

08-1575
LOCALLY ASSESSED PROPERTY
SIGNED 02-12-09

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER, Petitioner, v. BOARD OF EQUALIZATION OF SALT LAKE COUNTY, STATE OF UTAH, Respondent.	INITIAL HEARING ORDER Appeal No. 08-1575 Parcel No. ##### Tax Type: Property Tax / Locally Assessed Tax Year: 2007 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. The rule prohibits the parties from disclosing commercial information obtained from the opposing party to nonparties, outside of the hearing process. However, pursuant to Utah Admin. Rule R861-1A-37, 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: PETITIONER REP 1, Owner
 PETITIONER REP 2, Manager

For Respondent: RESPONDENT REP, from the Salt Lake County Assessor's Office

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5, on February 4, 2009.

At issue is the fair market value of the subject property as of January 1, 2007. The subject property is a medical office building located at ADDRESS in Salt Lake County, Utah. For the 2007 tax year, the property was assessed at \$\$\$\$\$, which the Salt Lake County Board of Equalization ("County BOE")

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sustained. The property owner asks the Commission to reduce the subject's value to \$\$\$\$\$, while the County asks the Commission to reduce the value to \$\$\$\$\$.

APPLICABLE LAW

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

“Fair market value” is defined in UCA §59-2-102(12) 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”

Any party requesting a value different from the value established by the County BOE has the burden to establish that the market value of the subject property is other than the value determined by the county board of equalization.

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 contained error, and (2) provide the Commission with a sound evidentiary basis for reducing the value established by the County BOE 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 Commission*, 530 P.2d. 332 (Utah 1979).

DISCUSSION

The subject property consists of 2.10 acres of land and a medical office building that was built in 1986. The building has 35,728 square feet of rentable space that is divided into ##### separate offices. The property owner indicates that the building consists primarily of dentists' offices. Although the building has been renovated, the HVAC system is antiquated, is costly to maintain, and needs to be replaced at a cost of approximately \$\$\$\$\$.

The property owner purchased the subject property for \$\$\$\$\$ in March 2006, approximately nine months prior to the lien date at issue. However, the property owner states that the purchase price was higher than the subject's fair market value for several reasons. First, he claims that he is from STATE and was unfamiliar with Utah prices, comparables and capitalization rates. Second, he claims that he received favorable financing terms due to his partner's credit history, specifically a lower interest rate on the property than typical for such properties. He also notes that "pro forma" expenses provided by the seller and used to calculate a purchase price were approximately \$\$\$\$\$ less than the expenses that actually occurred in 2006. The Commission notes that both parties are requesting values significantly less than the purchase price.

The property owner is asking the Commission to reduce the subject property's value to \$5,806,910, based on an income approach that uses actual income and expenses for 2006, as shown on the 2006 Statement of Revenue and Expenses, as follows:

\$\$\$\$\$	Actual Income (Includes actual rents of \$21.84 per square foot from rent roll)
- \$\$\$\$\$	Actual Expenses (Includes property taxes)
\$\$\$\$\$	Net Operating Income (NOI)
÷ %%%%	Capitalization Rate
<u>\$\$\$\$\$</u>	Property Owner's Income Approach Value

The County is asking the Commission to reduce the subject property's value to \$\$\$\$\$, based on an appraisal prepared by RESPONDENT REP. In the appraisal, RESPONDENT REP determined a sales approach value of \$\$\$\$\$ and an income approach value (modified at the hearing) of \$\$\$\$\$. RESPONDENT

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REP applied a % correlation factor to each approach and determined a final value of approximately \$6,790,000 for the subject.

For the County's market approach, RESPONDENT REP compared the subject property to six office buildings. From these, she determined that the subject property would have a value of \$\$\$\$ per square foot as of the lien date. When this rate is applied to the 35,728 square of rentable space, a value of approximately \$\$\$\$\$, is derived.

For the County's income approach, RESPONDENT REP derived at a value of \$6,612,145, as follows:

\$\$\$\$\$	Estimated Square Foot Market Rent as of January 1, 2007
x 35,728	Rentable Square Feet
\$\$\$\$\$	Potential Gross Income (PGI)
- \$\$\$\$\$	Stabilized Vacancy Loss (7% of PGI) plus Misc. Income
\$\$\$\$\$	Effective Gross Income (EGI)
- \$\$\$\$\$	Reserves Expense (3.0% of EGI)
- \$\$\$\$\$	Operating Expenses (Does not include property taxes)
\$\$\$\$\$	Net Operating Income (NOI)
÷ %%%%	Capitalization Rate (7.25% rate plus effective tax rate of 1.28%)
\$\$\$\$\$	County's Income Approach Value

Income Approaches. The property owner contends that actual income and expenses should be used to value the subject property. The County contends that the actual rent rates do not represent market conditions existing on the lien date. The major differences between the parties' respective income approaches involve the rental rate and the capitalization rate. The County used the property owner's actual expenses in its income approach that it revised at the Initial Hearing.

Rental Rate. The property owner provides rent roll information to show that the subject's actual rents for the 2006 calendar year equated to \$\$\$\$ per square foot (modified gross). The property owner asks the Commission to use the actual rents in an income approach, while the County asks that a \$\$\$\$ per square foot "market" rate be used. The subject property has stable tenants, and none of the offices in the

subject were leased in 2006 to show what market lease rates were near the lien date. However, three of the subject's offices leased in 2005 for rates of \$\$\$\$\$, \$\$\$\$\$, \$\$\$\$\$, and \$\$\$\$\$ per square foot, respectively.

In addition, the Commission notes that none of the County's ten rental comparables leased at a rate above \$\$\$\$\$ per square foot. Moreover, even after the ten comparables were adjusted, none show a rental rate in excess of \$\$\$\$\$ per square foot.¹ Furthermore, the only County comparable that is a medical building like the subject was leased at a rate of \$\$\$\$\$ and adjusted to a rate of \$\$\$\$\$ per square foot. Based on the information available at the Initial Hearing, the Commission is not convinced that the subject's market rental rate as of the lien date is more than the subject's actual rental rate of \$\$\$\$\$ per square foot.

Capitalization Rate. RESPONDENT REP determined that a %%% capitalization rate would be appropriate because the subject property has a desirable location, is able to generate high rents for an office building, and because it "operates" as Class A property.² RESPONDENT REP provided eleven capitalization comparables in her appraisal. The comparables appear to show that capitalization rates decreased between 2005 and 2006. Although the "rental class" of all the capitalization comparables is not shown in the appraisal, the four comparables identified as Class A properties sold between November 2005 and October 2006 at capitalization rates of %%%, %%%, %%% and %%%, respectively. The County contends that a %%% capitalization rate is appropriate because the subject property is more desirable than most office buildings.

1 A number of the County's comparables concern leases from early 2007. The property owner asks the Commission to disregard the County's appraisal because it contains post-lien date information. However, post-lien date information is often useful in determining how a market is reacting on the lien date. For example, information concerning events that occurred immediately after a lien date may be more useful in determining market trends on the lien date than information from several years prior to the lien date. As a result, the Commission declines the property owner's request to disregard the County's appraisal and the post-lien date information contained in it.

2 Although the property was constructed in 1986 as Class C property, RESPONDENT REP explains that it actually operates as Class A property, given its renovations, its quality tenants, and its rents.

One of the eleven comparables in the County's appraisal sold at a capitalization rate of %%% on February 21, 2006. The property owner points out that this comparable sold closest to the time that he purchased the subject property in March 2006 and asks the Commission to use the %%% rate to value the subject property. The Commission does not find the property owner's argument convincing. To establish a value as of the lien date, a comparable selling near the lien date would be more convincing than a comparable selling nearly a year prior to the lien date, all other factors being the same.

Nevertheless, the property owner submits additional capitalization rate information that he obtained from WITNESS, MAI, in a letter dated September 12, 2007. WITNESS indicated his letter is in response to a request from PETITIONER REP 2, the subject property's manager, to "inspect [the subject property] and determine an appropriate capitalization rate for potential valuation purposes." WITNESS indicates that the subject property sold in March 2006 at a %%% capitalization rate, but states that he can find "no market data to support an overall rate this low for an older multi-tenant office building with local tenants." WITNESS considers three comparables that sold in Salt Lake County in 2005 and 2006 at capitalization rates ranging between %%% and %%%. The comparable that sold at an %%% capitalization rate in June 2005 is a medical building near (X) Because this comparable was built in 1980, it appears similar to the subject. WITNESS concludes that as of September 12, 2007, the subject's capitalization rate would be %%%.

Little or no information is available about the County's comparables to determine if they are more similar to the subject than the comparable near (X) that WITNESS provided. In addition, the Commission is not convinced that the subject would sell as a Class A office building, as the County contends. First, WITNESS classifies it as a Class B office building. Second, even though it may attract Class A tenants, as RESPONDENT REP contends, the building itself, which a purchaser would be buying, is more than 20 years old as of the lien date and has an HVAC system that is expensive to maintain and that needs replacing.

For these reasons, the Commission finds that an %%% capitalization should be used in the income approach.

Summary. Based on the foregoing, the Commission finds that the property owner’s income approach appears to be reasonable, subject to the following changes. First, the Commission finds that the %%% capitalization rate used by the property owner should be reduced to %%%. Second, the Commission finds that the capitalization rate should be “loaded” to also account for the subject’s property taxes. The County showed in its income approach that the effective tax rate for the subject is 1.28% for the 2007 tax year. As a result, the “total” capitalization rate will be %%%. In addition, the property tax expense of \$\$\$\$\$, as reported for 2006, will be deducted from expenses in the income approach.³ With these changes, the Commission finds that an income approach produces a value of approximately \$\$\$\$\$, as follows:

\$\$\$\$\$	Actual Income
- \$\$\$\$\$	Actual Expenses (Does not include property taxes)
\$\$\$\$\$	Net Operating Income (NOI)
÷ %%%%	Capitalization Rate (8.00% rate plus effective tax rate of 1.28%)
<u>\$\$\$\$\$</u>	Income Approach Value

Based on the information available at the Initial Hearing, the Commission finds that a reasonable value for the subject property based on an income approach is \$\$\$\$\$.

Sales Approach. The subject property contains 35,728 square feet of rentable space. Based on this square footage, the \$\$\$\$\$ value determined under the income approach results in a value of approximately \$\$\$\$\$ per square foot.

The County is the only party to submit a sales approach. The County compared the subject to six comparables that sold between January 2005 and January 2007. The comparables sold for prices ranging

³ The total expenses of \$\$\$\$\$, as shown on the 2006 Statement of Revenue and Expenses, include a property tax expense of \$\$\$\$\$. Because the property tax expense is accounted for by “loading” the capitalization rate with the effective tax rate, the property tax expense is deducted from total expenses.

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between \$\$\$\$\$ and \$\$\$\$\$ per square foot. The County adjusted the comparables to prices ranging between \$\$\$\$\$ and \$\$\$\$\$ per square foot. The County determined that the mean of the six adjusted prices was \$\$\$\$\$ per square foot and the median was \$\$\$\$\$ per square foot. Based on this information, the County estimated a rate of \$\$\$\$\$ per square foot for the subject, which equates to a value of approximately \$\$\$\$\$.

The Commission, however, is not convinced that the County's sales approach shows that a \$\$\$\$\$ per square foot value, as derived above, is incorrect. First, three of the County's comparables are significantly newer than the subject, which was built in 1986. The remaining three comparables were built in 1985, 1986 and 1989, respectively, and sold for prices ranging between \$\$\$\$\$ and \$\$\$\$\$ per square foot. When a time adjustment is made, these three comparables sold for prices ranging between \$\$\$\$\$ and \$\$\$\$\$ per square foot. In addition, the County adjusted these three comparables by 10% on the basis that the subject property's "rental class" is superior. The Commission is not convinced that this adjustment is warranted, as there is no information to show that these properties lease at a lower rate than the subject or have inferior tenants. The Commission is especially not convinced that such an adjustment is warranted for County Comparable #3, which like the subject property, is a medical office building.

For these reasons, the Commission believes that the County's sales information supports the \$\$\$\$\$ value derived above under the income approach. The County's sales information does not convince the Commission that a \$\$\$\$\$ value for the subject is unreasonable. Furthermore, for income-producing commercial properties, the Commission generally believes that the income approach is more reflective of value than other approaches.

Conclusion. The Commission generally believes that the price paid for a property is reflective of its fair market value. In this case, however, evidence was proffered to show that the property owner overpaid for the property. First, there is evidence to show that the %%% capitalization rate used to determine the purchase price was too high. Second, the pro forma expenses used to determine the purchase

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price were too low. For these reasons and based on the information provided at the Initial Hearing, the Commission finds that the property owner has shown that the County BOE is incorrect. The Commission also finds that the evidence proffered at the Initial Hearing shows that \$\$\$\$\$ is a reasonable value of the subject.

DECISION AND ORDER

Based upon the foregoing, the Tax Commission finds that the fair market value of the subject property, as established by the County BOE, should be reduced from \$\$\$\$\$ to \$\$\$\$\$ for the 2007 tax year. It is so ordered.

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 Petitioner'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 _____, 2009.

Kerry R. Chapman
Administrative Law Judge

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BY ORDER OF THE UTAH STATE TAX COMMISSION.

The Commission has reviewed this case and the undersigned concur in this decision.

DATED this _____ day of _____, 2009.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

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