BEFORE THE IDAHO BOARD OF TAX APPEALS

IN THE MATTER OF THE APPEAL OF CAVANAUGHS HOSPITALITY LIMITED PARTNERSHIP from a decision of the Bannock County Board of Equalization for tax year 2013.	))))	APPEAL NO. 13-A-1082 FINAL DECISION AND ORDER

COMMERCIAL PROPERTY APPEAL

THIS MATTER came on for hearing November 4, 2013, in Pocatello, Idaho before Hearing Officer Travis VanLith. Board Members David Kinghorn, Linda Pike and Leland Heinrich participated in this decision. Attorney Gary Slette and Appraiser Greg Ruddell appeared at hearing for Appellant. Prosecuting Attorney Ian Service, Assessor David Packer, and County Appraisers Margie Woolf and Randy Larson appeared for Respondent Bannock County. This appeal is taken from a decision of the Bannock County Board of Equalization (BOE) modifying the protest of valuation for taxing purposes of property described by Parcel No. RPCPP004803.

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

The decision of the Bannock County Board of Equalization is reversed.

FINDINGS OF FACT

The initial assessed land value was $1,692,742, and the improvements' valuation was $2,885,289, totaling $4,578,031. The BOE reduced the improvements' value to $2,183,409, with no change in the land value, for a total assessment of $3,876,151. Appellant requests the total value be reduced to $2,200,000.

The subject property is a 6.7 acre irregularly-shaped parcel situated near Interstates 15 and 86 in Pocatello, Idaho. The property is improved with a two-story, full service hotel with 150 guest rooms. The hotel also offers a restaurant, lounge, fitness center, meeting space, business center, and indoor swimming pool, among other such amenities commonly associated with a hotel property. The facility also houses roughly 13,000 square feet of meeting and banquet space, which was the largest such space of all the hotels in the area. The property was constructed in 1978, with some remodeling work reported in 2006.

Appellant argued the most reliable approach to value for an older hotel property like subject is the income approach. It was argued a typical buyer of a hotel is primarily interested in the income-producing potential of such property. Reliability of the cost approach was challenged primarily on the basis of subject's older age, as well as, the differing depreciable life spans of the various components which comprise a full-service hotel. For example, different depreciation rates would likely apply to subject's restaurant components than the rate applied to guest rooms. Applying appropriate depreciation rates was viewed as too difficult to produce a reliable result.

Appellant also discounted the usefulness of the sales comparison approach for valuing hotel properties. It was reported finding good comparable sales for any hotel property is difficult. In most instances, substantial adjustments are required to account for differences in physical attributes, location, and other factors affecting value. In Appellant's view, the high degree of subjectivity involved in making such adjustments undermines the reliability of the approach. Appellant, however, did indicate the sales comparison method could provide a reasonableness test of the conclusion reached in an income approach.

In support of its requested value, Appellant provided an independent fee appraisal report produced by an international appraisal firm. Despite the concerns expressed above, the appraisal considered all three (3) appraisal methods. Ultimately the appraisal disregarded the cost approach because "[a]long with the difficulty in accurately quantifying physical deterioration, it is our experience that knowledgeable purchasers of complex hotel properties are more concerned with the economics of the investment. Hence, typical practice does not rely on the Cost Approach." (See Appellant's Exhibit 5, p. 128.)

The appraisal's sales comparison approach examined seven (7) hotel sales from 2012 and one (1) from 2011. The sale properties were located in Idaho, Colorado, Montana and Utah, had between 119 and 330 guest rooms. The properties were built between 1967 and 2005. Sale prices ranged from $5,000,000 to $16,500,000, or from $31,061 to $65,671 per room. While specific details were not included, the appraisal indicated some differences between subject and the sales. These included location, accessibility, size, services and facilities offered, rate structure, age, physical condition, and some other factors. No specific adjustments were made for the differences because in the view of the appraiser, "[i]n practice, it is virtually impossible to quantify . . . adjustment factors accurately because of their number and complexity, as well as the difficulty in obtaining specific, detailed information. Any attempt to manipulate the necessary adjustments is unsupportable and purely speculative." (Appellant's Exhibit 5, p. 127.) The sales comparison approach indicated the value range for subject was between $3,100,000 and $4,500,000, and was used only as a check on the reasonableness of the income approach value.

For the income approach, the appraisal used a discounted cash flow method, which discounted anticipated revenue streams into present value. In this model, the appraisal assumed a ten-year holding period and used subject's historical performance to project future income. The appraisal included extensive comparisons between subject and industry norms. It also included thorough details related to the selection of the 9.0% terminal capitalization rate and the 11.5% discount rate. The discounted cash flow indicated a total value of $3,100,000, which included $900,000 of personal property.

Respondent noted the above fee appraisal's effective date of valuation was May 2013, which was beyond the current January 1, 2013 assessment date. Appellant countered that the appraisal relied chiefly on historical income information and that a value opinion rendered five (5) months beyond the assessment date would not noticeably impact the value conclusion in this case. As such, Appellant petitioned the appraisal's effective valuation date not bar its consideration in the Board's final decision.

On appeal Respondent suggested the BOE decision to reduce the value of subject's improvements was erroneous. It was explained the BOE decision was the result of removing approximately $700,000 in personal property. The error was that Respondent had already removed the personal property value in arriving at the original assessment. In Respondent's opinion, the BOE decision to remove additional personal property amounted to "double dipping" and should be reversed.

Respondent contended controlling law requires all three (3) valuation approaches be used in assessing property. Thus, Respondent included each approach in its final conclusion. The cost approach first looked to develop subject's land value. In this regard, Respondent offered five (5) unimproved commercial site sales, two (2) of which occurred during 2004.

The first 2004 sale was a 54,401 square foot (1.18 acres) parcel which sold for $625,000, or $12.16 per square foot. The other 2004 sale concerned a 28,316 square foot (.65 acres) lot that sold for $525,000, or $18.54 per square foot. Next, was a 576,299 square foot (13.23 acres) parcel which sold in April 2008 for $3,321,337, or $5.76 per square foot.

The remaining land sales both closed during 2012. Lot sizes were 49,658 square feet (1.14 acres) and 498,326 square feet (11.44 acres) with sale prices of $818,000 and $4,218,239, or $16.47 and $8.46 per square foot, respectively. Using a curved-fit analysis, Respondent concluded a land value for subject's site of $3,093,631[1], or $10.60 per square foot, for subject's 291,852 square feet.

Respondent's cost approach next examined the improvements. Respondent calculated a base replacement cost of $9,415,541 for the basic 121,780 square foot structure. Additional value of roughly $570,000 was attributed to asphalt paving, a canopy, and a pool and jacuzzi. A depreciation factor of 50% was used and a total improvement value of $4,993,184 was calculated.

Next considered was the sales comparison approach. Information was provided on two (2) local, limited-service hotel sales from 2012. A third sale involved a full-service hotel located in Salt Lake City, Utah which Respondent stated was the nearest full-service hotel sale. Sale prices were between $3,450,000 and $9,076,250, or from $43,125 to $81,768 per room. Using its $3,093,631 land value conclusion from the cost approach, Respondent assigned a value of $2,906,369 to subject's improvements. Therefore in the sales comparison approach, the total value of the property was $6,000,000.

Appellant contested Respondent's sales primarily on the basis of comparability. The first two (2) were noted to be newer than subject. Further, the sales involved limited-service hotels which typically have lower operating costs and higher net operating income (NOI). The third sale was also noted to be newer than subject. Appellant explained this Utah hotel had much less

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[1] Subject's land value is $1,692,742, or $5.80 per square foot. At hearing, Respondent petitioned the higher land value be adopted.

meeting and banquet space than subject, as well as, a restaurant and bar which share the same space. Contrasted to subject's large banquet space, and separate bar and restaurant areas, the Utah hotel was reported to have lower operating expenses and a higher NOI per room than subject. In Appellant's view, none of the sales offered by Respondent were truly comparable to subject.

For its income approach, Respondent relied on subject's actual NOI. However management fees and replacement reserves were obtained from the market. The 9% overall capitalization rate was derived from four (4) Idaho hotel sales and one (1) sale involving a Utah hotel. Respondent calculated a total capitalized value of $2,106,144. Again relying on the land value conclusion of $3,093,631, Respondent found a negative improvement value of $987,487.

Respondent also processed a gross income multiplier (GIM) approach, but did not include the value result in its reconciliation. Three (3) hotel sales were reported to indicate GIMs between 2.39 and 3.76. Respondent only shared the GIM, income and prices related to the sales used in this approach. Appellant noted the considered hotels were of the limited-service variety with little or no food service, or meeting and banquet space Applying the average GIM of 3.05 to subject's $1,389,236 income, indicated a total value of $4,237,170.

In its final reconciliation, Respondent first considered subject's improvements value as follows.

Appraisal Approach	Indicated Improv. Value	Weight	Weighted Value
Cost	$4,993,184	10%	$ 499,318
Sales Comparison	$2,900,000	45%	$1,305,000
Income	$ 0	45%	$ 0

Based on this, Respondent determined a total improvement value of $1,804,318. Added to this was the $3,093,631 land value which resulted in a total value of $4,897,949. Respondent removed 12% to account for personal property, which reduced subject's total value to $4,310,195. Respondent petitioned subject's assessed value be increased accordingly.

CONCLUSIONS OF LAW

This Board's goal in its hearings is the acquisition of sufficient, accurate evidence to support a determination of fair market value, or as applicable exempt status. This Board, giving full opportunity for all arguments and having considered all testimony and documentary evidence submitted by the parties in support of their respective positions, hereby enters the following.

Idaho Code § 63-205 requires all taxable property be assessed at market value annually on January 1 of the relevant tax year. Market value is defined in Idaho Code § 63-201 as,

> "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.

There are three (3) generally accepted approaches to value: the cost approach, the sales comparison approach and the income approach. *Merris v. Ada County*, 100 Idaho 59, 63, 593 P.2d 394, 398 (1979). Both parties considered all three (3) approaches, however, varied greatly in terms of their value conclusions.

Respondent insisted current law requires all three (3) valuation approaches be used to assess property. Appellant disagreed and instead argued that all the approaches simply need to be considered. On this point, the Board concurs with Appellant.

Idaho Code § 63-208 provides in pertinent part,

> (1) It shall be the duty of the state tax commission to prepare and distribute to each county assessor and the county commissioners within the state of Idaho,

> rules prescribing and directing the manner in which market value for assessment purposes is to be determined for the purpose of taxation. The rules promulgated by the state tax commission shall require each assessor to find market value for assessment purposes of all property, except that expressly exempt . . . provided, that the actual and functional use shall be a major consideration when determining market value for assessment purposes.

Toward satisfying the requirements set forth above, the state tax commission enacted a set of property tax administrative rules. Specifically Rule 217.02 was adopted, which reads "Three (3) approaches to value will be *considered* on all property. The three (3) approaches to value are . . . (a) the sales comparison approach; b) the cost approach; and c) the income approach." See IDAPA 35.01.03.217.02. (Emphasis added). The rule requires each approach be considered, not necessarily relied on.

It is commonly understood certain types of property are more amenable to valuation by one method of appraisal than another. The goal in assessment is to find market value. This necessarily requires consideration of the marketplace and how the particular property trades therein. In this case, subject is an older income-producing property. Buyers of such property are typically found to be most interested in future income. As such, it follows that strong consideration should be given to the income approach when adequate information to process the approach is available. This was true here where extensive information related to subject's performance and the broader hotel market was available. This conclusion is further supported due to issues exposed in the cost and sales comparison approaches.

Subject is a full-service hotel constructed in 1978. In addition to 150 guest rooms, the hotel houses a restaurant, a lounge, a pool, and a very sizeable meeting and banquet space. While renovations have occurred since subject's initial construction, it was apparent to the Board that such were relatively minor. This was evidenced by Respondent applying a 50%

depreciation factor in the cost approach which was remarked to be the highest depreciation allowed on all hotels in the area. Subject's age alone coupled with the limited renovations, raises concerns with the reliability of the cost approach to indicate current market value.

The Board's concerns with the cost approach were further exacerbated by the fact subject is comprised of several different major components. Respondent's analysis did not examine each of these important components separately. Rather, it took a broad approach with no special consideration given to subject's unique characteristics. In the Board's view here, the complexity associated with valuing a diverse property like subject using the cost approach was too great to render a reliable result.

The Board likewise considered the parties' value conclusions reached under the sales comparison approach with some caution. Appellant contended the approach should not be relied upon, but rather should only be used as a test of reasonableness for the income approach. Respondent derived its final value by allocating 45% weight to the approach.

While the Board normally views the sales comparison approach favorably, such is not the case in this particular instance. The concern was not with the approach itself, but with how it was applied to subject. Respondent provided three (3) sales in its model, none of which appeared to be comparable to subject. Sale Nos. 1 and 2 involved local hotels, but both were newer than subject and neither were full-service. Questions of comparability were more apparent with regard to Sale No. 3 which involved an out-of-state hotel built in 2007 that was situated near an international airport. Respondent did not explain, nor was it otherwise apparent, how these properties were compared to subject or what adjustments were made to account for the vast differences.

The Board experienced similar concerns with Appellant's sales comparison approach. While the model considered eight (8) sales, mostly from Idaho, very few physical details were shared. No direct comparison between subject and the sale properties was made. The impact related to these issues was somewhat marginalized where the sales comparison approach was used only to gauge the reasonableness of the income approach conclusion.

Given the lack of detailed information regarding the sale properties, as well as how they were actually compared to subject, the Board viewed the parties' respective sales comparison approaches with caution.

Where the parties found some common ground was with the income approach. Both parties used a mixture of market inputs, as well as some factors specific to subject. A key difference was in the particular income model preferred by each party. Appellant used a discounted cash flow analysis. Respondent used a direct capitalization model. Appellant concluded a total value for subject of $2,200,000 while Respondent's value conclusion was $2,106,144.

While the Board generally viewed the parties' income approaches favorably, a weakness was evident in Respondent's analysis. Specifically, Respondent suggested subject's improvements contributed a nearly $1 million negative value to the overall value. This result came from the determination that subject's land value was roughly $3 million. The Board recognizes there are some instances where a property's improvements may negatively impact value. In this case, however, subject is an operational full-service hotel with no major structural or serious issues. The negative improvement value was found to be an irrational result.

The proposed $3 million land value was derived from a consideration of five (5) unimproved commercial site sales. The Board had some concerns with comparability of the referenced sale properties and a general lack of detailed analysis. Three (3) of the sales were only a fraction of subject's 6.7 acre size. The other two (2) were roughly twice as large as subject. More troubling was that two (2) of the sales occurred in 2004 and another in 2008. Such information is relatively stale given the January 1, 2013 valuation date. Respondent made no adjustments for site size or time of sale. Good support for the proposed land value which is almost $1.5 million more than the subject's current land value was found to be lacking.

A remaining issue concerns the effective date of valuation in Appellant's appraisal. The value conclusion was as of May 1, 2013. Typically the determination of current value on a particular date requires the examination of data which exists before such date. In other words, a buyer and seller would be unaware of data or events transpiring after the date of valuation and therefore would be unable to factor in such information. The concern is minimized in this instance where most of the relevant input factors, such as the income and expense data on subject, occurred prior to January 1. Given the circumstances here, the Board is unpersuaded Appellant's fee appraisal should be fully disregarded on the basis of its valuation date. There was evidence in record that moving the appraisal date to January 1, 2013 would not have materially affected the valuation conclusion.

In appeals to this Board the burden is on Appellant to prove error in subject's valuation by a preponderance of the evidence. Idaho Code § 63-511. The Board finds the burden of proof was satisfied in this case. The issues surrounding the cost and sales comparison approaches were notable. Ultimately, the Board was not persuaded either approach presented good evidence of subject's current market value. What remained was the parties' respective income approaches. Despite using different models the respective value conclusions were nearly identical. The significant difference was in the value Respondent attributed to subject's land and the corresponding value indicated for the improvements. As noted above, the Board did not agree with Respondent's land value conclusion and the suggested allocation of value between land and improvement components.

Given the above, the Board is satisfied subject's assessed value was overstated. As such, the decision of the Bannock County Board of Equalization will be reversed to reflect a decrease in subject's total value to $2,200,000.

FINAL ORDER

In accordance with the foregoing Final Decision, IT IS ORDERED that the decision of the Bannock County Board of Equalization concerning the subject parcel be, and the same hereby is, REVERSED, to reflect decreases as indicate below.

Land Value	$1,000,000
Improvements Value	$1,200,000
Total Parcel Value	$2,200,000

IT IS FURTHER ORDERED that 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.

DATED this 6th day of March, 2014.