BEFORE THE IDAHO BOARD OF TAX APPEALS

SUSAN AND DAVID WISHNEY FAMILY TRUST, Appellant, v. CANYON COUNTY, Respondent.	APPEAL NO. 22-A-1147 FINAL DECISION AND ORDER

COMMERCIAL PROPERTY APPEAL

This appeal is taken from a decision of the Canyon County Board of Equalization modifying the valuation for taxing purposes on property described by Parcel No. 045800000. The appeal concerns the 2022 tax year.

This matter came on for hearing November 8, 2022, in Caldwell, Idaho, before Hearing Officer Travis VanLith. Trustee David Wishney appeared at hearing for Appellant. Canyon County Chief Deputy Assessor Mike Cowen 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 Canyon County Board of Equalization is affirmed.

FINDINGS OF FACT

The assessed land value is $90,000, and the improvements' value is $985,000, totaling $1,075,000. Appellant contends the correct total value is $762,635.

The subject property is a .14 acre commercial parcel situated in the downtown core of Caldwell, Idaho. The property is improved with a two (2) story commercial building constructed in 1903. The building totals 14,879 gross square feet, with 5,878 square feet of retail space on the ground floor, 5,665 square feet of office space on the upper level, and 3,336 square feet in the basement, though the basement space is mostly inaccessible and usable only for storage purposes. The net leasable area of the building is roughly 10,280 square feet.

The subject property was initially assessed for a total value of $1,204,100 which was reduced by the Canyon County Board of Equalization to the current valuation of $1,075,000 following some corrections by the assessor's office to the building's size measurements.

Appellant contended the subject property does not generate the level of income reflected by the current assessed value, which is nearly double the 2021 assessed value. Appellant developed an income approach valuation model utilizing the direct capitalization method. Appellant used subject's actual 2021 gross income of roughly $80,000. For expenses, the average expense totals over the prior three (3) years were used. Appellant explained there was an atypical expense during 2021 concerning an HVAC issue, so the three (3) year average was used in an effort to normalize the expenses in the income model. As the subject property has enjoyed nearly 100% occupancy the prior several years, no vacancy was included. Appellant also deducted nothing for management expenses. The result was an approximate net income figure of $45,000. The model calculated two (2) value conclusions, one (1) using a 6% capitalization rate and the other based on a 5.5% rate. The former yielded a value estimate of $762,635, and the latter a value estimate of $831,965. As the 6% capitalization rate was obtained from Respondent, Appellant petitioned subject's assessed value be reduced to the lower value indication.

In further support of a lower valuation, Appellant proffered a *Broker Opinion of Value* report prepared by a commercial real estate firm. The report calculated 4,963 square feet of leasable space on the main level and 4,483 square feet on the upper floor. The report utilized the same net operating income as in Appellant's income model, stating the building, as a 100-year-old Class C building, suffers from economic, functional, and physical obsolescence, which will impact the ability to attract quality tenants at market rents. The report further opined, ". . . that attempting to achieve higher rents will lead to higher-than-average vacancy rates." In concluding a higher capitalization rate of 6.5% in its model, the report contended the property faces increased risks because it does not have any regional or national tenants under lease, and therefore a higher capitalization rate is warranted. The report concluded a value of $700,000 for the subject property.

Respondent disagreed with the use of subject's actual income and expense data in the respective income approach models above. Respondent contended subject's overall average lease rate of $7.92 per square foot was below market, thus skewing the value conclusions downward. Respondent also questioned whether some of subject's lease rates were from lease agreements which commenced several years ago prior to the unprecedented market activity in the last two (2) years and therefore were not reflective of current market conditions.

Appellant maintained subject's rents were at market levels and pointed to three (3) lease rates from the downtown area for support. Appellant reported lease rates of $4.80, $5.46, and $7.50 per square foot, plus utilities, for the referenced leases. Appellant additionally shared a $9.00 per square foot rate on a full-service lease for a professional office building but did not regard this property as comparable to subject because it included onsite parking. Based on these lease rates, Appellant contended subject's average lease rate is reflective of the current marketplace and should form the basis for developing a value estimate under the income approach.

In support of subject's current valuation, Respondent considered all three (3) recognized approaches to value. The cost approach indicated a value of $1,075,000, though this approach was ultimately disregarded due to the availability of more reliable sales and income data from subject's immediate neighborhood.

Respondent's sales comparison approach included four (4) commercial sales located within roughly one (1) block of the subject property. Sale No. 1 concerned a commercial building constructed in 1908 with a gross building area of 17,722 square feet which sold in January 2021 for $1,330,000, or $75.05 per square foot. Respondent characterized Sale No. 1 as the most comparable to subject due to its similar size, age, and condition. Sale No. 2 was the April 2021 purchase of a 1912 commercial building with 8,300 gross square feet for $795,000, or $95.78 per square foot. Sale No. 3 involved a 7,500 square foot commercial building constructed in 1957 which sold for $585,000 in August 2021, or $78 per square foot. Last was the $1,881,378, or $154.09 per square foot, purchase in August 2021 of a 1910 commercial building with a gross building area of 12,210 square feet.

Respondent noted the buildings involved in Sale Nos. 2 and 3 were vacant at the time of sale and had not been rehabilitated to a level needed for leasing to tenants. Respondent also shared the building associated with Sale No. 4 had been updated and was fully occupied at the time of sale, as reflected by the higher sale price.

Respondent adjusted each sale price for date of sale to bring prices up to January 1, 2022, levels. The 5% per month time adjustment applied to the sale prices was determined through an analysis of four (4) paired commercial sales, including Sale No. 4 in Respondent's sales model which sold in August 2019 for $550,000 and again in August 2021 for nearly $1,900,000, reflecting a 342% price differential over a period of twenty-four (24) months. The remaining paired sales showed price differentials from 193% to 243%. Respondent resolved to use the median rate of the paired sales, which was 5% per month or 60% on an annual basis. Applying this rate to the sale prices yielded time-adjusted price rates of roughly $120, $136, $94, and $166 per square foot for the four (4) sales, respectively. Respondent calculated a rounded value of $1,900,000 for subject using the median adjusted price rate of $128 per square foot.

Respondent cited IDAPA 35.01.03.217 (Rule 217) which requires the use of market rent in the income approach for purposes of assessment, not contract rent. In this regard, Respondent considered lease rates for thirteen (13) commercial properties, plus local market reports published by two (2) reputable commercial real estate firms. Roughly one-half (½) the lease comparables were multi-tenant buildings located in downtown Caldwell and the others were single-tenant buildings located outside the immediate neighborhood. All the leases were triple net, which Respondent noted was typical for the area. Lease rates stretched from a low of $8.57 per square foot to a high of $25.99 per square foot, with a median of $18.00 per square foot. According to Respondent, the data did not reveal any difference in lease rates between ground level space and upper floor space, as both had average rates of $18.00 per square foot. Applying the average lease rate to subject's total leasable area, Respondent calculated gross income of approximately $185,000.

In similar fashion, Respondent looked to market data and industry sources to determine an appropriate vacancy rate, which was 10% in this case based on the average of the data set. As expenses to the owner in a triple-net lease agreement are typically minimal because expenses are passed to the tenant, Respondent concluded a 7% expense ratio, comprised of a 5% management fee and a 2% expense rate. Applying these three (3) adjustments yielded a net operating income of nearly $155,000. The net income was capitalized at 6.5%, which was sourced from local sales and industry publications. Respondent's income approach concluded a value of $2,400,000 for the subject property.

In reconciling the value estimates produced by the three (3) valuation approaches, Respondent emphasized the sales comparison approach as the most reliable indicator of value due to the abundancy and reliability of the sales data from subject's immediate neighborhood. No weight was afforded the cost approach on account of the age of the subject building. Some weight was given to the income approach, but it was regarded as less reliable than the sales comparison approach in this instance because most of the reported lease rates were for fully rehabilitated buildings, whereas subject has only been partially updated. In the final analysis, Respondent concluded a value of $1,950,000, or $131 per square foot, for the subject property and petitioned the Board to increase the assessed value accordingly.

Appellant questioned some of the data Respondent used in its sales and income models. In particular, Appellant disputed the lease rate data because many of the properties were stand-alone single tenant buildings, and the multi-tenant properties were improved with fully updated commercial buildings, neither of which were regarded as comparable to subject. In Appellant's view, the lease rate data was inapplicable to the subject property and should be ignored. Appellant also disagreed with Respondent's methodology for calculating sale prices on a per square foot basis in its sales comparison approach. Appellant argued basement space should not be included in the total square footage figure, as the basements in most of the older commercial buildings in the downtown core have low ceiling heights and trapdoor access so are not useable for anything other than storage. Respondent explained basement footage was included because it takes into account the fact all the sale buildings have basements with similar limited utility as subject's basement. Respondent further stressed its income approach utilized only subject's net leasable space, not the gross square footage.

Appellant was additionally concerned with the current assessed values of several properties in the neighborhood in comparison to subject's. According to Appellant, the adjacent property, with 15,000 square feet of leasable space, was valued at $68.66 per square foot for the current assessment year. Appellant further questioned why the assessed values of Sale Nos. 1, 2, and 3 differed from their respective 2021 sale prices. Appellant stated Sale No. 1 sold for $75.05 per square foot yet was assessed at $80.50 per square foot. In similar fashion, Appellant reported sale rates of $95.78 and $78.00 per square foot for Sale Nos. 2 and 3, and assessed values of $75.26 and $68.67 per square foot, respectively. Based on these perceived inconsistencies, Appellant questioned the accuracy of subject's current assessment.

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 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). The income and sales comparison approaches are commonly used to estimate the market value of commercial property, though the income approach is often prioritized because such properties typically trade based on their potential to generate income.

Both parties developed value opinions using recognized appraisal methodologies, which efforts were much appreciated by the Board. There were, however, some concerns with aspects of the respective analyses. The primary issue with Appellant's income model was its reliance on subject's actual income and expense figures, with no apparent consideration for market rates. This runs contrary to Idaho's Rule 217 relating to use of the income approach for assessment purpose, which reads in relevant part, "[t]he appraisal procedures, methods, and techniques using the income approach to determine the market value for assessment purposes of income producing properties *must use market rent, not contract rent*." IDAPA 35.01.03.217.03 (emphasis added). A possible exception might be if the subject property's rents and expenses were demonstrated to be at market levels, but there was too much conflicting rental data in this case to reach such a conclusion. Therefore, market rents must be used in valuing the subject property for assessment purposes.

In addition to subject's average overall lease rate of $7.92 per square foot for the leasable space, Appellant shared lease rates for three (3) commercial spaces downtown and one (1) located outside the immediate neighborhood. A lease rate of $4.80 per square foot was reported for a tenant leasing 800 square feet of commercial space, plus 1,200 square feet of storage. Presumably, the $4.80 per square foot rate represents the overall lease rate for the totality of the space. This means 60% of the overall rate is weighed down by the lower lease rate associated with the less valuable storage space. It should also be noted the storage space included in this particular lease is more than double the 500 square feet of usable storage space in the entire subject building, which raises further questions of comparability between the buildings and the usefulness of this data. The remaining reported lease rates ranged from $5.46 to $9.00 per square foot, but with no details concerning the leased units, not even square footage or the type of space involved, the Board did not find the leasing data particularly meaningful in evaluating whether subject's lease rates are at market. Appellant's leasing information also contrasted sharply with the lease rates shared by Respondent, though there were some comparability concerns with that data as well.

So, where subject's overall lease rate was not demonstrated to be at market level, it cannot be used to estimate subject's value using the income approach. As such, the Board cannot rely on the value conclusion indicated by Appellant's income model. The same applies to the *Broker Opinion of Value* report submitted by Appellant, as it too relied on subject's actual income and expense data.

The inputs into Respondent's income approach model were derived from various market sources. While this adhered to the requirement of Rule 217 to use market rents, there were questions regarding the comparability of properties used to conclude a lease rate of $18 per square foot for the subject property. Respondent even acknowledged as much in its final reconciliation by noting the lease data was ". . . largely from rehabbed buildings and our subject has not been completely rehabilitated to quite the same extent at this time." It was also difficult to accept subject's current overall lease rate is less than one-half (½) market rates for comparable commercial space, as is suggested by Respondent's use of an $18 per square foot lease rate. In any event, as Respondent did not emphasize the income approach in its final reconciliation, the Board will follow suit and give this approach little weight.

Respondent's sales model was better received by the Board, as it was based on four (4) recent arm's-length sales of older commercial buildings in the downtown core. There were, however, some key differences between subject and the sale properties, especially Sale Nos. 2 and 3, both of which were commercial buildings with roughly one-half (½) the gross building area of subject. Sale No. 4 was likewise not regarded as particularly comparable, as it had been renovated prior to sale. Overall, Sale No. 1 was most comparable to subject in terms of gross building area, at 17,722 square feet, and age, with a year built of 1908. This property sold in January 2021 for $1,330,000, or $75.05 per square foot.

Differences in property characteristics are to be expected in the downtown area, as commercial properties in the area are relatively diverse in size, age, and condition. These differences, however, were less concerning to the Board than the 60% annual time adjustment factor Respondent applied to the sale prices, which by any reasonable appraisal standard is an aggressive adjustment. The time adjustment factor was developed through an analysis of four (4) paired sales, but little information other than sale dates and prices were provided for the sale properties, so there were some concerns from the Board's perspective.

One (1) of the paired sale properties was noted to also be included in Respondent's sales comparison approach. Respondent reported an August 2019 sale price of $550,000 for this property and a subsequent sale price of $1,881,378 in August 2021, which equates to a 342% price increase over a two (2) year period, or 14% per month. The problem with comparing these price points is the property had not been renovated at the time of the first sale, whereas the building had been fully rehabilitated and was fully occupied at the time of the second sale. While the address remained the same, these were effectively different properties on the respective dates of sale, which renders the comparison invalid in the Board's view. Nothing is known about the statuses of the other paired sale properties at their respective sale dates, but they too sold for remarkably higher prices in the second transaction than the first. In any event, the Board was not convinced Respondent's time adjustment factor accurately reflected the price appreciation in the downtown commercial marketplace.

In accordance with Idaho Code § 63-511, the burden is with Appellant to establish subject's valuation is erroneous by a preponderance of the evidence. The Board did not find the burden of proof satisfied in this instance. In balancing the parties' widely disparate value conclusions against the noted concerns with the respective analyses, the Board was not satisfied either value conclusion represented the most reliable estimate of subject's current market value. As neither party demonstrated its value conclusion was superior or a more accurate estimate of subject's market value, the Board found no good cause to disturb the current assessed value. Accordingly, the decision of the Canyon County Board of Equalization is affirmed.

FINAL ORDER

In accordance with the foregoing Final Decision, IT IS ORDERED that the decision of the Canyon County Board of Equalization concerning the subject parcel be, and the same hereby is, AFFIRMED.

DATED this 26th day of April, 2023.