BEFORE THE IDAHO BOARD OF TAX APPEALS

HEALTH TRUST, INC. - WEST VALLEY MEDICAL CENTER, INC., Appellant, v. CANYON COUNTY, Respondent.	)	APPEAL NO. 15-A-1128 FINAL DECISION AND ORDER

COMMERCIAL PROPERTY APPEAL

This appeal is taken from a decision of the Canyon County Board of Equalization denying the protest of valuation for taxing purposes of property described by Parcel No. 029440000. The appeal concerns the 2015 tax year.

This matter came on for hearing November 12, 2015, in Caldwell, Idaho before Hearing Officer Cindy Pollock. Attorney Clint Bolinder appeared at hearing for Appellant. Appraiser Darryl Speiser represented Respondent.

Board Members David Kinghorn, Linda Pike and Leland Heinrich participated in 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 reversed.

FINDINGS OF FACT

The assessed land value is $2,240,720, and the improvements' value is $15,828,200, totaling $18,068,920. Appellant contends the correct land value is $1,150,000, and the improvements' value is $9,350,000, totaling $10,500,000.

The subject property is a 6.43 acre parcel improved with a hospital. Construction of the hospital occurred in stages stretching from 1977 to 2006. Currently, the building is 140,686 square feet in size. In addition to the hospital structure, the subject property is improved with a 14,116 square foot non-hospital building, referred to as the Kaley Center. The Kaley Center houses administrative and other non-patient functions. Though not under appeal, the entire hospital property includes parking lots and several other buildings situated on different parcels. Subject is located in Caldwell, Idaho.

Appellant offered an independent fee appraisal with an effective valuation date of January 1, 2015. The appraisal included detailed summaries of the local marketplace, as well as broader trends in healthcare facilities and subject's immediate competition. The appraisal described subject, due to its older age and design, as outdated to suit the needs of the current healthcare environment. For example, the hospital was designed with double-occupancy rooms, rather than the single-patient rooms preferred today. Subject is licensed for 150 beds, however, it was estimated only roughly 99 beds are staffed and operational. The appraisal also noted the need for larger emergency and operating rooms to enable the hospital to provide the space needed for more complicated medical procedures. Further, updated and newer facilities were cited as a critical factor in attracting and retaining physicians. In all, the appraisal determined subject suffered from some serious functional and economic obsolescence compared to newer hospital facilities in the area.

The appraisal considered all three (3) approaches to value, however, concluded the cost and sales comparison approaches were most appropriate for valuing a hospital. The income approach was disregarded due to the difficulty in obtaining lease rates because hospitals are not generally leased. The cost approach began with an analysis of subject's land value. The appraisal considered five (5) vacant land sales and two (2) active listings. The sales occurred between 2010 and 2014. Lot sizes ranged from .42 to 7.76 acres and sale prices were between $94,900 and $950,000, or from $2.81 to $5.80 per square foot. The listings concerned 4.22 acre and 35.42 acre parcels, with asking prices of $459,885 and $6,943,028, or $2.50 and $4.50 per square foot, respectively. Adjustments were made to the sales and listings for differences compared to subject such as date of sale, size, location, and other pertinent factors. The appraisal determined a rate of $4.10 per square foot for subject, or a final land value of $1,150,000.

In analyzing the value of the improvements, the appraisal considered cost data from recent hospital construction projects, as well as, replacement cost information from the Marshall Valuation Service (MVS). The recent hospital construction projects indicated a replacement cost ranging between $275 and $290 per square foot for subject. MVS tables for a *Class A - Average Quality Hospital* pointed to a replacement cost rate of $285 per square foot. The appraisal concluded a replacement cost of $285 per square foot, which equated to an estimated value of $40,095,510. The appraisal next considered subject's depreciation factor, which considered several sources. The first source was a hospital replacement study which found hospitals are typically replaced when they reach between 23 and 45 years old. Hospital life expectancy according to MVS was between 35 and 50 years. Another source, the American Hospital Association, estimated the life of a hospital between 25 and 40 years. A 40-year life was concluded for subject. The appraisal then divided subject's effective age of 30.6 years, which reflects the various stages of construction, by the 40-year life expectancy. The result is a 76.5% depreciation factor. Applying the depreciation factor to the estimated replacement cost yielded a value of roughly $9,300,000. The Kaley Center was valued at $560,000 using the cost approach. Summing the three (3) value conclusions resulted in a total value estimate of $11,010,000.

The appraisal next developed a sales comparison approach. Five (5) hospital sales were offered in this regard. Though none of the sales involved hospitals located in Idaho, two (2) of the sales were located nearby, in eastern Oregon. Extensive details concerning the sale properties were provided, including allocations of the total sale prices to the real property, personal property, and intangible property. The sales transpired between 2009 and 2012. The sale hospitals ranged in size from 111,205 to 548,860 square feet. The appraisal explained each sale price included value attributable to non-real property components, such as personal and intangible property components. The appraisal reported real property prices ranging from $5,161,102 to $28,846,520, or from $27.91 to $67.46 per square foot. Adjustments for size, location, age, condition, and quality were made to the sale prices to account for differences compared to subject, resulting in adjusted prices between $34.89 and $66.67 per square foot. The appraisal determined a value rate of $60 per square foot for subject's hospital, to which the values of the land and the Kaley Center were added. The total value conclusion under the sales comparison approach was $10,120,000. A reconciliation of the two (2) value indicators yielded a final value conclusion for subject of $10,500,000.

Respondent similarly considered the three (3) approaches to value, however, concluded the cost approach was least reliable due to subject's older age and multiple construction efforts over the years. Respondent's sales comparison approach considered five (5) hospital sales which occurred between 2010 and 2013. Two (2) of the sales involved Idaho hospitals, one (1) was from southern California, and the remaining two (2) were the same Oregon hospitals used in Appellant's fee appraisal. With the exception of the Idaho hospital constructed in 2012, the sale hospitals were older facilities like subject. There was some variance in terms of square footage and licensed bed count, however, the sale hospitals were generally representative of subject. Respondent reported sale prices ranging from $12,916,000 to $70,000,000, or between $102 and $242 per square foot. Adjustments were made for age, size, and time of sale, resulting in adjusted sale prices between $112 and $286 per square foot. Respondent's sale comparison approach indicated a value of $32,455,706.

Appellant challenged some aspects of Respondent's sales comparison model. Of particular concern was the sale prices reported by Respondent. Appellant explained each of the sale prices included significant value not attributable to the real property. Appellant argued such values need to be removed from the sale prices in order to properly estimate subject's value. Using the two (2) Oregon sales provided by both parties, Appellant noted of the roughly $47,600,000 and $13,000,000 sale prices reported by Respondent, only approximately $17,000,000 and $5,000,000, respectively, represented the real property portions of the transactions. Appellant also contested Respondent's inclusion of a sale involving an Idaho hospital constructed recently in 2012, due to its much newer age and contemporary design.

Respondent also referenced five (5) vacant land sales in support of subject's land value. The parcels ranged in size from 1.03 to 13.53 acres and were located in Nampa and Caldwell. Sale prices were between $350,000 and $5,620,000, or between $5.74 and $16.72 per square foot. After making size and location adjustments, Respondent calculated adjusted prices ranging from $4.59 to $12.54 per square foot. Respondent valued subject at $8 per square foot.

Turning to the income approach, Respondent considered subject in two (2) parts; the hospital and the Kaley Center. Citing a lack of reliable income information concerning hospitals, Respondent considered the hospital as a medical office building for purposes of estimating value. Respondent obtained some local medical office lease rates, which ranged from $17.00 to $18.50 per square foot. Respondent also utilized locally-derived vacancy and capitalization rates of 17% and 7.5%, respectively, in its analysis. Respondent concluded a value of $26,503,691 for subject. Based on the two (2) estimates of value, Respondent argued subject's value should be increased to $25,661,360 and petitioned this Board to find accordingly.

Appellant questioned the comparability of the properties Respondent used in determining a lease rate. Appellant noted the compared properties were between roughly 4,000 and 23,000 square feet. Subject, by comparison is approximately 140,000 square feet, which Appellant argued would command a lower lease rate due to economies of scale. Appellant also challenged the 3% expense rate in Respondent's valuation model. Appellant acknowledged a typical office building may have a low expense rate, but a rate of 3% represented only a fraction of the actual expenses associated with operating a hospital.

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 taxable property be assessed at market value annually on January 1; January 1, 2015 in this case. 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.

Market value is estimated according to recognized appraisal methods and techniques. The three (3) primary methods of determining market value include the cost approach, the income approach, and the sales comparison approach. *Merris v. Ada County*, 100 Idaho 59, 63, 593 P.2d 394, 398 (1979). Good appraisal practice dictates consideration be given to each approach, which the parties did in this case. While all approaches were considered, the parties ultimately relied on two (2) approaches each. Appellant regarded the sales comparison and cost approaches as the most reliable indicators of subject's value, whereas Respondent relied on the income and sales comparison approaches.

Both parties submitted information related to a sales comparison approach, however, the respective value conclusions differed greatly. Admittedly, valuing a special use property such as a hospital is a difficult endeavor due to the complexity of the buildings which are often constructed or added onto over the years. There are also notable variances in size from one hospital to the next due the particular needs of the hospital or community. This was evident in both parties' sales, which varied widely in terms of square footage. Overall, the Board found both parties' sales comparison analyses reasonable in terms of properties chosen and adjustments made. The problem, however, was the sale prices reported by Respondent appeared to include considerable value not attributable to the real property. For example, Respondent reported one (1) of the Oregon hospitals sold for roughly $47,000,000. Appellant's fee appraisal included the same sale, however, noted according to the Medicare cost report, only approximately $17,000,000 of the purchase price was attributable to the real property. The remaining $30,000,000 represented values attributable to personal and intangible property. Intangible property, however, is not taxable, and personal property is taxed separately from real property. Failing to remove the non-real property components from the sale prices was found by the Board to be a material error which notably inflated Respondent's final value conclusion.

The Board was hesitant to rely heavily on Respondent's income approach. As the parties acknowledged, hospitals are rarely leased, which makes it difficult to accurately estimate income. Realizing this difficulty, Respondent developed an income approach using income and expense data for medical office buildings. Using such data may have been appropriate for the Kaley Center, but not for the main hospital, which is a decidedly different type of use. The same follows for the other input factors in Respondent's model such as vacancy, management, expenses, and the capitalization rate, which were pulled from local medical office market data. A hospital is a special use property and consideration must be given to the unique operating circumstances of such building type. Respondent's analysis was lacking in this key regard, thereby undermining the reliability of the value conclusion.

By contrast, Appellant's fee appraisal took care to value subject as a hospital, with major consideration given to subject's age, design, and other relevant factors. While the Board generally agrees the cost approach is typically more reliable in valuing newer properties, we find the appraisal's use of it in this instance reasonable. As noted above, the income approach is difficult to develop for a hospital property. This leaves only two (2) approaches to value, both of which point toward a similar value for subject. The Board did have concerns with some of aspects of the appraisal's cost approach, such as the high depreciation factor. In the end however, the appraisal was judged to represent the better supported and more thorough analysis.

Idaho Code § 63-511 places the burden of proof on Appellant to demonstrate error in subject's assessment by a preponderance of the evidence. The Board finds this burden satisfied here. Appellant's value evidence was judged superior to that offered by Respondent and supported the requested value reduction. Therefore, the decision of the Canyon County Board of Equalization is reversed to reflect a total value of $10,500,000.

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, REVERSED, to reflect a reduction in subject's land value to $1,150,000, and the improvements' value to $9,350,000, of which $560,000 is attributable to the Kaley Center, and $8,790,000 to the hospital.

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 18th day of March, 2016.