BEFORE THE IDAHO BOARD OF TAX APPEALS

CEDAR WOOD ESTATES, LLC, Appellant, v. KOOTENAI COUNTY, Respondent.	)))))))))))	APPEAL NO. 22-A-1171 FINAL DECISION AND ORDER

COMMERCIAL PROPERTY APPEAL

This appeal is taken from a decision of the Kootenai County Board of Equalization denying an appeal of the valuation for taxing purposes on property described by Parcel No. C9000000016A. The appeal concerns the 2022 tax year.

This matter came on for hearing October 12, 2022, in Post Falls, Idaho, before Board Member Kenneth Nuhn. David Peterson appeared as Appellant's representative at hearing. Appraisal Manager Troy Steiner represented Respondent.

Board Members Leland Heinrich, Kenneth Nuhn, and Doug Wallis join in issuing this decision.

The issue on appeal concerns the market value of an improved commercial property.

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

FINDINGS OF FACT

The assessed land value is $2,000,945, and the improvements' value is $7,972,774, totaling $9,973,719. Appellant contends the correct total valuation is $6,660,000.

The subject property is a 4.74 acre apartment complex located in Coeur d'Alene, Idaho. The development is comprised of sixty (60) apartment units spread across twelve (12) buildings constructed in 1984. There are forty-six (46) 902 square foot two (2) bedroom, one (1) bathroom units and fourteen (14) 1,280 square foot two (2) bedroom, one and one-half (1½) bathroom models. The complex includes a swimming pool and large landscaped yard areas available to tenants, though the apartment units were noted to have dated interiors and worn exterior siding.

In support of its value claim, Appellant offered an independent fee appraisal report prepared by a local appraisal firm with a retrospective date of valuation of December 31, 2021. The appraisal began with a sales comparison model using three (3) apartment complex sales located in Coeur d'Alene, three (3) in Post Falls, and one (1) in Dalton Gardens, noted to be a suburb of Coeur d'Alene. The sales were widely varied in year built, ranging from 1970 to 2020, and in number of apartments, from 6 units to 330 units. The sales occurred between April 2018 and August 2021 at prices ranging from $654,000 to $63,300,000, or from roughly $85,000 to $190,000 per unit.

The appraisal directly compared each sale property to the subject complex and made various appraisal adjustments for noted differences in property characteristics. Citing a report by the University of Washington, which reported an average rental rate increase of 17.4% in Kootenai County during the period from Summer 2020 to Spring 2022, the appraisal first adjusted the sale prices for the change in market conditions between the date of sale and the effective date of appraisal. The appraisal made further adjustments for differences in location, unit count, condition, unit mix, and amenities. The result was adjusted sale prices from $99,244 to $165,297 per unit. Considering "subject is an aging facility with a dated exterior", the appraisal concluded a value of $110,000 per unit for subject, which was noted to be near the middle of the range indicated by the adjusted price rates. Applying this rate to subject's sixty (60) units calculates to a total value of $6,600,000.

The appraisal next developed an income approach model. The appraisal examined six (6) rent comparables to identify market lease rates for similar unit types to estimate subject's potential gross income. The rates were adjusted to account for differences in amenities between the sale complexes and the subject development such as kitchen appliances, garages, carports, washer/dryer hookup, and pools. Based on these adjusted market lease rates, the appraisal determined a monthly rate of $945 for subject's two (2) bedroom, two (1) bathroom units, and a rate of $1,085 per month for the larger two (2) bedroom, one and one-half (1½) bathroom units. Both rates were noted to be somewhat higher than subject's actual lease rates. Applying these rates to the subject development, which calculates to an average annual rental income figure of $11,732 per unit, the appraisal calculated a potential gross rental income total of nearly $705,000, to which 5% was added for the additional income generated from covered parking and coin-operated laundry offered at the subject complex. The appraisal next applied a 5% vacancy and loss factor, resulting in an effective gross income total of approximately $705,000.

In similar fashion, the appraisal compared subject's actual operating expenses over the prior three (3) years against the expenses reported by four (4) local apartment complexes ranging in unit count from 25 to 132 units. The appraisal considered expenses for property taxes, insurance, utilities, repairs and maintenance, among others. The rent comparables had expense ratios ranging from 42.4% to 61.8%, which bracketed subject's actual expense ratios of 50.3%, 48.9%, and 50.5% for 2019, 2020, and 2021, respectively. Ultimately, the appraisal concluded an expense ratio of 47.7% for subject, which when applied to the effective gross income, resulted in a stabilized net operating income total of approximately $370,000.

The appraisal then considered an appropriate capitalization rate to apply to the net operating income figure. Capitalization rates for the seven (7) sales used in the earlier sales comparison model were calculated, which ranged from 4.51% for a 330-unit complex constructed in 2019 in Post Falls and sold in 2021, to 6.20% for the 2018 sale of a forty-eight (48) unit development in Dalton Gardens constructed in 2016. Giving consideration to subject's characteristics, location, condition, and age, the appraisal resolved to a capitalization rate of 5.50%. Applying the capitalization rate to the net operating income, a leased fee market value conclusion of $6,700,000 was calculated.

In the final reconciliation, the appraisal weighed the values determined under both valuation models and concluded a stabilized value of $6,700,000 for the subject development. In the final step, the appraisal deducted $40,000 as a discount for rent-up to stabilized occupancy. As explained by the appraisal, the $6,700,000 value conclusion is based on all units being leased at market rent; however, subject's actual rents are approximately 12% lower than market. In order to achieve market lease rates, subject's apartment units would need some interior updating as tenants vacate and new tenants occupy. The appraisal estimated a lease-up period of seven (7) months and concluded a total rent loss and cleanup cost of roughly $40,000, which was noted to equate to less than one percent (1%) of the market value. After removing the rent-up cost figure, the appraisal concluded a final value of $6,660,000 as of December 31, 2021. Appellant petitioned subject's assessed value be reduced accordingly.

Respondent shared all three (3) approaches to value were considered in valuing the subject property, however, the cost approach was ultimately excluded because it is generally not considered the most reliable indicator of current market value for an older commercial property like subject. With respect to the sales comparison approach, Respondent explained at the time subject's value was determined, the assessor's office was aware of only two (2) apartment complex sales during 2021. The first was a six (6) unit project constructed in 1905 which sold in November 2021 for $630,000, or $105,000 per unit. The other sale property was an eight (8) unit complex constructed in 1949 and purchased in December 2021 for $1,000,000, or $125,000 per unit. Respondent highlighted the ratios between the properties' sale prices and the 2022 assessed values, reported at 102.89% for the first sale and 91.42% for the second.

At some later point, Respondent learned of two (2) additional apartment sales which transpired during 2021. First was the August 2021 purchase of a 330-unit complex constructed in 2019 for $63,300,000, or nearly $192,000 per unit. Second was the $23,500,000, or $163,000 per unit, purchase in December 2020 of a 144-unit development constructed in 2019. The sale-price-to-assessment ratios for these sales were 102.96% and 99.33%, respectively. And with a mean assessment ratio of 101.11% for all four (4) sales, Respondent opined apartment values generally were at market level and maintained the same was the case with subject's assessed value.

Respondent next developed a comparative valuation model using the $23,500,000 December 2020 sale noted above and three (3) sales from 2022. The 2022 sale properties were constructed in 1977 and 1978 and ranged in unit count from four (4) to sixty (60). Sale prices stretched from $725,000 to $9,600,000. Each sale property was compared to subject and broad qualitative adjustments were made for differences in property characteristics. The first adjustment was for date of sale, which Respondent adjusted at a rate of 2% per month. The next adjustment category related mostly to differences in amenities, such as pools and garages, plus some consideration for land size, gross living area, unit count, and average unit size. Adjustments in this category ranged from -15% to +5%. Lastly, Respondent made condition adjustments ranging from -7% to +7%, resulting in adjusted sale prices from $750,375 to $23,970,000, or from roughly $166,000 to $188,000 per unit. The subject development is assessed at $166,229 per unit, which was reasonable in Respondent's view against the range indicated by the adjusted price rates.

Respondent next shared its income approach model, which was the methodology used to determine subject's assessed value. Respondent calculated a potential gross income figure of nearly $955,000 by using a lease rate of $1,275 per month for subject's forty-six (46) two (2) bedroom, one (1) bathroom units, and a monthly rate of $1,330 for the remaining fourteen (14) units[1]. To this, Respondent added roughly $27,000 in other income to arrive at the potential gross income amount of $955,000. A vacancy and rent loss factor of 2% was used, though it was not clear the source of that rate. For expenses, market data Respondent collects annually since at least 2015 indicated apartment complex expense ratios ranging from 35% to 44%, or from 26% to 34% after removing

[1] Respondent's income model indicated these fourteen (14) units had two (2) bathrooms, but Appellant confirmed these models have one and one-half (1½) bathrooms. It was not apparent if the reported count of two (2) bedrooms was a typographical error or if it potentially impacted Respondent's lease rate conclusion.

property taxes. Respondent utilized the average expense ratio of 28% for subject. Applying these vacancy and expense ratio factors to the potential gross income yielded a net operating income amount of roughly $675,000. This figure was capitalized at 6.75%, which was a loaded rate that included the local tax levy, and resulted in a final value conclusion of $9,973,719, or approximately $166,000 per unit for the subject property.

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, 2022, 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). Due to its income-producing potential, commercial property is often valued using the income approach, though the sales comparison approach can also produce a credible value estimate, provided there are a sufficient number of relevant sales and other market data.

In the case at bar, both parties developed value estimates using both the income and sales comparison approaches. While the parties' efforts to develop multiple valuation models were appreciated, there were some concerns from the Board's perspective, especially with respect to the sales comparison models. Specifically, none of the sale properties were found to be particularly comparable to the subject development, other than location and general property type.

The parties' sale properties were constructed from 1970 to 2019 and varied widely in unit count, from 6 to 330 units. These two (2) characteristics alone necessitated notable adjustments for purposes of comparison with subject. Another significant adjustment was for date of sale. Appellant's appraisal concluded an annual price appreciation rate of 18%, while Respondent utilized a 24% rate. Neither of these time-adjustment factors are concerning on their own, but when applied to sale prices from as far back as 2018, there is a material impact on the adjusted price rates and the resulting value conclusion. For example, the two (2) oldest sales in Appellant's appraisal were adjusted roughly 50% for date of sale alone. It is well-understood in appraisal that as more adjustments are made to a sale, the less reliable the value conclusion becomes.

The Board understands the parties' sales models were limited by a small pool of recent apartment sales, so there were no better comparable sales available. This, however, underscores a weakness in the sales comparison approach for commercial property; namely, that a strong sales model requires multiple sales of highly comparable property, which can be difficult to find with certain classes of commercial property. Such was simply not the case here, where the most similar apartment sale was the April 2018 purchase of a 48-unit complex constructed in 2016 for $7,185,000, which Appellant's appraisal adjusted 50.4% for comparison with subject. In short, the Board was not persuaded the sales comparison approach produced the most reliable indicator of market value in this particular instance.

Better received by the Board were the parties' income approach analyses, though there were some material differences between the respective models. Starting with the potential gross income, both parties recognized subject's current rents were somewhat below market levels so looked to the local apartment marketplace to identify appropriate lease rates for both of subject's unit types. Based on rental rates of six (6) competing apartment complexes constructed from 1994 to 2012, Appellant's appraisal concluded adjusted lease rates of $945 per month for subject's two (2) bedroom, one (1) bathroom units, and $1,085 for the two (2) bedroom, one and one-half (1½) bathroom models. The appraisal provided full details of the rent comparables, including all adjustments to the respective lease rates in reaching its market rate conclusions.

Respondent, by contrast, concluded monthly lease rates for subject's unit types of $1,275 and $1,330, respectively, though it was unclear how those rates were determined. Respondent provided two (2) tables of rental rates for various apartment projects, but only scant details of the comparison properties were shared. It was also unclear the locations of the other apartment complexes or when the lease rate data was collected. In any event, Respondent reported an average rental rate of $1,147 per month for two (2) bedroom, one and one (1) bathroom units in the first table and an average rate of $1,260 for two (2) bedroom, two (2) bathroom units in the second table. The lease rate

Respondent determined for subject's one (1) bathroom units was roughly 11% higher than the average rate in the first table and the two (2) bathroom rate was nearly 6% higher than the average rate of the second table. In fact, only six (6) of the nineteen (19) lease rates reported in the first table were higher than the $1,275 per month rate Respondent determined for subject's one (1) bathroom units. The subject development was described by both parties as an average apartment complex that has been maintained relatively well, so it was curious to the Board why Respondent settled on lease rates appreciably higher than the average rates of both data sets. Also, the data included in the second table was for two (2) bathroom units, whereas subject's larger units are only one and one-half (1½) bathroom models. From the Board's perspective, Respondent's rental rate conclusions for the subject property were somewhat aggressive compared to the entirety of the rental data in the record.

At first look, Respondent's operating expense rate of 28% appears wildly divergent from the 47.7% rate determined in Appellant's fee appraisal, but the variance is not as great as it seems. Respondent's 28% expense rate excludes property taxes, which were instead captured in a loaded capitalization rate applied later in the analysis. The 28% rate represents the average expense ratio of the rent and expense data Respondent has collected from various sources. Adding property taxes back into the expenses changes the expense ratio range from 35% to 44%, or an average of 38.6%. This narrows the gap somewhat, but still represents a notable difference from the 47.7% rate used in the appraisal. It was difficult to determine which was the most appropriate expense rate for the subject complex, but the appraisal provided detailed income and expense data on four (4) apartment developments, so the correlation of the data to the 47.7% expense rate concluded for subject was apparent. The same could not be said for Respondent's expense data which only revealed total expenses and property tax expenses, with no indication of the other expenses included in the total expense calculations. The Board does not doubt the veracity of the data reported by Respondent, but the analysis would have benefited from more details about the data.

Much the same was found with respect to the parties' vacancy and collection loss factors. Respondent's 2% vacancy and loss rate appeared suddenly in its income model, with no discussion or detail regarding how the rate was determined. Appellant's appraisal report, on the other hand, cited two (2) separate sources used to develop its vacancy and loss factor. One source reported September 2021 vacancy rates below 2%, while the other source identified an upward year-end vacancy trend at 8.5%. The appraisal used a 5% vacancy and loss factor for the subject property.

Where the parties' valuation models did mostly agree was with respect to the capitalization rate. Both parties offered various sources in support of the capitalization rates used in their respective analyses. The appraisal determined a capitalization rate of 5.50%, and Respondent concluded a loaded capitalization rate of 6.75%. But Respondent stressed if the tax rate was removed, the unloaded capitalization rate would be roughly 5.75%, which approximates the rate in the appraisal report. In the Board's experience, the value conclusion differs little whether property taxes are deducted as an operating expense or are instead captured in a loaded capitalization rate, so the parties' differing methodologies in this regard were not concerning.

The other noteworthy departure between the parties' methodologies was the appraisal's inclusion of a $40,000 discount for rent-up adjustment to the $6,700,000 value conclusion upon stabilization. In basic terms, in order to achieve market rents at the subject property, lease rates will need to be increased. This will in turn cause some tenant turnover, at which time the vacated units can be updated and freshened-up for the new tenants, whose rental rates will then be at market. The adjustment is intended to capture the difference between market rents and subject's currently below-market rents, plus the costs associated with updating the units as they turn over. Based on subject's size, the appraisal estimated a lease-up period of roughly seven (7) months, by which time the project should reach stabilized occupancy and the full $6,700,000 market value figure concluded by the appraisal. While the Board has seen discounts for rent-up to stabilized occupancy utilized in some appraisals, it is not a typical consideration in most valuations. In the Board's experience, this type of adjustment is more commonly used for newly constructed, highly unique, or specialized commercial projects. The subject property did not strike the Board as particularly unique, but where the adjustment in this case equates to 0.6% of the market value conclusion, the impact on the overall analysis is *de minimus* at most so is not cause for concern.

Considering the various value indicators and accompanying market data, the Board was not convinced the assessed value of $166,229 per unit accurately reflects subject's current market value. The subject apartment complex is nearly forty (40) years old and in need of some updating to keep up with current tenant demands and the influx of newly constructed rental projects entering the marketplace. It did not appear Respondent adequately considered subject's condition as evidenced by the "good" rating used in Respondent's sales comparison approach which contradicted the ProVal record reflecting an "average" condition rating. Respondent's analysis included an adjustment for condition, so by overstating subject's condition rating, the correlating condition adjustments made to the sales served only to inflate the respective adjusted price conclusions. In short, it was apparent to the Board some of subject's less-desirable characteristics were overlooked or minimized in Respondent's valuation of the property.

While there were concerns with the comparability of some of the sale properties, what was striking to the Board was only one (1) apartment complex sold higher than the $166,229 per unit rate at which subject is assessed. And even after the sale prices were heavily adjusted for comparison with subject, only Respondent's four (4) adjusted price rates of $166,458, $187,594, $167,200, and $176,800 per unit exceeded subject's valuation. By contrast, the adjusted price rates in Appellant's appraisal report ranged from $99,413 to $158,917 per unit. Combining all the sales data, the median unadjusted price rate calculates to approximately $125,000 per unit, and the median adjusted sale price is nearly $135,000 per unit. As subject was characterized by the parties as an average apartment complex, it is reasonable in the Board's view that the valuation should likewise be in the middle range. Therefore, the Board will reduce subject's valuation to $130,000 per unit, or a total valuation of $7,800,000.

The burden of establishing error in subject's valuation by a preponderance of the evidence is Appellant's to bear. Idaho Code § 63-511. Based on the above, the Board found the burden of proof satisfied but sdid not find sufficient support for the valuation petitioned by Appellant. Rather, given the evidence presented in this matter, the Board concluded a valuation of $7,800,000 for the subject property. The decision of the Kootenai County Board of Equalization is modified accordingly.

FINAL ORDER

In accordance with the foregoing Final Decision, IT IS ORDERED that the decision of the Kootenai County Board of Equalization concerning the subject parcel be, and the same hereby is, MODIFIED to reflect a decrease in total valuation to $7,800,000, with $2,000,945 attributable to the land and $5,799,055 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 27th day of March, 2023.

IDAHO BOARD OF TAX APPEALS