BEFORE THE IDAHO BOARD OF TAX APPEALS

LN CITY CENTER PLAZA, LLC, Appellant, v. ADA COUNTY, Respondent.	APPEAL NO. 24-A-1068 FINAL DECISION AND ORDER

COMMERCIAL PROPERTY APPEAL

This appeal is taken from a decision of the Ada County Board of Equalization denying an appeal of the valuation for taxing purposes on property described by Parcel No. R8886160020. The appeal concerns the 2024 tax year.

This matter came on for hearing October 28, 2024, in Boise, Idaho, before Board Member Leland Heinrich. Attorney Terri Pickens appeared at hearing for Appellant. Ada County Chief Deputy Assessor Brad Smith 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 Ada County Board of Equalization is modified.

FINDINGS OF FACT

The assessed value is $50,509,100. Appellant contends the correct value is $43,380,000.

The subject property is multi-tenant high-rise office building located in downtown Boise, Idaho. As a condominium, subject occupies a pro-rate share of the 2.51 acre parent site. The subject building, a nineteen[1] (19) story office tower with retail on the ground floor and a two and one-half (2½) level subterranean parking structure, is the second tallest in Idaho. The building was constructed in 1978 and has 276,099 total square feet, of which 256,568[2] square feet are leasable.

In support of a lower valuation, Appellant offered an independent appraisal of the subject property with an effective date of valuation of January 1, 2024. The appraisal first analyzed subject's market value using an income approach model. To determine the potential gross income, the appraisal separately evaluated the building's office space and the ground floor retail space. For the office space, the appraisal relied on lease data from six (6) multi-tenant office towers located in, or very near, the downtown core. Lease rates varied from $24.00 to $28.75 per square foot. The appraisal concluded an overall average lease rate of $25.50 per square foot for subject's office space, which recognizes lease rates vary depending on the floor, view, and interior finishes.

In considering the potential gross income of subject's ground floor retail space, the appraisal analyzed three (3) retail lease comparables. Two (2) of the comparables were located downtown, with reported lease rates of $27.50 and $28.93 per square foot. The third lease comparable, with a lease rate of $25 per square foot, was located less than two (2) miles from subject. The appraisal determined a market lease rate of $27 per square foot for subject's retail space, which, when combined with the office income above, equated to a combined potential gross income of nearly $6,600,000.

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[1] Appellant clarified that while county records reflect nineteen (19) stories, the building is technically twenty (20) stories, though the 20th floor lacks windows and has lower ceiling heights. The space is leased to a tenant who also occupies the 19th floor and portions of the 18th floor.

[2] This figure represents Respondent's estimate of subject's leasable area. Appellant's reported leasable area of 258,568 square feet was calculated using the rent rolls.

The appraisal next considered other income generated by the building. This included expense reimbursement income from the retail suites, income from the leased cellphone antenna space, parking garage income, as well as miscellaneous income, which typically stems from lease termination fees and storage unit rentals. After adding income from these sources, the appraisal concluded a total estimated potential gross income of approximately $7,200,000.

The appraisal next evaluated multi-tenant office vacancy data from the downtown submarket. Following an historically high vacancy rate of 15.1% in 2020 due to COVID-19, vacancy in downtown decreased to 10.5% for 2021. The appraisal reported vacancy rates for 2022 and 2023 of 12.3% and 12.4%, respectively. A 12% vacancy rate was utilized for subject's office space, which was consistent with the three (3) year average downtown vacancy rate of 11.7%, and the six (6) year average rate of 11.6%. In similar fashion, the appraisal relied on data from the downtown core to conclude a 5% vacancy rate for subject's retail space, which equated to a blended vacancy rate of 11.8% for the building.

In evaluating an appropriate operating expense rate, the appraisal considered subject's trailing three (3) year operating expenses, as well as expense data obtained from three (3) multi-tenant office buildings and two (2) broker portfolios comprised of downtown multi-tenant buildings. The appraisal compared subject's actual individual operating expenses, such as utilities, maintenance, and management, to the expense figures reported for the expense comparables. Due to subject's older age and additional operating costs associated with the parking garage, the appraisal reasoned subject's actual expenses were most appropriate for the valuation model. Though the appraisal's concluded expense rate of $11.55 per square foot was somewhat above the local expense comparables, which ranged from $7.93 to $10.10 per square foot, the rate was noted to be within subject's historical range from $10.06 to $11.76 per square foot.

The appraisal next analyzed several sources of capitalization rate data. First considered were six (6) local sales which occurred from 2019 to 2023 with reported capitalization rates from 5.21% to 6.75%. Because only one (1) of the local sales involved a building in excess of 100,000 square feet and most of the sales occurred during a more favorable economic period, the appraisal additionally considered eight (8) regional sales, with reported capitalization rates varying from 6.92% to 8.50%. Based on the sales and subject's older age, the appraisal concluded a capitalization rate of 7.25%. In further support of the concluded capitalization rate, the appraisal cited a national investor survey which reported an average capitalization rate of 6.78% for the last quarter of 2023, as well as a regional real estate report which reported an average rate of 7.60% for the western United States for the same period. After capitalizing the net operating income, the indicated value was approximately $47,000,000 for the subject property.

Though the appraisal regarded the income approach as the best methodology for estimating subject's market value for multiple reasons, a sales comparison model was also developed. Five (5) sales which transpired from December 2022 to January 2024 were included in the analysis. The one (1) sale in Meridian concerned a single tenant building formerly used as a call center, and three (3) of the remaining sales were mid-rise multi-tenant office buildings located in Utah, Colorado, and Washington. The sale property emphasized as most comparable to subject was a fifteen (15) story building located in downtown Salt Lake City, which sold for $44,200,000, or $169 per square foot, in January 2023. Overall sale prices ranged from $22,000,000 to $47,500,000, or from $143 to $215 per square foot. To refine the range, the appraisal analyzed the net operating income figures of the rent comparables included in the income approach above and concluded a value of $190 per square foot, or approximately $49,000,000, for the subject property.

In reconciling the value indicators, the appraisal assigned full weight to the roughly $47,000,000 value conclusion reached in the income approach. The appraisal then looked at the looming deferred maintenance and tenant improvement allowances expected in the near term for the subject property. The appraisal cited the deferred maintenance already scheduled to be completed within the next two (2) years at an anticipated cost of $3,090,000[3], as well as roughly $910,000 in tenant improvement allowances for currently vacant suites totaling approximately 30,000 square feet. Because a potential current purchase of the subject property would be faced with these additional costs, the appraisal deducted them from the income approach conclusion, resulting in a final market value conclusion of $43,380,000.

Respondent was critical of several aspects of Appellant's appraisal. To start, Respondent characterized the 12% vacancy rate, which is subject's actual vacancy, as atypical in the downtown market. Respondent also disagreed with the appraisal's use of an $11.55 per square foot operating expense rate, which was noted to exceed the appraisal's own expense comparables. Most importantly, Respondent objected to the appraisal's removal of deferred maintenance from the income approach value conclusion. Respondent agreed with subtracting roughly $900,000 for tenant improvements but

[3] The appraisal noted an additional $10.724 million for deferred maintenance projects is scheduled between 2027 and 2032.

contended the removal of approximately $3,000,000 for deferred maintenance amounted to double-counting, because a deferred maintenance allowance was also included in the operating expenses prior to being capitalized. Appellant clarified that the deferred maintenance included in the operating expenses represented reserves set aside for future long-term needs, whereas the deferred maintenance deduction at the end of the analysis was for immediate replacement needs which have already been scheduled for the next couple years and would be an immediately imminent cost to any purchaser.

Respondent likewise relied on the income approach to estimate subject's value, though utilized different inputs than the model in Appellant's appraisal report. To determine subject's potential gross income, Respondent analyzed lease rates from the downtown core, which ranged from $19.50 to $33.00 per square foot. Respondent ultimately concluded a market lease rate of $24 per square foot and noted the rate was consistent with current asking rates in the subject building, which range from $24 to $28 per square foot. Applied to subject's 256,568 square feet, Respondent calculated a potential gross income of approximately $6,000,000.

In considering an appropriate vacancy rate, Respondent analyzed the vacancies of the above rent comparables, as well as average local vacancy rates published by several different industry sources. Respondent determined a 10% vacancy rate, which yielded an effective gross income figure of roughly $5,500,000.

To estimate operating expenses, Respondent considered expense rates from six (6) multi-tenant office buildings in the general Boise market, and one (1) single-tenant office building. Leasable sizes stretched from roughly 26,000 to 260,000 square feet, and expense rates varied from $5.71 to $7.73 per square foot, with an average of $7.09 per square foot, or 36% of effective gross income. Respondent concluded a 30% expense rate for the subject property, which resulted in a net operating income of nearly $3,900,000.

Respondent's capitalization rate analysis relied on local sales data, as well as published capitalization rate information from a local industry source. The local sales were office buildings with leasable areas from approximately 4,200 to 88,000 square feet, with reported capitalization rates from 5.52% to 6.80%. The industry source reported an average capitalization of 6% for office space in the general Boise market area. Respondent determined a 6.5% market capitalization for the subject property and a loaded rate of 7.45% after adding the tax levy rate. Applying this rate to the above net operating figure yielded a value conclusion of $52,071,248 for the subject property, which Respondent noted was higher than the current assessed value of $50,509,100.

Appellant disagreed with some of the inputs Respondent utilized in its income model. Generally speaking, Appellant contended insufficient consideration was given to subject's somewhat unique circumstances. Appellant explained there are considerably higher costs associated with operating and maintaining a building of subject's size, including engineering, administration, and property management. Subject's older age was also noted to contribute to higher operating costs. Appellant also highlighted none of the properties referenced by Respondent had expenses related to a subterranean parking garage, whereas those costs are present at the subject building. Appellant further explained many of the sales Respondent utilized to determine a capitalization rate were derived from sales which occurred during a more favorable market, and are not reflective of current market conditions after a series of increases to the federal reserve rate, which has contributed to higher capitalization rates. Given subject's unique place in the downtown landscape, being the largest in size but one of the oldest in age, Appellant argued a reliable estimate of its market value must strongly consider the actual operating figures. Respondent maintained its income approach model represented the superior indicator of subject's market value because it was based exclusively on local market data, not regional or subject-specific information.

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, 2024, 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 often valued using the income approach, as such property is typically traded in the marketplace based on its income-producing potential.

Though Appellant's appraisal also included a comparative sales analysis, the parties' respective value positions were developed through direct income capitalization models. As such, the Board placed no emphasis on the sales comparison approach. Regarding the income approach, the parties' general methodologies were similar, but the inputs into the respective valuation models varied, most notably the operating expense ratios and the capitalization rates. Broadly speaking, the primary cause of these differences was due to Respondent's strict focus on local market data, whereas Appellant's appraisal emphasized subject's actual expense figures and also considered broader regional data in its capitalization rate analysis.

Looking more closely at the operating expenses, the parties' chosen expense rates were fairly aggressive in opposite directions. Respondent's analysis utilized a 30% operating expense rate, despite reporting an average rate of 36% for its expense comparables. This was somewhat curious given the expense comparables were mostly of newer buildings with generally lower expense rates, as well as one (1) markedly dissimilar single-tenant office building with the lowest expense rate of any property in the record. On the other side, the expense rates for the comparables in Appellant's appraisal, all of which exceeded 100,000 square feet in size, ranged from $7.93 to $10.10 per square foot, yet the appraisal concluded an expense rate of $11.55 per square foot, or 46.5% of effective gross income for subject. Though subject was larger than any single expense comparable offered by the parties, support for the appraisal's conclusion of an expense rate roughly 15% above the highest reported expense rate was thin in the Board's view. And by the same token, the Board found support for Respondent's use of an expense rate below the rate indicated by its own expense comparables somewhat lacking.

Turning to the parties' capitalization rates, support for the rate concluded by the appraisal was more directly focused on the subject property, as an older office tower that is atypically large for the local marketplace. The appraisal considered local sales data, but most of the sales involved notably smaller and newer office buildings, and many of the sales transpired prior to 2022. Therefore, in an effort to include more recent data, the appraisal expanded the geographical scope and considered sales of larger buildings from other markets in the region. The appraisal contended including regional sales in the analysis was reasonable because properties of this type are often transacted on a regional basis.

Respondent's capitalization rate was based exclusively on local data. This included sixteen (16) office sales in Boise, as well as average published capitalization rates for the general Boise office market. The parties agreed the Boise office market has remained relatively strong compared to others in the region, so Respondent's emphasis on local data is understandable. One concern, however, is none of the sale buildings approached subject's size, as only one (1) exceeded 40,000 square feet. Admittedly, Respondent's data was limited to those sales which had occurred, but subject is an entirely different class of property competing for different buyers than those included in the data set. In short, it was unclear how subject's larger size and older age was considered in Respondent's capitalization rate analysis. And in similar fashion, it was not apparent how average capitalization rate data from the general Boise office market correlated to an appropriate rate for the subject property, as no details were provided about the sales used to calculate the average rates.

As is evident from the above discussion, the Board had concerns with aspects of both parties' income models. In the final analysis, however, the Board ultimately favored Respondent's analysis because inputs into the valuation model were developed using local market data, particularly with respect to operating expenses for which Appellant's appraisal relied on subject's actual expense data, which was higher than all the expense comparables.

Though the Board generally preferred Respondent's analysis, it lacked below-the-line adjustments for tenant improvements and deferred maintenance. At hearing, Respondent agreed a deduction should be made for tenant improvements but argued a deferred maintenance adjustment would amount to "double-dipping" because an allocation for deferred maintenance is already included in the operating expenses. Respondent's concerns are understandable, but the Board disagrees the deferred maintenance deduction in this context constitutes double-dipping. As explained by Appellant, the deferred maintenance included in the operating expense rate is an allocation for long-term maintenance items, whereas here, the deferred maintenance deduction is for work already scheduled to be completed within the next couple years. As these maintenance projects are immediately imminent, it is difficult for the Board to accept that a buyer would not factor these impending maintenance costs into a potential purchase decision. In the Board's view, an adjustment for the tenant improvements and short-term deferred maintenance should be applied in this particular instance and subject's valuation reduced accordingly.

As the petitioning party, Appellant carries the burden of proving error in subject's valuation by a preponderance of the evidence. Idaho Code § 63-511. Though the Board found subject's assessed value somewhat overstated, we did not find sufficient support for the value advanced by Appellant. The Board was also not satisfied Respondent's income model represented the best evidence of subject's market value, as it concluded a value roughly $2,000,000 higher than the assessed value and did not include the below-the-line adjustments for short-term deferred maintenance and tenant improvement allowances, which adjustments the Board views as proper in this instance. Though Respondent did not share the details of the analysis used to determine subject's assessed value of approximately $50,000,000, there was nothing to indicate adjustments were made for tenant improvements and short-term deferred maintenance costs. Applying these adjustments reduces subject's value to $46,509,100. The decision of the Ada County Board of Equalization is modified accordingly.

FINAL ORDER

In accordance with the foregoing Final Decision, IT IS ORDERED that the decision of the Ada County Board of Equalization concerning the subject parcel be, and the same hereby is, MODIFIED to reflect a decrease in subject's assessed value to $46,509,100.

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 13th day of February, 2025.