

BEFORE THE IDAHO BOARD OF TAX APPEALS

LUTHER PARK AT SANDPOINT, LLC,)	
)	
Appellant,)	APPEAL NO. 21-A-1025
)	
v.)	FINAL DECISION AND ORDER
)	
BONNER COUNTY,)	
)	
Respondent.)	
)	
)	
)	

COMMERCIAL PROPERTY APPEAL

This appeal is taken from a decision of the Bonner County Board of Equalization denying an appeal of the valuation for taxing purposes on property described by Parcel No. RPS00000226460A. The appeal concerns the 2021 tax year.

This matter came on for telephonic hearing October 28, 2021, before Board Member Leland Heinrich. Appraiser Bruce Jolicoeur appeared at hearing for Appellant. Bonner County Chief Deputy Assessor Dina Brown 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 an improved commercial property.

The decision of the Bonner County Board of Equalization is modified.

FINDINGS OF FACT

The assessed land value is \$1,254,855, and the improvements' value is \$13,943,285, totaling \$15,198,140. Appellant contends the correct land value is \$880,000, and the improvements' value is \$12,190,000, totaling \$13,070,000.

The subject property is a 3.84 acre commercial parcel located in Sandpoint, Idaho. The property operates as a senior care facility providing housing, as well as assisted living and memory care services. There are sixty (60) assisted living units and twenty-seven (27) memory care units in the 84,721 square foot structure constructed in 2008. The assisted living units are comprised of a mix of one (1) and two (2) bedroom units, which are housed in a three (3) story building. Some of the assisted living facility's amenities include three (3) lobbies, various recreation spaces, several therapy areas, and a large community dining room. On the other side of the dining room is the single-level memory care wing comprised of studio and one (1) bedroom units. In addition to a large common living room, memory care residents have access to several smaller common areas, as well as a kitchen and dining room. Lastly, there is on-site parking for fifty-nine (59) vehicles, and the surrounding grounds were noted to be well landscaped.

In support of its value claim, Appellant offered an independent fee appraisal report authored by an MAI-designated appraiser based in nearby Spokane, Washington. The appraisal described senior care facilities as a somewhat special type of commercial property, with three (3) distinct components: real property, personal property, and intangible property. It was argued the latter property type is exempt from *ad valorem* taxation, so its value must be removed from the overall value, also referred to as the market value of the going concern. It was against this backdrop that the appraisal developed value estimates using all three (3) accepted approaches to value.

The appraisal's cost approach first looked to develop a land value estimate for the subject lot. Five (5) local sales were included in the analysis. At 167,314 square feet in size, the subject parcel was larger than the sale lots, which ranged in size from 61,420 to

138,521 square feet. Sale prices ranged from \$295,000 to \$920,000, or from \$3.50 to \$7.30 per square foot. Each sale property was directly compared to subject, and adjustments were made for differences in characteristics such as size, conditions of sale, and location. The result was a range in adjusted sale prices from \$4.38 to \$5.54 per square foot. The appraisal concluded a value of \$5.25 per square foot, or a rounded value of \$880,000, for the subject lot.

The appraisal next developed a cost approach model for subject's improvements using Marshall Valuation Service (MVS), a national cost service which provides cost information for new construction and is widely accepted in the appraisal industry. The appraisal concluded a total cost figure of roughly \$11,500,000 using MVS, which was compared to the developer's trended budget from 2007 when the subject property was developed of approximately \$14,500,000. The appraisal reconciled the two (2) cost indications into a final cost total of \$13,300,000. To this, the appraisal added \$1,330,000 for entrepreneurial incentive, which represents 10% of the final cost figure, and also added \$450,000 for furniture, fixtures, and equipment (FF&E). The final cost approach value conclusion for subject was \$13,070,000.

With respect to the sales comparison approach, the appraisal explained there were no sales of similar senior care facilities in Sandpoint, so the geographic scope was expanded in an effort to collect enough sales data to develop a reliable value estimate. The appraisal utilized seven (7) senior care facility sales located in Idaho and Oregon. The sale properties varied in size and design, with total unit counts ranging from 42 to 95 units. Five (5) of the sales transpired during 2021, with prices ranging from \$5,400,000 to \$15,700,000. The remaining two (2) sales occurred in 2020 and 2017, with sale prices of

\$11,850,000 and \$8,000,000, respectively. Overall, sale prices ranged from roughly \$113,000 to \$201,000 per unit. Each sale facility was directly compared to the subject property, and adjustments were made for conditions of sale, as well as date of sale. Those sales which occurred prior to January 1, 2021, were time-adjusted upward to reflect market pricing levels on the effective date of valuation, and a downward adjustment was applied to those sales which closed after January 1st. The result was adjusted sale prices ranging from approximately \$114,000 to \$204,000 per unit. Ultimately, the appraisal concluded a value of \$185,000 per unit for the subject facility, or a total dollar value of \$16,095,000.

The appraisal next developed an income approach model. Subject's actual income and expense data from the prior four (4) years was used in the analysis. An effective gross income of nearly \$4,400,000 was concluded, as was a total operating expense figure of roughly \$2,900,000. This resulted in a net operating income amount of approximately \$1,500,000. Based on the capitalization rates associated with the sales used in the sales comparison approach, the appraisal determined a capitalization rate of 8%, or an overall rate of 9.02% after adding the local tax levy rate. The appraisal concluded a total going concern value of \$16,410,000 for the subject property.

In reconciling the value indications reached in the three (3) valuation approaches, the appraisal remarked that the sales comparison approach is "less sensitive to the income considerations and is less market supportable," so the approach was used primarily as a test of reasonableness for the conclusion reached under the income approach. The appraisal then endeavored to identify the value of any intangible assets included in the total going concern value of \$16,410,000. To accomplish this, the

appraisal calculated the difference between the total going concern value and the value indication reached under the cost approach. The appraisal reasoned because the cost approach inherently excludes any intangible value, the difference between the value indications reached in the cost and income approaches represented the value of the intangible assets, which was \$2,905,000 for the subject facility. After removing the estimated value of the intangible assets from the value conclusion determined in the income approach, the appraisal calculated a value of \$13,495,000 for subject's real property and FF&E, and Appellant petitioned this Board to amend subject's current assessed value accordingly.

Respondent objected to the appraisal's methodology of estimating the value of subject's potential intangible property. Respondent pointed out there is no current widely accepted methodology for extracting intangible business value. At the very least, Respondent argued, a certified business valuation expert would be needed to analyze the data to identify potential intangible value attributable to the business. Respondent further contended any possible intangible business value associated with subject was accounted for in the operating expense rate applied in Respondent's income approach. Appellant countered that the revenue generated from subject's intangible assets exceeds the reported expenses, so the operating cost figure Respondent utilized was insufficient to offset the revenue, thereby resulting in a higher market value conclusion for the property.

Respondent explained all three (3) approaches to value were considered; however, the sales comparison approach was ultimately discarded due to the lack of recent sales of similar senior care facilities. Though details were limited, Respondent did

provide a summary of its cost approach model. Respondent determined a replacement cost new estimate of nearly \$14,400,000 for subject's improvements, from which a 6% physical depreciation factor was removed, resulting in a depreciated building value of roughly \$13,500,000. After adding the land value of approximately \$1,250,000, Respondent's cost model concluded a total value of \$14,754,045 for the subject property.

Respondent also prepared an income approach analysis using subject's 2018 financial data, which was the last time Appellant's financial information was provided to Respondent. The potential gross income from both operating revenue and other miscellaneous revenue was approximately \$3,900,000. Respondent applied a 0% factor for vacancy and collection loss. After removing expenses of roughly \$2,600,000, Respondent calculated a net operating income amount of \$1,300,000. The net operating income was capitalized at 8%, resulting in a value indication of \$15,784,846. To this, Respondent added \$146,138 for personal property, which yielded a total market value conclusion of \$15,638,708.

In reconciling the value indications reached under the cost and income approaches, Respondent assigned 35% weighting to the cost approach and 65% to the income approach. The result was a total value indication of \$15,329,080, which Respondent noted was higher than the current assessed value of \$15,198,140.

CONCLUSIONS OF LAW

This Board's goal in its hearings is the acquisition of sufficient, accurate evidence to support a determination of market value in fee simple interest or, as applicable, a 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, 2020, 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 three (3) primary approaches for determining market value include the sales comparison approach, the cost approach, and the income approach. *Merris v. Ada Cnty.*, 100 Idaho 59, 63, 593 P.2d 394, 398 (1979). Commercial property is commonly valued using the income approach, as a commercial property’s income-producing potential is often a key consideration in a buyer’s purchase decision. In fact, both parties agreed market participants typically rely on the income approach to estimate the market value of commercial property.

Not surprisingly, the income approach featured prominently in the parties’ respective valuation analyses. While both parties’ models were similar in approach, there were some differences which contributed to the divergent value conclusions. The parties both utilized subject’s actual financial data for income and expense numbers; however, Respondent’s data was from 2018, whereas Appellant’s fee appraisal was privy to several years of subject’s financial information, including 2020’s. Another important difference was the capitalization rate in the respective models. Appellant’s fee appraisal utilized an

8% capitalization rate and loaded it with the tax levy rate of 1.02%, resulting in an overall capitalization rate of 9.02%. Respondent also used an 8% capitalization rate, though it was unclear if the rate was loaded with the tax levy. Presumably, property taxes were removed as an operating expense in the net operating income calculation and not included in the capitalization rate, but the record is void of details on the matter. Indeed, there were no supporting details for any of the inputs Respondent utilized in its income model.

Upon closer review of Respondent's analysis, the Board identified an error in the calculation. There is a line item titled "Vacancy and Loss (2%);" however, no vacancy and loss factor was removed from the potential gross income figure. It is assumed this was more of a clerical error because to have a 0% vacancy and loss factor would be highly unusual in the Board's experience. Appellant's fee appraisal, using the prior four (4) years of subject's financial data, reported a stabilized vacancy rate of 7.4%. Even using the 2% vacancy and loss rate suggested in Respondent's income model would reduce the final value conclusion by roughly \$835,000.

The Board found much the same with respect to Respondent's land value conclusion of \$1,254,855. The land value is simply reported as a line item in Respondent's cost model. There was no market data, nor any other evidence to support the accuracy of the number. This represented another departure in the parties' respective analyses. Appellant's fee appraisal developed its land value conclusion of \$880,000 through a sales comparison approach in which five (5) sales were each directly compared to subject, and appraisal adjustments were made for noted differences. The Board favorably received the appraisal report's more thorough and better supported land value analysis.

While there were concerns with aspects of Respondent's valuation models, the more important issue for the Board was the appraisal report's methodology for removing potential intangible business value from subject's valuation. The approach advocated by the appraisal report is straight-forward: simply subtract the value conclusion reached in the cost approach from that reached in the income approach. It was argued the difference between the value indications represented the amount of intangible business value. The Board has heard this argument before and remains unpersuaded the methodology produces the most credible result. To wit, the appraisal report itself stated, "[t]echniques associated with identifying and separating [intangible business value] from total property have been debated over time, *but no standard currently exists.*" Appellant's Exhibit 1, p. 113 (emphasis added).

Appellant's appraisal report defined intangible business value, referred to as Business Enterprise Value in the appraisal, as, "[the] concept of the value contribution of the total intangible assets of a continuing business enterprise such as marketing and management skill, an assembled work force, working capital, trade names, franchises, patents, trademarks, contracts, leases and operating agreements." Appellant's Exhibit 1, p. 113. Property Tax Administrative Rule 615.01 (IDAPA 35.01.03.615.01) provides a similar list of intangible personal property exempt from *ad valorem* taxation. The appraisal report did not attempt to identify any specific intangible asset the subject property may potentially have, though there were references at hearing to an assembled workforce. While the Board can appreciate the advantage an assembled workforce could have on a continuing business enterprise, Appellant does not manage the operations at the subject facility. Rather, a third party operates and manages the assisted living and memory care

services, the costs of which are included in Appellant's operating expenses. The assembled workforce is not something Appellant developed, but rather a workforce Appellant has "purchased" from a third party.

The Board does not dispute there could be intangible business value associated with a going-concern enterprise, but any such intangible assets should at a minimum be identifiable. The International Association of Assessing Officers (IAAO) has published guidance related to intangible assets. Specifically, the IAAO has developed the following four-part inquiry to determine whether an asset is intangible: 1) is the asset identifiable; 2) does the asset have evidence of legal ownership; 3) is the asset separate and divisible; and 4) is the asset legally transferrable. Appellant's fee appraisal did not provide evidence of any of the above-listed intangible assets, other than references to an assembled workforce, nor did the appraisal attempt to assign any specific value to individual intangible assets. Rather, the appraisal assigned a blanket value of \$2,905,000 for all of subject's potential intangible assets. With such a notable amount of intangible value, it would seem reasonable that at least some specific intangible assets could be identified. The appraisal, however, made no such attempt, which was concerning to the Board.

Overall, the Board was not convinced the cost approach allocation method utilized in the appraisal report yielded the most reliable results. To start, while the cost approach inherently excludes any intangible asset value, it is generally not considered the best approach for older improvements, given the difficulty in estimating physical depreciation and economic obsolescence. In other words, the weakness in the cost approach allocation method advocated by the appraisal is the methodology relies on the cost approach itself, the accuracy of which is well-known to diminish as the age of the

improvements increases. And where, as the appraisal report confesses, there is no currently accepted standard for extracting potential intangible business value from a property's overall market value, the Board was reticent to accept the methodology proffered by the appraisal report. It was also not lost on the Board the value indication developed using the sales comparison approach at \$16,095,000 closely approximated the value conclusion of \$16,410,000 reached in the income approach, which could suggest perhaps the \$13,070,000 value determined in the cost approach was an outlier in the data set.

As the Idaho Supreme Court has previously observed, “the question is not what someone else, however eminent he may be in the field of appraisal work and knowledge of market values, may think is the proper method, but involves simply the determination as to whether the method used by the assessor was legitimate and fair, and was a reasonable method to use in arriving at the value of the property in question.” *Abbot v. State Tax Comm'n*, 88 Idaho 200, 206, 398 P.2d 221, 224 (1965). In the case at bar, Respondent relied primarily on the income approach to determine subject's assessed value, which both parties agreed was the approach that should receive the greatest weight. In short, the Board found no error in Respondent's primary reliance on the income approach.

While the Board agrees primary emphasis should be on the income approach, there were some concerns with Respondent's income model. As noted earlier, Respondent failed to deduct any vacancy and collection loss from the effective gross income calculation, which materially altered the value conclusion. Further, Respondent's income approach model was developed using subject's 2018 financial data, which is

somewhat stale for purposes of estimating a current market value. In the Board's view, the income model in Appellant's appraisal represented the better indication of value, as it was developed using subject's current financial information, and the inputs into the model were generally well-supported with relevant market data. The appraisal report determined a value of \$16,410,000 for the subject property, which is notably higher than the current assessed value of \$15,198,140. Despite representing the better-supported income model, the Board was ultimately disinclined in this instance to increase subject's valuation to the level suggested by the appraisal report.

Though the Board agrees with Respondent's conclusion regarding the value of subject's improvements, the same was not found with respect to subject's land value. Respondent reported a land value of \$1,254,855 but provided no support for the figure. Appellant's fee appraisal, on the other hand, developed a land value estimate of \$880,000 based on an analysis of five (5) recent local sales. The comparative analysis between subject and the sales adhered to accepted standards of appraisal practice, and the resulting value conclusion was found by the Board to represent a strong indication of subject's current land value. Therefore, the Board will reduce subject's land value to \$880,000.

In appeals to this Board, Appellant bears the burden of proving error in subject's valuation by a preponderance of the evidence. Idaho Code § 63-511. While the Board found the burden of proof satisfied, we did not find sufficient evidence to support the value petitioned by Appellant. Specifically, the Board found a reduction in subject's land value is warranted, but did not find an adjustment to the value of the improvements appropriate in this instance.

Based on the above, the decision of the Bonner County Board of Equalization is modified as detailed in the below final order.

FINAL ORDER

In accordance with the foregoing Final Decision, IT IS ORDERED that the decision of the Bonner County Board of Equalization concerning the subject parcel be, and the same hereby is, MODIFIED to reflect a decrease in total valuation to \$14,823,285, with \$880,000 attributable to the land, and \$13,943,285 to the improvements.

IT IS FURTHER ORDERED, pursuant to Idaho Code § 63-1305, any taxes which have been paid in excess of those determined to have been due be refunded or applied against other *ad valorem* taxes due from Appellant.

Idaho Code § 63-3813 provides that under certain circumstances the above ordered value for the current tax year shall not be increased in the subsequent assessment year.

DATED this 31st day of January, 2021.

IDAHO BOARD OF TAX APPEALS