BEFORE THE IDAHO BOARD OF TAX APPEALS

IN THE MATTER OF THE APPEALS OF CAVANAUGHS HOSPITALITY LTD. from the decisions of the Kootenai County Board of Equalization for tax year 2013.	)))))	APPEAL NOS. 13-A-1161 & 13-A-1162 FINAL DECISION AND ORDER

COMMERCIAL PROPERTY APPEALS

THESE MATTERS came on for hearing October 29, 2013, in Coeur d'Alene, Idaho before Board Member Linda Pike. Board Members David Kinghorn, Linda Pike and Leland Heinrich participated in this decision. Attorney Janet Robnett, Corporate Services Director Julie Langenheim, Assistant Corporate Controller Kathy Kiehl, Certified Public Accountant Greg Damico and Appraiser Greg Ruddell appeared at hearing for Appellant. Kootenai County Deputy Prosecuting Attorney David Ferguson, Assessor Mike McDowell, Appraisal Manager Rod Braun and Commercial Appraiser Donna Hoppe appeared for Respondent Kootenai County. These appeals are taken from decisions of the Kootenai County Board of Equalization denying protests of valuation for taxing purposes of properties described by Parcel Nos. P-4200-008-001-A and P-4200-008-002-A.

The issue on appeal concerns the market values of two (2) commercial parcels.

The decisions of the Kootenai County Board of Equalization are modified in part, and affirmed in part.

FINDINGS OF FACT

<u>Parcel No. P-4200-008-001-A</u> - (Appeal No. 13-A-1161)

The assessed land value is $2,794,296, and the improvements' valuation is $2,715,982, totaling $5,510,278. Appellant requests the combined value of this and the below parcel be reduced to $4,981,591.

Parcel No. P-4200-008-002-A - (Appeal No. 13-A-1162)

The assessed land value is $1,338,965, and the improvements' valuation is $1,333,625, totaling $2,672,590.

The subject properties operate jointly as a resort hotel business located on the Spokane River, in Post Falls, Idaho. For purposes of this decision, the parcel associated with Appeal No. 13-A-1161 will be hereinafter referred to as the "Hotel", and the parcel connected to Appeal No. 13-A-1162 as the "Marina".

The Hotel includes a 9.658 acre parcel improved with a three-story full-service hotel, 114,711 square feet in size. The Hotel improvement consists of 154 single and double rooms and nine (9) suites. Other amenities include a fitness center, indoor pool and spa, tennis courts, volleyball courts, and a private beach area. The Hotel also houses roughly 15,000 square feet of conference room space, in addition to a restaurant and lounge approximately 4,000 square feet in size. The Hotel, constructed in 1986, was renovated in 2005.

The adjacent Marina parcel, situated directly east of the Hotel, is 9.92 acres in size. The parcel is improved with 168 covered boat slips with jet ski slips and side ties. The property is further improved with an 880 square foot bar and grill, a 4,356 square foot service garage, a small convenience store, and tennis courts. The Marina offers boat moorage, boat rentals, and "River Queen Cruises".

In support of reducing subjects' assessed values, Appellant offered an independent fee appraisal report with an effective date of valuation of April 11, 2013. Appellant also provided an appraisal review report of the fee appraisal performed by a separate appraiser. Both reports considered the subject properties as a single integrated economic unit. Respondent, on the other hand, valued each parcel individually on a standalone basis. Respondent contended its separate valuation approach was proper because there are two (2) distinct parcels which could be sold individually.

The fee appraisal considered all three (3) generally accepted appraisal methods, however, relied on the income approach for the final value conclusion. The sales comparison approach was used as a test of reasonableness against the value indication from the income approach. Due to the age and complexity of the subject parcels, a cost approach model was not developed. The appraisal noted the income approach to value is the typical appraisal method relied on by hotel investors, and therefore the most relevant.

The specific income approach developed by the appraisal was a discounted cash flow model. This method looked at anticipated future net income streams and developed a reversionary value. Once the potential future incomes were determined, they were discounted to a present value using an internal rate of return.

The fee appraisal considered subject's actual net income information from the prior three (3) years, along with the performance of comparable properties and industry averages in forecasting subject's future revenues and expenses through a 10-year holding period. The appraisal provided considerable information related to subject's actual performance, its competitors' performance, and the overall industry. The appraisal concluded a value of $5,000,000 for the resort portion of the subject properties, which did not include the contributory value of nine (9) acres which the appraisal considered excess land.

For determining the excess land value, the appraisal looked to five (5) unimproved commercial and industrial land sales. Sale No. 1, which closed in April 2013, was 4.79 acres in size. The property sold for $130,000, or $0.62 per square foot. Sale No. 2 concerned a 5.62 acre parcel which sold in November 2012 for $269,287, or $1.10 per square foot. The 3.8 acre Sale No. 3 closed in February 2011 for $827,640, or $5.00 per square foot. The remaining two (2) sales closed in July and January 2010. Lot sizes were 1.1 and 2.26, with sale prices of $270,000 and $555,000, or $5.62 and $5.64 per square foot, respectively. After making appraisal adjustments to the sale properties for location, size, utility, and other differences, a land value of $1,600,000, or $4.00 per square foot was concluded for subject's excess nine (9) acres. In total, the fee appraisal's combined market value estimate for both subject properties was $6,600,000.

In its sales comparison approach, the fee appraisal used price-per-room as the unit of comparison, which was remarked to be typical in the hotel industry. Seven (7) hotel sales were included in the analysis, four (4) of which were other hotel properties owned by Appellant. With the exception of one (1), all the sales were situated in nearby states. It was further noted, only three (3) of the sale properties involved full-service hotels like subject. Sale prices ranged from $1,600,000 to $13,000,000, or from $13,235 to $67,042 per room. The appraisal concluded a value range for subject between $4,100,000 and $6,500,000, or between $25,000 and $40,000 per room, which was noted to fit nicely with the value indicated by the income approach.

The review appraiser generally agreed with the methodologies employed and conclusions reached in the fee appraisal, however, a couple changes were recommended. The most notable concerned the consideration of the excess land. The fee appraisal's treatment of the excess acreage reflected a highest and best use analysis. The review appraiser explained that for purposes of assessment, the land must be valued according to its actual and functional use. In this alternate analysis, the review appraisal reduced the size of the excess acreage to 3.8 acres. The same value rate of $4.00 per square foot was used, which resulted in an excess land value conclusion of $660,000.

The review appraisal also noted the final value of $6,600,000 failed to remove the personal property component. The fee appraisal estimated the value of personal property at $1,000,000, however the review appraiser used the $678,409 assessed value of the personal property. In final reconciliation, the review appraiser concluded a total value for subjects' real property components of $4,981,591.

In determining a value for the subject Hotel, Respondent considered all three (3) appraisal approaches, however, relied primarily on the income approach. The sales comparison approach was used to gauge whether its income approach conclusion was reasonable. Five (5) sales were included in the market analysis, some of which were the same included in Appellant's fee appraisal. The sales occurred between 2009 and 2012 and involved hotel properties located in both Idaho and Washington. Sale prices ranged from $2,500,000 to $11,969,424. All the sales concerned hotels smaller than subject in both square footage and room count. Further, only one (1) of the sales was classified as a full-service hotel. None of the sales were directly compared to subject, but the range of sale prices was argued to support subject's overall assessed value.

Respondent noted the income approach model was first developed for the 2012 tax year and was carried forward to the current 2013 year. For the various input factors, Respondent used data obtained from the marketplace rather than the Hotel's actual figures. As such, occupancy and expense rates of 60% and 80%, respectively, were applied to Respondent's estimation of market revenue at $5,354,550. The various rate factors were obtained from an industry publication which reported national and regional hotel data. The assessor's 10.25% capitalization, applied to the net income figure of $642,546, was likewise sourced from an industry publication. The total value conclusion for the Hotel was $6,268,741, from which Respondent removed $758,463 of personal property value to derive Hotel's real property value of $5,510,278. This value was allocated between the Hotel's land and improvements as detailed earlier.

An analysis similar to the above was followed in arriving at the assessed value of the Marina. Six (6) vacant land sales were used to determine the land value of the Marina. The sale lots ranged in size from .523 to 3.33 acres. Sale prices were between $79,950 and $623,225, or between $3.51 and $5.59 per square foot. The Marina's land value is $1,338,965, or $3.10 per square foot.

In its income approach, Respondent again used input factors obtained from independent marketplace sources. In calculating the Marina's gross income, Respondent used a rental rate of $1,600 for each basic covered boat slip, $1,800 for the larger slips, and $300 for the jet ski slips. The result was a gross income estimate of $285,600. A vacancy rate of 10% was used, as was an expense rate of 30%. A net income of $179,928 was determined, to which a 16% capitalization rate was applied. The capitalization rate was derived from two (2) somewhat recent marina sales, which indicated capitalization rates of 9% and 12%. Respondent used a higher rate for the subject Marina to account for its relatively lesser physical condition. A value of $1,124,550 was concluded for the marina-type improvements, to which Respondent added land value of $1,338,965 and another $209,075 for other improvements situated on the parcel.

Respondent's sales comparison approach examined two (2) marina sales which transpired in May 2009 and January 2013. Sale No. 1 was regarded as most similar to subject. The property included 3.023 acres and 138 boat slips. This marina property sold for $2,750,000, or $19,928 per slip. Sale No. 2 concerned a 176-slip marina associated with a 3.488 acre parcel. The property sold for $3,400,000, or $19,318 per slip. The 9.92 acre subject Marina was assessed at $2,672,590, or $15,908 per slip.

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.

For purposes of assessment, 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.

As noted by the Idaho Supreme Court, there are three (3) generally accepted methods for determining market value: the income approach, the cost approach and the sales comparison approach. *Merris v. Ada County*, 100 Idaho 59, 63, 593 P.2d 394, 398 (1979). The parties agreed the cost approach was not well-suited to accurately determine the value of a complex hotel and marina property like subject. The parties further agreed that due to the incomeproducing nature of the subject parcels, the income approach was the most reliable value indicator. As such, both parties emphasized the income approach and used the sales comparison approach to test the reasonableness of the value conclusions reached under their respective income approaches.

From the evidence provided, the Board agrees primary weight should be afforded the income approach in this case. Stated simply, neither party was able to develop what the Board considered reliable value estimates using the sales comparison approach. The sales included in both parties' analyses were not regarded by the Board as similar to the subject parcels. None of the considered sales included hotel/marina properties, and only one (1) involved a waterfront hotel. Further, only a handful of the sales were full-service hotels and nearly all were notably smaller than the subject Hotel in terms of square footage, room count, and lot size. To compare any of the sale properties to subjects would require large subjective appraisal adjustments, which in turn would likely undermine the reliability of a value conclusion reached thereunder.

Appellant provided an independent fee appraisal report along with a review appraisal of the report. The review appraiser concluded a somewhat lower overall value than the fee appraisal. Both reports considered the Hotel and Marina parcels as a single unit. It was argued the two (2) subjects operate together and should therefore be valued as an integrated facility. Respondent countered that while the Hotel and Marina share the same ownership, they are distinct tax parcels which could be sold individually. In this particular instance, the Board agrees with Respondent's conclusion.

The Hotel and Marina are marketed together for the purpose of generating business, however, they could easily be sold or operated independently. There was evidence in record that marinas and hotels often operate on an independent basis. Further, Respondent is tasked with determining market value for each parcel in the county. In this case, there are two (2) separate parcels, and to date, Appellant has not seen fit to combine the parcels.

Additionally, there is an abundance of market data for the hotel and marina components individually. The same, however, can not be said for a combined analysis. Indeed, neither party offered any market data or comparisons relating to another mixed hotel/marina use. Under the circumstances, the Board did not find error in Respondent's method of valuing the subject parcels individually.

While the Board generally agreed with Respondent's separate assessment treatment of the subject parcels, we did not necessarily concur with the final value conclusion of the Hotel. Respondent relied exclusively on broader market data with no special consideration for the Hotel's actual performance information. The Board understands much of the actual performance information was not made available to Respondent prior to preparing and issuing the 2013 assessment. However, now that this relevant information has come to light, it should factor into the analysis. In particular, the Board found a consideration should be given to subject's occupancy data, which materially impacts the final value conclusion. Between 2009 and 2012, Hotel's occupancy rate ranged from 43.1% to 46.7%. Respondent used a 60% occupancy rate derived from regional average occupancy data. Such market information should certainly be considered, but not to the exclusion of the Hotel's actual performance as evidenced here. In the Board's view, an occupancy rate of 50% is more reasonable under the circumstances. This rate bears some resemblance to subject's recent 3-year history and the potential evidenced by the greater marketplace.

Regarding the Marina valuation, the Board did not find cause to disrupt Respondent's income approach analysis. The boat slip rental income was reported to be similar to the Marina's actual rental rates. The vacancy and expense rates appeared reasonable, and were actually on the higher end of the indicated range. Likewise the 16% capitalization appeared conservative given the information provided in this regard. Overall, the Marina valuation was found to be well-supported and reflective of market value.

The Board appreciated Appellant's efforts related to its fee appraisal and subsequent review appraisal. However, the concluded values were not found to be the more reliable indication of value. This was particularly the case with the excess land analysis in the review appraisal which concluded a value of roughly $1,000,000 less than the fee appraisal. The data and analysis offered in support of the far reduced value was lacking. It was also not clear how the fee appraisal or the review appraisal considered subjects' prime waterfront location. Because the fee appraisal focused more on the hotel component, the Board was left with questions regarding the value attributed to the Marina and the various other improvements situated thereon. In all, the Board viewed Appellant's value conclusion with some caution.

In appeals to this Board, Idaho Code § 63-511 requires Appellant prove error in subjects' assessed valuation by a preponderance of the evidence. The Board is satisfied the requisite burden of proof was met in the case of the Hotel assessment. The evidence presented by the parties supports the conclusion that the Hotel's assessed value was overstated, though not to the extent petitioned by Appellant. Relying primarily on Respondent's income approach models, the Board will reduce the total assessed value of the Hotel parcel to $4,465,488. Having found the valuation of the Marina reasonable and correct, such value will remain as assessed.

Based on the above, the decisions of the Kootenai County Board of Equalization will be modified (Hotel) in part, and affirmed (Marina) in part, as follows:

Parcel No. P-4200-008-001-A - (Appeal No. 13-A-1161)		
Land	$2,794,296	
Improvements	$1,671,192	
Total	$4,465,488	(Hotel modified)

Parcel No. P-4200-008-002-A - (Appeal No. 13-A-1162)		
Land	$1,338,965	
Improvements	$1,333,625	
Total	$2,672,590	(Marina affirmed)

FINAL ORDER

In accordance with the foregoing Final Decision, IT IS ORDERED that the decisions of the Kootenai County Board of Equalization concerning the subject parcels be, and the same hereby are, MODIFIED in part, and AFFIRMED in part, as specified in the preceding chart.

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 28th day of April, 2014.