

12-913
TAX TYPE: PROPERTY TAX-LOCALLY ASSESSED
TAX YEAR: 2011
DATE SIGNED: 4-26-2013
COMMISSIONERS: D. DIXON, M. CRAGUN, R. PERO
EXCUSED: B. JOHNSON

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. BOARD OF EQUALIZATION OF DAVIS COUNTY, STATE OF UTAH, Respondent.	INITIAL HEARING ORDER Appeal No. 12-913 Parcel No. ##### Tax Type: Property Tax / Locally Assessed Tax Year: 2011 Judge: Chapman
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This Order may contain confidential "commercial information" within the meaning of Utah Code Sec. 59-1-404, and is subject to disclosure restrictions as set out in that section and regulation pursuant to Utah Admin. Rule R861-1A-37. Subsection 6 of that rule, pursuant to Sec. 59-1-404(4)(b)(iii)(B), prohibits the parties from disclosing commercial information obtained from the opposing party to nonparties, outside of the hearing process.

Pursuant to Utah Admin. Rule R861-1A-37(7), the Tax Commission may publish this decision, in its entirety, unless the property taxpayer responds in writing to the Commission, within 30 days of this notice, specifying the commercial information that the taxpayer wants protected. The taxpayer must mail the response to the address listed near the end of this decision.

Presiding:

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: REPRESENTATIVE FOR TAXPAYER-1, Representative
 REPRESENTATIVE FOR TAXPAYER-2, Current Owner
For Respondent: RESPONDENT-1, from the Davis County Assessor's Office
 RESPONDENT-2, from the Davis County Assessor's Office

STATEMENT OF THE CASE

TAXPAYER ("Petitioner" or "taxpayer") brings this appeal from the decision of the Davis County Board of Equalization ("County BOE"). This matter came before the Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5, on December 3, 2012.

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At issue is the fair market value of a commercial office building as of the January 1, 2011 lien date. The subject property is located at ADDRESS in CITY, Utah. The County BOE reduced the \$\$\$\$ value at which the subject property was originally assessed for the 2011 tax year to \$\$\$\$\$. The taxpayer asks the Commission to reduce the subject's value to \$\$\$\$\$. The County asks the Commission to sustain the subject's current value of \$\$\$\$.

APPLICABLE LAW

Utah Code Ann. §59-2-103(1) provides that “[a]ll tangible taxable property shall be assessed and taxed at a uniform and equal rate on the basis of its fair market value, as valued on January 1, unless otherwise provided by law.”

UCA §59-2-102(12) defines “fair market value” to mean “the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.”

UCA §59-2-1006(1) provides that “[a]ny person dissatisfied with the decision of the county board of equalization concerning the assessment and equalization of any property, or the determination of any exemption in which the person has an interest, may appeal that decision to the commission”

For a party who is requesting a value that is different from that determined by the County BOE to prevail, that party must: 1) demonstrate that the value established by the County BOE contains error; and 2) provide the Commission with a sound evidentiary basis for reducing or increasing the valuation to the amount proposed by the party. *Nelson v. Bd. of Equalization of Salt Lake County*, 943 P.2d 1354 (Utah 1997); *Utah Power & Light Co. v. Utah State Tax Comm’n*, 590 P.2d 332, (Utah 1979); *Beaver County v. Utah State Tax Comm’n*, 916 P.2d 344 (Utah 1996); and *Utah Railway Co. v. Utah State Tax Comm’n*, 5 P.3d 652 (Utah 2000).

DISCUSSION

The subject property is comprised of ##### acres and a “Class B” office building that was primarily built in YEAR-1 (a small addition was built in YEAR-2). The office building is two stories in height and is known as the NAME OF BUILDING. The office building contains ##### square feet of rentable space.

In 2007, the subject property was purchased for \$\$\$\$\$, at which time the building was 94% occupied (6% vacant). The subject property was foreclosed on in December 2010, the month prior to the 2011 lien date at issue in this appeal. The taxpayer had the subject property appraised as of January 17, 2011. As of this date, the subject property’s vacancy rate had increased to 35% (up from 6% vacancy in 2007).¹ In this appraisal, the market value of the subject’s “leased fee interest” value was estimated to be \$\$\$\$\$, and the subject’s “disposition value” for a quick or distressed sale of its leased fee interest was estimated to be \$\$\$\$\$. In reaching the leased fee interest market value of \$\$\$\$\$, the taxpayer’s appraisal determined a “stabilized value” based on a 7.5% stabilized vacancy rate, the deducted short-term losses associated with the subject’s 27.5% of excess vacancy (the 35% actual vacancy rate minus the 7.5% stabilized vacancy rate).

Taxpayer’s Information. After the subject property was foreclosed on and after the January 17, 2011 appraisal was prepared, the subject property was marketed for sale at \$\$\$\$\$. It is unclear when the property was listed for sale. In October 2012, almost two years after the 2011 lien date, the subject property was sold to its current owners for \$\$\$\$\$. By the time of subject property sold in October 2012, its vacancy rate had increased to 48% (up from 35% in January 2011). On the basis of the October 2012 sales price, the taxpayer asks the Commission to reduce the subject’s 2011 value to \$\$\$\$\$.

The new owners’ \$\$\$\$\$ purchase price from October 2012 is not a convincing “fair market value” for the subject property as of the January 1, 2011 lien date. First, the October 2012 sales occurred almost two

1 The 35% actual vacancy rate included some space that was not yet vacant, but for which the tenants had given notice that they were vacating their spaces prior to the 2011 lien date.

years after the 2011 lien date and at a time when the subject's vacancy rate was higher than it was in January 2011. Second, the \$\$\$\$ purchase price involved a distressed, foreclosure property. Section 59-2-103(1) provides that a property shall be taxed at its "fair market value" for purposes of property taxation. Section 59-2-102(12) defines "fair market value" as "the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts." Foreclosure sales involve sellers who are generally under some compulsion to sell. As a result, the price at which such a seller will sell may be different from "fair market value." Third, within three weeks of the lien date, an appraisal obtained by the taxpayer shows the subject's "market value" to be \$\$\$\$.

The taxpayer, however, presents some additional evidence to suggest that the taxpayer's appraisal's estimate of value at \$\$\$\$ is too high. The taxpayer proffered that in April 2011, one commercial real estate broker estimated that the subject property would sell for a price between \$\$\$\$ and \$\$\$\$, depending upon the length of the marketing period. The taxpayer also proffered that in January 2012, another broker estimated that the subject property would sell for a price between \$\$\$\$ and \$\$\$\$.

Furthermore, the taxpayer proffered a Real Estate Assessment Analysis ("analysis") prepared by its representative, REPRESENTATIVE FOR TAXPAYER. In his analysis, REPRESENTATIVE FOR TAXPAYER estimated the subject's value, as of the January 1, 2011 lien date, to be \$\$\$\$. REPRESENTATIVE FOR TAXPAYER used an income approach to derive this value. His income approach is similar to the one found in the taxpayer's appraiser except for two major differences, specifically: 1) REPRESENTATIVE FOR TAXPAYER used a lease rate of \$\$\$\$ per square foot instead of the \$\$\$\$ per square foot lease rate used in the appraisal; and 2) REPRESENTATIVE FOR TAXPAYER used a 15% stabilized vacancy rate and did not derive and subtract short-term losses associated with the excess vacancy,

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whereas the taxpayer's appraiser used a 7.5% stabilized vacancy rate and derived and subtracted short-term losses associated with the excess vacancy.

The income approach in the taxpayer's appraisal is more convincing than the income approach prepared by REPRESENTATIVE FOR TAXPAYER. The first difference between REPRESENTATIVE FOR TAXPAYER income approach and the taxpayer's appraisal's income approach involves the lease rates they used. REPRESENTATIVE FOR TAXPAYER derived a \$\$\$\$ lease rate from leases signed near the lien date, many of which included free rent or temporary rent reductions. The taxpayer's appraiser, on the other hand, determined that the "market rent" as of the lien date was \$\$\$\$ per square foot and used the subject's actual lease rate of \$\$\$\$ per square foot in its income approach. The taxpayer's appraisal persuasively explained why the free rent given near the lien date would be temporary and should not be incorporated into an income approach into perpetuity.

The second difference involves REPRESENTATIVE FOR TAXPAYER decision to use a higher vacancy rate of 15% and not to derive and subtract the short-term rent losses associated with the subject's excess vacancy. The taxpayer's appraiser persuasively explained that the subject's stabilized vacancy rate to be expected over the long term would be closer to 7.5% and would not be the higher vacancy rates seen in the market during 2010. His conclusion appears to be supported by the facts that the subject property had a vacancy rate of 6% in 2007 and less than 11% immediately prior to the 2011 lien date. As of the lien date, it would not be expected that the subject's perpetual vacancy rate would be at least 15%. For these reasons, the taxpayer's appraisal's income approach is more convincing than REPRESENTATIVE FOR TAXPAYER income approach, and the \$\$\$\$ value estimated in the taxpayer's appraisal is more convincing than the various values proffered by the taxpayer at the hearing.

County's Information. For the County's proposed value, it relies on the January 17, 2011 appraisal that the taxpayer had prepared. In this appraisal, the taxpayer's appraiser had determined a leased fee value for

the subject of \$\$\$\$ with the sales comparison approach and \$\$\$\$ with the income approach. The taxpayer's appraiser determined that the income approach should receive the most weight when reconciling these values and, within three weeks of the 2011 lien date, derived a final value of \$\$\$\$ for the subject property.

As mentioned earlier, the taxpayer's appraiser first derived a "stabilized" value for the subject property with his income approach, based on a 7.5% vacancy rate instead of its actual 35% vacancy rate. The appraiser used a 7.5% vacancy rate to derive a stabilized value because it determined that the subject's actual vacancy rate of 35% and the low month-to-month rental rates it was receiving for some of its non-vacant spaces were temporary. To the stabilized values the appraiser derived, he determined that a deduction of \$\$\$\$ of short-term losses associated with the excess vacancy was necessary.² He explained that these losses would occur during an estimated absorption period of approximately two years during which the excess vacancy would be absorbed. As a result, the stabilized sales comparison approach value of \$\$\$\$ (\$\$\$\$ per square foot) was reduced by \$\$\$\$ to arrive at the \$\$\$\$ sales comparison approach value. Similarly, the stabilized income approach value of \$\$\$\$ was reduced by \$\$\$\$ to arrive at the \$\$\$\$ income approach value. The taxpayer's appraiser reconciled these values by placing the most weight on the income approach and estimating a final market value of the leased fee interest at \$\$\$\$.

The County supports the value derived in the taxpayer's January 17, 2011 appraisal with one exception. The County contends that short-term losses associated with a commercial property's excess vacancy cannot be deducted from its stabilized value because the Utah Supreme Court has ruled that "absorption" cannot be considered for Utah property tax purposes. *See Board of Equalization v. Utah State Tax Comm'n ex rel. Benchmark, Inc.*, 864 P.2d 882 (Utah 1993). For these reasons, the County believes that

² The taxpayer's appraiser deducted short-term losses associated with rent loss, leasing commissions, tenant improvements, and holding costs (which are expenses the owner is responsible for when the building is vacant). The appraiser also deducted short-term losses associated with the temporary free rent given to tenants and with the lower month-to-month rents that some tenants negotiated near the lien date.

the \$\$\$\$ “stabilized” value the appraiser derived with the income approach before deducting short-term losses associated with excess vacancy best represents its fair market value for property tax purposes.³ The County, however, does not ask the Commission to increase the subject’s current value of \$. On the basis of the \$\$\$\$ value found in the taxpayer’s appraisal, the County asks the Commission to sustain the subject’s current value.

In the alternative, should the Commission find its *Benchmark* argument unpersuasive, the County asks the Commission to reduce the subject’s value to the \$\$\$\$ market value estimated in the taxpayer’s appraisal. The County’s *Benchmark* argument is not persuasive. In *Benchmark*, the Court did not address the valuation of a single property and how its excess vacancy might affect its fair market value, which is at issue in this case. Instead, the Court disallowed the “absorption valuation” method of assessing the fair market value of multiple subdivision lots. The absorption valuation method recognizes the time value of the owner’s investment in multiple lots by determining the rate at which the lots will sell per year and discounting those future sales to a present value. Because this method results in identical lots being assessed at different values depending on whether a taxpayer owns one lot or multiple lots, the Court found the absorption valuation method under such circumstances to be inequitable and, thus, inappropriate for Utah property tax purposes. In the instant case, these circumstances are not present, and the *Benchmark* ruling does not apply.

When a property is in the appeals process, the Commission is attempting to ascertain its ‘individual’ value as opposed to a value that might otherwise be appropriate for mass appraisal purposes. The Commission recognizes that a commercial property with excess vacancy will likely have a lower fair market value than an identical property that is fully leased. The Commission has recognized the validity of deducting short-term losses associated with excess vacancy from a stabilized value in many appeals over the years. For these

3 Although the taxpayer’s appraisal estimates a “leased fee interest” value for the subject, the County’s position leads one to conclude that the subject’s “leased fee” must be similar to its “fee simple” value that

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reasons, the Commission will consider the County's alternative proposed value of \$\$\$\$ and determine whether this value or a value proposed by the taxpayer is more convincing.

As explained earlier, the sale of the subject property for \$\$\$\$ in October 2012 does not convincingly show what the subject's fair market value was as of the January 1, 2011 lien date. Furthermore, the income approach found in the taxpayer's appraisal is more convincing than the income approach prepared by REPRESENTATIVE FOR TAXPAYER, also for the reasons explained earlier. The \$\$\$\$ value estimated in the taxpayer's January 17, 2011 appraisal also seems to be supported by a real estate broker's April 2011 estimate of value for the subject property if the subject property were marketed for sale for a period of at least nine months. It appears that the subject's 2011 value would only be below \$\$\$\$ if the property were marketed for a shorter period of time for a quick or distressed sale. For these reasons, the most convincing evidence proffered at the Initial Hearing shows that the subject's fair market value, as of January 1, 2011, is \$\$\$\$. Accordingly, the subject's 2011 value should be reduced from \$\$\$\$ to \$\$\$\$.

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Administrative Law Judge

would generally be used for property tax purposes. Neither party argued otherwise.

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DECISION AND ORDER

Based upon the foregoing, the Tax Commission finds that the subject's value should be reduced to \$\$\$\$ for the 2011 tax year. The Davis County Auditor is ordered to adjust its records in accordance with this decision.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the taxpayer's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2013.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner