11-1512
LOCALLY ASSESSED PROPERTY
TAX YEAR: 2010
SIGNED: 12-30-2011
COMMISSIONERS: R. JOHNSON, M. JOHNSON, D. DIXON, M. CRAGUN
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER, Petitioner, vs. BOARD OF EQUALIZATION OF SALT LAKE COUNTY, STATE OF UTAH, Respondent.	**INITIAL HEARING ORDER** Appeal No. 11-1512 Parcel No. ##### Tax Type: Property Tax/Locally Assessed Tax Year: 2010 Judge: Jensen

This Order may contain confidential "commercial information" within the meaning of Utah Code Section 59-1-404, and is subject to disclosure restrictions as provided in that section and Utah Admin. Rule R861-1A-37. In accordance with Section 59-1-404(4)(b)(iii)(B), Utah Admin. Rule R861-1A-37(6) prohibits parties from disclosing commercial information obtained from the opposing party to nonparties outside of the hearing process. As provided by Utah Admin. Rule R861-1A-37(7), the Tax Commission may publish this decision, in its entirety, unless the 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:
Clinton Jensen, Administrative Law Judge

Appearances:
For Petitioner: PETITIONER REP., for the Taxpayer
For Respondent: RESPONDENT REP., for the County

STATEMENT OF THE CASE

The above-named Petitioner (the "Taxpayer") brings this appeal from the decision of the Board of Equalization of Salt Lake County (the "County"). The parties presented their case in an Initial Hearing in accordance with Utah Code Ann. §59-1-502.5 on October 26, 2011. The Taxpayer is appealing the market value of the subject property as set by the board of equalization for property tax purposes. The lien date at issue in this matter is January 1, 2010. The County Assessor had set the value of the subject property, as of the lien date, at $$$$$. The board of

equalization sustained the value. The Taxpayer requests that the value be reduced to $$$$$. The County requests that the value set by the board of equalization be increased to $$$$$.

APPLICABLE LAW

All 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 provide by law. (Utah Code Ann. Sec. 59-2-103 (1).)

"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. (Utah Code Ann. 59-2-102(12).)

Utah Code Ann. §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 board of equalization 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.

To prevail, a party requesting a value that is different from that determined by the county board of equalization must (1) demonstrate that the value established by the county board of equalization contained error, and (2) provide the Commission with a sound evidentiary basis for reducing the value established by the county board of equalization 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*, 590 P.2d. 332 (Utah 1979).

In reviewing a county board's decision, the commission shall adjust property valuations to reflect a value equalized with the assessed value of other comparable properties if: (a) the issue of equalization of property values is raised; and (b) the commission determines that the property that is the subject of the appeal deviates in value plus or minus 5% from the assessed value of comparable properties. Utah Code Ann. Sec. 59-2-1006(4).) The evidence required for adjustment on the basis of equalization under Utah Code Ann. Sec. 59-2-1006(4) is a showing that there has been an "intentional and systematic undervaluation" of property that results in "preferential treatment" to the property owners receiving the lower valuations. *Mountain Ranch Estates v. Utah State Tax Comm'n,* 2004 UT 86, ¶ 16.

DISCUSSION

The subject property is parcel no. #####, located at ADDRESS 1 in CITY 1, Utah. It consists of a warehouse/service facility and office building. It has 48,811 square feet of which 4,115 square feet (ten percent) are office. The original building, with 38,411 square feet, was built in 1968 as a warehouse for the COMPANY 1. An addition of 10,400 square feet in 1999 added an automotive service facility. The building is partitioned to allow for multiple tenants using areas ranging from 355 square feet to 24,481 square feet. The original building is class D rental property; the parties did not discuss a rental class for the newer portion. The building is on 5.66 acres for a land-to-building ratio of 5.05.

The Taxpayer presented two approaches to market valuation and then modified its market values using an equalization argument. The Taxpayer's first approach to market value was a traditional income approach primarily based on actual income and expenses for 2009. In 2009, 37,916 square feet (78 percent) of the building was leased and 10,895 square feet (22 percent) was vacant. The leased portion had lease rates from $$$$$ per square foot to $$$$$ per square foot. The Taxpayer gave no explanation for the wide range in lease rates, but the lowest rate per square foot was for the largest space and the highest rent per square foot was for the smallest space. The Taxpayer received a total of $$$$$ for the 37,916 square feet rented in 2009.

For the 10,896 square feet vacant in 2009, the Taxpayer estimated a lease rate of $$$$$ per square foot for an estimated income of $$$$$ (rounded). The Taxpayer provided no lease rate comparables to support the $$$$$ rate. The Taxpayer's representative indicated that the building owner told him that $$$$$ was "what he thought he could get" for the vacant space. Adding $$$$$ estimated income to $$$$$ actual income yielded a potential gross income of $$$$$.

From potential gross income, the Taxpayer deducted 7.2% for vacancy. The Taxpayer relied on the Commerce CRG 2009 report for the 7.2% vacancy figure. Deducting $$$$$ for vacancy from potential gross income yielded an effective gross income of $$$$$. From this, the Taxpayer deducted actual expenses of $$$$$ for insurance, $$$$$ for insurance, $$$$$ for repairs and maintenance, $$$$$ for property taxes, $$$$$ for commissions, and $$$$$ for miscellaneous expenses. In addition to actual expenses, the Taxpayer deducted estimated expenses that the Taxpayer did not incur. This included a four percent property management expense ($$$$$) and a three percent capital improvement reserve ($$$$$). This $$$$$ left a net operating income of $$$$$.

The Taxpayer capitalized the $$$$$ net operating income using an %%%%% capitalization rate for a property value of $$$$$. Because the subject property had a greater vacancy than a stabilized rate as of January 1, 2010, the Taxpayer deducted $$$$$ for the time

required to bring the building to a stabilized occupancy rate. The Taxpayer did not present any support or calculation regarding the $$$$$ amount, but indicated that it had received it as an estimate from an MAI appraiser. The Taxpayer presented no comparables to support its %%%%% capitalization rate, but indicated that it was using the rate developed by the County's appraiser. By deducting $$$$$ from the stabilized-occupancy value of $$$$$, the Taxpayer arrived at a $$$$$ market value by the income approach.

In addition to a traditional income approach to value, the Taxpayer presented a discounted cash flow analysis. For this, the Taxpayer relied on County records indicating a ten-year remaining life in the older building on the subject property. The Taxpayer projected a stream of income for those ten years. To the present value of that stream of income, the Taxpayer added land value and the value of the newer building in ten years. The Taxpayer's representative indicated that he predicted the value of the newer building would be static for ten years and that the value of land would increase by either two or three percent. The Taxpayer's representative discounted future cash flows by eight percent per year. The Taxpayer did not present any basis for the percentage increases or discounts except to say that the County had used a ten percent discount figure for another property in another case. By the discounted cash flow approach, the Taxpayer arrived at a market value of $$$$$ for the subject property for the 2010 tax year.

The Taxpayer did not request that the 2010 value of the subject property be set at the market values derived by either its income approach to value or its or discounted cash flow analysis. Rather, the Taxpayer requested that these amounts be reduced by 28% to account for equalization to the assessed values of other properties. For equalization comparables, the Taxpayer used seven of the County's nine sales comparables. The Taxpayer compared the difference between the actual selling prices of these properties and their assessed values. The Taxpayer did two different analyses of this type. One compared selling prices to assessed values for the 2010 tax year. The other compared selling prices to the assessed value of the lien date closest to the sale date. In both of the Taxpayer's analyses, the assessed values of all of the properties that the Taxpayer considered were between 1% and 48% lower than the actual selling prices. Using an arithmetic average of the percentages, the Taxpayer concluded that the comparable properties sold for an average of 28% more than their assessed values. The Taxpayer excluded two sales with assessed values higher than actual selling prices. For one of these, the Taxpayer's representative explained that he excluded the sale because the selling price was so similar to the assessed value that it made little difference in the outcome. For the sale with a more

substantial difference, the Taxpayer's representative explained a superior rental classification in County records caused him to exclude the property from both of his equalization analyses.

The County provided an income approach to value as well as a market sales approach to value. For the income approach, the County relied on seven lease comparables with triple-net ("NNN") lease rates from $$$$$ to $$$$$ per square foot. The County made adjustments to these lease rates for differences between the subject property and the comparables for year built, building height, and time of lease. After taking these factors into account, the County's lease comparables indicated lease rates of $$$$$ to $$$$$ per square foot. The County reconciled these lease rate values to a final figure of $$$$$ per square foot. The County's representative noted that this rate appeared lower than the $$$$$ per square foot as estimated by the Taxpayer for vacant portions of the subject property. However, the $$$$$ rate is a NNN lease rate while the Taxpayer goes on to deduct substantial amounts from the lease income for expenses including utilities, repairs, and property taxes. The County's representative explained that a NNN lease is typical in the market for this type of property. As evidence of this, he pointed to the County's lease comparables, indicating that he found no comparables other than NNN leases.

The County's representative multiplied the $$$$$ lease rate by 48,811 total square feet to arrive at a potential gross income of $$$$$. From this, he deducted 8% for vacancy for an expected gross income of $$$$$ and 10% for expenses for a net operating income of $$$$$. To capitalize this, the County relied on capitalization rates from eleven comparable properties. The County's comparable sales had capitalization rates from %%%%% to %%%%% with an average of %%%%%. The County's representative reconciled these to a final capitalization rate of %%%%%, explaining that the sales with the higher capitalization rates had greater similarities to the subject property. The County did not add a tax load to the capitalization rate because it was using NNN leases for its lease rates. The capitalization of $$$$$ at %%%%% yielded final value by the income approach of $$$$$. The County did not provide market data or other support for its use of an %%%%% vacancy rate.

To value the subject property with a comparable sales approach, the County relied on nine comparable sales with sale dates from May 2008 to October 2010, building sizes from 9,312 to 50,680 square feet, and selling prices from $$$$$ to $$$$$. The sales generally bracket the subject property for building size, building age, and amount of land. The County's representative made adjustments to value to account for differences between the subject property and the comparable sales for factors such as location, land to building ratio, quality of construction, and building age. After taking these adjustments into account, the comparable sales indicated final

values between $$$$$ and $$$$$ per square foot with a mean of $$$$$ and a median of $$$$$ per square foot. The County's representative reconciled these to a final value for the subject property of $$$$$ per square foot or $$$$$ for the 48,811 square feet in the buildings on the subject property. The County reconciled its $$$$$ income approach value with its $$$$$ market approach to value to a final indicated value of $$$$$.

Because both parties request a value different from that determined by the board of equalization in this case, both parties have the same burden of proof – to show error in value set by the board of equalization. Because equalization prevails over market valuation in cases in which it is impossible to achieve both perfect uniformity and perfect market value, the Commission will first consider the Taxpayer's request for equalization under Utah Code Ann. Section 59-2-1006(4). *See Kennecott Copper Corp. v. Salt Lake County,* 799 P.2d 1156, 1161 (Utah 1990). Because relief under an equalization theory is a statutorily-created remedy, the Commission looks to the language of the section that creates the remedy. Utah Code Ann. Section 59-2-1006(4) requires that to gain relief, a Taxpayer is to compare two values to determine if the result has a difference greater than 5%. The two values are the value of the "property that is the subject of the appeal" and the "assessed value of comparable properties." *Id.* Rather than following this statutory mandate, the Taxpayer has compared the assessed values of comparable properties to the selling prices of those comparable properties. This is contrary to statute and is a fundamental flaw and prevents the Commission from further considering the Taxpayer's request for relief under Section 59-2-1006(4).

Even though the Taxpayer has not proven an equalization case under Section 59-2-1006(4), an equalization adjustment would be appropriate if the County assessed the Taxpayer's property at 100% of its fair market value and intentionally and systematically assessed other properties at a materially lower percentage or a materially higher percentage of fair market value. See Utah Code Ann. §59-2-704 and Rule R884-24P-27. In essence, the Taxpayer has used a technique similar that to used in a sales ratio study. However, that technique is misapplied and is too limited in scope to have any relevance to an equalization analysis. The Taxpayer has made two critical errors in its analysis.

To begin, a true sales ratio study ("ratio study") compares sales prices to assessed values, as did the Taxpayer's analysis. A ratio study is then used to establish the level of assessments for <u>all</u> properties of a similar, but general, type, i.e., commercial, residential, industrial, raw land, etc, within a given geographic area. If the ratio study indicates that assessments are lower than the sales prices, a county must raise the assessments of all relevant property types within the area.

That is, for example, if the ratio study indicates a ratio of 72% (1 minus 28%), as the Taxpayer concluded in his analysis, then all other properties (including the subject) should be raised by 28%. In this case, the Taxpayer did exactly the opposite; he assumed that since the comparable sales prices were 28% higher than the assessment, his property should be reduced by 28%.

This type of analysis might succeed, in limited circumstances, if proper statistical methods required in a ratio study are employed. With respect to this appeal, the Taxpayer, in the first place, used only seven of the County's nine comparables. One cannot conduct a valid equalization study by ignoring properties that are assessed higher than fair market value and including only properties that are assessed lower than fair market value. Second, a valid equalization analysis would need to include the sales of all reasonably comparable properties sold in the appropriate area—not just a sub-sample that were deemed to be reasonable comparables for establishing fair market value. Third, the "underassessments" alleged by the Taxpayer range from 1% to 48% lower than sales price. Moreover, those "underassessments" vary significantly from year to year for the properties in the study. Parcel #####-2, the most extreme example, was allegedly assessed at about 100% of fair market value in 2010, but underassessed by 53% in 2009. Presumably, the property's sale in 2009 brought the underassessment to the County's attention. In Utah, as in most other property tax systems, there is an incentive for taxpayers to notify the assessor when their property is overassessed. There is no incentive to notify the assessor when the property is underassessed. Thus, any continuing errors in the County records are much more likely to be underassessments than overassessments. In the absence of a statistically valid sales ratio study, however, we cannot find that the existence of those errors is an "intentional and systematic undervaluation" that would justify an equalization adjustment. *See Mountain Ranch Estates v. State Tax Commission*, 2004 UT 86, ¶ 16.

What the Taxpayer might have done, in order to avoid the pitfalls of his limited and misapplied ratio study, is to do a true equalization analysis. This requires only the comparison of assessments of similar properties, whether or not they have sold, to his property. There must be, however, a basis of comparison. The comparable assessments must be of a similar type; preferably have similar physical characteristics, such as size, age, construction, etc., and be located in a similar assessment or market area. The Taxpayer would also need to establish a basis to measure the value of the subject and comparable assessments. Dollars per square foot would be acceptable, for example, as long as appropriate adjustments were made for other features, such and land and building size and was not used as an attempt to compare properties that were too

dissimilar to make reasonable comparables. In this case there is no information on which the Commission can make such a determination.

Considering market value, the parties have both presented different approaches to value along with criticisms of each other's valuations. The Taxpayer argued that an approach to value using actual income and expenses is better than a valuation relying entirely on market rates. While the Commission has previously expressed a preference for actual income and expenses, the Taxpayer did not rely solely on actual figures here. For 10,895 square feet of the subject property, the Taxpayer relies on an estimate for rental income. That estimate is not supported by any comparable sales or other market data. The same is true of expenses. The Taxpayer used a market figure of 4% property management expense when it had no property management expense. The County agreed that this expense might be appropriate if the Taxpayer had incurred it. But the County also pointed out that its lease comparable rates showed that the Taxpayer's self-management was resulting in below market leases with expenses that other property owners were not experiencing. The Taxpayer estimated %%%%% for a capital improvement reserve, but made no showing that the $$$$$ figure for repairs and maintenance did not include major expenses that would normally be covered by a capital improvement reserve. This lack of proof is compounded because including large expenses would overstate expenses and understate net operating income. In a similar way, the Taxpayer has presented an excess vacancy adjustment of $$$$$ with no support other than to say that an appraiser provided the figure. The Taxpayer's discounted cash flow analysis uses the net operating income developed in the Taxpayer's income approach to value and thus has the problems of unsupported estimates changing actual values. The discounted cash flow analysis adds additional unsupported assumptions such as appreciation rates for land, lack of appreciation or depreciation for newer buildings, growth factors for rents, and a discount. These unsupported assumptions prevent the Taxpayer's presentation from sustaining the burden of proof necessary to show error in the value determined by the board of equalization.

Considering the County's data, it appears that the County has provided market support for the majority of its figures. The County's lease comparables support the County's contention that the subject property is leased at sub-market rates considering the expenses borne by the Taxpayer. However, the County has not accounted for a difference between an actual vacancy rate over 22% and its stabilized vacancy rate of 8%. Even though the 8% vacancy rate itself is higher than the 7.2% used by the Taxpayer, it is problematic that the County did not support its vacancy rate with market data.

Considering the totality of the evidence presented, it is noteworthy that removing unfounded expense assumptions from the Taxpayer's actual expenses of $$$$$ for property management expense and $$$$$ in capital improvement reserve still yields a net operating income of $$$$$. This would indicate a value from the Taxpayer's analysis of $$$$$ when capitalized at the %%%%% capitalization rate used by the Taxpayer. While there may still be criticisms of this value as well as the County's income approach to value at $$$$$ and its market value of $$$$$, the Commission is left with three indications of value that bracket and therefore support the $$$$$ value set by the board of equalization. On that basis, there is good cause to find that neither party has borne the burden of proof necessary to show error in the $$$$$ value as determined by the board of equalization.

Clinton Jensen
Administrative Law Judge

DECISION AND ORDER

On the basis of the foregoing, the Tax Commission finds that the value of the subject property as of January 1, 2010 is $$$$$. 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 __________________, 2011.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner