

11-1068
LOCALLY ASSESSED COMMERCIAL PROPERTY
TAX YEAR: 2010
SIGNED: 01-18-2012
COMMISSIONERS: M. JOHNSON, D. DIXON, M. CRAGUN
EXCUSED: R. JOHNSON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER, Petitioner, vs. BOARD OF EQUALIZATION OF DAVIS COUNTY, STATE OF UTAH, Respondent.	INITIAL HEARING ORDER Appeal No. 11-1068 Parcel No. ##### Tax Type: Property Tax/Locally Assessed Tax Year: 2010 Judge: Phan
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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:

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REP. 1, Representative By Telephone Conference Call
PETITIONER REP. 2, Representative
For Respondent: RESPONDENT REP. 1, Davis County Deputy Assessor
RESPONDENT REP. 2, Certified General Appraiser, Davis County

STATEMENT OF THE CASE

Petitioner ("Property Owner") brings this appeal from the decision of the Davis County Board of Equalization ("the County") pursuant to Utah Code §59-2-1006. This matter was argued in an Initial Hearing on October 11, 2011, in accordance with Utah Code §59-1-502.5. The Davis

County Assessor's Office had originally valued the subject property at \$\$\$\$ as of the January 1, 2010 lien date. The County Board of Equalization had reduced the value to \$\$\$\$\$. The Property Owner requested that the value be lowered to \$\$\$\$\$. The County had originally requested that the value remain as set by the County Board of Equalization, although during the hearing made a correction to its appraisal that would lower the value.

APPLICABLE LAW

Utah Code Ann. §59-2-103 provides for the assessment of property, as follows:

- (1) All tangible taxable property located within the state 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.

For property tax purposes, "fair market value" is defined in Utah Code Ann. §59-2-102(12), as follows:

"Fair market value" means 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. For purposes of taxation, "fair market value" shall be determined using the current zoning laws applicable to the property in question, except in cases where there is a reasonable probability of a change in the zoning laws affecting that property in the tax year in question and the change would have an appreciable influence upon the value.

A person may appeal a decision of a county board of equalization, as provided in Utah Code Ann. §59-2-1006, in pertinent part below:

- (1) Any 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 by filing a notice of appeal specifying the grounds for the appeal with the county auditor within 30 days after the final action of the county board.

To prevail in a real property tax dispute, the Petitioner must (1) demonstrate that the County's original assessment contained error, and (2) provide the Commission with a sound evidentiary basis for reducing the original valuation to the amount proposed by Petitioner. *Nelson v. Bd. of Equalization of Salt Lake County*, 943 P.2d 1354 (Utah 1997).

DISCUSSION

The subject property is parcel no. ##### and is located at ADDRESS 1, CITY 1, Utah. This is a 3.48 acre parcel of land that is improved with a 19,389 square foot retail strip center space and a 13,440 square foot multi-tenant flex warehouse. The improvements were constructed in 1988.

The Property Owner requested that the value be lowered to \$\$\$\$\$. It was the representative for the Property Owner's position that because this was a mixed use building and there was a lack of comparables, the value for the property should be determined based on an income approach. The representative explained that rents have been declining and vacancy increasing over the last three to four years and noted that it was likely that this would continue due to market conditions. He also indicated that vacancy has been about 32% for this property.

The Property Owner calculated an income approach from his actual net operating income for this property, which was \$\$\$\$\$. He provided a copy of a Profit and Loss statement for the subject property for calendar year 2009. This statement showed \$\$\$\$\$ in total income and \$\$\$\$\$ in total expenses. Some of the expenses listed were \$\$\$\$\$ in management and fees and another \$\$\$\$\$ in Asset Management Fees. Additional expenses included \$\$\$\$\$ in repairs and maintenance. The Property Owner also deducted property tax as an expense, noting that it was the highest single expense at \$\$\$\$\$.

Although the Property Owner had subtracted all his actual expenses, which, the County argued were higher than market, he then subtracted a reserve of \$\$\$\$\$. This resulted in an 'adjusted NOI' of \$\$\$\$\$. He capitalized this by a %%% capitalization rate, which resulted in a value of \$\$\$\$\$ or rounded to the \$\$\$\$\$ that he requested in this matter. He argued a %%% capitalization rate was appropriate for this property, but did not provide a published study or capitalization rate comparables, other than a letter from a real estate broker. The Property Owner also had submitted an Income and Expense Analysis, which he indicated was based on the valuation format that had been used by the "Davis County Independent Appraiser," ostensibly to set or explain the original \$\$\$\$\$ assessment. The Taxpayer then substituted his own income and vacancy rates, but used what he assumed were the same expense rates. However, the Taxpayer's analysis is flawed. On the original valuation the appraiser had applied actual figures from which he derived expense ratios based on effective gross income. The Taxpayer in contrast applied the County's calculated expense rates against potential gross income. This error is compounded by the way the Taxpayer calculated his income. The potential gross income before vacancy is virtually identical to the reported actual income, which is measured after vacancy. The Taxpayer then applied a vacancy rate, thus double counting for vacancy losses. For these and other reasons, the Commission gives no weight to this analysis.

The Property Owner also pointed out that the County had previously submitted several different values for this property for the subject year. It was also his contention that the County should be limited to determining its value based on the Standard for Mass Appraisal of Property

from the International Association of Assessing Officers. He argued this limited the County to using only the actual income and expenses and not market income and expenses.

The County submitted an appraisal that had been prepared by RESPONDENT REP. 2, Certified General Appraiser. RESPONDENT REP. 2 concluded that as of the January 1, 2010 lien date the value for the subject property was \$\$\$\$\$. He did not prepare a cost or sales comparison approach, relying solely on the income approach. In his income approach he considered market information in determining a vacancy rate, management fees, and reserves. RESPONDENT REP. 2 developed separate values for the commercial space and the warehouse/industrial space, which he then added together for his total value.

For the retail strip center he estimated an average rent of \$\$\$\$ per square foot. The potential gross income was \$\$\$\$\$. He subtracted 14% vacancy which resulted in effective gross income of \$\$\$\$\$. This vacancy rate was based on a rate for neighborhood shopping centers. He allowed 5% for management, 3% for reserves and \$\$\$\$ for operating expenses. The operating expenses were reported to be taken from the actual expenses. He stated in the appraisal that the expenses were significantly higher than market and noted that the lease terms for occupied units in the subject had tenants paying most expenses. From this he concluded that the net operating income for the retail strip center was \$\$\$\$\$. His capitalization rate was %%% to which he added %%% for the tax rate. He did provide some capitalization rate comparables to support this rate. It was his conclusion that the value of the retail strip portion was \$\$\$\$\$.

For the industrial/warehouse portion of the property, RESPONDENT REP. 2 determined that the potential gross income was \$\$\$\$\$. He subtracted 10% for vacancy and 10% for management expenses, real estate commissions, and reserves, which in total were lower than actual expenses. Unlike he did for the retail portion, RESPONDENT REP. 2 did not allocate or deduct any of the actual operating expenses. His net operating income was \$\$\$\$\$. He used a 10.35% overall rate based on a %%% capitalization rate and a 1.35% tax rate. This resulted in an estimated value of \$\$\$\$\$. However, during the hearing he acknowledged that both the vacancy and expenses should be increased to 15%. Using a 15% vacancy and a 15% expense, he estimated a value of \$\$\$\$\$. In the appraisal, RESPONDENT REP. 2 added his value conclusions for the two types of property for his total value of \$\$\$\$\$. However, with his change on the industrial/warehouse portion, the total value would be lowered to \$\$\$\$\$.

The representative for the Property Owner indicated that the subject property was an anchorless strip center not a neighborhood center, as had been represented by the County. He pointed to information published by Commerce/Cushman & Wakefield for the fourth quarter of

2009, which indicated vacancy rates for anchorless strip centers were much higher at 23.41% than the rate reported for neighborhood centers, which was 13.82%. The information presented supported the Property Owner's contention that this was in fact an anchorless strip center. The actual vacancy for this property has, for several years, been even higher than the 23.41% indicated in the study. Based on this information the County's vacancy rate for the retail portion is low. Using a stabilized vacancy rate rounded to 24% for the retail portion, and all other factors, in the County's appraisal held constant, results in a value rounded to \$\$\$\$\$ for the retail portion. With the adjustments to the industrial/warehouse portion that the County had made at the hearing, this results in a total value for the property, rounded, of \$\$\$\$\$.

The Property Owner had argued that it was inappropriate for the County to consider, in an appraisal, market rents and expenses instead of actual net income. He also argued that the County was limited to using mass appraisal techniques, which he represented were based on actual income and expenses. However, there is no basis in Utah law for this limitation. Property tax is based on the fair market value of the property as of January 1 of the tax year at issue under Utah Code §59-2-103. Utah Code §59-2-102 defines "fair market value" as the amount for which property would exchange hands between a willing buyer and seller. An appraisal is an acceptable basis by which fair market value is determined. It is appropriate for the County to submit a fair market value appraisal and to consider market factors in the appraisal.

In its appraisal, the County used typical appraisal methods in determining a market rent for the property, including what was described as "actual income," that roughly correlated with the Taxpayer's rent roll. Although some of the rents were consistent with the rent roll, others were not. The County did not provide specific market data to support differences. The County applied estimated vacancy rates to the annual estimated rent. The County also used "[a]ctual" operating expenses, for the retail portion, but did not explain how they were derived from the actual total operating expenses. Although the County argued that the income and expenses were derived from the market, no evidence, other than opinion, was provided to support this.

No operating expenses were deducted for the industrial/warehouse portion. The County estimated a management fee rate in place of the actual management fees, without explaining or identifying the actual management expenses. In addition, there were also factual errors in the County's appraisal, some of which the County acknowledged during the hearing, regarding the industrial/warehouse portion of the property. In addition, the Property Owner pointed out errors regarding the vacancy rate for the retail portion, which the County acknowledged. With these errors corrected, the indicated value for the property was \$\$\$\$\$.

In comparing the two value estimates, the primary differences can be attributed to three main items. First, the actual reported income was \$\$\$\$\$, higher than the effective gross income of \$\$\$\$\$ estimated by the County. Second, the Taxpayer's actual expenses at \$\$\$\$\$ were considerably higher than the County's adjusted estimate of \$\$\$\$\$. Finally, the Taxpayer applied a %%% capitalization rate, compared with the County's average rate, before applying a tax rate, of approximately 9.25%.

Generally, the Commission has concerns with mixing actual income and expenses with estimated market rates, especially when only based on appraisal opinion. Income, vacancy, and expenses for any given property are interrelated. Mixing actual data and estimated rates has the potential to distort a value estimate. Of particular concern, in this case is that the County allocated \$\$\$\$\$ in actual repair expenses for the retail portion but did not apply any of the actual expenses to the industrial/warehouse portion. With \$\$\$\$\$ in total repair expenses reported by the Property Owner, \$\$\$\$\$ in expenses was not considered by the County. This fact alone suggests that the County may have overestimated the value by as much as \$\$\$\$\$. (It is possible that some of the difference was accounted for when the County increased the industrial/warehouse total expense ratio from 10% to 15%.) Because of these problems, it is more appropriate to use either well supported market data or actual income rather than mixing portions of both without any explanation.

The Property Owner's calculation, however, also needs to be adjusted. In his income analysis he subtracts all actual expenses, but additionally subtracts a reserve. This results in a lower NOI than appears appropriate as it may double count some expenses. Without a detailed analysis of the expenses, it cannot be determined whether they included costs for items that would be typically accounted for as replacements in a market based expense calculation. If the \$\$\$\$\$ reserve is excluded, the NOI in the Property Owner's analysis would be \$\$\$\$\$. Using the Property Owner's capitalization rate of %%%, results in a value of \$\$\$\$\$, which is within 10% of the adjusted value estimate derived from the County's appraisal and the corrections noted above.

Considering all of the evidence submitted by the parties, the Commission finds that, giving most weight to the Property Owner's capitalized actual income, excluding the estimate for reserves, the most probable value is around \$\$\$\$\$. Without knowing whether the actual repair expenses included items typically considered as replacement reserves, it cannot be established whether the value may have been lower. On the other hand, any such adjustment would likely be

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offset, at least in part, by applying the County's capitalization rate, which was better supported than the rate used by the Taxpayer.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission finds the value of the subject property was \$\$\$\$ as of the January 1, 2010 lien date. The Davis County Auditor is hereby ordered to adjust its records accordingly. It is so ordered.

This Decision does not limit a party's right to a Formal Hearing. Any party to this case may file 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 _____, 2012.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner