N.J. Super. 294, 132 A.2d 314, *Donovan v. City of Haverhill*, 1923, 247 Mass. 69, 141 N.E. 564, 30 A.L.R.358.

This Court next dealt with the issue in *Homer v. Dadeland Shopping Center, Inc.*, 229 So.2d 834 (Fla. 1970). The taxpayer

owned a shopping center which consisted of several parcels of land. The Third District Court of Appeal had held that since some of the parcels were impressed with restrictive covenants, the existence of such covenants detracted from the value of the property, and directed an assessment to be made on the value of the property less the value of the restrictions -- i.e., a leased or encumbered fee. This Court found the taxpayer's contention to conflict with *Wolfson v. Heins, op.cit.*, and observed:

> The opinion of the District Court of Appeal in the case sub judice is based upon the theory that the encumbrances are "covenants restricting the use of land for purposes lower than its highest and best use." It was held that only the fee simple owner's interest in the real property was to be included in the tax assessment valuation, and that the value of the rights held by third parties should be excluded from that valuation.
>
> It is elementary that the tax assessment valuation must include all interests in the property except when the legislature authorizes the assessment of separate interests. See *Dickinson v. Davis*, 224 So.2d 262 (Fla. 1969).

This Court could not have more clearly expressed the fact that leasehold interests held by another should not be excluded in the valuation of "all interests in real property".

The District Court of Appeal, Third District, decided *Overstreet v. Brickell Lum Corporation*, 262 So.2d 707 (Fla. 3d DCA 1972). That case, incidentally, involved the same parcel of land as in *McNayr v. Claughton, op.cit.* The Court held:

> We express the view that the trial court erred in basing its assessment on the value of the lease, and accordingly remand for the purpose of taking testimony as to the proper assessment. It appears that the assessor did not evaluate all the interests in the property, the several leases and fee, as is required by *City of Tampa v. Colgan*,

121 Fla. 218, 163 So. 577 (1935). *Id.* @ 708.

> The error in only capitalizing the income from a lease to determine market value is apparent in the hypothetical situation where a lease is $1.00 per year for 99 years. Thus, employing the 'income approach' of evaluating real estate but using solely the capitalization of the income from that lease to determine value of the property would tend to yield an unrealistic result as to true market value for all the interests. *Id.* @ 709.

This Court specifically approved use of market rents in appraising property by the income approach to value in *Palm Corp. v. Homer*, 261 So.2d 822 @ 823 (Fla. 1972). (The issue of whether to use contract rent or market rent was not specifically before the Court in that case.) That decision is hardly "emphatic support" for use of contract rent, as suggested by the District Court of Appeal, Second District.

This Court held in *Southern Bell Telephone & Telegraph Company v. County of Dade*, 275 So.2d 4 (Fla. 1973):

> When no actual sale has occurred, Section 193.011 Fla.Stat. F.S.A. requires the assessor to place himself in the position of the parties to a hypothetical sale of *the property*, to consider all of the factors they would regard as important in fixing the price of *the property*, and to arrive at an opinion of value. *Id.* @ 8, e.s.

Once again, this Court did not order the property appraisers to value the "leased fee" or "landlord's interest", but "the property", i.e., in fee simple.

The market value test necessarily assumes a hypothetical willing seller and a hypothetical willing buyer. The reason for this is evident: The actual owner may have no desire whatsoever to sell the property. Or, through matters personal to the buyer

such as judgments, mortgage liens, injunctions or bankruptcies, the owner may have no ability to sell the property. The Courts have held that matters personal to the owner have no effect on market value. *Palm Beach Development & Sales Corp. v. Walker*, 478 So.2d 1122 (Fla. 4th DCA 1985), rev.den. 488 So.2d 831 (Fla. 1985). This includes improvident leases.

The Property appraiser in effect determines the most probable selling price were all those having interests in the property -- the owners of the leased fee and all the leaseholds together -- to sell whatever interests they held to a hypothetical buyer.

Two circuit court decisions on the point are *Arnow v. Overstreet*, 32 Fla. Supp. 106 (CC 11, 1969), aff'd per.cur. 237 So.2d 823 (Fla. 3d DCA 1970) and an unreported but almost identical decision, *Mac Corp. v. Culbertson*, aff'd per.cur. 237 So.2d 823 (Fla. 3d DCA 1970). *Arnow* holds:

> The income capitalization approach toward valuing property is one of the recognized appraisal hypotheses. However, the experts must use economic rent for if actual rent is not the equivalent of what rent the property would bring on the market, then the actual rent capitalization obviously does not represent fair market value. Thus, as in this case, where the fee owner is saddled with an unprofitable lease, the Tax Assessor must disregard the lease and value the property itself, that is, all of the interests in the property including the valuable interest held by that fortunate tenant who is paying less than economic rent. *McNayr v. Claughton*, 198 So.2d 366 (Fla. App., 1967).

In *Department of Revenue v. Morganwoods Greentree, Inc.*, 341 So.2d 756 (Fla. 1977), this Court held:

> We reaffirm the general rule that in the levy of property tax the assessed value of the land must represent all the interests in the land. *Homer v. Dadeland Shopping Center, Inc.*, 229 So.2d 834 (Fla. 1970); *McNayr v. Claughton*, 198 So.2d 366 (Fla.3d DCA 1967). This means that despite the mortgage, *lease, or sublease* of the property, the landowner will still be taxed as though he possessed the property in fee simple. The general property tax ignores fragmenting of ownership and seeks payment from only one "owner". See 1 Bonbright, Valuation of Property, 495-96 (1st ed. 1937). An encumbrance or restriction such as an easement will not per se reduce the assessment value of land simply because the owner has been divested of some proprietary interest. \4 *Id.* @ 758.

The case this Court cited in Footnote 4, *People ex rel. Gale v. Tax Commission of City of New York*, 17 A.D.2d 225, 233 N.Y.S.2d 501 (N.Y. A.D. 1963) is one of the leading cases holding that market rent controls to the exclusion of contract rent in the income approach to value.

The Second District Court of Appeal distinguished *Morganwoods Greentree, op.cit.*, by pointing out that leases were not involved in that case. A leasehold estate is an "interest in land". *DeVore v. Lee, op.cit. Morganwoods Greentree* held that all interests in land must be taxed. Therefore, *Morganwoods Greentree* is authority for the proposition that use of contract rent, which fails to value the leasehold estate, is not a lawful valuation technique for tax assessment purposes.

This Court in *Spanish River Resort Corp. v. Walker*, 526 So.2d 677 (Fla. 1988), held that the Property Appraiser is required to assess all of the sticks in the bundle of rights that constitute real estate. The argument was made that the only way to assess property subject to a time share plan is to assess just

the land and buildings, giving no credence to the "bundle of rights". And, in *Oyster Pointe Resort Condominium Assoc., Inc. v. Nolte*, 524 So.2d 415 (Fla. 1988), this Court held that the Property Appraiser was not required to deduct a developer's marketing and other costs; these were necessarily included in the "market (just) value" of real estate.

The Third District Court of Appeal next addressed the point in *Valencia Center, Inc. v. Bystrom*, 432 So.2d 108 (Fla. 3d DCA 1983), rev.den. 444 So.2d 418 (Fla. 1984):

> This argument [i.e., use of contract rent] overlooks two things. First, the property assessed is the unencumbered fee simple. Although Valencia Center, the lessor, is the taxpayer, the assessment must include the interest of all the lessees; the whole "bundle of rights" in the real property. *Homer v. Dadeland Shopping Center, Inc.*, 229 So.2d 834 (Fla.1970); *McNayr v. Claughton*, 198 So.2d 366 (Fla.App.1967). See also *Staninger v. Jacksonville Expressway Authority*, 182 So.2d 483 (Fla.1st DCA 1966); *Arnow v. Tax Assessor*, 32 Fla.Supp. 106 (11th Cir.1968).
>
> Secondly, if the lessor's interest in the property is now reduced by virtue of a lease which is now disadvantageous to itself, it follows that the lessees' interests are all the more valuable. The present market would contemplate the totality of the interests and a willing buyer would offer a willing seller (or sellers) a figure based on the lowered value of the encumbered property to the lessor plus the increased value (a premium) for the interest of the lessees.
>
> The appraiser's job, however, is not to assess the bundle of rights in a piecemeal fashion. *Id.* @ 111.

With this Court's opinion in *Valencia Center, Inc. v. Bystrom*, 543 So.2d 214 (Fla. 1989), this Court came full circle in relying on *City of Tampa v. Colgan, op.cit.* This Court specifically held that the assessment should not be decreased because of a below-market lease to Publix:

> Here the overall interest consists of two parts: the interest remaining in the hands of the owner-lessor, Valencia, and the interest held by the lessee, Publix. The amount a willing buyer would pay for the "fee simple" equals the value of both the lessor's and lessee's interests. The owner in this case, Valencia, has simply transferred a large part of the property's value to the lessee. Failing to consider the transferred interest would result in an assessment below fair market value. *Id.* @ 217.

This Court clearly understands the difference between a "leased fee" and "fee simple". The direction to the state's Property Appraisers is clear -- value all interests together in fee simple, using market rent.

In order to support the opinion of the District Court of Appeal, Second District, TM must necessarily argue that leasehold interests in privately owned property are not subject to taxation. TM could point to *Dade County v. Pan American World Airways, Inc.*, 275 So.2d 505 (Fla. 1973). That case only deals with the possibility of separate taxation of leasehold estates in publicly owned lands. *Walden v. HIllsborough County Aviation Authority*, 375 So.2d 283 (Fla. 1979), noted that the *Pan Am* case, *op.cit.* is no longer good law. This Court has never held that leasehold estates in privately owned property are not taxable as real estate.

B. THE DISTRICT COURT OF APPEAL, SECOND DISTRICT, MIS-CHARACTERIZED *Century Village v. Walker*, 449 So.2d 378 (Fla. 4th DCA 1984), rev.den. 458 So.2d 271 (Fla. 1984).

Amicus Curiae has asked this Court to take judicial notice of the Final Judgment of the Circuit Court in *Century Village v. Walker*, and the Property Appraiser's Motion for Summary Judgment in that case. The Affidavit which is attached to the Motion for Summary Judgment is an excellent short course in proper valuation of income-producing property that is encumbered by long-term leases. The Final Judgment at A-1-5 of the Appendix herein recites that the leases involved were "long term". This is distinctly at variance with the Second District's observation: :

> [W]e conclude that that case [*Century Village*], in significant contrast to this case, is not shown to have involved a long-term lease and, for the reasons indicated above and further explained below, cannot have soundly reached the result it did unless it involved a short-term lease. 14 FLW @ 1731.
>
> ...While there is language to that effect in *Century Village* and *Morganwoods Greentree*, none of the leases involved in *Century Village*, in contrast to the lease in this case, was shown to have been a long-term lease (and it may be concluded that none was a long-term lease) /7 FN: One reason is that for present purposes the correctness of the decision in that case is assumed. Accordingly, it is assumed that that decision was not to penalize unfairly a property owner, as did the asssessment in this case, who could not within a relatively short time shift the burden of increased taxes to the party benefitting from what caused that burden. ...Furthermore, as is indicated above and is further explained below, an assessment resulting from a disregard of the income approach for property subject to a below-market lease, as in *Century Village*, could only for such property subject to a short-term lease fulfill the requirement that an assessment not exceed fair market value.

The Second District also is incorrect in its statement at 14 FLW 1731 that the Palm Beach County Property Appraiser disregarded the income approach in assessing the shopping center which was involved in the Century Village case. See the Affidavit of Robert Lucas at A-11-12. There is a big difference in "not using the income approach" and "applying the income approach, but using market rents". The former is not permitted, the latter is the only way to assess all interests in the property unless the Property Appraiser adds the value of the leasehold interest to the value of the leased fee derived through the use of contract rents.

The Petition to the 1981 Property Appraisal Adjustment Board of Palm Beach County, which was incorporated into Mr. Lucas' Affidavit at A-15-19 shows that the leases in force as of January 1, 1981, were as follows:

Tenant	Space Rented Square Feet	Rent/SF	Expiration Year Including options
K-Mart (!)	65,600	$1.20	2001
Pantry Pride	26,000	3.25	2009
Gray Drug Stores	9,300	2.70	1998
G. Fried	10,300	2.80	1988
Total	111,400	2.80 average	
Total in center	157,700		

It is obvious from this that the burden of increased taxes could not be renegotiated until the end of the century, contrary to the Second District's language at 14 FLW 1732.

The Second District seems concerned about the inability of

a landowner to pass increased taxes along to its tenants. Only the laws of supply and demand and the bargaining power of landlords and tenants prevent the landlord from completely passing property taxes through to the tenant. It is not the function of the property appraiser nor the courts to relieve landowners from the burdens caused by misjudging the amount of property taxes in the future. As one wag expressed it, "Put all your money in taxes... it's the only thing sure to go up!"

The decision in this case is not distinguishable from *Century Village*, and is in hopeless conflict with that opinion.

Numerous appraisal texts support the proposition that one must use market (economic) income rather than contract rent to value all interests together in land. As the Court said in *Parkview Village Associates v. Borough of Collingswood*, 297 A.2d 842 (N.J. Super. 1972):

> It is of course settled that gross rental income for purposes of applying the capitalized income approach to valuation of property is to be taken at "fair rental value", professionally termed "economic" rent or income, if that differs from current actual rental. New Brunswick v. State of N.J. Div. of Tax Appeals, supra, 189 A.2d 702; American Institute of Real Estates Appraisers, *The Appraisal of Real Estate* (1967), p.227 et seq.; International Association of Assessing Officers, *Assessing and the Appraisal Process* (4 Ed. 1972), pp.82, 172; Kahn, Case & Schimmel, *Real Estate Appraisal and Investment* (1963), p.103 et seq.; Ring, *The Valuation of Real Estate* (1970), p.208.

See the language from *The Real Estate Professional*, Shenkel, Dow Jones-Irwin 1976, included in the Appendix at

A-20-21.

Numerous decisions from other States are harmonious with this Court's decisions that the property tax is on all interests in property, not just the leased fee estate. These decisions fall into three groups. The distinct minority position is that in applying the income approach to value, the property appraiser should use (and not just consider) the actual income from the property. Obviously this results in the tenant's leasehold interest escaping taxation. The Second District Court of Appeal placed great reliance on the Supreme Court of Michigan's case, *CAF Investment Co. v. State Tax Commission*, 392 Mich. 442, 221 N.W.2d 588 (Mich. 1974) and *CAF Investment Co. v. Saginaw Township*, 410 Mich. 428, 302 N.W.2d 164 (Mich. 1981). That Court concluded that when the income approach to value was used to value property encumbered by a long term, unfavorable lease, the statute then in effect required that the actual income of the property be used. See, *Uniroyal, Inc. v. City of Allen Park*, 138 Mich.App. 156, 162, 360 N.W.2d 156 (Mich. 1984). The reaction of the Michigan legislature was 1982 P.A. 539, deleting ss. 7.27(4) and (5), M.S.A. The Michigan statute presently provides that the income to be capitalized is "the ordinary, general and usual economic return realized from the lease or rental of property negotiated under current, contemporary conditions between parties equally knowledgable and familiar with real estate values". The actual income generated by the lease or rental of property shall not be the controlling indicator of its cash value in all cases. A reading of the *CAF* case demonstrates that the highest Court in

Michigan did not understand the difference between a leased fee and fee simple. The dissent in *CAF II* pointed out that the decision does not comport with the decision of any other jurisdiction in the United States which has considered the question. 302 N.W.2d @ 185.

At 14 FLW 1729-30, the District Court of Appeal, Second District, discusses and places heavy reliance on *Folsom v. County of Spokane*, 106 Wash.2d 760, 725 P.2d 987 (Wash. 1986) ("Folsom I" herein), and *Folsom v. County of Spokane*, 111 Wash.2d 256, 759 P.2d 1196 (Wash. 1988) (Folsom II). These two cases stand for exactly the opposite proposition than that for which they were cited.

Folsom I held, in the words of the Court in *Folsom II*:

> Folsom I held, in brief, that the assessor's valuation ought to reflect the value held by both the lessor and the lessee. The court therefore affirmed the trial court's decision to capitalize contract rent, but remanded with directions to add the value of the "leasehold bonus" or "surrender value" of the lease. The court defined this as the "value enjoyed by the lessee when market rent rises above contract rent;" in other words, the amount the lessee would receive were he to sublease or assign the lease at a profit. *Folsom I* @ 768. ...The Supreme Court of the State of Washington filed its opinion on October 2, 1986 and remanded the proceedings for determination of the assessment by including in the determination the "leasehold bonus". The Court in defining a leasehold bonus stated that this bonus is a value that the lessee enjoys when the market rent rises above the contract rent.

Folsom II held:

> [3] We conclude that Folsom I is not clearly erroneous. The opinion was ambiguous in one respect, however. We clarify the ambiguity, but affirm the holding of our prior opinion. Folsom I holds that both the lessor's and the lessee's interests should be valued in an assessment under RCW 84.40.030. The court determined that this should be

done by calculating separate values for those two interests and then combining those values in a single assessment. The County and amici contend that this method violates the "unit assessment rule". They contend that only valuation by an estimation of "fair market value" complies with RCW 84.40.030. The conclusion of Folsom I, that valuing both the lessee's and the lessor's interests does not in itself violate the unit assessment rule, is not clear error.

...Nevertheless, we believe that, in valuing property subject to a long-term lease, contract rent should be presumed the proper base figure for valuation in the absence of clear, convincing evidence that market rent exceeds contract rent. If market rent exceeds contract rent, the appropriate method of valuation is to add the present value of the leasehold bonus to the capitalized value of contract rent.

...Accordingly, we affirm the trial court's order to the extent the court directed Spokane County to capitalize contract rent for valuation purposes, but reverse and remand the case with direction to add the present worth of the difference between the capitalized value of contract rent and market rent to the value obtained by the capitalization of contract rent. Folsom I, at 769, 725 P.2d 987. It is undisputed that market rent exceeds contract rent in this case. Under the first, general rule therefore, the property in question should be valued by adding the present value of the leasehold bonus to the capitalized value of the contract rent.

...We remand the cause to the trial court for the calculation of the value of the property. The assessor should, in utilizing a capitalization of market rent approach for appraising the property, consider the value of the fee simple to be the sum of the lessor's and lessee's interests, though the assessor need not appraise those interests separately to arrive at a value for the unit. The lessor's interests will consist of (a) the right to receive contract rent, (b) the right of reversion, and (c) the right if any of improvements at the end of the lease; the lessee's interests will include (a) the right to occupy and (b) the right to the difference, if any, between contract and a higher (if so) market rent, and (c) any interest in improvements at the conclusion of the lease. In any event, the sum of the parts cannot exceed or be less than the value of the whole. *The ultimate appraisal should endeavor to arrive at the fair market value of the property as if it were an unencumbered fee.* (e.s.)

It is most difficult to understand how the Second District Court of Appeal reached its conclusion from the *Folsom County* cases at 14 FLW @ 1729 that only the lessor's interests are to be taxed.

Townsend v. Town of Middlebury, 134 Vt. 438, 365 A.2d 515 (Vt. 1976) is sui generis in Vermont. The case has never been cited by any court except the Second District in the case at bar. The Court adopted a unique position: The existence of an option to purchase the property for $20,000 by Getty Oil Company controls its market value! This conclusion is clearly wrong. The existence of an option simply means that the value of the owner's interest can not exceed the option price, for the holder of the option has the right to exercise it and thereby acquire the property, even from a subsequent purchaser. While the Court recites that market value is what a buyer would be willing to pay for "the property", it does not clearly think through the difference between a leased fee and "the property" in fee simple. *Palm Beach Development & Sales v. Walker, op.cit.* is contrary to the *Townsend* decision.

The Second District could have relied on several cases which prescribe use of contract rent. The first of these is *Northwest Land & Development Co. v. State Tax Appeal Board*, 661 P.2d 44 (Mont. 1983), which prescribes use of contract rather than market rent.

Wisconsin's highest court decided *Darcel, Inc. v. City of Manitowoc Board of Review*, 137 Wis.2d 623, 405 N.W.2d 344 (Wis.

1987), reh.den. 434 N.W.2d 786 (Wis. 1987). The facts are that the corporation owned a shopping center known as the Mid-Cities Mall. Unfavorable leases negotiated in 1968 encumbered the property for years in the future. Four months before the valuation, the instant stockholders of Darcel purchased their stock for $4,100,000 and after this purchase, invested $30,000 in the shopping center. The assessment was $5,231,900. The highest court of Wisconsin did not appreciate the difference between a leased fee and fee simple:

> Since the Board initially aserts that not all the property rights were transferred, it is necessary to determine what those property rights were before the sale. First, the prior owner had fee simple of all the actual real estate, including the mall area and parking areas. It is clear that the areas in fee simple were purchased in an arms-length sale. Second, the prior owner had leased certain areas of the property. By doing to, the right of occupation of the leasehold was contracted away for a right to a certain amount of rent. In addition, the prior owner retained the reversion of the leasehold estate. It is clear that the new owner received (1) the same right to collect rent that the prior owner had retained as a result of entering the lease agreements, and 2) the reversion of the leasehold estate. This, too, was part of an arms-length transaction. Third, all other encumbrances (such as easements) that might have been present on the property were transferred. These are not at issue in the present action.
>
> From this analysis, it is clear that all of the "bundle of rights" that made up the property were transferred in this sale. The new owners received exactly those rights possessed by the former owners.
>
> The board's complaint, however, is that the prior owners did not own the "full value" of the tenant's leasehold. By operation of the rental marketplace, like the marketplace for real estate itself, the value of the tenant's leasehold has increased independent of the contract itself. This increased value is evidenced by the difference between the rent specified by the long-term lease and "market" rental. Since the prior owners never "owned" this increased value, the prior owners could not transfer this value to the new owners, even though all the

> rights that made up the property were transferred. Although the rights themselves were transferred, some of the value of the rights were not transferred. therefore, the argument is the price paid by the new owners to the prior owners did not reflect the true value of all of the rights in the property.

Had the Wisconsin court used the term "leased fee" instead of "the property", its opinion would have been correct. It is obvious that since the tenants in possession did not sell their valuable leasehold interests to the new owners, all of the "bundle of rights" were not transferred. The Wisconsin court thus placed 100% weight on the sale of the leased fee and ordered that to be the assessment. Florida law does not agree: A sale of the subject property does not establish its value. *Walker v. Trump*, ____ So.2d ____, Case No. 88-1309 (Fla. 4th DCA 1989).

Clarke Associates v. County of Arlington, 369 S.E.2d 414 (Va. 1988) relies on *Nassif v. Board of Supervisors of Fairfax County*, 345 S.E.2d 520, 231 Va. 472 (Va. 1986). The case involved four office buildings subject to long term leases to the federal government. The case held that the assessment fell since the local tax assessor did not use contract rent. There is some contrary authority in Virginia. In *Board of Supervisors of Fairfax County v. Donatelli & Klein, Inc.*, 228 Va. 620, 325 S.E.2d 344 (Va. 1985), the Court held that the subject of taxation was the property in fee simple, not the owner's reversion after expiration of the lease. Also contra the *Clarke Associates, op.cit.* case is *R F & P. Ry. Co. v. Commonwealth*, 124 S.E.2d 206 (Va. C.A. 1962).

The overwhelming majority of jurisdictions in the United States are in harmony with this Court's holdings that the property tax is to be based on the value of all interests in the property valued together, ignoring the contract rent and capitalizing market rent into an opinion of value:

Arizona: *Pima County v. Trico Electric Co-operative*, 15 Az.App. 517, 489 P.2d 1219 (Az. 1971)

California: *DeLuz Homes v. County of San Diego*, 290 P.2d 544 (Cal. 1955), *Clayton v. County of Los Angeles*, 102 Cal.Rptr. 687 (CA Cal. 1972),

Connecticut: *Federated Department Stores v. Board of Tax Review, City of Stamford*, 291 A.2d 715 (Conn. 1971); cf. *Somers v. City of Meriden*, 174 A. 184 (Ct. 1934), holding that the assessor could "consider" actual income, even though it was not controlling.

Georgia: *Martin v. Liberty County Board of Tax Assessors*, 152 Ga.App. 340, 262 S.E.2d 609 (Ga. App. 1979),

Iowa: *Oberstein v. Adair County Board of Review*, 318 N.W.2d 817 (Ia. 1982), *I.C.M. Realty v. Woodward*, 433 N.W.2d 760 (Iowa App. 1988).

Kentucky: *Jefferson County Property Valuation Administrator v. Ben Schore Company*, 736 S.W.2d 29 (Ky. 1987)

Massachusetts: *Donovan v. City of Haverhill*, 247 Mass. 69, 141 N.E. 564 (Mass. 1923) [This case has been cited approvingly throughout the country.] *Pepsi-Cola Bottling Co. v. Board of Assessors of Boston*, 491 N.E.2d 1071 (Mass. 1986), *Alstores Realty Corp. v. Board of Assessors of Peabody*, 391 Mass. 1276, 460 N.E.2d 1276 (Mass. 1988), *Irving Saunders Trust v. Board of Assessors of Boston*, 26 Mass.App. 838, 533 N.E.2d 234 (Mass. App. 1989),

New Hampshire: *Demoulas v. Town of Salem*, 116 N.H. 775,367 A.2d 588 (N.H. 1976), *Coliseum Vickerry Realty Co. Trust v. City of Nashua*, 126 N.H. 368, 493 A.2d 460 (N.H. 1985), *Appeal of Net Realty Holding Trust*, 519 A.2d 313 (N.H. 1986).

New Jersey: *Parkview Village Associates v. Borough of Collingswood*, 297 A.2d 842 (N.J. 1972), *Bonner Properties v. Franklin Tp. Plan.Bd.*, 449 A.2d 1350 (N.J. Super.L. 1982), *Glen*

Wall Associates v. Wall Township, 99 N.J. 265, 491 A.2d 1247 (N.J. 1985),

New York: *Westbury Drive-In v. Board of Assessors of Nassau County*, 333 N.Y.S.2d 361 (N.Y.Sup. 1972), *People v. Tax Commission of City of New York*, 17 A.D.2d 225, 233 N.Y.S.2d 501 (A.D.N.Y. 1962), *Marine Midland Properties Corp. v. Srogi*, 91 A.D. 824, 458 N.Y.S.2d 108 (N.Y. 1982), *Barnum v. Srogi*, 54 N.Y.2d 896, 444 N.Y.S.2d 914, 429 N.E.2d 421 (N.Y. 1981), *McCrory Corp. v. Srogi*, 101 A.D.2d 696, 476 N.Y.S.2d 37 (A.D.N.Y. 1984), *F. W. Woolworth Corp. v. Srogi*, 92 A.D. 736, 461 N.Y.S.2d 97 (A.D.N.Y. 1983),

North Carolina: *Matter of Southern Railway Co.*, 313 N.C. 177, 328 S.E.2d 235 (N.C. 1985), *Matter of Greensboro Office Partnership*, 72 N.C. App. 635, 325 S.E.2d 24 (N.C. App. 1985), rev.den. 330 S.E.2d 610 (N.C. 198*),

Ohio: *Alliance Towers v. Stark County Board of Review*, 523 N.E.2d 826 (Ohio 1988)

Oregon: *Swan Lake Moulding Co. v. Department of Revenue*, 257 Or. 622, 480 P.2d 713 (Or. 1971)

Rhode Island: *Kargman v. Jacobs*, 113 R.I. 696,325 A.2d 543 (R.I. 1974);

South Dakota: *Yadco, Inc. v. Yankton County*, 89 S.D. 651, 237 N.W.2d 665 (S.D. 1975),

Virginia: *R, F & P R Co. v. Commonwealth*, 203 Va. 294, 124 S.E.2d 206 (Va. 1962), but see *infra*.

Washington: *Folsom v. County of Spokane*, 725 P.2d 987 (Wash. 1986). [This case also involved a K-Mart on long term leases.]

See annotation, 96 A.L.R.2d 666.

A small minority of jurisdictions have held that the Property Appraiser must at least consider the actual income from the property, even though those states approve the making of assessments based one hundred percent on market (economic) rent rather than contract rent. See, e.g.:

Illinois: *Application of County Collector of Pike County*, 88 Ill.Dec. 311, 133 Ill.App.3d 142, 478 N.E.2d 626 (Ill. App. 1985)

Minnesota: *Crossroads Center v. Commissioner of Taxation,*, 286

Minn. 440, 176 N.W.2d 530 (Minn. 1970)

North Carolina: *In Re Property of Pine Raleigh Corp.*, 258 N.C. 398, 128 S.E.2d 855 (N.C. 1963) but see cases cited *supra*.

Texas: *Rowland v. City of Tyler*, 5 S.W.2d 756 (Tex.Com.App. 1928)

Virginia: *Board of Supervisors of Fairfax County v. Nassif*, 223 Va. 400, 290 S.E.2d 822 (Va. 1982)

The Maryland Court of Appeals decided *Supervisor of Assessments of Allegany County v. Ort Children Trust Four*, 448 A.2d 947 (Md. 1982). The property was leased to Sears, Roebuck & Co. as a warehouse in 1962 with an initial term of 20 years, with options to renew until the year 2003. The initial assessment was $338,850. The owner's appraiser valued the income stream based on contract rent and added the value of the reversion, for a value of $80,700. The Tax Court lowered the assesment to $246,850, without stating its reasoning. The Court of Appeals held that it was not error to give some regard to the contract rent, as the tax court apparently did. The Court confuses sale of a leased fee with sales of property in fee simple as establishing market value.

C. THE DISTRICT COURT OF APPEAL'S DECISION RENDERS SECTION 196.011, FLORIDA STATUTES, UNCONSTITUTIONAL. IT CREATES CLASSES OF PROPERTY NOT AUTHORIZED BY THE CONSTITUTION TO BE ASSESSED AT LESS THAN JUST VALUATION, AND RESULTS IN EXEMPTION OF REAL PROPERTY NOT AUTHORIZED BY THE CONSTITUTION.

The effect of the Second District's decision is to create a class of property to be assessed on a different basis than other property. This Court has held that since the 1968 Constitution, the Legislature has no power to do this except for the four classes of property specifically described therein. *Interlachen Lake Estates, Inc. v. Snyder*, 304 So.2d 433 (Fla. 1974), *I.T.T. Community Development Corp. v. Seay*, 347 So.2d 1024 (Fla. 1977).

Section 196.011(1), Florida Statutes, provides that unless expressly exempted, all real property in Florida is subject to taxation. Not to value the leasehold estate would create an exemption for taxqation for such interests in land. This Court held in *Archer v. Marshall*, 355 So.2d 781 (Fla. 1978) that the Legislature is without authority to grant an exemption from taxes where the exemption has no constitutional basis. *Id* @ 784. The holding of the Second District Court of Appeal effectively nullifies Section 196.011, F.S. as it pertains to real property encumbered with long term leases at less than market rent.

If shopping centers were to be valued according to their contract rent, two centers across the street from each other would be appraised at different values if one had a serious market rent problem and the other were leased at market rents. This would violate the "uniformity of taxation" provisions of Art. VII, Sec. 2, Const.Fla. 1968. This Court held in *Gallant v. Stephens*, 358

So.2d 536 (Fla. 1978) @ 541 that the "uniformity of taxation" provisions of Art. VII, Sec. 2 apply to the properties being assessed rather than the rates of the taxing bodies.

CONCLUSION

The District Court of Appeal, Second District, requires the Property Appraiser to apply below-market contract rent in the valuation of income-producing real property. The Palm Beach County Property Appraiser respectfully suggests that there are two solutions to the question certified by the Second District Court of Appeal. The first solution is to permit the Property Appraiser to value the "leased fee" by its contract rent and reversion, then add to that the value of the "leasehold interest" for the tenant paying less than market rent. This is cumbersome, at best. The second, and better solution, is to hold that any appraisal technique that results in the market value of all interests in the property together is a lawful technique to be applied by the various Property Appraisers of Florida. In the case of income producing property subject to below market leases, the Property Appraiser should be permitted to apply the "direct sales comparison" approach, the "cost approach", or the "income approach" using market rents and typical expenses. Any one of these techniques will value all interests in the property, in fee simple.

This Court should reverse the decision of the District Court of Appeal, Second District.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Initial Brief of Amicus Curiae and Appendix was served by mail this 19th. day of February, 1990, on SUSAN H. CHURUTI, County Attorney of Pinellas County, 315 Court Street, Clearwater, Florida 34616; ROBERT E. V. KELLEY, JR., Rydberg, Goldstein & Bolves, P.A., 220 E. Madison Street, Suite 724, Tampa, FL 33602; Attorneys for Pinellas County Property Appraiser; HON. ROBERT BUTTERWORTH, Attorney General, C/O Tax Section, Room LL-04 The Capitol, Tallahassee, FL 32399-1050, Attorneys for State of Florida, Department of Revenue; ROBERT A. GINSBURG, Esq., Dade County Attorney, Metro-Dade Center, Suite 2810, 111 N.W. 1st. Street, Miami, Florida, 33128; JOHN G. FLETCHER, ESQ., 7600 Red Road, Suite 304, South Miami, Florida 33143, and KENT G. WHITTEMORE of Whittemore & Ramsberger, P.A., One Beach Drive, S.E., Suite 205, St. Petersburg, FL 33701, Attorney for Respondent.

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