BEFORE THE IDAHO BOARD OF TAX APPEALS

TIMBERLINE LODGE APARTMENT HOMES, LLC, Appellant, v. KOOTENAI COUNTY, Respondent.	)))))))))))	APPEAL NOS. 19-A-1226 & 19-A-1227 FINAL DECISION AND ORDER

COMMERCIAL PROPERTY APPEALS

These appeals are taken from decisions of the Kootenai County Board of Equalization denying the appeals of valuation for taxing purposes on property described by Parcel Nos. C5444001001A and C54400010020. The appeals concern the 2019 tax year.

These matters came on for hearing December 16, 2019 in Coeur d'Alene, Idaho before Board Member Kenneth Nuhn. Attorney Peter Smith, IV appeared at hearing for Appellant. County Assessor Rich Houser represented Respondent.

Board Members Leland Heinrich, David Kinghorn and Kenneth Nuhn join in issuing this decision.

The issue on appeal concerns the market value of two (2) improved commercial properties.

The decisions of the Kootenai County Board of Equalization are affirmed.

FINDINGS OF FACT

Appeal No. 19-A-1226 (Parcel No. C5444001001A)

The assessed land value is $422,632, and the improvements' value is $4,615,516, totaling $5,038,148.

Appeal No. 19-A-1227 (Parcel No. C54400010020)

The assessed land value is $276,646, and the improvements' value is $2,746,236, totaling $3,022,882

Appellant contends the correct total assessed value for both parcels is $7,500,000.

The subject properties are operated collectively as an apartment complex in Coeur d'Alene, Idaho. As the properties share in a common use, they will mostly be referred to as a single property for purposes of this decision. The 3.04 acre subject is improved with eight (8) multi-unit apartment buildings constructed in 2016. In total, there are forty-eight (48) apartment units in the development. The product mix is: sixteen (16) one (1) bedroom, one (1) bathroom units; sixteen (16) two (2) bedroom, two (2) bathroom units; and sixteen (16) three (3) bedroom, two (2) bathroom units. The property also includes forty-eight (48) garages.

Appellant described events leading up to subject's recent purchase in April 2018. Appellant is an investment group which owns income-producing properties throughout the greater Pacific Northwest region. Prior to subject's purchase, Appellant sold an asset in a 1031 exchange, which meant Appellant was bound to "roll" the money over into a new investment property within a certain timeframe. It was reported that Appellant became aware of the subject development toward the end of the allowable exchange timeframe. Based on the development's financial information, Appellant made an offer to purchase the property. After receiving multiple offers, the seller agreed to Appellant's offer of $7,850,000.

Appellant believed the purchase price was fair at the time of sale, but has changed its opinion since operating the property. Appellant discovered discrepancies in the financial records of the prior owner, including erroneous vacancy rates and delinquent tenant accounts. According to Appellant, subject's vacancy rate for 2018 was roughly 5%, not the 1% represented by the seller. In short, it was believed the prior owner was not forthright with subject's performance figures. Appellant additionally reported an inability to increase rents as anticipated, due to increased competition in the area. In light of these factors, Appellant contended subject's purchase was above market and that the current market value should be in the range of $7,500,000.

Appellant additionally offered a "Brokers Price Opinion" (BPO) report. The report was prepared by a local real estate brokerage firm. The report developed an income approach to value and also provided some sales information. For the income approach, the report used subject's actual rent roll for the gross potential rent, plus an allowance for ancillary income generated from the garages and other fees. A 5% vacancy and collection loss rate was used. With the exception of property taxes, which were specific to the subject property, the operating expenses were reportedly obtained from the broader marketplace. The report calculated an annual net operating income of $436,355, which was capitalized at 5.85%, resulting in a rounded value conclusion of $7,500,000.

The BPO also provided some information from three (3) apartment complex sales. Sale No. 1, located in Spokane Valley, Washington, was a 148 unit development constructed in 1996. The property sold in January 2019 for $18,200,000, or roughly $123,000 per unit. Sale No. 2 was a fifty (50) unit complex constructed in 2018. This property, located in Spokane, Washington, sold for $6,400,000, or $128,000 per unit in February 2019. Sale No. 3, also located in Spokane Valley, sold in September 2018 for $17,000,000, or about $177,000 per unit. This last development consisted of ninety-six (96) units, though the age was not indicated in the record. The BPO reported an average price rate of $141,496 per unit.

Respondent appraised each subject separately and developed value indications using all three (3) approaches to value. Ultimately, the cost approach was disregarded as an outlier. For the income approach, market-derived inputs were relied on for both revenues and expenses, not the subject's actual numbers. Through surveys and other sources, Respondent developed a table of typical rental rates for different types of apartment units. The rental rates used for subject's units approximated the median rates for each unit type in Respondent's table. A 2% vacancy and rent loss factor was reportedly gleaned from third-party sources, as was the 28% operating expense rate, in estimating net operating income. Instead of including property taxes as an expense, as was done in the BPO, Respondent utilized a loaded capitalization rate of 6.75%, which included a component for the local tax levy rate. After capitalizing the net operating incomes, the two (2) subjects had a combined value of $8,120,483.

In its sales comparison approach, Respondent examined six (6) sales, two (2) from 2017 and four (4) from 2018, including the subjects' purchase. Respondent did not regard any of the sale properties to be highly comparable to the subject apartments, due primarily to their older ages, ranging from 1968 to 1995. Further, four (4) of the sale complexes had twelve (12) units or less. Respondent did attempt to directly compare each sale property to the subject and made adjustments for differences in the property characteristics. The needed adjustments, however, were quite large, and Respondent did not place much weight on the value indications. Concluding the other sale properties were not representative of subjects, Respondent argued subjects' 2018 purchase was likely the best indicator of value under the sales comparison approach. The price needed to be time-adjusted to reflect market conditions on the January 1, 2019 assessment date. Respondent applied a 1% per month time adjustment, which rate was supported by two (2) paired sales and other available market data. This resulted in an adjusted sale price of $8,491,083, which was highlighted to be more than the total of subjects' combined assessed values.

Respondent additionally provided a copy of a fee appraisal on the subject apartments. The effective date of the value estimate was March 16, 2018. Commissioned by the lender near the time of subjects' last purchase. Similar to Respondent, the appraisal report developed value estimates using all three (3) approaches to value, with the cost approach ultimately being excluded. For the sales comparison approach, there were three (3) sales, one (1) each from 2015, 2016 and 2017, as well as one (1) pending sale. The sale prices ranged from $91,775 to $204,487 per unit. The sales were compared to the subject apartments and adjustments were made for noted differences. The appraisal concluded adjusted price rates ranging from $114,964 to $173,814 per unit. As subject is a newer development, the appraisal concluded a value by this approach near the upper end of the indicated range at $7,850,000, or $163,542 per unit.

For the income approach, the fee appraisal utilized market-derived revenue and expense figures, though subjects' actual numbers were also considered in the analysis. In addition to the basic lease income, the appraisal included the income from utility payments that Appellant collects from tenants as well as other income for miscellaneous charges and fees collected from the tenants. The appraisal used a 5% vacancy and collection loss rate. After removing operating expenses, the appraisal calculated a net operating income of $432,099. This figure was capitalized at 5.5% (non-loaded rate), which yielded a rounded value conclusion of $7,850,000.

CONCLUSIONS OF LAW

This Board's goal in its hearings is the acquisition of sufficient, accurate evidence to support determinations of market value in fee simple interest, or as applicable, property's exempt status. This Board, giving full opportunity for all arguments and having considered all the testimony and documentary evidence submitted by the parties, hereby enters the following.

Idaho Code § 63-205 requires taxable property be assessed at market value annually on January 1; January 1, 2019 in this case. Market value is always estimated as of a precise point in time. Idaho Code § 63-201 provides the following definition,

> "Market value" means the amount of United States dollars or equivalent for which, in all probability, a property would exchange hands between a willing seller, under no compulsion to sell, and an informed, capable buyer, with a reasonable time allowed to consummate the sale, substantiated by a reasonable down or full cash payment.

Market value is estimated according to recognized appraisal methods and techniques. The sales comparison approach, the cost approach and the income approach comprise the three (3) primary methods for determining market value. *Merris v. Ada Cnty.*, 100 Idaho 59, 63, 593 P.2d 394, 398 (1979). Income-producing property is commonly valued with chief reference to the income approach, because such property is typically transacted based on expectations for the potential future income.

Both parties offered relevant market data and utilized recognized appraisal approaches, which efforts were appreciated by the Board. That being said, the Board did identify some concerns. In particular, the Board was left with questions with respect to the sales comparison analysis included in the BPO report. The sale properties, all located in or near the Spokane metropolitan area, were widely varied in unit count, from 50 to 148, as well as in sale price, from $6,400,000 to $18,200,000, or from roughly $123,000 to $177,000 per unit. More concerning than the physical dissimilarities was the lack of any attempt at direct comparisons and the absence of any appraisal adjustments. In short, the Board was strained to find a correlation between the reported sale prices and subjects' current market value(s).

Respondent's sales comparison analysis was better received by the Board, though with some concerns. Most notably was the comparability of the sales, which was an acknowledged weakness. Indeed, ultimately Respondent effectively relied on the sale of the subject apartments. The only adjustment being needed there was for time of sale, which, when applied, yielded a value conclusion of $8,478,000, or roughly $176,000 per unit. While we agree the recent sale of the very property being valued is typically regarded as strong evidence of its market value, a proper sales comparison approach will look to consider multiple sales of similar properties. That being said, subjects' purchase was deemed to be good value evidence where it was an arm's length. Subjects' purchase featured prominently in the Board's consideration of the current market value.

Both parties developed value opinions using the income approach. The respective models were similar, with the biggest divergence being Appellant's use of subjects' actual revenues and Respondent's reliance on market-derived revenues. Appellant's contention the actual revenues should be used is understandable, market value however is established through a consideration of market rent, not just the performance of a single property in a broader marketplace. Indeed, the independent fee appraisal also advocated for the ultimate use of market rent (market rent and typical market expenses). This is consistent with accepted appraisal practices. See for example Property Tax Administrative Rule 217, IDAPA

35.01.03.217. For this reason, the Board was reluctant to rely heavily on the income model developed in Appellant's BPO report.

In accordance with Idaho Code § 63-511, the burden is with Appellant to prove subjects' valuations are erroneous by a preponderance of the evidence. Given the record in this matter, we did not find the burden of proof satisfied. The subject apartments were purchased in April 2018 in an arm's-length transaction between knowledgeable, unrelated parties for $7,850,000. The purchase price was closely aligned with a fee appraisal commissioned by the lending institution. That value information, however, reflected market value about eight (8) months prior to the relevant assessment date. Because we find the market continued to appreciate after subjects' purchase, the Board agrees the current assessed value should be higher than the purchase price. In this case, Respondent offered relevant information connected with the time of sale and the effective valuation date in this appeal. That evidence concluded a combined value of $8,061,030, which equates to an overall appreciation rate of roughly 3% over the eight (8) months since the purchase. Given there was evidence to suggest a notably higher market appreciation rate, the modest increase of 3% was not unreasonable. In all, the Board found subjects' assessed value to be well-supported by the available market data.

For the reasons expressed, the value decisions of the Kootenai County Board of Equalization are affirmed.

FINAL ORDER

In accordance with the foregoing Final Decision, IT IS ORDERED that the decisions of the Kootenai County Board of Equalization concerning the subject parcels be, and the same hereby are, AFFIRMED.

DATED this 3rd day of March, 2020.